FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
1250 H Street, NW Washington, DC 20005

THRIFT SAVINGS PLAN

GREGORY T. LONG
Executive Director

October 8, 2010

MEMORANDUM FOR: BOARD MEMBERS SAUL, SANCHEZ, DUFFY, KENNEDY AND BILYEU

FROM: GREG LONG
Executive Director

SUBJECT: Fiscal Year 2011 Budget and Fiscal Year 2012 Budget Estimate

At the FRTIB Board meeting last month, Board members requested options to revise downward the proposed FY 2011 budget and estimated FY 2012 budget. As a reminder, the budget memo of last month noted FY 2010 obligations of approximately \$115.5 million or \$14.8 million less than the \$130.3 million budget. We made additional commitments in September, bringing our FY 2010 obligated expenditures to \$119.0 million, which is \$11.3 million less than the \$130.3 million budget. The FY 2011 budget presented last month called for a budget of \$134.9 million. The initial estimate for FY 2012 is \$148.5 million. Assuming an unchanged asset value (\$264B at 9/30) in the TSP, the ratio of budget-to-assets was 0.049% (or 4.9 basis points) in FY 2010 and would be 0.051% (5.1 basis points) in FY 2011 and 0.056% (5.6 basis points) in FY 2012.

Increase to Budget in FY 2011 Relative to FY 2010

We under-spent our FY 2010 budget primarily because we had a significant number of open positions and the web redesign, automatic enrollment, and system modernization projects took longer than expected and diverted resources from other planned initiatives. There were also unplanned statutory and self-initiated projects which required both human and IT resources. These factors pushed a large amount of work and associated costs from FY 2010 forward into the proposed FY 2011 budget. Examples of deferred projects from FY 2010 include: establishing the OmniPay payment and tax reconciliation system, upgrading our document workflow management system to Omni AG, upgrading systems for the optical character recognition (OCR) of forms, mailing of a newly produced educational DVD, and targeted communications to specific populations (e.g., G Fund-only investors, uniformed service members, and participants with address issues). These items total approximately \$5.4 million in work deferred from FY 2010 to FY 2011. In addition, because we did not experience any significant market activity that resulted in unexpectedly higher transaction and call volumes, the operations and call center costs closed the year under budget.

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In weighing the import of these factors in relation to the necessity of items proposed in the FY 2011 budget, consideration of a hypothetical is instructive. That is, if positions had been filled and project work completed on schedule, the FY 2010 actual expenses would have been higher and much closer to the budgeted figure of $130.3 million. Accordingly, the FY 2011 budget submission would have been lower. The financial impact to participants of spending less than budgeted in one year, and then increasing the budget by a corresponding amount in the following year (for previously deferred work) is effectively zero. As the Board supported the FY 2010 budget that included these projects and personnel, my hope is that you will reaffirm those decisions in the FY 2011 budget.

FY 2011 Budget and FY 2012 Budget Estimate Reduction Options

FERSA assigns budget approval responsibility to the fiduciaries on the Board. As requested at the September meeting, I am providing options to reduce the FY 2011 budget and FY 2012 budget estimate in the attached spreadsheet. The options are listed in ascending order of participant impact and risk to plan operations. This prioritization process is designed to protect our ability to meet the primary goal articulated within our strategic plan, which is to maintain excellence in daily operations. While I continue to believe the budget presented last month is prudent, the Board can independently evaluate the risks and benefits associated with reducing the budget consistent with its fiduciary responsibilities.

The first group of options listed reflects the removal of our standard contingency budgeting practices in FY 2011 for our call centers, operations center, service bureau and mail operations. For the FY 2012 budget estimate, I list the same contingency removal options, plus a change in our staffing assumption. There is no immediate adverse effect to participant services or impact to expected costs associated with these items; however, they do increase the likelihood that emergency budget actions may be required if volumes spike above normal or we have significant workload increases as a result of implementing new programs (e-messaging which may prove much more popular than first anticipated, child support orders which we know have the potential to be significant, and the wild card represented by tax levies). If these contingencies were removed, the FY 2011 budget would be reduced by $1.8 million. For the FY 2012 budget estimate, I list the same contingency removal options, plus a change in our staffing assumption for the Agency. In this case, the FY 2012 budget estimate would be reduced by $4.1 million. Assuming an unchanged asset value ($264B) in the TSP, eliminating the contingencies would decrease the ratio of budget-to-assets by 0.0007% (or 0.07 basis points – or seven one-hundredths of a basis point) in FY 2011 and 0.0016% (or 0.16 basis points) in FY 2012.

The other options shown are program changes that reduce projected expenses but have an identifiable business impact. If all of these reductions were enacted, the FY

2011 budget would be reduced by $3.4 million and the FY 2012 budget estimate would be reduced by $2.9 million. Assuming an unchanged asset value ($264B) in the TSP, enacting all changes/reductions listed would decrease the ratio of budget-to-assets by 0.0013% (or 0.13 basis points) in FY 2011 and by 0.0011% (or 0.11 basis points) in FY 2012.

If still greater reductions than those listed are desired for FY 2011, I would look to suspending our policy of mailing an annual statement to each participant. We expect to spend approximately $3.5 million to mail these statements in FY 2011. I urged the Board to initiate this practice, as the benefits of mailing an annual statement are many. However, suspending the annual statement mailing would significantly reduce expenses. If greater reductions than those listed above are desired for FY 2012, I would then look to defer Roth by a greater period than the three-month delay contemplated in the attachment. Pushing a Roth launch into FY 2013 would push more communication expenses out of the FY 2012 budget estimate and into the next fiscal year.

Capacity

We underspent the budget in FY 2010 because we were capacity-constrained. The limitation here is not the budget, but rather our challenges in hiring experienced and skilled professionals in our areas of need. This challenge is not new. Over the last two years, we have endeavored to improve our success in hiring by internalizing the hiring function away from the National Business Center, adding two Personnel Specialists, and introducing new policies to enhance work/life benefits. We have increased the number of hires as a result, but finding well qualified candidates remains a challenge. OPM is in process of executing a Presidential directive establishing new government-wide policies to encourage more people to seek Federal employment and streamlining the hiring process – the efficacy of this initiative is unknown. I expect that our actions to date will improve our staffing process going forward and this may be aided further by OPM's new initiative. However, if we are unable to fill a significant number of open positions, our ability to complete planned projects could be similarly capacity-constrained in FY 2011.

Roth

Much of the previous budget discussion revolved around Roth and the significant related costs in the FY 2012 budget estimate. The costs for Roth implementation were initially discussed with the Board in a June 2007 memo. At that point, we estimated systems-related costs of $2.0 to $3.5 million. Communication costs would vary widely from $5.4 to $13.0 million depending on how much of a "splash" we desired to create. Additionally, the creation of enhanced services to provide participants with individualized tax guidance was estimated at $4.0 to $6.0 million. Thus, we projected costs to establish a Roth feature at $11.4 to $22.5 million. My recommendation in 2007 was to postpone a decision on the implementation of a Roth feature, and revisit the issue within two years and the Board voted in concurrence. In April of 2009, I provided another memo on Roth which included revised cost estimates. We reduced the scope of projected systems and communication work, bringing the projections down to the range of $10.3 to $12.3 million. My recommendation in 2009 was to seek Congressional action permitting a Roth feature and the Board voted in concurrence. The President signed the Thrift Savings Plan Enhancement Act in June of 2009 which included a requirement to establish a Roth feature at an undefined date.

In light of previously voiced concerns over cost, the September FY 2011 budget and FY 2012 budget estimate assumed an even more modest rollout and education plan for Roth than the 2009 estimate contemplated. Systems development, and implementation cost estimates, which run over the FY 2011 and FY 2012 periods, are expected to be $2.1 million. The communication expenses budgeted in FY 2011 and FY 2012 are currently expected to be $4.1 million. This estimate only includes a postcard mailing announcing the Roth program, a short DVD, general web-based educational information, and a very generic on-line Roth calculator tool for participants. The need to offer more sophisticated and individualized educational guidance to participants when making the pre- or post-tax deferral decision was recognized during the Roth discussions. However, the option to create a new service to provide individualized tax guidance was not included in the initial FY 2012 budget estimate at all, but rather was noted as a potential item for future consideration. I note that the costs listed above are for identifiable actions specific to Roth. Most plan enhancements, of which Roth is the most complex, add to capacity needs which along with organic growth increase cost in areas throughout the recordkeeping operation.

The attachment includes an option to further reduce Roth costs. Delaying the implementation of Roth for 3 months would allow us to eliminate the postcard mailing and replace it with a leaflet which would be included with the annual participant statement mailing. This would save approximately $2.5 million in postage costs. Board members should be aware that the currently budgeted expenses, while significant, will yield a "bare-bones" Roth education effort, which will likely be considered less than adequate by many participants seeking individualize assistance.

	Potential Actions to Reduce FY 2011 Budget		
	Action	**Business Impact**	**Budget**
1	Reduce budget for both call centers sufficient to handle projected volumes. Eliminate the allowance for spikes in call volume such as occurred in 2008 and 2009 or volumes above those projected, particularly with respect to the e-messaging launch which is an unknown at this time.	No immediate impact to participants since volumes have been relatively stable, but we will have no capacity to staff for unanticipated, sustained activity. This increases the likelihood that an emergency interim budget increase will be requested.	$ 794,000
2	Reduce the service bureau budget for mail handling, data entry, forms validation and related services, and the operations center budget sufficient for projected activity for death benefit, court order, legal processing, rollovers, and special processing. Eliminate the allowance for spikes in volume.	No immediate impact to participants, but we will have no capacity to staff for unanticipated, sustained activity. This increases the likelihood that emergency interim budget increase will be requested. Volumes in this category may climb above budgeted amounts due to new action on IRS tax levies and child support claims.	$ 911,000
3	Decrease budget for primary mail vendor (RR Donnelley), removing allowance for higher than expected workload for new account letters, PIN mailers, password mailers, notices and other special or targeted mailings.	No immediate impact to participants, but we will have no capacity to pay vendor for unanticipated activity or tasks (like a special mailing). This increases the likelihood that emergency interim budget increase will be requested. Volumes in this category are expected to climb due to the launch of auto-enrollment and beneficiary participant accounts, but the rate of expansion is uncertain.	$ 130,000
	Total for Removal of Contingency Budgets		**$ 1,835,000**
4	Cancel bi-annual participant satisfaction survey, thereby reducing vendor and postage costs. Initiate again after FY 2012. (Note that while survey is intended for bi-annual delivery, we budgeted to spread costs evenly annually through a multi-year contract.)	Deferring the survey introduces no new risk or service degradation, but hampers our recent efforts to better understand the factors that drive participant satisfaction and implement TSP enhancements based on that feedback.	$ 200,000
5	Cancel planned creation of new communications pieces in order to reduce printing and production costs. These pieces were intended to better assist participants in developing their investment plans, guide them through complex minimum distribution and withdrawal rules, and aid them in protecting their retirement security. We would also cancel a withdrawal pamphlet for agency representatives to give participants at separation in lieu of the entire withdrawal package and have eliminated printing a summary of the participant survey results intended as an insert in the annual statement.	Cancelling the creation of these items introduces no new risk or service degradation, but defers our planned push of new important educational messages.	$ 386,000

6	Cancel creation and distribution of new communications pieces to reduce postage and production costs. Specifically, we would defer plans to develop a leaflet for uniformed service participants encouraging higher deferral rates and discontinue the mailings to non-contributing FERS participants explaining the benefits of the TSP and the matching money that they are foregoing.	Cancelling the creation of these items introduces no new risk or service degradation but defers our planned push of important educational messages to identified groups. The direct mail efforts are intended to improve participant saving rates.	$ 376,000
7	Defer project to initiate new educational services, thereby reducing commercial contract costs. We would defer plans to contract with vendors to: 1) create a DVD targeted at separated participants to remind them of the benefits of leaving assets in the TSP and that a withdrawal at separation is not required, and to explain deaccummulation strategies within the TSP ; 2) support webinar services through which we would provide Agency training; and 3) provide assembly and mailing services specific to specialized and small-volume mail projects.	Deferring the creation of these items introduces no new risk or service degradation but defers our planned push of important educational messages to identified groups. The new services are intended to improve overall asset retention in the TSP and better educate front-line personnel and payroll office representatives that deal with participant questions and issues each day.	$ 450,000
8	Eliminate planned enhancements to testing software & applications, website vulnerabilities and other miscellaneous software purchases related to service and improvements.	This change introduces no new risk or service degradation but does not reduce existing risk in this area. The improvements were intended to shorten the system change testing/approval period and improve the quality of applications that enter production.	$ 760,000
9	Eliminate one previously authorized position in audit/control from FY 2011 Budget. Add same position back in FY 2012.	New audit/control positions are intended to allow internal controls (A-123) program and newly created risk mitigation team to accomplish their objectives. Reduced staffing will slow this progress. However, we have two positions open and are not likely to reach full staffing for several months.	$ 75,000
10	Eliminate one previously authorized benefits specialist position from FY 2011 budget. Add same position back in FY 2012.	Benefits specialists oversee contractors, assist them in delivering service to participants, and resolve complex service and individual participant challenges. Eliminating this position limits our ability to deliver excellent service through service enhancements and personal assistance.	$ 75,000
11	Postpone refresh of primary data center hardware, purchase of additional storage, servers and network devices. Push puchases into FY 2012.	Many hardware, software, storage, and network devices for primary data center were purchased in 2008 and scheduled to be refreshed in 2011, and increased capacity is an integral component of technology refreshment. We see only moderate risk in delaying this by one year as capacity growth is tied to participant growth and plan complexity. Delaying Roth would be closely tied to delaying increased capacity for storage and processing.	$ 1,030,000
	Total Program/Service Changes		**$ 3,352,000**
	Total		**$ 5,187,000**

Potential Actions to Reduce FY 2012 Budget Estimate			
	Action	**Business Impact**	**Budget**
12	Reduce budgeting assumption regarding staffing from full-staffing during the year to an assumption of 10% of positions remain open.	The 10% open positions figure is more realistic and still well below our current position of approximately 20%. This change has no direct impact to participants.	$ 1,808,000
13	Reduce budget for both call centers sufficient for projected activity, but removing the allowance for possible spikes in call volume or unanticipated workload related to e-messaging support and Roth activities.	No immediate impact to participants, but we will have no capacity to staff for unanticipated activity. Estimate would be refined for the FY 2012 budget based on 2011 experience and anticipated Roth activity.	$ 822,000
14	Reduce operations center budget expenses to meet projected activity for mail handling, data entry, forms validation and related services, but removing the allowance for spikes in volume. Estimate does not include projections for child support enforcement orders or potential impact of tax levies.	No immediate impact to participants, but we will have no capacity to staff for unanticipated activity. Estimate would be refined for the FY 2012 budget based on 2011 experience and anticipated Roth activity.	$ 878,000
15	Decrease budget for primary mail vendor (RR Donnelly) removing allowance for higher than expected workload for new account letters, PIN mailers password mailers, notices and other mailings.	No immediate impact to participants, but we will have no capacity to pay vendor for unanticipated activity. This increases the likelihood that emergency interim budget increase will be requested. Roth activity will likely have a significant effect if embraced by uniformed services.	$ 586,000
	Total for Removal of Contingencies / Staffing		**$ 4,094,000**
16	Delay Roth implementation by three months, thereby eliminating substantial postage costs. One-time Roth mailing to all participants is eliminated but this is partially offset by higher postage costs associated with the annual statement mailing.	Delaying Roth implementation from 1/2012 to 4/2012 allows us to piggy-back on the February annual statement mailing for communication. We are concerned that agency/service payroll offices will be challenged to have Roth payroll changes operational by 1/2012. A delay of three moths also allows them additional time to prepare.	$ 2,500,000
17	Cancel bi-annual participant satisfaction survey thereby reducing vendor and postage costs . Initiate again after FY 2012. (Note that while survey is intended for bi-annual delivery, we budgeted to spead costs evenly annually through a mutli-year contract.)	Deferring the survey introduces no new risk or service degradation but hampers our recent efforts to better understand the factors that drive participant satisfaction and implement TSP enhancements based on that feedback.	$ 200,000
18	Cancel planned creation of new communications pieces to reduce printing and production costs. The focus of new pieces is undefined at this point, but are intended to support Roth.	Cancelling the creation of these items introduces no new risk or service degradation but defers our planned push of new important educational messages.	$ 186,000

19	Cancel creation & distribution of new communications pieces to reduce postage and production costs. Groups targeted for mailing are G-Fund-only investors and uniformed service members, with a focus on Roth services.	Deferring the creation of these items introduces no new risk or service degradation but defers our planned push of important educational messages to identified groups.	$ 500,000
20	Cancel some communication and education services to reduce commercial contracts costs. Specifically, we would cancel plans to contract with vendors to: 1) host and support webinar services through which we would provide Agency training; 3) provide assembly and mailing services specific to specialized and smaller volume mail projects.	Deferring the creation of these items introduces no new risk or service degradation but defers our planned push of important educational messages to identified groups. The new services are intended to improve overall asset retention in the TSP and better educate front-line personnel/payroll office representatives that deal with participant questions and issues each day.	$ 400,000
21	Eliminate new position in software applications	This is a resource to support IT system documentation. While this relates to resources we need to satisfy an audit finding, this position can be reassessed next year.	$ 150,000
	Add-back FY 2011 deferral of refresh of primary data center hardware, purchase of additional storage, servers and network devices into FY 2012.	Dependant on FY 2011 changes. This assumes data center refresh scheduled for 2011 is pushed into FY 2012.	$(1,030,000)
	Total Program/Service Changes		**$ 2,906,000**
	Total		**$ 7,000,000**