

U.S. Department of Labor

Employee Benefits Security Administration
Washington, D.C. 20210



September 13, 2010

Mr. Gregory T. Long, Executive Director
Federal Retirement Thrift Investment Board
1250 H Street, N.W., Suite 200
Washington, D.C. 20005

Re: "Employee Benefits Security Administration Performance Audit of the Thrift Savings Plan Lifecycle Funds Process," dated March 26, 2010

Dear Greg:


As part of the DOL EBSA TSP Fiduciary Oversight Program, KPMG LLP has conducted a performance audit of the TSP Lifecycle (L) Fund process for the period October 1, 2008, through September 30, 2009. We provide this report to assist you and the Board in carrying out your fiduciary duties.

For the period under review, KPMG LLP concluded that the TSP L Funds process complied overall with FERSA and with applicable Board regulations. Also reported:

- Operating procedures were in place to achieve target allocations on a daily and quarterly basis,
- Assumptions used to derive fund allocations were reasonable and adequately reviewed by the Agency,
- Published administrative expenses were calculated correctly; and
- Published asset allocations agreed to the actual asset allocations.

We communicate no audit recommendations. We request no written response. If I can be of further assistance, please contact me at 693-8361 or Messrs. Auerbach or Bailey of this office.

Sincerely,


IAN DINGWALL
Chief Accountant

Encl (25)



Employee Benefits Security Administration

Performance Audit of the Thrift Savings Plan Lifecycle Funds Process

As of March 26, 2010

TABLE OF CONTENTS

<u>Section</u>	<u>Page</u>
EXECUTIVE SUMMARY	i
I. INTRODUCTION	
A. Objective	I.1
B. Scope and Methodology	I.1
C. Organization of Report	I.2
II. OVERVIEW OF THE THRIFT SAVINGS PLAN AND LIFECYCLE FUNDS	
A. The Thrift Savings Plan	II.1
B. The TSP Service Providers	II.1
C. The Federal Agencies and Uniformed Services	II.2
D. Overview of the Lifecycle Funds	II.3
III. FINDINGS AND RECOMMENDATIONS	
A. Introduction	III.1
<u>Appendices</u>	
A. Key Personnel Interviewed	
B. Key Documentation and Reports Reviewed	
C. Entrance Conference Attendees	
D. Agency's Comments to the Final Report	



KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

EXECUTIVE SUMMARY

Members of the Federal Retirement Thrift Investment Board
Washington, D.C.

Ian Dingwall
Chief Accountant
U.S. Department of Labor, Employee Benefits Security Administration
Washington, DC

As a part of the U.S. Department of Labor Employee Benefits Security Administration (EBSA) Fiduciary Oversight Program, we conducted a performance audit of the Thrift Savings Plan (TSP) lifecycle funds (L Funds) process. Our fieldwork was performed from December 8, 2009 through March 26, 2010, primarily at the Federal Retirement Thrift Investment Board's (the Board) Staff (Agency) headquarters in Washington, DC. Our scope period for testing was October 1, 2008 through September 30, 2009.

We conducted this performance audit in accordance with the standards applicable to such audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Criteria used for this engagement is defined in EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, which includes the Federal Employees' Retirement System Act of 1986 (FERSA), as amended; and applicable Board regulations. The detailed objectives of this engagement are enumerated within Section I.A.

The audit included assessing the TSP L Funds process to determine if (1) operating procedures were in place to achieve target allocations on a daily and quarterly basis; (2) assumptions used to derive fund allocations were reasonable and adequately reviewed by the Agency; (3) published administrative expenses were calculated correctly; and (4) published asset allocations agreed to the actual asset allocations.



Overall, based on the interviews conducted (Appendix A), documentation inspected (Appendix B), and test procedures performed in accordance with EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, we conclude that the TSP L Funds process complied with FERSA and applicable Board regulations for the period October 1, 2008 through September 30, 2009. During this period, we noted that (1) operating procedures were in place to achieve target allocations on a daily and quarterly basis; (2) assumptions used to derive fund allocations were reasonable and adequately reviewed by the Agency; (3) published administrative expenses were calculated correctly; and (4) published asset allocations agreed to the actual asset allocations. Our engagement communicates no recommendations.

Section I of this report discusses the EBSA's objectives, scope and methodology, and report organization. Section II is an overview of the TSP and the operations related to the L Funds. Section III presents our current year findings. In Appendices A and B, we identify the key personnel with whom we met and the documentation provided by the Agency personnel that we reviewed, respectively, during our performance audit.

This performance audit did not constitute an audit of the TSP's financial statements in accordance with *Government Auditing Standards*. KPMG was not engaged to, and did not render an opinion on the Agency's internal controls over financial reporting or over financial management systems (for purposes of the Office of Management and Budget's Circular No. A-127, *Financial Management Systems*, July 23, 1993, as revised). KPMG cautions that projecting the results of this audit to future periods is subject to the risks that controls may become inadequate because of changes in conditions or because compliance with controls may deteriorate.

KPMG LLP

August 10, 2010

I. INTRODUCTION

A. Objective

The U.S. Department of Labor (DOL), Employee Benefits Security Administration (EBSA) engaged KPMG LLP (KPMG) to conduct a performance audit of the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) process.

The specific objectives of this engagement were to determine if:

- The L Funds were rebalanced on a daily basis to reflect each fund's target allocation for the current quarter;
- The asset allocations of the L Funds were adjusted each quarter based on each fund's prescribed time horizon;
- The Federal Retirement Thrift Investment Board (Board) Staff (Agency) reviewed the assumptions of the L Funds at least annually to determine whether any changes to the allocations were warranted;
- The most current assumptions review was conducted in accordance with the terms of the contract between the Agency and the vendor;
- The assumptions used to develop the L Funds' allocations were reasonable.
- The published ratio of administrative expenses per \$1,000 account balance in the L Funds was properly calculated; and
- The published asset allocations for each L Fund agreed to the fund's actual asset allocation.

B. Scope and Methodology

We conducted this performance audit in accordance with EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, which is designed to comply with *Government Auditing Standards* issued by the Comptroller General of the United States. In particular, we conducted our engagement as a performance audit defined by *Government Auditing Standards* as an "objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability." We performed our engagement in four phases: (1) planning, (2) arranging for the engagement with the Agency; (3) testing and interviewing, and (4) report writing.

The planning phase was designed to help assist team members to develop a collective understanding of the activities and controls associated with the applications, processes and personnel involved with TSP operations. Arranging the engagement included contacting the Agency and agreeing on the timing of detailed testing procedures.

During the testing and interviewing phase, we conducted interviews, collected and inspected auditee-provided documentation and evidence, participated in process walk-throughs, and designed and performed tests of controls and compliance. We conducted these test procedures primarily at the Agency's headquarters in Washington, DC.

Additionally, our performance audit procedures included a non-statistical sample of Daily Rebalancing Reports, to determine if the L Funds are being rebalanced daily to reflect quarterly target allocations. We performed the tests above using judgmentally, rather than statistically, determined sample sizes. Accordingly, our conclusions are applicable to the sample we tested and were not extrapolated to the population.

The report writing phase entailed drafting a preliminary report, providing a draft report to the Agency for comment, and preparing and issuing the final report. Because no recommendations resulted from this engagement, an exit conference was not deemed necessary.

C. Organization of Report

Section II presents an overview of the TSP, the TSP service providers, and the L Funds process. Section III presents a detailed discussion of our findings.

II. OVERVIEW OF THE THRIFT SAVINGS PLAN AND LIFECYCLE FUNDS

A. The Thrift Savings Plan

Public Law 99-335, the Federal Employees' Retirement System Act of 1986 (FERSA), as amended, established the Thrift Savings Plan (TSP). The TSP is the basic component of the Federal Employees' Retirement System (FERS) and provides a Federal (and, in certain cases, state) income tax deferral on employee contributions and related earnings. The TSP is available to Federal and Postal employees, members of Congress and certain Congressional employees, and members of the uniformed services. For FERS participants, the TSP also provides agency automatic 1 percent and matching contributions. The TSP began accepting contributions on April 1, 1987, and as of December 31, 2009, had reported approximately \$244 billion in assets and approximately 4.3 million participants¹.

The FERSA established the Federal Retirement Thrift Investment Board (the Board) and the position of Executive Director. The Executive Director and the members of the Board are named TSP fiduciaries. The Executive Director manages the TSP for its participants and beneficiaries. The Board's Staff (Agency) is responsible for administering TSP operations.

B. The TSP Service Providers

Several organizations provide significant TSP services for the Agency under a Memorandum of Understanding (MOU) or contract. These organizations provide maintenance and operations support and disaster recovery capability for the TSP record keeping system (TSP system), certain record keeping services, call center services, and other services. These record keeping services include establishing and maintaining individual TSP participant accounts and generating reports for all payroll offices so that they can reconcile the information processed by the TSP system with information in their systems and correct transactions rejected by the TSP system.

The TSP, through its service providers, is also responsible for processing withdrawal and loan requests, disbursing participant TSP loans, and processing loan payments withheld from participants' pay by the participants' payroll office.

¹ Source: Minutes of the January 19, 2010 Board meeting, posted on www.frtib.gov.

Participants formally receive quarterly statements of TSP account activity from the TSP, through its service provider, electronically (default) or via hard copy (upon request). In addition, all participants receive an annual participant statement through the mail unless they opt out of the service. It is each participant's responsibility to determine that his/her TSP account activity is correct.

When participants retire or transfer, their employing agency or service is responsible for reporting the change in employment status to the TSP. Separated participants inform the TSP directly of other changes in circumstances, such as address or marital status. Additionally, such participants should contact the TSP if questions arise.

As discussed in section II.C, Federal agencies and the uniformed services calculate employee and agency contributions and submit to the TSP system the amount of money to be allocated to each participant's account. The TSP system accumulates transactions resulting in increases or decreases in the Lifecycle Fund (L Funds) investments. Because the L Funds are portfolio funds comprised of the Government Securities Investment (G) Fund, the Fixed Income Index Investment (F) Fund, the Common Stock Index Investment (C) Fund, the Small Capitalization Stock Index Investment (S) Fund, and the International Stock Index Investment (I) Fund, changes in L Funds investments result in changes in the underlying funds.

C. The Federal Agencies and Uniformed Services

Federal agencies and the uniformed services have a responsibility to provide timely and accurate participant account information to the TSP. As part of this responsibility, agencies and services provide, receive, and process participant contributions election forms. Federal agencies and services calculate employee and agency contributions and process deductions from employees' pay for contributions and loan repayments. Information for all active, recently separated, and transferred participants is submitted primarily electronically to the TSP each payroll period.

Federal agency payroll offices and uniformed services are also required to submit an Employee Data Record (06-Record) containing an appropriate separation code and date to the TSP when an employee or member separates from government service. The separation code and date provides the TSP system with information necessary to complete the processing of TSP withdrawals. Federal agency personnel offices and uniformed services are also responsible for distributing withdrawal forms or information to participants. Participants can also obtain forms and publications from the TSP website, ThriftLine, or a TSP Participant Support Representative.

D. Overview of the Lifecycle Funds

Prior to 2005, participants could elect to distribute their balances among the five primary TSP investment funds. These funds include the G, F, C, S, and I Funds. In August 2005, the Agency implemented the L Funds, which provided TSP participants an additional investment option. The L Funds diversify participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to five different time horizons. The time horizons are based on when participants intend to withdraw their funds. The objective of the L Funds is to achieve the highest rate of return relative to the level of risk taken. The L Funds are comprised of five funds, which include the L Income, L 2010, L 2020, L 2030, and L 2040. Participants can invest their TSP accounts in any combination of the original five investment funds and the five L Fund portfolios. Participants who select L Funds do not need to reallocate their account assets in order to maintain their target asset allocation or to make routine adjustments to their target asset allocation to reflect their changing time horizon to retirement; the lifecycle investment models automatically rebalance and reallocate participants' exposure to the five underlying funds. The L 2040, L 2030, L 2020, L 2010 and L Income Funds are for participants with specific investment time horizons and assumed investment objectives, as follows:

- L 2040 – For participants who expect to withdraw or begin to withdraw their money in the year 2035 or later. This fund's objective is to achieve a high level of growth with a very low emphasis on preservation of assets.
- L 2030 – For participants who expect to withdraw or begin to withdraw their money between 2025 and 2034. This fund's objective is to achieve a high level of growth with a low emphasis on preservation of assets.
- L 2020 – For participants who expect to withdraw or begin to withdraw their money between 2015 and 2024. This fund's objective is to achieve a moderate to high level of growth with a low emphasis on preservation of assets.
- L 2010 – For participants who expect to withdraw or begin to withdraw their money between now and 2014. This fund's objective is to achieve a moderate level of growth with a moderate emphasis on preservation of assets.
- L Income – For participants who are already receiving benefits or who expect to withdraw or begin to withdraw money immediately. This fund's objective is to achieve a low level of growth with a high emphasis on preservation of assets.

The Agency contracted with Mercer Investment Consulting, Inc. (Mercer) to design and review the asset allocations for the five L Funds. Mercer designed the quarterly asset allocations for the L Funds based on assumptions regarding future investment returns, inflation, economic growth, and interest rates. To develop the quarterly asset allocations, Mercer performed an efficient frontier analysis and a glide path analysis using the Monte Carlo simulation.

Mercer developed an efficient frontier based on the assumptions discussed above. The efficient frontier is the set of points that represent the highest expected return for an expected level of risk for all portfolios/ asset allocations in the opportunity set. Asset allocations below the efficient frontier are less than optimal because there is an alternative asset allocation that has a higher expected return for the same level of risk, or the same expected return for lower risk. Mercer constructed glide path alternatives approximating these risk-optimized portfolios and selected starting points along the glide path for the L Funds.

Mercer then performed a Monte Carlo stochastic analysis on the glide paths using a proprietary model. Based on certain criteria such as distribution of replacement rate, distribution of nominal value, and probability of loss during several time periods, Mercer recommended a set of quarterly asset allocations for the L Funds.

The prescribed asset allocations developed by Mercer for the L 2040, L 2030, L 2020, and L 2010 funds change quarterly, moving to a more conservative investment mix as the fund's time horizon shortens. When a fund reaches its horizon, it will roll into the L Income Fund, and a new L Fund will be added with a more distant horizon. For example, in July 2010, the L 2010 Fund will be rolled into the L Income Fund because its asset allocation will be the same as the L Income Fund, and the Agency will introduce the new L 2050 Fund. These quarterly adjustments are pre-determined based on each fund's original fund design and are reviewed for reasonableness at least annually by both the Agency's Office of Investments and Mercer to determine if any changes are necessary.

The L Income Fund's asset allocation represents the ending point for all of the other funds as they gradually roll down the efficient frontier towards it. The L Income Fund is designed to produce current income for participants who are already receiving money from their accounts through monthly payments, and for participants who plan to withdraw or begin withdrawing in the near future. The asset allocation of the L Income Fund does not change over time; it is maintained through daily rebalancing.

The asset allocation of each L Fund is maintained through daily rebalancing to that fund's quarterly target allocation. The L Funds are automatically rebalanced to their target allocations each business day through the Asset Manager Interface (AMI), which interfaces with the TSP system. A data file with the quarterly asset allocations for each fund's entire time horizon was uploaded into the AMI at inception of the funds and is adjusted, as necessary, for any changes to the funds' asset allocations. The actual balance for each of the L Funds, by underlying fund (G, F, C, S, and I Funds) flows into the AMI. Using the actual balances for each L Fund and the target allocations, target balances are calculated for each underlying fund within each L Fund. By comparing the actual and target balances, AMI is able to determine the amount of the trades that the TSP must process that day to rebalance the funds.

The administrative expenses of the L Funds are those of the underlying G, F, C, S, and I Funds proportionally allocated to each L Fund based on the amount invested in the underlying fund. The L Funds do not have any additional charges. Although Mercer charges a fee for its annual assumption review, the fees are not significant relative to total administrative expenses and are shared proportionately among all of the TSP funds.

Exhibit II-1 presents a summary of the L Fund investments held in the L Income, L 2010, L 2020, L 2030, and L 2040 Funds on September 30, 2009.

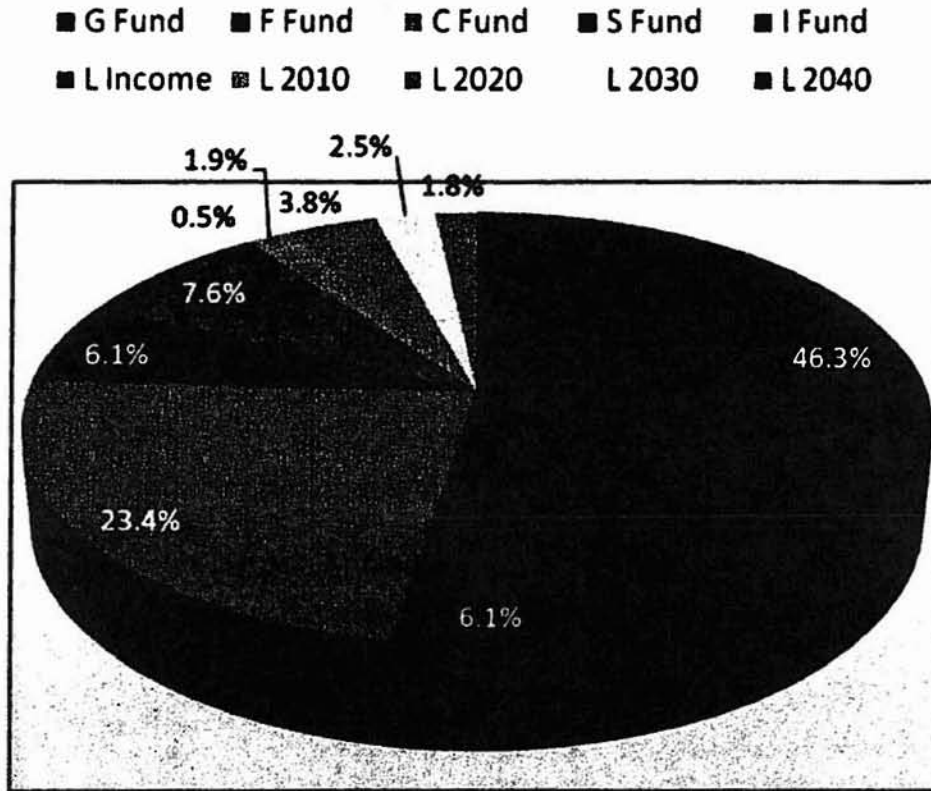
Exhibit II-1

L Fund	Fund Balances September 30, 2009	% of Total L Fund Investments	% of Total TSP Investments
L Income	\$1.118 billion	4.6%	.5%
L 2010	\$4.438 billion	18.2%	1.9%
L 2020	\$8.800 billion	36.0%	3.8%
L 2030	\$5.834 billion	23.9%	2.5%
L 2040	\$4.233 billion	17.3%	1.8%
Total	\$24.423 billion	100%	10.5%

Source: Federal Retirement Thrift Investment Board, Thrift Savings Fund Statistics, Board Meeting Minutes, October 19, 2009.

Exhibit II-2 presents the allocation of TSP Fund Investments as of September 30, 2009.

Exhibit II-2



III. FINDINGS AND RECOMMENDATIONS

A. Introduction

We performed procedures related to the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) at the Federal Retirement Thrift Investment Board's Staff (Agency) headquarters. This performance audit consisted of reviewing applicable policies and procedures and testing manual and automated processes and controls, which included interviewing key personnel (Appendix A), reviewing key reports and documentation (Appendix B), and observing selected procedures.

Overall, we concluded that the TSP L Funds process complied with the Federal Employees' Retirement System Act of 1986 and applicable Board regulations for the period October 1, 2008 through September 30, 2009. During this period, we also noted that (1) the L Funds were rebalanced on a daily basis to reflect each fund's target allocation for the current quarter; (2) the asset allocations were adjusted each quarter based on each fund's prescribed time horizon; (3) the Agency reviewed the assumptions of the L Funds at least annually to determine whether any changes to the allocations were warranted; (4) the most current assumptions review was conducted in accordance with the terms of the contract between the Agency and the vendor; (5) the assumptions used to develop the L Funds' allocations were reasonable; (6) the published ratio of administrative expenses per \$1,000 of account balance in the L Funds was properly calculated; and (7) the published asset allocations for each L Fund agreed to the fund's actual asset allocation.

We noted no prior recommendations. The current engagement produced no new recommendations.

APPENDIX A

KEY PERSONNEL INTERVIEWED

While performing fieldwork, we interviewed the following key personnel regarding the Thrift Savings Plan Lifecycle Funds process:

A. Federal Retirement Thrift Investment Board Staff

Tracey Ray	Chief Investment Officer
William Jacobson	Financial Analyst, Office of Investments
Susan Crowder	Chief Accounting Officer
Anne Beemer	Controller, Office of Finance
Stella Lane	Senior Financial Specialist

KEY DOCUMENTATION AND REPORTS REVIEWED

Federal Retirement Thrift Investment Board Documents and Reports:

- Summary of the Thrift Savings Plan, dated July 2009
- Fund Information Sheets for the G, F, C, S, I and L Funds, as of December 31, 2008
- Participant Behavior and Demographics, Analysis for 2000-2005
- Monthly Return Time Series Data, July 1988-November 2009
- Executive Director Memo – From General Counsel Regarding Lifecycle Funds, dated September 12, 2003
- Board Meeting Minutes, dated April 19, 2004
- Board Meeting Minutes, dated March 15, 2004
- Board Meeting Minutes, dated March 21, 2004
- Meeting Minutes, dated September 15, 2003
- Memo to the Board Members on Use of Target Asset Allocation Funds, dated March 8, 2004
- Memo to the Board on Use of Lifecycle Funds by the TSP, dated April 14, 2004
- TSP 3406 Investment True-Up of Trades Report Lifecycle Fund Rebalancing for a sample of dates
- Asset Manager Interface (AMI) Investment Detail for a sample of dates
- FedInvest Buy Request Confirmation Reports for a sample of dates
- Barclays Global Investors Asset Statements for a sample of dates
- Mercer Investment Consulting Contract # TIB-2005-0213
- TSP Features for Civilians: Understanding Agency Contributions
- August 2008 Performance Review – G, F, C, S, I, and L Funds
- Fact Sheet TSP Funds Annual and Monthly Returns, November 2, 2009
- Monthly Returns for the G, F, C, S, and I Funds, Updated November 2, 2009
- Questions and Answers about the L Funds, Updated September 18, 2008
- Mercer Presentation – Federal Retirement Thrift Savings Plan Lifecycle Fund Asset Allocation, dated March 2009
- Mercer Presentation – Federal Retirement Thrift Savings Plan Lifecycle Fund Asset Allocation, dated March 2008
- Mercer Presentation – Asset Allocation for the Lifecycle Funds: Final Results, dated March 2007
- Mercer Presentation – Capital Market Assumptions: Federal Retirement Thrift Savings Plan, dated November 2006
- Mercer Presentation – Development of Lifecycle Funds: Federal Retirement Investment Board, dated March 2005

KEY DOCUMENTATION AND REPORTS REVIEWED, CONTINUED

- Mercer Memo – Fund Structure Recommendations, dated December 31, 2004
- Target Allocations Over Time – 2010, 2020, 2030, and 2040
- CPI Detailed Report-December 2009
- Ibbotson SBBI Valuation Yearbook for 2009
- United States Quarterly Real GDP SAAR Economic Times Series Data Profile
- Employee Benefit Research Institute Issue Brief No. 297, *Measuring Retirement Income Adequacy: Calculating Realistic Income Replacement Rates*, September 2006
- Social Security Bulletin Vol. 65 No. 1, *Comparing Replacement Rates Under Private and Federal Retirement Systems*, 2003/2004
- Internal Revenue Service (IRS) Publication 1457, *Actuarial Valuations*, Version 3A

APPENDIX C

ENTRANCE CONFERENCE ATTENDEES

An overall entrance conference, covering the entire FY 2009 Thrift Savings Plan (TSP) audit plan and proposed schedule, was held at the Agency on November 19, 2008. Attendees were as follows:

A. Federal Retirement Thrift Investment Board's Staff

Jim Petrick	Chief Financial Officer
Mark Hagerty	Chief Information Officer (CIO)
Penny Moran	Director, Office of Participant Services
Anne Beemer	Controller, Office of Finance
Mark Allen	IT Security Specialist
Susan Smith	Deputy CIO, Software and Applications Management

B. Department of Labor, Employee Benefits Security Administration

William Bailey	Senior Auditor, FERSA Compliance
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C. KPMG LLP

Heather Flanagan	Partner
Don Farineau	Partner
Derek Thomas	Manager
Mark Munster	Computer Systems Analyst

APPENDIX C, Continued

ENTRANCE CONFERENCE ATTENDEES, CONTINUED

An entrance conference for the TSP Lifecycle Funds Process performance audit was held with the Agency on December 8, 2009. Attendees were as follows:

A. Federal Retirement Thrift Investment Board Staff

Jim Petrick	Chief Financial Officer
Tracey Ray	Chief Investment Officer
William Jacobson	Financial Analyst, Office of Investments
Susan Crowder	Chief Accounting Officer
Anne Beemer	Controller, Office of Finance

B. KPMG LLP

Heather Flanagan	Partner
Derek Thomas	Manager
Paul Li	Economic Analyst
Rui Fan	Economic Analyst
Rebecca Rider	Senior Associate



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

GREGORY T. LONG
Executive Director

August 10, 2010

Mr. Ian Dingwall
Chief Accountant
Employee Benefits Security
Administration
United States Department of Labor
200 Constitution Avenue, N.W.
Suite 400
Washington, D.C. 20210

Dear Ian:

This is in response to your email of July 30, 2010, transmitting the KPMG LLP report entitled "Employee Benefits Security Administration Performance Audit of the Thrift Savings Plan Lifecycle Funds Process" dated March 26, 2010.

We are pleased to note that the auditors concluded that the TSP L funds process complied with FERSA and applicable Board regulations. We are very pleased to note that there are no audit recommendations.

Thank you once again for the constructive approach that the Department of Labor and its contractors are taking in conducting the various audits of the TSP. The information and recommendations that are developed as a result of your reviews are useful to the continued improvement of the Thrift Savings Plan.

Very truly yours,

Gregory T. Long