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

THRIFT SAVINGS PLAN

MINUTES OF THE MEETING OF THE BOARD MEMBERS

October 18, 2010

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on October 18, 2010, at 9:00 a.m., Eastern Time. The meeting was open to the public at the Board's offices at 1250 H Street, N.W., Washington, D.C. In attendance were Alejandro M. Sanchez of Florida, member; Michael D. Kennedy of Georgia, member; by telephone, Dana K. Bilyeu of Nevada, member; Gregory T. Long, Executive Director; Thomas K. Emswiler, Secretary and General Counsel; Pamela-Jeanne Moran, Director, Participant Services; Mark A. Hagerty, Chief Information Officer; James B. Petrick, Chief Financial Officer; Tracey A. Ray, Chief Investment Officer; Thomas J. Trabucco, Director, External Affairs; and Renée Wilder, Director, Research and Strategic Planning.

1. <u>Approval of the minutes of the September 20, 2010 Board member meeting</u>.

Chairman Saul entertained a motion for approval of the minutes of the September 20, 2010 Board member meeting. The following motion was made, seconded, and adopted without objection:

> <u>MOTION</u>: That the minutes of the Board member meeting that was held on September 20, 2010 be approved.

2. <u>Thrift Savings Plan activity report by the Executive Director</u>.

   a. Sample Communications Materials

The Board reviewed the "The Time Is Near" publication which the Agency mailed to participants who are nearing the date on which they are required by law to make a withdrawal election. Mr. Sanchez asked if the Agency has ever considered using pop-ups on the Agency's web site to disseminate information to participants. Mr. Long said he is not inclined to use pop-ups because people tend find pop-ups irritating and because this publication in particular is relevant only for a narrow group of participants.

Ms. Moran reported that 12.5% of 351,000 previously non-contributing FERS population who received the "Green Light" mailing in March are now contributing. She also reported that the Agency sent letters to 127,605 participants who have money in the L 2010 Fund to inform them that the L 2010

Fund would be retired on December 31, 2010 and that their money would be rolled into the L Income Fund.

b. Monthly Participant Activity Report

Ms. Wilder discussed the report on TSP statistics. See "Thrift Savings Fund Statistics" (attached). The total balance of the TSP Funds is approximately $264 billion and the number of participants is up to almost 4.4 million. The uniformed services participation rates remained relatively unchanged in September.

Ms. Wilder reported that 18,230 newly hired Federal employees were automatically enrolled in September. Approximately 5,405 additional participants made an immediate affirmative election to participate in the TSP before they were automatically enrolled. Of the 18,230 participants who were automatically enrolled, 7,065 participants later made an affirmative investment decision to move money from the G Fund to one of the other funds. Approximately 333 new Federal employees declined participation in the TSP before they were automatically enrolled and 148 opted out of participation in the TSP after they were automatically enrolled.

Mr. Sanchez suggested the Agency offer a "TSP Military Award of the Year for Participation" to provide incentive for the service branches to increase participation among their members. Mr. Long explained that he expects Roth to drive the uniformed services participation rate up.

Mr. Kennedy asked whether the Agency can track the investment decisions of automatically enrolled participants who later decide to move money out of the G Fund. Mr. Long said the Agency has the ability to track those investment decisions but questioned the value of doing so given the frequency at which investment decisions can change.

c. Quarterly Investment Performance Report

Ms. Ray reviewed the October 8, 2010 memorandum, entitled "September 2010 Performance Review" (attached). The Fixed Income Fund outperformed by 6 basis points in September and by 15 basis points year-to-date primarily as a result of the optimization process. The Small Mid Cap Fund outperformed by 8 basis points in September and by 30 basis points year-to-date for the same reason.

The International Fund outperformed by 19 basis points year-to-date primarily as a result of the tax effect. Ms. Bilyeu asked whether the TSP has a qualification letter from the Internal Revenue Service. Mr. Petrick explained that statutory provisions confer tax qualified status on the TSP.

The trading costs for the year remain relatively low. The G Fund rate was 2.13 percent in September and that has remained unchanged in October.

The S Fund was up 11% and the C Fund was up 8.9% in September. The I Fund also had a strong month. That trend has continued in October with the S and C Funds up over 3% and the I Fund up 4.5%.

Total investment balances in the L Funds exceeded $30 billion in September. Mr. Saul commented that the L Fund participation has exceeded the Board's expectations and for that he credited the Agency's education efforts. Mr. Long predicted that participation in the L Funds would continue to grow.

Mr. Sanchez, Mr. Saul, and Ms. Bilyeu observed that nearly 50% of contributions are allocated to the G Fund and the F Fund. Mr. Long pointed out that asset allocation can be affected by market movements in addition to interfund transfer activity. When the equity market collapses like it did at certain points in 2008 and 2009, the allocation of equity relative to bonds goes down.

Mr. Sanchez observed that the uniformed services members seem to be more receptive to the L Fund than other participants. Mr. Long suggested that greater turnover in the military explains higher L Fund participation among uniformed service members relative to the population of civilian participants. Federal employees who were hired before the L Funds existed are less likely to consider investing in the L Funds.

The Executive Director recommended reaffirmation of the current G Fund policy of investing solely in short-term maturities and of the current F, C, S, and I Fund investment policies. Thereafter, the members made, seconded, and adopted the following resolution by unanimous vote:

RESOLUTION

WHEREAS the Federal Employees' Retirement System Act of 1986, as amended (5 U.S.C. § 8401 et seq.) provides that the Board members shall establish policies for the investment and management of the Thrift Savings Fund (5 U.S.C. § 8472(f)(1) and (2)); and

WHEREAS the Board members at this meeting have reviewed the investment performance and investment policies of the Government Securities Investment Fund, the Fixed Income Index Investment Fund, the Common Stock Index Investment Fund, the Small Capitalization Stock Index Investment Fund, and the International Stock Index Investment Fund; and

WHEREAS the Board members are satisfied with the investment performance and investment policies of these Funds;

NOW THEREFORE BE IT RESOLVED that the current investment policies for the Government Securities Investment Fund, the Fixed Income Index Investment Fund, the Common Stock Index Investment Fund, the Small Capitalization Stock Index Investment Fund, and the International Stock Index Investment Fund are affirmed without change.

d. Legislative Report

Mr. Trabucco informed the Board that Congress has been out of session since the last Board meeting. Congress will return on November 15th.

e. Labor Department Report on L Funds

Mr. Petrick reported that KPMG reviewed the structure and operation of the L Funds as part of the DOL EBSA Fiduciary Oversight Program. KPMG provided no audit recommendations.

3. Mid-Year Financial Audit Report.

Mr. Petrick explained to the new Board members that the mid-year audit is self-imposed, whereas the annual audit conducted in February is mandated by statute. He also informed the Board that the schedules were changed to show the comparison between the June 30, 2010 numbers and the June 30, 2009 numbers. Previously, the June 30, 2010 numbers were compared with the December 31, 2009 numbers.

Mr. Saul explained to the new Board members that the Board does not have an audit committee and that, therefore, the five Board members serve effectively as the audit committee. He further explained that all of the Board members are always accessible to the auditors and will remain so.

Mr. Petrick took a moment to acknowledge Susan Crowder, who is the Agency's Chief Accounting Officer and Anne Beemer who is the Agency's Controller, for their work preparing the financial statements. He then introduced Marie Caputo, who is the engagement partner at Clifton Gunderson. Ms. Caputo, in turn, introduced Bill Oliver, quality control partner, and Bob Halpin, IT audit senior manager on the engagement.

Ms. Caputo began her presentation (attached) with a brief overview of the scope of the audit. The audit was limited in scope and conducted in accordance with Generally Accepted Auditing Standards. The auditors analyzed financial data to determine if any material modifications should be made to the June 30, 2010 financial statements in order for them to be in conformity with generally accepted accounting principles. The auditors made inquiries of Agency and contract personnel, but did not verify information externally. Ms. Caputo cautioned that the purpose of evaluating the internal controls was to express an opinion as to the financial statements and not as to the internal controls themselves. With the scope of the audit explained, Ms. Caputo said she was pleased to report that Clifton Gunderson found that no material modifications to the June 30, 2010 financial statements were needed in order for them to be in conformity with generally accepted accounting principles.

Mr. Halpin provided an update on the status of prior recommendations that were made as a result of the calendar year 2009 audit. He explained that each of the recommendations have been carried forward from the previous year. Implementation of the recommendations was delayed due to implementation of the Agency's modernization initiative.

Mr. Halpin reported that the Agency intends to initiate Certification and Accreditation, Risk Assessment Process and Plans of Actions Milestones in spring 2011. By December 2010, the Agency expects to finalize a majority of the necessary IT policies and procedures, complete background checks on all employees, and complete recommended updates to configuration management policies. During the fall of 2010 through the spring of 2011, the Agency intends to implement password controls and baseline configurations for Windows 2003, databases, and mainframe platforms. Configurations for the Linux and Cisco platforms are already in production.

Mr. Sanchez asked the audit team if they found anything during their review of the financial statement that they want to share with the Board. He also asked the audit team if they would inform the Board if they had a concern about something that was outside the scope of the audit. Ms. Caputo assured the Board that her team would bring any significant concerns that they identified during the audit to the Board's attention. However, she reiterated that the audit was not an exhaustive review.

Ms. Bilyeu asked whether there has been any focus on risk assessment outside the context of IT operations. Mr. Long explained that, about a year ago, he created a risk mitigation team that reports directly to him. However, the Agency recently offered a position to a certified fraud examiner. The Agency also has a separate project focused on internal controls. The progress of these efforts has been limited because of challenges finding and hiring qualified people.

Mr. Kennedy asked Ms. Caputo to provide him some background about herself and her team's relationship with the Agency. Ms. Caputo explained that she has been working in public accounting for twenty years and that she has spent her entire career working with employee benefit plans. The 2010 audit will be her team's third annual audit of the TSP and the members of the team present at the meeting have been engaged since inception of Clifton Gunderson's relationship with the Agency.

Ms. Bilyeu disclosed that Clifton Gunderson is also the accounting firm for the Public Employees' Retirement System of Nevada. She explained that Clifton Gunderson is a significant auditing firm in the public pensions sector.

Ms. Bilyeu asked if the Agency seeks review of its internal controls on a periodic basis and, if so, how often. Mr. Petrick explained that the Agency only relatively recently decided that it should voluntarily comply with the intent of OMB Circular A-123, which is the government equivalent of Sarbanes-Oxley. The Board as not decided to audit its internal controls as the cost would be significant. Mr. Saul reminded Ms. Bilyeu that BlackRock does extensive auditing of the index funds and that the Department of Labor also audits the TSP.

Mr. Sanchez asked whether it would be beneficial for the Board to have a separate meeting with the auditors. Mr. Saul responded that the auditors are aware that they can arrange a separate meeting with the Board if they desired. Ms. Caputo affirmed that she has been reassured that the Board will meet separately with the auditors at her request.

4. Quarterly Vendor Financial Report

Mr. Petrick discussed the October 8, 2010 memorandum entitled "Quarterly Financial Assessment of TSP's Primary Vendors – October 2010" (attached). In the interest of time, Mr. Saul asked Mr. Petrick to conduct his report by bringing to the Board's attention only items of concern.

Mr. Petrick explained that the Agency reviews the financials of its vendors on a regular basis. Mr. Saul pointed out to the new Board members that the process has been simplified because so many of the Agency's smaller vendors have recently been acquired by or merged with major companies. He also noted that the Agency's staff would be apprised of any major financial difficulties experienced by its vendors because the Agency staff regularly visits vendor worksites.

Serco, the Agency's record-keeper, and BlackRock, the Agency's investment manager, are both profitable and stable. Mr. Kennedy reiterated a concern voiced at a previous Board meeting, which was whether BlackRock has sufficient compensation incentives to retain the team that currently manages the Agency's accounts. Mr. Long said that there is no indication that the compensation packages for BlackRock's managers and executives are not competitive. Ms. Ray pointed out that the TSP's fund performance is less dependent on individual talent because the funds are indexed.

Mr. Saul explained to the new Board members that the CEO of BlackRock is accessible and meets with the Board on an occasional basis. He suggested that the Agency and the Board should arrange for the new Board members to meet with the CEO of BlackRock some time next year.

Equinix, the company that hosts the Agency's data centers, experienced a 30% drop in the value of its stock one day in October. However, Mr. Petrick assured the Board that Equinix is still profitable and presents no concerns for the Agency.

R.R. Donnelley, which provides printing services for the Agency, looked profitable in the first six months of 2010. The company experienced losses in the previous few years because the printing industry as a whole has experienced difficult times. But its profitability has improved due to restructuring changes that made it a leaner operation.

Mr. Sanchez asked the Agency's staff to confirm that R.R. Donnelley does not do its printing overseas. Mr. Petrick explained that R.R. Donnelley must do its printing in the United States as a requirement of the Agency's contract with it. Ms. Moran assured Mr. Sanchez that R.R. Donnelley operates in Utah and Massachusetts.

MetLife, the Agency's annuity provider, experienced a loss in 2009. However, it is still one of the largest, strongest insurance companies in the United States and it has extremely large, liquid reserves. There has been no indication that MetLife would have issues paying benefits. The Agency will be re-competing the annuity contract in 2011. At that point, the Agency will consider MetLife's financial ratings vis-à-vis the ratings of MetLife's competitors.

5. Annual Budget Discussion

Mr. Long directed the Board's attention to the October 8, 2010 memorandum entitled "Fiscal Year 2011 Budget and Fiscal Year 2012 Budget Estimate" (attached). Mr. Long briefly summarized the key points of last month's budget discussion. He then began today's budget discussion by addressing the effect of TSP modernization on the budget increases in recent years.

The Agency spent approximately $17 million on the modernization project in FY 2008. Mr. Saul asked how much of that $17 million was for non-recurring expenses versus ongoing expenses. Mr. Hagerty explained that roughly five to six million dollars was incurred for ongoing expenses such as maintaining software licenses.

Mr. Saul then asked Mr. Long to explain why the budget did not decrease in FY 2009 if the bulk of the FY 2008 budget increase was attributable to non-recurring expenses. Mr. Long explained that, although the modernization project was largely a one-time expense, it has a significant service component which is a recurring cost. He also reminded the Board that the Agency had large expenses related to changing data centers in FY 2009. Mr. Hagerty explained that software and hardware maintenance costs went up commensurate with capacity.

Mr. Long explained that part of the reason it under-spent the FY 2010 budget is that the Agency planned to spend approximately $5.4 million on FY 2010 projects that were ultimately pushed forward to FY 2011. The $5.4 million that was not spent in FY 2010 must be spent in FY 2011 in order to complete those projects. However, the net financial impact to participants is zero.

Mr. Saul commended the Agency for accomplishing a tremendous amount in FY 2010. He requested examples of deferred projects. Mr. Long reported that FY 2010 projects yet to be completed include establishing the OmniPay Payment and Tax Reconciliation Program in order to implement the Roth feature; upgrading the Agency's document work flow management system; changing forms to OCR in order to improve quality, speed, and accuracy in processing; and mailing an educational DVD.

Mr. Long reiterated that budget approval responsibility belongs to the Board. The Board must independently evaluate the risks and benefits associated with reducing the budget consistent with its fiduciary duties. With that, he then presented a number of budget reduction options. He explained that he prioritized reduction options in a manner that protects the Agency's ability to meet its primary goal, which is to maintain excellence in daily operations.

Mr. Long's first suggestion for reducing the budget is to remove the contingency budget for call centers, operations center, and service bureau and mail operations. This would produce a $1.8 million reduction in the budget.

Mr. Kennedy suggested reducing the contingency budget to $300,000 or $400,000 rather than eliminating it entirely. He also suggested making the contingency amount a line item of its own rather than building it into existing line items.

Mr. Long next suggested that the Board could choose to cancel certain program and service changes. Specifically, he suggested the Board might cancel the bi-annual participant satisfaction survey; cancel the creation of several new educational publications and services; eliminate planned enhancements to testing software and applications, website vulnerabilities, and miscellaneous software purchases related to participant services; eliminate a previously authorized auditing position and a previously authorized benefits specialist position; and postpone refresh of primary data center hardware. These cuts together would reduce the budget by $3,352,000.

Ms. Bilyeu asked Mr. Long if he expects to be able to fill positions that he could not fill last year given that the reason the Agency under-spent the FY 2009 budget was that it had hiring challenges which caused it to be capacity-constrained. Mr. Long said that he anticipates being able to hire enough people to be 90% staffed by the end of this year. However, he added, if the Agency is unable to fill a significant number of open positions, its ability to complete planned projects could be similarly capacity-constrained in FY 2011.

Mr. Saul reiterated that the Agency accomplished a tremendous amount in FY 2010 and questioned whether the Agency could out do itself this year. He expressed skepticism that the Agency needed to budget more for FY 2011 than it actually spent in FY 2010. He also said the Board must be cognizant of the difficult economic times this country is experiencing as it considers the budget. Mr. Sanchez echoed this sentiment.

Ms. Bilyeu pointed out that the budget is mission driven. The mission, in turn, is driven by the kinds of services the participants need and want. For this reason, she expressed concern about eliminating the participant satisfaction survey. She explained that she understands the desire to "tighten our belts" but she also noted that the kind of growth in membership experienced by the TSP requires commitment of dollars. She agreed that the budget should be cut to some extent but argued that some of the suggested reductions would have an undesirable effect.

Mr. Kennedy concurred with Ms. Bilyeu. He expressed concern that some of the budget reduction options would cripple the Agency's ability to deliver important participant services. He said that he would be comfortable with a FY 2011 budget that was approximately the same as the FY 2010 budget. Mr. Kennedy and Ms. Bilyeu both also suggested that, in future, the Agency might consider benchmarking its costs against TIAA-CREF or other similarly large plans in the industry.

Mr. Saul agreed that Mr. Kennedy's and Ms. Bilyeu's points had merit. He suggested that the Board approve a $130.3 million budget. He then suggested the Board revisit the budget in May to make any needed adjustments and that approval of the 2012 budget should be deferred.

The following motion was made, seconded, and adopted without objection:

<u>MOTION</u>: That the Board approve a budget for FY 2011 of $130,330,000 that the Executive Director may allocate among the various offices at his discretion, understanding that the Executive Director will present a report for the Board in May that may require a budget adjustment.

Mr. Saul inquired about the consequence of not submitting a budget for FY 2012. Mr. Emswiler explained that the Agency is required by law to submit a budget for FY 2012 that complies with United States Code Title 31, Section 1105. Ms. Bilyeu asked how much detail is required in the FY 2012 budget submission. Mr. Petrick explained that the Office of Management and Budget requires an object class view of the budget.

Mr. Saul suggested the Agency submit the same budget for FY 2012 that it just approved for FY 2011 plus $6.2 million to pay for Roth implementation and then revise it later. Ms. Bilyeu and Mr. Long both expressed discomfort with using a flat dollar amount. Mr. Saul assured the Board and Agency staff that the FY 2012 budget would be revisited and adjusted at a later date.

The following motion was made, seconded, and adopted without objection:

MOTION: That the Board approve an estimated FY 2012 budget of $136,500,000 that the Executive Director may allocate among the various offices at his discretion, understanding that the Executive Director will present a report to the Board in May that may require an adjustment to the estimated budget.

6. Closed Session.

On a vote taken by the Secretary, the members closed the meeting at 11:58 a.m. for executive session.

At 1:06 p.m., upon completion of the executive session, the members reconvened the open portion of the meeting.

Whereupon, there being no further business, the following motion was made, seconded, and adopted without objection and Chairman Saul adjourned the meeting at 1:06 p.m.

MOTION: That this meeting be adjourned.

Thomas K. Emswiler
Secretary

Attachments
1. Thrift Savings Fund Statistics
2. September 2010 Performance Review –G, F, C, S, I, and L Funds
3. Clifton Gunderson Presentation - Federal Retirement Thrift Investment Board
4. Employee Benefits Security Administration Performance Audit of the Thrift Savings Plan Lifecycle Funds Process

5. Quarterly Financial Assessment of TSP's Primary Vendors—October 2010
6. Fiscal Year 2011 Budget and Fiscal Year 2012 Budget Estimate
7. Federal Retirement Thrift Investment Board Budget – Selected Summaries of Interest