



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

MINUTES OF THE MEETING OF THE BOARD MEMBERS

October 15, 2007

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on October 15, 2007, at 9:03 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, Thomas A. Fink of Alaska, member; Alejandro M. Sanchez of Florida, member; by telephone, Gordon J. Whiting of New York, member; by telephone, Terrence A. Duffy of Illinois, member; Gregory T. Long, Executive Director; Thomas K. Emswiler, Secretary and General Counsel; Mark A. Hagerty, Chief Information Officer; Pamela-Jeanne Moran, Director, Participant Services; James B. Petrick, Chief Financial Officer; Tracey A. Ray, Chief Investment Officer; and Thomas J. Trabucco, Director, External Affairs.

1. Approval of the minutes of the September 17, 2007 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the September 17, 2007 Board member meeting. The following motion was made, seconded, and adopted without objection:

MOTION: That the minutes of the Board member meeting held on September 17, 2007 be approved.

2. Executive Director's Report.

a. Participant Activity Report.

Mr. Long reviewed the report on TSP statistics. See "Thrift Savings Fund Statistics" (attached). He noted that the TSP fund balances had increased to \$230,836,000,000. Chairman Saul commented that it was incredible that plan assets had increased by over \$6 billion in one month. Mr. Long agreed and noted that \$1.6 billion came from new cash flow and the rest was attributable to investment decisions and the capital markets. Mr. Sanchez remarked on an article he had read advising TSP participants not to chase the latest returns. He added that this

was responsible advice and clearly warranted given the statistics on TSP returns over the last twelve months.

Mr. Long noted that all funds had positive returns over the last twelve months. The FERS participation rate was steady at 85.6 percent although the total number of FERS participants was down slightly. The number of FERS employees who are not yet eligible for Agency matching contributions is up, which is good news. The total number of CSRS participants continues to decrease by between 3,000 and 4,000 each month as that population retires. Currently, 346,000 CSRS employees participate in the TSP. The total number of uniformed service participants decreased slightly. However, we anticipate the total number of uniformed service participants to increase in the future. Chairman Saul noted that the total number of uniformed service participants has more than doubled in the five year period since the current Board was constituted. Mr. Long added that the uniformed service participation rate is lower than other groups, but he has been pleased to see the growth in the number of uniformed service participants.

The total number of participants just passed the 3.8 million mark. Many participants leave their money in the TSP after retiring. The number of plan loans increased slightly. This growth is consistent with the increase in plan participants and is in-line with 401(k) plans. TSP expenses are currently at one basis point although this will likely increase to two basis points by the end of the year.

The active duty participation rate remains constant at 34.2% (the Navy, at 50.4%, having the highest participation rate). The reserve participation rate fell slightly. This decrease was likely due to the number of reservists being called to active duty. Chairman Saul noted that in November 2002, 282,000 members of the uniformed services participated in the TSP. This number now stands at 566,000. This growth of almost 300,000, when members of the uniformed services do not receive matching contributions, is incredible. Mr. Sanchez congratulated Mr. Long and his staff for this increase. Mr. Long said congratulations to the uniformed services. Chairman Saul added his thanks to the uniformed services not just for TSP participation but for all that they do. Chairman Saul added that the TSP's growth in both participants and dollars points out the importance of ensuring that the technology enhancements approved by the Board last month are implemented and kept up to date.

b. Legislative Report.

Mr. Trabucco reported that the Congressional Budget Office is currently pricing the Agency's proposal to automatically enroll new employees and members of the uniformed services in the TSP and to set an age-appropriate L Fund as the default fund. He hoped that the cost would be low because this would increase the likelihood that the legislation would be enacted this session.

Mr. Trabucco noted that Congress is still considering divestment legislation but that the TSP is no longer a target. He added that Congressional staff members are aware of the Board's resolution against entering political and social considerations into TSP investment decisions. Chairman Saul remarked that foreign policy is not in our investment portfolio because we must act solely in the interest of the TSP's participants and beneficiaries. He pointed out that complying with this fiduciary duty does not mean we are not patriotic.

3. Investment Policy Review.

Ms. Ray reviewed the October 5, 2007 memorandum (attached), on the performance of the G, F, C, S, I, and L Funds through September 2007.

She noted that the S Fund had a tracking error of six basis points for the month but is ahead by fifteen basis points for the year due to the optimization program. The I Fund outperformed the index by 22 basis points due to the tax effect.

In September, \$3 billion was traded in the F Fund. This is especially significant because the F Fund is only a \$10 billion fund. For the year, \$7 billion has been traded in the F Fund versus \$1.7 billion during the same period last year. In September, \$4.6 billion was traded in the I Fund; \$3.2 billion was traded in August. For the year, \$19 billion has been traded in the I Fund versus \$10.2 billion during the same period last year. So, we're seeing a lot of activity in these funds and an increase in transaction costs. For the year, transactions costs for the F Fund are \$767,000 versus \$140,000 during the same period last year. Transaction costs for the I Fund are 6.4 basis points. Mr. Long added that he and Ms. Ray are studying this increased activity and plan to report on it and make appropriate recommendations at either the November or December Board member meeting.

Ms. Ray then reviewed Fund performance as set-out on page three of the memorandum. Chairman Saul remarked that what we are seeing in the I Fund reflects the perception that the foreign economy is growing faster than the domestic economy. Ms. Ray agreed and said it is also attributable to the decline in the value of the dollar. The 2040 fund, due to its high exposure to equity, performed best in September, and, year-to-date has outperformed all funds except the I Fund. The L Funds, which had shown a net outflow in August, had a \$400 million inflow in September. Mr. Sanchez asked what had likely caused this and Chairman Saul asked what it meant for the long-term investor? Ms. Ray explained that anyone who left the L Funds in August missed a great month in September and in the first two weeks of October. The mortgage crisis precipitated the outflow in August. The commercial paper market, while still recovering, has certainly improved since then.

Ms. Ray then reviewed proxy voting and noted that there were no exceptions to the proxy voting policy at Barclays. She noted that Barclays had revised its non-U.S. proxy voting guidelines to better align them with the changes made to its U.S. proxy voting guidelines last year. Barclays also made additional changes to its U.S. proxy voting guidelines in the realm of executive compensation.

After this discussion, 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.

4. Vendor Financial Reports.

Mr. Petrick provided the Board members with the quarterly report on vendor financial status as discussed in a memorandum to the Executive Director dated October 5, 2007 (attached).

SI International maintained its pattern of aggressive growth through acquisition. It does almost all of its business with the government and has won several new contracts. Although growth means more liability, stockholder equity continues to increase. We have no concerns regarding its continued viability.

Barclays' financials have not changed significantly. Its financials continue to exceed regulatory requirements for capitalization. Its profitability, shareholders equity, and cash (and cash equivalents) grew during this period. We have no cause for concern.

Mr. Sanchez asked Mr. Petrick to return to the report on SI. Mr. Sanchez remarked that he was still troubled that good will constitutes a significant portion of SI's assets. Mr. Petrick explained that, when SI acquires a company, it is required to book, as goodwill, the difference between the value of the company's tangible assets and what SI paid for the company. Consequently, any company that is pursuing an aggressive acquisition strategy will show a large good will number on its balance sheet.

As previously reported, Switch & Data's initial purchase offer in February was successful. This caused its balance sheet to improve significantly. Long-term debt is down and cash is up. It is, however, still unprofitable. Consequently, we need to watch it carefully and be prepared to implement a mitigation strategy. We do not believe this will be a problem in

the short term, but there is still a possibility that the company could experience financial difficulties in a few years. Mr. Sanchez remarked that it is good that we have a plan for contingencies. Chairman Saul remarked that it appears that Switch & Data is improving; for example, it almost broke even this quarter versus a loss of \$12 million in the same quarter last year. Additionally, its ratio of current assets to current liabilities is over 2.1 to 1, and this is a significant improvement. Mr. Petrick agreed and stated that what most concerns us is that the balance sheet still shows a loss from current operations. Mr. Fink pointed out that the line on the balance sheet entitled "Total Liabilities, Preferred Stock and Shareholders Deficit" should be amended since it is no longer a deficit but is, instead, a positive number. Mr. Petrick agreed and said he would make the change on future reports.

We have no concerns regarding R.R. Donnelley & Sons. It continues to pursue growth through acquisition. Its sales have increased significantly. Earnings did decrease this quarter because it wrote-off a number of trade lines. We have no particular concerns and foresee no problems. And, if there ever were a problem, we could obtain printing services from numerous other companies.

MetLife continues to be one of the largest and strongest U.S. insurance companies with excellent ratings from all rating services. We have no basis for concern.

Spherix, which operates the Cumberland call center, was sold to the Active Network in August. Consequently, we will no longer need to report on Spherix's financials. The Active Network's main business is providing reservation services and other services in sports related venues. It is a private company and provided its financials to us pursuant to a confidentiality agreement. Consequently, we will discuss its financials in the closed session. Chairman Saul asked whether there had been any change in call center operations since the Active Network acquired the operation. Mr. Long explained that there had not been; the center was managed and run by the same people.

5. Board Policy Manual.

Mr. Emswiler explained that several months ago Mr. Whiting had suggested that it would be a good idea to compile a record of all Board policy votes. He noted that Ms. Graziano had done an excellent job in compiling the votes as well as any memoranda that formed a basis for the votes. He provided each

member with a binder that included these documents as well as a CD-Rom that included them electronically. He added that this would be a living document and that his office would amend it to reflect future Board votes. Mr. Whiting commented that Ms. Graziano did a great job putting this together and added that it was exactly what he was looking for.

6. Mid-Year Financial Audit.

Melissa Krauss, from Deloitte, reviewed a power point presentation entitled "Thrift Savings Plan June 30, 2007 Review" (attached). She noted that the scope of the review was less than a full audit. Consequently, they will not express an opinion on the Agency's financial statements. However, she added that, based on their review, she was not aware of any material modifications that needed to be made to the financial statements to make them conform with generally accepted accounting principals.

Mr. Fink remarked on a footnote that said that expenses are net of loan fees and forfeitures. He asked why loan fees were included. Mr. Petrick explained that the Agency had decided to make the change on the December financial statements rather than implement the change mid-year. The Agency has received \$6.3 million in loan fees through June 30th.

Mr. Sanchez asked why Deloitte had expressed no opinion on the Agency's internal controls. Ms. Krauss explained that Deloitte had not been engaged to conduct a review of controls. Consequently, the audit contained no opinion on controls. However, because it was necessary for Deloitte to understand the Agency's controls in order to conduct the audit, they were mentioned in the audit. Mr. Sanchez asked whether Ms. Krauss and her team had noted anything regarding the controls that concerned them and was told that they had not. Mr. Fink asked whether that Agency had ever had an internal control audit and was told that it had not. Mr. Sanchez asked whether one was needed. Mr. Petrick stated that he would report on the Agency's A-123 effort at the November Board meeting and that they could then discuss the need for an audit. Such an audit is expensive and is not required of all Federal agencies. Mr. Sanchez asked whether other agencies were having such reviews conducted and was told that a few were. The Deloitte representative stated that, for example, the Social Security Administration and VA had contracted to perform such audits. Mr. Whiting asked whether the Agency would ever be required to conduct such reviews and was told that OMB might extend the requirement. We would then

need to examine whether OMB could legally require the Agency to conduct such a review.¹ Chairman Saul noted while the Agency is small in number of employees it is large in assets under management. We have excellent oversight that other agencies do not. For example, we must hire an independent auditor annually and the Department of Labor conducts its own audits of the Agency annually. Our vendors have auditors and we have hired consultants to review the TSP's systems. We are not an unwatched Agency. Mr. Fink added that we have very detailed reviews.

Mr. Petrick then returned to the question of whether expenses are net of loan fees and forfeitures. He said that they are not. The audit reflects gross expenses. Chairman Saul said that this means the \$36,325,000 shown on the audit reflects actual expenses paid by the Agency through June 30th and that this compares to the \$80,985,000 expended by the Agency during all of 2006. Mr. Fink stated that he still believed these were net figures and was promised a further discussion of this matter with Board staff after the next Board meeting.

Chairman Saul asked whether Ms. Krauss had anything else that she wished to address. He explained that the Board serves as the Agency's audit committee and that if she ever had any concerns she should contact them directly. Ms. Krauss said that she appreciated that and would take advantage of it if it was ever needed. She noted that there had been good progress in resolving prior audit recommendations. She added that the audit plan is similar to prior years. Chairman Saul stated that the Board had recently approved significant upgrades to the TSP's operating systems and that he wanted to make sure Ms. Krauss was aware of this because it could affect Deloitte's upcoming audits. Ms. Krauss replied that they were well aware of the pending upgrades. Chairman Saul stated that he was sure the Department of Labor would monitor these upgrades and added that he wanted Deloitte to also examine these upgrades closely. Ms. Krauss agreed to do so.

7. Account Numbers.

¹ The Agency receives no appropriations from Congress. TSP contributions and earnings provide its operating revenue. These amounts are maintained in trust for TSP participants and must be expended solely in the interest of the TSP participants and beneficiaries. Consequently, a directive from another executive branch agency must be examined to see if complying with it is consistent with this fiduciary duty.

Ms. Moran explained that the switch from using social security numbers to account numbers as the principal means of identifying TSP participant accounts had gone very smoothly. We announced the upcoming change in July and in August we mailed each of the 3.8 million TSP participants a letter advising them that the change was coming and to look for their account numbers in September. In September, we mailed an account number to each of the 3.8 million TSP participants. On October 1st, we turned the feature on for our personal service representatives at the call centers and, on October 8th, we switched the website and ThriftLine over to account numbers. On Tuesday, October 9th, we received 3,000 more calls than usual. The number of calls reduced significantly by Thursday and Friday. This month we've answered 10,000 calls on account numbers and have reissued 99,000 account numbers. Mr. Sanchez noted that he had read in the press that many people had misplaced their account numbers. Ms. Moran confirmed that this was the case. She added that the Agency had recently participated in the Association of the U.S. Army convention. She and her staff had asked attendees whether they had received account numbers. Some had it with them, some remembered they had it, some said they needed to check their junk mail pile, and some said that they needed to be reissued one. Most who ask to be reissued an account number are using the web, which is exactly what we want. We mail them the day after the request.

Mr. Long stated that we have had some challenges and some complaints, but, as a percentage, the number of complaints has been very small. We made the switch out of concern for participant security and it was a step we needed to take.

Mr. Fink asked what happens to returned mail. Ms. Moran explained that if it includes a forwarding address, we forward it along with a reminder to the participant to update his or her address. If the mail is undeliverable, we scan the bar code on the letter, and we annotate the account to reflect that it came back undeliverable. We then add it to our data base of those participants for whom we don't have a valid address. We'll use that data base to contact the participants' employing agencies and will ask those agencies to submit valid addresses. We will continue this process with other mailed TSP materials (particularly the annual statement next February) in order to ensure that we have valid addresses for our participants. We've received between 100,000 and 120,000 pieces of returned mail. This means we have valid addresses for 97 percent of our participants. Most agencies send information to their employees electronically. Consequently, they may not keep their

employees' addresses up to date. Considering that the TSP receives addresses from the agencies, that the TSP has accurate addresses for 97 percent of its participants is very good. We will use the account number mailing and the annual participant statement mailing in February to improve this percentage and to assist us in addressing the issue of dormant accounts.


Mr. Long stated that we know with 3.8 million participants we can never have perfection, but this is a significant first step toward ensuring we have valid addresses for our participants. Mr. Sanchez noted that a big concern in the banking industry and a personal concern of his is that we focus on locating the older retirees, particularly those with medical conditions who may be unable to respond to our notices. He added that people do need to be responsible for notifying the TSP when they change addresses and remarked that only 100,000 to 120,000 pieces of returned mail from a population of 3.8 million is excellent.

8. Closed session.

On a vote taken by the Secretary before the meeting, the members closed the meeting for a discussion of security matters.

Whereupon, there being no further business, the following motion was made, seconded, and adopted without objection and Chairman Saul adjourned the meeting at 11:25 a.m.

MOTION: That this meeting be adjourned.


Thomas K. Emswiler
Secretary

NOTE: Ace-Federal Reporters, Inc. made a verbatim transcript of this meeting.

Attachments

1. Thrift Savings Fund Statistics
2. September 2007 Performance Review - G, F, C, S, I, and L Funds
3. Quarterly report on vendor financial status

4. Thrift Savings Plan June 30, 2007 Review