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

MINUTES OF THE MEETING OF THE BOARD MEMBERS

February 24, 2010

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board convened a meeting of the Board members on February 10, 2010, at 9:05 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; by telephone, Alejandro M. Sanchez of Florida, member; by telephone, Gordon J. Whiting of New York, 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; Thomas J. Trabucco, Director, External Affairs; and Renée Wilder, Director, Research and Strategic Planning.

1. Approval of the minutes of the January 19, 2010 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the January 19, 2010 Board member meeting. The following motion was made, seconded, and adopted without objection:

> MOTION: That the minutes of the Board member meeting that was held on January 19, 2010, be approved.

2. Thrift Savings Plan activity report by the Executive Director.

Mr. Long commented that the recent closings and delays due to snow in the Washington, D.C. area tested the Agency's ability to conduct business when the 1250 H St. building was not usable. The organization performed well. Ms. Moran and her team successfully directed traffic at the call centers so that the waiting periods were up only modestly. Additionally, when one of the Agency's data centers lost power, the Agency's back-up generators kicked in and provided uninterrupted power to the Agency's servers. Further, the accounting team was able to stay in communication with Treasury and ensure that the Agency's investments and disbursements were successfully processed. The rest of the senior staff was able to conduct business via conference call, Web-X, e-mail, etc., and Mr. Long was very pleased with how the Agency's continuity of operations plan worked.

a. Participant Activity Report

Ms. Wilder reviewed the report on TSP statistics. See "Thrift Savings Fund Statistics" (attached). For the month of August, assets under management for the TSP fell slightly from $244 billion to $242 billion. Cash flow remained strong at $1.8 billion. The participation rate increased in January from 81.5% to 82.4%. The participation rate is getting closer to where it was prior to the June 2009 implementation of automatic agency contributions. Automatic agency contributions caused the denominator in the equation used to calculate the participation rate to grow faster than the numerator.

Ms. Wilder noted that she and Ms. Moran have been focusing on the 400,000 FERS employees who are receiving the Agency's automatic one percent but are not contributing. Though it is difficult to determine why these individuals are not contributing, it is likely that many individuals simply cannot afford to contribute their own funds to the TSP. Ms. Moran's group sent these individuals a mailer in December encouraging them to contribute their own money to the TSP. From December to January, the number of individuals who were receiving the Agency one percent but not contributing dropped from 421,000 to 400,000. The Agency will do a follow-up mailing to continue to encourage these individuals to contribute to the TSP in order to receive agency matching contributions which they are forgoing. Further, the annual participant statement will be mailed to all participants soon, and this statement includes a letter from Mr. Long encouraging participants to save for retirement.

When automatic enrollment is implemented this summer, newly-hired FERS employees will have three percent of their salary automatically contributed to the TSP. While these employees can opt out of the TSP, the hope is that the percent of non-contributing FERS employees will decline. Automatic enrollment requires many programming (e.g., payroll) changes for agencies, and, therefore, the goal is to have it implemented in August but smaller agencies may require more time. The authorizing legislation did not provide a firm date for implementation, and, instead, gave the Executive Director the authority to implement automatic enrollment via regulation.

Chairman Saul commended Ms. Moran and Ms. Wilder for their efforts in trying to reduce the number of non-contributing FERS employees. Mr. Long emphasized that these individuals are leaving free money on the table because, by not contributing, they are not receiving their agencies' matching contributions. The Agency will continue to focus efforts on reducing the number of noncontributing FERS employees.

Mr. Fink requested a copy of the annual statement as well as a copy of the letter from Mr. Long to the participants. Ms. Moran noted that return mail continues to be a challenge though this returned mail provides the Agency with valuable information regarding the mailing addresses of its participants.

The implementation of automatic agency contributions has resulted in significant Plan growth over the past six months, and the Agency anticipates that automatic enrollment will also have a large impact on the Plan. In particular, the participation rate should increase as the numerator in this equation will likely grow faster than the denominator. Mr. Long noted that he does not think it is unreasonable to expect that over several years, the FERS participation rate will get into the high 80s and even the low 90s.

b. Quarterly Investment Performance Report

Ms. Ray reviewed the February 5, 2010 memorandum (attached), entitled "January 2010 Performance Review." The percent of contributions going into the L Funds is up to 15 percent which is good news. Also, the percent of account dollars invested in the G Fund is down from 47 percent to 43 percent which shows that people are getting more comfortable with the markets.

In January, the International (I) Fund had a tracking error of negative 77 basis points which is due to a fair value adjustment at the end of January.

Although the market started out strong in January and though GDP was up 5.7 percent for the fourth quarter (which was the fastest rate of growth in six years), when the President called for limits to trading activities of financial institutions and when Chairman Bernanke's reconfirmation looked questionable, the market faltered. Additionally, the market suffered from weakness in Europe due to concerns about Greece and Portugal. This is evidenced in the I Fund which is down five percent in January. Month-to-date the declines in the C and F Funds have partially reversed. The C Fund is up 0.29 percent month-to-date, and the S Fund is up 1.81 percent. However, the I Fund, month-to-date, is down another 2.11 percent and down seven percent for the year.

The G Fund rate is 3.13 percent.

During the month of January, the L Funds declined which is expected when the underlying funds perform poorly. The fund experiencing the biggest decline was the L 2040 Fund which has the most aggressive asset allocation. Finally, the total number of participants in the L Funds is now 657,364.

c. Legislative Report

Mr. Trabucco reported that legislative activity has been slow to commence this year, and the recent snow storm delayed things even further. Mr. Sanchez asked whether Senator Brown would be on any committees impacting the TSP. Mr. Trabucco will look into this and report back to the Board.

3. <u>Vendor Financials</u>.

At the request of the Board, Mr. Petrick provided an update on the merger between Equinix and Switch and Data as well as an update on the Agency's annuity provider, MetLife. On January 29th, the Switch and Data shareholders voted and approved a merger between Switch and Data and Equinix. There had been several lawsuits filed by shareholders against the merger but these suits have been settled, and the only hurdle to this completion of the merger is approval by the Department of Justice. The merger will likely be complete in the first quarter of 2010.

Mr. Petrick will report on Equinix's financials in the next quarterly Board meeting report. Its revenue was $182.5 million which was a 25 percent increase over the previous year. Overall, Equinix's financials look quite strong.

Mr. Petrick also reported that, though still strong, MetLife's ratings have been downgraded. In particular, MetLife's ratings have been been downgraded one notch by Fitch and by Moody's. Fitch's rating of MetLife is AA- Stable and Moody's is Aa3 Stable. MetLife's A.M. Best rating is A+ Stable and its S&P rating is AA- Watch Negative. Mr. Petrick noted that most public insurance companies in the U.S. have suffered ratings downgrades in the last six months. MetLife was one of the last to experience a downgrade. Generally speaking, the mutual insurance companies have somewhat stronger ratings and this may be reflective of the fact that these companies were not involved in the investment markets to the same extent as the publicly-traded insurance companies.

MetLife remains one of the strongest, if not the strongest, publicly-traded insurance companies. Nevertheless, the Agency takes these downgrades very seriously, and Mr. Petrick and Ms. Moran have spoken to MetLife's financial analysts and are in the process of scheduling a conference call with the company's Chief Financial Officer to discuss the effects of these ratings. Further, the Agency is requesting that one of its consultants review the situation as well. Mr. Petrick also noted that the annuity contract is going to be rebid next year, and, therefore, the Agency will have an opportunity to consider what the target ratings for its annuity provider should be.

Overall, Mr. Petrick does not believe that these downgrades are cause for alarm but the Agency is staying on top of the matter. Mr. Long noted that MetLife has been very forthright regarding the downgrades, and the CEO of MetLife is visiting the Agency on February 25th. Chairman Saul noted that the situation should be watched as these annuities are very critical to their holders who depend on their income. Mr. Whiting added that all of MetLife's current ratings are the second highest possible.

4. <u>Report on Participant Behavior in Financial Crisis.</u>

Ms. Wilder then reported on her February 9, 2010 memorandum (attached) entitled "Update on Participant Investment Behavior During the 2008 Financial Crisis." Account balances decreased during this period as a result of market activity and not as a result of participants withdrawing funds. Loan and withdrawal activity during this period also did not show a significant increase. In the last few months, loan activity has picked up. This may be due to participants who are taking advantage of the Homeowner's Tax Credit. Investment behavior during this time was exactly would it should not be. During the crisis, participants moved money out of the equity funds and into the G Fund. Now as the market is recovering, participants are moving money back into the equity funds.

Mr. Sanchez commented that this behavior of selling low and buying high distressed him. Chairman Saul noted that the equity funds dropped significantly in value and the G Fund did not, and that it is understandable why participants felt more secure placing their money in the G and F Funds. Mr. Long commented that the Agency has delivered the message that participants should not be selling low and buying high via several different mediums. The Agency's job is to educate, not advise, participants, and ultimately, investment decisions are individual decisions. Mr. Sanchez commended Ms. Moran's team for the Agency's excellent educational services.

Ms. Wilder noted that the new Website will go a long way toward supporting and strengthening the Agency's educational services. Chairman Saul commented that the Website is probably one of the most important efforts that the Agency is currently working on, and he would like to see it go live in May as planned. The Agency is dedicating many resources to the Website's redesign. Ms. Wilder noted that even after the Website's initial launch, there will be a series of follow-on enhancements. Mr. Long commented that the Agency does not have the luxury of having only one priority. The Agency's main priority is to keep the Plan running. Additionally, the Agency is involved in many projects such as the Web and also the legislative initiatives.

5. Thrift Savings Plan Enhancement Act Implementation Update.

Ms. Wilder then discussed the January 9, 2010 memorandum from her and Mr. Long (attached) regarding the Agency's progress on projects related to the 2009 Thrift Savings Plan Enhancement Act (Act). Spousal beneficiary accounts, which are strongly supported by the Employee Thrift Advisory Council (ETAC), are currently in place via an interim solution until the programming necessary to establish a fully-functioning spousal account is completed. These accounts permit the spouses of deceased participants to maintain and manage a TSP account. Previously, spouses of deceased participants had to make a withdrawal election within 60 days of their spouses' death.

The implementation of immediate agency contributions is complete. The Agency is in the process of working on automatic enrollment which should be implemented in August. Upon speaking to several agencies, it was clear that the Agency's original June/July timeframe for the implementation of automatic enrollment was too ambitious based on the modifications that many agencies would have to make to their payroll systems.

Chairman Saul commented that Mr. Long and the Agency should carefully prioritize its projects. Mr. Long stated that the Agency is constantly updating its priorities and balancing the operational needs of the Agency with its ongoing projects.

Ms. Wilder noted that the implementation of the Roth 401(k) feature will be a massive project for the Agency. Every Agency system will be impacted by the addition of the Roth feature. Recently the Agency hosted an industry day during which several companies discussed some of their best practices as far as providing education regarding the Roth feature. Coming out of these discussions, the Agency is beginning to formulate its strategy as far as Roth education. The Roth feature will likely be rolled out at the end of 2011 so that it is effective for the first pay period of 2012.

Mr. Hagerty commented that his group's priority is currently to get the new Website up and running. His group is also juggling other priorities such as wrapping up the modernization effort which will be completed in July. The two tasks outstanding from the modernization effort are completion of the new storage devices that sync between the Agency's primary and backup data centers and migration to the virtual environment.

The Agency has largely completed implementing the subpoena authority granted it under the Act. The subpoenas will be issued primarily to resolve issues of fraud, forgery, and mistaken identity. The Agency published a regulation and an internal directive which specify how subpoenas will be issued.

The Act also gave the Board the authority to establish a mutual fund window for the TSP. The Board was split 2:2 on whether to move forward with the mutual fund window, and ETAC was similarly undecided. Currently the Agency is not moving forward with adding a mutual fund window but may at some future point.

6. <u>DOL Audit Briefing.</u>

Mr. Petrick then discussed his February 5 memorandum (attached) entitled "Update on audit recommendations 2003-2009." There are currently 31 open Department of Labor (DOL), KPMG audit recommendations. Of those, the Agency feels that the work has been done for 11, and, therefore, the Agency reports having only 20 open DOL-KPMG recommendations. There are also six open recommendations from Clifton Gunderson which should be resolved within this year's financial audit. Of the four recommendations from GAO, the Agency closed two and did not concur with the other two. The GAO has not returned to the Agency to revisit these recommendations.

Per its own books, the Agency has 26 open audit recommendations. Mr. Petrick then discussed the Department of Labor, Employee Benefits Security Administration (EBSA)'s audit reports regarding the TSP Participant Support

Process and the Computer Access and Technical Security Controls over the TSP System (attached). The Agency has nine new audit recommendations from the participant support process. The computer access and technical security controls was a review of existing, outstanding audit recommendations.

The participant support report focused on the call centers and in particular their handling of participant services as well as their underlying technical infrastructure. Most of the recommendations are related to the call center infrastructure. For example, there is a pair (one for each call center) of recommendations for logical access controls, technology, and physical access controls. There were also several miscellaneous recommendations regarding Privacy Act training and responding to written inquiries. The Agency feels as though it is doing what is necessary in these latter areas and considers these recommendations closed. Mr. Petrick noted that he considers the call centers a work in progress, and the Agency is constantly reviewing the controls at these facilities.

The second report focused on computer access and technical security controls. The purpose of this audit was to look at outstanding audit recommendations, and, therefore, there are no new audit recommendations. Each recommendation has approximately four or five parts. Some of these parts are satisfied and some still remain open. These recommendations are related mainly to the Agency's efforts in the area of security documentation. Mr. Hagerty noted that there are no gaping security holes or major issues related to these findings. Instead, these findings are related to finalizing internal directives and policies.

Mr. William Bailey of the Department of Labor, Employee Benefits Security Administration, then presented the Department of Labor's Fiscal Year 2010 Thrift Savings Plan Fiduciary Oversight Program report (attached). Mr. Bailey introduced several key contacts from EBSA. In particular he mentioned that Ms. Phyllis Borzi is now the Assistant Secretary. Mr. Bailey introduced his colleague, Mr. Michael Auerbach, who is the Chief, Division of Accounting Services. The KPMG team has been in place for the last several years and includes Ms. Diane Dudley, Ms. Heather Flanagan, Mr. Don Farineau, Mr. Derek Thomas, and Mr. Mark Munster.

For the fiscal year 2009, DOL found no instances of material non-compliance with FERSA. The big projects this year were in the areas of computer access and participant support. The Department of Labor would like to see its audit findings in the area of security and information technology closed more timely. Mr. Long commented that the Agency continues to prioritize its business and operational needs with accelerating the rate at which these findings are closed. The call center audit only touched on certain provisions of the call center contract and, therefore, DOL cannot comment on the entire contract.

In addition to open issues regarding system security, there are also items dealing with participant support. The Agency's TSP participant support process complies with FERSA, applicable Board regulations, bulletins and the relevant provisions of the call center contracts.

Future DOL audit initiatives include reviewing the L Funds and the loan process. Additionally, DOL intends to look at the TSP's relationship with BlackRock after the merger activity settles down. Finally, DOL intends to look at the uniformed services, and, in particular, the United States Air Force, Navy, and Coast Guard.

Mr. Farineau then reviewed the scope of the TSP performance audits from 2006-2009 and planned 2010 activities. To date, DOL has three funded audits. On the IT side, DOL is scheduled to do a special project that is focused on reviewing the TSP modernization project. Specifically, DOL is going to conduct an independent verification of the discreet projects that fall under the systems modernization effort. DOL will look at the project's different components (e.g., the Website, mainframes, etc.) as well as consider the effort's project management attributes. DOL also intends to do a full scope review of account maintenance. Aside from a special review of the L Funds last year, DOL has not done a full scope review of account maintenance since 2004. This audit will cover daily valuation, participant account forfeitures, forfeiture restoration, interfund transfers, and participant investment elections and contributions.

There are currently no reviews for any of the non-agency TSP activities. DOL has planned its third performance audit at a federal agency and it will be at the USDA. This audit will include testing loan payments, participant support activities, separation, financial hardship withdrawals, and contributions. Since the inception of oversight program, DOL has reviewed over 44 agencies.

As far as FY 2010 audit activities, the account maintenance audit started on January 19th and the exit date is tentatively scheduled for April 15. The TSP system modernization project will likely be scheduled to commence at some point in February and then end at some point mid-year. The USDA NFC TSP operations audit will start at the end of March.

DOL currently reports twelve open IT-related audit findings. Of these, three are related to system enhancements and software control change, one is from IT operations management, six are from the computer access controls and security, and two from service continuity controls. There are also several open recommendations from the participant support audit. In particular, there is one in account maintenance, nine in participant support/call centers, four in withdrawals, and one in loan operations. In total, there are 31 open recommendations. While this total number has increased by five since February 2009, four items have been closed since last period. DOL cannot comment on items that the Agency has recorded as closed since DOL has not conducted any follow-up reviews. Chairman

Saul thanked DOL and members of the KPMG team for their recommendations and cooperation.

7. Closed Session.

On a vote taken by the Secretary before the meeting, the members closed the meeting at 11:44 a.m. for a discussion of proprietary data and personnel.

At 1:10 p.m., upon completion of the executive session, the members reconvened the open portion of meeting.

Whereupon, there being no further business, the following motion was made, seconded, and adopted without objection and Chairman Saul adjourned the meeting at 1:10 p.m.

MOTION: That this meeting be adjourned.

Thomas K. Emswiler
Secretary

Attachments
1. Thrift Savings Fund Statistics
2. January 2010 Performance Review – G, F, C, S, I, and L Funds
3. Update on Participant Investment Behavior During the 2008 Financial Crisis
4. Update on Status of 2009 Legislative Initiatives
5. Update on audit recommendations 2003-2009.
6. Employee Benefits Security Administration – Performance Audit of the Computer Access and Technical Security Controls over the Thrift Savings Plan System
7. Employee Benefits Security Administration – Performance Audit of the Thrift Savings Plan Participant Support Process
8. U.S. Department of Labor Employee Benefits Security Administration – Fiscal Year 2010 Thrift Savings Plan Fiduciary Oversight Program