



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

MINUTES OF THE MEETING OF THE BOARD MEMBERS

January 19, 2010

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on January 19, 2010, at 9:00 a.m., Eastern Time. Parts of the meeting were 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; 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 November 16, 2009 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the November 16, 2009 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 November 16, 2009, be approved.

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

Mr. Emswiler discussed the decision to cancel the Board meeting that had been scheduled for December 21, 2009. The Federal Government was closed that day due to a blizzard. Owing to the continuing bad weather, upcoming holidays (to include the President's decision to close the Federal Government at noon on December 24th), and legal requirements requiring advance public notice of meetings, the only day a meeting could be held was December 31st. Since there was no urgent business pending before the Board, Mr. Emswiler determined it prudent to take up December's business at the January meeting. See memorandum entitled "Canceling the December Board Meeting" (attached).

- a. Participant Activity Report

Ms. Wilder reviewed the report on TSP statistics. See "Thrift Savings Fund Statistics" (attached). Due to positive cash flow and investment performance, the total fund balance had increased from approximately \$233 billion at the end of October to approximately \$244 billion at the end of December.

The FERS participation rate decreased slightly from 81.8 percent at the end of October to 81.5 percent at the end of December. The decrease was due to the statutory change allowing new Federal employees to immediately receive Agency Automatic (1%) Contributions. Many of these new employees have not started making their own contributions to the TSP. As a consequence, while more FERS employees have TSP accounts, the percentage of FERS employees who are actively contributing to the TSP fell slightly. In fact, the total number of FERS employees who received agency contributions but did not make their own contributions increased from 412,000 in October to 421,000 in December.

FERS employees must contribute their own pay to receive Agency Matching Contributions. Because these employees are missing out on these matching contributions, the Office of Participant Services mailed a pamphlet to these employees encouraging them to begin contributing to the TSP. Ms. Moran, the Director of the Office of Participant Services, said that the Agency will provide additional reminders on the importance of contributing with the quarterly and annual participant statements. She hopes that these efforts will lead to an increase in the participation rate.

Ms. Wilder noted that withdrawal and loan activity had not changed significantly since the November Board meeting. Chairman Saul asked to be briefed on loan activity since the middle of 2007. He added that he would have expected the number of loans and outstanding loan balances to have gone up, but it does not seem to have done so.

Ms. Wilder concluded by remarking that we continue to see a slow, but steady increase in the number of uniformed service participants. Chairman Saul noted that the participation rate varied significantly by service.

b. Quarterly Investment Performance Report

Ms. Ray reviewed the December 4, 2009 memorandum, entitled "November 2009 Performance Review" (attached) and the January 8, 2010 memorandum, entitled "December 2009 Performance Review" (attached). BGI's Small Mid Cap fund underperformed the index by 12 basis points in November due to the index provider's optimization process (it cannot purchase some securities in the index). The I Fund outperformed the index by 117 basis points in November due to fair valuation adjustments.

The Small Mid Cap fund underperformed the index by 8 basis points in December due to the index provider's optimization process. The I Fund had no tracking error in December because it had no fair valuation adjustments. Mr. Fink asked what Ms. Ray meant when she said there was no fair valuation adjustment. She explained that it meant that there was no fair valuation adjustment on December 31, 2009. There had been such an adjustment on December 31, 2008.

and this was principally responsible for the index's 171 basis point tracking error for the year. Mr. Fink asked who made the fair valuation adjustment and was told that the fund manager did so when the fund manager believed the market would open at a different price than it had closed at (for example, when U.S. markets close down 300 points). Chairman Saul said that when U.S. markets close down 300 points, you would assume international markets would open lower because you would expect a sell-off in response to a large decline in the U.S. markets. Ms. Ray agreed and added that, since there had not been a fair valuation adjustment on December 31, 2009, she expected I Fund tracking error to be less in 2010 than it was in 2009. Mr. Long pointed out that we have not changed our investment policy. The fund manager had simply determined that there was not a need to make a fair valuation adjustment at the end of 2009. Mr. Fink asked what the acronym "BTC" stood for on the first page of the report and was told it stood for BlackRock Trust Company.

Ms. Ray explained that trading costs and amounts traded are much lower than they were before the Agency limited the number of monthly interfund transfers a participant could make. In fact, the 2009 numbers are approximately one-half those of 2008. The G Fund rate of return is 3.5 percent due to higher mid and long-term interest rates. The fixed income fund was down 1.5 percent in December due to rising interest rates (the Fund's first decline since February). All equity funds did well in 2009.

Chairman Saul noted that 55 percent of TSP investments are currently in fixed income and 45 percent are in equity. He asked what the ratio was before the stock market crash. Ms. Ray responded that in 2007, FERS participants were invested 32 percent in the G Fund and 5 percent in the F Fund. FERS participants are currently invested 44 percent in the G Fund and 6 percent in the F Fund. Mr. Whiting pointed out that this has, nevertheless, fallen from 56 and 7 percent respectively at the end of February 2009. Mr. Long added that these changes are not just due to interfund transfer activity, they are also due to market activity. That is, declines in the value of the equity indices affect the percentage of TSP funds invested in the more stable debt indices. Ms. Ray pointed out that page 8 shows interfund transfer activity. Participants moved \$4.4 billion from equity into the G Fund in January 2008. Ms. Wilder pointed to similar activity in September and October 2009 and Mr. Long noted the return to equity in 2009. Chairman Saul stated that the return to equity was mainly after the markets started to improve in March of 2009.

Chairman Saul asked whether the G Fund was composed solely of 10 and 30 year treasury bonds. Ms. Ray stated that it reflected the weighted average of all treasuries with more than four years to maturity. She noted that the L Funds did well in 2009 because of strong equity markets. All L Funds have shown positive returns since inception, but the C Fund has shown a negative return since the date the L Funds were created. The number of participants who have invested in the L Funds is at an all time high—647,040.

Chairman Saul asked what the Agency had done to educate participants about the L Funds since sending an L Fund DVD to all participants in 2005. Mr. Long said that Ms. Moran has spent a good part of 2009 working on a new DVD. Ms. Moran stated that the Agency will send the DVD to participants who have not made a contribution allocation or interfund transfer (currently 300,000 to 400,000 participants). This will be an on-going effort and not just a one-time mailing. Mr. Long noted that the DVD will work on a Sony PlayStation, which we hope will make using it attractive to younger TSP participants. Its content (but not its animation) will also be available on the web. Chairman Saul complimented Ms. Moran on her outstanding continuing education program. Mr. Long added that we have learned that, in order to make participant education successful, we must make it fun. The DVD is "cool."

Ms. Wilder said that the Agency was sponsoring a Roth industry day next week. Vendors who have developed Roth education programs will come to the Agency and explain what they found to be successful and unsuccessful in educating plan participants about a Roth 401(k) feature. These discussions will help Agency personnel to develop a Request for Proposals from vendors to educate TSP participants about the Roth feature the Agency will add to its program. The goal is to implement a program that will enable participants to make an informed decision about the Roth feature. Mr. Long added that the decision to use a Roth feature is both an investment and tax decision. We will use the industry day to obtain the best ideas on how to educate participants regarding these decisions.

Chairman Saul asked Mr. Long to review the status of the Agency's efforts to implement the programs authorized by the Thrift Savings Plan Enhancement Act of 2009 at the next Board meeting.

Ms. Ray noted that there had been no exceptions to the BGI proxy voting policy for the third quarter of 2009.

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.

c. Legislative Report

Mr. Trabucco reported that the 111th Congress was returning for its second session and that the President would deliver his State of the Union address on January 27th. He noted that we will be following up with Congressman Lynch regarding allowing separating or retiring employees to contribute the value of unused terminal annual leave to the TSP. He expects that Congressman Lynch will introduce such legislation and added that the Internal Revenue Service authorizes such contributions in private-sector plans.

3. Web Re-Design Update.

Ms. Wilder reported that the Agency rolled-out its beta site to participants on December 13th. Initially, approximately one in fifteen participants who accessed www.tsp.gov was invited to test the beta site. Currently, approximately one in three participants is invited to test the beta site. We had planned to survey approximately 5,000 participants but have actually surveyed over 7,000. This allowed for excellent feedback and an opportunity to test the capacity of the TSP's operating systems.

Feedback has been overwhelmingly positive. Participants like the site's appearance, ease of navigation, and speed. They also suggested modifying the site to allow one to check one's civilian account balance and uniformed service account balance without logging out. They also requested more investment and retirement guidance. The Agency plans to implement these suggestions in phases.

Ms. Wilder noted that the Office of Participant Services, the Office of Automated Systems, and Serco, Inc. have been heavily involved in the web re-design project as well as implementing the new programs authorized by the Thrift Savings Plan Enhancement Act of 2009. In order to ensure that the new website is rolled out properly, we have revised the implementation schedule. In May, we will start the new website with information content equivalent to the current website. In July, we will enhance the site with information concerning such matters as retirement planning and life events and will also implement a messaging center and new calculators. Chairman Saul asked whether we would close the current website in May and was told that we would. The beta will be up until then, but we have turned

off the survey. Mr. Long stated that the beta site allows for feedback and assures us that we have sufficient capacity to operate it.

Chairman Saul stated that the phased approach to rolling out the site and then enhancing it was the right thing to do. Mr. Long said that this was a significant leap forward for the plan. We expect at least 85 to 90 percent of participants will like it. Nevertheless, some won't. Chairman Saul stated that that is a very high approval rating and noted that the Agency is using the beta site to address participant suggestions. When we roll out the site, we should note that even more improvements will be forthcoming.

4. IT Modernization Plan Update.

Mr. Hagerty stated that he had reported several months ago that the Agency had made its last investment in the current IT modernization program. Since then, we have been testing on loaner equipment provided by the vendor to ensure synchronization between the primary and back-up site. This testing has been very successful. Chairman Saul asked the name of the vendor who had conducted the testing and was told it was EMC Corporation. We have been using loaned equipment to ensure that it operated effectively. We will complete testing in January and take delivery of the new equipment shortly thereafter. It will provide us with even better service and capability.

The migration from the old to new data center is almost complete. The only function still processed at the old data center is employing agency payroll connections. Chairman Saul asked when we would be completely out of the old data center and was told July. This is time consuming because we must coordinate the move with each employing agency separately.

Chairman Saul asked whether we continue to test the back-up site. Mr. Hagerty responded that we do. We are ensuring that we have redundant communication lines and will do a disaster recovery test in May. Chairman Saul asked when the modernization plan would be complete and was told July. Everything is going very well and we will not require any additional funds to complete the modernization project.

Mr. Sanchez asked whether there would be any other necessary expenses that Mr. Hagerty would need to request. Mr. Hagerty stated that there would not be because the approved operating budget was sufficient. Chairman Saul asked whether operating costs had increased. Mr. Hagerty explained that they had gone up modestly. The Agency needed to add staff with new skill sets and has implemented enhanced security capabilities.

Chairman Saul and Mr. Sanchez both thanked Mr. Hagerty for an excellent report. Chairman Saul then asked what remained to be completed.

Mr. Hagerty stated that they would add storage and some new applications, but none of these would be a significant capital expense. We will be able to address plan growth (including more participants and implementing legislative initiatives) without requiring new mainframe computers. Mr. Fink stated that we have identical primary and back-up sites and asked whether we own one of the sites. Mr. Hagerty responded that we lease both sites, but we own the equipment at both sites. Mr. Fink stated that we should have different vendors for each site. Mr. Hagerty did not disagree, but stated that, at the time the Agency awarded the most recent contract, there were not so many vendors available. When modernization is complete, we will do a cost-benefit analysis to determine whether we should award a contract to a different vendor.

5. Quarterly Vendor Financial Report.

Mr. Long noted that we normally do the January report by exception and that we have two matters of interest from the report entitled "Quarterly Financial Investment of TSP's Primary Vendors – January 2010" (attached).

Mr. Petrick then reported that on October 21st, Equinix, Inc. entered into an agreement to acquire Switch & Data during the first quarter of 2010. We expect the acquisition to be approved. Equinix, Inc. is a bigger player in the data center market than Switch and Data and it is also profitable. It has a much longer, stronger history of profitability than Switch & Data. The acquisition will relieve the Board of the concerns it had regarding Switch & Data.

Chairman Saul asked that the Board be advised on the status of the merger at every meeting. He then asked about Equinix's reputation. Mr. Hagerty responded that it has a very good reputation. We do not expect the acquisition to have any negative impact on our operations. The personnel at the TSP data centers will likely remain the same. Mr. Whiting asked when the data center contracts expire and was told five years. Mr. Long stated that we view this as very good news. He added that we still have concerns regarding one vendor and that we will revisit the matter once the IT modernization plan is complete.

Mr. Petrick reported that Dun & Bradstreet had reduced MetLife's credit rating. Its insurance ratings, however, remain the same. We do not know why Dun & Bradstreet reduced MetLife's credit rating. It was probably due to a few delinquent payments to vendors and the deteriorating outlook for the industry as a whole. We are not overly concerned about this. The credit score is not the most predictive indicator of a company's financial stability. MetLife remains the strongest, or among the strongest, of the industry's annuity providers.

Mr. Fink remarked that MetLife is the strongest of all our vendors. Chairman Saul added that all fifty states provide coverage for MetLife's annuities. Mr. Petrick stated that the minimum coverage is \$100,000. We require our annuity provider to be licensed in all fifty states. Consequently, it must comply with the

strictest regulatory scheme of all the states. Chairman Saul cautioned that this is very serious. If MetLife could not deliver on its annuities, it could devastate the TSP participants who have chosen to rely on them. Individuals who purchase annuities are fiscally conservative. They rely on it for income. If the annuity were to fail, they likely would not have any other source of investment income.

6. Review of Gross and Net Expense Ratios.

Mr. Long noted that we started reviewing gross and net expense ratios several years ago.

Mr. Petrick then reviewed the report entitled "Gross and Net Expenses" (attached). He remarked that the report contained two charts. One displayed expenses in terms of basis points and one displayed expenses in terms of dollars. The Agency's gross expenses in 2009 were 5.193 basis points and \$108.71 million.

Chairman Saul asked how much the Agency expended in 2002 and 2003 and was told \$110.7 million and \$106.7 million respectively. Chairman Saul noted that the Agency was operating at roughly the same cost that it was operating at when the current Board took over and that a significant portion of recent expenditures were for system modernization. Mr. Petrick commented that it included system modernization and additional contractors to assist with new programs and projects like web re-design. Chairman Saul asked what the 2010 budget was and was told \$130.3 million. Mr. Long added that if we actually expend the full amount authorized, our expenses, in terms of basis points, should remain about the same because of growth of assets under management.

Chairman Saul noted that the Agency budget was \$106 million in 2003 and remarked that the Agency may have cut its budget by too much in the following years. He added, however, that we need to be careful going forward that we do not have increases on top of increases. Mr. Long responded that he will watch the budget very carefully going forward. Mr. Sanchez thanked Mr. Long and remarked that the plan had more than doubled since the current Board was seated and that we needed to ensure that the TSP's systems matched its growth. However, as Chairman Saul stated, we do not want continuing increases except as absolutely necessary. Mr. Long agreed.

Chairman Saul added that the plan had \$98 billion under management when the current Board took over. It now has almost a quarter of a trillion dollars and has added over one million participants. It is a very different plan and he expressed his appreciation that we could accommodate this growth. This is why he asked Mr. Hagerty to be ready for similar growth over the next seven years. This is why the Board authorized significant expenditures for systems modernization. We need to ensure that we do not stumble along the way and that the system could accommodate a macro event. Mr. Petrick noted that the TSP now has two call

centers and a true back-up data center. The TSP itself is more complex and sophisticated.

Mr. Fink then inquired about the forfeitures that were used to offset plan expenses. He stated that Mr. Petrick had predicted this amount would go down this year and noted that it had. He asked whether this trend was likely to continue. Mr. Petrick stated that it might. However, most of the forfeitures are attributable to correction of retirement system coverage under the Federal Erroneous Retirement Coverage Correction Act of 2000 (FERCCA). Under FERCCA, Federal employees who were erroneously placed under a retirement system that made them eligible for agency TSP contributions are then placed under a system in which they are not eligible for agency contributions must forfeit the agency TSP contributions. Because many Federal employees deferred retirement due to the economy, we may see increasing retirements and increasing retirement system corrections.

Ms. Moran remarked that FERCCA corrections will continue for some time. Mr. Fink observed that FERCCA forfeitures offset TSP expenses by \$12 million in 2006, \$40 million in 2008 and \$38 million in 2009. TSP expenses charged to participants will go up significantly when these forfeitures are no longer available. Mr. Long agreed and stated that this is why we disclose it. These forfeitures will eventually dry up.

Chairman Saul asked for an example of a FERCCA forfeiture. Mr. Long replied that an employee may be placed under the FERS retirement system and then receive matching contributions throughout his or her career. If the employee is then placed under the CSRS system, the employee must forfeit the matching contributions because, under CSRS, the employee is not eligible to receive them. Mr. Whiting asked why the forfeited matching contributions are not returned to the employing agencies. Mr. Emswiler explained that Internal Revenue Service rules prohibit returning employer contributions that are more than one year old.

Chairman Saul asked why the forfeitures had increased so dramatically in recent years. Ms. Moran explained that the Office of Personnel Management is pushing to close these cases. FERS was created in 1986 and people who were working in 1986 are starting to retire in significant numbers. As more of these employees retire, more of these cases will surface.

Chairman Saul mentioned that loan fees went from zero when the Board took over to \$13 million in 2009. This was due to the Board's new policy in 2004 that requires participants who take TSP loans to pay a \$50 processing fee to cover the expense associated with the loan. Mr. Petrick added that the 2004 loan fee number was only \$2.38 million because the policy was not in place for the full year.

Chairman Saul concluded the open session by stating that the budget was \$106 million in 2003 and \$108 million in 2004. Given the increase in the size of

the TSP and the improvements to the operating systems, this has been a very credible performance. The Agency is still spending in 2010, in terms of inflation adjusted dollars, the same amount that it was expending in 2003. This is an exemplary Federal agency. He told Mr. Long he did not want him to come to the Board and request a large budget increase for 2011. Mr. Long responded, message heard.

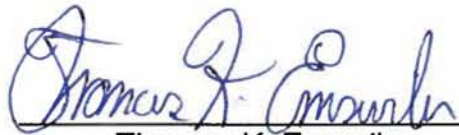
7. Closed Session.

On a vote taken by the Secretary before the meeting, the members closed the meeting at 10:40 a.m. for a discussion of confidential financial information.

At 11:00 a.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 11:00 a.m.

MOTION: That this meeting be adjourned.


Thomas K. Emswiler
Secretary

Attachments

1. Canceling the December Board Member Meeting
2. Thrift Savings Fund Statistics
3. November 2009 Performance Review – G, F, C, S, I, and L Fund
4. December 2009 Performance Review – G, F, C, S, I, and L Fund
5. Quarterly Financial Investment of TSP's Primary Vendors – January 2010
6. Gross and Net Expenses