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

MINUTES OF THE MEETING OF THE BOARD MEMBERS

April 18, 2011

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board convened a joint meeting of the Board members and the Employee Thrift Advisory Council on April 18, 2011, 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, Alejandro M. Sanchez of Florida (by phone), Board Member; Dana K. Bilyeu of Nevada, Board Member; Michael D. Kenndey of Georgia, Board 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; James Sauber, NALC, ETAC Chairman; William Dougan, NFFE, Council Member; Kurt Vorndran, NTEU, Alt. Council Member; Gina Lightfoot-Walker, NAGE, Alt. Council Member; Myke Reid, APWU, Council Member; Clifford Dailing, NRLCA, Council Member; Frank Augustosky, Alt. Council Member, NLPAS; Rhonda Trent, FEW, Alt. Council Member; Richard Thissen, NARFE, Council Member; Jessica Klement, FMA, Alt. Council Member; Don Svendsen, DOD, Alt. Council Member.

1. Introductory Remarks.

Chairman Saul introduced the newest Board members, Dana K. Bilyeu and Michael D. Kennedy to the ETAC members. He then shared some statistics about the TSP. In 2002, the Agency held $98 billion in trust for participants. Today it holds $284 billion in trust for participants. Since 2002, the number of Federal employees participating in the TSP has grown by 47% to 4.4 million. The plan expenses are 3 basis points, whereas the average mutual fund expense is about 100 basis points. He explained that TSP participants pay only 30 cents a year per $1000 or $30 a year per $100,000 that they have in the plan.

Chairman Saul also briefly summarized some of the Agency's recent activities. The Agency recently implemented automatic enrollment and spousal accounts. The Agency is near completion of a four year modernization project, has a brand new website, and is preparing to implement a Roth feature in 2012.

2. Approval of the minutes of the March 28, 2011 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the March 28, 2011 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 March 28, 2011, be approved.

3. Approval of the minutes of the October 19, 2009 Employee Thrift Advisory Council meeting.

ETAC Chairman Sauber entertained a motion for approval of the minutes of the Employee Thrift Advisory Council meeting held on October 19, 2009. The motion was approved.

4. Elections of ETAC Chairman and Vice Chairman.

The Council agreed that ETAC Member Clifford Dailing, nominated by ETAC Chairman Sauber, would serve as new ETAC Chairman and current ETAC Chairman Jim Sauber, nominated by Council Member Reid, would serve as Vice Chairman.

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

a. Monthly Participant Activity Report

Ms. Wilder reviewed the report on TSP statistics. See "Thrift Savings Fund Statistics" (attached). She reported that the TSP has over 4.4 million participants and holds nearly $284 billion in trust for its participants.

Ms. Wilder also explained that the "Thrift Savings Fund Statistics" incorporate a change in accounting rules. For years, loans have been classified as investments and, therefore, have been reflected in the total fund balance. In September 2010, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) clarifying how participant loans should be classified and measured by defined contribution plans such as the TSP. The update requires participant loans to be classified as notes receivables, segregated from investments. For consistency with accounting standards, the figures for the total fund balances in January, February, and March no longer include loans outstanding.

Ms. Wilder reported that 97.5% of new civilian Federal employees are automatically enrolled in the TSP or affirmatively elect to participate in the TSP. Mr. Sauber asked what percentage of new civilian Federal employees affirmatively elected to participate in the TSP before automatic enrollment was implemented. Ms. Wilder responded that approximately 45% of new civilian Federal employees elected to participate before the Agency eliminated the waiting period for receiving agency contributions and later implemented automatic enrollment.

Mr. Saul pointed out that the uniformed services' participation rate is lower than the civilian participation rate because uniformed services participants do not receive matching contributions from their services.

b. Quarterly Investment Policy Review

Ms. Ray reviewed the April 8, 2011 memorandum (attached), entitled "March 2011 Performance Review." All of the funds closely tracked their underlying indices for the month of March. Year-to-date, the S Fund has out-performed its index by 7 basis points. This is related to the optimization process used in the fund. Year-to-date, the I Fund has out-performed its index by 14 basis points, primarily due to the tax effect. The index is reported after-tax, but the fund does not pay taxes on dividend because it is tax-exempt.

The trading costs for the F, C, and S Funds were low, as normal. The trading costs for the I Fund, however, were approximately $8 million, or 88 basis points, in March. High trading costs in the I Fund are attributable to volatility in international markets caused by the tsunami in Japan and the differences in market closing times that cause a discrepancy between price when a trade is ordered and price when a trade is actually executed.

The G Fund rate is 3% in March and April. The March net rates of return for the F Fund and the C Fund were slightly positive. The S Fund was up 2% and the I Fund was down 2% in March. The L Income Fund had slightly positive rates of return and the other L Funds had slightly negative rates of return.

Participants transferred $1.3 billion into the G Fund and $151 million into the F Fund during March. Board Member Bilyeu asked Ms. Ray whether she tracks what time period during the month interfund transfer activity occurs. Ms. Ray said she receives that information. She added that most of the interfund transfer activity into the F & G Funds during March occurred at the beginning of the month. The total would have been even higher, but participants began moving money back into equities during the second half of the month.

Nearly 771,000 participants have money in the L Funds. Of these 771,000 participants, 23,000 participants have money in the new L 2050 Fund. Chairman Saul commended the Board for educating participants about the L Funds. Executive Director Long used Mr. Saul's commendation as a segue to introduce an article written by Miriam Settles, a member of Ms. Moran's communication's team, which is published in the Federal Manager magazine.

Ms. Ray noted that an independent audit shows that BlackRock voted all of its proxies in line with their own proxy guidelines. The members then revisited the Board's investment policy and 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 there have been no proposals in Congress to reduce TSP benefits. Mr. Trabucco is working with Congressman Lynch's staff to reintroduce a legislative proposal that would allow participants to contribute the cash value of unused terminal annual leave to the TSP. Mr. Trabucco is requesting three additional legislative changes that would (1) resolve a conflict of law regarding whether IRS tax levies apply against TSP accounts, (2) codify the Agency's status as a non-appropriated fund instrumentality (NAFI), and (3) create a statute of limitations on benefit claims. Mr. Trabucco explained that the ETAC members requested a longer statute of limitations than the Agency initially proposed. On the advice of ETAC, the Agency is now asking Congress for a five year statute of limitations rather than a three year statute of limitations.

d. Quarterly Vendor Financial Review

Mr. Petrick reviewed the memorandum entitled "Quarterly Financial Assessment of TSP's Primary Vendors – Year End 2010." The Agency's financial analysis consists of a review of each primary vendor's key financial statistics from their current income statement and balance sheet for the most recent quarter available to determine their overall financial stability.

Mr. Petrick explained that Serco is the Agency's primary recordkeeping contractor, that Serco operates the Virginia Call Center, and that Serco provides software and development maintenance. Mr. Petrick reported that Serco has been a very responsive contractor over the years and that the Agency has no concerns about Serco's financial stability.

Next, Mr. Petrick discussed BlackRock, Inc., which he explained is one of the leading investment management companies in the U.S. He noted that BlackRock was added to the S&P 500 on April 4th and reported that the Agency has no concerns about BlackRock's financial condition.

Mr. Petrick turned to Equinix, Inc. (formerly Switch & Data) next. Equinix is a U.S. based public corporation that provides network-neutral data centers and interconnection services. It acquired Switch & Data in May 2010. Equinix's data center hosts services for the TSP at two sites: one in northern Virginia and one in western Pennsylvania. Mr. Petrick reported that Equinix has experienced revenue growth and that its market share remains strong.

Next, Mr. Petrick discussed R.R. Donnelley, which provides printing services for the TSP. Mr. Petrick noted that R.R. Donnelley had several unprofitable years during the recession, but in 2010 returned to profitability as a result of restructuring. There is no indication that R.R. Donnelley will be unable to meet its contractual obligations to the TSP.

Mr. Petrick continued with MetLife, the Agency's annuity provider and the largest insurance company in the U.S. He reported that MetLife is very well capitalized, but in 2009 it had its first loss in at least twenty or thirty years. Mr. Petrick notes MetLife showed strong profits in 2010, despite a decrease in ratings due to the recession and disclosure of the potential acquisition of Alico, an AIG company. Although there has been no increase in Metlife's ratings following disclosure of the potential acquisition of Alico, MetLife has been stable since 2009. Metlife's financial strength ratings are still very good and Mr. Petrick reported that he has no concerns about Metlife's ability to meet its contractual obligations to the TSP and TSP participants for which the Agency purchases annuities.

Finally, Mr. Petrick reported that The Active Network, which operates the Agency's Maryland Call Center, has filed a Form S-1 with the SEC regarding a proposed initial public offering for their stock. Mr. Petrick explained that the financial data reviewed in his report is the public financial data disclosed in The Active Network's SEC filing. Thus, it is no longer confidential.

Mr. Petrick indicated that The Active Network's public data only goes through September 30, 2010, not December 31, 2010, because of certain SEC public offering rules. Based on the available data, Mr. Petrick reported that The Active Network is not profitable yet, but it is rapidly growing and expanding through acquisitions. He noted that The Active Network's revenues continue to grow, and that it expects to get additional capitalization from its initial public offering. He determined there are no problems with the operation of the call center or deterioration in service; therefore, he has no concerns about The Active Network's ability to meet its contractual obligations to the TSP.

ETAC Alternate Trent asked Mr. Petrick whether the vendor contracts are performance-based. Mr. Petrick responded that the Agency conducts constant performance reviews of its contractors and current contracts are reviewed on performance. He further noted that the next round of contracts will contain even more performance-based standards. Mr. Long added that the next topic on the agenda deals with an audit finding and Agency response to include service-level requirements in its future contracts that do not already contain such requirements.

ETAC Alternate Trent then asked whether all of the Agency's contracts are with large vendors. Mr. Petrick explained that The Active Network is a relatively small company compared with the other vendors. ETAC Alternate Trent requested a report on whether there are requirements in the large vendors' subcontracting plans requiring subcontracts with small vendors of particular socioeconomic groups. Mr. Long agreed to follow up on Ms. Trent's inquiry.

ETAC Member Dougan asked whether he was correct in understanding that Serco also provides call center services and, if so, why the Agency has separate contractors for the two call centers. Mr. Petrick confirmed Serco operates one of the Agency's two call centers and that the Agency has two separate contracts for the call centers.

Chairman Saul explained that having two call centers, which are on entirely separate electrical and phone grids and in entirely separate regional locales, is a risk diversification measure. Previously, all Agency systems were located in New Orleans, and could have been wiped out in the Hurricane Katrina disaster. Fortunately, the Agency set up call centers in Maryland and Virginia, as well as computer operations in Reston, Virginia and a back up in Pittsburgh to avoid the problem that would have otherwise come to fruition with Hurricane Katrina. Chairman Saul explained that back up sites and duplicate services are necessary to keep the system running in the event of a natural disaster or other emergency.

ETAC Alternate Lightfoot-Walker asked whether Mr. Petrick's report addressed all of the Agency's primary vendors. Mr. Long explained that there are other vendors, small vendors, but the ones mentioned handle the Agency's primary and critical services. Chairman Saul added that the senior staff work closely with vendors and monitor the vendors to stay ahead of the curve on potential problems and minimize risk to the greatest possible extent.

Board Member Kennedy noted that the Agency's contract with BlackRock will be recompeted next year. The Agency will be conducting an RFP.

Mr. Emswiler passed out copies of the now public Active Network financials. Mr. Long asked for and did not receive any additional vendor financials-related questions.

6. Annual Financial Audit Report.

Chairman Saul introduced the TSP's team of independent auditors from Clifton Gunderson who were in attendance to present the results of their 2010 financial audit: Marie Caputo, Engagement Partner; Bill Oliver, Unassociated Partner; and Bob Halpin, Senior IT Audit Manager.

Ms. Caputo proceeded to describe the scope and details of the 2010 financial audit, which was performed in accordance with Generally Accepted Auditing Standards. The audit focused on providing the TSP and the Board with an independent auditor's report over financial statements, including disclosures to financial statements. Based on the team's audit review, Clifton Gunderson provided an Unqualified Audit Opinion (sometimes called a Clean Audit Opinion), which is the highest (i.e., most positive) level of assurance that Clifton Gunderson can share with the TSP as its auditors. Thus, Clifton Gunderson concluded that the financial statements and disclosures presented in all material respects the financial operations of the TSP in accordance with Generally Accepted Accounting Principles.

Ms. Caputo also explained that because the audit focused on the risks associated with the financial statements, Clifton Gunderson could not provide an opinion over internal controls. However, in order to provide an Opinion over the financial statements, the audit had to test underlying internal controls. Clifton Gunderson is required to report any "Material Weaknesses" or "Significant Deficiencies" concerning internal controls that are discovered during these tests.

Ms. Caputo stated that Clifton Gunderson did not identify or report any Material Weaknesses. However, it did discover one Significant Deficiency. This Deficiency was related to where the risk management framework ties into the security program of the TSP.

In the spirit of open and transparent communications, Mr. Halpin described a number of additional matters that were identified during the audit that did not rise to the thresholds of required reporting for a Significant Deficiency. Three of these matters represent prior year findings drawing forward: One, although there is an IT policies and procedures framework in draft, the framework has not been formally implemented and authorized by management; Two, some configuration managements weaknesses related to the development of policies on change control exist; and Three, Clifton Gunderson did not see a formalized policy or procedure in place capturing access control for items related to password controls, logging of system access, and access administration procedures, and it also identified some duplicate or generic network password accounts in access control. Mr. Halpin emphasized, however, that management took corrective actions as to some of these matters once Clifton Gunderson apprised management of the weaknesses.

The remainder of the additional matters identified during the audit that did not rise to the level of a Significant Deficiency constituted new findings for 2010. One of these matters, related to disaster recovery plans, is due to the moving nature of the TSP's ongoing modernization efforts. Another matter was that Clifton Gunderson did not identify any SAS-70 audit reports for the TSP's major data center provider—such reports provide a certain level of assurance of controls existing at the data center. Further, with respect to service level agreements, Clifton Gunderson did not find any memorandums of understanding or service level agreements between TSP and certain service providers to ensure certain levels of performance are provided.

At this point, Executive Director Long explained that the TSP is in a far better place today than it was four years ago, in terms of the safety and security of TSP systems. Executive Director Long explained how the TSP has engaged in a very significant modernization project, which has resulted in approximately $18 million being spent to improve IT infrastructure. Nevertheless, he stated that the TSP still has a significant amount of work to do as far as the documentation of safety and security procedures. Executive Director Long emphasized that the TSP now has the appropriate people on its team to achieve its goals for the safety and security of TSP systems.

Executive Director Long then turned over the discussion to Mr. Hagerty. Mr. Hagerty reiterated that there have been significant changes during the past couple years within the IT infrastructure and that these changes have been made on an ongoing basis. He explained that the TSP has 57 continuity plans in place; however, the continuity plans need to be updated to reflect the current infrastructure, once the current infrastructure meets a static state.

Mr. Hagerty also described how the TSP errs on the side of implementation vis a vis documentation in almost all cases. For example, with respect to the business continuity posture, the TSP has a primary data center in Northern Virginia, and a backup data center in Pittsburgh—the TSP has ensured that all the mission critical lines are redundant. Thus, Mr. Hagerty stated that the TSP is in a very good posture with many of these activities. However, with respect to Clifton Gunderson's audit and the Department of Labor's performance audit, Mr. Hagerty concurs that the TSP has significant work to do in terms of documentation.

Chairman Saul then asked Mr. Hagerty whether he has outlined a time-table for the actions that need to be accomplished in order to satisfy Clifton Gunderson and the Department of Labor. Chairman Saul also asked whether the TSP has the personnel in place to accomplish these actions.

Mr. Hagerty responded that the TSP is trying to complete most of the activities by the end of the fiscal year, and substantially all of the activities by the end of the calendar year. However, Mr. Hagerty noted that there is a fairly comprehensive list of tasks that need to be completed. Executive Director Long pointed out that some tasks (such as, the risk management framework, which is one of the TSP's priorities) will take a bit longer than the end of the calendar year to complete. In addition, Mr. Hagerty explained that the TSP now has the appropriate personnel in place, despite some recent personnel changeover. Executive Director Long also stated that the TSP is looking to add additional staff, if needed.

Board Member Bilyeu then asked what type of time frame the TSP is facing in terms of risk management framework. Executive Director Long responded that the TSP will have substantial progress completed on the new system (including the first certification and authorization packet) by the end of 2011.

Mr. Hagerty also explained that the TSP is on the threshold of recompeting the major Serco recordkeeping contract. Thus, things like performance based contracting and performance metrics will be one of the TSP's major activities going forward. In addition, he stated that audit compliance, security, and similar things will also be major components of the TSP's contracts going forward. As a result, the TSP will be in a much more proactive position with respect to these activities.

Executive Director Long then described how costs increase as the TSP moves towards contracts that include requirements for service-level deliverables. Consequently, the TSP is working with a consultant to determine when it is reasonable to include requirements for service-level deliverables in contracts.

Ms. Caputo then proceeded to discuss communications that auditors are required to discuss with the Board—these communications were summarized in a letter that Clifton Gunderson separately sent to the Board. She explained that within the Significant Accounting Policies there was one update during the year. This update was just a reclassification of the presentation of participant loans on the face of the financial statements; she explained that this reclassification makes for a much more reasonable, understandable, and logical presentation. She also explained that Clifton Gunderson looked very closely at the valuation of investments and tested them accordingly. Clifton Gunderson provided Unqualified Audit Opinions on each of the Investment Funds. In addition, she stated that Clifton Gunderson identified one Audit Adjustment that was posted and corrected in the financial statements.

Further, Ms. Caputo emphasized the TSP management's very high level of professionalism and cooperation, and she thanked management for its efforts. She stated that there were no disagreements or major issues discussed prior to retention—she highlighted that this is important to note from an independence perspective.

Mr. Petrick then thanked Anne Beemer, the Agency's Comptroller, and Susan Crowder, the Agency's Chief Accounting Officer, for their hard work.

7. Miscellaneous Matters.

Chairman Saul asked whether there were any other topics that anyone wanted to raise or whether anyone had a question. Chairman Saul reiterated that the TSP staff exists to serve participants and ETAC members' needs.

ETAC Member Dougan then inquired into whether participants who are affected by natural disasters or other emergencies (such as Hurricane Katrina or recent storms in the Midwest) can make withdrawals from their TSP accounts and not incur early withdrawal and other penalties in order to fix their houses, etc. He stated that when participants are affected by such emergencies, they often look towards their TSP funds as a source of ready money to help them cope with, or recover from, the emergency.

Mr. Trabucco explained that early withdrawal penalties are imposed by the IRS, that they apply to everyone equally, and that the TSP has no authority to waive the penalties. However, Mr. Trabucco described how, during Hurricanes Katrina and Rita, the TSP and the IRS made it simpler for participants to get loans. Ms. Moran stated that she recalled an IRS ruling that allowed, for a limited time, participants who had taken out money from the TSP to return it—she also stated that she would look into this issue some more.

Executive Director Long then reiterated that the TSP, like any other 401(k) plan, is subject to IRS rules that cannot be waived. He explained that it is critical that the TSP comply with all IRS rules. However, he stressed that when an emergency situation arises, the TSP tries to be as flexible as possible in order to assist participants, while at the same time complying with IRS rules.

Mr. Dougan then suggested that, to the extent possible, it would be helpful to have up-to-date information on the TSP website that informs participants as to their options when they are trying to cope with, or recover from, an emergency. He said it is important for participants to be able to make informed decisions during emergency circumstances.

Executive Director Long provided assurances that the TSP is prepared to answer participants' questions and assist them during emergency situations. He explained that the majority of withdrawal transactions occur over the phone. The TSP has two call centers that employ many people for the specific purpose of answering participants' questions about how they can access their money, including how they can access their money during emergency situations.

ETAC Alternate Trent proceeded to commend the TSP staff for their excellent support. She expressed her thanks that the TSP staff, including the senior staff, is always available to answer her questions and address his concerns.

Ms. Trent also explained that the TSP website is easy to use, friendly, and great, especially when compared to other 401(k) plan's websites. Ms. Trent then asked whether the TSP has any plans to increase its staff, especially its IT staff, in light of the facts that the number of TSP participants and the amount of TSP funds continues to increase.

In response, Chairman Saul explained that the Board and Executive Director Long seek to ensure that the TSP's budget enables the TSP to have an appropriate number of qualified personnel to effectively serve participants' needs. The Board and Executive Director Long also seek to ensure that the TSP runs as efficiently as possible and does not become a bureaucratic organization. Looking back over past budgets, it is evident that the TSP has successfully minimized operating expenses. Recently, the TSP has sought to increase services and improve IT systems. Indeed, one of the reasons why the TSP's budget has increased over the past several years is because of the TSP's modernization efforts. Board Member Bilyeu stated that she too believed that the security of the IT system is first and foremost and that budget and personnel decisions need to reflect such. She explained that more detailed discussions on the topic will occur during the May Board Meeting.

Ms. Trent also stated that she would like to know more information about the audit's finding with respect to password controls. Mr. Hagerty explained that the TSP does not have any issues in terms of password weaknesses, passwords being compromised, or password access to accounts. Rather, he explained that the password control issue has arisen because the TSP uses commercial off-the-shelf packages that do not support the Government's recommendations on how strong a password encryption must be. Since the TSP does not have access to the packages' source code, the TSP is precluded from force-fitting the Government's recommendations on passwords into the packages.

In closing, the new Chairman of the ETAC Board, Mr. Dailing, stated that he looked forward to working with everyone in the future. Further, ETAC Member Sauber thanked Mr. Trabucco for all his hard work and efforts and for the tremendous job he has done.

Whereupon, there being no further business, the following motion was made by Chairman Saul and newly elected ETAC Chairman Dailing.

MOTION: That this meeting be adjourned.

The motion(s) was seconded, and adopted without objection and the meeting adjourned at 11:09 p.m.

Thomas K. Emswiler
Secretary

Attachments

1. Thrift Savings Fund Statistics
2. March 2011 Performance Review – G, F, C, S, I, and L Funds
3. Quarterly Financial Assessment of TSP's Primary Vendors – Year End 2010
4. TSP Financial Statements
5. Clifton Gunderson Audit Presentation