THRIFT SAVINGS PLAN

FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

MINUTES OF THE MEETING OF THE BOARD MEMBERS

October 28, 2019

Michael D. Kennedy, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on October 28, 2019, at 8:30. a.m., Eastern Time. The meeting was open to the public at the Board's offices at 77 K Street, N.E. In attendance were Dana K. Bilyeu of Oregon, member; Ronald D. McCray of Texas, member; David A. Jones of Connecticut, member; William S. Jasien of Virginia, member; Ravindra Deo, Executive Director; Megan G. Grumbine, General Counsel and Secretary; Suzanne Tosini, Chief Operating Officer; Renée C. Wilder Guerin, Director, Office of Enterprise Planning; Kimberly A. Weaver, Director, External Affairs; Susan Crowder, Chief Financial Officer; Jay Ahuja, Chief Risk Officer; Gisile Goethe, Director, Office of Resource Management; James Courtney, Director, Office of Communications and Education; Tee Ramos, Director, Office of Participant Services; Sean McCaffrey, Chief Investment Officer; Vijay Desai, Chief Technology Officer; and Ernest Witherspoon, Executive Advisor to the Executive Director.

1. Approval of the Minutes of the September 16, 2019 Board Member Meeting.

Chairman Kennedy entertained a motion for approval of the minutes of the September 16, 2019 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 September 16, 2019 be approved.

2. Investment Benchmark Update

Chairman Kennedy began by acknowledging receipt of a second letter from several Senators regarding the I Fund benchmark index. Chairman Kennedy explained that the Board asked Aon Hewitt Investment Consultants (AHIC) to review its 2017 recommendation to move to the expanded index, which the Board adopted.

Mr. Deo provided opening remarks, including a brief summary of the agenda for the meeting and provided additional background on the TSP. See "Background on the TSP" (attached).

Mr. McCaffrey introduced AHIC, which conducted the 2017 benchmark study for TSP investment options. AHIC representatives William Ryan and Russell

Ivinjack presented a summary of their recent re-examination of their 2017 work related to the I Fund benchmark. See "I Fund Policy Benchmark Review" and "I Fund Benchmark Study" (attached).

Mr. Ivinjack explained that before 2017, AHIC conducted two reviews of the I Fund index and recommended at those times to remain with the MSCI EAFE Index (EAFE Index). In 2017 AHIC recommended expanding to the MSCI All Country World ex US IMI Index (ACWI ex USA IMI Index) to add Canada, emerging markets and small cap equities to the TSP's I Fund holdings. After summarizing the agenda for AHIC's presentation, Mr. Ivinjack stated that after AHIC's review, it is reaffirming its 2017 recommendation.

Mr. Ivinjack discussed FERSA's legislative requirements in relation to the I Fund, which requires the Board to select a commonly recognized index that is a reasonably complete representation of the international equity markets.[1] Mr. Ivinjack explained that the ACWI ex US IMI Index covers 99 percent of the international markets, which AHIC believes better meets the statutory requirements of FERSA. He noted that, in contrast, the current I Fund benchmark index, MSCI EAFE, covers only 58 percent of the non-US equity market.

Prior to 2017, AHIC had recommended not moving from the EAFE Index because of liquidity concerns and because of the TSP's size and circumstances in stress situations. Due to the development of the markets, increased liquidity, and capabilities of index managers and peer practices, AHIC became comfortable with the ACWI ex US IMI Index.

AHIC explained the due diligence it has conducted since the 2017 report and talked about peer practices. AHIC examined the practices of twenty large defined contribution plans (comprised of plans of the ten largest publicly traded companies and ten top federal contractors) all of which include emerging markets as part of their international equities options.

In response to questioning by Board Member Jasien, Mr. Ivinjack estimated approximately 50 percent of the twenty plans offered a brokerage window and offered between 15 and 20 funds on their investment menu. Board Member Jasien asked if it was possible for participants in these twenty plans to invest internationally without exposure to emerging markets to which Mr. Ivinjack replied that many plans had a similar benchmark to the ACWI ex US IMI Index while others bifurcated between the MSCI EAFE Index and emerging markets separately.

Mr. Ivinjack explained that AHIC's examination found that 100 percent of the twenty largest public defined benefit plans invest in emerging market equity, including Chinese equities. In response to questioning by Board Member Jasien, Mr. Ryan explained the relevance to the TSP of examining investment practices of not only defined contribution plans but also defined benefit plans and target date funds. Mr.

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[1] 5 U.S.C. § 8438(b)(4).

Ryan then explained that the six largest target date asset managers, representing 86 percent of the target date fund market, are building target date portfolios with exposure to non-US stocks, including emerging markets and small-cap equities on their benchmark. The increased investment by defined contribution plans, defined benefit plans, and target date funds has provided additional liquidity to emerging markets over the past three to five years, which made AHIC more comfortable with recommending the ACWI ex US IMI Index for the TSP I Fund benchmark.

Mr. Ryan then discussed investment metrics and the modern portfolio theory. AHIC reviewed the merits of expanding the I Fund benchmark to provide more complete coverage of the international equity opportunity set. By expanding the index, TSP participants would gain exposure to Canada, emerging markets and non-U.S. small cap stocks not previously available to them.

Mr. Ryan discussed the changes from 2017 to 2019. AHIC's forward-looking capital market assumptions signal that the expansion to the ACWI ex US IMI Index can improve the expected return and decrease volatility. In response to Board Member McCray's questioning, Mr. Ryan explained that similar to the last ten years in the U.S. equity market, market growth in international equities is expected to decrease the volatility in that market.

Mr. Ryan discussed AHIC's modeling of the impact of an expanded international equity index on three L Funds. Investment in the L Funds is the primary way participants are exposed to the I Fund. AHIC found that the expanded benchmark can improve the expected return over a future 10-year period. AHIC also found that the reduction in volatility may improve outcomes even in down markets.

Mr. Ryan discussed the inclusion of Chinese equities in the portfolio. Over the past ten years, U.S. retirement funds' investment in Chinese equities is estimated to have grown from $53 billion to $161 billion. China is one of the fastest growing emerging markets countries. The two major Chinese exchanges combined would be ranked the third largest exchange after the New York Stock Exchange and NASDAQ. Additionally, there is an improvement in transparency, the overall regulatory environment and scrutiny. The market itself will reflect when an individual company does not have a positive outlook and value that security accordingly. In response to Board Member McCray's question, Mr. Ryan explained that AHIC's model accounted for different disclosure and transparency across markets.

In response to Board Member Bilyeu's questions, Mr. Ryan explained that when determining which countries will be represented on an index, MSCI applies rules based on a number of factors. The MSCI EAFE Index represents 21 developed markets, large- and mid-cap stocks, and 900+ companies. The MSCI ACWI ex USA IMI Index represents 22 developed countries and 26 emerging markets, large-, mid- and small-cap stocks and 6,000+ companies.

Board Member Jones asked whether AHIC considered recommending an emerging markets index as a separate option for the TSP. Mr. Ryan explained that AHIC believed a separate index for emerging markets as well as the MSCI EAFE Index would conflict with the current legislative requirements for the I Fund and that legislation would need to be passed to segment emerging markets from the TSP international fund. Mr. Ivinjack further explained that AHIC's investment structure review showed that a standalone emerging markets fund would be too risky for participants.

Board Member Jasien asked whether the largest defined contribution plans had a separate emerging market index option. Mr. Ryan responded that three of the 10 largest plans of publicly traded companies and six plans out of 10 top federal contractors have a standalone emerging market equity fund. Mr. Ryan further explained that the average U.S. investor selects between two and three investment options. Because investors base their selection on trailing investment performance, AHIC stated that stand-alone emerging market funds tend not to serve defined contribution participants well.

Board Member Jasien asked what the actual returns would be for TSP participants had they been mapped to the ACWI ex US IMI Index in 2017 and whether participants would be better off since 2017 with the EAFE Index or the ACWI ex US Index. Mr. Ryan stated they did not calculate the actual returns for that time period, but will do so for the Board.

In response to Chairman Kennedy's questions, Mr. Ivinjack stated that the TSP would be an outlier in the investment industry if the Board decided to stay with the EAFE Index. By providing access to emerging markets, Canada and small cap equities, the TSP would be in line with the practices of its peers. In response to Board Member McCray's question, Mr. Ivinjack explained that comparable funds are moving to the expanded index because their expected return and risk are enhanced and that participants in those plans are better off.

Board Member Jones noted that the 2050 L Fund carries the greatest investment risk based on AHIC's projection that shows only a minimal difference of expected returns over 10 years between the EAFE Index and the ACWI ex US IMI Index. Mr. Ryan explained that part of the minimal differential in the 2050 L Fund has to do with savings and salary rates of younger participants in that fund who may not benefit from the compounding effect that comes with having larger balances.

Mr. Ryan then summarized AHIC's findings. Based on AHIC's understanding of how participants build their portfolios, expanding from the EAFE Index to the ACWI ex US IMI Index is in the best interest of TSP participants. AHIC believes that the expansion will provide a more efficient portfolio and a simple way for participants to get access to Canadian equities, emerging markets and small cap equities and will be in line with the best practices of the TSP's peers. Mr. Ivinjack added that broader diversification – including an additional 30 plus percent of the non-US markets – is a true benefit of the expansion and better meets the legislative requirements.

In response to Board Member Jasien's questioning, Mr. Deo explained that participants would be mapped automatically to the new I Fund if the Board elects to reaffirm its 2017 decision. Mr. Deo explained that participants can reallocate money currently invested in the existing I Fund to another TSP Fund before or after the mapping to a new I Fund. Mr. Deo stated that a participant who is opposed to investing in China would not have another international equities investment option under the TSP. In further response to Board Member Jasien's questions, Mr. Deo stated that it would be challenging to add an emerging markets index fund to the TSP's current funds lineup and explained the risk of participants choosing the emerging markets fund at the wrong time. Mr. Deo also noted that the Board currently does not have the legislative authority to add a separate emerging markets fund.

In response to Board Member McCray's questions, Mr. Deo confirmed that a participant who wanted to invest in China would not have a way to do so with the current benchmark. Board Member Jasien pointed out that participants could invest in China with a brokerage window. Mr. Deo explained that a procurement is underway to offer a mutual fund window that would allow a participant who wanted to invest internationally, but not in the I Fund, to do so through that window. Chairman Kennedy explained that the mutual fund window is anticipated to be implemented in the year 2022. Board Member Jasien asked whether there was an international index that specifically excluded China to which Mr. Ryan answered that he was not aware of any such index.

After confirming there were no additional questions, Chairman Kennedy concluded the I Fund presentation, and there was a 15 minute break. Upon return, Chairman Kennedy turned it over to Mr. Deo for the monthly reports.

3. Monthly Reports.

a. Participant Activity Report

Mr. Ramos reviewed the monthly participant activity report. See "Thrift Savings Fund Statistics" (attached). Mr. Ramos shared some statistics from the deployment of the Additional Withdrawals Project (AWP). Single payment total-account transfers out of TSP decreased by 47 percent. Partial withdrawals increased by 333 percent, and age-based withdrawals increased by 254 percent. On the Monday after deployment, the contact center received more volume than any previous peak day resulting in a one-day blip in service levels across the Board. The average number of calls per day increased by nearly 2,000 calls immediately following AWP.

b. Legislative Report

Ms. Weaver indicated that the SECURE Act is still under discussion in the Senate. Ms. Weaver noted that the current continuing resolution (CR) expires on November 21, 2019. Extensions for the CR are under discussion in both chambers: the House is considering an extension to December, whereas the Senate is contemplating an extension to February or March of next year. The Agency is watching this closely in light of the shutdown situation earlier this year.

4. Quarterly reports

a. Investment Policy

Before presenting a quarterly investment report, Mr. McCaffrey reviewed the monthly investment performance report. See "September 2019 Performance Review – G, F, C, S, I, and L Funds" (attached). Mr. McCaffrey noted that for the month of September, performance for the F, C, and I Funds was in line with indices. Performance for the S Fund was ahead of the benchmark by 6 basis points primarily due to securities sampling.

For the year to date, the F and C Funds were in line with the respective indices. The S Fund was ahead of the benchmark by 6 basis points, primarily attributable to securities sampling. The I Fund was 40 basis points ahead of benchmark, primarily attributable to tax effect.

Mr. McCaffrey noted that, during September, the Federal Open Market Committee cut its target for the federal funds rate for a second consecutive meeting. The move seemed to appease some investors who were concerned about sustainability of the economic expansion. However, ongoing trade tensions and geopolitical concerns continued to temper optimism in the equity markets. The C and S Funds posted gains. The I Fund also rose, although a stronger dollar hurt its performance modestly. The equity funds' positive returns for the month added to already very strong returns year to date. Longer-term interest rates rose slightly, leading to a loss in the F Fund. All of the L Funds posted gains.

Global stock markets are ahead month-to-date through Friday, October 25. The C Fund is ahead by 1.64 percent. The S Fund is up 1.88 percent. The I Fund up 2.97 percent. The F Fund is down 0.34 percent.

An audit of BlackRock's proxy voting found no exceptions to established guidelines during the 2nd quarter of 2019. Mr. McCaffrey also noted that with respect to class action settlements, there were 61 claims open at the start of the second quarter of 2019. Ten claims were opened during the quarter. One claim was closed in the C Fund due to administrator action. Six were closed in the S Fund, three of these due to administrator action and three claims were settled for a total of $236,218. At the end of the quarter, 64 claims remained open.

Chairman Kennedy entertained motions to reaffirm current G, F, C, S, and I Fund investment policies. The Board members made, seconded, and adopted the following recommendations by unanimous vote:

MOTION: That the Board reaffirm the current G Fund policy of investing solely in short-term maturities without change.

MOTION: That the Board reaffirm the current F, C, S, and I Fund investment policies without change.

b. Budget Review

Ms. Crowder gave a presentation on the FY 2019 budget. See "FRTIB FY 2019 4th Quarter Budget Review" (attached). Ms. Crowder noted that FRTIB was under budget for the year, using approximately 94 percent of its projected budget. Of the $340.1 million expended, $235.9 million was spent on recordkeeping. Average assets at the conclusion of FY19 were $574.9 billion. Ms. Crowder provided a five year history of net and gross administrative expense ratios as was previously requested by the Board. She noted that administrative expenses are calculated on a calendar year basis. In response to Board Member McCray's question on how FRTIB expense ratios compare to those of industry peers, Ms. Crowder noted that our expense ratios are quite a bit lower.

c. Audit Status

Mr. Boone provided a quarterly update on the status of the Agency's open audit findings. See "Audit Status/Security & Remediation Status" (attached). Twenty external audits were completed in FY 2019. Eleven external audits are planned for FY 2020. EBSA awarded KPMG its TSP audit contract. The annual TSP financial statement audit for CY 2019 was awarded to CliftonLarsonAllen.

Mr. Boone reported the audit objectives and audit findings for five FY 2019 EBSA audits: Corrective Action Plans Process; Dallas Contact Center, IT Operations Controls, Service Continuity Controls, and TSP Operations at the Defense Finance and Accounting Services (DFAS).

Mr. Deo provided an update on the remediation status of audits. The FY 2019 goal for audit closures was 120. As of September 30, 2019, 202 findings were closed. Audit findings activity was presented from two perspectives: that of auditors and that of the Agency. According to auditors, 414 audit findings remain open for FY 2019.

According to the Agency, 280 audit findings remain open for FY 2019. The difference in numbers is due to non-concurrence and findings that have closed by the FRTIB, but have not yet been re-visited by the auditors.

5. Office of Enterprise Planning Annual Report.

Ms. Wilder Guerin provided the Office of Enterprise Planning (OEP) annual report. See "Office of Enterprise Planning" (attached). Ms. Wilder Guerin highlighted OEP's functional statement and organizational structure – noting the designation of a Chief Data Officer. She reviewed OEP's significant FY 2019 accomplishments and discussed key initiatives for the new fiscal year, which include a participant survey, foundational work for the Agency's next strategic plan, project management, and developing an acquisition planning framework.

In response to Board member questions regarding the frequency of participant surveys, Ms. Wilder Guerin explained that OEP is looking to transition to an annual participant survey which will be conducted by U.S. mail and e-mail. In response to Board member questions regarding the zone of confidence data model, Ms. Wilder Guerin discussed the use of such modeling for participant benefit and the variables the model will consider in the future given the expansion of the TSP participant and beneficiary population with servicemembers under the Blended Retirement System (BRS) since 2018.

Mr. Courtney briefly highlighted the work of the Office of Communication and Education with the Department of Defense in providing messaging to the servicemember participants.

6. Update on Implementation of Additional Withdrawal Options.

Mr. Tanner Nohe, Supervisory Project Manager, presented an update on the Additional Withdrawals Project (AWP). See "FRTIB Additional Withdrawals Project" (attached). Mr. Nohe reported that the additional withdrawal options went live as scheduled on September 15, 2019. Post deployment, contact center volumes spiked. On the day after AWP launched, the contact centers received 19,000 calls and contact centers are now averaging 2,000 more calls per day. Website bugs have been reported and fixed over the past five weeks. Mr. Nohe shared that post separation withdrawal statistics after the launch of AWP indicate a reduction in the amount of money withdrawn given the increased flexibility for participants to access their accounts.

In response to Board Member Jasien's question on the productivity and efficiency gains in automating the AWP process, Mr. Nohe and Mr. Ramos explained that such efforts will be undertaken as more data becomes available over time.

7. Adjourn.

On a vote taken by the Chairman, the members closed the meeting at 10:44 a.m. for executive session, which commenced after a 15 minute break at 11:00 a.m.

At 1:25 p.m. upon completion of the executive session, the members reconvened the open portion of the meeting.

Whereupon, there being no further business, the following motion was made, seconded, and adopted without objection and Chairman Kennedy adjourned the meeting at 1:25 p.m.

MOTION: That this meeting be adjourned.

Megan G. Grumbine
Secretary

Attachments

1. Background on the TSP
2. I Fund Policy Benchmark Review (PowerPoint)
3. I Fund Benchmark Study
4. Thrift Savings Fund Statistics
5. September 2019 Performance Review – G, F, C, S, I, and L Funds
6. FRTIB FY 2019 4th Quarter Budget Review
7. Audit Status/Security & Remediation Status
    a. Audit Remediation Status PowerPoint
    b. Audit Report Summary – 2019 IT Operations
    c. Audit Report Summary – 2019 Service Continuity
    d. Audit Report Summary – 2019 CAP and Prior Year
    e. Audit Report Summary – 2019 Dallas Contact Center
    f. Audit Report Summary – 2019 DFAS
8. Office of Enterprise Planning
9. FRTIB Additional Withdrawals Project