MINUTES OF THE MEETING OF THE BOARD MEMBERS

June 30, 2008

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on June 30, 2008, at 9:20 a.m., Eastern Time. The meeting was held at the Board’s offices at 1250 H Street, N.W., Washington, D.C. The meeting was a joint meeting including the Agency’s Board and members of the Employee Thrift Advisory Council (ETAC). In attendance for the Agency’s Board were Thomas A. Fink of Alaska, member; Gordon J. Whitin of New York, member; Alejandro M. Sanchez of Florida, member; Terrence A. Duffy of Illinois, member (by telephone); Gregory T. Long, Executive Director; 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; Renée Wilder, Director, Research and Strategic Planning; and Megan Graziano, Acting Secretary.

In attendance for ETAC were Chairman James W. Sauber of the National Association of Letter Carriers; Jacqueline Simon of the American Federation of Government Employees; Richard N. Brown of the National Federation of Federal Employees; Kurt Vorndran of the National Treasury Employees Union; David J. Holway of the National Association of Government Employees; Myke Reid of the American Postal Workers Union; Paul Swartz of the National Rural Letter Carriers’ Association; Oscar Dale Goff, Jr. of the National Association of Postmasters of the United States; Charles Mapa of the National League of Postmasters of the United States; Bruce Moyer of the National Association of Postal Supervisors; Sharon Roydes of the Federally Employed Women, Inc.; Alan Lopatin of the National Active and Retired Federal Employees; Jessica Klement of the Federal Managers Association; Richard L. Strombotne of the Senior Executives Association; and Chuck Witschonke representing the uniformed services.

1. Welcome ETAC.

Chairman Saul welcomed the members of ETAC and specifically noted that he and the Board have enjoyed
working with Chairman Sauber. Chairman Saul also noted that this joint meeting was an experiment and that he hoped to make such meetings an annual event.

2. Approval of the minutes of the May 19, 2008 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the May 19, 2008 Board member meeting. The following motion was made, seconded, and adopted without objection:

MOTION: That the minutes of the Board member meeting held on May 19, 2008, be approved.

3. Approval of ETAC minutes.

Chairman Sauber entertained a motion for approval of ETAC’s December minutes. The ETAC Representatives moved to approve the minutes.

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

Prior to the formal reports, Chairman Saul introduced Mr. Long by noting that the Board was very fortunate that the former Executive Director, Mr. Gary Amelio, had hired Mr. Long and that Mr. Long has the full support of the Board.

Mr. Long then welcomed the members of ETAC and noted that Mr. Thomas Braviler, General Counsel, was not in attendance as he was on vacation and that Ms. Graziano would serve as Acting Secretary and also introduced Ms. Renée Wilder who is the Director of Research and Strategic Planning. Mr. Long then turned over the Thrift Savings Plan activity report to Ms. Wilder.


Ms. Wilder reviewed the report on TSP statistics. She noted in particular that in May assets grew $3.6 billion to just over $234 billion. Ms. Wilder noted this growth is due to an increase in cash flow as well as positive fund performance. She also stated that the FERS participation rate is 86 percent and has been holding steady for several months. The total number of
uniformed services members who participated in the TSP was up to approximately 608,000 compared to 600,000 in April, and, in particular, more than 500,000 members on active duty are participating in the TSP. The participation rates for members of the Ready Reserve also increased in May. The number and amount of loans outstanding remained relatively unchanged. While noting there is still work to be done, Mr. Sanchez commended the Army and Air Force Ready Reserve for their improvements in participation rates.

b. Highlights.

Mr. Long commented on the July 2008 Highlights which Ms. Moran and her group compiled. In particular, Mr. Long noted the publication’s section entitled “Look before you leap!” which addresses, among other things, advertisements which mislead participants by stating that their investment products are a solution for “old TSP accounts.” This Highlights is intended to make sure participants are well informed before transferring their accounts to other investment products and, in particular, are mindful of the cost advantages of the TSP.

c. Investment Performance Report.


Ms. Ray noted that in May the Small to Mid-Cap fund outperformed its index by 8 basis points and by 29 points for the year. This is due primarily to the sampling technique used by the Fund. Additionally Ms. Ray stated that in May the International Fund outperformed its index by 13 basis points primarily due to taxes (the index is adjusted for taxes, but the Fund does not pay taxes).

Ms. Ray also highlighted how interfund transfer activity dropped off in April and May. In particular Ms. Ray pointed to page 3 of her report which shows that the interfund transfer regulation has been effective in reducing the activity. Chairman Saul noted that the Board recognizes that the interfund transfer regulation was a big issue for some participants but that the change was necessary not only to reduce costs but also to control the instability it created in the funds. Chairman Saul also said that even though 99.9 percent of
participants were unaffected by this change, he wanted to emphasize that the Board did not make this decision casually. Chairman Saul also said that when the TEF system first permitted daily trading, he was concerned about frequent trading and noted that the activity left unchecked would have been a serious problem.

Ms. Ray highlighted the reduced transfer activity in the I Fund, where most of the past activity occurred. In May, approximately 1,220 participants had requested, and subsequently been denied, a third interfund transfer request. Chairman Saul stated that these numbers support the Agency's research that only a very small percentage of participants would be impacted by the interfund transfer regulation.

Chairman Sauber asked whether there had been any litigation related to the interfund transfer regulation. Mr. Long stated no. Mr. Brown noted that he had seen many e-mails related to the regulation change, and he mentioned that he took one call in which he explained that frequent trading was driving up the costs for the rest of the participants but this participant said he did not care. Mr. Long said that it is the Agency's job to care about those participants who are not e-mailing.

Ms. Ray continued with her report and noted that, in May, the total number of interfund transfers was approximately 84,000 which is a huge drop and the lowest level since September 2004. Chairman Saul added this number is also impressive considering that there was a significant amount of volatility in the markets across the month of May. Ms. Ray pointed out that the G Fund rate climbed up to 4 percent and stated that this fund was an attractive short-term investment option.

Ms. Ray also noted that, in May, the S Fund outperformed the other equity funds, and that trend continued for June. Because the equity markets were up for May, those L Funds with the greatest risk exposure, like the L 2040, had the highest return. The L 2040 Fund has returned 9 percent since its inception. Since inception, the L 2020, L 2030 and L 2040 Funds have outperformed all funds except the I Fund. The L Funds are doing what they are designed to do.
Chairman Sauber mentioned that this Plan was created during the time of a bull market and that it is interesting to note that, even during such a turbulent time, there is no sense of panic among Federal employees. Ms. Ray said that she believes Chairman Sauber's point is a good thing and specifically noted that participation in the G Fund rose slightly, but not to a great extent, from 32 percent to 36 percent. Finally, Ms. Ray noted that the uniformed services are staying more in equity accounts.

5. New Business

a. TSP Systems Modernization

Mr. Hagerty presented the Board with an update on the ongoing TSP systems modernization project. As background, Chairman Saul noted that when the current Board was elected there were several gaps in the TSP systems. In particular, there was no daily record keeping, the backup systems were basically non-existent, and there was one call center in one building. If a crisis or natural disaster, like a hurricane, had occurred during this time, the system would have been down for several months and a goal of this Board was to ensure business continuity. Chairman Saul stated that during this modernization effort, the board has been able to keep costs down and spent resources very reasonably. This modernization project is an ongoing process and one aimed at supporting the Plan's ongoing growth. Chairman Saul commended the TSP systems' team and, in particular, the hard work of Mark Hagerty, Susan Smith, and Roy Friend.

Mr. Hagerty commenced his report by introducing his two deputies, Ms. Susan Smith and Mr. Roy Friend. He noted a key to the systems' improvement project was upgrading the technology at the Agency's primary and backup data centers in Reston and Pittsburgh. Mr. Hagerty also provided background relating to outsourcing operations from NFC to SI International and opening up additional call centers. The underlying principle behind the systems' improvements is to create business assurance so that the Plan can survive emergencies, disasters, cyber attacks, etc.

Mr. Hagerty stated that the TSP now has two, geographically dispersed data centers which create necessary redundancy and also path and carrier diversity.
These two centers are 250 miles apart and, while they do not operate in parallel fashion, the Pittsburgh site operates in a standby mode to ensure no more than 59 minutes of data will be lost because the system's data is "shadowed" every hour. Further Mr. Hagerty noted that these buildings are very secure. None of the buildings have any name that would associate them with the TSP or the Agency. These buildings look physically just like any other building and have sufficient security components and proper infrastructure.

Mr. Hagerty stated that the Agency recently completed a comprehensive review of the TSP technology infrastructure which included reviewing mainframes, storage subsystems, the server environment, the network, security and quality assurance and configuration management.

Mr. Hagerty discussed the current status of the TSP systems' mainframes and in particular the Agency's 2007 purchase of new mainframes. The previous mainframes were not going to be able to grow with the Plan and could be considered trailing edge technology. At the time this system made sense based on resources, but these needed to be replaced and the Agency has been able to do so and gotten an outstanding deal on mainframes with fantastic capabilities.

Mr. Hagerty continued his report by discussing the systems' storage subsystems. The Plan's existing infrastructure leverages several different types of disparate storage devices, increasing overhead and risk. The engineering review determined the need for a common storage infrastructure serving both the mainframe and distributed systems environment. Implementation of the resulting Storage Area Network (SAN), which, when completed, will provide for better business continuity.

Mr. Hagerty also described several improvements to the network. In particular, improvements were needed to improve bandwidth, redundancy, and path and carrier diversity. Mr. Hagerty discussed that these network improvements were underway and would continue across the course of 2009. The network modernization will also provide the capability to monitor and manage the network in a more proactive fashion.
Mr. Hagerty also reported on the TSP systems' security which he has been looking into since he has been with the Agency. Mr. Hagerty remarked that it is no news that there are bad guys out there who are very creative. He highlighted several changes on the Web site. Participants can now create a customizable ID and also no longer use a 4-digit PIN but instead a more secure password. Mr. Hagerty also mentioned security improvements related to encrypting data and noted that the Agency hired a security expert. The threat of social engineering is also a focus for his team. Several years ago, the software in this area was underdeveloped but now it has advanced, and the Agency is working toward procuring integrated solutions in this area.

Mr. Hagerty also discussed improvements related to quality assurance. Ms. Smith took on this responsibility approximately two years ago and has done a fantastic job implementing and improving internal controls. Finally, Mr. Hagerty stated that the Board has been very generous in allocating resources to allow these changes and that he is totally confident that these efforts will yield the long-term architecture the Agency requires.

Mr. Fink noted that from a security aspect the Agency is breaking its back to control that which it can control but that ultimately there are things which it cannot control. Mr. Fink noted that it must be emphasized to participants that it is their responsibility to keep their home computers up-to-date and to check their statements and alert the Agency if something does not look right.

Chairman Sauber agreed and noted that ETAC used to use the open season as an opportunity to discuss this topic of security. Chairman Sauber said it is difficult for people to remember the various passwords that they have to use. Mr. Brown has confidence that the Agency's systems are secure because he recalled that during his testimony a Congresperson complained that he could not access his account.

Chairman Saul noted that the Board has struggled with the balance between cost considerations and modernization and that, ultimately, the Board does not want the Agency's systems to be where they were six years ago. Chairman Saul noted that the Board has tremendous
confidence that Mr. Hagerty will continue the work that his team is doing.

b. Congressional discussion draft.

Mr. Long noted that the Agency received a discussion draft from Congress regarding several proposed legislative changes and then turned the discussion over to Mr. Trabucco. Mr. Trabucco noted that 2006 Pension Protection Act brought about several changes in pension policy. In particular, it allows for automatic enrollment and default fund options and made the Roth 401(k) feature permanent.

Chairman Sauber said that there may be some confusion among Federal employees regarding automatic enrollment. In some sense, Federal employees already have automatic enrollment as agencies automatically contribute one percent. However, this automatic enrollment refers to automatically deducting pay from employees’ paychecks to place into their TSP accounts.

Mr. Trabucco continued and noted that, as was discussed with ETAC at a meeting in June 2007, the Board recommended moving forward with legislation on the first two issues but to hold off on the Roth feature for now. According to Agency research, very few people who were eligible had actually started a Roth IRA and, therefore, the Agency needed more time to research this option. Mr. Trabucco noted that the Board’s proposed legislation had not moved forward primarily because of the cost to Treasury associated with automatic enrollment. The Roth feature would offset some or all of the cost. The Agency has seen interest for the Roth feature primarily from judges and the military.

Mr. Trabucco then turned to the draft legislation dated May 16. In particular, Mr. Trabucco noted that the legislation contained not only the two issues which the Board previously supported, but also legislation to add a Roth feature, authority for the Board to add new funds, and authority for the Board to add a self-directed mutual fund window. Mr. Long then noted that Ms. Wilder is working on a second version of the participant survey and it will include questions pertaining to the demand for the Roth feature and the issue of a mutual fund window. Offering the mutual fund window would
be a significant departure for the Plan, and the Agency is in the early steps of considering this.

Chairman Sauber mentioned that members of ETAC were very concerned about the provisions allowing the Board to add new funds without approval of Congress. These provisions could result in the Plan going in a direction no one intended. He noted that because the Board positions are unelected and the ETAC is really just advisory in nature, he is troubled with the idea of moving away from having Congress make these retirement decisions. Chairman Sauber also noted that he felt somewhat mixed about the mutual fund window option and said that he does not really like the idea. It is important to keep costs down for the Plan but also to provide options to participants. Ms. Simon supported Chairman Sauber’s statements and is in support of automatic enrollment and is not going to oppose the Roth feature. She added that APFE is going to lobby against making the L Fund the default fund.

Ms. Klement asked whether it is possible to oppose only specific provisions of the bill as opposed to the entire bill and asked what the costs versus savings were in the proposed legislation. Mr. Trabucco replied that he does not have precise figures. He has been told that the cost of the auto-enroll is in the hundreds of millions, while the Roth feature would really divert funds from pre-tax to post-tax treatment. He is sure that these cost figures will be sorted out by Congressional Budget Office and the Joint Committee on Tax.

Mr. Brown reported that NFPE does not support the proposal to give the Board unilateral authority to add funds because ETAC is not really in a position to stop anything. He noted that the KEIT situation showed how the size of the Plan is increasing the amount of political pressure on the TSP and that the key to the TSP is keeping the Plan cost effective and simple. As far as the default fund, Mr. Brown said that he struggles with this option but that it is important to think back when you first started your Federal career. He often talks to people who comment that they wished they had contributed more and earlier in their careers.

Chairman Sauber added that he wanted to clarify his statement regarding ETAC’s power with the Board. Fortunately, ETAC has been blessed with this Board
and the leadership of the Agency who have been focused on participants’ retirement funds. This good fortune does not mean that this will always be the case with future Boards. Chairman Sauber said that there really is no way for ETAC to control the Board, and, therefore, he is against the proposal that the Board be able to add funds without Congressional consent. Mr. Strombotne asked whether it is possible to allow the Board to exercise its own judgment and timing regarding the Roth feature and added he was surprised at how complex adding a Roth option is. He also noted that the investment report showed that L Funds provide stability over time and are performing as expected.

Mr. Masa asked Chairman Sauber, if the Board is not given the authority to select the funds, what method of selecting funds would he prefer. He noted that Congress is subject to political pressure, and he suggested that it may be preferable to have members of a Board who are not subject to political pressure select the TSP’s funds. Chairman Sauber responded that he preferred the universe of five hundred and thirty-five members of Congress to a universe of five.

Mr. Saul noted that the Board had already discussed the proposal to allow the Board to select the Plan’s funds, and it is wholly against it and that the Board is not trying to grab power. Mr. Saul noted that he believes that the way things are set up keeps things apolitical. Mr. Whiting added that allowing this change would go against the original intent and design of the Plan, and that the Board fully supports the original design under which the Board presents its proposals to Congress. Mr. Sanchez said that, as the Plan gets bigger, it is important to guard against people trying to push to get their own fund in the Plan. The current system of checks and balances is very important to the Board.

Mr. Witschonke said that the Department of Defense supports auto-enroll but he believes that each agency should have the option to determine whether it wants to automatically enroll its employees or not. Mr. Witschonke also explained the benefits of the Roth option to the members of the uniformed services - especially those who are between the ages of 18 and 24 years old who qualify for the combat zone tax exclusion. He noted that these young people have the tax situation that would make a Roth option attractive. For example, he stated, that almost
one-third of their pay is not subject to income tax. Mr. Witschonke, however, said that he takes the position that the default fund should be the G Fund. If you automatically enroll 18-20 year olds who are in basic training, many may not know where their money is or that they are potentially losing money.

Mr. Long thanked Mr. Witschonke for summarizing the interests of the uniformed services and noted that the Roth feature is one the Board will continue to study. Chairman Sauber asked if part of the systems’ upgrade was to track two streams (pre- and post-tax) money and noted that tracking these streams of money could be resource intense. Chairman Sauber stated that he will be interested to learn about Ms. Wilzer’s survey results regarding the Roth feature.

Mr. Long noted that costs as far as education are also a consideration. The Roth addition will change the nature of the education that the Agency provides and, specifically, will shift its education from focusing on where participants should invest their money to tax planning advice. This type of education is very technical and expensive. Mr. Witschonke suggested that perhaps the Roth option can be limited to only the military or just military and the judiciary and that employees at these agencies can have an open season once a year to determine whether or not they want to participate. Chairman Saub noted that this should be something to consider when the Agency does its research for Roth - whether 95 percent of the demand is only in two places. Mr. Brown added that in his experience some agencies are great at distributing information and others are not and this was a dynamic to consider.

Mr. Sanchez thanked Mr. Witschonke and the rest of the uniformed services for increasing participation rates and noted that if the this Board was reconfirmed by the Senate it would continue to support such efforts. In closing, Mr. Lopatin noted that the current system in which the fiduciaries propose changes and Congress approves them has worked and should continue.

c. Allowing a spousal beneficiary to inherit and maintain a TSP account.
Chairman Sauber noted that Mr. Strombotne first raised the issue of changing the current TSP policy and allowing spousal TSP participants to leave their assets in the TSP. Ms. Wilder reported that the TSP currently requires spouses of deceased participants to withdraw their funds within 60 days of notification of death of the participant. The Agency has begun preliminary analysis into allowing spouses to leave their money in the TSP, and the Agency believes this is a very good idea. This change will touch nearly every element of the TSP's system. Though Ms. Wilder reported she cannot provide an exact cost for the change, the intent is to move forward to make a decision on this issue some time next year.

Mr. Strombotne circulated an attached resolution in support of allowing spouses to leave their assets in the TSP. Mr. Brown noted that it may make sense to inquire into allowing other beneficiaries to leave their assets in the Plan. Mr. Trabucco added that the Agency still has research to do regarding the tax aspects of the proposed spousal retention program.

6. Closing and Closed Session.

Chairman Sauber noted that the all five Board members are currently serving beyond their terms and thanked them for their service. Chairman Sauber also noted that the meeting had been very useful. Chairman Saul said that he believed that the meeting was interesting, and that he hoped a similar meeting could be held each year.
Finally, Mr. Saul commended the Agency’s senior staff and thanked the ETAC members for joining the meeting.

On a vote taken by the Secretary before the meeting, the members closed the meeting at approximately 11:40 a.m. to discuss procurement/confidential financial and security information.

After a brief break, at approximately 11:55 a.m., the closed session commenced. At 1:04 p.m., upon completion of the closed 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 1:05 p.m.

MOTION: That this meeting be adjourned.

Megan Graziano
Acting Secretary

Attachments

1. Thrift Savings Fund Statistics
3. TSP Systems Modernization Report
4. Congressional Discussion Draft on (1) automatic enrollment (2) L Fund default option, (3) Roth account option, (4) Board authority to add funds or create a self-directed mutual fund window
5. ETAC Resolution