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

MINUTES OF THE MEETING OF THE BOARD MEMBERS

October 20, 2008

Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on October 20, 2008, at 9:05 a.m., Eastern Time. The meeting was open to the public at the Board's offices at 1250 H Street, N.W., Washington, D.C. In attendance were, Thomas A. Fink of Alaska, member; Alejandro M. Sanchez of Florida, member; by telephone, Gordon J. Whiting of New York, member; by telephone, Terrence A. Duffy, of Illinois, 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 September 15, 2008 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the September 15, 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 September 15, 2008, be approved.

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

Mr. Long stated that the markets have been tumultuous. This has led to lots of participant activity via the web and the call centers. In response, we posted on the TSP web site a letter from the Executive Director advising them that this is a time for prudence, not panic (attached). Other Agency publications also emphasize that participants should view the TSP as a long-term investment vehicle and that, historically, the markets have always rebounded. Chairman Saul and Mr. Sanchez asked about the paragraph in the letter advising participants that the government could not divert amounts in the G Fund to other purposes. Mr. Long explained that this rumor recurs periodically and that he wanted to assure participants that amounts in the G Fund are held in trust exclusively for the benefit of TSP participants. Mr. Trabucco added that the G Fund is backed by the full faith and credit of the United States. Chairman Saul asked how the G Fund interest rate is calculated. Mr. Trabucco explained that the TSP participants earn interest at the average rate of intermediate and long-term outstanding Treasury debt. This means participants are receiving the intermediate to long-term interest rate without principal risk. Chairman Saul asked Ms. Ray to comment on the F Fund. Ms. Ray stated that the F Fund tracks the Lehman Brothers Aggregate Bond Index. It consists of high quality, triple B or better fixed-income securities with maturities of more than one year including Treasury and Agency bonds, asset-backed securities, and corporate and non-corporate bonds. If a bond is downgraded, it is removed from the index at the end of the month. Barclays now owns the index. Chairman Saul added that this discussion was useful because it could make participants, who do not want to be invested in equity, aware that the Agency also offers two high quality debt funds. He added that he hoped the reporters who were present would note this in their articles. Mr. Long added that participants with long-term investment goals should still consider the L Funds or creating their own mix of TSP funds that include the TSP equity funds. He noted that the participants need to determine what is best for them, but that the Agency provides educational material to help them with their choices.

Mr. Long then reviewed call center statistics for the period October 1st through October 16th. On October 10th, the day of greatest market volatility, call volume doubled from the 15,000 per day average to over 30,000. This caused wait times to be unusually high – averaging five minutes. Web transactions were also slowed due to increased volume. Nevertheless, the system was never overwhelmed; it never shut down. It would be cost prohibitive to staff the call centers in anticipation of such tremendous spikes in volume. Chairman Saul stated that the Agency did take some necessary measures to address this. Mr. Long replied that we extended the operating hours of each call center and increased staff by asking part-time employees to work longer hours and used over-time for full-time employees. We also kept the call centers open on Columbus Day which is contrary to our normal practice. We did take extraordinary steps to ensure our call centers were adequately staffed during this period of market volatility. Chairman Saul said that he wanted to ensure participants were aware that the senior staff, Executive Director, and Director of Participant Services worked very hard to meet the needs of TSP participants. Mr. Duffy asked what were the major concerns raised by callers. Mr. Long and Ms. Moran explained that we received the usual number of calls regarding loans and withdrawals, but the number of inquiries pertaining to interfund transfers increased markedly. We also received a large number of calls asking about the make-up of the G Fund and a large number called to have their PINs and passwords reissued to them. We viewed these calls as being as much about education as about transferring money into different TSP funds. Mr. Duffy remarked that he was surprised call volume did not triple and stated that Agency staff did a great job for TSP participants. Mr. Long and Mr. Sanchez also complimented Ms. Moran and call center staff for their dedication. Chairman Saul pointed out that this proved the wisdom of operating two independent call centers. The Agency could never have mounted this response in the days when it had only one center in New Orleans.

Chairman Saul asked Mr. Hagerty to brief the Board members on the status of the TSP system modernization plan. Mr. Long first stated that the system modernization effort is ongoing. As a result, on October 10th, the day of busiest web activity a small percentage of TSP participants received server-busy notices. They could, however, retry, but, at times, processing was slower than usual. When the TSP system modernization plan is fully implemented, we will be able to handle two, three, even four times normal volume. Mr. Hagerty noted that activity on October 10th was three times normal volume. We had a 92.5 percent success rate, but that is unacceptable. Our goal is a 100 percent success rate. The goal of TSP system modernization is to be able to handle four times normal volume. We have installed new mainframes which has enhanced batch-processing. Software upgrades will further enhance these features. We have also improved our storage subsystems and recently awarded a contract for server modernization. This will enable us to leverage the entire group of servers to meet demand and thereby allocate resources to meet volume even greater than a four times event. We also awarded a contract that will give us additional bandwidth and greater carrier and path diversity. We have awarded a $2.2 million dollar contract for security upgrades and a contract to improve infrastructure monitoring. The modernization initiative is on-schedule. Chairman Saul asked when the move to a new data center would take place. He was told we should sign the contract this week and that the move will be complete by late Spring. We are staging the move carefully in order to mitigate risk. We will also delay installing some new components until the move is completed. Chairman Saul asked whether the events of October 10^{th} had led Mr. Hagerty to revise the modernization plan. Mr. Hagerty replied that the events validated the plan and led him to conclude that we are on a solid foundation. We will use lessons learned to fine tune the final engineering and schematics. Chairman Saul stated that the October 10th event demonstrates the need to plan for the future. He stated that Mr. Hagerty, Ms. Moran, and their respective staffs deserved accolades.

Mr. Fink commented that it appeared participant contributions had not diminished and that withdrawals were not up significantly. Participants have, however, moved their investments from equity to the G Fund. Mr. Long stated that there has been movement to the G Fund and that there has been a slight decrease in participation and a slight increase in withdrawals.

a. Monthly Participation Activity.

Ms. Wilder reviewed the report on TSP statistics. See "Thrift Savings Fund Statistics" (attached). She noted that the FERS participation rate decreased slightly from 85.1 percent to 85 percent. While that is not good, the decrease is much less than private sector plans have experienced. Private sector plans have also seen much larger increases in loans and withdrawals than the TSP has experienced. TSP participants have weathered the storm well and have not bailed out of the TSP.

Mr. Sanchez stated that news reports on the TSP have been responsible. The reports have emphasized that you should not sell low when you bought high. He congratulated the media for encouraging participants not to panic but to take a long term view. Mr. Long added that he and Mr. Trabucco do a weekly radio show in which they emphasize that message.

b. Monthly Investment Performance Report.

Ms. Ray reviewed the October 10, 2008 memorandum (attached), entitled "September 2008 Performance Review - G, F, C, S, I, and L Funds."

She noted that September was a very bad month in the markets. She then summarized the events of 2008 beginning in January when Bank of America bought Countrywide. Société Générale then experienced the rogue trading incident which led the markets to fall. Bear Stearns failed in March. September began with Fannie Mae and Freddie Mac on September 7^{th}. On September 15^{th} Lehman Brothers filed for Bankruptcy and Bank of America bought Merrill Lynch. On September 16th, the Government bailed out AIG and the SEC banned short selling on the 17th. On the 26th, J.P. Morgan took over the deposits of Washington Mutual and, on the 29th, the Citicorp-Wachovia deal was announced.

The September activity was a lot for investors to digest. The effect was felt most strongly in October. It is heartening that the markets were up five percent last week—the largest weekly increase since 2003. It is also a good sign that, despite the announced Dutch government infusion of capital into ING, Asian, European, and futures markets are up today. Chairman Saul asked about the status of London Interbank Offered Rate (LIBOR). He noted that the LIBOR may be one of the most significant indicators regarding the credit markets. Mr. Duffy stated that the rate has fallen from about 6 percent down to 3.5 percent. This shows more confidence in the credit markets; banks are willing to lend to banks.

Ms. Ray stated that it seems the markets are in a bottoming process. The panic may be over and the markets may give the U.S. government's $700 billion bailout time to work. Chairman Saul cautioned against being overly optimistic because the earthquake in the financial markets is just beginning to be felt on Main Street. Retail sales and auto sales are off and unemployment may increase. We must be careful to educate, but not advise participants. We should not paint an overly rosy picture. Mr. Duffy concurred and added that we must see earnings reports over the next several quarters to fully assess the state of the economy. Mr. Sanchez stated that at least we have the good news that the price of a barrel of oil is down. Chairman Saul replied that this could be good or bad news; the country still needs to fix its energy policy. Mr. Long added that none of us has a crystal ball. We educate participants on investing in index funds but do not advise them on particular investment strategies.

Ms. Ray then reviewed the portion of the report pertaining to tracking error. She pointed out that one trade in the I Fund cost 70 basis points and another cost 60 basis points. Those trades brought the average cost up to 30 basis points for the month. Chairman Saul asked what caused this. Mr. Long explained that it was the difference between opening and closing prices. Whatever happens between when the U.S. markets close and the international markets open is borne by the I Fund (the result can be positive or negative). We're more exposed in the I Fund because we price shares using the value at the close of the U.S. business day but cannot execute the trades until the international markets open the next day. We cannot control prices but we did limit the volume of the trades when we imposed interfund transfer limitations. Ms. Ray added that if we had seen the same volume in I Fund trading as we had seen the previous September, the cost to the I Fund would have been $14 million.

Ms. Ray noted that September had seen significant redemptions in the C Fund but that S and I Fund activity was down significantly from the previous year. The G Fund rate was 3 5/8 in September as compared to the 3-month T-bill rate of under 1 percent. That is the G Fund advantage that Mr. Trabucco explained earlier. All equity funds were down significantly in September as were all L Funds, with the most aggressive L Funds being down the most. Since inception, however, all L Funds have shown positive returns. Chairman Saul pointed out that international equity markets are down 28 percent for the year and domestic equity markets are down 20 percent. However, the L 2030 Fund is down just 13 percent. While this is a big loss, it is not a total calamity. Mr. Long stated that this validates the Board's decision to add the L Funds. Interfund transfer activity rose from last month's low of 67,000 to this month's total of 166,000 resulting in $3.4 billion being transferred into the G Fund. Mr. Long added that the interfund transfer rules always allow participants to move to the G Fund and Mr. Sanchez stated that we should emphasize that point. Ms. Ray then turned to page 11 of the report and noted that L Fund participation declined for the first time. Amounts invested in the G Fund increased significantly in September. Chairman Saul noted that average investments are now approximately 50 percent in cash/debt and 50 percent in equity.

There were no exceptions to Barclays' proxy voting policies.

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 Congress is in recess awaiting the results of the national elections. It is likely Congress will convene a lame duck session but that will not be decided until after the elections.

3. Mid-Year Audit Review.

Mr. Long noted that this would be last review by Deloitte and Touche and he stated how much he had appreciated working with Ms. Krause. Mr. Petrick concurred and noted that it had been a positive working relationship.

Ms. Krause then turned to the Deloitte & Touche report dated October 3, 2008 (attached), and reported that a review of the Agency's financial statements for the period January 1, 2008, through June 30, 2008, determined that Deloitte & Touche were not aware of any material modifications that would be required to bring the financial statements into compliance with accounting principles generally accepted in the United States. She added that this is a good opinion.

Mr. Petrick stated that this is a clean opinion and that the mid-year opinion assures us that things are operating properly. He stated that we are moving to a new audit firm, Clifton Gunderson, LLP and that Marie Caputo would be the managing partner. The transition is on-schedule. Chairman Saul asked whether the new firm was prepared to spend the time necessary to fully understand TSP operations and was assured that it was. Mr. Sanchez asked whether Mr. Petrick had any concerns, and Mr. Petrick stated that he did not. He added that last month (due to the market volatility) had also been a challenge for his accounting staff and that they all had worked late every night. Chairman Saul stated that it was important that the Board acknowledge the contributions of the accounting staff. In fact, everyone at the Agency has done a great job during this period. Chairman Saul also noted that Mr. Petrick had made significant improvements to the Agency's internal controls in order to make it compliant with the standards set-out in OMB memorandum A-123.

5. <u>Vendor Financial Reports</u>.

Mr. Petrick reviewed the October 10, 2008 memorandum entitled "Quarterly Financial Assessment of TSP's Primary Vendors - October 2008" (attached). He noted that SI International is being acquired by Serco, Inc. We have met with the CEO's of both entities and are comfortable that, if the acquisition goes forward, it will not affect day-to-day TSP operations.

Barclays is well-capitalized. The Government of the United Kingdom may provide Barclays with additional capital. Barclays is currently capitalized at 7.9 percent, but the UK government wants 11 percent. However, Ms. Ray noted that Barclays will first try to raise additional capital on in its own. Mr. Fink asked how the 7.9 percent number was calculated and was promised an explanation at the next Board member meeting. Mr. Sanchez stated that, in the United States, a bank is well-capitalized at 10 percent.

Mr. Fink inquired about securities lending. Chairman Saul stated that Mr. Long and Ms. Ray were in constant touch with BGI and with Ennis Knupp and were monitoring securities lending very closely. Mr. Long stated BGI does engage in securities lending because it is beneficial to participants. There are risks associated with securities lending, but the vast majority of securities in the BGI collateral pool are money good and we are taking steps to further limit risks. Mr. Long added that, because the securities lending program involved proprietary data, he would prepare a publically releasable statement that describes the program in greater detail.

Mr. Petrick noted that the Agency was close to entering into a new contract with Switch & Data for a primary and back-up data center. He stated that Switch & Data's financials improved in 2008 and showed a profit for the first time. Its continued profitability will be important for it to be able to service its debt.

R.R. Donnelley and Sons showed a loss in 2007 due to certain write downs. It returned to profitability in 2008 and we have no concerns regarding its viability.

MetLife maintains its top rating but is not immune from market volatility. To ensure that TSP annuitants are protected, we require it to be licensed in all 50 states and in the District of Columbia. As a consequence, if MetLife were to experience financial difficulties, TSP annuitants could look to state guarantee funds for relief. We expect MetLife to maintain its top ratings, but we do monitor it closely.

Before the meeting moved to Executive Session, Ms. Moran stated that it is "National Save for Retirement Week" and that the TSP website contains a statement reflecting this.

4. Closed session.

On a vote taken by the Secretary before the meeting, the members closed the meeting at 11:00 for a discussion of confidential financial information and procurement.

At 11:25, 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 11:25 a.m.

MOTION: That this meeting be adjourned.

Thomas K. Emswiler
Secretary

Attachments

1. Letter from Executive Director to TSP Participants
2. Thrift Savings Fund Statistics
3. September 2008 Performance Review - G, F, C, S, I, and L Funds
4. Deloitte & Touche report (October 3, 2008)
5. Quarterly Financial Assessment of TSP's Primary Vendors - October 2008 for an Emergency Transfer of TSP Assets