FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

77 K Street, NE Washington, DC 20002

THRIFT SAVINGS PLAN

MINUTES OF THE MEETING OF THE BOARD MEMBERS

November 13, 2019

Michael D. Kennedy, Chairman of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on November 13, 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 (by telephone); 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; 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. In attendance for the Employee Thrift Advisory Council (ETAC) were Chairman Clifford Dailing, National Rural Letter Carriers Association, and Vice Chair James Sauber, National Association of Letter Carriers.

1. <u>Approval of the Minutes of the October 28, 2019 Board Member Meeting.</u>

Chairman Kennedy entertained a motion for approval of the minutes of the October 28, 2019 Board member meeting. The following motion was made, seconded, and adopted without objection:

<u>MOTION:</u> That the minutes of the Board member meeting that was held on October 28, 2019 be approved.

2. <u>BlackRock Reports</u>

Mr. Deo introduced Larry Fink, CEO of BlackRock, and Mr. Fink's BlackRock colleagues.

a. Comments from Mr. Fink

Mr. Fink provided a general overview and outlook of the U.S. economy and the global economy.

b. BlackRock Overview

Lillian Wan, Managing Director of BlackRock, presented a review of assets under management by BlackRock. See "BlackRock Overview" (Attached). Ms. Wan noted that BlackRock manages approximately 358 billion dollars in TSP participant assets across the C, S, I, and F Funds.

Ms. Wan then introduced Alan Mason, Managing Director of BlackRock, to present additional information concerning management of the C, S, and I Funds. Mr. Mason stated that there were 53 billion dollars in total contributions and withdrawals across the C, S, and I Funds for the year, and that these funds have all outperformed their benchmarks. The S Fund outperformed its benchmark primarily due to the securities lending program, while the I Fund has outperformed the benchmark as a result of tax advantages. Mr. Mason noted that BlackRock added several hundred assets to the S Fund this year so that it more closely tracks the benchmark.

Mr. Mason next introduced Scott Radell, Managing Director of BlackRock. Mr. Radell provided an overview of F Fund management. Mr. Radell stated that, because fixed income bonds are traded over the counter, rather than exchange traded, managing transaction costs is a key to tracking, and potentially outperforming, benchmarks. Currently, the benchmark has approximately 10,000 securities in it; the F Fund does not have all of those securities, but relies on sampling to try and replicate the benchmark.

Mr. Radell introduced Paul Whitehead, Managing Director of BlackRock. Mr. Whitehead generally explained that BlackRock's performance depends on their experienced staff, innovative processes, and leveraging of technology.

Mr. Whitehead then introduced Jason Strofs, Managing Director of BlackRock, to deliver remarks on securities lending. Mr. Strofs explained that securities lending is the practice of lending securities to banks or broker dealers who then often lend those securities to end users. He stated that all of BlackRock's loans are over-collateralized.

According to Mr. Strofs, the primary benefit of securities lending is that it adds to returns, allowing the TSP to outperform the benchmark. A secondary benefit is that securities lending creates more efficient markets, and bolsters transparency, liquidity, and trading volume while narrowing bid-ask spread. Mr. Strofs further noted that BlackRock uses technology to ascertain the best prices and venues for securities lending, adding to better risk-adjusted return for TSP participants.

Mr. Strofs stated that the majority of lending for BlackRock's U.S. fixed-income funds remains the U.S. Treasury securities, because there is demand for high-quality, liquid debt. However, corporate bond lending has increased over the course of the last decade and continues to rise, becoming a larger share of BlackRock's overall fixed income lending returns.

Mr. Strofs noted that, this year, lending returns and fixed income have been down somewhat because of a less favorable cash reinvestment environment. There has also been less demand in equities, in part because increased outflows from hedge funds have created less demand. There have been some bright spots, though, notably in IPOs.

Mr. Strofs also explained that because the C Fund is focused on high capitalization stocks, with a high market cap and ample supply, there is not an opportunity to charge much for securities lending or to generate large returns. However, the top five performing stocks in the Fund added about 4.2 million dollars for TSP participants over the first nine months of 2019. The S Fund's mid-cap and small-cap securities are very much in demand. The top five performers in the S Fund generated 8.2 million dollars for TSP participants in the first nine months of 2019. The top five performers in the I Fund generated about 3.3 million dollars for TSP participants, with much of that revenue coming from France.

Chairman Kennedy asked for an update on the emerging broker program. Mr. Whitehead replied that, in equity trading, BlackRock executed 52.7 percent of TSP activity through emerging brokers, while 1.5 percent of fixed income activity was executed with emerging brokers, and these rates represented increases.

3. Investment Benchmark Discussion

Chairman Kennedy began discussion of the investment benchmark update by acknowledging receipt of a second letter from several Senators requesting review of the decision to transition the I Fund benchmark to the MSCI All Country World ex-U.S. Investable Market Index (MSCI ACWI ex-US IMI) from its current index, the MSCI EAFE Index. Chairman Kennedy stated that, in addition to consultation with Aon Hewitt Investment Consultants during the October Board Meeting, the Board also solicited the opinions of the Employee Thrift Advisory Council (ETAC), for consultation in the November Board Meeting as part of the requested review.

Chairman Kennedy introduced Clifford Dailing, Chairman of the ETAC, and James Sauber, Vice Chair of the ETAC, to present the viewpoint of participants. Chairman Dailing stated that ETAC favors transitioning to a new benchmark. ETAC believes investment options for TSP participants should closely mirror those available to private sector investors. ETAC believes that the I Fund transition provides TSP participants with the option to invest as they choose, without respect to political concerns. Vice Chair Sauber agreed with Chairman Dailing, and reminded the Board that when political concerns have arisen over the past 30 years, ETAC has consistently opposed using the TSP for any purpose other than the benefit of participants and beneficiaries.

Following comments from ETAC, Chairman Kennedy asked Member Bilyeu to discuss consultations with the Department of the Treasury's Office of Foreign Assets Control (OFAC). Member Bilyeu explained that OFAC is the Federal entity responsible for determining the international securities in which Americans may invest. OFAC maintains a list of individuals, companies, and countries in which Americans may not invest. Member Bilyeu noted that the TSP, like all U.S. investors, abides by OFAC decisions. However, she believes that TSP participants and beneficiaries should not face broad restrictions on international investment opportunities that are not applied to private sector investors. Member Bilyeu opined that if policymakers wish to limit international investment opportunities, OFAC is the entity to consult.

Following Member Bilyeu's comments, Ms. Grumbine provided remarks on FRTIB's and the TSP's legislative history. See "FRTIB Legislative History" (attached). As acknowledged by Congress in drafting the Agency's statute, funds in TSP accounts are the personal property of accountholders, not Government property. Relatedly, the legislative history of the TSP shows Congress discussed concerns that as the TSP grew, external entities, including Congress, could attempt to tamper with the funds. To address these concerns, the legislative framers designed the FRTIB and TSP so as to limit susceptibility to external pressure. Especially notable among the features designed to ensure independence, FRTIB is self-funded without appropriations from Congress, and the FRTIB Board members are statutorily obligated to exercise their fiduciary responsibilities solely in the interest of participants and beneficiaries.

Chairman Kennedy next recalled four highlights from Aon Hewitt's October presentation favoring the I Fund transition. First, a move to include emerging markets is popular and widely accepted in retirement plans. Chairman Kennedy recalled that the ten largest U.S. companies include an emerging markets option in their defined contribution plans, as do the ten largest federal contractors. The largest state pension plans generally have access to emerging markets funds. The market is continuing to shift to emerging markets. Second, the evidence demonstrated overall investment performance of the I Fund would be enhanced by the transition. Third, the I Fund transition would provide greater coverage of the global economy by picking up additional markets, including Canada. Fourth, if the TSP failed to include an option to invest in emerging markets, it would be an outlier among institutional investors.

Member Bilyeu added that the I Fund transition appears to be in the best interest of most of the 5.6 million TSP participants. She stated that the TSP should not be moving away from an accepted investment practice by declining to include an emerging markets investment option. Member Bilyeu noted that although it may be appropriate to more closely scrutinize where Americans may invest, FRTIB is not the forum for that discussion. She explained that FRTIB is a fiduciary body, and Congress requires the Board members to confine their considerations to a narrow realm, namely the financial interests of participants and beneficiaries. FRTIB is not a foreign policy board, and is not equipped or permitted to ascertain those countries in which Government employees should be barred from investing. She reiterated that the Department of the Treasury makes such foreign investment decisions, and those decisions apply not only to Government employees, but to all Americans.

Member Bilyeu added that, by law, the I Fund is supposed to resemble a completion index, designed to illustrate the greater market beyond the United States. The transition of the I Fund would provide much greater exposure, and better comply with statutory guidance on the scope of the I Fund. Member Bilyeu remained in favor of the transition.

Member McCray stated his belief that transitioning the I Fund to the MSCI ACWI ex-US IMI is in the best interest of the TSP's participants and beneficiaries. The decision to transition the I Fund was motivated solely by that consideration. The Board's careful review of the 2017 recommendation has only strengthened his opinion that a transition is appropriate. Member McCray remained in favor of the transition.

Member Jones noted that a transition of the I Fund to the MSCI ACWI ex-US IMI would be consistent with the Board's obligations to serve the interests of the TSP's participants and beneficiaries. Moreover, statute requires the I Fund to provide great diversification with regard to international investment opportunity. He added that FRTIB cannot respond to external pressure. If there are concerns beyond the scope of FRTIB's considerations, they must be addressed by other means, such as legislative action, or through OFAC rules applicable to all Americans. Member Jones remained in favor of the transition.

Member Jasien thanked his colleagues for respectful, spirited debate, but opposed the transition to the MSCI ACWI ex-US IMI. Member Jasien explained that if the Board were voting to add an additional investment option of an All-World Index, without mapping assets, he would support the measure, because it would be adding a voluntary choice for participants and beneficiaries. He would also be more willing to support an I Fund transition if there was a brokerage window currently in place that allowed participants options with respect to their international investments. However, he was firmly opposed to transitioning from an index of large- and mid-cap stocks in 21 developed markets, to a very different index of large-, mid-, and small-cap stocks from 22 developed and 26 developing markets, without providing participants a meaningful alternative for international investment. Member Jasien acknowledged that the private sector often provides investors with access to emerging markets, but explained that is typically though a separate investment option.

In sum, Member Jasien stated he favors delaying the I Fund transition for at least one year, in order to study additional international investment options, so that TSP participants may have two or more international investment options.

After weighing the comments of the other Board members, Chairman Kennedy reiterated that the FRTIB is intended to make its decisions solely based on the interest of TSP participants and beneficiaries, and it is designed to resist political pressure. Chairman Kennedy also expressed his opinion that continuing with the transition would further the Board's decade-long effort of improving the TSP with structural changes. Moreover, he believes that a transition in the I Fund would maximize investment returns for participants and beneficiaries. Accordingly, Chairman Kennedy remained in favor of the transition.

Chairman Kennedy entertained a motion from Member Jasien to delay transition of the I Fund benchmark for at least one year in order to study alternative international investment options for TSP participants. The following motion was made, and defeated for lack of a second:

MOTION: That the transition of the I Fund benchmark be delayed for one year.

Chairman Kennedy remarked that, because the motion to postpone the I Fund transition was defeated, the Board's prior decision to transition the I Fund to the MSCI ACWI ex-US IMI benchmark stands.

4. Monthly Reports.

a. Participant Activity Report

Mr. Ramos stated that due to the short turnaround time between board meetings, the monthly participant activity report was not able to be produced this month. Mr. Ramos noted that a data analysis of the Additional Withdrawals Project is ongoing, and he hopes to share information at the December Board meeting. Mr. Ramos also noted that TSP participation inched upwards to a record high 91 percent participation rate.

b. Investment Performance

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

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 12 basis points, primarily attributable to securities sampling. The I Fund was 42 basis points ahead of benchmark, primarily attributable to tax advantage.

Mr. McCaffrey noted that, during October, healthy corporate earnings helped equity markets, while the Federal Open Market Committee cut its target rate range for the third consecutive meeting. The C and S Funds both posted gains. The I Fund rose to an even greater extent thanks to a weaker U.S. dollar. Longer-term interest rates rose just slightly, limiting the F Fund to a small gain. All of the L Funds were ahead.

For the month through November 12, the C Fund was up 1.88 percent. The S Fund gained 2.09 percent and the I Fund was ahead by 1.34 percent. The F Fund was down 0.86 percent.

Mr. McCaffrey explained that the L Funds are reasonably strong on an absolute basis, and that is because they are diversified across fixed income and equity asset classes and have the ability to smooth out the more volatile returns of individual asset classes in line with the funds' respective overall risk profiles.

Recent improvements in the equity markets appear to have muted interfund transfers (IFTs). Mr. McCaffrey noted that if the decline in IFTs is a sign that people are sticking with their long term investment plans, he believes that is a positive attribute.

c. Legislative Report

Mr. Courtney delivered the legislative report in Ms. Weaver's absence. Mr. Courtney noted that, although many Government agencies would run out of funding on November 21, it was anticipated that Congress would pass a continuing resolution through December 20, while discussions continued on a full appropriations measures.

Member Jasien inquired whether there was any legislative movement addressing potential changes to the I Fund. Mr. Courtney answered that Senator Rubio introduced a bill that could impact the I Fund, and there was a companion bill introduced in the House of Representatives.

5. <u>Quarterly Reports</u>

a. Metrics Report

Geof Nieboer delivered the quarterly metrics report. <u>See</u> "FY 2019 Fourth Quarter Key Performance Indicator Results" (attached). He stated that there has been generally good performance, although he addressed three metrics where FRTIB or the TSP have not met a target.

First, on July 19, 2019, the Department of the Treasury experienced network difficulties, requiring G Fund investments to be communicated by phone and facsimile. Daily investment completed at 3:08 p.m., eight minutes after the target. However, the actual investments were completed as scheduled. The Department of the Treasury is confident its phone and fax systems are sufficiently robust to compensate for any future network disruptions.

Second, the FERS full matching contribution rate remains short of the desired 80 percent target, though it is ten percentage points higher than the industry average. When new participants are automatically enrolled at five percent beginning in September 2020, it will likely increase the number of employees who are fully matching.

Third, Blended Retirement System contribution rates are below target. The two-step process where an employee must first elect to participate, and then separately initiate contributions, made contributions complex. FRTIB and the Department of Defense are working to educate members of the armed services that they must elect to contribute.

6. Annual Reports

a. ORM Annual Report and FEVS Update

Ms. Goethe provided the Office of Resource Management (ORM) annual report and Federal Employee Viewpoint Survey (FEVS) results. See "ORM Update" (attached). Ms. Goethe highlighted that, this year, ORM implemented the National Archives and Records Administration records schedule for FRTIB email management and retention. This project covered capstone officials, federal employees, and contractor staff. ORM also continued business continuity outreach, conducting tabletop exercises for four FRTIB offices with respect to key business processes. Additionally, ORM developed five new policies and procedures, and updated 15 existing policies and procedures. ORM also completed a review of all official personnel records to ensure accuracy.

In Agency-wide highlights, FRTIB has 267 employees onboard, which is 84 percent of the authorized staffing level. Overall attrition rate for Fiscal Year 2019 was 9.2 percent. Coaching resources were expanded, and 45 of 70 managers participated in 360 assessments. ORM completed a skills gap analysis for 11 offices, and another analysis is planned for 2020. FRTIB also hosted its second annual honorary awards ceremony to effectively recognize outstanding employee achievements.

Ms. Goethe also reviewed the results of the Federal Employee Viewpoint Survey. The results demonstrate improvement in employee satisfaction and illustrate additional positive changes in relation to last year. Overall scores are, generally, slightly higher than government-wide average scores.

Member Jones requested context regarding the 9.2 percent attrition rate. Ms. Goethe stated that the rate was in line with historical averages for FRTIB, and up from the 7.6 percent attrition rate in Fiscal Year 2018. Excluding employees who transferred to other Federal agencies, the attrition rate is approximately 5.4 percent.

Member Bilyeu inquired what the authorized staffing level was, and whether any particular office had a larger number of vacancies. Ms. Goethe answered that FRTIB has an authorized staffing level of 316 and that the Office of Technology Services has the largest number of vacancies, primarily due to transfers to other agencies.

Member Jasien urged FRTIB to address the drop in scores for employee satisfaction with their supervisors, and address improvements with substantive training.

Ms. Goethe noted that FRTIB provides supervisors with several specialized trainings as part of a continual program.

Chairman Kennedy congratulated Ms. Goethe on the good results, and stated his hope that the work atmosphere, training opportunities, and FEVS scores continue to improve next year.

7. Adjourn.

On a vote taken by the Chairman, the members closed the meeting at 11:32 a.m. for executive session.

At 11:42 a.m. upon completion of the executive session, the members reconvened the open portion of the meeting.

Whereupon, there being no further business, the following motion was made, seconded, and adopted without objection and Chairman Kennedy adjourned the meeting at 11:42 a.m.

MOTION: That this meeting be adjourned.

Megan G. Grumbine
Secretary

Attachments

1. BlackRock Overview
2. FRTIB Legislative History
3. October 2019 Performance Review – G, F, C, S, I, and L Funds
4. FY 2019 Fourth Quarter Key Performance Indicator Results
5. ORM Update