FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

# MINUTES OF THE MEETING OF THE BOARD MEMBERS

March 28, 2023

Michael F. Gerber, Chair of the Federal Retirement Thrift Investment Board, convened a meeting of the Board members on March 28, 2023, at 10:02 a.m., Eastern Daylight Time. The meeting was held at the Board's offices at 77K Street, NE and was open to the public via teleconference. In attendance were Dana K. Bilyeu of Oregon, member (by telephone); Leona M. Bridges of California, member; Stacie Olivares of California, member; Ravindra Deo, Executive Director; Dharmesh Vashee, General Counsel and Secretary; Suzanne Tosini, Chief Operating Officer and Deputy Executive Director; Gisile Goethe, Director, Office of Resource Management; James Courtney, Director, Office of Participant Experience; Sean McCaffrey, Chief Investment Officer; Vijay Desai, Chief Information Officer; and Thomas Brandt, Chief Risk Officer.

Welcome and Introductions.

Chair Gerber called to order the monthly meeting of the Federal Retirement Thrift Investment Board (FRTIB or Agency) at 10:02 a.m. and welcomed everyone present to the meeting.

1. Approval of the Minutes of the February 28, 2023, Board Meeting.

Chair Gerber entertained a motion for approval of the minutes of the February 28, 2023, Board meeting. The following motion was made, seconded, and adopted without objection:

> MOTION: That the minutes of the Board meeting held on February 28, 2023, be approved.

Mr. Deo then gave opening remarks and provided a brief summary of the agenda.

2. Investment Manager Annual Service Review – BlackRock.

Mr. McCaffrey welcomed and introduced Laurence Fink, Chairman and Chief Executive Officer and his colleagues from BlackRock Institutional Trust Company, N.A. (BlackRock). Ms. Kim Klenk Howells, Managing Director at BlackRock, provided an introduction and a brief overview of the agenda for BlackRock's presentation. She then introduced Mr. Fink and their BlackRock colleagues.

a. Comments from Mr. Fink

Mr. Fink's opening remarks spoke to broader industry trends, then turned to BlackRock's relationship with the TSP. He stated that the TSP is BlackRock's largest client worldwide. As a fiduciary, BlackRock's fund and trade management activities seek to maximize returns for TSP participants.

Mr. Fink discussed the causes of inflation, suggesting that fiscal stimulus from recent legislation and aggressive monetary policy after the financial crisis and continuing through the pandemic are contributors. He cited national security concerns around certain products as another reason for prolonged inflation. Mr. Fink predicted that policies for the protection of goods, in the U.S. and abroad, will accelerate in the next couple of years and elevate inflation. Though the Federal Reserve is working to lower it, he suggested that inflation will likely prevail for a while longer.

Mr. Fink indicated that another area of concern for markets relates to the crisis faced by a limited number of banks. He suggested the source of the crisis was duration mismatches due to the rapid increase of interest rates. Mr. Fink highlighted that the current banking crisis is not a credit crisis, though with a continued increase in interest rates to address inflation, more banks will experience duration mismatch for at least three to five years.

Mr. Fink expects an additional event in the markets related to defined benefit plans that are experiencing illiquidity. Mr. Fink noted that as a defined contribution plan, this is not an issue for the TSP. He suggested that low interest rates since about 2008 resulted in defined benefit plans investing approximately 12 to 18 percent of their portfolios in illiquid assets. They've made these investments to achieve targeted returns of seven and a half to eight percent. Some defined benefit plans need to distribute assets in greater amounts than they accept in contributions. While not a systemic market stress, some institutions will sell assets for a loss in order to satisfy requests for distributions and to adjust their asset allocations. He further suggested a pension fund can achieve a more conservative asset allocation with the current availability of products with higher interest rates.

Finally, Mr. Fink suggested that geopolitical issues and other global phenomena such as declining birth rates and increased savings may affect GDP in the long-term. He emphasized that BlackRock focuses on issues that will affect long-term investing.

In response to a question from Member Olivares, Mr. Fink deferred to Anne Ackerley, Managing Director at BlackRock who indicated that employers with defined contribution plans are interested in guaranteed income options for participants in retirement, such as traditional annuity payments or annuities that are part of a target date fund so participants will have a monthly income in retirement. Mr. Fink described BlackRock's undertaking to attach annuities to target date funds.

In response to a question from Member Bridges, Mr. Fink stated that raising the FDIC insurance limit is related to the question of how to keep the banking system free of activities leading to systemic risk without additional government interference. Member Bridges remarked that, while not an issue for the TSP, she is concerned about pension fund illiquidity. Mr. Fink agreed and acknowledged this is not an issue for the TSP.

In response to a question from Chair Gerber, Mr. Fink suggested that investors will seek returns in the next few years in the private debt market and in income-oriented investments, while moving away from equity-oriented investments. This trend may depend in part on the population demographics of a pension fund and their investment allocation in illiquid assets.

In response to a subsequent question from Chair Gerber, Ms. Ackerley referenced a Department of Labor rule which indicates companies could consider including illiquid investments in target date funds under certain conditions. She suggested BlackRock would consider this, though she does not see demand from defined contribution plans because of concerns about litigation risk.

b. BlackRock Overview

Ms. Klenk Howells introduced Ms. Ackerley, who provided an overview of BlackRock's annual service review. <u>See</u> "Investment Manager Annual Service Review (BlackRock)" (attached).

Ms. Ackerley began with a general description of challenges for people in retirement including healthcare costs and inflation. Ms. Ackerley then noted the innovations the retirement industry has adopted to meet these challenges. These include allowing automatic enrollment in a retirement plan, which increases participation, and having a target date fund as the default investment. Ms. Ackerley also mentioned that participants who have access to an emergency savings account at work to cover short-term expenses will also invest at a higher rate in the employer's defined contribution plan than participants who do not have such access.

Finally, Ms. Ackerley noted that surveys indicate 90 percent of employees and employers want a guaranteed income option for retirement, but only 10 percent of plans offer it. The TSP is ahead of the curve with its annuity and an income calculator to assist participants with understanding how their retirement balance may become a stream of income under the annuity. Ms. Ackerley noted that many small- to medium-sized businesses do not offer retirement plans, but innovations in financial technology and pooled employer plans will enable these employers to offer plans to their employees.

In response to a question from Chair Gerber, Ms. Ackerley noted that employees moving from one employer to another is a big issue for industry. She further suggested that the Retirement Clearinghouse's work with recordkeepers to automatically transfer small balance accounts as employees move is a type of technology innovation. Ms. Ackerley also described BlackRock's efforts to increase financial literacy and empowerment.

In response to a question from Member Bridges, Mr. Fink and Ms. Ackerley noted that savings rates in the United States traditionally have been lower than in other countries. Ms. Ackerley further noted that employer actions have increased savings, for example, default contribution rates on average have increased from three percent to six percent.

In response to a question from Member Olivares, Ms. Ackerley affirmed the importance of employees investing early and often in a retirement plan in order to benefit from compounding interest.

Ms. Ackerley introduced Mr. Paul Whitehead, Co-Head of Index Equity at BlackRock. Mr. Whitehead explained that BlackRock continues to invest in a proprietary platform called Aladdin, which it uses to manage BlackRock's TSP funds. Mr. Whitehead noted this platform allows portfolio managers more time to perform fiduciary oversight by automating certain processes.

Finally, Mr. Whitehead noted that the C Fund returned three basis points more than its benchmark in 2022. The S Fund returned 34 basis points more and lastly, the I Fund returned 59 basis points more than its benchmark. Mr. Whitehead attributed the performance of the C Fund to revenue from securities lending, the performance of the S Fund to revenue from securities lending, securities sampling, futures and cash management, and the performance of the I Fund to revenue from securities lending and tax advantage.

Mr. Whitehead introduced James Mauro, Managing Director at BlackRock. Mr. Mauro noted that for the F Fund BlackRock has added three portfolio managers among other analytical support. Mr. Mauro described the portfolio tracking used by portfolio managers and how the information produced was used to identify risk and reposition the portfolio's assets. Mr. Mauro noted that the F Fund returned 31 basis points more than its benchmark in 2022, which he attributed to revenue from securities lending.

In response to a question from Member Olivares, Mr. Mauro indicated there had been no changes to key personnel with respect to their defined contribution portfolio managers.

Mr. Jason Strofs, Managing Director at BlackRock began his presentation on securities lending in response to Member Olivares' question about changes in securities lending risk in the current environment. Mr. Strofs provided a brief summary of securities lending with TSP fund assets and its risks. He noted that it increases TSP fund returns and that all loans of securities are over-collateralized and mark to market daily. BlackRock further analyzes the credit quality of entities it lends to and approves credit limits for these entities. He noted that BlackRock only lends to the largest, most capitalized counterparties in the market. Mr. Strofs then highlighted the elements BlackRock uses to manage securities lending, including trading research. He further noted a proposed Securities and Exchange Commission rule, expected to be finalized in the fall, that would make securities lending transaction data public.

Finally, Mr. Strofs indicated that current volatility in markets leads to additional returns from securities lending and discussed the demand for securities in each of the TSP's funds.

In response to a question from Member Bridges, Mr. Strofs described that all TSP securities lending transactions are collateralized with cash. In response to a question from Chair Gerber, Mr. Fink noted that securities dealers and algorithmic trading funds benefit from the current lack of transparency in securities lending transactions.

3. Monthly Reports.

a. Participant Activity Report

Mr. Courtney reviewed the monthly Participant Activity Report. See "Participant Activity Report" (attached). Mr. Courtney reported on vendor support of participant inquiries, participant satisfaction and participant transaction statistics.

In response to a question from Chair Gerber, Mr. Courtney noted that the tax season and the start of the new year are busy times for the ThriftLine. The current vendor is performing better than the legacy contractor did one year ago with respect to certain parameters, such as call abandonment rates and average wait times.

In response to a question from Member Olivares, Mr. Courtney noted that participants are satisfied with the ThriftLine customer service at levels similar to the prior vendor.

b. Investment Report

Mr. McCaffrey reviewed the monthly investment performance report. See "February 2023 Investment Program Review" (attached). For the month of February 2023, BlackRock's performance for the F Fund was in line with the Fixed Income Index, the C Fund matched the Large Cap Index, the S Fund was ahead of the Small Mid Cap Index by 4 basis points due to securities sampling and the I Fund returns trailed the International Index by 82 basis points, primarily due to fair value pricing.

Next, Mr. McCaffrey noted for the month of February 2023, State Street's performance for the F, C, and S Funds was in line with the respective indices. For the I Fund, performance was behind the International Index by 43 basis points, primarily due to fair value pricing.

Mr. McCaffrey then reported that February began with some optimism that the Federal Reserve's 25 basis point rate increase signaled a moderation in monetary policy. Later in the month, though, surprisingly strong employment growth and persistently high inflation measures reversed much of that sentiment. Domestically, the C and S Funds' returns were negative. The International Fund also fell, influenced in part by a stronger U.S. dollar. Higher interest rates drove a decline in the F Fund. All L Funds finished lower.

Mr. McCaffrey also reported that BlackRock's year-to-date performance for the F Fund was ahead of the benchmark by 18 basis points due primarily to a difference between end-of-year pricing for the benchmark and the Fund. C Fund performance was flat to the benchmark. S Fund performance was ahead of the index by 7 basis points, primarily due to securities lending. The I Fund's performance was behind the benchmark by 60 basis points, due to fair value pricing.

Mr. McCaffrey reported that State Street's year-to-date performance for the F Fund was ahead by 18 basis points because of the end-of-year pricing difference. C Fund performance matched the index. Both S Fund performance and I Fund performance were in line with the respective indices.

Mr. McCaffrey reported that investment performance is mixed so far in March. Through Monday, March 27, the C Fund has returned 0.33 percent. The S Fund is down 6.54 percent. The I Fund has returned negative 0.20 percent. The F Fund is ahead by 2.03 percent. The G Fund has earned a positive 0.30 percent.

Finally, Mr. McCaffrey recognized members of his office who supported BlackRock's presentation.

c. Legislative Report

Speaking for Kimberly A. Weaver, Director, Office of External Affairs in her absence, Mr. Deo reported that two bills were introduced in the House of Representatives that relate to the TSP. Representative Adam Schiff introduced a measure to establish a corporate responsibility stock index fund as a TSP investment and Representative Eleanor Holmes Norton introduced a measure to establish an inspector general for the FRTIB.

Finally, Mr. Deo reported that Congress will be in recess until April 17, 2023.

In response to Mr. Deo's report, Chair Gerber noted that the TSP mutual fund window may present an opportunity for participants interested in investments not offered by the TSP.

4. Quarterly Reports.

a. Quarterly Vendor Risk Management Update

Mr. Brandt presented the Office of Planning and Risk's (OPR) synopsis ofthe risk assessment for five key vendors that are critical to operating the TSP. See "Quarterly Vendor Risk Assessment – 4th Quarter Calendar Year (CY) 2022" (attached).

Mr. Brandt reported that OPR's analysis found no indication that the vendors are unable to fulfill their contractual obligations to FRTIB. OPR will continue to monitor these vendors on a quarterly basis and inform the Board of any changes to the vendor risk profile.

In response to a question from Chair Gerber, Mr. Brandt noted that OPR responds to news about a bank failure by determining if there is any connection or exposure of the FRTIB's vendors to the bank.

5. Internal Audit Update.

Ms. Barbara Holmes, Chief Audit Executive, provided an update on the 2023 Internal Audit Plan. See "Internal Audit Update" (attached). Her office is currently performing (Federal Information Security Modernization Act (FISMA), Insider Threat, TSP Fraud Risk Oversight, and TSP Death Benefit audits.

Ms. Holmes reported that the Decommissioning of Legacy Assets audit was completed in December 2022. Her office has reported on deficiencies, made recommendations, and is now awaiting management response. The OTS Shared Drive preliminary review was completed and her office provided preliminary observations to the program office on whether the shared drives are organized in accordance with their file plan.

Ms. Holmes reported highlights from the Internal Audit Strategic Plan. For the development of the annual audit plan, every two years her office works with program offices and the Board to determine areas of highest risk. Further, they engage in continuous process improvement by considering new technologies and how to improve risk assessment. Finally, Ms. Holmes reported on other internal audit activities.

Chair Gerber thanked Ms. Holmes for her work and noted that he is reassured by the time spent by her office on these audits.

In response to a question from Member Olivares, Ms. Holmes noted that vendors can be introduced into the internal audit schedule after coordination with OPR. Ms. Holmes noted that her office can audit the program, but not the vendor risk. Mr. Brandt noted there can be higher risk with sole source vendors.

6. Adjourn.

On a vote taken by the Chair, the members closed the meeting at 12:00 p.m. to enter into executive session.

At 1:26 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 Chair Gerber adjourned the meeting at 1:26 p.m.:

MOTION: That this meeting be adjourned.

STEFANIE GEORGE

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Date: 2023.07.03 11:50:16 -04'00'

Dharmesh Vashee
General Counsel and Secretary

Attachments

1. Investment Manager Annual Service Review (BlackRock)
2. Participant Activity Report
3. February 2023 Investment Program Review
4. Quarterly Vendor Risk Assessment - 4th Quarter Calendar Year (CY) 2022
5. Internal Audit Update