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

MINUTES OF THE MEETING OF THE BOARD MEMBERS
August 18, 2008
Andrew M. Saul, Chairman of the Federal Retirement Thrift Investment Board, by telephone, convened a meeting of the Board members on August 18, 2008, at 10:02 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, by telephone, Terrence A. Duffy of Illinois, member; by telephone, Thomas A. Fink of Alaska, member; by telephone, Alejandro M. Sanchez of Florida, member; by telephone, Gordon J. Whiting of New York, 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 July 21, 2008 Board member meeting.

Chairman Saul entertained a motion for approval of the minutes of the July 21, 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 July 21, 2008, be approved.
2. Thrift Savings Plan activity report by the Executive Director.
a. Monthly Participation Activity.

Ms. Wilder reviewed the report on TSP statistics. See "rhrift Savings Fund Statistics" (attached). She noted that contributions remained steady at $\$ 1.9$ billion, and that, owing to market impact, total assets under management remained steady at approximately $\$ 225$ billion. The number of TSP participants increased by 17,000; however, the overall percentage of Federal employees who participate in the TSP fell slightly, from 85.3
percent to 85.2 percent. This slight decrease may be attributable to participants taking hardship withdrawals and thereby having their contributions stopped for six months. However, further study would be required to determine the precise cause of this decrease. The active duty participation rate increased slightly, from 35.9 percent to 36.1 percent. Most of the increase was attributable to an increase in active duty Army participants (active duty Army participation increased from 24.8 to 25.1 percent). One year ago, the active duty Army participation rate was 23.7 percent and the active duty Navy participation rate was 50.7 percent. Today, they are at 25.1 and 55.7 percent respectively. Mr. Sanchez noted that this was an excellent trend especially considering where the participation rates were just four years ago. Ms. Wilder added that the number of outstanding participant loans continues to increases slightly, but, as a percent of assets under management, the percentage of outstanding loans remains the same. Mr. Long noted that many $401(k)$ plans were seeing significant increases in loans and hardship withdrawals. The increases in the TSP, however, have been relatively minor.

## b. Legislative Report.

Mr. Trabucco reported that the House Committee on Oversight and Government Reform had approved TSP legislation (H.R. 6500). H.R. 6500 favorably addressed a number of concerns that had been raised by both the Board and the Employees Thrift Advisory Council (ETAC). The initial draft of the TSP legislation would have allowed the Board, rather than the Congress on the recommendation of the Board to add new funds. Both the ETAC and the Board preferred that any new fund be approved by Congress upon recommendation by the Board. This process allows the Board to do its work and engages everyone at the proper time. H.R. 6500 deleted this provision and instead, would allow the Board to add a mutual fund window after consultation with the ETAC. The initial draft of the TSP legislation would have mandated that the default investment fund be an age-appropriate $L$ Fund. The American Federation of Government Employees and the Department of Defense had expressed concerns about this proposal. H.R. 6500 addressed their concerns by allowing the Board to determine the default fund as part of the regulatory process after consultation with ETAC. The initial draft of the TSP legislation would have required the Board to add a Roth feature. The Board felt it had additional work to do before it could add a Roth feature. H.R. 6500 would require the Board to add a Roth feature but does not impose a deadline for doing so. This will allow the Board to complete its work and to track private sector
implementation. One very significant feature of H.R. 6500 is that it will eliminate the 6 to 12 month waiting period for new participants to receive matching and Agency Automatic (1\%) Contributions. As a consequence, all benefits would start at the same time. H.R. 6500 was subsequently attached to H.R. 1108 and passed the House.

Mr. Long stated that this was a very positive development. While the Board still has some concerns and some work to do, we are very pleased with the direction the legislation is heading. Mr. Sanchez asked whether there was any chance the Senate would pass the legislation this session. Mr. Trabucco stated that he is hopeful. The Senate is currently in recess, but there appears to be interest in the legislation.

Mr. Trabucco also reported that the Defense Department had just released the volume of its Quadrennial Review of Military Compensation that pertains to deferred and non-cash compensation. The report looks at the TSP as a potential additional source of compensation. It recommends that the Services make mandatory contributions to the TSP on behalf of their members. The percentage of pay contributed would increase as the member's length of service increased. Each Service must now review the report and make formal recommendations. The Defense Department will then make legislative recommendations to congress. Chairman Saul asked whether this proposal would apply to non-career service members or to career service members also. He also asked about the Army's pilot TSP-matching program. Mr. Trabucco stated that the Army had yet to release its report on the pilot program and promised to update Chairman Saul on his questions at the next Board member meeting.
c. Investment Policy Review.

Ms. Ray reviewed the August 8, 2008 memorandum (attached), entitled "July 2008 Performance Review - G, F, C, S, I, and L Funds."

She noted that the I Fund had a tracking error of 54 basis points, primarily due to a fair value adjustment. Year-to-date, the I Fund has underperformed its index by 23 basis points. This is due to the fair value adjustment and the tax effect. Trading costs for the I Fund were $\$ 2.8$ million in July. These costs stemmed from a $\$ 200$ million trade made before the $4^{\text {th }}$ of July but not executed until July $7^{\text {th }}$. This single trade cost $\$ 3.8$ million to execute. She added that this expensive trade demonstrates why we needed to institute trading re-
strictions rather than impose trading fees. That is, we can't predict trading costs because timing affects everything. Mr. Long stated that this is the hypothetical he had posed to the Board-a large trade over a long weekend with a volatile market. Although this was a large trade, it might have been significantly larger had we not implemented trading restrictions. Chairman Saul asked whether the Agency could have minimized this expense. He was told that trading restrictions should limit, but cannot eliminate, such events.

Ms. Ray noted that the dollar amount traded in the C Fund in July increased significantly over June but the dollar amount traded in the $F$ Fund was significantly lower. Two point four billion dollars were transferred into the $G$ Fund in July. Mr. Sanchez remarked that no matter how much we try to educate our participants, many of them still chase after yesterday's news. This causes them to sell low and buy high. Mr. Long stated that we do emphasize that participants should expect short-term volatility but take a long-term view. In particular, participants should consider the L Funds. Mr. Trabucco added that Mr. Long had done a televised report on this for Navy News and recently identified additional opportunities to get this message out with a local television station whose audience is largely Federal employees. Mr. Sanchez noted that he enjoyed reading the columns written by Mike Causey, a reporter on the Federal beat. Ms. Ray added that, with the exception of May, every month this year has seen significant amounts transferred into the G Fund. The bright spot is the L Fund balances continue to grow and, in particular, in the longer dated funds. This may demonstrate that younger TSP participants are viewing the TSP as a long-term plan.

The dollar amount traded in the I Fund exceeded \$1 billion in July but this was still much lower than the amount traded before we imposed trading restrictions. The I Fund fell 3.72 percent in July, primarily due to the strengthening of the dollar. This trend has continued in August although the C Fund and $S$ fund have posted positive returns. Chairman Saul asked whether the I Fund was priced in local currency. He was told that it is priced in dollars. As a consequence, a strong dollar causes the I Fund to decrease in value.

Trading costs for the I Fund were $\$ 2.8$ million in July. As a consequence, trading costs for the I Fund, year-todate, are now positive. The small to mid-cap fund outperformed its index by 10 basis points (by 25 basis points year-to-date), primarily due to sampling.
3. Report on Potential Risk of Loss to TSP Assets as a result of the Theoretical Insolvency of Barclays Global Investors.

Mr. Emswiler reviewed the report prepared by the law firm of Buchanan, Ingersoll, \& Rooney on the potential risk of loss to the assets of the Thrift Savings Plan that might arise as a result of (1) the theoretical insolvency of BGI or (2) rogue trading at BGI. The Board had directed the Agency to hire outside counsel to conduct this independent review due to financial difficulties experienced by other investment banks. This report will be available to the public after any BGI proprietary data is redacted.

Mr. Emswiler reported that he found the report very reassuring. TSP assets are safe because TSP assets are held in a true trust arrangement. As a consequence, if BGI were to experience financial difficulties, the TSP's assets would be protected. No creditor of BGI could claim the TSP's assets. Instead, the assets would be transferred to another independent fiduciary.

Additionally, the plan's assets would be protected even if there were a rogue trader at BGI. In the event of a rogue trader, BGI could voluntarily make up the loss. If it were unwilling to do so, U.S. Securities law would allow the TSP to sue BGI to recover the losses. Finally, the TSP could likely file a claim under Barclay's Director and Officer insurance policy. Chairman Saul suggested that we amend the contract to require BGI to indemnify us in the event of rogue trading. Mr. Long stated that he would review the current contract. Mr. Duffy noted that credit controls have greatly restricted the ability of employees to act as rogue traders. He added that his experience has been that the firms make up any losses caused by rogue traders. He concluded that he is hopeful that credit trade controls will eventually eliminate all rogue trading. Chairman Saul asked Mr. Duffy whether the Agency should ask BGI to indemnify it in the event of rogue trading. Mr. Duffy agreed that the Agency should ask, but was not hopeful that BGI would agree. Mr. Whiting asked Mr. Duffy whether rogue traders are trading proprietary capital or managed accounts like the TSP. Mr. Duffy replied that they are trading proprietary funds. He added that it would be very difficult for a rogue trader to hide any transaction other than one that involves proprietary funds.

Mr. Fink noted that the report contained several references to statutes and seemed to imply that Congress would be
obligated to make up any losses caused by BGI's insolvency or by a rogue trader. Mr. Emswiler explained that those references pertain to the judgment fund. If a Board member were successfully sued for a breach of fiduciary duty, the judgment fund of the United States, rather than the individual Board member, would be liable for the amount of the judgment. Otherwise the judgment fund is not available to cover losses.
4. Closed session.

On a vote taken by the Secretary before the meeting, the members closed the meeting at 10:40 a.m. for a discussion of procurement matters.

At 11:40 p.m., upon completion of the executive 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 11:40 a.m.

MOTION: That this meeting be adjourned.


Attachments

1. Thrift Savings Fund Statistics
2. July 2008 Performance Review - G, F, C, S, I, and L Funds
