



**Employee Benefits Security Administration**

**Performance Audit of Thrift Savings Plan Investment  
Management Operations**

**September 4, 2020**

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## EXECUTIVE SUMMARY

Members of the Federal Retirement Thrift Investment Board  
Washington, DC

Michael Auerbach  
Chief Accountant  
U.S. Department of Labor, Employee Benefits Security Administration  
Washington, D.C.

As a part of the U.S. Department of Labor (DOL) Employee Benefits Security Administration (EBSA) Fiduciary Oversight Program, we conducted a performance audit of the Thrift Savings Plan (TSP) investment management operations related to the Fixed Income Index Investment Fund (F Fund), Common Stock Index Investment Fund (C Fund), Small Capitalization Stock Index Investment Fund (S Fund), and International Stock Index Investment Fund (I Fund). Our fieldwork was performed remotely from March 16, 2020 through July 10, 2020, in coordination with personnel primarily from BlackRock Institutional Trust Company, N.A. (BTC). Our scope period for testing was January 1, 2019 through December 31, 2019.

We conducted this performance audit in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and the American Institute of Certified Public Accountants' *Standards for Consulting Services*. *Government Auditing Standards* require that we plan and perform the audit to obtain sufficient, appropriate audit evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Criteria used for this engagement are defined in EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, which includes United States Code (USC) Title 5, Chapter 84, and Code of Federal Regulations (CFR) Title 29, Chapter XXV.

The objectives of our audit over the TSP investment management operations were to:

- Determine whether the investment manager implemented certain procedures to: (1) promptly and accurately deposit TSP investments in the authorized investment funds; (2) properly summarize and report TSP investment transactions, including investment management fees relating to TSP investment funds, to the Agency; (3) accurately report the daily yield on each investment fund, less authorized management fees, to the Agency; (4) invest index investment funds in a portfolio that matches the indices selected by the Board; (5) vote proxies of the C, S, and, I Fund investments in accordance with its stated guidelines; and (6) accurately and timely process TSP investment transactions.
- Review policies and procedures to determine how the TSP deals with foreign currency transaction fees (especially as they relate to the I Fund transactions).
- Test the investment manager's compliance with FERSA, applicable Agency regulation, and applicable DOL prohibited transaction exemptions.

We noted no prior recommendations, and the current engagement produced no new recommendations.

Based upon the performance audit procedures conducted and the results obtained, we have met our audit objectives. We conclude that for the period January 1, 2019 through December 31, 2019, BTC implemented certain procedures to (1) promptly and accurately deposit TSP investments in the authorized investment funds; (2) properly summarize and report TSP investment transactions, including investment management fees relating to TSP investment funds, to the Agency; (3) accurately report the daily yield on each investment fund, less authorized management fees, to the Agency; (4) invest index investment funds in a portfolio that matches the indices selected by the Board; (5) vote proxies of the C, S, and, I Fund investments in accordance with its stated guidelines; and (6) accurately and timely process TSP investment transactions. We also reviewed policies and procedures and determined how the TSP deals with foreign currency transaction fees (especially as they relate to the I Fund transactions). As a result of our compliance testing, we did not identify any instances of noncompliance with FERSA, Agency Regulations, or Prohibited Transaction Exemptions.

This performance audit did not constitute an audit of the TSP's or BTC's financial statements in accordance with *Government Auditing Standards*. KPMG was not engaged to and did not render

an opinion on BTC's internal controls over financial reporting or over financial management systems (for purposes of the Office of Management and Budget's Circular No. A-127, *Financial Management Systems*, July 23, 1993, as revised). KPMG cautions that projecting the results of this audit to future periods is subject to the risks that controls may become inadequate because of changes in conditions or because compliance with controls may deteriorate.

While we understand that this report may be used to make the results of our performance audit available to the public in accordance with *Government Auditing Standards*, this report is intended for the information and use of the U.S. Department of Labor Employee Benefit Security Administration, Members of the Federal Retirement Thrift Investment Board, and Agency management. The report is not intended to be, and should not be, used by anyone other than these specified parties.

**KPMG LLP**

September 4, 2020

## **I. BACKGROUND OF THE TSP AND BTC'S INVESTMENT MANAGEMENT OPERATIONS**

### **A. The Thrift Savings Plan**

Public Law 99-335, the Federal Employees' Retirement System Act of 1986 (FERSA), as amended, established the Thrift Savings Plan (TSP). The TSP is the basic component of the Federal Employees' Retirement System (FERS) and provides a Federal (and, in certain cases, state) income tax deferral on employee contributions and related earnings. The TSP is available to Federal and Postal employees, members of Congress and certain Congressional employees, and members of the uniformed services. The TSP began accepting contributions on April 1, 1987, and as of December 31, 2019, had approximately \$632.6 billion in assets and approximately 5.9 million participants<sup>1</sup>.

The FERSA also established the Federal Retirement Thrift Investment Board (Board) and the position of Executive Director. The Executive Director and the members of the Board are TSP fiduciaries. The Executive Director manages the TSP for its participants and beneficiaries. The Board's Staff (Agency) is responsible for administering TSP operations.

The TSP is required to offer five investment options: the Government Securities Investment Fund (G Fund), the Fixed Income Index Investment Fund (F Fund), the Common Stock Index Investment Fund (C Fund), the Small Capitalization Stock Index Investment Fund (S Fund), and the International Stock Index Investment Fund (I Fund). FERSA requires the following<sup>2</sup>:

- G Fund contributions are to be invested in nonmarketable U.S. Treasury securities specially issued to the TSP. These securities earn interest at a rate that is equal, by law, to the average market yield on outstanding marketable U.S. Treasury securities with four or more years to maturity;
- F Fund contributions are to be invested in insurance contracts, certificates of deposit, or other fixed income securities selected by a qualified professional asset manager;

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<sup>1</sup> Source: Minutes of the January 27, 2020, Federal Retirement Thrift Investment Board meeting, posted on FRTIB's website

<sup>2</sup> Sources: G, F, C, S, and I Fund requirements from FERSA, United States Code Chapter 5, Sections 8438(b)(1)(A)-(E), 8438(b)(2)-(4).

- C Fund contributions are to be invested in a portfolio designed to replicate the performance of a commonly recognized index. The index should be a reasonably complete representation of the U.S. equity markets;
- S Fund contributions are to be invested in a portfolio designed to replicate the performance of a commonly recognized index. The index should be a reasonably complete representation of the U.S. equity markets excluding the common stocks included in the C Fund; and
- I Fund contributions are to be invested in a portfolio designed to replicate the performance of a commonly recognized index. The index should be a reasonably complete representation of the international equity markets excluding the U.S. equity markets.

Additionally, the TSP offers the Lifecycle Funds (L Funds), which are portfolio funds comprised of the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to meet investment objectives based on ten different time horizons.<sup>3</sup>

#### **B. TSP Investment Management Operations<sup>4</sup>**

During the scope period, the Agency contracted with BlackRock Institutional Trust Company, N.A. (BTC), a national banking association and subsidiary of BlackRock, Inc., to manage assets for the F Fund, C Fund, S Fund, and I Fund. As investment manager, BTC is responsible for ensuring that:

- Investments and investment management operations comply with FERSA and provisions of the contract between the Agency and BTC;
- Investment management and custodian operations safeguard F, C, S, and I Fund investments;
- F, C, S and I Funds investment transactions are processed accurately and timely;
- Proxies related to the C, S, and I Funds' investments are voted in accordance with BTC's stated guidelines;

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<sup>3</sup> Source: "Lifecycle (L) Funds" page posted on TSP's website

<sup>4</sup> Sources: [REDACTED]

- Cross-trades, securities lending, and transactions involving minority passive shareholders (MPS) are executed in accordance with the terms of the applicable DOL exemptions; and
- The Agency receives timely transaction reports to facilitate reconciliations to the TSP general ledger.

The G Fund investments are managed by the Agency, not BTC, and were not within the scope of this performance audit.

### **1. The F Fund Overview<sup>5</sup>**

F Fund assets are invested in BTC's Thrift Savings Fund (TSF) F Fund Fixed Income Index Account (F Fund Account), a daily-valued, separate account that holds only TSP assets and is designed to track the performance of the Bloomberg Barclays U.S. Aggregate Bond Index. The Bloomberg Barclays U.S. Aggregate Bond Index was designed to provide a representative measure of the U.S. fixed income markets; it is a broad index representing U.S. Government, asset-backed, corporate, and foreign government (issued in the U.S.) sectors of the U.S. bond market.

Because the Bloomberg Barclays U.S. Aggregate Bond Index is comprised of numerous securities, some of which are infrequently traded, it is not practical for the F Fund Account to hold every security. Consequently, BTC uses mathematical models to select a representative sample of the types of U.S. Government, foreign government, corporate, taxable municipal, mortgage-backed, commercial mortgage-backed, and asset-backed securities included in the Bloomberg Barclays U.S. Aggregate Index. As illustrated in *Exhibit I-1*, the portfolio profile of the F Fund Account (in dollar terms) closely represented the Bloomberg Barclays U.S. Aggregate Index as of December 31, 2019.

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<sup>5</sup> Sources: "F Fund" page posted on TSP's website; BlackRock *TSF F Fund Profile* as of December 31, 2019; TSF Fund Series Audited Financial Statements as of December 31, 2019.



*Exhibit I-1*

Sector Breakdown	F Fund Account	Barclays U.S. Aggregate Index
U.S. Government Securities	40.38%	40.80%
Corporate Credit	25.13%	25.08%
Foreign Government Securities	3.84%	3.88%
Taxable Municipal	0.66%	0.67%
Mortgage-Backed Securities and Hybrid Adjustable-Rate Mortgages	26.88%	27.03%
Commercial Mortgage-Backed Securities	2.15%	2.09%
Asset-Backed Securities	0.51%	0.45%
Cash and Other	0.46%	0.00%

Although the investment policy related to the F Fund Account allows the use of futures to improve tracking or provide liquidity, futures were not used in the account during the period January 1, 2019 through December 31, 2019.

## 2. C Fund Overview<sup>6</sup>

C Fund assets are invested in BTC's TSF C Fund Equity Index Account (C Fund Account), a daily-valued, separate account that only holds TSP assets and is designed to track the performance of the S&P 500 Index. The S&P 500 Index was designed to provide a representative measure of U.S. stock market performance. It consists of approximately 500 common stocks, representing more than 150 separate industries, which trade primarily on the New York Stock Exchange.

A portion of the C Fund Account assets is reserved to meet the needs of daily participant activity. This liquidity reserve is invested in S&P 500 Index futures contracts, a type of derivative, to equitize cash balances<sup>7</sup>, reduce tracking error, and provide liquidity. For the C Fund Account,

<sup>6</sup> Sources: "C Fund" page posted on TSP's website; TSF Series Audited Financial Statements as of December 31, 2019.

<sup>7</sup> To purchase an equity, forward, or options synthetic position which is generally collateralized by or maintained against a cash equivalent position.

BTC invests only in S&P 500 Index futures that are freely traded on major futures exchanges in order to minimize the counter-party credit risk with these transactions.

### **3. S Fund Overview<sup>8</sup>**

S Fund assets are invested in BTC's TSF S Fund Small Cap Stock Index Investment Fund Account (S Fund Account), a daily-valued separate account that only holds TSP assets and is designed to track the performance of the Dow Jones U.S. Completion Total Stock Market Index. The Dow Jones U.S. Completion Total Stock Market Index is an index of all actively traded U.S. common stocks that are not included in the S&P 500 Index. As of December 31, 2019, the Dow Jones U.S. Completion Total Stock Market Index was comprised of over 3,200 common stocks included in the U.S. stock market, excluding the 500 issues that are represented in the S&P 500 Index. The S Fund Account holds a majority of stocks in the index; however, it is not practicable to hold all such stocks because some stocks are illiquid and infrequently traded, or priced at less than \$1.00 per share and thus inefficient to invest in. Therefore, the S Fund Account is managed as a model-driven fund with the objective of replicating the returns of the Dow Jones U.S. Completion Total Stock Market Index. The S Fund Account also invests in related index futures to improve tracking and liquidity.

### **4. I Fund Overview<sup>9</sup>**

I Fund assets are invested in BTC's TSF I Fund International Stock Index Investment Fund Account (I Fund Account), a daily-valued separate account that only holds TSP assets and is designed to track the MSCI EAFE (Europe, Australasia, Far East) Index (MSCI EAFE Index). The MSCI EAFE Index is an index of the equity markets of the developed world outside of the United States and Canada. As of December 31, 2019, the MSCI EAFE Index consisted of the stocks of over 900 companies in 21 countries. The I Fund also invests in selected futures that have been approved by U.S. regulators for investment by U.S. persons and that have substantial liquidity to improve tracking (i.e., SPI 200 Index, Euro Stoxx 50 Index, NIKKEI 225 Index, and FTSE 100 Index futures).

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<sup>8</sup> Sources: "S Fund" page posted on TSP's website; Dow Jones publication *Dow Jones U.S. Completion Total Stock Market Index* as of December 31, 2019; TSF Fund Series Audited Financial Statements as of December 31, 2019.

<sup>9</sup> Sources: TSP publication *I Fund Information Sheet* as of December 31, 2019; MSCI publication *MSCI EAFE Indexes (USD)* and [REDACTED]; TSF Fund Series Audited Financial Statements as of December 31, 2019.

The I Fund Account holds securities from all 21 countries included in the EAFE Index. The primary source of earnings for the I Fund is the net changes in the prices of securities in BTC's I Fund Account, although at times, net foreign currency changes relative to the U.S. dollar can be a greater component of earnings than stock price gains or losses. Dividend income and securities lending income are also important sources of earnings. The MSCI EAFE Index is diversified among countries and industries, so that the effect of poor performance in one stock market or group of companies may be reduced.

The I Fund does not incur foreign currency transaction fees; however, the Fund does incur costs related to slippage, as well as other effects of changes in exchange rates. Slippage refers to the difference between a trade's executed price and the actual price at which the trade is executed and occurs when the bid/ask spread changes between the time the order is requested and the time the other market executes the order. These costs are not specific to the I Fund; however, benchmark slippage is the most pronounced in the I Fund because BTC executes trades at 4pm Eastern Time, which may differ greatly from the international closing times and prices.

## 5. BTC Investment Management Process Overview<sup>10</sup>

The Agency submits orders daily by 2:00pm and has the option to submit its orders by call, fax, email, web, or [REDACTED]. All of the Agency's orders in 2019 were submitted electronically, according to both the Agency and BTC. Electronic orders are processed automatically through [REDACTED] via an Electronic Order Interface between TSP and [REDACTED].

Upon receipt of the order, [REDACTED] will check that key attributes are valid, generate an automated electronic confirmation and submit back to the Agency. Since this is an automated process, BTC's [REDACTED] group reviews electronic investment orders only if there are exceptions or rejections of the data submitted for Agency review. Once the order has been properly verified, it is routed through [REDACTED] to the Portfolio Managers to determine equitable trade options and then to traders for execution. The trading file then goes to [REDACTED] for custodial and fund accounting. The following business day, reports are generated denoting the trade.

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<sup>10</sup> Source: [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]

Prior to trading, authorized cross-trades are executed through the [REDACTED], a crossing application that resides on the [REDACTED] platform. The [REDACTED] identifies cross-trading opportunities among eligible funds and accounts. Cross-trades for the C Fund Account, S Fund Account, and I Fund Account occur when another fund or account managed by BTC or one of its affiliates is a buyer or a seller of an equity security or securities for which one of these three TSP Fund Accounts is a seller or a buyer, respectively (See Section D). The [REDACTED] is designed to only authorize cross-trades qualified under class prohibited transaction exemption (PTE) 2002-12 (See Section E). Traders execute remaining trades with external brokers. The [REDACTED] group confirms the trades with executing brokers and uses the [REDACTED] system to transmit the information electronically to [REDACTED] to record the accounting and custodial information.

TSP trades settle one business day after the trade date. The Agency's accounting staff authorizes the wire transfer of the F, C, S, and I Fund net contributions to BTC on the settlement date for purchases. (In the case of a redemption, the money is wire transferred from BTC to the TSP's account with the U.S. Department of the Treasury). The BTC [REDACTED] sends the Agency transaction reports confirming the trades. These reports include the Agency's trading costs, if any (See Section D).

The BTC [REDACTED] also sends monthly transaction reports for the TSP investments in the various TSP Fund Accounts to the Agency's Office of Investments. These reports list the details of all TSP transactions during the month as well as the market and book values of the funds at the end of the month.

## **6. Management Fees<sup>12</sup>**

On a monthly basis, the BTC Financial Reporting Group reports its management fees to the Agency. Management fees are based on rates established in the investment management contracts between the Agency and BTC.

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<sup>12</sup> Sources: [REDACTED]



*Exhibit I-2*

<b>TSF Account</b>	<b>As of December 31, 2019</b>	<b>As of December 31, 2018</b>
F Fund Account	1.99%	25.70%
C Fund Account	3.32%	5.22%
S Fund Account	2.89%	20.68%
I Fund Account	0.58%	1.95%

The TSP Funds experienced a significant change in the loans outstanding as a percentage of holdings as of December 31, 2019 compared to December 31, 2018, as seen in Exhibit I-2. While U.S. equity securities remained in demand from borrowers, there was a compression in the lending spreads borrowers were paying for shorts in 2019. This was primarily driven by a bullish market sentiment and strong equity market returns in 2019. The Funds also experienced a less attractive cash reinvestment environment driven by a shift in Fed policy; the combination of these factors led to a reduction of on-loan balances relative to prior years.

Lending opportunities are allocated to a particular BTC managed fund or account via an algorithm in BTC's ██████████ system that seeks to allocate loan opportunities among funds and accounts in a manner that, over time, seeks to approximate the outcome of a pro-rata allocation. The algorithm takes into account factors such as whether a lending fund or account has been passed over for previous loan opportunities; availability of the security sought by the borrower; applicable legal, tax and credit restrictions for each lending fund or account; any restrictions imposed by the borrower; and constraints imposed by the lending fund's or account's custodian or relevant sub-custodian(s) or the relevant securities market.

BTC bears all operational costs directly related to securities lending. The chart below (Exhibit I-3) presents the effect (i.e., percent increase) of securities lending, and the income generated therefrom, on fund returns for the TSF Fund Accounts for the 12-month period ended December 31, 2019, and the proportion of securities lending income to net investment income for the fiscal years ended December 31, 2019 and 2018, respectively.<sup>15</sup>

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<sup>15</sup> Sources: TSF Fund Series audited financial statements as of December 31, 2019 and December 31, 2018

*Exhibit I-3*

TSF Account	Securities Lending Income as of December 31, 2019	Securities Lending Income to Net Investment Income	
		2019	2018
F Fund Account	\$58.8 million	6.81%	26.21%
C Fund Account	\$108.4 million	2.62%	4.35%
S Fund Account	\$267.9 million	25.30%	27.72%
I Fund Account	\$28.5 million	1.66%	2.43%

The factors that impacted loan balances as of December 31, 2019, also caused the decrease in the F Fund’s 2019 securities lending income as a percentage of net investment income as compared to 2018, as seen in Exhibit I-3. The other Funds, such as the S Fund, were able to generate a large amount of lending income from a few loans, even though there were a smaller amount of loans.

#### **D. Trading Costs<sup>16</sup>**

Trading costs associated with client transactions in the C Fund Account, S Fund Account, and I Fund Account generally consist of negotiated commissions on common stock purchases and sales or the buying and selling of futures contracts. Trading costs in the F Fund Account consist of the spreads between a dealer’s bid price and ask price on debt securities purchased and sold. Trading costs associated with client transactions are borne by the TSP as the sole participant in the respective accounts. Trading costs do not contribute significantly to the tracking error of the TSP’s accounts.

To minimize trading costs, BTC cross-trades, in the case of equities only, among eligible BTC managed funds and accounts before trading in the external market. Transaction costs are also decreased to the extent that cash from client contributions are available for cash redemptions on a fund opening day (i.e., a “unit exchange”).

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<sup>16</sup> Source: [REDACTED]

## 1. Cross-Trades<sup>17</sup>

A cross-trade is the purchase or sale of securities between two accounts or funds managed by, but not necessarily under the custody of, BTC or one of its affiliates. BTC uses cross-trades among eligible funds and accounts, where appropriate, to reduce transaction costs and facilitate achieving client or fund investment objectives. BTC is obligated by its fiduciary responsibilities to ensure that no cross-trading activity has created an advantage to any client or fund relative to any other client or fund. By internally matching BTC's sell orders for a particular day with its buy orders for the same day, both funds and/or accounts save by avoiding transaction costs.

For BTC, as a manager of index and model-driven funds and accounts, cross-trading is a method of executing a securities transaction that the portfolio manager has already included on a trade list and that would occur even if cross-trades were not permitted. After a separate decision has been made that the fund or account will buy or sell the security, BTC will trade that security through a cross-trade if crossing opportunities are available. Therefore, cross-trading is a cost-efficient mechanism for implementing prior decisions to buy or sell.

DOL's position is that, without an applicable exemption, cross-trading transactions result in violations of one or more provisions of Part 4 of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). FERSA contains similar restrictions in section 8477(c)(2)(B). The basis for this position is that by representing the buyer on one side and the seller on the other in a cross-trade, a fiduciary acts on behalf of parties that have adverse interests to each other.<sup>18</sup> DOL has issued PTE 2002-12 allowing certain passive investment managers of plans to cross-trade securities. BTC may use PTE 2002-12 for cross-trades of equity securities, and used it for the TSP C, S, and I Fund Accounts during the scope period. While PTE 2002-12 allows for the cross-trading of fixed income securities, BTC did not engage in cross-trades of fixed income securities in the F Fund Account during our scope period.

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<sup>17</sup> Sources: ██████████ BlackRock publication *Managing ERISA Assets*; PTE 2002-12.

<sup>18</sup> Federal Register, Volume 63, Number 64, *Notices – Department of Labor – Pension and Welfare Benefits Administration, Cross-Trades of Securities by Investment Managers*, 63 FR 13696.



**E. Exemptions<sup>19</sup>**

DOL grants certain class and individual exemptions for transactions prohibited by ERISA and FERSA. BTC currently utilizes the following exemptions from DOL related to the TSP investment activities:

- PTE 2002-12 permitted the cross-trading of index and model-driven accounts and funds and certain client restructure accounts.
- PTE 2006-16 permitted entities to lend securities to various banks and broker-dealers under certain conditions. These banks and broker-dealers are typically “parties in interest” under the Employee Retirement Income Security Act of 1974 (ERISA). This exemption also permitted the entity to receive compensation with respect to securities lending services.
- IPTE 2013-05 permitted BTC, as an affiliate of an equity owner of [REDACTED], to use the EquiLend platform to sell or license products/services of [REDACTED] to plans, and includes a provision for the use of off-platform security lending data. The [REDACTED] platform is a common electronic platform provided by [REDACTED] for negotiating securities lending transactions, identifying borrowing opportunities with pre-approved borrowers, negotiating specific loans, maintaining appropriate records, marking to market all outstanding loans, ensuring collateral maintenance, and monitoring delivery and control of collateral.
- IPTE 2012-09 permitted BTC to enter into certain transactions with, or involving, BlackRock stock or its minority passive shareholder (MPS)<sup>20</sup>.

**F. Tracking Error<sup>21</sup>**

As previously described, the F Fund Account, C Fund Account, S Fund Account, and I Fund Account were designed to replicate the performance of the Bloomberg Barclays U.S. Aggregate

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<sup>19</sup> Sources: DOL’s Office of Exemptions; BlackRock publication *Managing ERISA Assets*; IPTE 2013-05, 2012-09 and PTE 2002-12 and 2006-16.

<sup>20</sup> [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Bond Index, S&P 500 Index, Dow Jones U.S. Completion Total Stock Market Index, and the MSCI EAFE Index, respectively. The difference between the performance of each of the TSP’s Fund Accounts and the performance of the index it is designed to replicate is known as “tracking error.” BTC’s established procedures over tracking error enable it to monitor the TSP portfolios against the investment indices selected by the Board. On a monthly basis, BTC reports monthly tracking error, as well as cumulative tracking error over periods of three, six and twelve months, to the Agency for each TSP Account. Exhibit I-4 presents the TSP Fund Account performance compared to the benchmark index performance and calculated the tracking error for the 12 months ended December 31, 2019.

*Exhibit I-4*

<b>TSP Account</b>	<b>TSP Fund Account Performance<sup>22</sup></b>	<b>Benchmark Index Fund</b>	<b>Tracking Error</b>
F Fund Account	8.72%	8.72%	0.00%
C Fund Account	31.50%	31.49%	0.01%
S Fund Account	28.01%	27.94%	0.07%
I Fund Account	22.49%	22.01%	0.48%

**G. Proxy Voting<sup>23</sup>**

In accordance with FERSA Section 8438 (g), “The Board, other Government agencies, the Executive Director, an employee, a Member, a former employee and a former Member may not exercise voting rights associated with the ownership of securities by the Thrift Savings Fund.”

The contracts between the Agency and BTC delegate the authority to vote the Thrift Savings Fund’s proxies to BTC. BTC is required to vote the C Fund Account, S Fund Account, and I Fund Account proxies in the best interests of the TSP participants and beneficiaries.

<sup>22</sup> This column reflects the performance of the “TSP Fund Accounts” residing at BTC, and is reported to the Agency prior to any deductions of TSP administrative costs and certain transaction costs. The Agency separately reports performance for the individual TSP Funds net of the aforementioned costs.

<sup>23</sup> Sources: 5 USC 8438(g); [REDACTED] TSP monthly Board minutes throughout the period January 2019 through January 2020 available on FRTIB’s website; [REDACTED]

Although the Board does not vote proxies directly, its fiduciary responsibilities include monitoring BTC's voting of the C Fund Account, S Fund Account, and I Fund Account proxies. BTC's fundamental policy is to vote in the best economic interest of its clients. BlackRock publishes global proxy voting guidelines; The Agency has reviewed such guidelines for adherence to appropriate fiduciary standards. To facilitate the Agency's monitoring of BTC's proxy voting, BTC provides the Agency with (1) its written proxy voting guidelines when they are revised or updated, and (2) monthly reports of how it has voted each proxy issue for the applicable TSP Fund Account. The Agency reviews the proxy voting policy and the quarterly independent reports by Institutional Shareholder Services (ISS), a proxy voting analysis firm, to ensure that BTC has voted the proxies according to BTC's written guidelines, and reports results quarterly at a regularly scheduled meeting for Board members.

BTC uses the proxy voting clearinghouse services of ██████████ to collect various domestic company proxy voting materials. To facilitate the proxy voting process, BTC downloads its securities holdings to ██████████ daily to create ballots for U.S. entities. ██████████ creates the proxy ballots that BTC votes via ██████████'s online system, ██████████e. For non-U.S. securities (e.g., I Fund Account), BTC relies upon interfaces between ██████████ and ISS to create ballots. BTC reconciles position holdings against the ballots received on behalf of BTC to ensure all of the account/funds' shares are voted. Shareholder meetings are then sorted and assigned to the relevant proxy analyst for review. The proxy analyst votes all matters with consideration for the economic benefit to account/fund participants.

## **H. Audits and Regulatory Reviews**

BlackRock, its subsidiaries, and joint venture operations are subject to examinations and audits by government regulatory agencies and independent public accountants. From January 1, 2019 through December 31, 2019, examinations and audits related to BTC included the following.

- PricewaterhouseCoopers LLP – Financial Statement and Internal Control Audits of BlackRock's TSF Fund Series and Collective Trust Funds for the Years Ended December 31, 2019 and 2018;
- Deloitte & Touche LLP – Financial Statement Audit of BlackRock Institutional Trust Company, N.A. for the Years Ended December 31, 2019 and 2018;

- Deloitte & Touche LLP – Report on Controls at BlackRock Placed in Operation and Tests of Operating Effectiveness for Asset Management Services for the period October 1, 2018 – September 30, 2019;
- Deloitte & Touche LLP – Financial Statement Audit of BlackRock, Inc. for the Years Ended December 31, 2019 and 2018;
- The Office of the Comptroller of the Currency, examination cycle ending December 31, 2019

We reviewed the reports related to the examinations and audits listed above. No matters were noted during our review of these reports that would impact our conclusions on the performance audit objectives listed in Section I.A of this report.

### I. TSP Investment Statistics<sup>24</sup>

As of December 31, 2019 and 2018, the largest portion of TSP investments was held in the G Fund. The chart below (Exhibit I-5) presents a summary of TSP investments held by the G, F, C, S, and I Funds as of December 31, 2019 and 2018. The data in this table is unaudited.

*Exhibit I-5*

TSP Fund	Fund Balances December 31, 2019 (in millions)	% of Total December 31, 2019	Fund Balances December 31, 2018 (in millions)	% of Total December 31, 2018
G	\$250,764	39.20%	\$253,357	45.33%
F	33,542	5.25%	27,635	4.94%
C	226,873	35.47%	177,548	31.77%
S	74,147	11.59%	59,698	10.68%
I	54,305	8.49%	40,693	7.28%
<b>Total</b>	<b>\$639,631</b>	<b>100.00%</b>	<b>\$558,931</b>	<b>100.00%</b>

The table below (Exhibit I-6) compares the TSP Fund returns for the G, F, C, S, and I Funds for the 12-month periods ending December 31, 2019, 2018 and 2017.

<sup>24</sup> Sources for the statistics on the following pages: FRTIB Meeting Minutes and Audited Thrift Savings Fund Financial Statements, December 31, 2019 and 2018; Sources available at [www.FRTIB.gov](http://www.FRTIB.gov).

<b>Rates of Return on TSP Investment Funds</b> <b>(unaudited)</b>			
<b>TSP Fund</b>	<b>12 Months Ended December 31, 2019</b>	<b>12 Months Ended December 31, 2018</b>	<b>12 Months Ended December 31, 2017</b>
G Fund	2.24%	2.91%	2.33%
F Fund	8.68%	0.15%	3.82%
C Fund	31.45%	(4.41%)	21.82%
S Fund	27.97%	(9.26%)	18.22%
I Fund	22.47%	(13.43%)	25.42%

## **II. OBJECTIVE, SCOPE AND METHODOLOGY**

### **A. Objective**

The U.S. Department of Labor (DOL), Employee Benefits Security Administration (EBSA) engaged KPMG LLP (KPMG) to conduct a performance audit of the Thrift Savings Plan (TSP) investment management operations related to the Fixed Income Index Investment Fund (F Fund), Common Stock Index Investment Fund (C Fund), Small Capitalization Stock Index Investment Fund (S Fund), and International Stock Index Investment Fund (I Fund).

The objectives of our performance audit were to:

- Determine whether the investment manager implemented certain procedures to: (1) promptly and accurately deposit TSP investments in the authorized investment funds; (2) properly summarize and report TSP investment transactions, including investment management fees relating to TSP investment funds, to the Agency; (3) accurately report the daily yield on each investment fund, less authorized management fees, to the Agency; (4) invest index investment funds in a portfolio that matches the indices selected by the Board; (5) vote proxies of the C, S, and, I Fund investments in accordance with its stated guidelines; and (6) accurately and timely process TSP investment transactions.
- Review policies and procedures to determine how the TSP deals with foreign currency transaction fees (especially as they relate to the I Fund transactions).
- Test the investment manager's compliance with FERSA, applicable Agency regulation, and applicable DOL prohibited transaction exemptions.

### **B. Scope and Methodology**

We conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and the American Institute of Certified Public Accountants' *Standards for Consulting Services*, using EBSA's *Thrift Savings Plan Fiduciary Oversight Program*. Our scope period for testing was January 1, 2019 through December 31, 2019. We performed the audit in four phases: (1) planning, (2) arranging for the engagement with BTC and the Agency, (3) testing and interviewing, and (4) report writing.

The planning phase was designed to assist team members to develop a collective understanding of the activities and controls associated with the applications, processes and personnel involved with BTC investment management operations. Arranging the engagement included contacting the Agency and BTC and agreeing on the timing of detailed testing procedures.

During the testing and interviewing phase, we conducted interviews, collected and inspected auditee-provided documentation and evidence, participated in process walkthroughs, and designed and performed tests of controls and compliance. We conducted these audit procedures remotely in coordination with personnel primarily from BlackRock's San Francisco, CA (BTC's headquarters), New York, NY, and Wilmington, DE offices. In Appendix B, we identify the key documentation provided by BTC and Agency personnel that we reviewed during our performance audit.

Our performance audit procedures included using [REDACTED] sampling to select specific samples related to TSP investment transactions, which we used to determine if BTC timely and accurately processed, deposited, and managed TSP investments, summarized and reported TSP investment transactions to the Board, and voted proxies of the C, S, and I fund investments in a manner that complied with FERSA, Federal Regulations, and Prohibited Transaction Exemptions. We selected the following samples in this manner:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]  
[REDACTED]
- [REDACTED]  
[REDACTED]
- [REDACTED]
- [REDACTED]

- [REDACTED]

The report writing phase entailed drafting a preliminary report, conducting an exit conference, providing a formal draft report to the Agency and BTC for comment, and preparing and issuing the final report.



### **III. FINDINGS AND RECOMMENDATIONS**

#### **A. Introduction**

We performed procedures related to the Thrift Savings Plan (TSP) investment management operations for the Fixed Income Index Investment Fund (F Fund), Common Stock Index Investment Fund (C Fund), Small Capitalization Stock Index Investment Fund (S Fund), and International Stock Index Investment Fund (I Fund) while remotely conducting a performance audit related to activities at BlackRock Institutional Trust Company, N.A. (BTC) in San Francisco. Our scope period for testing was January 1, 2019 through December 31, 2019. This performance audit consisted of reviewing applicable policies and procedures and testing manual and automated processes and controls, which included interviewing key personnel, reviewing key reports and documentation (Appendix B), and observing selected procedures.

Based upon the performance audit procedures conducted and the results obtained, we have met our audit objectives. We conclude that for the period January 1, 2019 through December 31, 2019, BTC implemented certain procedures to (1) promptly and accurately deposit TSP investments in the authorized investment funds; (2) properly summarize and report TSP investment transactions, including investment management fees relating to TSP investment funds, to the Agency; (3) accurately report the daily yield on each investment fund, less authorized management fees, to the Agency; (4) invest index investment funds in a portfolio that matches the indices selected by the Board; (5) vote proxies of the C, S, and, I Fund investments in accordance with its stated guidelines; and (6) accurately and timely process TSP investment transactions. We also reviewed policies and procedures and determined how the TSP deals with foreign currency transaction fees (especially as they relate to the I Fund transactions).

As a result of our compliance testing, we did not identify any instances of noncompliance with FERSA, applicable Agency regulation, and applicable DOL prohibited transaction exemptions.

We noted no prior recommendations, and the current engagement produced no new recommendations.

AGENCY'S RESPONSE



FEDERAL RETIREMENT THRIFT INVESTMENT BOARD  
77K Street, NE Washington, DC 20002

September 4, 2020

Mr. Michael Auerbach  
Chief Accountant  
Employee Benefits  
Security Administration  
United States Department of Labor  
Suite 400  
122 C Street, N.W.  
Washington, D.C. 20001-2109

Dear Michael:

This is in response to KPMG's email of July 31, 2020, transmitting the KPMG LLP report entitled Employee Benefits Security Administration Performance Audit of Investment Management Operations, dated August 2020.

We are pleased to note during the FY 2020 audit that the auditors did not identify any instances where TSP investment management operations did not comply with FERSA and with applicable Board regulations and bulletins for the period of January 1, 2019 through December 31, 2019. We are very pleased to note there are no audit recommendations.

Thank you once again for the constructive approach that the Department of Labor and its contractors are taking in conducting the various audits of the TSP. The information and recommendations that are developed as a result of your reviews are useful to the continued improvement of the Thrift Savings Plan.

Very truly yours,

RAVINDRA  
DEO

Ravindra Deo

Digitally signed by RAVINDRA DEO  
DN: cn=US, o=U.S. Government, ou=Federal  
Retirement Thrift Investment Board,  
cn=RAVINDRA DEO,  
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2  
Date: 2020.09.04 09:05:42 -04'00'

Enclosure

KEY DOCUMENTATION AND REPORTS REVIEWED

Audit, Compliance, and Other Reports

- BlackRock Institutional Trust Company, N.A. (BTC) Consolidated Financial Statements for the year ended December 31, 2019
- BTC, TSF Series, Audited Financial Statements, December 31, 2019 and 2018
- BTC, Cash Equivalent Fund A3 Financial Statements, December 31, 2019
- BTC, Short-Term Investment Fund Financial Statements, December 31, 2019
- Thrift Savings Fund Financial Statements, December 31, 2019 and 2018
- [REDACTED]
- [REDACTED]
  - [REDACTED]
  - [REDACTED]
  - [REDACTED]
- [REDACTED]
  - [REDACTED]
  - [REDACTED]
  - [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- OCC Examination Reports for the three examination cycles covering January 1, 2017 through December 31, 2019
- [REDACTED]
- [REDACTED]
- [REDACTED]
  - [REDACTED]
  - [REDACTED]
  - [REDACTED]
  - [REDACTED]
  - [REDACTED]
  - [REDACTED]



**KEY DOCUMENTATION AND REPORTS REVIEWED, CONTINUED**

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

**[REDACTED] and Other External Fund Information Documents**

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

- Composition of the MSCI EAFE Index as of December 31, 2019
- Composition of the S&P 500 Index as of December 31, 2019
- Composition of the Dow Jones U.S. Completion Total Stock Market Index as of December 31, 2019
- Composition of the Bloomberg Barclays U.S. Aggregate Bond Index as of December 31, 2019

**KEY DOCUMENTATION AND REPORTS REVIEWED, CONTINUED**

- “F Fund” page posted on TSP’s website
- “C Fund” page posted on TSP’s website
- “S Fund” page posted on TSP’s website
- “I Fund” page posted on TSP’s website

■ [REDACTED]