



Employee Benefits Security Administration

Performance Audit of the Thrift Savings Plan Lifecycle Funds Process

June 22, 2021

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EXECUTIVE SUMMARY

Members of the Federal Retirement Thrift Investment Board
Washington, D.C.

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

As part of the U.S. Department of Labor Employee Benefits Security Administration (EBSA) Fiduciary Oversight Program, we conducted a performance audit of the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) process. Our audit was performed remotely from January 19, 2021 through April 17, 2021, in coordination with personnel primarily from the Federal Retirement Thrift Investment Board's Staff's (Agency) headquarters in Washington, D.C. Our scope period for testing was January 1, 2020 through December 31, 2020.

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 objectives. Criteria used for this audit is defined in the EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, which includes United States Code (USC) Title 5, Chapter 84, and the Code of Federal Regulation (CFR) Title 5, Chapter VI.

The objectives of our audit over the TSP L Funds process were to:

- Determine if the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance

with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation;

- Determine if the current assumptions used to develop the L Funds' allocations are consistent with industry benchmarks¹;
- Determine whether the Agency implemented certain procedures to affect the adoption of the new 'five-year' L Fund intervals;
- Test compliance of the TSP L Funds process with applicable provisions of 5 USC 8438 (hereinafter referred to as FERSA), and 5 CFR 1601.40 (hereinafter referred to as Agency regulations); and
- Determine the status of the prior EBSA TSP open recommendation reported in *Performance Audit of the Thrift Savings Plan Lifecycle Funds Process*, dated June 14, 2019.

The current engagement produced no new recommendations.

Based upon the performance audit procedures conducted and results obtained, we have met our audit objectives. We conclude that for the period January 1, 2020 through December 31, 2020, the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation. In addition, as a result of our audit procedures, we determined that the assumptions used to develop the L Funds' allocations, as identified in the vendor's annual review as of March 2020, were consistent with industry benchmarks¹, and that the

¹ Assumptions were compared to industrial standard sources [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] All sources are standard resources frequently used in business and asset valuation analysis.

Agency implemented certain procedures to affect the adoption of the new ‘five-year’ L Fund intervals. As result of our compliance testing, we did not identify any instances of noncompliance with FERSA or Agency regulations.

We also reviewed one prior EBSA recommendation related to the TSP L Funds process to determine its current status. Section III.B documents the status of this prior recommendation. In summary, the recommendation has been implemented and closed.

This performance audit did not constitute an audit of the TSP’s financial statements in accordance with *Government Auditing Standards*. KPMG was not engaged to, and did not, render an opinion on the Agency’s internal controls over financial reporting or over financial management systems. 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

June 22, 2021

I. BACKGROUND OF THE TSP AND LIFECYCLE FUNDS PROCESS

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 the uniformed services, and members of Congress and certain Congressional employees. The TSP began accepting contributions on April 1, 1987, and as of December 31, 2020, had approximately \$710 billion in assets and approximately 6.2 million participants².

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

For civilian participants enrolled in the TSP on or after September 5, 2015, all contributions received by the TSP are deposited into an age-appropriate Lifecycle Fund (L Fund), unless another investment option is selected.

B. Overview of the Lifecycle Funds³

Prior to 2005, participants could only elect to distribute their balances among the five primary TSP investment funds. These funds include the Government Securities Investment Fund (G Fund), Fixed Income Index Investment Fund (F Fund), Common Stock Index Investment Fund (C Fund), Small Capitalization Stock Index Fund (S Fund), and International Stock Index Investment Fund (I Fund). In August 2005, the Agency implemented the L Funds, which provided TSP participants an additional investment option. The L Funds diversify participant accounts among the G, F, C, S, and I Funds, using professionally determined investment mixes (allocations) that are tailored to different time horizons. In July 2020, the Agency implemented five new L Funds to shorten each time horizon from ten to five-year intervals – L 2025, L 2035, L 2045, L 2055, and L 2065. Presently, there are ten different L Funds, as follows:

² Source: Minutes of the January 26, 2021, Federal Retirement Thrift Investment Board meeting, posted on www.frtib.gov.

³ Sources: Summary of the Thrift Savings Plan, Investing in the TSP, dated March 2019, and [REDACTED]

- L 2065 – For participants who will begin to withdraw their money in 2063 or later.
- L 2060 – For participants who will withdraw their money beginning 2058 through 2062.
- L 2055 – For participants who will withdraw their money beginning 2053 through 2057.
- L 2050 – For participants who will withdraw their money beginning 2048 through 2052.
- L 2045 – For participants who will withdraw their money beginning 2043 through 2047.
- L 2040 – For participants who will withdraw their money beginning 2038 through 2042.
- L 2035 – For participants who will withdraw their money beginning 2033 through 2037.
- L 2030 – For participants who will withdraw their money beginning 2028 through 2032.
- L 2025 – For participants who will withdraw their money beginning 2022 through 2027.
- L Income – For participants who are currently withdrawing their account in monthly payments.

The objective of the L Funds is to achieve the highest rate of return relative to the level of risk taken. No restrictions on investing in the L Funds are in place, as participants may invest any part of their TSP account in any L Fund, and even invest in more than one L Fund. Participants who select L Funds do not need to reallocate their account assets in order to maintain a target allocation that is designed to be consistent with an expected time horizon (retirement); the lifecycle investment model automatically rebalances and reallocates participants' exposure to the underlying funds.

The asset allocations of these funds are automatically adjusted on a quarterly basis, moving to a more conservative mix, gradually approaching those of the L Income Fund. These quarterly adjustments are pre-determined based on the fund design and are reviewed for reasonableness at least annually by both the Office of Investments and external consultants to determine if any changes are necessary. Between quarterly adjustments, the asset allocations of each fund are maintained through daily rebalancing to the fund's target allocation.

The L Income Fund's asset allocation represents the ending point for all of the other funds as they gradually move toward a less risky mix of investments. When a target date L Fund reaches its horizon, it will roll into the L Income Fund, and a new L fund will be added with a more distant horizon. For example, the L 2020 Fund was rolled into the L Income Fund in July 2020, and the L 2060 Fund was created in July 2020. The L Income Fund is designed to produce current income for participants who are already receiving money from their accounts through monthly payments or who will begin withdrawing money in the near-term. Typically, the asset allocation of the L Income Fund does not change over time; it is maintained through daily rebalancing. Based on the annual review conducted in 2018, the L Income Fund is gradually increasing its allocation to equities from 20% to 30%. Once it reaches its new target in 2028, the asset allocation will again be constant over time.

The Agency contracted with ██████████ to design the original quarterly asset allocations for the L Funds based on assumptions regarding future investment returns, inflation, economic growth, and interest rates. ██████████ and other investment consultants performed annual reviews of the L Funds' assumptions to determine whether any changes to the asset allocations currently in place for the L Funds were warranted. During the scope period, the Agency contracted with ██████████ to perform the annual review of the L Funds' assumptions, as well as to determine the allocations for the five new L Funds implemented in July 2020. To review the appropriateness of the current quarterly asset allocations, ██████████ performed two separate analyses: an efficient frontier analysis and a glide path⁴ analysis.

██████████ developed an efficient frontier based on the assumptions discussed above. The efficient frontier is the set of points that represent the highest expected return for an expected level of risk for all portfolios/asset allocations in the opportunity set. Asset allocations below the efficient frontier are less than optimal because an alternative asset allocation exists with a higher expected return for the same level of risk, or the same expected return for lower risk.

██████████ also constructed alternative glide paths, which are schedules of asset allocations over time for each target date fund, to approximate these risk-optimizing portfolios and selected starting points along the glide path for the L Funds. ██████████ then performed a simulation on the glide paths using a proprietary model. Based on certain criteria such as changes in broad equity allocation, different mixes of equity structure, and different mixes of fixed income, ██████████ recommended a set of quarterly asset allocations for the L Funds for the Agency's consideration.

As part of the annual assumptions review of the L Funds conducted by ██████████ in March 2020, ██████████ analyzed the impacts of potential changes to the existing asset allocations. After considering this analysis, the Agency implemented a new set of asset allocations in July 2020.

The administrative expenses associated with the L Funds are those of the underlying G, F, C, S, and I Funds, which are calculated by the Office of the Chief Financial Officer in proportion to their allocations in each L Fund. The L Funds do not have any additional charges. While ██████████ charges a fee for its annual assumption review, the fees are not significant relative to total administrative expenses and are shared proportionately among all of the TSP funds.

⁴ Glide path refers to a formula that defines the asset allocation mix of a target date fund, based on the number of years to the target date. The glide path creates an asset allocation that becomes more conservative as the fund approaches the target date.

Exhibit I-1 presents a summary of the L Fund investments held in L Income, L 2025, L 2030, L 2035, L 2040, L 2045, L 2050, L 2055, L 2060, and L 2065 Funds as of December 31, 2020.

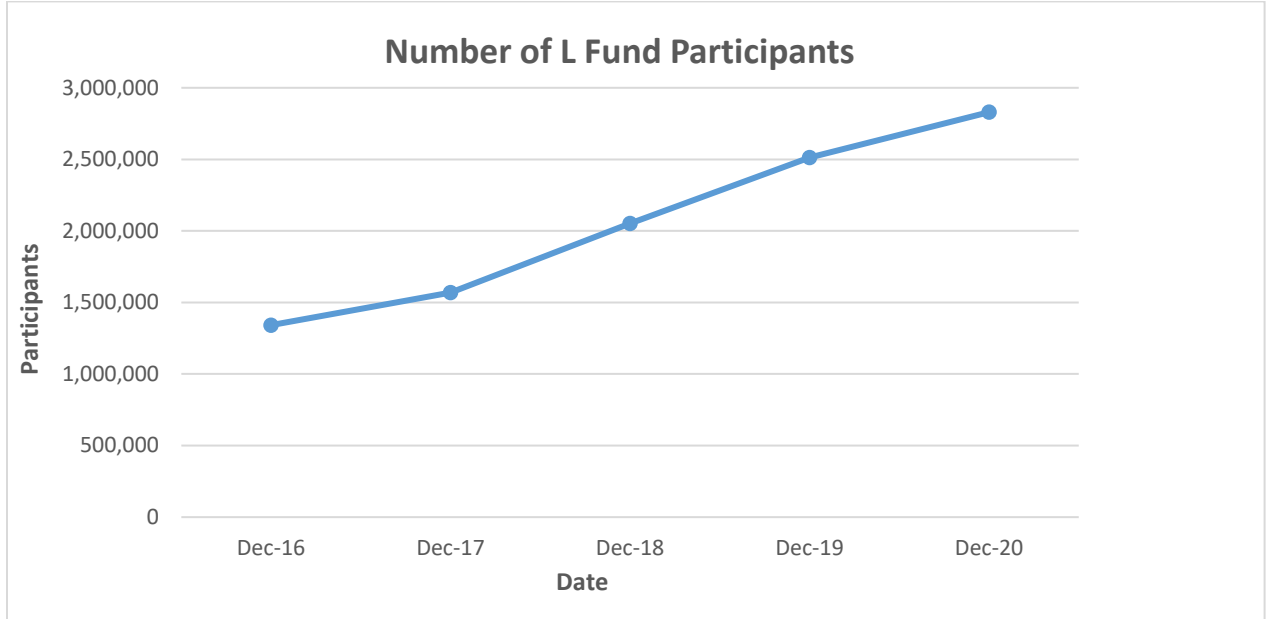
Exhibit I-1 (unaudited)

L Fund	L Fund Balances December 31, 2020	% of Total L Fund Balances	% of Total TSP Fund Balances
L Income	\$30.096 billion	20%	4%
L 2025	\$6.360 billion	4%	1%
L 2030	\$47.357 billion	31%	7%
L 2035	\$2.130 billion	1%	0%
L 2040	\$39.124 billion	26%	5%
L 2045	\$1.106 billion	1%	0%
L 2050	\$25.049 billion	16%	3%
L 2055	\$0.685 billion	0%	0%
L 2060	\$0.423 billion	0%	0%
L 2065	\$1.039 billion	1%	0%
Total	\$153.369 billion	100%	21%

Source: Thrift Savings Fund Financial Statements for the years ended December 31, 2020 and December 31, 2019.

Exhibit I-2 presents the number of L Fund participants from December 2016 through December 2020.

Exhibit I-2 (unaudited)



Source: Underlying data used from the minutes of the January 26, 2021 Federal Retirement Thrift Investment Board meeting, December 2020 Performance Review – G, F, C, S, I and L Funds, posted on www.frtib.gov.

II. OBJECTIVE, SCOPE AND METHODOLOGY

A. Objectives

The U.S. Department of Labor Employee Benefits Security Administration (EBSA) engaged KPMG LLP (KPMG) to conduct a performance audit of the Thrift Savings Plan (TSP) Lifecycle Funds (L Funds) process.

The objectives of this performance audit over the TSP L Funds process were to:

- Determine if the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation;
- Determine if the current assumptions used to develop the L Funds' allocations are consistent with industry benchmarks¹;
- Determine whether the Agency implemented certain procedures to affect the adoption of the new 'five-year' L Fund intervals;
- Test compliance of the TSP L Funds process with United States Code (USC) Chapter 5, Section 8438 and Code of Federal Regulations (CFR) Title 5, Part 1601.40; and
- Determine the status of the prior EBSA TSP open recommendation reported in *Performance Audit of the Thrift Savings Plan Lifecycle Funds Process*, dated June 14, 2019.

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, 2020 through December 31, 2020. We performed the audit in four phases: (1) planning, (2) arranging for the engagement with the Agency, (3) testing and interviewing, and (4) report writing.

During the planning phase, team members developed a collective understanding of the activities and controls associated with the applications, processes, and personnel involved with the TSP L Funds process. Arranging the engagement included contacting the Agency 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, and participated in process walkthroughs. Procedures performed included the following:

- Tested a non-statistical sample of business days to determine if the L Funds were rebalanced accurately on a daily basis, reflected quarterly target allocations, and complied with 5 USC 8438 and 5 CFR 1601.40;
- Inspected the 2020 assumptions review documentation to determine if the assumptions review was conducted at least annually and in accordance with the terms of the contract between the Agency and the vendor;
- Inspected the December 31, 2019 L Fund information sheets, published in 2020, and related supporting documentation and performed certain recalculations to determine if the published ratios of administrative expenses per \$1,000 of account balance in the L Funds were accurately calculated;
- Inspected the quarterly Lifecycle Funds asset allocations published on the TSP website during the scope period to determine if the published asset allocations for each L Fund agreed to the actual asset allocation;
- Inspected documentation evidencing review and approval of the asset allocation changes made within the [REDACTED] system during the scope period;
- Inspected the service tickets for changes made to the [REDACTED] system related to the implementation of the five-year interval L Funds to determine that the changes were tested, reviewed and approved by the appropriate individuals in accordance with the Agency's established program change procedures; and

- Compared current assumptions used to develop the L Funds' allocations to industry standard sources, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED], to determine consistency with industry benchmarks.

We conducted these test procedures remotely in coordination with personnel primarily from the Agency's headquarters in Washington, DC. Appendix B lists the key Agency documentation and reports we reviewed during our performance audit. Because we used non-statistically determined sample sizes in these instances, our results are applicable to the sample items we tested and were not extrapolated to the population.

Criteria used for this engagement is defined in the EBSA's *Thrift Savings Plan Fiduciary Oversight Program*, which includes USC Title 5, Chapter 84, and CFR Title 5, Chapter VI.

The report writing phase entailed drafting a preliminary report, conducting an exit conference, providing a formal draft report to the Agency 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) Lifecycle Funds (L Funds) process while remotely conducting a performance audit related to activities at the Agency headquarters. Our scope period for testing was January 1, 2020 through December 31, 2020. 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, 2020 through December 31, 2020, the Agency implemented certain procedures to (1) rebalance the L Funds on a daily basis to reflect the fund's target allocation for the current quarter; (2) adjust the asset allocations of the L Funds each quarter based on each fund's prescribed time horizon; (3) review the assumptions of the L Funds at least annually to determine whether any changes to the allocations are warranted; (4) conduct the most current assumptions review in accordance with the terms of the contract between the Agency and the vendor; (5) accurately calculate the published ratio of administrative expenses per \$1,000 of account balance in the L Funds; and (6) verify that the published asset allocations for each L Fund agree to the actual asset allocation. In addition, as a result of our audit procedures, we determined that the assumptions used to develop the L Funds' allocations, as identified in the vendor's annual review as of March 2020, were consistent with industry benchmarks¹, and that the Agency implemented certain procedures to affect the adoption of the new 'five-year' L Fund intervals. As result of our compliance testing, we did not identify any instances of noncompliance with United States Code Chapter 5, Section 8438 or Code of Federal Regulations Title 5, Part 1601.40.

The current engagement produced no new recommendations.

We also reviewed one prior U.S. Department of Labor Employee Benefits Security Administration (EBSA) recommendation related to the TSP L Funds process to determine its current status. Section III.B documents the status of this prior recommendation. In summary, the recommendation has been implemented and closed.

B. Findings and Recommendations from Prior Reports

The findings and recommendations from prior reports that required follow-up are presented in this section. The discussion below includes the current status of each recommendation.

[REDACTED]

[REDACTED] [REDACTED]
[REDACTED] [REDACTED]
[REDACTED] [REDACTED]
[REDACTED]

[REDACTED] [REDACTED]
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[REDACTED] [REDACTED]

AGENCY'S RESPONSE



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

June 22, 2021

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 dated June 8, 2021, transmitting the KPMG LLP report entitled Employee Benefits Security Administration Performance Audit of Lifecycle Funds Process, dated June 2021.

We are pleased to note during the FY 2021 audit that the auditors did not identify any instances where TSP operations did not comply with FERSA and with applicable Board regulations and bulletins the period of January 1, 2020 through December 31, 2020. 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

Enclosure

KEY DOCUMENTATION AND REPORTS REVIEWED

Other Documents and Reports

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