



**Employee Benefits Security Administration**

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

**December 13, 2013**

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## EXECUTIVE SUMMARY

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Washington, DC

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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 from April 8, 2013 through September 13, 2013, primarily at the offices of BlackRock Institutional Trust Company, N.A. (BTC) located in San Francisco, CA. Our scope period for testing was January 1, 2012 through December 31, 2012.

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. Those 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 is 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 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 investments funds, to the Federal Retirement Thrift Investment Board's (Board) Staff (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 matched 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.

- Test compliance of BTC's TSP investment management operations with USC Chapter 5, Sections 8438(b), 8438(b)(1), 8438(c), and 8477(c)(2) (hereinafter referred to as FERSA), CFR Title 29, Part 2509.08-2 (hereinafter referred to as Agency Regulations), Individual Prohibited Transaction Exemptions (IPTE) 92-11, 2013-05, 2002-30, 2011-17, and 2012-09, and Prohibited Transaction Class Exemption 2006-16 in the TSP F, C, S, and I Funds investment management operations (hereinafter referred to as Prohibited Transaction Exemptions).
- Identify and evaluate BTC access to the TSP systems for potential risks to TSP investment data.

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, 2012 through December 31, 2012, 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 the 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 matched 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. As a result of our compliance testing, we did not identify any instances of noncompliance with FERSA, Agency Regulations, or Prohibited Transaction Exemptions in BTC's TSP investment management operations. Our engagement communicates no recommendations. In addition, we did not identify instances in which BTC had access to TSP systems.

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.

KPMG LLP

December 13, 2013

## **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. For FERS participants, the TSP also provides agency automatic 1 percent and matching contributions. The TSP began accepting contributions on April 1, 1987, and as of June 30, 2013, had approximately \$358 billion in assets and approximately 4.6 million participants<sup>1</sup>.

The FERSA 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 (the 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 Investment Fund (F Fund), the Common Stock Index Investment Fund (C Fund), the Small Capitalization Stock Index 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 of market yields on U.S. Treasury marketable securities outstanding with 4 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 July 22, 2013, Federal Retirement Thrift Investment Board meeting, posted on [www.frtib.gov](http://www.frtib.gov).

<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 stock fund 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 stock fund 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 stock fund 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 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 five different time horizons.<sup>3</sup>

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

The Agency contracted with BlackRock Institutional Trust Company, N.A. (BTC) to manage assets for the F, C, S, and I Funds. The TSP has more assets under management by BTC than any other defined contribution plan.

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;

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<sup>3</sup> Source: Lifecycle Funds “Key Features” tab posted on [www.tsp.gov](http://www.tsp.gov).

<sup>4</sup> Sources: TSP standard operating procedures; TSP Investment Management Oversight Manual.

- Proxies related to the C, S, and I Funds' investments are voted in accordance with BTC's stated guidelines;
- 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>**

During calendar year 2012, F Fund assets were invested in BTC's U.S. Debt Index Fund-E (BTC's daily-valued investment fund that was invested in BTC's U.S. Debt Index Fund), a commingled fund that was designed to track the performance of the Barclays Capital U.S. Aggregate Bond Index<sup>6</sup>. The Barclays Capital 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, mortgage-backed, corporate, and foreign government (issued in the U.S.) sectors of the U.S. bond market.

Because the Barclays Capital U.S. Aggregate Bond Index is comprised of numerous securities, it is not practical for BTC's U.S. Debt Index Fund to hold every security. Consequently, BTC uses mathematical models to select a representative sample of the U.S. Government, foreign government, corporate, taxable municipal, mortgage-backed, commercial mortgage-backed, and asset-backed securities included in the Barclays Capital U.S. Aggregate Bond Index. As illustrated in *Exhibit I-1*, the portfolio profile of the U.S. Debt Index Fund (in dollar terms) closely represented the Barclays Capital U.S. Aggregate Bond Index, as of December 31, 2012.

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<sup>5</sup> Sources: TSP publication *F Fund Information Sheet* as of December 31, 2012; BlackRock *U.S. Debt Index Fund Information Sheet*; Barclays publication *U.S. Aggregate Index Fact Sheet*; BTC publication *Fixed Income Index Funds Collective Investment Funds Profile, August 2012*; BlackRock Thrift Savings Fund F Fund Portfolio Profile, for the period ending March 31, 2013.

<sup>6</sup> Beginning in March 2013, the F Fund was invested in the Thrift Savings Fund (TSF) F Fund – Fixed Income Index Account. This is a client account that was set up solely for the TSP. This account is designed to track the performance of the Barclays Capital U. S. Barclays Capital U.S. Aggregate Bond Index.



Sector Breakdown	BTC's U.S. Debt Index Fund	Barclays Capital U.S. Aggregate Bond Index
U.S. Government Securities	36.05%	36.41%
Corporate Credit	26.34%	26.26%
Foreign Government Securities	4.68%	4.50%
Taxable Municipal	0.97%	1.02%
Mortgage-Backed Securities and Hybrid Adjustable-Rate Mortgages	29.58%	29.61%
Commercial Mortgage-Backed Securities	1.80%	1.83%
Asset-Backed Securities	0.35%	0.35%
Cash and Other	0.67%	0.03%

Although the U.S. Debt Index Fund–E’s investment policy allows the use of futures, the Fund did not use them to improve tracking or provide liquidity during 2012.

## 2. C Fund Overview<sup>7</sup>

C Fund assets are invested in the TSF C Fund - Equity Index Account (Equity Index Account), which is a daily-valued investment account that was set up solely for the TSP. The Equity Index Account only holds TSP assets and is designed to track the performance of the Standard and Poor’s 500 Composite Stock Price Index (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 500 common stocks, representing more than 100 separate industries, which trade primarily on the New York Stock Exchange.

A portion of the C Fund 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

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<sup>7</sup> Source: TSP publication *C Fund Information Sheet* as of December 31, 2012.

cash balances<sup>8</sup>, reduce tracking error, and provide liquidity. (See further discussion below under subsection Use of Futures in BTC's Index Funds in Section C.1)

### **3. S Fund Overview<sup>9</sup>**

S Fund assets are invested in BTC's Extended Equity Market Fund-E (BTC's daily-valued investment fund that is primarily invested in BTC's Extended Equity Market Fund), a commingled fund that tracks 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, 2012, the Dow Jones U.S. Completion Total Stock Market Index was comprised of approximately 3,400 common stocks included in the U.S. stock market, excluding the 500 issues that are represented in the S&P 500 Index. The BTC Extended Equity Market Fund holds a majority of these non-S&P 500 stocks; however, it is not practicable to hold all such stocks. Therefore, the BTC Extended Equity Market Fund 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 BTC Extended Equity Market Fund also invests in related index futures to improve tracking and liquidity. (See further discussion below under subsection *Use of Futures in BTC's Index Funds*, in Section E.1.)

### **4. I Fund Overview<sup>10</sup>**

I Fund assets are invested in BTC's EAFE Equity Index Fund-E (BTC's daily-valued investment fund that is invested primarily in BTC's EAFE Equity Index Fund), a commingled fund that tracks the Morgan Stanley Capital International Europe, Australasia, and 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, 2012, the MSCI EAFE Index consisted of the stocks of 909 companies in 22 countries.

BTC's EAFE Equity Index Fund directly, or through the funds in which it invests, holds the stocks of all 22 countries included in the EAFE Index. The BTC EAFE Equity Index Fund and

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<sup>8</sup> To purchase an equity, forward, or options synthetic position which is generally collateralized by or maintained against a cash equivalent position.

<sup>9</sup> Sources: TSP publication *S Fund Information Sheet* as of December 31, 2012; Dow Jones publication *Dow Jones U.S. Total Stock Market Completion Index Fact Sheet*.

<sup>10</sup> Source: TSP publication *I Fund Information Sheet* as of December 31, 2012; Morgan Stanley publication *MSCI EAFE Index Fact Sheet*.

the EAFE Equity Index Fund-E also invest in related index futures to improve tracking and to provide liquidity. (See further discussion below under subsection Use of Futures in BTC's Index Funds, in Section E.1.)

The primary source of earnings for the I Fund is the net changes in the prices of stocks in BTC's EAFE Equity Index Fund, 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.

## **5. Fund Percentages Owned by TSP<sup>11</sup>**

TSP assets represent significant percentages of the investments in the BTC index funds in which they are invested. As noted earlier in this report, the TSP assets of the F, S and I Funds are invested in daily-valued and daily-traded investment funds managed by BTC. The BTC fund designator "E" or "EX" identifies the fund as a daily-valued and daily-traded fund. The underlying investments of these "E" designated funds are primarily shares in the daily valued (although not necessarily daily-traded) funds in which all of the physical securities transactions occur. The "E" designated funds also hold a small amount of liquid investments in order to accommodate daily investment transactions; in the case of the I Fund, this includes futures and forwards.

The percent of TSP assets of the total investments in the related BTC collective trust funds (i.e., "E" Funds), the percent of "E" Fund holdings of the underlying BTC funds in which the actual security trading occurred, and the percent of TSP assets of the underlying BTC funds as of December 31, 2012, were as noted in Exhibit I-2 below.

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<sup>11</sup> Sources: Security Cross Reference Reports for the U.S. Debt Index Fund, Equity Index Account, Extended Equity Market Fund, and EAFE Equity Index Fund; BTC Thrift Savings Fund Assets Under Management Report as of March 31, 2013.

Fund (TSP Fund)	TSP Assets as a % of ‘E/EX’ Fund	‘E/EX’ Fund Holdings as a % of Underlying Fund	TSP Assets as a % of Underlying Fund
U.S. Debt Index	64.0%	*	*
Equity Index Account	**	**	**
Extended Equity Market	83.6%	95.6%	80.0%
EAFE Equity Index	97.2%	41.7%	42.0%

\*U.S. Debt Index sold out of the underlying fund as of October 2011 and purchased the underlying modular funds directly.

\*\*The Equity Index Account does not have underlying funds as the account invest directly in the securities needed to replicate the applicable benchmark.

## 6. BTC Investment Management Process Overview<sup>12</sup>

By 2:00 p.m. Eastern time on each trade date, the Agency notifies BTC of its investment order for the TSP funds. BTC’s Client Order Management Group (COM) is responsible for the investment order process, which is facilitated through BTC’s Order Management System. The Agency typically submits its investment orders electronically via an interface to BTC’s Order Management System for each of the four TSP accounts. Once the Agency determines the investment amounts for each of the TSP funds, it is entered into the Asset Manager System (AMS) and transmitted via electronic order interface to the Order Management System. Upon receipt of the electronic order, an automated electronic confirmation is generated and sent back to AMS for review by the Agency.

Once the order has been received and confirmed, the Order Management System produces the “Core Funds Report,” listing all the contributions and withdrawals requested by BTC’s clients. Managers in BTC’s Portfolio Management Group then prepare security level trade lists for each

<sup>12</sup> Sources: TSP Operating Procedures

fund. The lists for equity securities are then submitted to the Fund Optimizing and Crossing (FOX) System, BTC's centralized cross-trading record keeping system.

The FOX System identifies cross-trading opportunities among funds managed by BTC. Cross-trades for the Equity Index Account, Extended Market Index Fund, and EAFE Equity Index Fund occur when another fund or account maintained by BTC is a buyer or a seller of an equity security or securities for which one of these three funds is a seller or a buyer, respectively. (See Trading Costs in Section 2.D below.) The FOX System is designed to only authorize cross-trades qualified under individual prohibited transaction exemption (IPTE) 92-11 and the minority passive shareholder exemptions, IPTE 2011-17 and IPTE 2012-09. (See Section E below.) The residual trade lists are given to the BTC Trading Group to execute. For fixed income trades, BTC's Trading Operations Department verifies the trades with executing brokers and uses BTC's Aladdin System to transmit the information to State Street Corporation<sup>13</sup> to record the accounting and custodial information. For equity trades, an interface occurs between systems used by BTC's Trading Group and State Street's system. State Street's Trading Operations Group verifies the equity trades with executing brokers and sends the information electronically to State Street's systems.

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 Client Reporting Group sends the Agency transaction reports confirming the trades. These reports include the Agency's trading costs, if any. BTC's trading costs are charged on a pro rata basis to the plans that make a contribution to or withdrawal from BTC's U.S. Debt Index Fund, U.S. Debt Index Fund-E, Equity Index Account, Extended Equity Market Fund, Extended Equity Market Fund-E, EAFE Equity Index Funds, or EAFE Equity Index Fund-E.

The BTC Client Reporting Group also sends to the Agency's Office of Benefits and Investments monthly transaction reports for the TSP investments in the various BTC funds. 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.

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<sup>13</sup> BTC outsources its custodial and fund accounting processes to State Street Corporation (State Street). State Street is an independent company that specializes in investment custodial services and offers integrated accounting and custodial management systems to its customers that provide for fund accounting in a daily valuation environment.

## **7. Management Fees<sup>14</sup>**

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

### **C. Futures and Securities Lending**

BTC engages in certain investment management transactions, including investing in futures and securities lending. See sections below for detailed information on BTC's use of futures in the index funds and its securities lending activities.

#### **1. Use of Futures in BTC's Index Funds<sup>15</sup>**

BTC's Index Funds and Accounts invest in futures to reduce tracking error and to equitize cash balances. BTC's Equity Index Account invests in S&P 500 Index futures to reduce the tracking error, which resulted from the dividend reinvestment assumptions inherent in the S&P 500 Index. The S&P Index treats dividends as if they were reinvested on the ex-dividend date<sup>16</sup>. Dividends are not paid to investors until after that date. In addition, BTC's Equity Index Account uses futures contracts to equitize cash balances maintained for liquidity. For the Equity Index Account, 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. The S&P 500 Index futures constituted 0.01 percent of the value of BTC's Equity Index Account assets as of December 31, 2012.

BTC's Extended Equity Market Fund also invests in futures to improve tracking against the Dow Jones U.S. Completion Total Stock Market Index. In addition, BTC's Extended Equity Market Fund uses futures contracts to equitize cash balances maintained for liquidity. While no single futures market exactly matches the components of the Dow Jones U.S. Completion Total Stock

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<sup>14</sup> Sources: BTC Operating Procedures; Contract with the Board and Invoices to the Board during 2012

<sup>15</sup> Sources: BTC Operating Procedures; TSP Fund C Separate Account Audited Financial Statements as of December 31, 2012, BTC C, S, and I Fund Holdings Reports as of December 31, 2012.

<sup>16</sup> The ex-dividend date is the day a stock begins to trade without its dividend and represents the cut-off day for earning the dividend. Those investors who purchased the stock by the end of the day prior to ex-dividend date would be entitled to the dividend, while those investors who purchased the stock on or after the ex-dividend date are not entitled to the dividend.

Market Index, BTC's Extended Equity Market Fund used Russell 2000 Index futures and S&P Midcap 400 Index futures to improve tracking. The index futures constituted 0.03 percent of the value of BTC's Extended Equity Market Fund assets as of December 31, 2012.

BTC's EAFE Equity Index Fund-E and its underlying funds invest in various forward contracts relating to foreign currency and futures contracts relating to foreign stock exchanges (e.g., SPI 200 futures, Topix Index futures, and FTSE 100 Index futures). However, futures contracts do not exist for all 22 country stock markets represented in the EAFE Index. Therefore, BTC typically invests in selected futures (i.e., that have been approved by U.S. regulators for investment by U.S. persons and that have substantial liquidity) to improve tracking. The index futures constituted 0.07 percent of the value of BTC's EAFE Equity Index Fund-E assets as of December 31, 2012.

As described in the section on Securities Lending, BTC invests cash collateral obtained from its securities lending activities in investments that may have derivative components.

## **2. Securities Lending<sup>17</sup>**

Brokers occasionally borrow specified securities to complete a trade that would otherwise fail or to short sell (i.e., sell with the expectation of buying the securities to settle the trade at a later time at a lower price). BTC is responsible for negotiating securities lending transactions for its funds within its established guidelines.

BTC has implemented procedures to limit the risk of default on securities loaned. Potential borrowers undergo a credit screening process and, if approved, must provide collateral equal to at least 102 percent of the market value of the U.S. securities loaned and 105 percent of the market value of international securities loaned. The collateral is marked-to-market daily so that it is maintained at the levels described above. U.S. collateral may be in the form of cash, U.S. government obligations, bank certificates of deposit, bankers' acceptance, certain mortgage-backed securities or irrevocable letters of credit from BTC-approved institutions that are not affiliated with the borrower. Non-U.S. collateral may be in the form of cash denominated in certain non-U.S. currencies, securities issued or guaranteed by certain multilateral development banks, highly rated sovereign debt, and letters of credit issued by certain non-U.S. banks. Cash

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<sup>17</sup> Sources: Various BlackRock Global Credit and Market Risk Group standard operating procedures documents.

collateral is segregated from other assets of the lending fund by identification on the books and records of the lender, and is invested in cash collateral funds.

BTC invests securities lending collateral in various investments, some of which may have derivative components. Per BTC policy, the type of derivatives involved in these collateral investments is limited to synthetic cash investments designed to replicate traditional money market risk characteristics or derivatives used for portfolio management purposes to adjust the average life of the portfolio. To further limit the risk involved with these transactions, BTC subjects potential counterparties to the same credit screening process to which BTC subjects its security lending borrowers. BTC has set limits on the amount of securities lending and collateral investments that it has with any one entity. Exhibit I-3 shows the percent of the securities in each underlying fund applicable to the TSP that were on loan to approved brokers as of December 31, 2012 and 2011.<sup>18</sup>

*Exhibit I-3*

<b>Fund</b>	<b>As of December 31, 2012</b>	<b>As of December 31, 2011</b>
U.S. Debt Index Fund	27.3%	30.7%
Equity Index Fund	6.2%	9.3%
Extended Equity Index Fund	23.0%	22.2%
EAFE Equity Index Fund	2.3%	4.60%

Lending opportunities are allocated to a particular BTC fund through a calculation performed by BTC's Global Loan Manager system at the time of the loan. The system evaluates each fund's amount on loan as a percentage of its lendable market value. For securities held by more than one fund, the fund with the lowest loan percentage will be assigned the lending opportunity.

The lending funds receive 50% of the net income earned from securities lending transactions, and BTC retains the remainder. The income divided between the funds and BTC is net of cash collateral management fees and accrued borrower rebate fees. BTC bears all operational costs directly related to securities lending. In its current agreement with the TSP, BTC rebates a portion of the income received from securities lending transactions to the TSP. The chart below

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<sup>18</sup> Sources: Loan Positions by Account reports during 2012.



(Exhibit I-4) presents the effect (i.e., percent increase) of the use of securities lending income on fund returns for BTC’s underlying funds applicable to the TSP for the 12-month period ended December 31, 2012, and the proportion of securities lending income to net investment income for the fiscal years ended December 31, 2012 and 2011, respectively.<sup>19</sup>

*Exhibit I-4*

Fund	Range of Effect of Securities Lending on Monthly Fund Returns		
	2012	2012	2011
U.S. Debt Index Fund	0.36 bps to 0.59 bps	3.97%	3.09%
Equity Index Fund	0.58 bps to 0.99 bps	3.81%	2.02%
Extended Market Index Fund	1.3 bps to 1.86 bps	19.06%	17.92%
EAFE Equity Index Fund	0.24 bps to 1.93 bps	1.23%	2.01%

During 2012, BTC expected a higher ratio of securities lending income to net investment income for the Extended Market Index Fund because it had relatively higher securities lending activity.

#### **D. Trading Costs<sup>20</sup>**

Trading costs associated with client transactions in BTC’s Equity Index, Extended Equity Market, and EAFE Equity Index Funds generally consist of negotiated commissions on common stock purchases and sales or the buying and selling of futures contracts. Trading costs in BTC’s U.S. Debt Index Fund consist of the spreads between dealer’s bid price and ask price on debt securities purchased and sold. The trading costs are shared proportionately by the plans causing the trade (i.e., those with contributions if the fund is in a net buy position or those with withdrawals if the fund is in a net sell position). These trading costs do not contribute to the tracking error of the various funds.

<sup>19</sup> Sources: U.S. Equity Series, International Equity Series, U.S. Fixed Income Series, and TSP Fund C Allocated Account Audited Fund Financial Statements as of December 31, 2012; E Series, U.S. Fixed Income Series, and TSP Fund C Allocated Account Audited Fund Financial Statements as of December 31, 2011.

<sup>20</sup> Source for Trading Costs and H.1 Unit Exchanges: BTC operating procedures

The costs associated with rebalancing the U.S. Debt Index, Extended Equity Market, and EAFE Equity Index Funds are borne by the respective funds and are, therefore shared by all fund participants. The costs associated with rebalancing the Equity Index Account are borne by the TSP as they are the sole participant in the account. To minimize trading costs, BTC cross-trades, in the case of equities only, among eligible BTC managed funds 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”), or when a client chooses to contribute securities to a fund (i.e., an “in-kind contribution”).

### **1. Unit Exchanges**

The terms “unit exchange” or “unit cross” are used to describe the process in which cash received by a fund from client contributions on a given day permits the fund to provide cash to withdrawing clients on that day. To the extent that the amounts of contributions and withdrawals coincide, it is not necessary for the fund to buy or sell securities because of client contributions and withdrawals. With a “unit exchange,” securities are not actually transferred or exchanged among clients. The term “unit” simply refers to an entry in BTC’s records indicating a client’s interest in a collective fund.

### **2. In-Kind Transactions<sup>21</sup>**

An in-kind contribution is the standard process by which a client obtains an interest in a collective investment fund through the contribution of securities rather than cash, thus minimizing transaction costs. When a client authorizes BTC to restructure all or a portion of its portfolio into an index or model driven fund, BTC may use in-kind contributions.

When a client requests that BTC accept an in-kind contribution into a BTC collective fund, BTC’s Transition Services Group, in conjunction with the portfolio managers, analyzes the client’s existing portfolio to assess if any securities qualify to be contributed in-kind into the fund. The Transition Services Group analyzes which securities in the client’s existing portfolio match the fund’s index and how many shares of any given security can be contributed. The portfolio manager confirms whether the shares can be accepted while remaining within the

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<sup>21</sup> Source: BTC in-kind transaction records from January 1, 2012 through December 31, 2012

normal operating guidelines of the fund. (For example, it is BTC's policy not to accept a security into the Equity Index Fund if it would cause that stock's holdings to be misweighted in the portfolio by more than 1 basis point in comparison to that stock's weighting in the S&P 500 Index.) Therefore, the extent of in-kind contributions is considered in determining other trades necessary to ensure that the portfolio is tracking the appropriate index, to the extent practicable.

Following written instructions from the client, those securities that fit these criteria are then accepted into the collective index fund at the closing price on the day of contribution. BTC executes the in-kind contributions using the same pricing mechanisms as used to price cross-trades and to value the fund. This method eliminates discretionary pricing that may benefit either the client restructure account or collective fund. The client receives units in the collective fund corresponding to the aggregate value of the securities contributed.

### **3. Cross-Trades<sup>22</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 its minority passive shareholder. 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 save by avoiding transaction costs.

For BTC, as a manager of index and model-driven funds, 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 will buy or sell the security, BTC will trade that security through a cross-trade if crossing opportunities are available. BTC does not exercise subjective or discretionary investment management decisions regarding whether to buy or sell a security. Therefore, cross-trading is a cost-efficient mechanism for implementing prior decisions to buy or sell.

DOL's position is that 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

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<sup>22</sup> Sources: BTC cross-trade transaction records from January 1, 2012 through December 31, 2012; DOL's Office of Exemptions; BlackRock publication *Managing ERISA Assets*; IPTE 92-11.

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>23</sup> However, DOL has issued exemptions allowing certain passive investment managers of plans to cross-trade securities. BTC has such an exception with IPTE 92-11. Cross-trading is available in BTC's Equity Index, Extended Equity Market, and EAFE Equity Index Funds, but not BTC's U.S. Debt Index Fund. DOL prohibited class transaction exemption 2002-12, allows, among other provisions, the cross-trading of fixed income (e.g., U.S. Debt Index Fund) securities; however, BTC had not used that exemption as of the end of our scope period.

### **E. Exemptions<sup>24</sup>**

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

- IPTE 92-11 permitted the cross-trading of index and model-driven accounts and funds and certain client restructure accounts.
- Prohibited Transaction Class Exemption 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 replaced IPTE 2002-30, effective October 1, 2012. It permitted BTC, as an affiliate of an equity owner of EquiLend, to use the EquiLend platform, to sell or license products/services of EquiLend to plans, and includes a provision for the use of off-platform security lending data. The EquiLend platform is a common electronic platform provided by EquiLend Holdings LLC for negotiating securities lending transactions, identifying borrowing opportunities with pre-approved borrowers, negotiating specific loans,

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<sup>23</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.

<sup>24</sup> Sources: DOL's Office of Exemptions; BlackRock publication *Managing ERISA Assets*; IPTE 92-11, 2013-05, 2002-30, 2011-17 and 2012-09, and PTCE 2006-16.

maintaining appropriate records, marking to market all outstanding loans, ensuring collateral maintenance, and monitoring delivery and control of collateral.

- IPTE 2011-17 (temporary exemption, effective through 3/21/2012) and IPTE 2012-09 (permanent exemption, effective beginning 3/22/2012) permitted BTC to enter into certain transactions with, or involving, one or more of its minority passive shareholders.

## **F. Tracking Error<sup>25</sup>**

As previously described, BTC's U.S. Debt Index Fund, Equity Index Account, Extended Equity Market Fund, and EAFE Equity Index Fund were designed to replicate the performance of the Barclays U.S. Aggregate 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 BTC's fund (i.e., the C, S, I, or F fund) and the performance of the index it is designed to replicate is known as "tracking error."

### **1. U.S. Debt Index Fund-E**

From January 2012 through December 2012, the performance of the U.S. Debt Index Fund-E, as measured by BTC, differed from that of the Barclays Capital U.S. Aggregate Bond Index by no more than approximately 7 basis points in any month. Tracking error in the U.S. Debt Index Fund-E occurs primarily as a result of the methodology used to select a representative sample of securities for purchase by this collective trust fund. Additionally, positive tracking error can occur as a result of securities lending income received by the U.S. Debt Index Fund-E. The U.S. Debt Index Fund-E outperformed Barclays Capital U.S. Aggregate Bond Index, as measured by BTC, by approximately 10 basis points for the 12 months ending December 31, 2012.

### **2. TSP C Fund Equity Index Account**

From January 2012 through December 2012, the performance of the Equity Index Account, as measured by BTC, differed from that of the S&P 500 Index by no more than approximately 1 basis point in any month. This tracking error is primarily the result of corporate actions (e.g., mergers) and index change trades. The Equity Index Fund-EX outperformed the S&P 500 Index,

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<sup>25</sup> Sources: U.S. Debt Index Fund E Historical Performance Analysis 2002-2012; EAFE Equity Index Fund E Historical Performance Analysis 2002-2012; Extended Market Fund E Historical Performance Analysis 2002-2012; TSF C Fund-Equity Index Account Historical Performance Analysis 2002-2012

as measured by BTC, by approximately 12 basis points for the 12 months ending December 31, 2012.

### **3. Extended Equity Market Fund-E**

From January 2012 through December 2012, the performance of the Extended Equity Market Fund-E, as measured by BTC, differed from that of the Dow Jones U.S. Completion Total Stock Market Index by no more than approximately 11 basis points in any month. Because BTC only holds approximately 3,400 names out of the 4,500 in the Dow Jones U.S. Completion Total Stock Market, tracking error in the Extended Equity Market Fund-E occur primarily because of the methodology used to select representative securities for purchase by this collective trust fund. Tracking error also occurs as a result of securities lending activities, securities litigation payments, and futures misweights. The Extended Equity Market Fund-E outperformed the Dow Jones U.S. Completion Total Stock Market Index, as measured by BTC, by 58 basis points for the 12 months ended December 31, 2012.

### **4. EAFE Equity Index Fund-E**

From January 2012 through December 2012, the performance of the EAFE Equity Index Fund-E, as measured by BTC, differed from that of the MSCI EAFE Index by no more than 60 basis points in any month except for December 2012, which differed by approximately 82 basis points. This tracking error occurred as a result of the EAFE Equity Index Fund-E having to be fair valued on certain days. Tracking error can also occur as a result of the fund not holding all securities in the index, securities lending revenue, and favorable tax advantage treatment for securities and unequitized cash. The EAFE Equity Index Fund-E outperformed the MSCI EAFE Index, as measured by BTC, by approximately 128 basis points for the 12 months ended December 31, 2012.

## **G. Proxy Voting<sup>26</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 contract between the Agency and BTC delegates the authority to vote the Thrift Savings Fund's proxies to BTC. BTC is required to vote the Equity Index, Extended Equity Market, and EAFE Equity Index Funds' proxies in the best interests of the TSP participants and beneficiaries.

Although the Board does not vote proxies directly, its fiduciary responsibilities include monitoring BTC's voting of the Equity Index, Extended Equity Market, and EAFE Equity Index Funds' proxies. The Agency has reviewed BTC's written 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 funds. 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 Automated Data Processing (ADP) to collect the various domestic proxy voting materials. To facilitate the proxy voting process, BTC downloads its securities holdings to ADP daily to create ballots for U.S. entities. ADP creates the proxy ballots that BTC votes via ADP's online system, ProxyEdge. BTC reconciles position holdings against the ballots received on behalf of BTC to ensure all of the collective trust 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 fund participants.

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<sup>26</sup> Sources: 5 USC 8438(g); BTC Operating Procedures; BTC proxy voting guidelines; BTC proxy voting reports during 2012.

For non-U.S. securities (e.g., EAFE Equity Index Fund holdings), BTC relies upon interfaces between State Street and ISS to create ballots. ISS, acting as an independent voting agent, votes routine matters in accordance with BTC's proxy guidelines for non-U.S. securities. BTC receives referrals of votes from ISS on non-routine matters (e.g., capital transactions, mergers, and special situations) which BTC then votes internally. BTC also performs periodic reviews of the proxy voting by ISS for its non-U.S. securities to ensure adherence to its written guidelines.

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

BlackRock, its subsidiaries, and joint venture operations are subject to examinations and audits by government regulatory agencies, independent public accountants, and internal auditors. From January 2011 through December 2012, examinations and audits related to BTC included the following.

- PricewaterhouseCoopers LLP -- Financial Statement and Internal Control Audits of BlackRock's Collective Trust Funds for the Years Ended December 31, 2012 and 2011;
- PricewaterhouseCoopers LLP -- Financial Statement Audit of BlackRock Institutional Trust Company, N.A. for the Years Ended December 31, 2012 and 2011;
- PricewaterhouseCoopers LLP -- Report on the Processing of Transactions for the Years Ended December 31, 2012 and 2011;
- Deloitte & Touche – Financial Statement Audit of BlackRock, Inc. for the Years Ended December 31, 2012 and 2011;
- The Office of the Comptroller of the Currency, examination cycle ending December 31, 2012
- BlackRock's Internal Audit Group -- various reviews of internal controls.

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>27</sup>

### TSP Fund Balances and Returns

As of December 31, 2012, the largest portion of TSP investments was held in the C Fund. The chart below (Exhibit I-5) presents a summary of TSP investments held by the G, F, C, S, I, and L Funds as of December 31, 2012 and 2011. The data in this table is unaudited.

*Exhibit I-5*

TSP Fund	Fund Balances December 31, 2012 (in millions)	% of Total December 31, 2012	Fund Balances December 31, 2011 (in millions)	% of Total December 31, 2011
G	\$139,990	43.02%	\$130,273	45.07%
F	25,218	7.75%	20,098	6.95%
C	75,142	23.09%	65,744	22.75%
S	24,276	7.46%	21,511	7.44%
I	17,087	5.25%	14,874	5.15%
L Income	5,310	1.63%	5,006	1.73%
L 2020	15,454	4.75%	13,572	4.70%
L 2030	12,448	3.83%	9,971	3.45%
L 2040	9,204	2.83%	7,205	2.49%
L 2050	1,267	0.39%	764	0.26%
<b>Total<sup>28</sup></b>	<b>\$325,396</b>	<b>100.00%</b>	<b>\$289,018</b>	<b>100.00%</b>

<sup>27</sup> Sources for the statistics on the following pages: FRTIB Meeting Minutes and accompanying Fund Performance Reports throughout the period December 2010 through December 2012 (i.e., January 2013 minutes); Audited Thrift Savings Fund Financial Statements, December 31, 2012 and 2011; Sources available at [www.FRTIB.gov](http://www.FRTIB.gov).

<sup>28</sup> The balances of the L Funds are invested in the underlying five funds (i.e., F, G, C, S, and I Funds).

The table below (Exhibit I-6) compares the TSP Fund returns for the G, F, C, S, I, and L Funds for the 12-month periods ending December 31, 2012, 2011 and 2010.

*Exhibit I-6*

<b>Rates of Return on TSP Investment Funds</b>			
<b>(unaudited)</b>			
<b>TSP Fund</b>	<b>12 Months Ended December 31, 2012</b>	<b>12 Months Ended December 31, 2011</b>	<b>12 Months Ended December 31, 2010</b>
G Fund	1.47%	2.45%	2.81%
F Fund	4.29%	7.89%	6.71%
C Fund	16.07%	2.11%	15.06%
S Fund	18.57%	(3.38%)	29.06%
I Fund	18.62%	(11.81%)	7.94%
L Income Fund	4.77%	2.23%	5.74%
L 2020 Fund	10.42%	0.41%	10.59%
L 2030 Fund	12.61%	(0.31%)	12.48%
L 2040 Fund	14.27%	(0.96%)	13.89%
L 2050 Fund	15.85%	NA	NA

## **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 BTC implemented certain procedures to (1) promptly and accurately deposit TSP investments in the authorized investment funds; (2) accurately summarize and report TSP investment transactions, including investment management fees relating to TSP investments funds, to the Federal Retirement Thrift Investment Board's (Board) Staff (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 matched 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.
- Test compliance of BTC's TSP investment management operations with USC Chapter 5, Sections 8438(b), 8438(b)(1), 8438(c), and 8477(c)(2), CFR Title 29, Part 2509.08-2, Individual Prohibited Transaction Exemptions (IPTE) 92-11, 2013-05, 2002-30, 2011-17, and 2012-09, and Prohibited Transaction Class Exemption (PTCE) 2006-16 in the TSP F, C, S, and I Funds investment management operations.
- Identify and evaluate BTC access to the TSP systems for potential risks to TSP investment data.

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

We conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States using EBSA's *Thrift Savings Plan Fiduciary Oversight Program*. Our scope period for testing was January 1, 2012 through December 31,

2012. We performed the audit in four phases: (1) planning, (2) arranging for the engagement with BTC, (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 Federal Retirement Thrift Investment Board's Staff (Agency) and BTC and agreeing on the timing of detailed testing procedures.

During the testing and interviewing phase, we performed the following procedures to achieve our performance audit objectives:

- Conducted interviews, collected and inspected auditee-provided documentation and evidence, participated in process walk-throughs;
- Tested a statistical sample of daily TSP investment transactions during 2012 to determine whether the transactions were promptly and accurately deposited in the authorized funds in accordance with the Board's orders;
- Tested a statistical sample of cross-trades involving TSP investments during 2012 to determine whether the cross-trades were executed in accordance with IPTE 92-11 and IPTE 2012-09.
- Tested a statistical sample of securities lending transactions involving TSP investments during 2012 to determine whether the transactions were executed in accordance with PTCE 2006-16, IPTE 2012-09, and IPTE 2011-17.
- Tested a statistical sample of securities from each of the TSP index funds to determine if the securities were part of the applicable benchmark index.
- Tested a statistical sample of daily reports submitted to the Agency to determine if BTC properly summarized TSP investment transactions and accurately reported daily yield, management fees, and other contractually required information.
- Tested a statistical sample of proxy votes to determine whether BTC voted the proxies of the C, S, and I fund investments in accordance with BTC's stated proxy-voting guidelines;

- We tested a non-statistical sample of monthly BTC reports remitted to the Agency to determine whether BTC provided the monthly reports required by its contract; and
- We tested a non-statistical sample of monthly invoices submitted to the Agency, to determine whether BTC invoiced the Board accurate management fees.

We conducted these test procedures primarily at BTC's offices in San Francisco. In Appendix B, we identify the key documentation provided by BTC personnel that we reviewed during our performance audit. For the non-statistically determined sample sizes in our sampling procedures, our results are applicable to the sample we tested and were not extrapolated to the population.

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 Thrift Savings Plan (TSP) 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) investment management operations while conducting a performance audit primarily at the BlackRock Institutional Trust Company, N.A. (BTC) in San Francisco. Our scope period for testing was January 1, 2012 through December 31, 2012. 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 performing 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, 2012 through December 31, 2012, BTC implemented certain procedures to 1) promptly and accurately deposit TSP investments in the authorized investment funds; 2) accurately summarize and report TSP investment transactions, including management fees relating to TSP investment funds, to the Federal Retirement Thrift Investment Board's (Board) Staff (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; 6) accurately and timely process TSP investment transactions. In addition, we did not identify any instances in which BTC had access to TSP systems.

As a result of our compliance testing, we did not identify any instances of noncompliance with United States Code Chapter 5, Sections 8438(b), 8438(b)(1), or 8477(c)(2), Code of Federal Regulation, Title 29, Part 2509.08-2, Individual Prohibited Transaction Exemptions 92-11, 2013-05, 2002-30, 2011-17, or 2012-09, or Prohibited Transaction Class Exemption 2006-16 in the TSP F, C, S, and I Funds investment management operations.

We noted no prior recommendations. The current engagement produces no new recommendations.

AGENCY RESPONSE



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

December 13, 2013

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

Dear Ian:

This is in response to KPMG's email on November 27, 2013, transmitting the KPMG LLP report entitled Employee Benefits Security Administration Performance Audit of the Thrift Savings Plan Investment Management Operations as of December 13, 2013. We are pleased to note that there are no recommendations in this audit report.

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.

Very truly yours,

A handwritten signature in black ink, appearing to read "G. Long", written over the typed name "Gregory T. Long".

Gregory T. Long

**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, 2012
- BTC, Collective Trust Funds for Employee Benefit Trusts, Report on Audits of Financial Statements for the year ended December 31, 2012
- Thrift Savings Fund Financial Statements, December 31, 2012 and 2011
- BlackRock SSAE16 Report for the period ending September 30, 2012
- State Street Bank & Trust SSAE16 Reports for the period ending September 30, 2012
  - Global Fund Accounting and Custody
  - Information Technology General Controls
  - U.S. Investment Services
- Review by Institutional Shareholder Services (ISS) of BTC's Proxy Votes for the quarters ending March 31, 2012, June 30, 2012, September 30, 2012, and December 31, 2012
- BTC Exemption Compliance Officer's Report (for the quarters ending March 31, 2012, June 30, 2012, September 30, 2012, and December 31, 2012)
- S&P 500 Index Composition as of December 31, 2012
- Barclays U.S. Debt Index Composition as of December 31, 2012
- Dow Jones Wilshire 4500 Index Composition as of December 31, 2012
- MSCI EAFE Index Composition at December 31, 2012

**BlackRock Internal Audit Group Reports**

- Listing of BlackRock Internal Audit Reports issued from January 1, 2011 through December 31, 2012 (i.e., CY 2012 and 2011 Audit Plans)
- Internal Control Overall Risk Assessment of Auditable Entities for 2011 and 2012
- Internal Audit Policies and Procedures Manual
- 2012 Internal Audit Reports:
  - Client Orders and Instructions
  - Global Pricing and Valuation
  - Office of the Comptroller of the Currency (OCC) Operating Agreement
  - Regulation 9
  - Portfolio Compliance
  - Model-based/Index Fixed Income
- 2011 Internal Audit Reports



**KEY DOCUMENTATION AND REPORTS REVIEWED, CONTINUED**

- Aladdin User Permissions-Segregation of Duties and Sensitive Permissions
- Index Equity Portfolio Management
- Counterparty and Concentration Risk Management
- BlackRock Multi-Asset Client Solutions (BMACS) – Structured Solutions Group – Portfolio Management

**BTC Publications and Internal Documents and Records**

- BTC Publication – *Managing ERISA Assets: A Comprehensive Guide to ERISA Exemptions Used by BlackRock Institutional Trust Company, N.A.*
- BTC Publication – *Information about BTC: 16 Things You Should Know*
- Organizational Chart
- Code of Business Conduct and Ethics
- Advisory Employee Investment Transaction Policy
- Applicable amendments to Limited Liability Company Agreement of Equilend Holdings LLC
- Employee Benefits Security Administration Compliance Program
- Electronic Listing of Cross-Trade transactions (at security level) from January 1, 2012 through December 31, 2012 (for all funds applicable to TSP)
- Electronic Listing of Security Lending transactions from January 1, 2012 through December 31, 2012 (for all funds applicable to TSP)
- Electronic Listing of In-Kind transactions from January 1, 2012 through December 31, 2012 (for all funds applicable to TSP)
- Security Cross Reference Report, U.S. Debt Index as of December 31, 2012
- Security Cross Reference Report, Equity Index as of December 31, 2012
- Security Cross Reference Report, Extended Market Index as of December 31, 2012
- Security Cross Reference Report, EAFE Index as of December 31, 2012
- Global Credit and Market Risk Group, Counterparties Approved for Securities Lending Trading in the San Francisco Office
- Global Credit and Market Risk Group, Counterparties Approved for Securities Lending Letters of Credit
- U.S. Debt Index Fund, Portfolio Profile, as of December 31, 2012
- Thrift Savings Fund F Fund Fixed Income Account Portfolio Profile, as of March 31, 2013 and December 31, 2013
- Historical Performance Analysis, (Summary of Results and Month-to-Month Results) - U.S. Debt Index Fund, as of December 31, 2011 and December 31, 2012

**KEY DOCUMENTATION AND REPORTS REVIEWED, CONTINUED**

- Historical Performance Analysis, (Summary of Results and Month-to-Month Results) - Equity Index Fund, as of December 31, 2011 and December 31, 2012
- Historical Performance Analysis, (Summary of Results and Month-to-Month Results) - Extended Market Index Fund, as of December 31, 2011 and December 31, 2012
- Historical Performance Analysis, (Summary of Results and Month-to-Month Results) - EAFE Index Fund, as of December 31, 2011 and December 31, 2012
- Global Credit and Market Risk Group, Risk Principles
- Global Credit and Market Risk Group, Counterparties Credit Exposure
- Transition Services Policies and Procedures Manual
- Proxy Voting Guidelines issued January 1, 2012 through December 31, 2012
- BTC Proxy Voting Reports from January 1, 2012 through December 31, 2012
- BTC Securities Lending Procedures for Lending to Affiliates
- BTC, Federal Employees Thrift Savings Plan - F Fund Transaction Summary Reports, January 1, 2012 through December 31, 2012
- Thrift Savings Fund Assets Under Management Report, as of March 31, 2013
- BTC, Federal Employees Thrift Savings Plan - C Fund Transaction Summary Reports, January 1, 2012 through December 31, 2012
- BTC, Federal Employees Thrift Savings Plan - S Fund Transaction Summary Reports, January 1, 2012 through December 31, 2012
- BTC, Federal Employees Thrift Savings Plan - I Fund Transaction Summary Reports, January 1, 2012 through December 31, 2012
- BTC, Federal Employees Thrift Savings Plan – F, C, S, and I Fund Monthly Account Balances, January 1, 2012 through December 31, 2012
- U.S. Compliance Program and Risk Matrix
- U.S. Compliance Report, Monthly Status Reports, January 1, 2012 through December 31, 2012
- Composition of BTC's Equity Index Fund (Fund "A") as of December 31, 2012
- Composition of BTC's Extended Index Fund (Fund "A") as of December 31, 2012
- Composition of BTC's EAFE Index Fund (Fund "A") as of December 31, 2012
- Composition of BTC's Debt Index Fund (Fund "A") as of December 31, 2012
- Report of Future Positions for the U.S. Debt Index, Equity Index, Extended Market Index, and EAFE Index as of December 31, 2012
- Regulation 9 (Reg-9) Annual Review for the F, C, S, and I Funds for 2012
- Loan Positions by Account Report for the U.S. Debt Index Fund as of December 31, 2012
- Loan Positions by Account Report for the U.S. Equity Index Fund as of December 31, 2012

**KEY DOCUMENTATION AND REPORTS REVIEWED, CONTINUED**

- Loan Positions by Account Report for the Extended Market Index Fund as of December 31, 2012
- Loan Positions by Account Report for the EAFE Index Fund as of December 31, 2012
- Security Lending Income Performance Report for U.S. Debt Index Fund as of December 31, 2012
- Security Lending Income Performance Report for U.S. Equity Index Fund as of December 31, 2012
- Security Lending Income Performance Report for U.S. Extended Equity Index Fund as of December 31, 2012
- Security Lending Income Performance Report for EAFE Index Fund as of December 31, 2012
- Audit Committee meeting minutes for the period January 1, 2012 to December 31, 2012
- BTC Annual Compliance Acknowledgement for Year 2012

**Laws and Regulations**

- Federal Employees' Retirement System Act of 1986, and Related Amendments
- Department of Labor Individual Prohibited Transaction Exemption 92-11
- Department of Labor Prohibited Transaction Exemption 2006-16
- Department of Labor Individual Prohibited Transaction Exemption 2013-05 (which replaced 2002-30)
- Department of Labor Individual Prohibited Transaction Exemption 2011-17
- Department of Labor Individual Prohibited Transaction Exemption 2012-09
- U.S. Code of Federal Regulations, Title 29, Chapter XXV, Part 2509, Interpretive Bulletins relating to the Employee Retirement Income Security Act of 1974

**Other Documents**

- TIB-2006-C-003, Contract for Investment Management and Custodian Services for the C, S, I & F Funds, effective September 5, 2006 and related contract modifications