

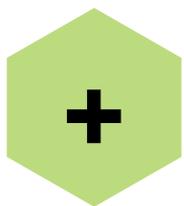
Executive Summary

- **Objective:** Identify key risks related to the investment management structure of the index funds in the Thrift Savings Plan (TSP)
- **Outcome of Risk Assessment:** Organization concentration risk exists because a single firm currently manages all index fund investments. A negative event could cause:
 - Disruption of participant trading activity
 - Loss of confidence in the TSP
 - Missed corporate action, tax reclaim, dividend, or other administrative item
- **Solutions:**
 1. Retain multiple index fund managers – 2 Options:
 - a) Multiple index fund managers across the TSP funds
 - b) Two index fund managers for each TSP fund
 2. Internally manage a portion of the index fund assets
- Pros and cons exist with each solution
- **Conclusion:** Aon Hewitt believes that utilizing two index fund providers for each TSP fund is the most optimal structure to diversify risk and would be in the best interest of the TSP and its participants

Pros And Cons:

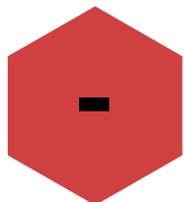
Multiple Index Fund Managers Across TSP Funds

- Retain more than one index fund manager across the TSP funds (each fund is managed by only one index fund manager)
- The TSP would have at least two index fund manager relationships, but as many as four



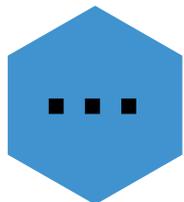
Pros

- Ready back-up; redundancy
- Additional source of input on market issues
- Healthy competition
- Avoidance of headline risk



Cons

- Potentially higher cost
- Greater operational complexity
- Index fund manager may not be best provider for a fund
- Additional resources required to monitor



Other
Considerations

- Procurement process
- Securities lending

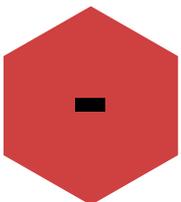
Pros And Cons: Multiple Index Fund Managers For Each TSP Fund

- This solution contemplates retaining two index fund managers to manage each TSP fund



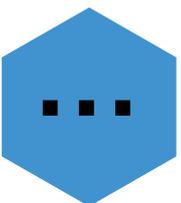
Pros

- Ready back-up
- Additional source of input on market issues
- No negative impacts on participant transactions
- Potentially higher crossing opportunities
- Avoidance of headline risk



Cons

- Potentially higher cost
- Greater operational complexity
- Index fund manager may not be best provider for a fund
- Additional resources required to monitor

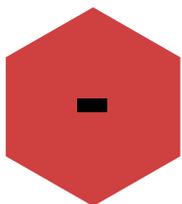


**Other
Considerations**

- Procurement process
- Securities lending
- Allocations

Pros And Cons: Internally Manage A Portion Of The Index Fund Assets

- FRTIB manages (or has the ability to manage) a portion of each index fund
- In the event that the external index fund manager for a TSP fund is unable to fulfill its responsibilities, the FRTIB could manage all of the fund's assets
- While internal management may be one way to minimize or mitigate the operational risk associated with the use of a single index fund provider, there are too many negatives for us to recommend this solution



Cons

- Increased internal risk (compliance, trade errors, and tracking error)
- Challenge retaining skilled talent on an ongoing basis
- Increased complexity of internal investment organization
- Develop, manage, and monitor multiple vendor relationships – brokers, analytical and risk management providers, etc.

Conclusions

- Retaining multiple index fund providers significantly minimizes the operational risk associated with the current approach of using a single index fund manager for all TSP funds
- Furthermore, utilizing two index fund managers for each TSP fund is the most optimal structure
- FRTIB can direct the other index fund manager to assume responsibility to manage all assets in case of disruption at the other manager
 - Switching an account's investment discretion would be nearly seamless under this solution

Recommendation

- The TSP should hire two index fund managers for each TSP fund
- The TSP should have a direct custodian bank relationship for safe-keeping and custody of the index fund assets

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