



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

MEMORANDUM TO BOARD MEMBERS KENNEDY, BILYEU, JONES, MCCRAY, AND JASIEN

FROM: Ravindra Deo *Ravindra Deo*
Executive Director

DATE: November 20, 2017

SUBJ: Benchmark Study by Aon Hewitt Investment Consulting; summary and recommendations

INTRODUCTION

The FRTIB requested that Aon Hewitt Investment Consulting (AHIC) conduct a study of the benchmark indices against which the current individual F, C, S, and I Fund investment options of the TSP are managed to determine if these continue to be in the best interest of participants and beneficiaries. In addition, the study encompassed a potentially expanded I Fund benchmark that would include additional exposure to Canadian and emerging market large and mid-capitalization stocks as well as small capitalization stocks across non-U.S. developed nation and emerging market stocks.

In conducting its study, AHIC considered the TSP's enabling statute, its size, and its liquidity needs. It examined index related characteristics such as construction methodology, market coverage, investability, liquidity, acceptance in the institutional investment space, and appropriateness for the TSP. For any case of new benchmark recommendation, it examined transactions costs, custody related issues, and other aspects of transitioning.

As a result, AHIC determined that the benchmark indices currently in use for the TSP's F, C, and S Funds are appropriate for those options. It recommended that the I Fund's benchmark index be changed from the currently in use MSCI EAFE Index to the MSCI ACWI ex-U.S. Investable Market Index (MSCI ACWI ex-U.S. IMI), an index that not only includes all stock exposures of the MSCI EAFE Index but also Canadian and emerging market large and mid-capitalization stocks and small capitalization stocks across all of the included countries.

RECOMMENDATIONS

AHIC made the following recommendations:

1. The C Fund's and the S Fund's benchmark indices should remain the S&P 500 Index and the Dow Jones U.S. Completion Total Stock Market Index respectively.
 - a. Together, the indices provide 100% U.S. equity market coverage with no overlap.
 - b. The markets covered are liquid and investable, allowing holding of a majority of stocks in those indices.
 - c. They are broadly accepted and available in the institutional investor marketplace.
 - d. The S&P 500 Index has high recognition across professional and non-professional investors.

2. The F Fund's benchmark index should remain the Bloomberg Barclays U.S. Aggregate Index.
 - a. It provides broad exposure to U.S. dollar denominated investment grade bonds.
 - b. The market covered has adequate liquidity and is investable on a characteristics basis, at a minimum.
 - c. It is broadly accepted and available in the institutional investor marketplace.
 - d. It has high recognition across professional investors; non-professionals tend not to have high familiarity with fixed income benchmarks.

3. The I Fund's benchmark index should change to the MSCI ACWI ex-U.S. IMI.
 - a. MSCI indices are broadly recognized in institutional investing for gaining international exposure.
 - b. The ACWI ex-U.S. IMI provides access to all developed nations (excluding the U.S.) and emerging market stocks from large capitalization through small capitalization, providing opportunity for additional diversification and for access to returns from potentially faster growth areas of the international stock markets.
 - c. The markets covered have adequate liquidity and are largely investable directly or through sampling.
 - d. Transition costs to the new benchmark and timing are deemed to be within an acceptable range.
 - e. Securities lending is expected to be enhanced.

CONCLUSION

Based on the study conducted by AHIC, including costs and other information provided in its written report and presentation with regard to transition related issues, we believe that it is appropriate to change the benchmark index for the I Fund. The most appropriate time for this would be following the selection of an investment manager during the next re-compete of the I Fund's investment management, currently scheduled to be concluded in the third quarter of calendar year 2018. This means that transition to the new benchmark index should occur over three to six months and conclude no later than the end of first half calendar year 2019.

As a result of the above study and recommendations by AHIC, I am:

1. Asking for the Board's approval for the FRTIB to change the I Fund's benchmark index to the MSCI ACWI ex-U.S. Investable Market Index from the current benchmark of the MSCI EAFE Index, to be executed by the single investment manager chosen with the next re-compete of investment management.