

United States Senate

WASHINGTON, DC 20510

August 26, 2019

Honorable Michael Kennedy
Chairman
Federal Retirement Thrift Investment Board
77 K Street NE
Washington, D.C. 20002

Dear Chairman Kennedy:

We write to urge the Federal Retirement Thrift Investment Board (FRTIB) to reverse its November 2017 decision to change the Thrift Savings Plan's International Stock Fund (TSP's I Fund) to mirror the MSCI All Country World ex-U.S. Investable Market Index (ACWI ex-US IMI). The FRTIB's decision to track this MSCI index constitutes a decision to invest in China-based companies, including many firms that are involved in the Chinese Government's military, espionage, human rights abuses, and "Made in China 2025" industrial policy, and therefore poses fundamental questions about the Board's statutory and fiduciary responsibilities to American public servants who invest in federal retirement plans. This change, which is expected to be implemented next year, will expose nearly \$50 billion in retirement assets of federal government employees, including members of the U.S. Armed Forces, to severe and undisclosed material risks associated with many of the Chinese companies listed on this MSCI index.

On November 28, 2017, representatives from Aon Hewitt Investment Consulting, Inc., presented FRTIB Board Members with the *Benchmark Study for the Thrift Savings Plan*. Although this presentation—which was given the same day as the Board adopted the motion to change the I Fund to mirror the MSCI ACWI ex U.S. IMI—addressed issues related to general market exposure, liquidity, and transaction costs, there is no evidence that due diligence related to national security, human rights, or financial transparency was ever performed. This is surprising given not only that China received the third-most investment on a per-nation basis within the MSCI ACWI ex-US IMI as of July 31, 2019, at 7.56 percent of the index's total assets, but also that MSCI Inc. has recently begun to increase the weight of China A shares, stocks traded on mainland China exchanges in Renminbi, on its indexes. In fact, the notes from that meeting clearly state that "the primary concern with the MSCI All Country World ex-U.S. Investable Market Index in the past was the lack of maturation of some of the emerging markets."

It is well known that the Chinese Government uses state-owned and state-directed enterprises to control production, compete in global markets, and serve the Chinese Communist Party's military, political, and economic goals. Many of these Chinese companies may soon receive investments directly from the paychecks of members of the U.S. Armed Services and other federal government employees because of your decision. Indeed, the MSCI ACWI ex-US IMI lists among its constituents many Chinese issuers that pose national security, human rights, and financial disclosure risks. We have listed a few illustrative examples of these risks below.

- *On national security.* The MSCI ACWI ex-US IMI or its sub-indexes have included **AviChina Industry & Technology Ltd.**, the listing company for the Aviation Industry Corporation of China (AVIC) and its numerous subsidiaries that develop manned aircraft, unmanned aerial vehicles, missiles, and other weapons systems for the People's Liberation Army Air Force, People's Liberation Army Naval Air Force, and People's Liberation Army Rocket Force. AVIC is a state-owned entity that the U.S. Trade Representative has called "the sole domestic supplier of military aircraft to the People's Liberation Army (PLA)." This firm and its subsidiaries were the subjects of repeated sanctions for proliferation activities related to the *Iran, North Korea, and Syria Nonproliferation Act* and other statutes.

The index or its sub-indexes have also included **China Mobile Ltd.**, a Chinese state-owned enterprise that the Federal Communications Commission unanimously voted to bar from entering the U.S. market in May 2019 due to national security concerns. The FCC noted China Mobile poses "substantial and unacceptable national security and law enforcement risks," citing how "China Mobile is subject to exploitation, influence, and control by the Chinese government".

- *On human rights.* This MSCI index or its sub-indexes has also included **Hangzhou Hikvision Digital Technology (Hikvision)**, a state-run technology firm with tens of thousands of surveillance cameras throughout the Xinjiang Uighur Autonomous Region that support the Chinese Government's detainment of over one million Uighur Muslims and other ethnic and religious minorities. Constituent entities of Hikvision's controlling shareholder, the China Electronics Technology Group Corporation, were added to the U.S. Commerce Department's Entity List in August 2018 for "acting contrary to the national security or foreign policy interests of the United States." Moreover, the *John S. McCain National Defense Authorization Act for Fiscal Year 2019* (Public Law 115-874) prohibits the U.S. federal government from procuring equipment from Hikvision—along with **ZTE Corporation**, which also has been in this MSCI index or sub-indexes—effective August 13, 2019, and will ban federal contracts with companies using Hikvision's equipment or services beginning in August 2020.
- *On financial disclosure.* The dangers of fraud and deceit are well-documented for companies listed on Chinese exchanges, which are not transparent or subject to the disclosure requirements that American companies must abide by. For example, in April 2019, **Kangmei Pharmaceutical Co.**, a Chinese company that has been included in this MSCI index or its sub-indexes, admitted to falsely overstating the value of its cash holdings by \$4.4 billion. Moreover, Ruihua, China's second-largest domestic accounting firm and the client of multiple Chinese firms in the MSCI indexes, was implicated in a scandal over the quality of its audits.

In order to fully inform Congress of the risks that you have considered in making this decision, we respectfully ask that you answer the questions below by September 6, 2019.

- (1) What criteria were used to identify and evaluate the suitability of a new index for the I Fund, and to what extent was due diligence related to security, human rights, and financial transparency performed by the Board? What criteria did the Board use when deciding that

federal employees and military personnel should be investing in Chinese military modernization?

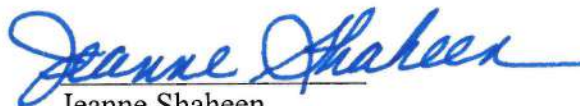
- (2) Were the members of the Board aware at the time of the motion to adopt the new index for the I Fund that constituent firms of this index were previously subject to U.S. Government sanctions? Since the Board's November 2017 vote, the U.S. government has censured constituent firms of the MSCI ACWI ex-US IMI—or the controlling shareholders of such firms—through such measures as designation to the Entity List and federal procurement prohibitions. How did the Board take these developments into account when considering or revisiting investment decisions?
- (3) What disclosures is the Board planning to issue to TSP participants warning them of the material risks associated with investment in Chinese firms, including those sanctioned by the U.S. Government? How was the Board planning to inform federal employees that the I Fund may invest in companies involved in the build-up of the People's Liberation Army's conventional and nuclear-related military capabilities as well as firms responsible for the Chinese Government's Orwellian surveillance and egregious human rights abuses against Uighur Muslims and other religious and ethnic minorities in Xinjiang?
- (4) What alternative investment vehicles, designed to shield TSP participants from exposure to Chinese national security, human rights, and financial disclosure risks, did the Board consider?

It is our responsibility to these public servants to ensure that their savings do not undermine the American interests for which they serve. We look forward to your reply.

Sincerely,



Marco Rubio
U.S. Senator



Jeanne Shaheen
U.S. Senator

CC: Secretary of State Michael R. Pompeo
Secretary of the Treasury Steven T. Mnuchin
Secretary of Defense Mark T. Esper
Secretary of Commerce Wilbur Ross
Assistant to the President for National Security Affairs John R. Bolton
Securities and Exchange Commission Chairman Jay Clayton
Federal Retirement Thrift Savings Board Members
Federal Retirement Thrift Investment Executive Director