

Statement of Barclays Global Investors

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Thank you for inviting me to testify today about Barclays Global Investors (“BGI”) and its role as the external asset manager for the Federal Thrift Savings Plan (“TSP”). We appreciate the concerns of this committee in looking out for the best interests of all investors, including Federal employees, especially in the context of certain practices in the mutual fund industry that have recently come under close scrutiny. We are honored to have served as an investment manager for the TSP since 1988, and we take our responsibilities very seriously for the management of the retirement assets of the Federal workforce. We at BGI take great pride throughout our organization in maintaining the highest ethical and fiduciary standards. You have our commitment that no compromises to these standards are acceptable at BGI.

To understand why federal employees should feel confident that BGI is managing their retirement assets responsibly, it is important to first discuss our investment philosophy and our structure, both of which are focused on delivering highly reliable, low cost investment results to institutional investors like the TSP. By ‘institutional’ I refer to defined benefit and defined contribution pension plans sponsored by corporations or public agencies, and to endowments, foundations and other similar pools of capital. I will then say a few words about the service we provide for TSP, elaborate on how we keep the costs associated with trading and investing as low as possible, and briefly

describe how BGI is organized and regulated. Before concluding, I will comment on the issues concerning mutual fund managers that have received so much attention lately, and how BGI has addressed these in our business.

Barclays Global Investors was founded in 1971 as part of Wells Fargo Bank in San Francisco, California. Today, we are owned by Barclays PLC, one of the world's leading financial service providers. We remain headquartered in San Francisco with approximately 1100 employees in California and elsewhere in the U.S. and 1000 more employees worldwide serving the needs of our global clients. With more than \$1 trillion in assets under management, BGI, together with its affiliates, is the world's largest index manager. BGI created the first index strategy in 1971, just one of many financial innovations we have pioneered.

Since our founding, BGI has remained true to a single global investment philosophy, which we call *Total Performance Management*. BGI manages *performance* through the core disciplines of *risk*, *return* and *cost* management. The success of our indexing methodology results from our focus on delivering superior investment returns over time while minimizing trading and other implementation costs and rigorously controlling investment and operational risks. This simple, yet profound approach is rather unique in our industry, and helps us avoid investment "fads" or a dependence on "star managers" or "stock pickers." It has been the foundation for the way we've managed money for over 30 years and we believe it has served our clients very well.

As I noted earlier, since 1988 one of those clients has been the TSP. BGI is honored to manage four of the five investment options available for participants—the TSP C Fund (based on large-capitalization US equities), the S Fund (based on mid- and small-capitalization US equities), the F Fund (based on the Lehman Aggregate Long-term Bond index) and the I Fund (based on the MSCI Europe Australia Far East (EAFE) index of non-US equities). It is important to note that we have successfully retained this relationship in regular, highly competitive bidding processes since 1988.

BGI's services to the TSP are completely focused on investment management; we do not provide any other services. Management of payroll contributions, record keeping (e.g., changes made by participants in investment elections), distributions and communications to participants are handled directly by the TSP or its other vendors.

BGI understands that the costs and expenses of investing detract from investment performance and investment returns, and therefore we seek to minimize transaction costs in all our investment activities. In fact, the key to our success in index management has been our ability to minimize implementation and trading costs. Let me say a few words about how we do this.

The majority of BGI's clients are large institutional investors, such as defined benefit and defined contribution plans, foundations, and endowments. Because of BGI's size as an investment manager and the ability to commingle the assets of our clients, we offer

considerable economies of scale for investors and, therefore, we can achieve lower implementation and trading costs for our institutional clients, such as the TSP.

To expand on this point, each of our index funds is structured to match the performance of a specific index. These indexes (such as the S&P 500 or the MSCI EAFE) are designed, however, as ‘paper portfolios’ and do not include any of the trading costs that real-world investors experience. Thus to successfully achieve the performance target—that is, to track the index as closely as possible—BGI strives to minimize the “real world” costs through a variety of highly efficient trading approaches.

The size and diversity of our client base enable us, for example to match or offset a significant percentage of our clients’ buy and sell orders internally, thereby reducing or eliminating transaction costs. The internal matching of buy and sell orders is commonly referred to as “crossing,” and is conducted by BGI pursuant to the terms and conditions of an exemption issued by the Department of Labor. Compliance with the exemption’s conditions is actively monitored. All these transaction savings, which we estimate are in the hundreds of millions each year, are passed directly to our clients.

When we trade in the external markets, we utilize carefully developed and managed trading strategies and we access all possible sources of liquidity, including electronic marketplaces. Our trading activities are supported by a dedicated trading research team, whose sole job is to develop new trading techniques and strategies to minimize the impact of trading costs on BGI’s funds. We execute our trades through broker-dealers

who have been pre-screened for credit-worthiness, and we rigorously monitor the prices at which our trades are executed relative to a number of market-related benchmarks to ensure we are receiving superior execution. We also use our scale to negotiate low per share commission rates. In light of the current controversy regarding soft dollars, I should emphasize that BGI does not and has never used soft dollars in its trading activities on behalf of its funds.

The majority of our assets are managed for large institutional clients such as the TSP and the average account size for our US clients is \$880 million. BGI is able to charge lower investment management and administrative fees to its institutional clients than a mutual fund firm geared towards retail investors, where the average account size is comparatively small¹ and costs of administrative services (including shareholder communications and recordkeeping) are considerably higher. By way of example, the average fee for large capitalization US equity index portfolios of \$100 million in size that are managed for institutional clients is 0.05% versus retail-oriented equity index mutual funds where the fees average 0.73%.

Over the course of a long-term investment, lower management fees and expenses (including trading commissions) can translate into considerable savings for an investor. Indeed, index investing remains the most cost-efficient and diversified way to gain exposure to various segments of the capital markets. We believe index funds are the best

¹ According to the Investment Company Institute's Mutual Fund Fact Book 2003, the median household had mutual fund assets of \$40,000 as of December 2001.

core investment for most investors' portfolios – whether they are the largest pension fund in the world, or an individual investor.

Let me say a few words about the comprehensive regulatory oversight of BGI. Barclays Global Investors, N.A. is a national banking association organized under the laws of the United States. BGI operates as a limited purpose trust company, whose primary regulator is the Office of the Comptroller of the Currency (“OCC”), the agency of the US Treasury Department that regulates national banks. The OCC ensures that the fiduciary activities of national banks are conducted in a manner that promotes the safety and soundness of both the overall national banking system and the individual bank. The OCC conducts regular and frequent examinations of BGI to ensure that it is exercising its powers in accordance with these requirements.

BGI is also subject to the jurisdiction of the US Department of Labor to the extent that its clients are subject to the Employee Retirement Income Security Act of 1974 (“ERISA”). As the manager of the assets of the TSP, BGI is also subject to the Federal Retirement Income Security Act of 1974, a statute modeled closely on ERISA.

BGI provides investment management services for separate accounts, common trust funds and group trusts and other investment vehicles. The TSP, along with many of our other institutional clients, is invested in bank collective funds (legally trusts), which are subject to OCC oversight. TSP assets are commingled with ERISA assets in BGI's collective funds. In contrast, mutual funds are investment companies subject to SEC oversight, and the activities of mutual funds are not subject to ERISA. Bank collective

funds are only open to qualified institutional investors such as public and corporate pension funds, foundations and endowments—hedge funds and individual investors (except indirectly through their defined contribution plans) are not permitted to invest in them.

BGI's operating procedures and internal controls with respect to its fund management activities are examined annually by an independent accounting firm, currently PricewaterhouseCoopers LLP, and Barclays Internal Audit Group. BGI's procedures and controls are also reviewed by the Audit Committee of BGI's Board of Directors and the Audit Committee of Barclays Group. The purpose of these annual reviews is to ensure that adequate controls are in place to safeguard client assets.

Under OCC regulations, a bank, such as BGI, that administers collective funds must have an annual audit made of each fund by auditors responsible only to the bank's board of directors. Based on this audit, the bank must prepare an annual financial statement of each fund within 90 days of the end of the fund's fiscal year. Copies of the annual financial statements of the funds in which the TSP assets are invested are provided each year to the Thrift Investment Board and other participating clients.

Additionally, other regulators, including the Securities and Exchange Commission, the National Association of Securities Dealers, the Commodity Futures Trading Commission and the National Futures Association provide regulatory oversight as to other parts of BGI's business, generally unrelated to the service provided to the TSP.

Before concluding, allow me to comment on certain practices in the mutual fund industry that have recently come under close scrutiny. We recently conducted a thorough review at BGI of these issues, including late trading, market timing and personal trading by BGI personnel. I am pleased to report that we have found no issues at BGI of significant concern, or any practices that compromise our fiduciary responsibilities to the TSP, or any other client. Our review also confirmed that BGI's choice of brokers is made only in regard to their ability to provide best execution for BGI's clients. As I said, we take our responsibilities as an investment manager for the retirement assets of federal employees very seriously.

Mr. Chairman, as a citizen and taxpayer, I appreciate the service that federal employees provide for this country, and every federal employee should feel confident that we at BGI are managing his or her TSP retirement assets responsibly. We appreciate the trust that has been placed with BGI.

As an organization, we take great pride in maintaining the highest ethical and fiduciary standards, and you have our commitment that no compromises to these standards are acceptable at BGI. We look forward to maintaining an open dialogue with the TSP and members of this Subcommittee on these key issues in the future. Thank you very much for the opportunity to share our views today with the Subcommittee.