THE WHITE HOUSE

WASHINGTON

May 11, 2020

The Honorable Eugene Scalia
Secretary of Labor
Department of Labor
200 Constitution Avenue N.W.
Washington, D.C. 20210

Dear Secretary Scalia:

It has come to our attention that billions of dollars from our federal employees' retirement funds in the Thrift Savings Plan (TSP) will soon be invested in Chinese companies.[1] This action would expose the retirement funds to significant and unnecessary economic risk, and it would channel federal employees' money to companies that present significant national security and humanitarian concerns because they operate in violation of U.S. sanction laws and assist the Chinese Government's efforts to build its military and oppress religious minorities. Further, the Federal Retirement Thrift Investment Board (Board) is set to implement these plans during a time of mounting uncertainty concerning China's relations with the rest of the world, including the possibility that future sanctions will result from the culpable actions of the Chinese Government with respect to the global spread of the COVID-19 pandemic. In view of these considerations, we do not believe that proceeding with the investment of the retirement savings of hardworking federal workers in Chinese companies is prudent.

Departing from the Board's established index for the International Stock Investment Fund (I Fund) to track one that maintains Chinese equities is risky and unjustified. Investing in certain Chinese equities based on this latter index poses significant investment risks, which are likely only to increase as China's share of emerging-market investment indexes increases in future years. The financial impact of this risk is significant: scandals involving Chinese companies in recent years have cost investors billions of dollars.[2] In addition, the Chinese Government currently prevents companies with Chinese operations listed on U.S. exchanges from complying with applicable U.S. securities law, leaving investors without the benefit of important protections. According to the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB), Chinese authorities have impeded the PCAOB's ability to oversee PCAOB-registered audit firms in mainland China and Hong Kong who serve mainland Chinese companies. This has prevented the PCAOB from conducting

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[1] *See* Minutes of the Meeting of the Board Members, Federal Retirement Thrift Investment Board (Nov. 28, 2017), *available at* https://www.frtib.gov/MeetingMinutes/2017/2017Nov.pdf; Minutes of the Meeting of the Board Members, Federal Retirement Thrift Investment Board (Nov. 13, 2019), *available at* https://www.frtib.gov/MeetingMinutes/2019/2019Nov.pdf.

[2] Ryan Vlastelica, Daniel Bases, *Special report: Chinese stock scams are the latest U.S. import,* Reuters (May 11, 2011), https://www.reuters.com/article/us-china-shortsellers/special-report-chinese-stock-scams-are-the-latest-u-s-import-idUSTRE74A71F20110511.

inspections of those firms' audits of Chinese companies in violation of U.S. law.[3] Recently, a Chinese law came into effect that prevents the PCAOB from directly conducting its oversight function inside Chinese territory.[4] This is part of the significant legal and practical obstacles to the SEC and PCAOB obtaining information needed for investigations or enforcement actions.[5] The Chinese Government's intentional thwarting of U.S. investor protections should raise serious concerns about the reliability of financial information from Chinese companies and demonstrate the significant risks to investors, especially retail investors such as TSP beneficiaries, of investing in the companies listed on the Chinese exchanges that would be represented in the new index.

In addition to the uncertainties surrounding the financial reporting of these companies, some of the Chinese companies themselves present significant national security and humanitarian concerns for the United States, which increases the risk that they could be subject to sanctions, public protests, trade restrictions, boycotts, and other punitive measures that jeopardize their business and profitability. The list of companies that would receive federal retirement funds under the Board's decision includes, for example, military contractors that provide military aircraft and telecommunications support to the People's Liberation Army. The list also includes companies that manufacture surveillance equipment that China uses to oppress religious minorities as well as one company indicted for engaging in economic activity with Iran and North Korea in violation of U.S. sanctions law.

Recent events, which the Board could not have anticipated when it affirmed its decision in November 2019 to move forward with adding Chinese-listed equities to the I Fund, have heighted these risks. The Chinese Government concealed critical information from the United States and the rest of the world regarding COVID-19 and exacerbated the ensuing global pandemic. After first reporting its cases of the novel coronavirus in late December 2019, the Chinese Government concealed and delayed releasing critical information about the virus's origins and characteristics. These events dramatically increase the risk that Chinese companies could be subject to sanctions or boycotts that jeopardize their business and profitability and

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[3] *See* Statement on Continued Dialogue with Audit Firm Representatives on Audit Quality in China and Other Emerging Markets; Coronavirus – Reporting Considerations and Potential Relief (Feb. 19, 2020), *available at* http://www.sec.gov/news/public-statement/statement-audit-quality-china-2020-02-19; Press Release, SEC Chairman Clayton, PCAOB Chairman Duhnke, and Members of SEC Staff Meet With Auditing Firm Representatives to Discuss Audit Quality in Emerging Economies and Markets (Nov. 4, 2019), *available at* http://www.sec.gov/news/press-release/2019-228; Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China (Dec. 7, 2018), *available at* https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other.

[4] Kingsoft Cloud Holdings Ltd., Amendment No. 3 to Form F-1 Registration Statement, at 53 (May 6, 2020) ("According to Article 177 of the PRC Securities Law which became effective in March 2020, no overseas securities regulator is allowed to directly conduct investigation or evidence collection activities within the territory of the PRC."), *available at* https://www.sec.gov/Archives/edgar/data/1795589/000119312520134935/d805184df1a.htm.

[5] Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China (Dec. 7, 2018), *available at* https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting#_ednref20.

strongly militate against the Board making a significant investment of federal workers' retirement funds in Chinese companies at this time.

Finally, the Board has available alternatives that would permit it to expand its I Fund investment offering to a broader range of international equities while avoiding the risks of Chinese-listed equities. Even if the Board believed that the I Fund's investments should expand to include what MSCI has labeled "Emerging Markets," there are means by which the Board could make investments broadly tracking the rest of those markets while excluding China, given the unique concerns associated with companies on Chinese exchanges. As it has for decades, the Board therefore may fulfill its statutory obligation to offer federal workers "a reasonably complete representation of the international equity markets excluding the United States equity markets" using "commonly recognized" indexes without making a risky venture into Chinese companies.[6] Indeed, the fact that MSCI maintains an "Emerging Markets ex China Index"—which excludes Chinese equities—underscores that there are prudent investment choices that allow for a more broadly diversified portfolio without exposure to the special risks associated with China at this time.

Given that transactions to effectuate the change in the I Fund's benchmark index are expected to begin as early as the first week of June, we believe that the Board should cease implementation immediately. We would appreciate a response regarding the Board's intentions by May 15, 2020.

Respectfully,

Lawrence Kudlow
Director, National Economic Council

Robert C. O'Brien
National Security Advisor

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[6] *See* 5 U.S.C. § 8438(b)(4).