



MEETING OF THE BOARD OF TRUSTEES
FEBRUARY 25, 2014



PRESENTED FOR REVIEW AND APPROVAL
MAY 20, 2014

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**BOARD OF TRUSTEES MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS**

**February 25, 2014
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

TRUSTEES PRESENT

Brian Ragland, Chair
Frederick E. Rowe, Jr., Vice-Chair
Cydney Donnell, Member
Yolanda Griego, Member
I. Craig Hester, Member
Cheryl MacBride, Member

ERS STAFF PRESENT

Ann S. Bishop, Executive Director
Larry Zeplin, Chief Operating Officer
Tony Chavez, Internal Auditor
Paula A. Jones, General Counsel and Chief Compliance Officer
Robert P. Kukla, Director of Benefit Contracts
Mel Mireles, Chief Information Officer
Shack Nail, Deputy Director of Governmental Affairs
Ralph Salinas, Human Resources Director
Marc B. Sundbeck, Manager of Enterprise Risk Management
Catherine Terrell, Director of Governmental Affairs
Tom Tull, Chief Investment Officer
Debbie Warren, Director of Customer Benefits
Mike Wheeler, Chief Financial Officer
Carolyn Anderson, Investments
Lori Blewett, Benefits Communication
Kelley Davenport, Executive Office
Robin Hardaway, Customer Benefits
Sharmila Kassam, Investments
Debbie Leatham, Finance
Robert Lee, Investments
Betty Martin, Investment
Nancy McCarthy, Investments
Leighton Shantz, Investments
Martha Wall, Governmental Affairs
Mary Jane Wardlow, Governmental Affairs

ALSO PRESENT

Anthony Bookman, Cross River Advisors
Leslie Cunningham, Texas State Employees Union
Vernma Elliott, State Auditors Office
Meredyth Fowler, Speaker Joe Straus
Melissa Fullerton, Delta Dental
Juan Garcia, Office of the Governor
Melinda Griffith, CLEAT
Kirk Lavalley, Delta Dental
Alyssa Martin, Weaver L.L.P.

Belinda Martinez, Delta Dental
Emily Morgani, Legislative Budget Board
Anca Pinchas, State Auditors Office
John Wauson, Weaver L.L.P.

Mr. Brian Ragland, Chairman of the Board of Trustees (BOT) of the Employees Retirement System of Texas (ERS), called the meeting to order and read the following statement:

“A public notice of the Joint Meeting of the Board of Trustees (Board) and Investment Advisory Committee (IAC) containing all items on the proposed agenda was filed with the Office of the Secretary of State at 9:16 a.m. on Friday, February 14, 2014 as required by Chapter 551, Texas Government Code, referred to as The Open Meetings Law.”

The Board of Trustees convened as a committee of the whole at 8:30 a.m. to consider Audit Committee agenda items.

I. PRESENTATION, DISCUSSION AND CONSIDERATION OF AUDIT COMMITTEE AGENDA ITEMS:

a. External Audit Reports – Mr. Hester, Chair of the Audit Committee opened up the meeting by introducing Mr. Tony Chavez, ERS Director of Internal Audit. Mr. Chavez introduced Ms. Vernma Elliott and Ms. Anca Pinchas from the State Auditors Office to present the results of the SAO’s financial opinion audit of ERS’ Comprehensive Annual Financial Report.

Ms. Pinchas, SAO Project Manager for the financial audit, stated that the financial statements were materially correct and presented in accordance with accounting principles generally accepted in the United States of America. Ms. Pinchas also reported audit procedures did not identify any material weaknesses in internal control over financial reporting or any non-compliance with laws and regulations that materially affect the financial statements. The SAO did communicate to ERS management certain issues that were not material or significant to the audit objective.

Mr. Chavez continued with the second external report which was regulatory compliance review performed by the Texas Workforce Commission (TWC). This is a statutorily required review performed on a six-year cycle and consisted of reviewing policies and procedures for compliance with employment and discrimination laws. Mr. Chavez reported based on the report dated of January 8, 2014, that TWC certified compliance with statute in all respects.

Mr. Chavez then reported Internal Audit has initiated an insurance actuarial review RFP in connection with ERS insurance actuary and the actuary assumptions used in FY12 and FY13. The review is performed every five-years as an internal initiative and the final report is scheduled to be presented at the August 2014 Audit Committee meeting.

There being no further questions or discussion the Board then took the following action:

MOTION made by Ms. Donnell, seconded by Ms. MacBride and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas to accept the financial audit reports as prepared by the State Auditor’s Office and presented in this agenda item.

b. Internal Audit Reports – Mr. Chavez reported the next agenda item on internal audit reports and stated in accordance with the *Fiscal Year 2014 Annual Audit Plan*, ERS conducted quarterly investment compliance procedures for October – December 2014. Mr. Chavez reported there were changes to this report to address quality assessment review recommendations. Revisions include language and format edits to clarify level of assurance provided in accordance with audit standards. Mr. Chavez reported there were exceptions noted for procedures performed over proxy voting and securities lending.

There were no questions or further discussion, and no action was required on this item.

II. ADJOURNMENT OF THE AUDIT COMMITTEE – FOLLOWING ADJOURNMENT OF THE AUDIT COMMITTEE, THE BOARD OF TRUSTEES WILL TAKE UP THE REMAINING AGENDA ITEMS

III. REVIEW AND APPROVAL OF THE MINUTES TO THE DECEMBER 6, 2013 MEETING OF THE BOARD OF TRUSTEES

Chair Brian Ragland opened the floor for a motion on the approval of the minutes to the Board of Trustees meeting held on December 6, 2013.

MOTION made by Ms. Donnell, seconded by Mr. Hester and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas to approve the minutes to its meeting held on December 6, 2013.

IV. REVIEW AND DISCUSSION OF ENTERPRISE RISK MANAGEMENT UPDATE

Ms. Marci Sundbeck, Director of Enterprise Risk Management (ERM), presented to the Board an update on ERM and introduced Ms. Alyssa Martin, Executive Partner, and John Wauson, Senior Manager of Weaver.

Ms. Sundbeck reminded the board that at the December 6, 2013 meeting the results of the entity-wide risk assessment was presented. Three risk assessment forum meetings with staff from across the agency were held to discuss and evaluate how entity-level risks influence operational, financial and compliance activities. ERS used the top seven internal and external risk factors identified in the entity-wide risk assessment. Activities were ranked for risk probability and impact using the same scale used for entity-level risk assessment. A 12- to 18-month forward-looking view for the risk ratings was used. She also reported that staff developed consensus for the risk ratings regarding significant risk activities and calculated the probability and impact ratings to derive one enterprise risk score for each of those processes.

Each area was individually ranked based on the specific risk factors identified for the seven entity-level risk categories:

- Economic Risk
- Political Risk
- Financial Stability Risk
- Human Capital Risk
- Regulatory Risk
- Information Technology Risk
- Investment Risk

Ms. Sundbeck continued to discuss the top 20 highest rated risk activities and risk map from the process level assessment. Activities were ranked on a scale of 1 to 5, with 1 representing a low (remote and insignificant) risk of probability and impact and a 5 representing a high (highly probable and massive) risk of probability and impact. The risk map of the top 20 risk rated activities provides a visual representation of the risk processes in relation to one another overall.

Ms. Sundbeck proceeded to discuss the risk maps by process in the operational group benefits & retirement programs and the investment program areas. The risk assessment is designed to assess inherent risk. Ms. Sundbeck reported on the mitigating factors that are in place. The ERM program will incorporate identification and monitoring of key risk mitigation activities.

There were no questions or further discussion, and no action was required on this item.

V. REVIEW, DISCUSSION AND CONSIDERATION OF PROPOSED RETIREMENT PROGRAM FACTOR TABLES

Ms. Martha Wall, Retirement Policy Analyst, introduced to the board Ms. Robin Hardaway, Assistant Director of Customer Benefits, who presented the next agenda item on Proposed Retirement Program Factor Tables. Ms. Wall stated the proposed set of retirement factor tables are being proposed for an effective date of September 1, 2014. Upon the board's adoption, factor tables will be used to calculate various retirement annuity reductions and also service purchases made by our members. Ms. Wall stated that it is important that the factors used to calculate these annuity benefits and service purchases reflect the plans benefits and also reflect the adopted assumptions that were adopted by the board last year.

Ms. Wall reminded the board of the results of the 2011 experience study where there were some recommended changes to some demographic assumptions that resulted in about \$80 million savings (or a reduction to the total plan liability). As a result, the study found that fewer employees had retired than expected, more regular employees left state employment and across various populations there were fewer deaths than expected. In addition S.B. 1459 created Plan 3 for new employees hired after August 31, 2013. Plan 3 includes the following changes:

- Individuals that retire before age 62 (57 for LECOS) receive a 5% reduction to their annuities for each year retired before age 62;
- Unused annual leave cannot be used to increase annuity if it is cashed out upon retirement; and
- Final average salary used to calculate annuity is based on the highest 60 months.

Ms. Hardaway reported factors to the board that were used to reduce the annuities when members select a beneficiary option (options 1-5), select a partial lump sum option, qualify for disability retirement, and retire under the LECOS early retirement provisions. She also stated ERS carefully reviewed the factors and determined that there is minimal impact to the member.

Ms. Wall reported that system implementation for annuity reduction factors were produced internally from the programmed formulas. Gabriel Roeder Smith & Company (GRS), ERS' consulting actuary for retirement, has reviewed, tested and certified that the factor tables produced by the ERS system have been calculated correctly. Upon adoption by the Board, the proposed annuity reduction factors will be ready for the "go-live" date of June 1, 2014 for September retirements.

Ms. Hardaway reported there are two types of service purchases. Qualified ERS members may purchase up to 3-years of additional service credit on an actuarially neutral basis and a 90-day waiting period can be purchased after the waiting period has concluded. GRS advised ERS of a way to simplify its process and administration of certain service purchases. Ms. Hardaway stated that one of the methods is to apply a consistent method of determining the salary used to calculate the cost and eliminate the need for a separate set of factors for those eligible to retire before/after the purchase of additional service. Salary averaging periods are incorporated directly into the factors. Ms. Hardaway reported that methodology does not affect all service purchases. The judicial and elected class calculation methods remain unchanged, but the tables were adjusted based on the adopted assumptions. Withdrawn service and military service purchase costs will continue to be calculated based on a 10% interest.

Ms. Wall then proposed that staff recommends the adoption of the factor tables with an effective date of September 1, 2014.

There being no further questions or discussion the Board then took the following action:

MOTION made by Ms. MacBride, seconded by Ms. Yolanda Griego and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas to adopt the proposed retirement program actuarial factor tables effective September 1, 2014.

VI. REVIEW AND DISCUSSION OF ELIGIBILITY AND COMPLIANCE FOR FISCAL YEAR 2013 OF THE INVESTMENT ADVISORY COMMITTEE

Ms. Sharmila Kassam, Investment Chief of Staff, presented the next agenda item on Eligibility and Compliance for fiscal year 2013 of the Investment Advisory Committee. She informed the board that pursuant to the *ERS Investment Policy*, the Investment Advisory Committee (IAC) was established at the discretion of the Board of Trustees (BOT) in the Texas Administrative Code. The Texas Government Code and *ERS Investment Policy* prescribe requirements for the IAC eligibility and those eligibility requirements are reviewed by the Board annually.

Ms. Kassam reported that ERS staff has facilitated the Board's review of the IAC for calendar year 2013. IAC members are required to complete an affirmation of their qualifications and eligibility, and staff prepared an accounting of their attendance for calendar year 2013. Ms. Kassam reported that staff found the IAC members were all eligible according to statute and policy.

There were no questions or further discussion, and no action was required on this item.

VII. EXECUTIVE DIRECTOR'S REPORT

Ms. Ann Bishop proceeded with the next agenda item on the Executive Director's Report. Her report to the Board is included with these minutes¹.

XVI. CHIEF INVESTMENT OFFICER REPORT

This item was taken out of order and presented during the Board of Trustees Meeting

Mr. Tom Tull, Chief Investment Officer, presented the Chief Investment Officer report. Mr. Tull discussed major initiatives for fiscal year 2014 and staffing changes since the last CIO report.

Mr. Tull introduced the initiatives for fiscal year 2014. The investment division wants to continue to address a plan for the unfunded pension liability, continue to enhance and develop the risk management processes and implement a derivatives program to efficiently implement tactical asset allocation.

Mr. Tull discussed the development of the internship program for under-graduate and graduate students. Additionally, an OMS program is being implemented for ERS staff interested in the investments industry. The program will also focus on diversity in the industry. The Investments department is working closely with Human Resources to create internal career path development and succession planning.

¹ Exhibit A – page 7

Regarding staffing changes, with the retirement of Jim Sherwin, the strategic research group was split in two. Carlos Chujoy, Strategic Research Portfolio Manager, is leading Risk Management and Applied Research and Sharmila Kassam, Investments Chief of Staff, is now leading the External Management team, which includes the Emerging Manager Program. Three internal promotions have been awarded, and one individual departed from the ERS Investments department.

Mr. Tull described the new asset allocation program. ERS is continuing to accelerate the transition and the allocation commitments in all investment programs are on track to be in place by 2016. Private real estate commitments are on track for meeting allocation targets by 2015 and private equity by 2016. Private infrastructure commitments are being restrained due to an unfavorable investment environment (too much money chasing too few good deals). The Hedge Funds/Absolute Return assets should meet their target this fiscal year. The fixed-income Transition mandate, which is made up of legacy investment grade issues prior to a shift to Rate and Credit has been largely liquidated more effectively than expected due to market volatility.

Mr. Tull concluded the CIO report by announcing the fiscal year-to-date savings. Due to negotiated fee quotes and terms, the legal department saved the trust \$4.8 million. He also welcomed input from the Board and IAC to take the investment program to the next level.

There were no questions or further discussion, and no action was required on this item.

VIII. SET DATE FOR THE NEXT JOINT MEETING OF THE ERS BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE, THE NEXT MEETING OF THE BOARD OF TRUSTEES AND THE NEXT MEETING OF THE AUDIT COMMITTEE

Tuesday, May 20, 2014, was set for the next regular meetings of the Board of Trustees and Investment Advisory Committee, Board of Trustees and Audit Committee.

IX. RECESS OF THE BOARD OF TRUSTEES – FOLLOWING A TEMPORARY RECESS, THE BOARD OF TRUSTEES WILL RECONVENE WITH THE INVESTMENT ADVISORY COMMITTEE TO TAKE UP THE REMAINING AGENDA ITEMS

PUBLIC AGENDA ITEM - #7

7. Executive Director's Report

February 25, 2014

Survey of Employee Engagement (SEE)

ERS participated in the Survey of Employee Engagement (SEE), again this year. The Institute for Organizational Excellence conducts the survey every two years and ERS has participated since 2000.

The SEE gauges employee job satisfaction, identifies what the agency does well, and where we can improve employee engagement and satisfaction. The survey focuses on the key drivers an organization needs to engage employees toward successfully fulfilling the vision and mission of the organization.

Following the 2012 survey, ERS followed up to get more information on specific areas where we needed to improve. For example, staff in Customer Benefits wanted more cross training within the division and the agency. Staff in Investments, Finance, and Communications and Research asked for additional team building activities. Staff from most areas indicated that compensation needed to be fair.

We took those results and concentrated on expanding internal communications, increasing compensation for positions paid below fair market value, further developing cross-divisional teams, and building and enhancing internal training by focusing on topics of interest to employees. We also created the Office of Management Support (OMS) program to develop staff for succession planning.

As with any organization, there is always room for improvement. My plan is to share the results with you at the next board meeting in May, so we can celebrate our successes for achieving positive change in the agency.

Interim Charges

The Lieutenant Governor and the Speaker of the House have issued interim charges. The House Pensions Committee will be examining the impact of the new GASB reporting requirements. In a joint charge with House Appropriations, the Pension Committee will also examine the immediate and long term fiscal impact of the ERS employee health care plan. The House State Affairs committee has an interim charge about state agency contracting, including studying the procedures agencies use to determine the costs versus benefits when evaluating proposals.

In the Senate, the Government Organization Committee is also studying state agency contracting. The Senate State Affairs Committee has a charge to study the impact of the Affordable Care Act on Texas. ERS will continue to monitor the interim charges, and provide information or testimony as requested.

GetFitTexas State Agency Challenge

ERS employees are participating in a wellness challenge for state agency employees that started January 13 and runs through March 22. The GetFitTexas State Agency Challenge is a fun and easy opportunity for state employees to get and stay active in a friendly agency-to-agency competition. Participants commit to completing at least 150 minutes per week of physical activity and then track and log their activities on the GetFitTexas website.

I am proud to report that ERS has a 65% participation rate and is ranked fifth across all state agencies. ERS encourages employees to meet their weekly goals with organized walk breaks throughout the day, or yoga and salsa dancing which is offered on site.

ERS grants four hours of administrative leave to employees successfully completing at least 6 of the 10 weeks of the challenge. Those successfully completing the full 10-week challenge are entered into a drawing for a month of a "VIP" parking space.

The Texa\$aver 401(k) and 457 Program wins a 2014 Eddy Award and 2013 MarCom Awards

Pensions & Investments (P&I) magazine announced the Texa\$aver Program is a winner of its Eddy Award for its “**1% Contribution Increase**” campaign. The award will be presented on March 3, 2014. *P&I* is a highly respected publication in the financial industry, and the Eddy Award is a prestigious honor.

The Association of Marketing and Communication Professionals announced Texa\$aver is the winner in five of its MarCom Award categories: a platinum award for Employee Benefits; gold awards for Marketing, Mobile & Web-Based Technology, and Design; and an honorable mention for Writing.

The 1% campaign focused on encouraging Texa\$aver participants who were auto-enrolled in the 401(k) plan at 1% to increase their contribution rate. The campaign consisted of more than 20 communication touch-points designed to encourage participants to increase their savings rate through creative web, mobile, and marketing communications. Each touch-point featured a cleverly designed “What’s Your Excuse” call-out, such as “I’ll save when I’m older,” and “I’ll just wait until I win the lottery.” The campaign helped 2,753 participants move toward increasing their contribution beyond 1% to a higher savings percentage. The Texa\$aver Program emphasizes the three-legged stool for retirement savings: contributions to the ERS retirement plan, Social Security, and additional savings through a Texa\$aver 401(k) or 457 account.

Dawn Eserini Selected AAFAME President for 2014

I am proud to announce that Dawn Eserini has been selected to serve as President of the Austin Association of Facility and Maintenance for 2014. Dawn is the first woman to serve as president since it was organized in 1985. Dawn is a 20-plus year employee of ERS who currently serves as our Building Superintendent. She has been a member of the association since 2001. AAFAME [*say A-fame*] is a non-profit and volunteer-based organization with 440 members who represent more than 175 companies in Austin and the surrounding area.

Dawn has completed certification from UT in the Project Management Program, and currently is working toward her designation for Leadership in Energy and Environmental Design. She is a member of the Austin chapter of the US Green Building Council (USGBC), an active member of Executive Women in Texas Government, Chair of the ERS Worklife and Wellness Committee and serves as the agency’s Safety Officer. Congratulations, Dawn!

ERS expands outreach

ERS hosted its popular Staying Connected Fair in two more cities this winter – Dallas and Houston. The popular events are open to all retirees and family members in the area. The fairs have speakers, exhibitors and give retirees the opportunity to speak with ERS representatives one on one. State Representative Roberto Alonzo and a staff member from Representative Stefani Carter’s office attended the Dallas fair. Both events were a success with about 250 in attendance at each fair in Dallas and Houston.

We have also hosted a number of briefing sessions for members of the legislature and their staff, as well as speaking at association conferences. In addition, ERS staff is traveling with HealthSelect representatives to visit with members at the Capitol and throughout the state to identify and resolve any lingering issues that may have occurred with the transition.