



Meeting of the Board of Trustees

August 18, 2015



Presented for Review and Approval

December 4, 2015

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

**AUGUST 18, 2015
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

TRUSTEES PRESENT

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

ERS STAFF PRESENT

Porter Wilson, Executive Director
Shack Nail, Interim Deputy Executive Director
Paula A. Jones, General Counsel and Chief Compliance Officer
Tony Chavez, Internal Auditor
Bernie Hajovsky, Director Enterprise Planning Office
Jordan Hajovsky, Director Operations Support
Robin Hardaway, Director of Customer Benefits
Robert Kukla, Director of Benefit Contracts
Wendy McAdams, Director Operations Support
Ralph Salinas, Director of Human Resources
Catherine Terrell, Director of Governmental Affairs
Kathryn Tesar, Director of Benefits Communications
Tom Tull, Chief Investment Officer
Charles Turner, Chief Information Officer
Mike Wheeler, Chief Financial Officer
Nora Alvarado, Benefit Contracts
Brannon Andrews, Legal Services
Georgina Bouton, Benefit Contracts
Lisa Caffarate, Benefit Contracts
Kelley Davenport, Executive Office
Brian Dowdy, Finance
Blaise Duran, Benefit Contracts
Leah Erard, Governmental Affairs
Beth Gilbert, Internal Audit
Megan Hunter, Benefit Contracts
Dana Jepson, Governmental Affairs
Sharmila Kassam, Investments
Debbie Leatham, Finance
Betty Martin, Investments
Patricia Maugham, Executive Office
Jonathan Puckett, Internal Audit
Tanna Ridgway, Investments
Lauren Russell, Benefit Contracts
Chineque Sterns, Human Resources
John Streun, Investments
Bernely Tharp, Benefit Contracts
Angelica Torres, Benefit Contracts
MaryJane Wardlow, Governmental Affairs

Keith Yawn, Enterprise Planning Office

ALSO PRESENT

Steve Alexander, UnitedHealthcare
Nick Arnold, Humana
Anjali Bhalodia, Gensler
Phil Dial, Rudd & Wisdom, Inc.
Kris Hefner, CVS/Caremark
Peter Jansen, CBRE Public Institutions & Education Solutions
Priya Kapila, CBIZ Humana Capital Services

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

“A public notice of the Board of Trustees meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 9:38 a.m. on Thursday, August 6, 2015 as required by Chapter 551, Texas Government Code, referred to as “The Open Meetings Law.”

Upon adjournment of the Audit Committee, the Board of Trustees convened as a committee of the whole to consider the following Board agenda items. Minutes to the May 19, 2015 Audit Committee Meeting are located under the Audit Committee agenda minutes.

X. EXECUTIVE DIRECTOR’S REPORT *(This item was presented during the Joint Meeting)*

Mr. Porter Wilson, Executive Director proceeded with the next agenda item, Executive Director’s Report. His report¹ to the Board is included with these minutes.

XII. REVIEW AND APPROVAL OF THE MINUTES TO THE MAY 19, 2015 MEETING OF THE BOARD OF TRUSTEES

Board of Trustee Chair, Brian Ragland opened the floor for a motion on the approval of the minutes to the Board of Trustees Meeting held on May 19, 2015.

MOTION made by Ms. Yolanda Griego, seconded by Mr. Craig Hester and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas to approve the minutes held on May 19, 2015.

XIII. REVIEW, DISCUSSION AND CONSIDERATION OF THE TEXAS EMPLOYEES GROUP BENEFITS PROGRAM:

a. *HealthSelectSM of Texas Financial Status Update as of June 30, 2015* – Mr. Rob Kukla, Director of Benefit Contracts presented to the board an update on the Texas Employees Group Benefit Program (GBP) health plan financial status update and reported that the July FY2015 results of the total revenue for the GBP health plan is estimated to be \$3,085.8 million with a total GBP plan expenditures estimated at \$3,078.5 million. The plan is estimated to have a net gain of \$7.3 million. Mr. Kukla reported that the GBP should finish the plan year at \$386 million in the contingency fund.

Mr. Kukla reported there are five Patient Centered Medical Home (PCMH) programs in place across Texas: two in Austin, one each in Tyler, Lubbock and Houston. An additional cost containment strategy utilized by the agency is the Dependent Eligibility Audits (DEA). The Gap Audit, a review of those members who added dependents since the last audit was completed in FY2014. Along with a new on-going DEA at time of enrollment, the DEA is expected to save \$8.7 million in FY2015.

¹ Exhibit A - Page 16

Mr. Blaise Duran, Team Lead of Underwriting, Data Analysis and Reporting stated the Affordable Care Act (ACA) has added some cost to the plan and effective September 1, 2014 there is a change to the waiting period from the first of the month following 90-days of employment to the first of the month following 60-days of employment. Mr. Duran reported there are some fees associated with the ACA that total about \$41.4 million for FY2015. The Patient Centered Outcomes Research Institute (PCORI) fee is at \$1.1 million, the transitional reinsurance fee at \$22.7 million and the health insurance provider's fee at \$17.6 million. Effective January 1, 2015, ERS implemented an out-of-pocket maximum as required by the ACA. Mr. Duran noted this is a \$6,350 for the individual and \$12,700 for the family. This is for medical expenses only and does not include prescription drugs.

Mr. Duran reported the prescription drug program experienced a higher than normal trend and cost impact during FY2015 due to the increased utilization of drugs used to treat and cure Hepatitis C. There are three drugs that are new to the market as of the end of FY2014: Sovaldi, Harvoni and Olysio. They represent 3.4% of the total HealthSelect drug spend as of May. Mr. Kukla reported that ERS has been working with Caremark to ensure that these drugs are dispensed appropriately and that the individuals who are utilizing them. The medications are expensive. They should be prescribed and utilized appropriately and people need to adhere to the therapy prescribed.

In a response to a question asked by Mr. Hester wanting to know if it is a one-time treatment regimen and how long does the treatment regimen last, Mr. Kukla reported that depending on which drug you use, the therapy is 12-weeks at a cost of \$8,000 per week or \$96,000.

In a response to a question asked by Mr. Shad Rowe wanting to know what happens when an employee turns 65 and becomes eligible for Medicare, Mr. Kukla stated the employee ages into the Medicare Employer Group Waiver Plan (EGWP+Wrap) so they are provided exactly the same benefits they would have received under the HealthSelect while an active employee. The age-in process becomes the only plan that is available to them and it allows ERS to take advantage of significant subsidies the federal government offers through the Centers for Medicare Medicaid and offsets a significant portion of the cost to those people.

Mr. Duran reported that in 2014, ERS saw a huge increase in utilization cost of compound drugs. As an example in June 2014, it was 346% more than June 2013 and in FY2014, ERS paid nearly \$36 million. So to mitigate the risk, ERS implemented the following strategy:

- All compound ingredients not FDA approved, including bulk chemicals, are excluded; and
- Prior authorization is required for prescriptions \$300 and up.

As a result of these changes, the plan cost of compound drugs has decreased significantly as the plan spent slightly less than \$92,000 on compound drugs in June 2015.

Mr. Kukla began to speak on the outlook for FY2016 prescription drug trend and stated the ACA fees are projected to go down in 2016 from \$41.4 million to \$35.5 million due to reduction in the transitional reinsurance fee which will be eliminated next year. Effective January 1, 2016, as required by the ACA, both the network medical and pharmacy copayments, coinsurance, and applicable deductibles will be included in an overall total out-of-pocket maximum of \$6,450 per individual and \$12,900 per family. Cost to the plan is expected to increase by \$1.2 million in FY2016.

Mr. Duran reported trends are expected to remain high due to the continued utilization of specialty drugs (Sovaldi, Harvoni and Olysio). The anticipated launch of new class of specialty drugs referred to as Proprotein Convertase Subtilisin Kexin type 9 (PCSK9) inhibitors for the treatment for uncontrollable high cholesterol. Mr. Duran reported it is expected to have a large impact on the specialty drug trend and they could potentially have a really broad application and could be utilized in the treatment of up to as many as 1 in 3 Americans. In order to control the cost and ensure appropriate use of the drugs, PCSK9 will be subject to prior authorization.

Mr. Kukla provided an outlook on FY2016 HealthSelect Medicare RxSM and stated that ERS implemented an EGWP+Wrap for Medicare-primary participants in the HealthSelect prescription drug plan on January 1, 2013 and is at a projected savings of \$55 million over and above the Retiree Drug Subsidy program. Since September 1, 2014 ERS has required Medicare-primary participants to automatically age into HealthSelect Medicare Rx when they become eligible. Participants who became Medicare-primary prior to September 2014 were previously held from aging into the program but were moved into HealthSelect Medicare Rx as of January 1, 2015. Mr. Kukla noted there was a jump in the additional subsidies which has continued to improve. This is the rationale as to why we went from a negative one to a positive seven for FY2015.

In conclusion, the GBP is in good financial shape and should end the FY2015-2016 biennium with \$326.3 million after a loss of \$60.3 million for FY2016. ERS staff will continue to monitor the health benefit cost trend closely.

In a response to a question asked by Mr. Ragland wanting to know what the estimated balance was in May when increased premiums on members who have dependents, Mr. Kukla stated the estimated balance would have been about \$340 million and ERS had projected at that time needed an 11% increase in rates effective on September 1, 2015, yet we only received 7%.

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

b. Approval of Rates for Medicare Advantage HMO Plans for Calendar Year 2016 – Mr. Rob Kukla, Director of Benefit Contracts reported that on September 1, 2011 Texas Employees Group Benefits Program (GBP) began offering a Medicare Advantage Health Maintenance Organization (MA HMO) which is a fully insured program that is designed for retirees and their dependents who are primary Medicare Part A and B living in the Houston metropolitan area. Mr. Kukla reported that participants have to be covered by both in order to be eligible for a Medicare Advantage plan of any kind.

Mr. Blaise Duran, Team Lead of Underwriting, Data Analysis and Reporting stated that in order to comply with the rider ERS utilized a model developed by Rudd & Wisdom called the Theoretical Cost index model (TCI). The TCI estimates the total cost that would be required to cover the MA HMO's participants if they were enrolled in HealthSelect. The MA HMO must agree to charge premium rates that are no greater than 95% of the TCI.

Mr. Duran informed the board that currently KelseyCare Advantage is the only MA HMO offered in the GBP and MA HMO participants receive their medical coverage through KelseyCare while prescription drug coverage is through the self-funded HealthSelect Medicare RxSM plan administered by SilverScript Insurance Company. Mr. Duran reported that this plan has been very successful for the participants that live in the Houston area. Mr. Kukla reported that in January 2012, there have been 572 enrolled and as of June 2015 there are 1,181 participants enrolled in the program.

Mr. Kukla noted that KelseyCare provides MA HMO coverage in eight Houston-area counties and has not requested any service-area changes in 2016. Mr. Duran reported that in order to develop the rates, there are three parts for the total rate which is the KelseyCare's proposal for medical coverage, the cost of the health insurer's provider's fee and the projected cost of drugs under the HealthSelect Medicare Rx prescription drug plan. ERS staff worked with Rudd & Wisdom, ERS' consulting actuary to project this cost to provide prescription drugs to MA members will decrease slightly in rates for CY2016.

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

MOTION made by Ms. Yolanda Griego, seconded by Mr. Doug Danzeiser, and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas approve the contribution rates as presented in this agenda item for the following Medicare Advantage HMO for participation in the Texas Employee Group Benefits Program for Calendar Year 2016:

- **KS Plan Administrators, L.L.C., D/B/A KesleyCare Advantage MA HMO Plan** to provide Medicare Advantage HMO medical-only coverage in the Houston Application area which includes the counties indicated in this agenda item.

c. *Approval of Rates for Medicare Advantage PPO Plans for Calendar Year 2016* – Mr. Rob Kukla, Director of Benefit Contracts reported that in January 1, 2012, the Board approved a Medicare program with a preferred provider network (PPO). The unique feature is the structured benefits are the same whether a participant utilized a network or non-network provider but the provider must accept Medicare. Mr. Kukla reported that enrollment has been steadily increasing. Mr. Kukla reminded the board that in January 2012, every eligible individual in this plan was given the option to opt out and stay in HealthSelect or one of the HMOs they were currently in.

Mr. Duran reported that the HealthSelect MA PPO continues to provide the most cost-effective medical benefits for Medicare primary GBP participants for both the state and eligible members. The medical benefits are provided under a fully insured arrangement in exchange for a monthly premium.

The contribution rates are based on premiums for the medical benefits, the projected cost for prescription drug, and the health insurance provider's fee. The state contribution rates for HealthSelect MA PPO will be the same as the state contribution rates for HealthSelect for FY2016. The premium is negotiated with Humana and it is based on plan experience and federal payment changes.

Mr. Kukla announced that Humana has agreed to a rate reduction of 2.2% in the base premium rate and has also agreed to reduce ERS' share of the Health Insurance Provider fee of 3.7%. The net cost to provide prescription drugs to MA members will decrease slightly in CY2016 of 1.6%.

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

MOTION made by Mr. Doug Danzeiser, seconded by Ms. Yolanda Griego, and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas approve the proposed Health Select Medicare Advantage Preferred Provider Organization rates for Calendar Year 2016 as presented in this agenda item effective January 1, 2016.

XIV. REVIEW, DISCUSSION AND CONSIDERATION OF THE ERS COMPENSATION PROGRAM:

a. *Review and Discussion of the 2015 Compensation Study* - Keith Yawn, Enterprise Planning Office and Ralph Salinas, Director of Human Resources presented the next agenda item on Review and Consideration of the 2015 Compensation Study. Mr. Yawn noted the objective of this study was to provide ERS with market comparative compensation data as part of the agency's ongoing efforts to attract and retain qualified employees that align with program, goals and strategies. Since the last board briefing in May, agency staff has worked with CBIZ extensively to further customize the survey document. Mr. Yawn reminded the board that positions from the Investments, Legal Services, and Benefit Contracts divisions were reviewed for the study. The Investments division has been through extensive surveys and studies on their compensation and Incentive Compensation Plan (ICP) practices in previous years. The staff worked with CBIZ to perform additional customization of the Legal Services and Benefit Contracts position surveys. Mr. Yawn reported that ERS received draft reports July 2, 2015 and had worked with CBIZ to understand the report methodologies and findings to ensure ERS had the appropriate clarifications and understanding to make use of the reported data.

Mr. Yawn reported the custom surveys for the Investment Division had an extremely strong response rate. Twenty-five peer organizations were selected (both public and private) and ERS received 19 organizational responses. For Benefit Contracts and Legal Services the response rate was much smaller. Benefit Contracts received responses from four out of 26 surveys requested and Legal Services received four out of 17.

Priya Kapila, Senior Manager of the Compensation Consulting division of CBIZ and the project lead throughout the work performed for ERS presented next. Ms. Kapila reported the overall objectives underlying goals and needs of a compensation study typically seek to ensure an organization's compensation policy follows a philosophy that ultimately has the ability to attract, retain and motivate employees while maintaining a flexible structure and alignment with broader organizational goals.

Ms. Kapila informed the board that CBIZ asked employees to complete a job analysis questionnaire to identify what employees do on a day-to-day basis, the qualifications for their position, and to ensure the positions were appropriately paired with peer comparative data. CBIZ worked to identify comparable organizations for each division, based on location, industry, size, and activity requirements. For example, some positions may be recruited largely locally or across the state of Texas while other positions are recruited nationally.

The reports for all three divisions resulted in fairly consistent findings and recommendations. For Investments as well as Legal Services the actual pay fell below the market median. Benefit Contracts salaries were roughly in line with the resulting industry median. However, these average results varied more widely when the averages are reduced to individual positions. Ms. Kapila reported when compared individually to the 50th percentile, there are a number of employees that would require pay adjustments to achieve the market median. The individual employee impact varies across the divisions in terms of amounts needed to meet the median as well as the number of employees affected. Ms. Kapila noted that it is important to keep in mind a new employee would not necessarily need to be paid at the market median.

CBIZ recommends ongoing review of compensation policies to ensure continued alignment and effectiveness with agency goals and the ability to retain qualified, highly skilled staff. Other recommendations included incorporating regular market data analysis into pay practices and making sure ERS moves forward with market-based adjustments in a consistent manner across divisions. Ms. Kapila reported CBIZ also recommends a comprehensive study or market review every three to five years of the agency's Incentive Compensation Plan to ensure that it remains effective.

Ms. Yolanda Griego asked how many employees participated in the study, and Mr. Yawn responded there were 89 total positions reviewed with the majority located in the Investments Division.

In a response to a question asked by Mr. Doug Danzeiser wanting to know if CBIZ looked at current practices used by comparable peer organizations regarding the number of hours worked in a week, Ms. Kapila's response was, "No. Hours is a consideration when we do see some public pension systems that work under 40-hours a week as policy, but in this case for ERS, it was not something that we looked to specifically as a value-add or in terms of quantifying it." Mr. Wilson stated ERS has been in conversations with each of the divisions discussing how to best implement appropriate compensation strategies reflective of the agency's employment trends, turnover rate, ability to attract skilled employees, and how long positions remain posted.

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

b. *Review and Consideration of the Incentive Compensation Plan* - Mr. Ralph Salinas, Director of Human Resources, introduced Ms. Chineque "DeeDee" Sterns, Human Resources Supervisor, Ms. Sharmila Kassam, Deputy Chief Investment Officer, and Mr. Tom Tull, Chief Investment Officer for presentation of the Incentive Compensation Plan (ICP). Mr. Salinas reported that as part of the ERS

succession plan and preparation of his upcoming retirement, ERS has been working on a transition plan in Human Resources and has asked Ms. Sterns to report to the Board on this agenda item.

Ms. Sterns noted the ICP is to encourage and sustain an outstanding investment performance level without undue risk, to promote teamwork, to support the agency's strategic and operational goals, to attract and retain key employees and to focus on high-quality outcomes.

Mr. Tull stated that ERS has been very fortunate in attracting talented individuals to work with the program and one of the benefits the staff provide is managing the money more effectively and more inexpensively. ERS manages over 60% of total Fund assets internally and is always on the alert to see where costs can be cut. Mr. Tull reported ERS has made a considerable effort in reducing the total amount of fees that are paid to external advisors.

Ms. Kassam reported on the three categories of changes for the plan document. First, plan design changes were discussed, which were reflected in the exhibit provided to the Board with rationale for these changes. The second category of changes related to more formalized Board reporting, which will be a high-level summary of awards and actual realizations. Staff encourages the Board members to request any other details they would like to see to ensure transparency into the ICP program. The third category is a participation evaluation, which is the most significant change to the plan document.

The plan was originally designed to include quantitative and qualitative metrics. The original intent of ICP had been to use quantitative metrics whenever possible, which would include trust fund performance as well as other relative performance measures that were either tied to the benchmarks in the Investment Policy or reasonably derived from the Investment Policy. Ms. Kassam reported that one of the challenges in implementing ICP was not being able to quantitatively evaluate staff members at the start of the alternative investment programs in private equity, real estate, hedge funds and private infrastructure. Under the ICP prior to the current proposed revision, the default was to use a qualitative measure when a quantitative measure was not available as in the case of these alternative investment programs that remained too immature to compare to their benchmarks. Staff has spent several months looking at the data points from peer plans, industry resources, CBIZ's compensation study and the private market consultants, Altius, RVK and Aon to try to find the best practices for quantitative evaluation of these private market asset classes. Ms. Kassam reported that staff has been successful in establishing appropriate quantitative measures, which are reflected in the plan document.

Ms. Kassam informed the Board the proposed methodology for ICP for all participants would be 75% of the overall evaluation would be quantitative, with at least a minimum of 25% based on trust fund performance. The remaining 25% of each participant's evaluation would be qualitative. The qualitative evaluation will be based upon performance goals that may include leadership, contribution to key organizational objectives which support ERS' strategic and operational goals, interpersonal relationship skills, professional accomplishments, effective teamwork, accountability, training and mentoring, project participation, or process improvement.

This methodology will also be used for Investment Operations, Investment Administration and certain legal staff contributing to the Investment Program.

Mr. Hester questioned if there could be some consideration of moving the responsibility for administration of ICP from Investments to Human Resources, Mr. Salinas confirmed that at the direction of the Board and the Executive Director, Human Resources would take over responsibility for the administration of the ICP and the plan document. Mr. Wilson further explained to the Board that the proposed revisions to ICP were collaboratively developed by staff in Human Resources, Investments,

Legal and Executive Office and justification for the suggested changes are provided in the plan document.

Mr. Danzeiser noted to the Board that he would like to keep the ICP discussion going throughout the year with staff and the Board. Mr. Ragland also noted his concern about too much qualitative evaluation becoming less objective in terms of evaluating staff. Ms. Donnell commented from her experience that some portion of qualitative evaluation is a good idea because quantitative metrics do not always incentivize the right results. After further discussion among members and staff, along with inquiry of CBIZ, it was discussed that the proposed 25% of overall participant evaluation based on qualitative attributes was comparable to peers and not considered excessive.

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

MOTION made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas approve the ERS Incentive Compensation Plan for Key Investment Professionals and Leadership employees as presented in Exhibit A, except that Section 6.11 would contain an additional sentence that would read, "Any discretionary action exercised under Section 6.4 shall be highlighted on such report."

XV. PRESENTATION, DISCUSSION AND CONSIDERATION OF ERS' OPERATIONAL ITEMS:

a. *Review of the FY2016 ERS Roadmap Items* – Mr. Bernie Hajovsky, Director of Enterprise Planning Office presented the next agenda item on FY2016 ERS Roadmaps. The creation and finalization of the list of projects for FY2016 was a collective effort and it required input from all the divisions in ERS. The project planning process began in April 2015 and division directors were asked to propose project and initiatives to meet the directions, goals and objectives within the strategic plan. Each proposed projects must satisfy at least one of the four strategic directions for additional consideration. The four directions are Supporting Retirement Security, Sustaining Competitive GBP, Engaging Stakeholders for Informed Decision Making and Enhancing Agency Performance and Accountability.

Mr. Hajovsky reported that each proposed project was evaluated and analyzed in terms of scope, timing, priority level and anticipated resources needed to complete the work. Based on the volume of projects, ERS conducted forecast modeling to estimate the resources necessary to accomplish the work. After additional discussions and running resource forecast models for all divisions, the list was narrowed to 47 for FY2016. Mr. Hajovsky stated that these projects reflect the important strategic and operational efforts to meet the needs of our membership, to educate and communicate with stakeholders and to improve products and services. He also stated each of these projects impacts the FY2016 operating budget. Of the 47 projects for next fiscal year, 11 of them are noted as roadmap items based upon their magnitude or level of impact to ERS' members, retirees and stakeholders.

Under the direction of *Supporting Retirement Security*, staff plan to evaluate the fund offerings within the Texa\$aver program and also explore the possibility of introducing custom funds and determine the feasibility of an optional internally managed fund within Texa\$aver. Mr. Hajovsky reported that in *Sustaining a Competitive Group Benefits Program*, staff will bid the pharmacy benefit manager contract in 2016 and will begin developing the requirements for the HealthSelect TPA bid.

Under the *Engaging Stakeholders for Informed Decision Making*, Mr. Hajovsky reported that the passage of HB 966 relates to creating an optional Consumer-Driven Health Plan (CDHP) for participants within the GBP effective as of September 2016. The CDHP will consist of a high deductible health plan along with a health savings account component. Mr. Hajovsky also reported the Form 1095 Issuance

necessitated by the Affordable Care Act and begins in January 2016, GBP participants will receive tax forms indicating medical coverage received in 2015.

Under *Enhancing Agency Performance and Accountability* there is the Benefits Administration Services (BAS) project. Mr. Hajovsky reported ERS is in the first stage of the Sunset Review process which is where ERS will lay out the agency's purpose, key functions and services in the form of a written report and will submit a self-evaluation report no later than September 1, 2015. Mr. Hajovsky also noted ERS will become more efficient in the way we manage and maintain contracts and will assess the possibility of a centralized contract management system for the agency. ERS will bid and evaluate a new content management solution for our public website as support for the current solution is scheduled to end by the early part of 2017.

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

b. Review of the ERS Space Planning Study Update – Ms. Jordan Hajovsky and Ms. Wendy McAdams, Co-Directors of Operations Support presented to the board the ERS Space Planning Study Update. August 2014 ERS shared the history with the board and the purpose for the space planning study which was to identify the options available to accommodate expected growth in personnel. ERS' full-time positions have increased by 42 positions in the last five years and staff growth is due to a number of factors and is needed to properly support programs and members such as the addition of new investment asset class managers and staff throughout the agency. Ms. Hajovsky informed the board that to gain more offices for staff, current floor plans will have to be re-designed to accommodate space for additional workers where possible including more efficient, smaller work areas and cubicles, adding a second worker in some of the larger cubicles and offices and repurposing huddle rooms, which are small meeting rooms, into offices.

Ms. McAdams provided the board with a breakdown of the three phases of this project. Phase 1 is completed which consisted of CBRE and Gensler who came onboard to ERS in the spring to conduct the study. They reviewed the ERS organization, vision and leadership structure, they evaluated workplace effectiveness and efficiency, conducted focus group sessions with various ERS staff members and interviewed appropriate executives and managers. They compiled their findings into a presentation of the business case development which is phase 2 of this project. Phase 3 is the implementation which will take place during FY2016 and FY2017.

Mr. Peter Jansen, with CBRE, informed the board he was brought on board in March in partnership with Gensler Architects to assist ERS in this study and has had a great level of participation across the organization. Mr. Jansen reported the number one key finding is there is insufficient space to accommodate the future growth of ERS. He stated that after looking at the effectiveness of the workplace, there are insufficient meeting and collaboration spaces to accomplish the goals of ERS. CBRE is recommending better natural lighting, more access to collaborative space, commitment to the health and wellness of employees and members and a much more flexible work environment.

In a question asked by Ms. Donnell wanting clarification what is support space, Ms. Anjali Bhalodia, Consulting Analyst and Designer of Gensler Architects stated support space can be anything such as file rooms, storage room for divisions, the boardroom would be categorized as an amenity.

Mr. Jansen reported next on the key findings in regards to the asset as excellent condition with long remaining useful life, operates at close to market standards, no major capital expenditures anticipated, ERS building is restricted to 130 foot height, site is half developed and severely under parked

with only 40 spaces currently dedicated to ERS. Mr. Jansen noted that according to City of Austin code, 300-400 spaces to park in this building would be required. Ms. Hajovsky informed the board that has 384 FTEs. Mr. Jansen reported that for ERS, parking is controlled by the Texas Facilities Commission and staff at ERS is dependent on coordinating with DPS and other organizations for their parking spaces.

Mr. Jansen reported that with all these findings there are six scenarios and feel it is best to redevelop the site and attempt to use other developer's money to fund it. Ms. Donnell asked if ERS building is leased and Mr. Jansen responded that it's a fee simple controlled by ERS. Mr. Jansen reported that for the next 60-90 days they will be exploring a massing study to understand the total capacity of the ERS site for development and a preliminary request for information from the development and investment community and will update the board at the December meeting with the financial models and the financing and phasing strategy for any potential decisions. In the future an action is required with respect to space management and the board will be required to achieve a number of benefits by adopting new space standards effectiveness with effective workplace strategy.

In a response to a question asked by Mr. Hester wanting to know if CBRE has experience bringing together public-private partnerships for investment options, Mr. Jansen responded that they have a significant amount of experience and are in the market with very similar transaction across the country for about six or eight different cities in the United States now.

Ms. Paula A. Jones, General Counsel and Chief Compliance Officer noted ERS is going to be looking at the investment aspect from a legal standpoint because as a trust, the Constitution limits us to purchasing securities, so ERS is going to be looking at different options to look at a real partnership manner. Ms. Jones also clarified that ERS will be looking at a Request for Information (RFI).

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

c. Review and Consideration of ERS Fiscal Year 2016 Proposed Operating Budget –

Mr. Wilson informed the board the ERS Finance team received a Certification of Achievement for Excellence in Financial Reporting from Government Finance Officers Association that was effective August 31 and being the 26th year in a row for receiving this award.

Mr. Mike Wheeler, Chief Financial Officer introduced Ms. Machel Pharr Assistant Director of Finance and Ms. Debbie Leatham, Budget Manager who will assist with presenting this agenda item on the ERS FY2016 proposed Operating Budget. Mr. Wheeler informed the board that this is his last board meeting as he is retiring at the end of the month. Ms. Griego and Mr. Wilson then thanked Mr. Wheeler for all of his service.

Mr. Wheeler noted that FY2015 was a very good year for ERS and several of the accomplishments have been multi-year projects by the whole agency and the biggest one is the funding for the retirement plan. The funding for ERS' retirement plan increased for both the employer and employee. Mr. Wheeler reported that by adding staff in investments we've increased the in-house management from FY14 to FY15 and had about a \$3 million decrease in the external advisory fees.

In the FY16 proposed budget there is a \$6.7 million increase in external advisory fees and will also substantially achieved the transition to new asset allocation targets. Staff is proposing a \$6.9 million budget for FY16 which is about a \$2.9 million increase (4.3% increase) over the FY15 budget. Mr. Wheeler stated ERS came in under budget for FY2015 at about \$2 million.

Ms. Pharr announced the increase in the budget of \$2.9 million is grouped in four categories (statutory, investment related, strategic projects and agency operations). Statutory changes accounted for \$1.3 million or 2.0%, investment-related expenses increased by \$1.8 million or 2.7%, and agency operations increased by \$0.7million or 1.0%. In strategic projects, there was a decline of 1.4%.

Ms. Pharr noted that ERS is underspending the 2015 budget by approximately \$1.9 million and those funds stay in the trust fund. In the 2016 budget, 1% is included for merits and promotions as well as another 1% for career ladder equity adjustments.

The \$1.8 million investment-related increase was a comparison of budget to budget. When comparing 2016 budget to the 2015 forecast, there is approximately a 16% increase. Ms. Pharr reported that one additional position is being added for Investments for a total of eight new positions for the agency. Due to continued positive performance in achieving investment benchmarks, the budget reflects an expected increase in the amount of incentive compensation payment for 2016 over 2015. Ms. Pharr also stated that the increase in the investment related category is due to increases in rate subscriptions and inclusion of funds for upgrading the Eagle software which is the investment reconciliation used by the Investment and Finance staff.

Ms. Pharr informed the board that ERS' budget is focused on meeting the strategic directions. In terms of Strategic Direction one, Supporting the Retirement Security, ERS will be implementing the changes for the 84th Legislative Session, enhancing risk management, and continuing to expand options for participants in the Texa\$aver program. In Strategic Direction two, Sustaining Competitive Group Benefits, ERS will continue to evaluate the effectiveness of the cost containment initiatives, implement the qualified transportation fringe benefit, establish the high-deductible health care plan with a health savings account as directed by legislation, coordinate the annual reporting requirements for the Affordable Care Act, and conduct summer and fall enrollments for members. Under Strategic Direction three, Engaging Stakeholders for Informed Decision Making, the agency will conduct communication efforts for the consumer driven health plan and the qualified transportation fringe benefit and provide training to Benefits Coordinators. For Strategic Direction four, Enhancing Agency Performance and Accountability, Ms. Pharr stated ERS will be undergoing a Sunset Commission review during this next year and anticipate issuing the RFP for Benefits Administrative Service (BAS), evaluate a contract management system as well as implementing several new pieces of legislation related to human resources, including HB 426 which relates to the acceptance of employment applications, and HB 1771 relating to donating sick leave by employees.

Ms. Leatham provided an explanation of variance from FY2015 forecast and stated that variances compare FY2016 budget to FY 2015 forecast and in summary items over \$200,000 are explained and in division items over \$100,000 are noted. She also reported salaries and other salary costs make up approximately 62% of the budget. Most of the variance in salary and other salary costs is due to unfilled positions in FY 2015, a legislative pay increase, additional contribution and an increase in positions proposed for FY 2016. Ms. Leatham reported that the Incentive Compensation Plan payout is greater this year based on estimating to positive performance exceeding the benchmark plus payouts for the previous two years. Subscriptions and electronic communication increased due to rate increases.

Ms. Leatham informed the board that each division has an organization chart and lists the FY 2015 accomplishments, the FY 2016 initiatives, their budget chart and an explanation of variances.

Ms. Leatham pointed out that Exhibit A showed the increase of eight FTEs by division. Then she stated that board approval of the FY2016 Budget, including Exhibit B, authorized the Executive Director to negotiate, enter into, and to administer contracts on behalf of ERS.

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

MOTION made by Mr. Craig Hester, seconded by Ms. Yolanda Griego and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas approve the Fiscal Year 2016 Proposed Operating Budget, for the Employees Retirement System of Texas as amended to add an increase for the non-investment portion of the classified separation line item of the proposed 2016 agency budget by 1% for merit consideration and promotion to be used at the discretion of the Executive Director and senior management team, authorize the Executive Director to administer the operating budget as necessary for the efficient and effective administration of the System, and authorize the transfer of interest from the interest account as required to fund the operating budget.

XVI. REVIEW, DISCUSSION AND CONSIDERATION OF REAPPOINTMENT OF ERS INVESTMENT ADVISORY COMMITTEE MEMBERS WITH TERMS EXPIRING AUGUST 31, 2018

Mr. Tom Tull, Chief Investment Officer reported there are two Investment Advisor Committee (IAC) members whose terms are expiring August 31, 2015. Dr. Laura Starks who is Dean *ad interim* of McCombs School of Business has been actively involved with the IAC since 1990. Mr. Bob Alley who was previously the Chief Fixed Income Officer for AIM Advisors has been a member of the IAC since 1999. IAC members serve at the pleasure of the ERS Board of Trustees for staggered three-year terms and subject to compliance with ERS Investment Policy and Texas Government Code sections 815.5091 through 815.5092. ERS staff would recommend both be considered for reappointment to the IAC with the following motion from the board:

MOTION made by Ms. Cydney Donnell, seconded by Mr. Craig Hester and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas reappoint Mr. Bob Alley and Dr. Laura Starks to the Investment Advisory Committee for a three-year term ending August 31, 2018. I further move that the Executive Director be authorized to execute and administer contracts in connection with the reappointment of Mr. Alley and Dr. Starks.

XVII. ELECTIONS OF CHAIR AND VICE-CHAIR OF THE ERS BOARD OF TRUSTEES FOR FISCAL YEAR 2016

Texas Government Code, Title 8, section 815.201, provides that the Board shall elect new officers from its membership. As a result of such an election, the newly elected Chair and Vice-Chair of the ERS Board of Trustees will each serve a one-year term beginning September 1, 2015 and ending August 31, 2016.

The board took the following action:

MOTION made by Ms. Cydney Donnell, seconded by Ms. Yolanda Griego and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas elect Craig Hester as Chair and Doug Danzeiser as vice-chair of the ERS Board of Trustees for one-year terms beginning September 1, 2015 and ending August 31, 2016.

XVIII. REVIEW, DISCUSSION AND CONSIDERATION OF THE RISK APPETITE STATEMENTS

Mr. Bernie Hajovsky, Director of Enterprise Planning Office presented the Risk Appetite Statements to the Board. Mr. Hajovsky reminded the Board that staff presented the results of the risk appetite survey at its May meeting. The survey helped staff to determine the common ground between the Board and staff as it relates to the level and types of risk each group is willing to assume related to different strategic and operational activities. The goal is to find a balance between the appropriate levels of risk while maintaining flexibility to capitalize on any opportunities when they present themselves. The board and staff were aligned in many areas. The survey results were used to formulate risk statements to serve as a guide to leadership to determine appropriate action when faced with different situations.

Mr. Hajovsky provided the board with an overview of the risk statements related to supporting retirement security and sustaining a competitive Group Benefits Program (GBP). Under the direction of supporting retirement security on the matter of actuarial soundness, the board and staff prefer a balanced employee/employer contribution model instead of benefit reductions. Mr. Hajovsky reported that support of this matter requires a great deal of effort by internal staff to educate associations and legislative leadership on the merits of a balanced model.

For the strategy of preparing members for retirement, ERS will invest money and resources in areas of technology and education to provide more access and choice options for our members, which goes above and beyond simply meeting the basic functionality of our members. Mr. Hajovsky reported the Board and staff have expressed less interest to expand ERS' authority to manage investments for other entities even if it means losing out the opportunity to earn additional streams of revenue.

On sustaining a competitive GBP, the Board and staff preferred that cost increases and additional plan choices are applied uniformly across all segments of our membership regardless if certain segments of our membership are more expensive. On the issue of GBP participants and their responsibility for their health, ERS is willing to accept the short-term cost associated with implementing incentives for those participating in wellness initiatives in return for healthier membership and long-term savings to the GBP. He reported that one of the projects for FY2016 is to look at ways to design incentives to encourage participants to live healthier.

Under the area of enhancing use of data analytics, ERS accepts a limited degree of risk in sharing data with approved vendors and service providers that can potentially offer cost-saving solutions to the GBP. On the next direction which is engaging stakeholders, Mr. Hajovsky reported both the Board and staff are willing to invest in the resources required to increase stakeholder awareness program status and changes which could impact the operating budget from year to year. ERS will use technology and internet-based platforms in hopes of increasing overall engagement with our stakeholders. Mr. Hajovsky noted that as part of the strategy to improve outreach to members and stakeholders, the Board and staff are committed to using a variety of hard copy and electronic mediums to disseminate and receive information.

On the direction of enhancing agency performance and accountability, Mr. Hajovsky reported that on the matter of leveraging staff skills, ERS is supportive of training, developing and compensating staff in a manner similar to the overall public and private sectors to remain competitive in the marketplace. He noted that investing internally in staff is an effective way to control external cost related to third-party vendors. Mr. Hajovsky reported that the board and staff will consider partnering with third-party technology and service providers when such opportunities can improve operational capabilities. Board and staff are willing to negotiate certain contractual matters with vendors and service providers, but are opposed to compromising legal and business positions merely for sake of entering into an agreement when it comes to adapting to changes in ERS' business environment.

In a response to a question asked by Mr. Ragland wanting to know if formal risk statements have been previously adopted, Mr. Hajovsky responded this is a new process, but a similar process occurred in the past when ERS' investments program conducted its asset allocation study in 2012.

Mr. Hester questioned, "What is the need for the Board to adopt the risk statements?", and Mr. Hajovsky stated the risk statements are intended to serve as a foundation for high-level decision making within the organization. Mr. Wilson noted the statements are a recitation of some of the conclusions that staff can draw from the survey administered prior to the last Board meeting.

Mr. Wilson suggested the Board and staff could come back to the December two-day meeting to discuss if that seems appropriate and to touch base on some of the statements. The Board, in further discussion, agreed that they recognized the risk statements, but declined the request for motion to formally adopt the risk statements.

There were no questions or further discussion. No motion was made by the Board to adopt the risk statements.

XIX. BOARD OF TRUSTEE RECOGNITION

Chair, Brian Ragland recognized Ms. Yolanda Griego of her service on the ERS Board of Trustees. Mr. Ragland presented Ms. Griego with an ERS Resolution², an honorary gavel and a photograph taken of current and past board members who she has worked with over the years. Mr. Ragland thanked Ms. Griego for her compassion for state of Texas employees.

Mr. Hester then thanked Ms. Griego for her service and stated how he has enjoyed working with her over the years. Ms. Cydney Donnell echoed Mr. Hester's comments and stated she appreciated the professionalism she brought to the board and also her knowledge on the human resource side of issues were extremely helpful.

Ms. Griego thanked everyone and stated that she has gained so much from being a part of the ERS Board of Trustees and that she will miss everyone.

XX. EXECUTIVE SESSION – IN ACCORDANCE WITH SECTION 551.074, TEXAS GOVERNMENT CODE , THE BOARD OF TRUSTEES WILL MEET IN EXECUTIVE SESSION TO EVALUATE THE DUTIES AND PERFORMANCE OF THE EXECUTIVE DIRECTOR OF THE EMPLOYEES RETIREMENT SYSTEM OF TEXAS; AND TO DELIBERATE THE APPOINTMENT, EMPLOYMENT, EVALUATION, REASSIGNMENT, DUTIES, DISCIPLINE, OR DISMISSAL OF ONE OR MORE PUBLIC OFFICERS OR EMPLOYEES. THEREAFTER, THE BOARD MAY CONSIDER APPROPRIATE ACTION IN OPEN SESSION

At 4:06 p.m. on August 18, 2015, Chair Brian Ragland announced that the Board of Trustees (Board) will now meet in Executive Session in accordance with section 551.074, Texas Government Code, to evaluate the duties and performance of the Executive Director of the Employees Retirement System of Texas; and to deliberate the appointment, employment, evaluation, reassignment, duties, discipline, or dismissal of one or more public officers or employees. Thereafter, the Board may consider appropriate action in open session.

Upon returning from Executive Session, Mr. Ragland announced that it is 5:20 p.m. on August 18, 2015 and that the Board is now in Open Session. No action, decision, or vote was taken by the Board while in Executive Session. At this time Mr. Ragland opened the floor for a motion from the Board.

MOTION made by Ms. Yolanda Griego that the Board of Trustees of the Employees Retirement System of Texas affirm that effective September 1, 2015, Porter Wilson, ERS Executive Director, is approved to participate in the ERS Incentive Compensation Plan for key Investment

² Exhibit B - Page 29

professionals and leadership employees (ICP) as a leadership employee with a maximum award percentage available of 100% of his salary in accordance with the terms of the plan. I further move that Mr. Wilson's performance goals for fiscal year 2016 should reflect 50% of his possible award under the ICP as a quantitative goal of relative trust fund performances and 50% of his possible award under the ICP as qualitative metrics reflecting his overall agency leadership, management, communications, policy matters, staff development and implementation of the agency's strategic initiatives as reflected in the Board's approved operating budget for fiscal year 2016. I further move that the ICP be amended to reflect the terms of this motion, and that ERS Human Resources is directed to finalize the documentation necessary to implement the terms of this motion.

The motion was subsequently seconded by Trustee Craig Hester, and carried unanimously by the present members of the Board of Trustees. Mr. Shad Rowe was absent during this vote.

XXI. 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

Thursday, December 3, 2015 and Friday, December 4, 2015, was set for the next regular meetings of the Board of Trustees and Investment Advisory Committee, Board of Trustees and Audit Committee.

XXII. ADJOURNMENT OF THE ERS BOARD OF TRUSTEES

The August 18, 2015 Meeting of the Board of Trustees adjourned at 5:20 p.m.

PUBLIC AGENDA ITEM - # 10

10. Executive Director's Report

August 18, 2015

Summer Enrollment Plan Year 2016 Update

Summer Enrollment has concluded for employees, pre-Medicare retirees and their families. The enrollment period was June 29-July 31. We mailed custom Personal Benefits Enrollment Statement packets to 268,500 members to provide each member with current enrollment, eligible coverage options and information on Plan Year 2016 changes. Summer Enrollment fairs were conducted around the State to allow members to receive important benefit information as well as share information with us.

This enrollment period we transitioned to ADP, LLP (ADP) to manage the TexFlex program and added a new HMO, KelseyCare powered by Community Health Choice (KelseyCare powered by Community) for members in the Houston area.

Members participated in Summer Enrollment in the following ways:

- 53,600 members made changes to coverage;
- attendance of 5,200 at 40 fairs across the State;
- participation of over 400 in four online webinars;
- 9,994 phone calls:
 - 795 at ERS
 - 9,199 at ACT;
- 53 visits to ERS; and

Enrollment for KelseyCare powered by Community for PY16:

- 664

Fall Enrollment for Medicare eligible retirees and survivors will be:

November 2 – November 20, 2015

We will host numerous enrollment fairs around the state and Medicare preparation sessions for those nearing Medicare eligibility.

Benefits Administrative Services (BAS)

Over the past year, the board has been provided updates on a multi-year project aimed at evaluating and implementing a course of action for replacing the existing Benefits Administration system and realigning processes and resources for member support of the Group Benefits Program (GBP). The goal is to determine the best possible option for providing eligibility and enrollment services to our members.

Given the size, scope and complexity of this initiative, careful consideration has been given to the planning and development process. Because of that, periodic adjustments have been required to ensure quality execution of the project.

After continued evaluation and in light of the recent focus on the state contracting process, we decided that the additional modifications to this initiative were necessary.

- In early August, coordination of the RFP was shifted to Benefit Contracts (BC). BC will use their well-developed, internal process to complete this project. Several BC staff have completed courses and are Certified Texas Contract Managers.
- For tracking purposes, the project will be renamed, Benefit Administration Services (BAS). This will establish a benchmark for when Benefit Contracts assumed responsibility for the RFP process.
- Benefit Contracts will use all the work already completed and expand on it to meet the new contract management rules.
- As previously indicated, this RFP will be routed through the Contract Advisory Team for review and comment prior to release to the market place. This is currently targeted for mid-January 2016.
- Given these adjustments, a request for Board action is anticipated in February 2017 with a target implementation date of January 1, 2018.

Legislative Update

The 84th Legislature brought changes to the programs that ERS administers. The Legislative Analysis Group (LAG) met weekly to discuss filed bills, committee hearings, and other legislative business. By the time the session ended, LAG members tracked 224 bills and analyzed 121 bills, often performing multiple analyses as bills were regularly amended.

ERS is currently working on implementing legislative changes relating to changes in elected class retirement, increased benefits for survivors of law enforcement officers killed in the line of duty, offering a TRICARE supplemental health plan, new contracting regulations (see below), and more.

The most significant legislative changes were the improvements to pension funding from House Bill 9 and the budget. Together, the bills increased the combined employer contribution rate to the pension trust fund of 10% (9.5% state contribution and 0.5% agency contribution), increased the employee contribution to 9.5% (with a corresponding pay raise of 2.5%), and eliminated the 90-day waiting period for new employees to become contributing members. Based on the most recent actuarial valuation, this moves the amortization period from infinite to a 32 year period. The changes stop the unfunded liability from growing \$500 million per year, and have significant impact on the State's GASB reporting and balance sheet.

The other major implementation challenge is the development of a Consumer Directed Health Plan (CDHP). House Bill 966 requires ERS to offer a CDHP consisting of a High Deductible Health Plan with a Health Savings Account to GBP members starting on September 1, 2016.

Finally, on June 26th, 2015, in deciding *Obergefell v. Hodges*, the United States Supreme Court ruled that the right to marry is a fundamental right, and that same-sex couples "may not be deprived of that right." The Court also ruled that state laws banning same-sex marriage are unconstitutional. The Texas Insurance Code makes all spouses eligible for dependent coverage in the GBP, and the budget entitles spouses to a 50% contribution. As a result, in consultation with General Counsel Paula A. Jones, First Assistant General Counsel Tim Sims, and assistant attorneys general from the Attorney General's office, I authorized the enrollment of same-sex spouses in the GBP effective July 1, 2015.

Legislative Implementation Update - Budget Riders

- **HealthSelect of Texas Contract.**
 - Consistent with ERS' fiduciary duties, ERS must comply with the State Auditor's Office's (SAO) recommendations in its November 2014 Report No. 15-007 or explain why such recommendations were not followed. ERS must submit evidence of this and certain other related information to the Legislative Budget Board (LBB) and SAO at designated times during the procurement and contract award process.

- **Notification of Certain Purchases or Contract Awards, Amendments and Extensions.**
 - For any contract (which is broadly defined as an original contract, an amendment or extension to a contract, a purchase order, an interagency grant or agreement, or an interlocal grant agreement) exceeding \$10 million or exceeding \$1 million if awarded as an emergency or awarded without otherwise participating in the competitive bidding process, an agency must timely provide certain notification regarding the contract to the LBB before expending funds under that contract. If these notification provisions are not satisfied, the Director of the LBB shall provide written notification to the comptroller, governor and LBB detailing what requirements were not met and recommendations to address identified risks, *including contract cancellation*. Further analysis is required to determine the applicability of this section to ERS' contracts.

SB 20 – Contracting Bill (high-level summary of the more pertinent sections)

- **Centralized State Purchasing Study.**
 - By December 31, 2016, the comptroller must finalize a report on the “feasibility and practicality of consolidating purchasing functions into fewer state agencies or one state agency.” It specifies that the report is to include a list of state agencies with purchasing responsibilities. However, it also provides that it must indicate the total cost to the *state* for the purchasing responsibilities for each state agency. Further analysis is required to determine the applicability of this section to ERS' contracts.

- **Revolving Door Restriction.**
 - This provision prohibits a former state officer or agency employee from working for a vendor for at least two years following when the officer's or employee's service or employment has ceased if the officer or employee has participated on behalf of the agency in a procurement or contract negotiation with that vendor. ERS' current contract prohibits recruiting, retaining, or employing any ERS personnel who have worked on a project for two years from termination or expiration of *that particular contract*.

- **Enterprise Resource Planning and Reporting on Contracts/Purchases.**
 - This section of the bill slightly modifies the definition of enterprise resource planning (ERP) as to its purchasing function so as to specifically include “solicitations and contracting.” ERP refers to a component of the comptroller's uniform statewide accounting project. ERS does not currently participate in the statewide ERP system. The legislation also requires that agencies report certain contract and purchasing information as required by comptroller rule.

- **Verification of Use of Best Value Standard.**
 - Chapter 2155 of the Texas Government Code is amended to require that, for each state agency contract in which the agency must use the best value standard, a state agency's contract manager or procurement director must approve the contract, ensure that the agency documents the best value standard used, and acknowledge in writing that the agency complied with the Contract Management Guide. ERS must designate a contract manager or procurement director who will be tasked with this and other new statutory requirements.

- **Vendor Performance Reporting.**
 - Several provisions were added relating to vendor performance reporting. Under the new legislation, agencies must use the comptroller's vendor performance tracking system when determining whether to award a contract to a vendor. Previously, agencies had the discretion to rely on this information. A new provision also specifies that an agency must report on a vendor's performance after contract completion or termination. This requirement was previously statutorily implicit and explicit by comptroller rule. Application of this particular provision is limited to ERS' contracts with a nongovernmental entity for claims administration of a group health benefit plan under Subtitle H, Title 8, Insurance Code. This category likely includes the following current and prospective ERS contracts: HealthSelect Third-Party Administrator, Pharmacy Benefit Manager (PBM) for HealthSelect, PBM for Employer Group Waiver Plan Prescription Drug Program, Dental PPO, and potentially the prospective Vision Plan.

- **DIR Purchases.**
 - Chapter 2157 is amended to specify that a state agency purchasing a commodity item from the Department of Information Resources' (DIR) cooperative purchasing program must request pricing from at least three vendors if the contract is valued at more than \$50,000 but not more than \$150,000, and from at least six vendors if the contract is valued at more than \$150,000 but not more than \$1 million. The statutory provision now specifies that an agency cannot enter into such a contract if the value of the contract exceeds \$1 million. ERS currently requests pricing from at least three vendors when purchasing through DIR's cooperative purchasing program. ERS also does not currently hold any contracts with DIR vendors valued at more than \$1 million. Another provision provides that, for any DIR contract that requires a state agency to develop a statement of work (SOW), the state agency must consult with DIR on the SOW and have DIR sign the SOW if the purchase is valued at more than \$50,000. If the SOW is not signed by DIR, the contract is invalid and no money can be paid to the vendor under the contract. This requirement will have to be further analyzed in light of the fact that ERS cannot abrogate its fiduciary duties.

- **Ethics, Reporting, and Approval Requirements for Certain Contracts.**
 - This legislation adds subchapter F to chapter 2261. As to ERS, this subchapter is only applicable to any ERS contract with a nongovernmental entity for claims administration of a group health benefit plan under Subtitle H, Title 8, Insurance Code (the same subset of contracts identified above).
 - Disclosure of Potential Conflicts of Interest; Certain Contracts Prohibited: Under this new subchapter, any employee or official who is involved in procurement or contract management for an agency must disclose any potential conflict of interest. ERS already has numerous policies in place to avoid any conflicts of interest. It further provides that a state agency may not enter into a contract with a private vendor with whom certain high level employees or officials (members of the governing body, governing official, executive director, general counsel, chief procurement officer, and procurement director), or a family member of such within the second degree by affinity or consanguinity, have a financial interest. Financial interest is broadly defined as owning or controlling an ownership interest of at least one percent (1%) or if it could reasonably be foreseen that a contract with that person could result in a financial benefit to the employee or official. Certain interests, such as a retirement plan and insurance coverage, are excluded from this definition. ERS is developing specific reporting procedures relating to this prohibition for the subset of contracts subject to this requirement.
 - Required Posting of Certain Contracts: Agencies are required to post on their websites each contract entered into for goods or services and the solicitation documents related to the same. ERS already posts on its website a list of the vendors in which ERS has executed a contract valued at more than \$100,000. For those certain ERS contracts

subject to this subchapter, ERS will now need to post the requisite non-confidential documents as well.

- Enhanced Contract and Performance Monitoring: By rule, an agency must establish a procedure to identify each contract that requires additional monitoring. This process must include submitting information on the contract to the agency's board and the contract management officer or procurement director immediately notifying the board of any serious issue or risk. ERS is currently drafting a rule consistent with this provision.
- Reporting Requirements: For contracts over \$1 million, an agency must implement certain contract reporting requirements to include certain information provided in the legislation (including compliance with financial provisions, corrective action plans, and liquidated damages assessed or collected). The agency must verify the accuracy of any such reported information. For contracts exceeding \$1 million, the board must approve the contract and the presiding officer (or if delegated then the executive director) must sign the contract. For the contracts subject to this subchapter, ERS is working to ensure reporting procedures align with the requirements of the statute. As to these contracts, the board generally approves these expenditures in the annual operating budget, and has expressly delegated to the executive director the authority to sign such contracts.
- Verification: For contracts exceeding \$5 million, the contract management office or procurement director must verify in writing that the solicitation and purchasing methods and contract selection process complies with state law and agency policy, and submit to the board information relating to any issues with such processes. ERS will need to adopt this process for those certain contracts subject to this subchapter.
- Risk Analysis and Contract Management Handbook: Each state agency must develop and comply with a purchasing accountability and risk analysis procedure. Each state agency must also publish a contract management handbook consistent with the Contract Management Guide. The procedures must be posted and the link submitted to the comptroller. ERS already has systematic processes for its purchasing and contracting; for those contracts subject to this subchapter, ERS is working to ensure that these processes encompass each of the requirements in the legislation.

Investments Update

- Shar Kassam won the Consortium EAST 2015 Stand-Out Advisory Committee Member Award for her tireless commitment and service to emerging manager education. Shar was recognized for committing time, talent and energy to help in identifying key issues, speakers and more for the Consortium. She was able to do all this with the help of Lauren Honza, the Real Estate team, the Private Equity team and the support of ERS' Board, Investment Advisory Committee.
- ERS Traders were featured in Global Trading, a well-known magazine for the trading community. The article discussed the value added by the internal trading capabilities of ERS' trading team for both internal and external portfolios. The team's experience and competitive tools have successfully contributed to competitive risk adjusted performance for the Trust at a reasonable cost.

Wellness Initiative

On August 25, ERS will launch an American Heart Association(AHA)-sponsored initiative, Check Change Control. This program empowers participants to learn about, monitor and manage their blood pressure primarily through self-monitoring. Participants in CCC are responsible for recording their blood pressure results bi-monthly in a secure, confidential "health vault" online account. AHA will have the ability to track ERS' progress – with no employees' names identified. In conjunction with the program, monthly Lunch & Learn sessions will feature guest speakers from Seton who will discuss healthy lifestyle choices relating to controlling high blood pressure and preventing heart disease.

Heart disease is the number one killer of Americans and has been for 100 years, with the exception of 1918 (flu epidemic). AHA's data shows hypertensive participants see an average decrease of 27 points systolic and 10 points diastolic.

ERS is the first state agency to launch this program. But, AHA will make the program available to other state agencies in the future. Anyone may participate in the program, regardless of their blood pressure.

Senior Level Retirements

As of July 31, Chief Operating Officer Larry Zeplin has retired from ERS. Larry's 10-year contribution to ERS was significant and his legacy here will long be felt. With Larry's departure, the agency has been left with a hole in its leadership team. We are especially reminded of it today as we discuss the agency's operating budget and remember Larry's years of work on the ERS budget.

To address this departure, I have posted for a Deputy Executive Director position with the goal of having someone in place by early fall. In the meantime, I have named Shack Nail as the Interim Deputy Executive Director.

Shack currently serves as Special Projects and Policy Advisor to the Executive Director and over the years has played a number of roles here at ERS including General Counsel, Director of Governmental Affairs, and Deputy Executive Director. I will keep you updated as the search for a permanent Deputy Executive Director progresses and look forward to introducing that person to you once a decision has been made.

August 31 will be Chief Financial Officer Mike Wheeler's last day with ERS. Mike is retiring after serving ERS for almost twelve years. He has played a key role in ensuring the efficient and effective operation of ERS. Like Larry, Mike's contribution to ERS will be appreciated for years to come.

Effective September 1, I am naming Machel Pharr as the Interim Chief Financial Officer. Machel joined ERS in 2014 as the Assistant Director of Finance and has quickly distinguished herself in that role. I look forward to working with Machel in her new capacity and know she will continue to foster the tradition of excellence that Mike has cultivated.

Finally, I would be remiss if I did not bring to your attention the retirement of Rosa Duran-Jaime. Rosa joined the staff of ERS in 1979 working as a receptionist for the Executive Director and concluded her career here as a Program Specialist on the Customer Benefits payroll team. Rosa's 37 years of ERS service highlights the level of commitment that ERS employees have to this agency and its mission. It also reinforces what ERS staff and other state employees have known for years: ERS is a great place to work. Thank you, Rosa for your service and commitment to ERS, its members and retirees.

STAFF RECOMMENDATION:

This agenda item is presented for discussion purposes only. No action is required.

ATTACHMENT – 1

Exhibit A – Legislative Board Report

**Filed Legislation Affecting the Employees Retirement System of Texas
84th Texas Legislature, Regular Session**

Bill	Author	Summary	June 29, 2015
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GENERAL APPROPRIATIONS BILLS

		<p>Retirement:</p> <ul style="list-style-type: none"> • ERS – State contribution rates of 9.5% for both years of biennium; plus an additional state agency contribution at the rate of 0.5% of base payroll • LECOSRF – 0.5% state contribution rate for both years of biennium • JRS 2 – 15.66% state contribution rate for both years of biennium • JRS 1 – Fully funded 	
SB 2	Nelson	<p>Group Health Plan:</p> <ul style="list-style-type: none"> • Funded sufficiently to potentially avoid benefit changes through FY 2017 	
HB 1	Otto	<ul style="list-style-type: none"> • Maintains current 100% member and 50% dependent state contribution • Maintains 1% of base payroll contribution from participating state agencies and higher education institutions • Requires ERS to provide reports regarding the bidding and administration of the HealthSelect contract to LBB and SAO. • Requires ERS to work with Texas Diabetes Council to study pre-diabetes and consider developing a diabetes prevention program. <p>Other Benefits:</p> <ul style="list-style-type: none"> • Public Safety Benefits (Chapter 615) – Fully funded • Retiree Death Benefits – Fully funded 	

RETIREMENT

Retirement - Elected Class

HB 131	Simpson	Fixes elected class annuity at 2% of \$125,000 for members entering the class on or after 9/1/2015, with a maximum of 12 years of service.	Left pending in Pensions 4/27/15
SB 1683	Huffines		Referred to State Affairs 3/23/15
SB 110	Taylor, Van	Suspends or reduces annuities of elected class officers on final conviction of a felony or certain misdemeanors related to the officer's official duties.	Referred to State Affairs 1/27/15
HB 1538	Meyer		Referred to Pensions 3/10/15

Bill	Author	Summary	June 29, 2015
SB 115	Taylor, Van	Prohibits ERS from withholding as confidential the name or amount of annuity of a retired member of the legislature.	Referred to Business & Commerce 1/27/15
HB 1698	Capriglione		Referred to Pensions 3/12/15
HB 408	Turner, Chris	Prevents certain members of the elected class from transferring service to the employee class, or from retiring from the employee class while still in elected office.	Signed 6/19/15
SB 1773	Menendez		Referred to State Affairs 3/24/15
HB 425	Fallon	Makes elected officials ineligible to receive an annuity if convicted of bribery, embezzlement, or perjury.	Left pending in Pensions 3/23/15
HB 681	Sheets		Referred to State Affairs 5/18/15
HB 3461	Fallon	Fixes elected class annuities at 2% of \$140,000 for members of the elected class with all service earned as member of the legislature.	Left pending in Pensions 4/27/15
HB 3699	Simpson		Left pending in Pensions 4/27/15
SB 19	Taylor, Van	Adds reporting requirements for individuals required to file financial reports to the Ethics Commission, including public and private retirement income. Applies to ERS Board members. Makes elected officials ineligible to receive an annuity if convicted of bribery, embezzlement, or perjury.	On House Calendar 5/26/15
SB 1516	Seliger	Fixes retirement annuity of members of the legislature and statewide elected officials at 2% of a district judge's salary, as that salary existed on August 31, 2015.	Referred to State Affairs 3/23/15
Retirement - Employee Class			
HB 442	Gonzales	Allows beneficiaries to have all or part of an employee's or retiree's death benefits be payable directly to a funeral director or establishment.	Referred to Senate State Affairs 5/4/15

Bill	Author	Summary	June 29, 2015
HB 3182	Fallon	Limits the maximum retirement annuity amount for new employees hired after August 31, 2015 to the amount of the gross salary of an active duty General or Admiral of the US armed forces.	Sent to Calendars 4/24/15
HB 701	Allen, Alma	Provides an immediate 10% COLA, effective 9/1/15, plus a 4% annual COLA for annuitants. Also provides a supplemental payment equal to the lesser of the monthly annuity or \$2,000, payable in January '16.	Left Pending in Pensions 5/4/15
SB 465	Taylor, Van	Suspends or reduces annuities of Texas Juvenile Justice Department employees on final conviction of a certain offenses against a minor student.	Referred to State Affairs 2/10/15
HB 9	Flynn	Raises the employee contribution to 9.5%, effective 9/1/2015, and ties the employee and state contributions together. Also eliminates the 90-day waiting period to become a member of the retirement system	Signed 6/9/15
HB 2859	Marquez	Permits an individual to establish service credit in the employee class for employment with a tribal government.	Referred to House Pensions 3/16/15
SB 1157	Hall	Repeals Section 814.009, Texas Government Code, which allows ERS to deduct membership fees for a state employee organization from a retiree's annuity.	Referred to State Affairs 3/17/15
SB 1917	Watson	Raises the employee contribution to 8%, the state agency contribution to 1%, and the state contribution required by the Texas Government Code to 10%, effective 9/1/2015.	Referred to State Affairs 3/25/15
SB 1941	Huffman	Clarifies that a member who terminates must designate a new beneficiary on returning to work, and that a death benefit is not payable to a member on leave without pay.	Referred to State Affairs 3/25/15
Retirement - Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOSRF)			
HB 1821	Alonzo	Permits peace officers employed by institutions of higher education and public schools to move from TRS to ERS, effective 1/1/2016, and participate in LECOSRF. Also adds certain peace officers employed by the state and correctional officers at the Texas Juvenile Justice Department to LECOSRF.	Left pending in Pensions 3/30/15

Bill	Author	Summary	June 29, 2015
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Retirement - JRS I & II

HB 3377	Hughes	Allows JRS II retirees to resume service in JRS II if they return to service as a judicial officer after a break of more than 12 months.	Sent to Calendars 5/1/15
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CHAPTER 615
(Survivor benefits for officers killed in the line of duty)

SB 436	Lucio	Increases lump sum survivor benefit from \$250,000 to \$500,000, and doubles the monthly benefit paid to surviving minor children.	Referred to State Affairs 2/09/15
HB 1278	Hughes		Signed 6/17/15

INSURANCE

Insurance - Coverages

SB 194	Ellis	Requiring HIV tests to be a part of routine blood work.	Referred to Health and Human Services 1/27/15
SB 264	Ellis	Allows dependents of the wrongfully imprisoned to participate in the GBP.	Referred to State Affairs 1/28/15
HB 3476	Coleman	Requires ERS to establish a telehealth and telemedicine pilot program for annuitants, to begin June 1, 2016.	Referred to Senate Health & Human Services 5/14/15
SB 575	Taylor, Larry	Requires health plans to offer abortion coverage as a separate coverage, and cover abortions under the health plan only when a life-threatening physical condition exists.	On House Calendar 5/26/15

Bill	Author	Summary	June 29, 2015
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HB 1435	Smithee	Requires health plans to offer abortion coverage as a separate coverage, and cover abortions under the health plan only when a life-threatening physical condition exists.	Referred to House Insurance 3/10/15
HB 3130	Farney		On House Calendar 5/12/15

Insurance - Plan Design/Funding

HB 966	Crownover	Requires ERS to establish a voluntary consumer-directed health plan in the form of a high deductible health plan (HDHP) with a Health Savings Account (HSA) as an alternative to HealthSelect with coverage to begin September 1, 2016.	Signed 6/19/15
SB 482	Hancock		Referred to State Affairs 2/24/15

SB 481	Hancock	Adds assistant surgeons to the definition of "facility-based physicians" subject to a request for mediation of an out-of-network claim, and reduces the minimum claim from \$1,000 to \$500.	Signed 6/15/15
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HB 3307	Miller, Rick	Requires ERS to offer a TRICARE Military Health System Supplemental plan.	Signed 6/17/15
SB 1816	Hinojosa		Referred to State Affairs 3/25/15

Insurance - Eligibility

HB 2123	King, Phil	Allows a member of the state military forces who has been on active duty for more than 60 days to participate in the GBP as a full-time state employee.	Signed 6/19/15
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SB 1834	Menendez	Allows a member of the Texas National Guard who is on active duty providing border security to participate in the GBP as a full-time state employee and receive a state contribution towards insurance premiums.	Referred to State Affairs 3/25/15
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Bill	Author	Summary	June 29, 2015
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BENEFITS ELIGIBILITY

HB 4105	Bell	Prohibits state employees from recognizing or enforcing any marriage license or certification that does not comply with Section 32, Article 1, Texas Constitution	Set on House Calendar 5/12/15
HB 1797	Marquez	Makes certain "qualified individuals" eligible to participate as dependents in the GBP if they are at least 18, not related to the GBP participant, financially interdependent, and cohabitating.	Left Pending in State Affairs 4/29/15
HB 3890	Stephenson	Makes a same-sex spouse of a member or retiree of a public retirement system ineligible for benefits from that retirement system.	Referred to State Affairs 3/23/15

INVESTMENTS

HB 3071	Anchia	Changes required reports on prohibited investments in Sudan and Iran from annually to 30 days after the updated list is received.	Referred to Int'l Trade, 3/24/15
SB 940	Taylor, Van		Signed 6/16/15

BOARD OF TRUSTEES

HB 3227	Hernandez	Allows one of the members elected to the Board of Trustees to be a retiree.	Referred to Senate State Affairs 5/7/15
SB 1146	Watson	Adds option for one elected Board member to be a retiree.	Referred to State Affairs 3/17/15
HB 3573	Alonzo	Allows one of the members elected to the Board of Trustees to be a retiree.	Engrossed 5/15/15

Bill	Author	Summary	June 29, 2015
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FUNDING

HB 3310	Paul	Requires certain public retirement systems (but not ERS) to work with the Legislature to develop a funding soundness restoration plan.	Signed 6/18/15
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SJR 68	Eltife	Proposed constitutional amendment to transfer \$1.5 billion from the Economic Stabilization Fund (Rainy Day Fund) to the ERS trust.	Referred to Finance 4/8/15
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CONTRACTING

SB 20	Nelson	This bill creates various new processes for state agency contracting. Provisions include increased reporting and disclosure requirements, new oversight and review authority, required contract terms, and other provisions.	Signed 6/4/15
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RESOLUTION

WHEREAS,

THE HONORABLE YOLANDA GRIEGO

was elected to serve on the Board of Trustees of the Employees Retirement System of Texas by her fellow state employees and State of Texas retirees to serve two six-year terms that began September 1, 2003 and September 1, 2009, serving as one of three elected members; and

WHEREAS,

Yoly was selected by her fellow members of the Board of Trustees to serve as vice-chair for Fiscal Year 2008 and served as chair for Fiscal Year 2012; and served with distinction as a member of the ERS Audit Committee; and

WHEREAS,

as a Board member, Yoly was responsible for overseeing the administration of retirement assets and benefits for more than 200,000 state employees, retirees and beneficiaries, and the health and life benefits of more than 500,000 state and higher education employees, retirees and dependents; and

WHEREAS,

during her service on the Board, the ERS Trust Fund improved investment performance; added new asset classes to increase diversification; obtained additional funding for the retirement plan through increased state and member contributions; modified retirement benefits for new employees while preserving benefits for existing members; lowered costs for retirees through a new Medicare Advantage plan; and selected new administrators for the HealthSelect plan, the TexFlex program and the disability and life insurance programs; and

WHEREAS,

Yoly's leadership, influence and unwavering support for ERS employees, state employees, retirees and their family members were always present at the many board meetings and ERS events she attended, and her caring and compassion for others were evident in her decisions; and

WHEREAS,

after more than 12 years of service as an honorable member of the ERS Board of Trustees, Yoly Griego ends her ERS Board of Trustee service today; therefore be it

RESOLVED,

that the Trustees, staff and members of the Employees Retirement System of Texas hereby express their highest respect and sincerest appreciation to the Honorable Yoly Griego for her selfless commitment by honoring and recognizing her with this Resolution as a lasting token of her noble public service as an ERS Board of Trustee Member.

ADOPTED THIS DAY, THE EIGHTEENTH DAY OF AUGUST 2015.

Board of Trustees
Employees Retirement System of Texas

Brian D. Ragland, Chair

Frederick E. "Shad" Rowe Jr., Vice-Chair

Doug Danzeiser, Member

Cydney Donnell, Member

I. Craig Hester, Member