Joint Meeting of the Board of Trustees and Investment Advisory Committee

February 25, 2014

ERS
Employees Retirement System of Texas

Presented for Review and Approval
May 20, 2014

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JOINT MEETING OF THE
BOARD OF TRUSTEES AND
INVESTMENT ADVISORY COMMITTEE
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

February 25, 2014
ERS Auditorium
200 E. 18th Street
Austin, Texas 78701

COMMITTEE MEMBERS PRESENT
Lenore Sullivan, Chair
James Hille, Vice-Chair
Robert Alley, Member
Caroline Cooley, Member
Monty Jones, Member
Ken Mindell, Member
Laura Starks, Ph.D., Member
Vernon Torgerson, Member

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 Bishop, Executive Director
Larry Zeplin, Chief Operating Officer
Tom Tull, Chief Investment Officer
Paula Jones, General Counsel and Chief Compliance Officer
William Nail, Deputy Director of Governmental Affairs
Tony Chavez, Internal Auditor
Robert Kukla, Director of Benefit Contracts
Marci Sundbeck, Manager of Enterprise Risk Management
Catherine Terrell, Director of Governmental Affairs
Michael Wheeler, Chief Financial Officer
Carolyn Anderson, Investments
Wesley Gipson, Investments
Andrew Hodson, Investments
Lauren Honza, Investments
Sharmila Kassam, Investments
Debbie Leatham, Finance
Robert Lee, Investments
Betty Martin, Investments
Nancy McCarthy, Investments
Tanna Ridgway, Investments
Ralph Salinas, Director of Human Resources
Leighton Shantz, Investments
Robert Sessa, Investments
John Streun, Investments
Chris Tocci, Investments

Martha J. Wall, Governmental Affairs
Mary Jane Wardlow, Governmental Affairs

ALSO PRESENT
Anthony Bookman, Cross River Advisors
Leslie Cunningham, Texas State Employees Union
Kristen Doyle, Hewitt EnnisKnupp
Juan Garcia, Office of the Governor
Jon Mathers, Office of Representative Bill Callegari
Steve Voss, Hewitt EnnisKnupp

Mr. Brian Ragland, Chairman of the Board of Trustees for the Employees Retirement System of Texas 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."

X. REVIEW AND APPROVAL OF THE MINUTES TO THE DECEMBER 5, 2013 JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE

Ms. Lenore Sullivan, Chair of the Investment Advisory Committee, opened the floor for a motion to approve the ERS Joint Meeting minutes of December 5, 2013. The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Bob Alley, seconded by Mr. Ken Mindell and carried unanimously by the members present that the Investment Advisory Committee approve the minutes of the ERS Joint Meeting of December 5, 2013.

The Board of Trustees (Board) then took the following action:

> **MOTION** made by Ms. Cydney Donnell, seconded by Ms. Cheryl MacBride, and carried unanimously by the members present that the Board of Trustees approve the minutes of the ERS Joint Meeting of December 5, 2013.

XI. REVIEW AND DISCUSSION OF THE STATE OF ERS' UNFUNDED PENSION LIABILITY

Mr. Tom Tull, Chief Investment Officer of ERS, and Ms. Martha Wall, from Governmental Affairs for ERS, presented the review and discussion of the state of ERS' unfunded pension liability.

Ms. Wall addressed factors regarding calculating the unfunded pension liability. The factors of liability are based on demographics and assumptions of how long members will work and how long they will live.

Ms. Wall reviewed the report that the actuarial consultant Gabriel Roeder Smith and Company (GRS) provided during the December 2013 Board meeting. GRS concluded that the unfunded liability had increased and is now at $7.2 billion. Contributing factors to the increase in unfunded liability are long-term underfunding, investment losses and a shrinking state workforce.

In 2001, ERS had a surplus of almost $1 billion due to investments. However, the cumulative figures from 2003 through 2013 represent the worse decade of investments and aided in the unfunded liability balance. Retirement incentives were given from 2003 to 2005, but reforms were made in 2005 after demographic changes were recognized by the Legislature. Additionally, provisions for return to work were rolled back and some gain service credits were removed.

Since 2009, the demographic experience at ERS has been favorable. However, there is still a $1.844 billion deficit from that time period, which is not covered by contributions or investment returns.

Ms. Ann Bishop recognized that the Board and Legislature should feel good about identifying and recognizing the issues and taking actions to correct them, but there is the potential for truing up some of the past mistakes or past issues that have impacted the retirement fund.

An experience study by ERS in 2008 found that during the incentive period, $475 million was added to the unfunded liability. In 2002, the study recognized that the workforce was smaller and that people were retiring earlier, which added $450 million to the unfunded liability balance.

Ms. Cydney Donnell questioned if there has been any discussion to encourage people to work longer. She commented on how employees with longevity are assets to the company and it's more cost effective than rehiring.

Last year the Legislature implemented S.B. 1459 and S.B. 1 in response to the issue of unfunded liability. S.B. 1459 lowered the annual cost of benefits being earned by new employees. S.B. 1459 and S.B. 1 increased state and employee contributions and lowered the funding gap from 5.25% to 4.13% of payroll. This is also the first year that agencies are contributing to the fund in addition to the state employees and the retirees.

ERS is keeping a "high" standard for grandfathering based upon the member's age and service. Members who are 50 years or older, Rule of 70 or have 25 years of service were grandfathered.

Ms. Wall introduced data from an interim benefits study from 2012. The study examined other state funds for the purpose of finding options to reduce the unfunded amount. The study includes several options to increase revenue into the plan. Two options would require legislative action - general obligation bonds produced by the State of Texas, or a one-time revenue source, such as the one-time infusion from the rainy day fund.

The LECOS plan was an ongoing alternative revenue resource to assist in decreasing liability. Up until about 1995, it was receiving portions of motor vehicle inspection fees until it was overfunded. Also, 11% of court fees were coming directly into the LECOS fund, which equates to about $20 million a year.

Ms. Wall explained that cost of living adjustments (COLA) were also considered in the study. They found that the common multiplier for cost of living is 2%. ERS is about 2.3%, and LECOS is at 2.8%.

According to the study, all the states had done some reform over the last five years. The easiest reform to increase a fund is to increase contributions from employees and from the employer. In 2012, the average employee contribution rate was about 5.5% and now it is 6%. While the employer contribution rate was 11.14%, it has now increased to 12.09%. State of Texas employees contribute more to the ERS plan than the State because the State also pays social security for employees.

Ms. Wall concluded the discussion by explaining the effect of GASB requirements. Employers have been increasing their contributions, which could be attributed to the new GASB requirements. The GASB rules will produce a lower discount rate resulting in a blended discount rate which will apply to liabilities rather than 8%. There is a new commitment to funding the benefits and paying down unfunded liability.

Mr. Frederick Rowe commented about the importance of presenting the extent of the unfunded pension liability to the Legislature to alert them to respond, but without alarming the members in the system.

Ms. Cheryl MacBride discussed a State Auditor report that mentioned a lot of people retiring and high employment turnover in the 30 and under group, which affects contributions to the fund. Additionally, turnover will create of lack of seniority and experience. Ms. Wall responded that ERS is talking to the State Auditor's Office on an ongoing basis.

ERS staff will continue education and outreach on options to decrease the unfunded pension liability.

Mr. Brian Ragland reiterated the importance of discussing the unfunded liability issue as a standing agenda item.

The Board recognized Leslie Cunningham to speak on her own behalf. Ms. Cunningham is a state retiree and a member of the Texas State Employees Union. She discussed the correlation between state employee turnover and the decrease of benefits for new employees that is not good for the state of Texas. She commented that the employees need to continue efforts with the Legislature and appreciated this discussion. Ms. Bishop recognized Ms. Cunningham's efforts in participating in the process and education of members and the Legislature.

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

XII. REVIEW OF INVESTMENT PERFORMANCE AND THE PORTFOLIO FOR THE FOURTH CALENDAR QUARTER OF 2013

Mr. Chris Tocci, Public Equities Senior Portfolio Manager for ERS, and Ms. Kristen Doyle and Mr. Steve Voss, consultants from Hewitt EnnisKnupp, introduced the review of investment performance and the portfolio for the fourth calendar quarter ending December 31, 2013.

Ms. Doyle began the review of the fourth quarter performance presentation. She reported that numbers were very strong in the fourth quarter. In contrast, US equity was down 3% in January and non-US equity markets were down almost 5%, but all improved in February to a flat year-to-date. The bond market is up about 1%. She discussed the very strong equity returns for the major capital markets for the calendar year. The large cap was up over 32.1% and the small cap was up over 41%.

Regarding the global equity markets, the US market was up 32% and emerging markets were negative. This had a great effect on the portfolio since it is overweight in US equity and underweight in emerging markets. Over the past two years, the US equity market has outperformed the non-US equity market.

Mr. Craig Hester questioned the panel regarding implementing a short term tactical plan due to the strength in the equities market and low bond yields.

Mr. Tom Tull answered Mr. Hester by explaining that ERS is trying to find new opportunities to invest, but very few compelling opportunities to invest in private equities have arose. The equity team is creating new policies, procedures and an incubation approach to help address this issue.

Ms. Cydney Donnell agreed that it was best to wait to invest in the right deal and that the team is pursuing the correct strategy.

The plan has benefitted from a relative underweight in the large cap equities. The large cap has been outperforming the small cap. There has been a lot of volatility and the results look different year-to-year.

The investment earnings of $3 billion over the past year out-paced the net cash outflow of the plan. It grew from $23 billion to $25 billion in one year. Total fund growth has outperformed its policy benchmark by 50 basis points over the one year period.

Ms. Doyle described the allocation of funds in the ERS Plan. Funds are allocated to three different categories – asset allocation, strategic allocation, and long term allocation. Global credit is up to almost 4% relative to its target of 10%. Real assets are growing as well. They are up to 8% with additional investments in infrastructure and private real estate moving toward their goal of 14%.

Mr. Voss continued the presentation and revisited the performance of benchmarks. He discussed phasing of benchmarks in emerging market debt, high yield and bank loans down the road. Due to the faster than expected reduction in transition fixed income assets in the trust it makes sense to combine transition assets into Rates as ERS de-risks relative to the benchmark. This is to be discussed in more detail at the next board meeting with the fixed income team. Mr. Leighton Shantz also commented that the liquidity in the Rates portfolio from the accelerated transition of the asset allocation has allowed us to re-invest and continue buying equities rather than sell them to fund benefit obligations.

Real assets are made of real estate and infrastructure. Public real estate was up slightly 20 basis points relative to its benchmark. Private real estate is up almost 12% for the year. Total capital committed for the private real estate program is about $2 billion. Infrastructure has about $275 million committed.

The risk reduction part of the trust was also strong relative to the benchmark. Hedge funds/ absolute return assets earned 9.1% versus the benchmark (T bills plus 4%) return of 4.1%.

Mr. Voss discussed the importance of downside protection. He stated that in a crisis, you want elements of protection from equity beta risk suggesting that minimum exposure to fixed income helps you eat well over the long term, but also sleep well at night as well.

Mr. Voss concluded that the fund continues to evolve through the long term policy targets. He highlighted the strategies of fund allocation and liquidity. The addition of 50 basis points of value attributed to tactical decisions made by the investment team resulting in a positive year.

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

(Recess was taken for lunch)

XIII. REVIEW AND DISCUSSION OF GLOBAL PUBLIC EQUITY STRATEGIES PROGRAM:

a. Program Overview and Market Update

Mr. Neil Henze, Chief Equity Trader for ERS, and Mr. Andrew Hodson, Mr. Tim Reynolds, Mr. John Streun, and Mr. Chris Tocci, all Senior Portfolio Managers for ERS, presented the review and discussion of the global public equity strategies program overview and market update.

Mr. Streun presented the investment objectives and strategies. They have not changed from 2013 and are working well. The investment objective is to outperform the global benchmark over a rolling five-year time period. The ERS fund has outperformed by 12 basis points per year over the last five years.

Last year, the policy benchmark outperformed by 32 basis points. Mid Cap and Emerging Market Managers both outperformed their benchmark over 200 basis points. Legato and Leading Edge performed well as emerging managers. Four of the seven external advisors outperformed their benchmark.

Mr. Streun highlighted changes in ERS Investment division personnel. He mentioned the retirement of Mr. Jim Sherwin, Director of Strategic Research, and the creation of a new public equity leadership team and external advisor team. Additionally, there is an open position for an analyst to assist portfolio managers and senior analysts.

He commented on the external advisor program and the importance of having a select pool of advisors for the program. External advisors supplement the niche and skill set that the internal equity group does not have.

Mr. Streun concluded his portion of the presentation by discussing the strategy of global equities. They want to pay less attention to the benchmark and spend more time on the concept of active share.

Mr. Tocci began the presentation by discussing the fund allocations of global public equities. At the high level of global allocations, they will continue to remain overweight in global equities until private markets reach their allocation, subject to market conditions.

Domestic public equities current portfolio allocation is $7.3 billion. The fund is diversified and they measure risk as portfolio weight times their tracking error. In global international equities there is an allocation of $6.7 billion.

Mr. Tocci concluded that the portfolio managers and external advisors for ERS are warming up to financials sector instead of utilities. There is a slight overweight in discretionary. Healthcare sector exposure and tilts are being driven by external advisors.

Mr. Frederick Rowe inquired how the fund is doing in comparison to the S&P. Mr. Tocci responded that the US large cap is up 32%, small cap is up 41%, international is an under performer, but still up 15%, and emerging markets are down 3%. Mr. Tom Tull additionally responded that the trust is up over 14% and that he would get Mr. Rowe the figures that he requested.

Mr. Hodson presented the 2014 global market outlook. He highlighted various geographic regions for the different markets and key economic data points. After 4 or 5 years, the US is producing very low single digit GDP growth. Japan is looking to stabilize after the second year of reforms by Prime Minister Shinzō Abe. The Prime Minister is trying to reform wage inflation. Europe has stabilized and the outlook looks flat and marginally positive for GDP growth. European unemployment is still high, but stabilizing at 12%. PMIs for Germany, Italy, and Spain are expanding due to low interest rates.

Elections in Brazil, Turkey, India, and Indonesia will be instrumental in benefiting or further hindering the economic growth in these countries. China avoided problems in 2013, but with new leadership is transitioning from a manufacturing to a consumption based economy.

Mr. Craig Hester addressed issues with China's banks and real estate and asked if Mr. Hodson felt that they would avoid a hard landing in 2014. Mr. Reynolds replied during the second half of the year confidence in China may improve. Some people speculate that China may reach 8% GDP growth rate again. Overall, Mr. Reynolds does not think China will have a hard landing in 2014, but they will not be the exciting dynamic economy they were previously.

Mr. Hodson concluded with comments on the record amounts of cash on corporate balance sheets that should produce investment opportunities.

Next, Mr. Reynolds introduced a new committee called the Best Ideas Committee (Committee). It is comprised of the Risk Management and Applied Research Group, the CIO, Public Equities and External Management representatives. The objective is to provide an incubation approach for ongoing new ideas. Currently corporate spin-offs, moats and lobbying were three investment strategies that emerged from the Committee. The Committee selected to delve deeper into the spin-offs and moats options.

Mr. Craig Hester commented about what portfolio spin-offs will be and if they are able to be in more than one portfolio. Mr. Streun responded that spin-offs can be in two portfolios, if the analyst or portfolio managers like the stock.

Ms. Cydney Donnell responded on the soundness of the rationale behind the Committee. She continued that many energy companies are creating spin-offs. There are many aspects of the spin-off to investigate, such as the motivation behind the spin-off, who the management team is, and if they are loading up on options.

Once the due diligence and analytical process is completed, the best ideas that survive the process will be funded. The objective over time is to build an investment pool for best ideas of approximately $900 million.

Mr. Neil Henze continued the presentation and gave an update on trading activity. He presented an overview of ERS' total commissions over the past six years. Last year commissions were $7.3 million for domestic and international. The average commission rate is 2.6 cents per share. ERS traded at a rate of 1.6 cents last year and their emerging managers traded at 1.8 cents. ERS is consistently lower than their peers on a commission rate comparison. Mr. Henze discussed the breakdown of the commissions. The internal portfolios generate 60% of the commissions. The external portfolio generated approximately $3 million in 2013. The international account typically has the highest commission.

ERS has reduced the number of brokers. Domestic brokers have decreased 15% from 52 to 44 brokers. Internationally brokers have decreased 15% as well, from 32 to 27 brokers. The investments team is leveraging the existing brokers and re-evaluating them to provide the most value to the fund.

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

b. Proposed Revisions to the Global Public Equities Policies and Procedures

Mr. John Streun addressed the Board and IAC regarding changes to the Global Public Equities Policies and Procedures. One of the changes to the policy will be the incorporation of the Best Ideas program. The equity team's objective is to create a framework and formal structure to the new initiative.

He reiterated to the allocation of the Best Ideas program. No more than 10% of the internally advised portion of global equity asset class will be allocated to the program. Currently, about $900 million could be allocated to the best ideas program.

Ms. Ann Bishop explained that from a management standpoint, it is important that the investment programs be structured and organized, so the staff has specific goals and are accountable, as well as rewarded for being innovative and creative.

Ms. Cydney Donnell expressed support in favor for the new program and for anything that avoids benchmark hugging.

Mr. John Streun opened the floor to propose revisions to the Global Public Equities Policies and Procedures. The Investment Advisory Committee then took the following action:

MOTION made by Mr. Ken Mindell, seconded by Mr. Robert Alley and carried unanimously by the members present that the Investment Advisory Committee approve the proposed revisions to the ERS *Investment Policy* Addendum XI, Global Public Equities Policies and Procedures.

The Board of Trustees (Board) then took the following action:

MOTION made by Mr. Craig Hester, seconded by Ms. Cydney Donnell, and carried unanimously by the members present that the Board of Trustees approve the proposed revisions to the ERS *Investment Policy* Addendum XI, Global Public Equities Policies and Procedures.

XIV. ANNUAL REVIEW AND CONSIDERATION OF PROXY VOTING AND CORPORATE GOVERNANCE

Ms. Nancy McCarthy, global equity analyst for ERS, presented the annual review and consideration of proxy voting and corporate governance.

The Board has recognized that the right to vote proxies has economic value and includes the management of voting rights as fiduciaries and must be exercised for the sole economic benefit of ERS. The proxy voting guidelines have been updated annually since February of 2011.

Proxies are voted through the Institutional Shareholder Services electronic proxy voting system. Mergers, acquisitions, and proxy fights are referred to ERS analysts and portfolio managers for a final vote. In 2012 and 2013, 2.2% of proposals were referred to ERS staff, respectively.

Ms. McCarthy outlined the voting activity of 2013. ERS voted on over 26,000 proposals and agreed with management 91% of the time, which is consistent with 2012. There was a decrease in social environmental issue votes between 2012 and 2013. ERS tends to support calling for disclosure of political contributions and lobbying payments and policies. Globally, ERS has voted in 2,526 meetings in 52 separate markets. The United States is ERS' largest market with over 1,200 meetings, and Europe is the second largest market with 382 meetings.

European authorities have developed initiatives to encourage passive shareholders to become more engaged with their fiduciary responsibility. In 2007, they passed the Shareholder Rights Directive, which established minimum voting. Some countries disclose voter turn-out information. However, the number of companies that provide this information varies. All Austrian companies provide voter information.

From 2008 to 2013 there has been a 5% increase in voter turnout in Europe. In the United States the average voter turnout was 72.1%.

ERS is a member of the Council of Institutional Investors, a non-profit association of pension funds, employee benefits, foundations, and endowments. The council membership approved two policies in 2013. The first policy is a designated universal proxy in director and the second policy specifies that a Board of Directors can consider tenure as a factor in director independence.

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

XV. REVIEW, DISCUSSION AND CONSIDERATION OF THE EMERGING MANAGER PROGRAM:

a. Program Overview and Market Update

Ms. Lauren Honza, Emerging Manager Program Director for ERS, and Ms. Sharmila Kassam, Investments Chief of Staff for ERS, presented a program overview and market update for the Emerging Manager Program.

The Emerging Manager Program was formed in 2010 after legislation that required ERS make a good faith effort to consider and hire emerging managers, which is defined in statute as firms with assets under management of less than $2 billion. Additionally, an annual report is due to the Board regarding efforts of the program.

Ms. Honza discussed allocation of funds for the Emerging Manager Program. 6% of externally advised assets are invested with emerging managers, and the goal is to increase that amount to 10% of externally advised assets over the next five years. At the end of 2013, the trust had $8.7 billion in externally advised assets. Approximately $526 million at this time has been invested or committed to emerging managers. A further breakdown shows the commitment to each division - $176 million to public equity, $50 million to private equity, $105 million in private real estate, and $194 million in hedge funds.

Ms. Honza explained that ERS is continuing to expand the efforts of the Emerging Manager Program, including improving the external advisor website and encourage more registration as well as reaching out to the emerging manager community and being proactive by speaking and hosting conferences.

In January, ERS co-hosted the Texas Emerging Manager Conference with Teacher Retirement Systems of Texas (TRS). That same week the Real Estate Emerging Manager Summit was held, which was a packed house event hosted by ERS, TRS and Morgan Creek Capital Management.

Ms. Honza described several initiatives planned for 2014 beginning with formalizing the program by incorporating it into policies and procedures in the Investment Policy. The philosophy for the program is that, over the long term, inclusion of emerging managers as part of external investment management should enhance and diversify ERS' expected trust portfolio and complement ERS' internal investment management. ERS seeks to provide open access to all managers and ensure an inclusive approach when investing the trust's capital.

Smaller managers have proven to deliver competitive risk-adjusted investment returns. Employee-owned firms tend to have a stronger alignment of interest with investors. Entrepreneurial managers can provide ERS with unique investment strategies and diversity of thought. This program can provide ERS with long-term access to the next generation of talent. ERS's goal is to reach smaller managers that can be integrated into externally managed assets of the trust management and help provide the best risk adjusted returns net of fees.

Ms. Honza continued by describing the process of registration, which is located on the public ERS website. Ms. Kassam explained that the ERS Emerging Managers Program encourages all managers to register for the program, but will respect the resources of managers and staff by meeting with managers that fit with ERS. If ERS cannot invest in a manager, ERS will leverage its partners - manager of emerging managers – so that a manager may be mentored and introduced to other investors. The Emerging Managers Program is committed to a frank, timely feedback process summarized by the acronym – PATH.

<u>P</u>rocess: Develop clear policies and procedures for emerging managers to follow.

<u>A</u>ccess: Encourage any and all emerging managers to register and complete an introductory questionnaire.

<u>T</u>ransparency: Give full disclosure on ERS' process and investments through the ERS Investment Policy and website.

<u>H</u>elpful: Provide support to smaller and newer managers even when an investment is not feasible.

Ms. Honza concluded the program overview of the Emerging Managers Program by acknowledging strategic relationships with industry leaders including New America Alliance, Toigo, SEO, Association of Asian American Investment Managers, and NAIC to encourage diversity and inclusiveness in all our searches.

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

b. Proposed ERS Investment Policy Addendum XV: Emerging Manager Program Policies and Procedures

Ms. Sharmila Kassam discussed the policies and procedures including the outreach process, which relies on the managers of emerging managers as an extension of staff, so these managers are held to very high standards. The duties of managers of emerging managers are they must source managers, construct a portfolio for emerging managers, monitor and mentor the emerging managers for ERS, initiate outreach to the industry and share best practices on emerging manager programs. She noted that we are proud to work with Grosvenor Customized Fund Investment Group in private equity, Morgan Creek/Oak Street in real estate, and Legato and Leading Edge in global equities.

The Emerging Manager Program will be incorporated into each asset class to complement ERS' internal management, so managers will be held to the same high standards as expected of any manager. The process is broader to perform extensive due diligence for these smaller managers.

Ms. Lenore Sullivan opened the floor for the approval of the Emerging Manager Program Policies and Procedures. The Investment Advisory Committee then took the following action:

MOTION made by Mr. Bob Alley, seconded by Ms. Laura Starks and carried unanimously by the members present that the Investment Advisory Committee approve the ERS *Investment Policy* Addendum XV, Emerging Manager Program Policies and Procedures.

The Board of Trustees (Board) then took the following action:

MOTION made by Ms. Cheryl MacBride, seconded by Ms. Yolanda Griego, and carried unanimously that the Board of Trustees approve the ERS *Investment Policy* Addendum XV, Emerging Manager Program and Policies and Procedures.

c. Proposed Emerging Manager Program Annual Tactical Plan for Fiscal Year 2014

Ms. Honza discussed the proposed Emerging Manager Program Annual Tactical Plan for fiscal year 2014. The goal is to commit 10% of the externally advised assets to emerging managers over the next five years, which will equate to a billion dollar program by FY2019 (based upon a $25 billion trust).

Ms. Lenore Sullivan opened the floor for the approval of the Proposed Emerging Manager Program Annual Tactical Plan for Fiscal Year 2014. The Investment Advisory Committee then took the following action:

> **MOTION** made by Ms. Laura Starks, seconded by Mr. Vernon Torgerson and carried unanimously by the members present that the Investment Advisory Committee approve the Emerging Manager Program Annual Tactical Plan for Fiscal Year 2014 to be added as Appendix A of the ERS Emerging Manager Program Policies and Procedures.
>
> The Board of Trustees (Board) then took the following action:
>
> **MOTION** made by Ms. Yolanda Griego, seconded by Mr. Craig Hester, and carried unanimously that the Board of Trustees approve the Emerging Manager Program Annual Tactical Plan for Fiscal Year 2014 to be added as Appendix A of the ERS Emerging Manager Program Policies and Procedures..

XVI. <u>CHIEF INVESTMENT OFFICER REPORT</u>

(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, to enhance and develop the risk management processes, and to 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.

Regarding staffing changes, with the retirement of Mr. Jim Sherwin, the strategic research group was split in two. Mr. Carlos Chujoy, Strategic Research Portfolio Manager, is leading Risk Management and Applied Research and Ms. 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.

XVII. <u>ADJOURNMENT OF THE JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE</u>

The February 25, 2014 Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee was adjourned at 2:00 pm.