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August 16, 2016

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

**August 16, 2016 – 12:18 p.m.
ERS Building – Board Room
200 E. 18th Street, Austin, Texas 78701**

TRUSTEES PRESENT

I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Ilesa Daniels, Member
Cydney Donnell, Member
Brian Ragland, Member

TRUSTEES NOT PRESENT

Jeanie Wyatt, Member (excused by the Board)

ERS STAFF PRESENT

Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director and General Counsel
Shack Nail, Special Projects and Policy Advisor
Tony Chavez, Internal Auditor
Bernie Hajovsky, Director of Enterprise Planning Office
Jordan Hajovsky, Co-Director of Operations Support
Robin Hardaway, Director of Customer Benefits
Robert Kukla, Director of Benefit Contracts
Wendy McAdams, Co-Director of Operations Support
Machelle Pharr, Chief Financial Officer
DeeDee Sterns, Director of Human Resources
Gabrielle Stokes, Director of the Office of Procurement & Contract Oversight
Kathryn Tesar, Director of Benefits Communications
Tom Tull, Chief Investments Officer
Chuck Turner, Director of Information Systems
Nora Alvarado, Benefit Contracts
Brannon Andrews, Legal Services
Adriana Ballard, Investments
Georgina Bouton, Benefit Contracts
Amanda Burleigh, Legal Services
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits
D'Ann DeLeon, Benefit Contracts
Brian Dowdy, Finance
Peter Ehret, Investments
Leah Erard, Governmental Affairs
Liz Geise, Benefits Communications
Beth Gilbert, Internal Audit
Wesley Gipson, Investments
Gunther Goetz, Legal Services
Megan Hunter, Benefit Contracts
Jennifer Jones, Governmental Affairs
Sharmila Kassam, Deputy Chief Investment Officer
Nick Maffeo, Investments

Betty Martin, Investments
Pamela Maas, Benefit Contracts
Roger Nooner, Benefits Communications
Davis Peacock, Investments
Jonathan Puckett, Internal Audit
Tanna Ridgway, Investments
Lauren Russell, Benefit Contracts
Cheryl Scott Ryan, Legal Services
Randi Schultz, Office of Procurement & Contract Oversight
Robert Sessa, Investments
Bernely Tharp, Benefit Contracts
Tommy Williams, Information Systems
Keith Yawn, Enterprise Planning Office

ALSO PRESENT

Nick Arnold, Humana
Keith Barnes, Blue Cross Blue Shield of Texas
Chason Beggerow, Altius Associates
Tiffany Calderon, Humana
Amy Chamberlain, Texas Public Employees Association
Andrew Clark, Office of the Speaker of the Texas House of Representatives
Darryl Collier, Empower Retirement
Chris Cook, AAG/Empower Retirement
Philip Dial, Rudd and Wisdom
Joseph Halbert, Senator Schwertner's Office
Bill Hamilton, Retired State Employees Association
Meg Hare, Accenture Health & Public Service
Kris Hefner, Caremark
Yves-Laurent Khoury, Blue Cross Blue Shield of Texas
Kim McLeod, UnitedHealthcare
Brittany McCollum, Caremark
Ashley Odom, UnitedHealthcare
Peter Ossian, Empower Retirement
Toni Parsley, Texas Commission on Environmental Quality
Laura Pinkard, Humana
Gabriel Puente, Strategic Partnerships Inc.
Bill Thornton, Empower Retirement
Brad Untiedt, Empower Retirement
James Walsh, Albourne America
Karen K. Wilson, Northrop Grumman

Craig Hester, Chairman of the Board of Trustees of the Employees Retirement System of Texas (ERS), noting a quorum was present, 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 10:56 a.m. on Thursday, August 4, 2016 as required by Chapter 551, Texas Government Code, referred to as “The Open Meetings Law.”

The Board of Trustees then convened as a committee of the whole at 12:18 p.m. to consider Board of Trustee meeting agenda items.

XI. Review and Approval of the Minutes to the May 17, 2016 Meeting of the Board of Trustees

Board of Trustee Chair, Mr. Craig Hester opened the floor for a motion on the approval of the minutes to the Board of Trustees Meeting held on May 17, 2016.

MOTION made by Mr. Doug Danzeiser, seconded by Ms. Ilesa Daniels and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas to approve the minutes to the meeting held on May 17, 2016.

XII. Review, Discussion and Consideration of Reappointment of ERS Investment Advisory Committee Member

Tom Tull, Chief Investment Officer, recommended the Board reappoint Mr. Ken Mindell to the Investment Advisory Committee (IAC) for a new three-year term ending May 31, 2019. Biographical information is in Exhibit A. Mr. Hester and Porter Wilson, Executive Director, briefly discussed the makeup of the IAC and future direction. Mr. Hester opened the floor for a motion on the approval of the reappointment of Mr. Ken Mindell to the IAC.

MOTION made by Mr. Brian Ragland that the Board of Trustees of the Employees Retirement System of Texas reappoints Mr. Ken Mindell to the Investment Advisory Committee for a three-year term ending May 31, 2019. Mr. Ragland further moved that the Executive Director be authorized to execute and administer contracts in connection with the reappointment of Mr. Mindell. The motion was seconded by Ms. Cydney Donnell and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

XIII. Review, Discussion and Consideration of the Rules of the Board of Trustees, Texas Administrative Code, Title 34, Part IV: Required Rule Review and Amendments to Chapter 81 (Insurance) and Amendment to Chapter 85 (Flexible Benefits)

Mr. Gunther Goetz, Office of the General Counsel, and Ms. Laurie Kuehner, Customer Benefits Division, presented proposed amendments to Texas Administrative Code, Title 34, Part IV, Chapter 81 (Insurance) and Chapter 85 (Flexible Benefits). ERS staff informed the Board that it performed a thorough review of Chapter 81, which covers the Texas Employees Group Benefits Program (GBP), including eligibility, enrollment, and cancellation of coverage and health plans. Amendments were proposed that included updating terminology, clarifying existing definitions and eliminating terms that are no longer necessary throughout the rule.

Staff discussed that proposed amendments clarify that a member's spouse must be formally married or in a common law marriage with a filed Declaration of Informal Marriage prior to the effective date of the dependent spouse's enrollment in the GBP. The amendment also created a narrow exception to the requirement to file the declaration based on clear and compelling evidence sufficient to ERS that the marriage existed prior to enrollment in the GBP. The definition regarding dependents was also proposed to be amended to specify the requirements for continuing health insurance eligibility for children ages 26 years and older who are mentally or physically incapacitated as authorized by Texas Insurance Code §1551.004(a)(3).

Staff discussed proposed amendments to §81.5 (Eligibility) which clarify that a former COBRA unmarried child would be eligible to enroll a newly acquired dependent child within 30 days of the child's

date of birth or placement for adoption. These particular GBP participants would otherwise be unable to add dependents to their coverage.

Additionally, staff explained that proposed changes also would amend the rules to comply with provisions of the Affordable Care Act (ACA) by decreasing the waiting period for coverage to the first day of the month following 60 days of employment, deleting references to a preexisting conditions limitation or exclusion, and provide that married dependents under age 26, who are otherwise eligible dependents, could continue to be enrolled as dependents and would not be required to apply for COBRA coverage until they reach age 26.

Staff explained that proposed amendments to §81.7 (Enrollment and Participation) include addressing payment of insurance required contributions and state contributions, and clarify that a Medicare-eligible surviving dependent, eligible for health coverage under the GBP, may be automatically enrolled in the Medicare Advantage Plan unless the surviving dependent opts out and enrolls in other coverage. The proposed amendments would also add requirements related to the new optional coverage for a vision plan and the new Consumer Directed HealthSelectSM plan, offered through the GBP. The proposed amendments would also allow participants enrolled in an HMO whose contract is not renewed to enroll in another approved HMO for which they are eligible. Such participants may also enroll in HealthSelect of Texas or Consumer Directed HealthSelect, instead of another HMO. The proposed amendments also clarify that qualifying life events may permit a change in coverage for participants, including dropping or adding eligible dependents, if the requested change is consistent with the qualifying life event.

Staff discussed the proposed amendments to §81.9 (Grievance Procedure), including adding clarity regarding available grievance rights for participants whose claims are denied by administering firms or carriers in the GBP, and clarifying that participants with a denied claim in certain plans must request reconsideration from the carrier or administering firm prior to seeking grievance review by ERS.

Staff also discussed proposed non-substantive amendments and reorganization of provisions to all sections that were before the Board for consideration.

The notice of proposed amendments to Chapter 81 was published in the July 8, 2016 issue of the *Texas Register*, and ERS received one comment. The Coalition for Nurses in Advanced Practice (CNAP) requested that certified nurse-midwives be added as practitioners who could certify the date of birth for a newborn natural child for purposes of eligibility and enrollment in life and accidental death & dismemberment (AD&D) coverage. ERS staff agreed and recommended the change.

Staff also presented a proposed non-substantive amendment to Section 85.4 (Separate Plans) to update a numerical reference in subsection (c) regarding the Insurance Premium Conversion Plan described in Chapter 81 to conform with proposed amendments to Chapter 81. The notice of the proposed amendment for Chapter 85 was published in the July 8, 2016 issue of the *Texas Register*. ERS did not receive any comments.

Staff also reported that Texas law requires review of rules every four years, and staff reviewed Chapter 81 (Insurance) per §2001.039, Tex. Gov't Code. The notice of proposed rule review was published in the February 14, 2014 issue of the *Texas Register* as required by statute, and ERS did not receive any comments.

Mr. Hester asked about changes to the definition regarding dependents ages 26 years and older, and he also asked if the rule changes would cause any increase in costs to maintain benefits. Staff

explained that the rule changes were not expected to cause any increase in costs to maintain any of the benefits that ERS offers. Ms. Donnell inquired about the amendments regarding COBRA coverage. Staff explained that the amendment is consistent with current practice by allowing a one-time opportunity to add a natural or adopted child for 36 months of coverage within 30 days of the child's birth or placement for adoption.

The Board then took the following action:

MOTION made by Mr. Danzeiser, seconded by Ms. Donnell and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas that the Board take the following actions with regard to the Rules of the Board of Trustees, Texas Administrative Code, Title 34, Part IV, as presented in Exhibits A and B to the agenda item:

- Adopt the proposed amendments to Chapter 81, Insurance, as reflected in Exhibit A attached to the agenda item;
- Readopt Chapter 81, which includes the changes adopted by the Board as provided by Exhibit A to the agenda item, because the reasons for initially adopting the chapter continue to exist; and
- Adopt the proposed amendment to Chapter 85, concerning Flexible Benefits, as reflected in Exhibit B and the agenda item.

XIV. Review, Discussion and Consideration of the Texas Employees Group Benefits Program:

a. HealthSelect of Texas Financial Status Update as of June 30, 2016

b. Approval of Proposed Rates for Medicare Advantage Health Maintenance Organization Plan for Calendar Year 2017

c. Approval of Proposed Rates for HealthSelect Medicare Advantage for Calendar Year 2017

Texas Employees Group Benefits Program (GBP) health benefits include HealthSelect of Texas (HealthSelect); three fully insured health maintenance organizations (HMOs); HealthSelect Medicare Advantage, a Medicare Advantage preferred provider organization (MAPPO); KelseyCare Advantage, a Medicare Advantage HMO (MA HMO); and two prescription drug plans (PDPs). HealthSelect is a self-funded point of service health benefit plan offered under the GBP. About 82% of GBP health plan participants are enrolled in HealthSelect, which offers health benefits coverage throughout Texas and the United States.

a. HealthSelect of TexasSM Financial Status Update as of June 30, 2016

Mr. Rob Kukla, Director of Benefit Contracts, explained that all GBP health plans' financial status is positive. During FY16, total revenue is estimated to be \$3.382 billion and total GBP health plan expenditures are estimated at \$3.349 billion. As of June 30, the plan is estimated to have a net gain of \$33.6 million for the year. As a result of favorable experience and cost saving measures adopted by the plan, the GBP should finish the plan year with \$474.1 million in the contingency fund.

The positive outcome of the contingency fund is credited to higher rebates and higher Medicare Part D subsidies. In addition to these increased projections, there have also been gains due to lower pharmacy cost trends than previously reported.

Cost containment strategies of the patient-centered medical homes (PCMHs) continue to be successful, resulting in a reduction in health care costs for the last five years of \$49.2 million. Beginning in September 2016, ERS will add Texas Tech University and the Physicians Network Services in Lubbock, and will continue to negotiate adding a PCMH in the Amarillo area. ERS continues to work to expand its PCMH strategy. The Board asked about expansion in larger metro areas. Staff explained the current rationale, past experience and current success.

As far as the outlook for Fiscal Year 2017, the IRS will increase the maximum out-of-pocket limits for health plans. ACA fees are projected to increase costs by approximately \$12.5 million in FY17.

Beginning September 1, 2016, Consumer Directed HealthSelect will become available for GBP participants not eligible for Medicare. This is a new choice for members, in addition to HealthSelect of Texas and the regional HMOs. The enrollment was only 343, much less than the anticipated 7,500. The Board and staff discussed the minimal financial impact on HealthSelect rates and the result of a legislative mandate. Another approved new plan was for vision care – a success, with 56,280 members enrolling (107,000 total, including dependents).

Mr. Blaise Duran, Benefit Contracts Manager of Underwriting, Data Analysis and Reporting, explained the health cost trend is expected to remain at about 8%. The fund balance is currently estimated to be \$560.1 million at the end of FY17, after an estimated gain of \$86 million for FY17. This gain is due to the new pharmacy benefits manager (PBM) contract with UnitedHealthcare, effective January 1, 2017. This contract is expected to save approximately \$100 million over the last eight months of the fiscal year. ERS staff will continue to monitor the health benefit cost trend closely. Mr. Kukla added that the contingency fund (60 days) would need to be \$687 million. All the health plans together – HealthSelect, the Medicare Advantage plans and the HMOs – are financially solid moving into the next biennium. The Board and staff discussed the contingency fund's importance to the sustainability and financial health of the GBP.

This agenda item was presented for informational and discussion purposes only.

b. Approval of Proposed Rates for Medicare Advantage Health Maintenance Organization Plan for Calendar Year 2017

Mr. Kukla, Director of Benefit Contracts, reviewed the Medicare Advantage Health Maintenance Organization (MA HMO). The MA HMO option has been available since September 1, 2011. The program provides medical benefits to certain retirees and their eligible dependents who are Medicare eligible for primary coverage under Medicare Part A and Part B. Benefits are designed to provide coverage that is at least as comprehensive as provided under HealthSelect of Texas. Participants can enroll in the plan; they may elect to opt back into their originating medical program at the next annual enrollment.

KelseyCare is the only MA HMO currently offered and provides coverage at 19 clinics in eight Houston-area counties. Participants must use providers in the network. Mr. Duran explained the MA HMO member contribution rates are based on the plan premium, HealthSelect Medicare Rx prescription drug coverage and the Health Insurance Provider (HIP) fee. Enrollment continues to steadily grow. Rates must conform to the state's appropriation rider stating ERS cannot charge more or pay more for a fully insured plan than the cost of coverage under the basic plan, HealthSelect of Texas. There are changes in federal payments and payment methodology. These payment policies include substantial changes to the MA payment system. The staff and consulting actuary projected the cost of prescription drug coverage under HealthSelect Medicare Rx, with decreases in costs. The decreases in medical rates, pharmacy costs and the suspension of the HIP fee result in a rate decrease proposal for CY17. The Board and staff discussed plan benefit comparisons with in-network and out-of-network costs.

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

MOTION (14b) made by Ms. Cydney Donnell, seconded by Mr. Brian Ragland and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas: I move that the Board of Trustees of the Employees Retirement System of Texas approve contribution rates as presented in this agenda item for the following Medicare Advantage HMO for participation in the Texas Employees Group Benefits Program for Calendar Year 2017:

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

c. Approval of Proposed Rates for HealthSelect Medicare Advantage for Calendar Year 2017

Mr. Kukla explained that retired GBP participants who are eligible for Medicare have been able to enroll in a statewide Medicare Advantage Preferred Provider Organization (MAPPO) option since January 1, 2012. The plan, known as HealthSelect Medicare Advantage (HealthSelect MA), provides medical benefits to retirees and their eligible dependents. All participants must be eligible for primary coverage under Medicare Part A and Part B (Medicare-primary).

The medical benefits are designed to provide comparable coverage to that provided under HealthSelect of Texas, the GBP's self-funded, point-of-service health plan, which coordinates benefits with traditional Medicare for Medicare-primary participants. All Medicare-primary participants are automatically enrolled in the MAPPO, but can choose to opt into the traditional HealthSelect plan at the beginning of any month.

Enrollment for Medicare-eligible retirees continues to increase, with 65,000 participants currently enrolled. The plan rates are set on a calendar year basis to coincide with the Medicare plan. The HealthSelect MA plan continues to provide the most cost-effective medical benefits for Medicare-primary GBP participants – for both the state and eligible members. The plan is fully insured by Humana.

Mr. Duran reviewed the basis for the MAPPO member contribution rate, which combines the HealthSelect MA premium, the HealthSelect Medicare Rx cost and the health insurance provider's fee for a total rate. For CY17, the medical portion of the rates will increase, the pharmacy cost will decrease and the HIP fee is waived. As a result, staff is recommending rates remain the same for CY17.

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

MOTION (14c) made by Mr. Doug Danzeiser, seconded by Ms. Ilesa Daniels and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas: I move that the Board of Trustees of the Employees Retirement System of Texas approve the Calendar Year 2017 plan rates as presented in this agenda item effective January 1, 2017 for the statewide HealthSelect Medicare Advantage plan as offered under the Texas Employees Group Benefits Program.

XV. Review, Discussion and Selection of a Money Market Fund for the Texa\$aver 401(k) and 457 Program on or before October 14, 2016

The Texa\$aver program is composed of two separate plans: the Texa\$aver 401(k) plan and the Texa\$aver 457 plan. The 457 plan is authorized by Section 457 of the Internal Revenue Code; the 401(k) plan, by Section 401(k). ERS is the trustee of the program, and the Executive Director is designated to administer the program under the authority of ERS' Board of Trustees. ERS maintains and administers the 401(k) and 457 plans through their respective plan documents.

Mr. Rob Kukla, Director of Benefit Contracts, and Ms. Georgina Bouton, Assistant Director of Benefit Contracts, presented an overview and proposed changes to the Texa\$aver program. As of June 30, 2016, the 401(k) plan has \$1.9 billion in assets and the 457 plan has \$647 million in assets. There are numerous investment options, either through mutual funds or collective investment trusts (CITs); the investment offerings provided in each of the plans are the same. The investment funds offered within the 401(k) and 457 plans are the same, including a money market mutual fund. The federal Securities and Exchange Commission (SEC) issued amendments to the rules governing money market mutual funds.

These rule changes become effective October 14, 2016. TexaSaver's money market offering is the BlackRock TempFund; this fund is impacted by the upcoming SEC regulation changes.

The ERS Product Review Committee (PRC) provides guidance, direction and special expertise specific to TexaSaver. After review and analysis, the PRC recommended replacing the current BlackRock money market mutual fund with a CIT fund. Using established fund criteria, staff worked with the TexaSaver third-party administrator, Empower Retirement, to identify a pool of CIT funds to evaluate. Based on performance criteria and expense ratio, staff suggested the Black Rock Short-term Investment Fund as a new CIT fund to replace the current BlackRock TempFund. They also outlined plans for transitioning from a money market mutual fund to a CIT with participant notification. The Board clarified with staff the purpose for the change, citing liquidity fees and redemption gate issues, and that there would not be fund transition costs to participants. The recommended CIT was chosen because of better results, lower fees and diversification. Mr. Porter Wilson, ERS Executive Director, asked present PRC members for further clarification. Mr. Tom Tull, ERS Chief Investments Officer, concurred with the recommendation presented by staff.

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

MOTION made by Ms. Cydney Donnell, seconded by Mr. Brian Ragland and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas:

Based on the information provided to PRC and ERS in response to the fund selection criteria, the evaluation process and results presented to the Board at this meeting, we are making a recommendation to replace the money market offering within the TexaSaver program, thereby removing the BlackRock Liquidity TempFund (Money Market Mutual Fund – TMPXX). Therefore:

I move that the Board of Trustees of the Employees Retirement System of Texas approve the selection of the Black Rock Short-term Investment Fund as the money market fund provider within the TexaSaver Deferred Compensation Program beginning on or after September 16, 2016, conditioned on the Black Rock Short-term Investment Fund application agreement having terms that are fully acceptable to ERS, and to authorize the Executive Director to thereafter administer the fund application agreement agreed to and by the parties.

In the event that a fund application agreement that is fully satisfactory to ERS is not executed with BlackRock in a timely way, or if it appears to the Executive Director that BlackRock will not be capable of performing the required money market fund provider services to ERS' satisfaction, then the Board authorizes the Executive Director to resume the due diligence process and any negotiations with the JP Morgan CIT Fund and to negotiate and execute a fund application agreement with JP Morgan with terms that are fully acceptable to ERS, and to authorize the Executive Director to thereafter administer the fund application agreement to and by the parties.

XVI. Review, Discussion and Consideration of the ERS Fiscal Year 2017 Proposed Operating Budget

After a brief recess, Mr. Hester called for the next agenda item. Ms. Mabelle Pharr, CPA and Chief Financial Officer, presented the Employees Retirement System of Texas (ERS) Proposed Operating Budget for Fiscal Year 2017. The Operating Budget contains organizational charts, budgets, methods of finance and sources of funds. It also contains Fiscal Year 2016 accomplishments and Fiscal Year 2017 major initiatives based on the most recent ERS Strategic Plan.

Ms. Pharr highlighted the Fiscal Year 2016 accomplishments – noting new legislation that improves sustainability of ERS retirement programs by increasing both the employer and employee

contributions, and the addition of a new vision insurance benefit and a new consumer-driven health plan (with optional health savings account) as part of the GBP. Additional accomplishments were the implementation of weekly Texa\$aver benefit counseling; issuance of ACA-required 1095-B healthcare coverage reports for HealthSelect of Texas members; engaging members in a variety of ways; successful third-party administrator communications, and the introduction of several new wellness programs.

The FY17 operating budget will cover operation expenses from September 1, 2016 through August 31, 2017. ERS operating expenses are covered by interest from the retirement trust funds, with any unspent monies remaining in the trust funds. The operating budget supports ERS' strategic goals to support the retirement system, communicate with stakeholders for informed decision making, sustain competitive group benefits, and enhance agency performance and accountability.

Ms. Pharr outlined ERS major initiatives for FY17:

- Evaluate the current and future state of the Investment Division's systems architecture
- Expand the derivatives program
- Explore and conduct Texa\$aver custom fund evaluation
- Support the 85th legislative session
- Bid, evaluate and implement the third-party administrator for HealthSelect of Texas and Consumer Directed HealthSelect, effective September 1, 2017
- Install new pharmacy benefit managers for the HealthSelect Prescription Drug Program and HealthSelect Medicare Rx, effective January 1, 2017
- Establish a benefits advisory committee for the GBP – a recommendation of the Sunset Advisory Committee
- Increase transparency in the grievance process – a recommendation of the Sunset Advisory Committee
- Continue to enhance contract oversight and management
- Conduct Summer and Fall Enrollment for members
- Complete the usability audit and redesign of the public website
- Identify alternatives for improving group benefit administration services
- Enhance data quality and data analysis capabilities
- Continue to improve data and member information security
- Continue ERS building space planning
- Apply appropriate stakeholder input to design employee programs based on the Survey of Employee Engagement

Mr. Porter Wilson, ERS Executive Director, noted the new benefits advisory committee would be formed after the upcoming legislative session.

Ms. Pharr presented an overview of the budget. The FY17 proposed operating budget is \$5.9 million, or 8.45% over FY16. Significant budget increases are salary related, with a request for 11 additional full-time employees. Additionally, funds are requested for one-time expenses for actuarial services, the 2017 Trustee Election and space planning/building renovation.

Another initiative is relocation of the data center. The total one-time cost of the data center relocation is about \$1.2 million, including \$120,000 expended in FY16. There are one-time costs included of \$570,000 in FY17, and ongoing costs are anticipated to be \$308,000. Other initiatives in the Business Process Review and Improvement category include the evaluation of a benefit administration system; development of an RFP and implementation of a contract management system, as well as reviewing the Investment Division's system architecture.

In terms of Investments' operations, additional funding was included to reflect additional index data for the Investment Risk System. Funding was also included for an investment banking contractual increase.

The last category is Data Integrity and Security, including additional data sources for our data

warehouse, annual maintenance increases, security counseling and consulting services. Some funding for additional contractors was included for testing of various systems.

The Investments Division and investment-related resources in other divisions total approximately 40% of the ERS' budget. As with the rest of the agency, approximately 61% of the budget is salaries.

Exhibit B notes the various contracts anticipated during FY17. The Executive Director is authorized to contract on behalf of ERS for these contracts. Also included in Exhibit B is a listing of the investment advisory fees estimated for FY17.

Exhibit E provides a statistical trend of the operating budget, full-time employees, and various other pieces of information or metrics from FY09 through FY17. Also, a listing of some of the increases in complexities we have added to our programs over the course of the last few years is included in Exhibit E.

The Board and staff discussed the budget's detail and custodial fees for the System's assets. Ms. Betty Martin, CPA, Director of Investment Services, and Ms. Pharr clarified the custodial fee percentage. The Board and Mr. Porter Wilson, Executive Director, discussed requested budgetary increases as a result of one time expenditures and personnel growth. Board members, Mr. Wilson and Ms. Robin Hardaway, Director of Customer Benefits, discussed customer service levels, wait times and interactions with members.

MOTION made by Mr. Craig Hester that the Board of Trustees of the Employees Retirement System of Texas approve the *Fiscal Year 2017 Proposed Operating Budget*, for the Employees Retirement System of Texas as presented, and including the amendment that an additional 1% of relevant salary be available for recognizing, retaining and recruiting non-Investments staff (that would be 1% of the non-Investments staff payroll added to the budget) and 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. These motions were seconded by Ms. Cydney Donnell and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

XVII. Review, Discussion and Consideration of the ERS Incentive Compensation Plan

Ms. DeeDee Sterns, Director of Human Resources, highlighted recommended changes for the Incentive Compensation Plan for Fiscal Year 2017. In December, 2006, the Board of Trustees (Board) approved the ERS Incentive Compensation Plan (Plan or ICP). During the May board meeting, staff presented a draft ICP plan with revisions for discussion. The plan communicates strategic performance priorities to certain ERS staff. The proposed revisions seek to simplify and clarify expectations while maintaining the overall objective. Staff annually reviews the plan and related processes and recommends revisions to the Board.

Some of the proposed revisions are to modify the eligibility date for new hires. Staff recommends deferring eligibility in the plan to the first of the month following a six month employment period. The plan will allow for the use of the Board's or the Executive Director's discretion after a 90 day employment period, under limited circumstances and if written justification warrants it.

Staff recommends the participant's weighted salary be used to calculate the Incentive Compensation Award instead of the participant's salary as of the last day of the plan year.

Additional plan process improvements include centralized administration of plan oversight in Human Resources, assigning who will perform the calculation of awards, inclusion of global investment

performance standards, refine payment dates, and retain current qualitative performance goals and metrics. Mr. Craig Hester, Chair, previously requested to add the definition of weighted salary. Mr. Porter Wilson, Executive Director, noted last years' experience administering the plan combined with recommendations from Internal Audit and the State Auditor's office contributed to improvement in the policy document. Ms. Sterns confirmed that Excel Global Partners will conduct the award verifications.

Based on internal discussions among Human Resources, Investments, Legal Services, and the Executive Office, in addition to discussion at the May board meeting, staff recommends the following:

MOTION made by Ms. Cydney Donnell that the Board of Trustees of the Employees Retirement System of Texas approves the ERS Incentive Compensation Plan for key investment professionals and leadership employees as presented in Exhibit A. This motion was seconded by Mr. Brian Ragland and carried unanimously by the present members of the Board of Trustees of the Employee Retirement System of Texas.

XVIII. Review, Discussion and Consideration of the 2017 ERS Trustee Election Calendar

Mr. Bernie Hajovsky, Director of the Enterprise Planning Office, presented information on the 2017 Board of Trustee election process and staff recommendation for the 2017 election calendar. Board of Trustee elected member Brian Ragland's term will expire August 31, 2017. Rules require the Board adopt a calendar prior to each election.

To be eligible to run, state employees must be contributing ERS class members. State employees working for the Texas Health and Human Services Commission and the Texas Department of Insurance are excluded because those agencies are already represented on the Board.

As of January 31, 2017, if an employee has an ERS account balance, or a retiree receives an annuity from ERS, they are eligible to vote. All eligible voters can cast their ballot by mail or online. As a new feature, reminder emails will be sent to eligible voters. The reminder email will have an imbedded link that will allow eligible voters to be automatically directed to the online voting portal and cast their ballot. The provision that disqualifies both votes for any member who votes twice has been eliminated. In such cases, the first vote received, either paper or electronic, will count as the official vote of record.

Survey and Ballot Systems serves as our third-party administrator for the election. The election budget for 2017 is \$261,000, with the majority of those funds paying for postage. For the 2015 election, 308,000 eligible voters were mailed ballots.

The election process runs from January through May 2017. Beginning January 2, nominating petitions are distributed. The nomination period closes February 1. On February 15, eligible candidates are certified and the ballot order is determined. The candidate forum is scheduled for March 9; the forum is an opportunity for members and retirees to hear from the candidates. Voting begins March 10 and ends April 14. On May 10, the new trustee-elect is announced. There is no run-off election; the candidate with the most votes is the trustee-elect.

The Board and staff discussed the expense of paper ballots and postage, noting electronic voting would decrease costs significantly. With new technological advances, ERS hopes to reduce reliance on paper ballots without lowering voter participation. It was noted that some non-contributing members, active employees and retirees may not have ready access to a computer to vote online. While the postage costs are substantial, the election is an important process. The Board noted that voting closes on April 14, Good Friday.

MOTION made by Ms. Cydney Donnell that the Board of Trustees of the Employees Retirement System of Texas adopt the 2017 Trustee Election Calendar as presented in this agenda item. This motion

was seconded by Ms. Ilesa Daniels and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

XIX. Elections of Chair and Vice-Chair of the ERS Board of Trustees for Fiscal Year 2017

Texas Government Code, Title 8, §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, 2016 and ending August 31, 2017.

Ms. Donnell noted that Chair Hester was doing a great job. Mr. Danzeiser expressed appreciation for Mr. Hester's willingness to serve such a big commitment. Mr. Hester appointed Mr. Brian Ragland to serve as Audit Chair for FY17.

MOTION made by Ms. Cydney Donnell that the Board of Trustees of the Employees Retirement System of Texas re-elect Mr. Craig Hester as Chair and Mr. Doug Danzeiser as Vice-Chair of the ERS Board of Trustees for one-year terms beginning September 1, 2016 and ending August 31, 2017.

This motion was seconded by Mr. Brian Ragland and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

XX. Executive Director Agency Update

- **Sunset Update**
- **Legislative Appropriations Request for Fiscal Years 2018-2019**
- **Fiscal Year 2017 Roadmap Development**
- **Space Planning Update**
- **Summer Enrollment Plan Year 2017**
- **ERS Medical Board Retirements**
- **SECC Excellence in Philanthropy Award**
- **Investments Update**

Mr. Porter Wilson, ERS Executive Director, presented the agency update. Recognizing ERS staff and their great work, Mr. Wilson explained ERS capable staff would assist him with the overview.

Sunset Staff Recommendations

Mr. Wilson asked Mr. Keith Yawn, Enterprise Planning Office, to review recommendations and ERS' responses. The Sunset Committee hearing before the Sunset Commission is next week and ERS leadership will attend. Since the Sunset staff report was issued, ERS has been reviewing recommendations and strategizing implementation plans. Multidisciplinary ERS teams have determined a plan of action to address the report findings addressing legislative concerns while improving services to members and operations at the agency.

Recommendations are divided into three implementation categories:

- Organizational actions are recommendations ERS can take action on and address by the end of 2016 with no statutory changes and within existing agency resources. Creating the Office of Procurement & Contract Oversight is an example of organizational action.
- The development category involves recommendation proposals that may require additional resources, clarification from Sunset or long-term timelines to implement – such as policy, process or organizational changes.
- The third involves recommendations requiring approval by the legislature or changes to statutory language to implement. The creation of a health program advisory committee is an example of this category. ERS will seek to participate in the development of statutory language for these items as opportunities allow. Although the Agency is able to enact current

recommendations, ERS looks to the Sunset Advisory Commission and the Texas Legislature for input and guidance.

ERS Legislative Appropriations Request (LAR) for Fiscal Years 2018-2019

Presented by Ms. Mabelle Pharr, CPA and Chief Financial Officer, the FY18-19 base appropriations request totals \$5.2 billion -- \$1.4 billion for retirement and \$5.2 billion for the Texas Employees Group Benefits Program. ERS works with the Legislative Budget Board and the Office of the Governor to determine the base level of funding for the retirement and insurance programs. The LAR is due August 26, 2016. Retirement and the GBP are exempted from the 4% reduction in budgets requested by the Governor; ERS was instructed to maintain funding at the FY17 levels for both Fiscal Years 2018 and 2019. Items above base-level funding are considered "exceptional items" and must be itemized, prioritized and justified in the LAR document.

Fiscal Year 2017 Roadmaps - Strategic Planning for Major Projects

Ms. Pharr and Mr. Bernie Hajovsky, Director of the Enterprise Planning Office, reviewed agency project planning for the next 12 to 18 months. With 70 projects planned, Mr. Hajovsky highlighted a few major initiatives – so-called "roadmap" items.

- Solicit Benefits Administration Services – The request for proposal (RFP) will be issued in 2017.
- Solicit HealthSelect Third-Party Administrator – The RFP was issued in June.
- Conduct Asset Liability Study – February 2018 is target for the adoption of the new asset allocation.
- Implement Contract Content System – In 2017, have a central repository for all ERS contracting and information, including reporting requirements to oversight bodies.
- Implement Data Center Move – The RFP has been issued, with expected implementation in January 2017.
- Implement Public Website Redesign – The content and usability assessment is currently taking place.
- Implement Sunset Recommendations – Recommendations will continue to be implemented throughout 2017.
- Space Planning Implementation – The assessment is ongoing.

Space Planning Update

Ms. Jordan Hajovsky and Ms. Wendy McAdams, Co-Directors of Operations Support, presented a space planning project update. A geotechnical analysis of the building foundation was conducted over two days, and coring samples were taken both inside and outside. Exterior cores went down to 50 feet, while internal cores hit solid rock at 12 feet. The Board asked several questions about the project and core samples were passed around. The purpose of the engineering study was to evaluate the pertinent geotechnical conditions at ERS site and to develop geotechnical parameters, which will assist in the design and construction of structural improvements and renovations. The engineers will use the study to determine whether the buildings can support additional floors. ERS will receive the results from the structural analysis in the coming weeks.

Plan Year 2017 Summer Enrollment for employees, pre-Medicare retirees and their families

Ms. Robin Hardaway, Director of Customer Benefits, and Ms. Kathryn Tesar, Director of Benefits Communications, reviewed this year's Summer Enrollment. During Summer Enrollment, ERS mailed 277,000 Personal Benefits Enrollment Statement (PBES) packets. The ERS Contact Center and ACT, the "overflow" call center, received 14,193 phone calls. More than 63,000 members made coverage changes, and 51 members visited ERS in person.

To educate participants, ERS held 35 fairs across Texas with 5,455 attendees and 10 webinars with 956 participants. Ms. Tesar noted increased attendance at the fairs over last year, probably driven by substantial interest in the new vision plan. The well attended fairs afforded staff an opportunity to visit with members. Three new plans were offered:

- State of Texas Vision, administered by Superior Vision Services, Inc., enrolled 56,413 members.

- Consumer Directed HealthSelect, the new high-deductible health plan with health savings account, administered by UnitedHealthcare and Optum Bank, respectively, enrolled 346 participants.
- A limited flexible spending account, the TexFlex LFSA, can be used by Consumer Directed HealthSelect members for vision and dental expenses. A total of 35 participants enrolled.

ERS Medical Board

Ms. Hardaway explained the Medical Board meets weekly to review disability retirement cases and provide guidance and recommendations. Two Medical Board members recently retired: Dr. Marvin Cressman, a prominent neurosurgeon who served for ten years, and Dr. William McCarron, a highly regarded cardiologist who served for four years. As ERS works to fill their positions, two respected doctors will serve as interim Medical Board members: Dr. Ace Alsop, an Internal Medicine physician, and Dr. William Taylor, an orthopedic surgeon.

ERS' State Employee Charitable Campaign (SECC) Receives Excellence in Philanthropy Award

Mr. Wilson recognized and thanked Ms. Beth Gilbert, Internal Audit Division, as the SECC lead. United Way for Greater Austin (UWATX), the manager for the SECC, honored ERS for an outstanding campaign in 2015. In February 2015, ERS was recognized for all three SECC achievement categories: Highest Per-Capita Gift, Greatest Increase in Campaign and Highest Percent Participation. ERS was the only state agency recognized for outstanding achievement. Ms. Gilbert announced Ms. Carla Lawrence, Customer Benefits Division, would lead the SECC in FY17.

Investments Update

Mr. Wilson congratulated Bob Sessa and the Real Estate Team on winning the 2016 Investments and Pensions Europe (IPE) Real Estate Award for the Best Listed Strategy. He also congratulated Leighton Shantz and the ERS Fixed Income Team, who were featured in *The DESK* magazine's lead article, "Trading for Retirement Funds."

XXI. Evaluate the duties, performance and compensation of the Executive Director of the Employees Retirement System of Texas

EXECUTIVE SESSION – In accordance with Section 551.074, Texas Government Code, the Board of Trustees will meet in executive session to evaluate the duties, performance and compensation 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.

Last year the Board of Trustees set out specific evaluation criteria for Executive Director Porter Wilson. Some of these criteria included expectations for leadership, management communications and policy matters as well as staff development. He is also accountable to lead initiatives as set forth in the agency budget. We reviewed the outcomes and Mr. Wilson and his team have met these expectations and done excellent work in continuing to secure the trust for the retirement and insurance benefit programs for active and retired members. We commend Mr. Wilson for his leadership in managing the budget, reducing agency turnover, developing the senior team, overseeing a successful Sunset evaluation and keeping the Board informed.

MOTION made by Ms. Cydney Donnell that the Board of Trustees of the Employees Retirement System of Texas award ERS Executive Director Porter Wilson an increase in his annual compensation of 4% of FY16 annual salary effective September 1, 2016. And further move that the Executive Director be awarded the maximum incentive compensation for which he is eligible based on his participation in the Incentive Compensation Plan for FY16 for the qualitative 66% of his 50%, which reflects his leadership and management accomplishments for the year and on the quantitative 100% of 50%. And further move that staff amend Appendix B of the Incentive Compensation Plan to

reflect that his discretionary metrics equal 50% and his quantitative metrics equal 50% as reflected in relative Trust performance. The motion was seconded by Mr. Brian Ragland, and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

MOTION made by Ms. Cydney Donnell that the Board of Trustees of the Employees Retirement System of Texas affirm that effective September 1, 2016, that ERS Executive Director Porter Wilson is approved to participate in the ERS Incentive Compensation Plan for key investment professionals and leadership employees 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 FY17 shall reflect 50% of his possible award under the ICP as a quantitative goal of relative Trust performance and 50% of his possible award under the ICP as a qualitative goal 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 2017. I further move that the ICP be amended to reflect the terms of this motion and that ERS Human Resources be directed to finalize the documentation to implement the terms of this motion. The motion was seconded by Mr. Doug Danzeiser, and carried unanimously by the present members of the Board.

MOTION made by Ms. Cydney Donnell that the Board of Trustees of the Employees Retirement System of Texas use the agency initiatives identified in the Fiscal Year 2017 operating budget and approved by the Board to evaluate the Executive Director's job performance by measuring the initiatives against the accomplishments reported in Fiscal Year 2017 operational budget. Motion was seconded by Mr. Brian Ragland, and carried unanimously by the present members of the Board.

XXII. Select 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

Mr. Craig Hester, Board Chair, acknowledged the next Joint Meeting of the ERS Board of Trustees, Investment Advisory Committee and Audit Committee would be a workshop on Thursday and Friday, December 1 and 2, 2016 at the ERS offices.

XXIII. ADJOURNMENT OF THE ERS BOARD OF TRUSTEES

Mr. Hester noted the completion of agenda items and adjourned the ERS Board of Trustees.