EMPLOYEES RETIREMENT SYSTEM OF TEXAS
JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE
ERS Building – Board Room
200 E. 18th Street, Austin, Texas 78701
August 16, 2016 – 8:00 a.m.

Meeting of the ERS Board of Trustees' Audit Committee

1. Review and Approval of the Minutes to the May 17, 2016 ERS Audit Committee Meeting

2. Presentation, Discussion and Consideration of Audit Committee Agenda Items:
   a. External Audit Reports
   b. Internal Audit Reports
   c. Internal Audit Administrative Items

3. EXECUTIVE SESSION – In accordance with Section 551.076, Texas Government Code, the Audit Committee of the Board of Trustees, a committee of the whole of the Board, will meet in executive session to deliberate: (1) the deployment, or specific occasions for implementation, of security personnel or devices; and (2) a security audit. Thereafter, the Board may consider appropriate action in open session.

4. **ADJOURNMENT OF THE ERS BOARD OF TRUSTEES AUDIT COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES–** Following a temporary recess, the Board of Trustees will reconvene with the Investment Advisory Committee to take up the following Joint Board of Trustees and Investment Advisory Committee agenda items.

Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee

5. Review and Approval of the Minutes to the May 17, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee

6.* Review and Discussion of the Investment Performance for Second Calendar Quarter 2016

7.* Review, Discussion and Consideration of the ERS Private Equity Program:
   a.* Market Update and Program Overview
   b. Proposed Private Equity Annual Tactical Plan for Fiscal Year 2017

8.* Review, Discussion and Consideration of the Hedge Fund Program:
   a.* Market Update and Program Overview
   b. Proposed Revisions to the ERS Investment Policy Addendum X: Hedge Fund Policies and Procedures
   c. Proposed Hedge Fund Annual Tactical Plan for Fiscal Year 2017

9.* Review and Discussion of the Asset Allocation Study

10. **ADJOURNMENT OF THE INVESTMENT ADVISORY COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES** – Following a temporary recess, the Board of Trustees will reconvene to take up the remaining Board of Trustee agenda items.

Meeting of the ERS Board of Trustees

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

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

13. 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)

14. Review, Discussion and Consideration of the Texas Employees Group Benefits Program:
    a. HealthSelect of Texas^{SM} Financial Status Update as of June 30, 2016
    b. Approval of Proposed Rates for Medicare Advantage Health Maintenance Organization Plans for Calendar Year 2017
    c. Approval of Proposed Rates for HealthSelect Medicare Advantage for Calendar Year 2017

15. Review, Discussion and Selection of a Money Market Fund for the Texa$aver 401(k) and 457 Program

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

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

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

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

20. Executive Director Agency Update
    - Legislative Appropriations Request for Fiscal Years 2018-2019
    - Strategic Plan and FY17 Roadmaps
    - ERS Space Planning Study Update

21. 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.

22. 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

23. **ADJOURNMENT OF THE ERS BOARD OF TRUSTEES**

** We are accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. These agenda items may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees.*

NOTES: 1. Persons with disabilities who plan to attend this meeting and who may need special assistance are requested to contact Kelley Davenport at (512) 867-7772 three to five (3-5) working days prior to the meeting date so that appropriate arrangements can be made.

2. The Employees Retirement System of Texas Board of Trustees Audit Committee is scheduled to meet from 8:00 a.m. to approximately 9:05 a.m. on Tuesday, August 16, 2016. The Board of Trustees and Investment Advisory Committee are scheduled to meet jointly from approximately 9:05 a.m. to 11:50 a.m. on Tuesday, August 16, 2016. The Board of Trustees may take up the remaining board agenda items from approximately 12:20 p.m. to 5:00 p.m. on Tuesday, August 16, 2016, but may hear those items before or after the anticipated time frame. Meetings are tentatively scheduled to follow each other consecutively, but they may start earlier or later than the posted time depending on the length of the discussions within each agenda item and meeting and other circumstances not presently anticipated. Please note that the estimated times and sequence of agenda items are only approximate, and the time reflected in the posted agenda item, order of meetings or agenda items may be moved or adjusted as necessary.

PUBLIC AGENDA ITEM - # 1

1. Review and Approval of the Minutes to the May 17, 2016 Audit Committee Meeting

August 16, 2016

BACKGROUND:
The minutes to the Employees Retirement System of Texas Audit Committee meeting held on May 17, 2016 are included with this agenda item as Exhibit A. The minutes are submitted to the Board for review and approval.

PROPOSED MOTION:

Staff recommends the following motion to the Board of Trustees:

> I move that the Board of Trustees of the Employees Retirement System of Texas approve the minutes to the Audit Committee meeting held on May 17, 2016.

ATTACHMENT – 1
Exhibit A – Proposed Minutes to the ERS Audit Committee Meeting of May 17, 2016

Audit Committee Meeting

May 17, 2016

Presented for Review and Approval

August 16, 2016

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AUDIT COMMITTEE MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

May 17, 2016
ERS Board Room
ERS Building – 200 E. 18^{th} Street
Austin, Texas 78701

TRUSTEES PRESENT
I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Ilesa Daniels, Member
Brian Ragland, Member

TRUSTEES NOT PRESENT
Cydney Donnell, Member *(Excused by the Board)*
Frederick E. Rowe, Jr., Member

ERS STAFF PRESENT
Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director & General Counsel
Shack Nail, Special Projects and Policy Advisor
Tony Chavez, Internal Auditor
Robert Kukla, Director of Benefit Contracts
Machelle Pharr, Chief Financial Officer
Gabrielle Stokes, Director of Procurement & Contract Oversight
Tom Tull, Chief Investment Officer
Kelley Davenport, Executive Office
Beth Gilbert, Internal Audit
Robert Lee, Investments
Betty Martin, Investments
Karen Norman, Internal Audit
Jonathan Puckett, Internal Audit
Robert Sessa, Investments
Keith Yawn, Enterprise Planning Office

ALSO PRESENT
Keith Barnes, Blue Cross Blue Shield of Texas
David Dorman, Active Health Management
Joseph Halbert, Senator Schwertner's Office
Yves-Laurent Khary, Blue Cross Blue Shield of Texas
Bobby Wilkinson, Office of the Governor

Mr. 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 9:03 a.m. on Thursday, May 5, 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 8:15 to consider Audit Committee agenda items.

I. REVIEW AND APPROVAL OF THE MINUTES TO THE FEBRUARY 23, 2016 ERS AUDIT COMMITTEE MEETING

Mr. Craig Hester, opened the floor for a motion on the approval of the minutes from the Audit Committee Meeting held February 23, 2016.

> **MOTION** made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser and carried unanimously by the present members of the Audit Committee approved the minutes to the meeting held on February 23, 2016

II. PRESENTATION, DISCUSSION AND CONSIDERATION OF INTERNAL AUDIT REPORTS

Mr. Tony Chavez, Director of Internal Audit (IA), introduced Ms. Karen Norman, internal auditor. Mr. Chavez reported on the Group Benefits Program (GBP) procurements follow-up audit. Based on related internal and State Auditor audit recommendations, the objective was to assess the status of corrective actions and implementation of recommendations in the contract procurement and management process following the Texas contract management guide. Exhibits presented an overview of contract management framework made up of contract planning, procurement and monitoring/oversight areas. Mr. Chavez referenced the numerous GBP related contracts procured and monitored by the Benefits Contracts Division.

Ms. Norman reviewed inherent operational risk factors in the procurement process when evaluating and communicating best value, performance factors and lowest cost measurements. She emphasized the GBP program's complexity containing multiple deliverables and price points. As a result of Senate Bill 20, regulatory changes in contract management best practices have been instituted to comply with the new Contract Management Guide. While compliance, planning and development scope areas were rated "satisfactory", the overall rating for the procurement, selection and recommendation process was "needs improvement". Management is in compliance with the State Auditor's Office contract management requirements. However, the procurement evaluation process methodology needs to improve RFP evaluation scoring tools incorporating elements recommended in the Texas Contract Management Guide.

Mr. Hester asked about the timing of this audit and the creation of the new Office of Procurement and Contract Oversight (OPCO). IA worked with the both Benefit Contracts and OPCO during this audit. Board members asked questions concerning the evaluation matrix and best value. Mr. Chavez stated the audit was concerned with methodology. The board asked about the complexity and necessary elements of the scoring sheet. Ms. Norman stated no elements were missing from the scoring sheets. The board asked additional questions about the complexity of the scoring matrix and performance factors. Ms. Gabrielle Stokes, Director of OPCO, further clarified the scoring process methodology evolution during the audit and its future use for contract evaluation.

Mr. Chavez then introduced Mr. Jonathan Puckett, internal auditor, to review the quarterly procedures to test compliance with ERS' Investment Policy using agreed upon procedures (AUP) as a part of the FY16 Annual Audit Plan. Reporting impacts and risk to the organization concerning investment compliance – securities lending, Mr. Puckett reported that in February the Investments Division temporarily suspended its securities lending program. Recalling these borrowed securities contributed to atypical instances of noncompliance in diversification limit for Eurozone counterparties exceeding 10% and diversification limit for non-Eurozone counterparties exceeded 20%. Mr. Chavez stated that Investments kept Internal Audit informed so IA was aware when the compliance flags were raised.

Two other minor compliance issues were noted. They were both a result of corporate timing issues and were resolved within a few days. Mr. Hester noted on the personal trading side, there were no policy violations and congratulated the Investments staff.

There being no further discussion, the Audit Committee adjourned.

III. <u>ADJOURNMENT OF THE ERS BOARD OF TRUSTEES AUDIT COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES</u>

Following a temporary recess, the Board of Trustees will reconvene with the Investment Advisory Committee to take up the following Joint Board of Trustees and Investment Advisory Committee agenda items.

PUBLIC AGENDA ITEM -#2a

Presentation, Discussion and Consideration of Audit Committee Agenda Items:

2a. External Audit Reports

August 16, 2016

BACKGROUND:

An audit of the Employees Retirement System (ERS) of Texas Incentive Compensation Plan (Plan) was performed by the Texas State Auditor's Office (SAO) for Plan year 2015. The audit objective was to determine whether ERS correctly calculated and paid incentive compensation in accordance with policies and procedures. The audit included three other agencies with incentive compensation plans. The SAO's report, dated June 2016, is included as Exhibit A. The SAO's report concluded ERS generally awarded and paid incentive compensation in accordance with its policies and procedures for Plan year 2015. However, ERS incorrectly calculated one employee's award which resulted in an overpayment of $177. In addition SAO noted, ERS does not have written policies and procedures regarding the incentive compensation calculation and review process.

In conducting this audit, the SAO also relied on ERS internal audit report 2016-01, Incentive Compensation Plan, released on December 7, 2015. This report required SAO to perform additional procedures to determine whether it could rely on audit work conducted by ERS Internal Audit. SAO determined that the ERS internal audit division was qualified. The SAO could rely on ERS internal audit work.

STAFF RECOMMENDATION:

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

ATTACHMENTS -

Exhibit A – Audit Report on Incentive Compensation at Selected Agencies

An Audit Report on

Incentive Compensation at the Permanent School Fund, General Land Office, Employees Retirement System, and Teacher Retirement System

June 2016

Report No. 16-030

State Auditor's Office reports are available on the Internet at http://www.sao.texas.gov/.

An Audit Report on

Incentive Compensation at the Permanent School Fund, General Land Office, Employees Retirement System, and Teacher Retirement System

SAO Report No. 16-030
June 2016

Overall Conclusion

The Permanent School Fund (PSF) of the Texas Education Agency and the General Land Office (GLO) calculated and paid incentive compensation awards in accordance with their policies and procedures for plan year 2015. GLO should strengthen controls over its incentive compensation plan by formally approving that plan prior to the start of the plan performance period. GLO also should retain documentation of management's review of plan calculations in accordance with its policies and procedures.

Incentive Compensation for Plan Year 2015

The PSF, GLO, ERS, and TRS awarded a total of $15,311,127 in incentive compensation to 253 employees through their incentive compensation plans for plan year 2015. Specifically:

- The PSF awarded $1,639,513 to 47 employees.
- GLO awarded $299,655 to 5 employees.
- ERS awarded $4,764,067 to 63 employees.
- TRS awarded $8,607,892 to 138 employees.

Sources: The PSF, GLO, ERS, and TRS.

The Employees Retirement System (ERS) generally awarded and paid incentive compensation in accordance with its policies and procedures for plan year 2015. However, ERS overpaid an employee $176.77 because it did not calculate that employee's award in accordance with its policies and procedures. Additionally, ERS should strengthen controls over its incentive compensation calculation and review process by developing formal calculation and review procedures. The ERS executive director, who was appointed on June 1, 2015, did not receive any incentive compensation for the 2015 performance period.

The Teacher Retirement System (TRS) generally awarded and paid incentive compensation in accordance with its policies and procedures for plan year 2015. However, TRS overpaid a total of $2,236.00 to 9 employees because it input incorrect information into its calculation. TRS should strengthen controls over its incentive compensation calculation and review processes to prevent and detect errors and ensure that it records all incentive compensation payments correctly in its general ledger.

Auditors communicated other, less significant issues in writing separately to management of the PSF, GLO, ERS, and TRS.

This audit was conducted in accordance with Texas Government Code, Section 321.0132.

For more information regarding this report, please contact Michael Clayton, Audit Manager, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters and Related Issue Ratings		
Chapter	**Title**	**Issue Rating** [a]
1	The PSF Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low
2	GLO Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low
3	ERS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low
4	TRS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures	Low

[a] A chapter is rated **Priority** if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter is rated **High** if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter is rated **Medium** if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter is rated **Low** if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Summary of Management's Response

At the end of Chapters 2 through 4 in this report, auditors made recommendations to address the issues identified during this audit at GLO, ERS, and TRS; those agencies agreed with their respective recommendations.

Audit Objective and Scope

The objective of this audit was to determine whether the PSF, GLO, ERS, and TRS calculate and pay incentive compensation in accordance with policies and procedures.

The scope of this audit covered incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015, at TRS.

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Detailed Results

Chapter 1

The PSF Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 1 Rating:

Low [1]

The Permanent School Fund (PSF) of the Texas Education Agency calculated and paid incentive compensation for its plan year ended August 31, 2015, in accordance with its policies and procedures. The commissioner of education formally approved the PSF incentive compensation plan before the beginning of the plan performance start date.

The PSF awarded a total of $1,639,513 in incentive compensation to 47 employees. The PSF awarded the most incentive compensation to its chief investment officer, who was awarded $143,551 payable during a three-year period. That $143,551 represented 9 percent of the $1,639,513 in total incentive compensation that the PSF awarded.

Gross of Fees and Net of Fees

Gross of fees indicates that the effect of fees has not been reflected in a return; net of fees indicates that the effect of fees has been reflected in a return.

Source: CFA Institute Web site at http://www.cfapubs.org/doi/full/10.2469/ipmn.v2011.n1.1

Basis Points

One basis point is 0.01 percent or one one-hundredth of a percentage point.

Source: Morningstar, Inc. Web site at http://www.morningstar.com/InvGlossary/basis_point_definition_what_is.aspx.

The PSF calculates incentive compensation based on an employee's achievement of goals related to total fund performance and the performance of the employee's assigned asset classes. Except for the performance of certain asset classes that are measured since their inception using an internal rate of return calculation, fund and asset class performance are calculated on a three-year rolling average performance period. The PSF calculates investment returns for its incentive compensation plan on a gross-of-fees-paid-to-external-manager basis (see text box for more information on gross of fees and net of fees). PSF awards incentive compensation if investment performance exceeds benchmarks. Total fund investment performance exceeded the target benchmark by 0.28 percent (28 basis points) for the three-year period from September 1, 2012, to August 31, 2015 (see text box for more information on basis points).

The PSF pays incentive compensation awards in installments over time. Specifically, for most employees, the PSF pays 50 percent of an incentive compensation award for the current plan year, 25 percent of that award in the next year, and 25 percent of that award in the

[1] Chapter 1 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

third year. As a result, payments to employees may consist of partial awards from three years.

Table 2 shows the positions eligible to earn incentive compensation in the PSF plan and the incentive compensation payment awards for each position for plan year 2015.

Table 2

PSF Incentive Compensation Awards for Plan Year 2015	
Eligible Position	Incentive Compensation Award or Award Range
Chief Investment Officer	$143,551
Deputy Chief Investment Officer and Director of Fixed Income	$105,837
Deputy Executive Administrator	$80,551
Director of Equities	$110,851
Director of Global Risk Control Strategies	$94,897
Director of Private Markets	$106,295
Portfolio Manager I - IV	$27,922 to $80,777
Risk Manager	$27,165
Investment Analyst I - IV	$14,240 to $41,612
Risk Analyst	$6,421
Director of Finance	$25,366
Director of Investment Operations	$32,264
Director of Legal and Compliance	$25,859
Director of Operational Due Diligence	$19,422
Accountant I - VII	$10,564
Attorney I - VI	$7,914
Director of Investment Technology	$14,450
Financial Analyst I - IV	$1,873 to $9,382
Program Specialist I - VII	$1,125 to $4,276
Systems Analyst I - VI	$3,162 to $5,153
Executive Assistant I - III	Position was vacant
Staff Services Officer I - V	$651

Source: The PSF.

GLO Calculated and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 2 Rating:

Low [2]

The General Land Office (GLO) calculated and paid incentive compensation for its plan year ended June 30, 2015, in accordance with its policies and procedures. However:

- The land commissioner and the chief clerk did not formally approve the incentive compensation plan until July 9, 2014, which was after the performance period began. Obtaining formal approval of the incentive compensation plan prior to the beginning of the performance period could help ensure that the plan aligns with the intent of executive management.

- GLO did not retain documentation of one manager's review and approval of the incentive award calculation spreadsheet in accordance with its policies and procedures. Management review provides additional assurance that the incentive awards are calculated and paid in accordance with plan policies and procedures.

GLO awarded a total of $299,655 in incentive compensation to 5 employees. GLO awarded the most incentive compensation to its chief investment officer, who was awarded $211,815 payable during a two-year period. That $211,815 represented 71 percent of the $299,655 in total incentive compensation that GLO awarded.

The GLO incentive compensation plan compares investment performance of the total fund with a target benchmark on a one-year, three-year, and five-year basis. GLO calculates incentive compensation based on an employee's achievement of goals in investment performance (60 percent) and a qualitative component (40 percent) that is tied to employee job performance during the performance period. GLO calculates investment returns for its incentive compensation plan on a gross-of-fees-paid-to-external-manager basis. GLO awards incentive compensation for exceeding one-year, three-year, or five-year investment performance benchmarks. If the one-year total fund return is negative but outperforms the benchmark, the payment of incentive compensation awarded for the current performance period is deferred and payable on December 1 of the following year, regardless of performance results. Total fund investment performance:

[2] Chapter 2 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

- Exceeded the target benchmark by 5.99 percent (599 basis points) for the five-year period from July 1, 2010, to June 30, 2015.
- Exceeded the target benchmark by 4.63 percent (463 basis points) for the three-year period from July 1, 2012, to June 30, 2015.
- Exceeded the target benchmark by 2.37 percent (237 basis points) for the one-year period from July 1, 2014, to June 30, 2015.

GLO pays incentive compensation awards in installments over time. Specifically, it pays 50 percent of the award on December 1 following the end of the performance period, and it pays the remaining 50 percent on the anniversary of the first payment. As a result, payments to employees may consist of partial awards from two years.

Table 3 shows the positions eligible to earn incentive compensation in the GLO plan and the incentive compensation payment awards for each position for plan year 2015.

Table 3

GLO Incentive Compensation Awards for Plan Year 2015	
Eligible Position	Incentive Compensation Award or Award Range
Deputy Commissioner of Funds Management	$211,815
Real Assets Portfolio Manager	$56,040
Senior Financial Analyst	$645 to $20,002
Program Specialist	$11,153

[a] GLO changed the Deputy Commissioner of Funds Management title to Chief Investment Officer after the adoption of the plan

Source: GLO.

Recommendations

GLO should:

- Formally approve the incentive compensation plan prior to the start of the plan performance period.
- Retain documentation of management's review of plan calculations in accordance with its policies and procedures.

Management's Response

Recommendation: Formally approve the incentive compensation plan prior to the start of the plan performance period.

Management's Response: We agree with the finding. The FY2016 plan was approved prior to the start of the plan performance period.

Recommendation: Retain documentation of management's review of plan calculations in accordance with its policies and procedures.

Management's Response: We agree with the finding. The documentation will be retained per the policies and procedures.

Title of Responsible Person: Director of Budget and Planning

Chapter 3

ERS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 3 Rating:

Low [3]

The Employees Retirement System (ERS) generally calculated and paid incentive compensation for its plan year ended August 31, 2015, in accordance with its policies and procedures. However:

- ERS incorrectly calculated the proration for one employee, which resulted in an overpayment of $176.77. For incentive calculations, ERS employee promotions are prorated effective as of the date of the promotion. The overpayment occurred because ERS used the wrong promotion date for the proration calculation, and subsequent reviews did not identify the error.

- ERS does not have written policies and procedures regarding the incentive compensation calculation and review process. That increases the risk of inaccurate award payouts due to mistakes in the calculation and review process.

ERS awarded a total of $4,764,067 in incentive compensation to 63 employees. ERS awarded the most incentive compensation to its chief investment officer, who was awarded $382,777 payable over a three-year period. That $382,777 represented 8 percent of the $4,764,067 in total incentive compensation that ERS awarded. The ERS executive director, who was appointed on June 1, 2015, did not receive any incentive compensation for the 2015 performance period.

ERS awards incentive compensation based on a combination of investment performance and qualitative performance. All investment performance goals are measured against benchmarks, except for securities lending, which requires fixed income staff to have positive earnings for one-year and three-year periods to earn incentive compensation. The qualitative performance component assesses if ERS employees exceeded the applicable job performance standards. The ERS incentive compensation plan allows the ERS executive director to exercise discretion in plan-related matters. The following is an excerpt of plan section 7.1.

[3] Chapter 3 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

> 7.1 The Plan shall be administered by the Board, as it relates to participation of the Executive Director, and by the Executive Director, as it relates to participation of other ERS employees, in accordance with the terms hereof, as amended from time to time. In administering the Plan, the Board or Executive Director, with input from ERS senior management, shall have discretionary authority to interpret the Plan document and to administer the Plan in accordance with its terms.

For plan year 2015, the executive director used his discretion to reduce the qualitative performance assessments for all but one employee that participated in the plan.

ERS calculates the investment performance component of incentive compensation based on total trust fund performance and individual assigned goals. ERS awards incentive compensation for exceeding one-year, three-year, or five-year investment performance benchmarks, depending on an employee's length of service. ERS employees earn awards if the fund performance is negative for the year but exceeds the benchmark performance; however, award payment is deferred until the next plan year in which the one-year total trust performance is positive. ERS calculates total trust fund performance returns for its incentive compensation plan on a net-of-fees-paid-to-external-managers basis. The total fund investment performance:

- Exceeded the target benchmark by 0.38 percent (38 basis points) for the five-year period from September 1, 2010, to August 31, 2015.
- Exceeded the target benchmark by 0.49 percent (49 basis points) for the three-year period from September 1, 2012, to August 31, 2015.
- Exceeded the target benchmark by 1.32 percent (132 basis points) for the one-year period from September 1, 2014, to August 31, 2015.

In conducting the audit at ERS, State Auditor's Office auditors relied on ERS internal audit report number 2016-01, *Incentive Compensation Plan*, released on December 7, 2015. The State Auditor's Office conducted procedures to confirm that the ERS internal audit department was qualified and that the internal audit work on which the State Auditor's Office relied was sufficient.

ERS pays incentive compensation awards in installments over time. Specifically, for most employees, ERS pays 50 percent of an incentive compensation award for the current plan year, 25 percent of that award in the next year, and 25 percent of that award in the third year. As a result, payments to employees may consist of partial awards from three years. ERS pays investment operations team members in two installments of 50 percent each, as directed by the previous executive director.

Table 4 shows the positions eligible to earn incentive compensation in the ERS plan and the incentive compensation payment awards for each position for plan year 2015.

Table 4

ERS Incentive Compensation Awards for Plan Year 2015	
Eligible Position	**Incentive Compensation Award or Award Range**
Investment Analyst I - II	$2,193 to $17,564
Investment Analyst III - IV	$2,948 to $60,783
Portfolio Manager I - V	$14,083 to $199,435
Supervising Portfolio Manager	$111,390 to $122,224
Trader I - II	$40,660
Chief Trader I - II	$82,169 to $107,665
Asset Class Portfolio Managers/Directors	$134,650 to $202,005
Risk Management and Applied Research	$121,133
Financial Analyst I-IV	$1,781 to $23,998
Investment Administrative Support	Opted out of incentive compensation for plan year 2015
Director of Investment Services	$130,044
Chief of Staff	Position was vacant
Deputy Chief Investment Officer	$172,010
Investments and Securities, Paralegal	Position was vacant
Investments and Securities, Attorney	$73,552 to $102,479
General Counsel and Chief Compliance Officer	$127,598
Chief Investment Officer	$382,777
Executive Director	Did not receive incentive compensation for plan year 2015

Source: ERS.

Recommendations

ERS should:

- Strengthen its payment review process to ensure that it identifies calculation errors.

- Develop written policies and procedures for its incentive compensation calculation and review process.

Management's Response

ERS management agrees with both recommendations. An initial draft of the Incentive Compensation Plan's process procedures has been completed. ERS staff will continue the review and improvement process of the plan procedures and expect to have a finalized document by August 31, 2016. The Director of Human Resources is the responsible staff for implementation.

TRS Generally Awarded and Paid Plan Year 2015 Incentive Compensation in Accordance with Its Policies and Procedures

Chapter 4 Rating:

Low [4]

The Teacher Retirement System (TRS) generally calculated and paid incentive compensation for its plan year ended September 30, 2015, in accordance with its policies and procedures. However, TRS overpaid a total of $2,236 to 9 employees because it input incorrect information into its calculation. Specifically, to calculate the performance of one portfolio, TRS used a performance target that differed from the performance target documented in its incentive compensation plan. That overstated the performance of the employees assigned to that portfolio and resulted in the overpayments. TRS did not detect the error during its reviews.

TRS awarded a total of $8,607,892 in incentive compensation to 138 employees. TRS awarded the most incentive compensation to its chief investment officer, who was awarded $329,708 payable over a 2-year period. That $329,708 represented 4 percent of the $8,607,892 in total incentive compensation that TRS awarded.

Auditors relied on the work of the TRS internal audit department as part of this audit. Specifically, auditors reviewed the TRS internal audit report *Quarterly Investment Testing of compliance with the requirements of the Investment Policy Statement (IPS), Securities Lending Policy (SLP), Employee Ethics Policy, Code of Ethics for Contractors, Performance Incentive Pay Plan, and Procedures for Wire Transfers for the Quarter ended September 30, 2015*, released on November 10, 2015. The State Auditor's Office conducted procedures to confirm that the TRS internal audit department was qualified and that the internal audit work on which the State Auditor's Office relied was sufficient.

TRS changed one incentive compensation award amount for plan year 2014. (TRS made that change after the State Auditor's Office had audited incentive compensation for plan year 2014.). That change resulted in TRS paying an additional $22,453 to one employee, and TRS incorrectly recorded $5,613 of that amount as a one-time merit payment (rather than incentive compensation) in its general ledger. TRS paid the additional compensation to an employee who retired during the 2015 plan performance period.

The employee who received the award discussed above was the only individual affected by a change that TRS made to its incentive compensation

[4] Chapter 4 is rated Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

plan prior to the start of the 2015 plan performance period. That change allowed qualified employees who retire to receive incentive compensation that they have earned but that has not been paid by their retirement date. As discussed above, TRS paid $5,613 to the employee as a one-time merit payment in February 2015, and it paid the remaining $16,840 in February 2016 as incentive compensation.

The TRS incentive compensation plan is based on a combination of investment performance and qualitative performance. The investment performance component compares investment performance with benchmarks (50 percent) and the performance of peer groups (30 percent). The qualitative performance component (20 percent) assesses performance in a variety of areas such as interpersonal relationship skills, accountability, and effective teamwork.

The TRS incentive compensation plan measures investment performance of the total fund and of an employee's individual assigned asset classes on both a one-year (33 percent) and three-year (67 percent) basis. If investment performance exceeds the benchmarks or the performance of other large public funds, that triggers the awarding of incentive compensation. TRS calculates investment returns for its incentive compensation plan on a net-of-fees-paid-to-external-managers basis. TRS employees may earn incentive compensation in years in which the total fund return is negative if that return exceeds the benchmark return. However, TRS defers the payment of those awards until the total fund has a positive return in a subsequent year. The total fund investment performance:

- Exceeded the benchmark by 62 basis points for the three-year period from October 1, 2012, to September 30, 2015.
- Exceeded the benchmark by 46 basis points for the one-year period from October 1, 2014, to September 30, 2015.

TRS pays incentive compensation awards in installments over time. Specifically, it pays 50 percent of an award on February 1 following the end of the performance period, and it pays the remaining 50 percent on the anniversary of the first payment. As a result, payments to employees may consist of partial awards from two years.

Table 5 shows the positions eligible to earn incentive compensation in the TRS plan and the incentive compensation payment awards for each position for plan year 2015.

Table 5

TRS Incentive Compensation Awards for Plan Year 2015	
Eligible Positions	Incentive Compensation Award or Award Range
Chief Investment Officer	$329,708
Deputy Chief Investment Officer	$210,174
Senior Managing Director	$164,655 to $256,806
Managing Director	$159,109 to $160,669
Senior Director	$120,405 to $176,000
Director	$45,740 to $151,319
Senior Investment Manager	$64,545 to $122,763
Investment Manager	$14,750 to $89,850
Senior Associate	$31,159 to $51,807
Associate	$3,119 to $36,721
Senior Analyst	$4,029 to $20,775
Analyst	$1,460 to $10,978
Junior Analyst	Position was vacant
Administrative Assistants	$1,067 to $1,891

Source: TRS.

Recommendations

TRS should:

- Strengthen controls over the incentive compensation calculation and review processes to prevent and detect calculation input errors.
- Record all incentive compensation payments correctly in its general ledger.

Management's Response

TRS is in agreement with the findings of the State Auditor's Office. We are constantly striving to improve processes, procedures, and internal controls related to incentive compensation payments. In fact, the changes made in plan year 2015 were the most comprehensive undertaken by the agency to date and provided additional checks and balances that had not been in place before. However, there are still several manual spreadsheet processes being used that increase the potential for human error. To that end, TRS is currently *seeking a technology solution that will minimize manual processes and we expect to have the necessary software implemented this year so that it can be used to calculate the results of the 2016 incentive compensation plan year.*

Title of Responsible Person: Chief Financial Officer

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether the Permanent School Fund (PSF) of the Texas Education Agency, the General Land Office (GLO), the Employees Retirement System (ERS), and the Teacher Retirement System (TRS) calculate and pay incentive compensation in accordance with their policies and procedures.

Scope

The scope of this audit covered incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015, at TRS.

Methodology

The audit methodology included collecting information and documentation from the audited agencies; reviewing incentive compensation plans, policies, and procedures, and other guidance related to incentive compensation; and analyzing and evaluating data and the results of tests.

Auditors tested sample items to determine whether selected recipients were eligible to receive incentive compensation payments, payment calculation data inputs were correct, payment calculations were correct based on the terms of the incentive compensation plans, and payment amounts distributed to recipients matched amounts calculated for each recipient.

Auditors reviewed calculations, personnel files, payroll data, and externally reported fund performance results to determine whether the audited agencies calculated and paid incentive compensation in accordance with their policies and procedures. Auditors also tested access controls over the spreadsheets and data that the audited agencies used to calculate incentive compensation.

Auditors tested access controls for key calculation data inputs and conducted procedures to determine whether auditors could rely on the work that ERS and TRS internal auditors conducted.

Data Reliability and Completeness

Auditors assessed the reliability of the incentive compensation award data used in this audit by tracing the data to supporting documentation and reviewing access to the data. Auditors verified the completeness of the incentive compensation award data by comparing information in the incentive compensation award calculation spreadsheets the audited agencies used to the data in Uniform Statewide Payroll/Personnel System. Auditors determined that the incentive compensation award data was sufficiently reliable for the purposes of this audit.

Auditors also determined that the investment performance data obtained from custodians was sufficiently reliable for the purposes of this audit.

Sampling Methodology

Auditors selected samples of incentive compensation awards for testing using professional judgment at the PSF, ERS, and TRS. Auditors tested the entire population of incentive compensation awards at GLO.

<u>Information collected and reviewed</u> included the following:

- Incentive compensation plan documentation at the PSF, GLO, ERS, and TRS.
- Incentive compensation payment calculation spreadsheets for incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015, at TRS.
- Incentive compensation recipients' personnel files.
- Payroll data related to incentive compensation recipients.
- Investment performance reports from custodian banks.
- Agency internal audit documents.

<u>Procedures and tests conducted</u> included the following:

- Interviewed management and key personnel at the PSF, GLO, ERS, and TRS.
- Tested and recalculated incentive compensation awards for recipients of incentive compensation for incentive compensation plan years ending August 31, 2015, at the PSF and ERS; June 30, 2015, at GLO; and September 30, 2015 at TRS.

- Verified that incentive compensation award payments matched award calculations.
- Reviewed and tested compliance with the audited agencies' policies and procedures.
- Reviewed ERS and TRS internal auditors' education, professional certification, and continuing education to determine whether they complied with *Government Auditing Standards,* Sections 6.40 and 6.41.
- Examined, on a test basis, ERS and TRS internal auditors' work to determine whether it could be used as audit evidence.

Criteria used included the following:

- *Texas Education Agency Permanent School Fund Division Performance Incentive Pay Plan*, effective September 1, 2014.
- *General Land Office Performance Incentive Pay Plan*, effective July 1, 2014.
- *Employees Retirement System of Texas Incentive Compensation Plan for Key Investment Professionals and Leadership Employees*, effective September 1, 2014.
- *Teacher Retirement System of Texas Performance Incentive Pay Plan*, effective October 1, 2014.
- TRS and ERS board of trustees meeting minutes.
- Section 44, Article III, Texas Constitution and related statutes.
- Rider 13, page III-34, and Rider 22, pages III-9 and III-10, General Appropriations Act (83rd Legislature).
- Texas attorney general opinions related to incentive compensation.
- *Government Auditing Standards*, 2011 Revision, Section 6.41.
- *Teacher Retirement System of Texas Performance Incentive Calculation and Verification* procedures document, revised April 23, 2015.

Project Information

Audit fieldwork was conducted from February 2016 through April 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Benjamin Nathanial Keyfitz, CPA (Project Manager)
- Yue Zhang, MPA (Assistant Project Manager)
- Doug Stearns
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Michael Owen Clayton, CPA, CISA, CFE, CIDA (Audit Manager)

Appendix 2

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; violation of state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 6 provides a description of the issue ratings presented in this report.

Table 6

Summary of Issue Ratings	
Issue Rating	**Description of Rating**
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Appendix 3

Related State Auditor's Office Work

Related State Auditor's Office Work		
Number	**Product Name**	**Release Date**
15-032	An Audit Report on Incentive Compensation at Selected Agencies	May 2015
14-033	An Audit Report on Incentive Compensation at the Teacher Retirement System, the Permanent School Fund, the General Land Office, and the Employees Retirement System	May 2014
13-033	An Audit Report on Incentive Compensation at the Teacher Retirement System, the Permanent School Fund, and the Employees Retirement System	April 2013

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Employees Retirement System

Members of the Employees Retirement System Board of Trustees
- Mr. I. Craig Hester, Chair
- Mr. Doug Danzeiser, Vice Chair
- Ms. Ilesa Daniels
- Ms. Cydney Donnell
- Mr. Brian D. Ragland
- Mr. Frederick E. Rowe Jr.

Mr. Porter Wilson, Executive Director

General Land Office

The Honorable George P. Bush, Land Commissioner and Chairman of the School Land Board
Members of the School Land Board
- Mr. Gilbert Burciaga
- Mr. David S. Herrmann

Permanent School Fund

Members of the State Board of Education
- Ms. Donna Bahorich, Chair
- Mr. Thomas Ratliff, Vice Chair
- Mr. Ruben Cortez, Jr., Secretary
- Mr. Lawrence A. Allen, Jr.
- Ms. Erika Beltran
- Mr. David Bradley
- Ms. Barbara Cargill
- Dr. Martha M. Dominguez
- Ms. Patricia Hardy
- Mr. Tom Maynard
- Ms. Sue Melton-Malone
- Mr. Ken Mercer
- Ms. Geraldine Miller
- Ms. Marisa B. Perez
- Mr. Marty Rowley

Mr. Mike Morath, Commissioner of Education

PUBLIC AGENDA ITEM - #2b

Presentation, Discussion and Consideration of Audit Committee Agenda Items:

2b. Internal Audit Reports

August 16, 2016

BACKGROUND:

Internal Audit completed three engagements

1. Disability Retirements
2. Investment Compliance Agreed-upon Procedures (AUP)
3. Status of Audit Recommendations as part of the Fiscal Year 2016 audit plan.

These audits are included in this agenda as Exhibit A-C.

STAFF RECOMMENDATION:

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

ATTACHMENTS – 3

Exhibit A – Disability Retirements

Exhibit B – Investment Compliance AUP

Exhibit C – Status of Audit Recommendations

ERS

EMPLOYEES RETIREMENT SYSTEM OF TEXAS

Disability Retirement Audit #2016-06

June 27, 2016

ERS INTERNAL AUDIT DIVISON

To provide independent and objective assurance on the effectiveness of controls and operations to meet ERS' strategic direction.

FROM THE DIRECTOR

Internal Audit has completed its Disability Retirement audit at the Employees Retirement System of Texas.

Based on the audit scope areas reviewed, internal controls are effective and substantially address significant risks related to operational execution and regulatory compliance. The organization's system of internal controls provides reasonable assurance that key goals and objectives will be achieved despite control gap corrections and improvement opportunities identified. The following observations were noted in the audit:

1. Monitoring activities provide limited assurance for continued participation in disability program
2. Follow-up not performed on information in application packets that may impact eligibility.

Detailed results and observations are included in subsequent pages. Other matters deemed less significant were communicated with management directly. We thank management and staff of the Customer Benefits and Legal divisions for their courtesy and cooperation extended to us during the review.

Sincerely,

Anthony Chavez, CIA, CGAP, CRMA

Director, Internal Audit Division

Table of Contents

OBJECTIVE

The overall objective of the audit was to determine if disability benefits are processed in accordance with regulatory requirements. The sub-objectives of the audit were:

Disability Retirement Monitoring:

a) Are monitoring procedures operating effectively to determine if members no longer meet eligibility requirements after disability retirement has been approved?

Disability Retirement Eligibility:

a) Are disability retirements granted for eligible members, according to regulatory requirements?

b) Are applicants provided information to appeal denied applications?

c) Are disability retirement annuity payments calculated correctly?

CONCLUSION AND SUMMARY RESULTS

OVERALL ASSESSMENT		**SATISFACTORY**
SCOPE AREA	**RESULT**	**RATING**
Disability Retirement Monitoring	1. Monitoring activities provide limited assurance for continued participation in disability program. (Moderate)	**Needs Improvement**
Disability Retirement Eligibility	2. Follow-up not performed on information in application packets that may impact eligibility. (Moderate)	**Satisfactory**

BACKGROUND

When ERS members become disabled and are no longer able to perform their job duties, they may be eligible for occupational or non-occupational disability retirement. To be eligible for occupational disability retirement, a member must prove that the injury was sudden and unexpected, resulting from a dangerous job duty not common to the general public. To be eligible for non-occupational disability retirement, a member must have at least 10 years of creditable service and contributed to ERS in the month the member became disabled.

Texas Government Code[1] outlines requirements for the application process of disability retirement for each employee class. It also includes a list of eligibility requirements and the process for calculation of disability annuities.

ERS's Specialty Retirements staff manage the disability retirement program through a detailed application approval process and monitoring of retirees after approval.

Application Approval Process

The application approval process requires an applicant to submit a physician's statement, departmental statement (from applicant's agency), the previous two years' medical records, and the completed application itself. The process also requires the medical board's certification and approvals from the Legal Services Division and the Director of Customer Benefits.

Monitoring Process

Specialty retirements staff perform a quarterly review to determine if disability retirees have returned to work in the state of Texas and are earning at least 80% (comparable pay[2]) of their final state base pay, which is prohibited under statute[1]. Specialty retirements staff also perform ad-hoc reviews of continued eligibility of retirees if requested by Legal Services Division or the Director of Customer Benefits.

EXEMPLARY CONTROLS

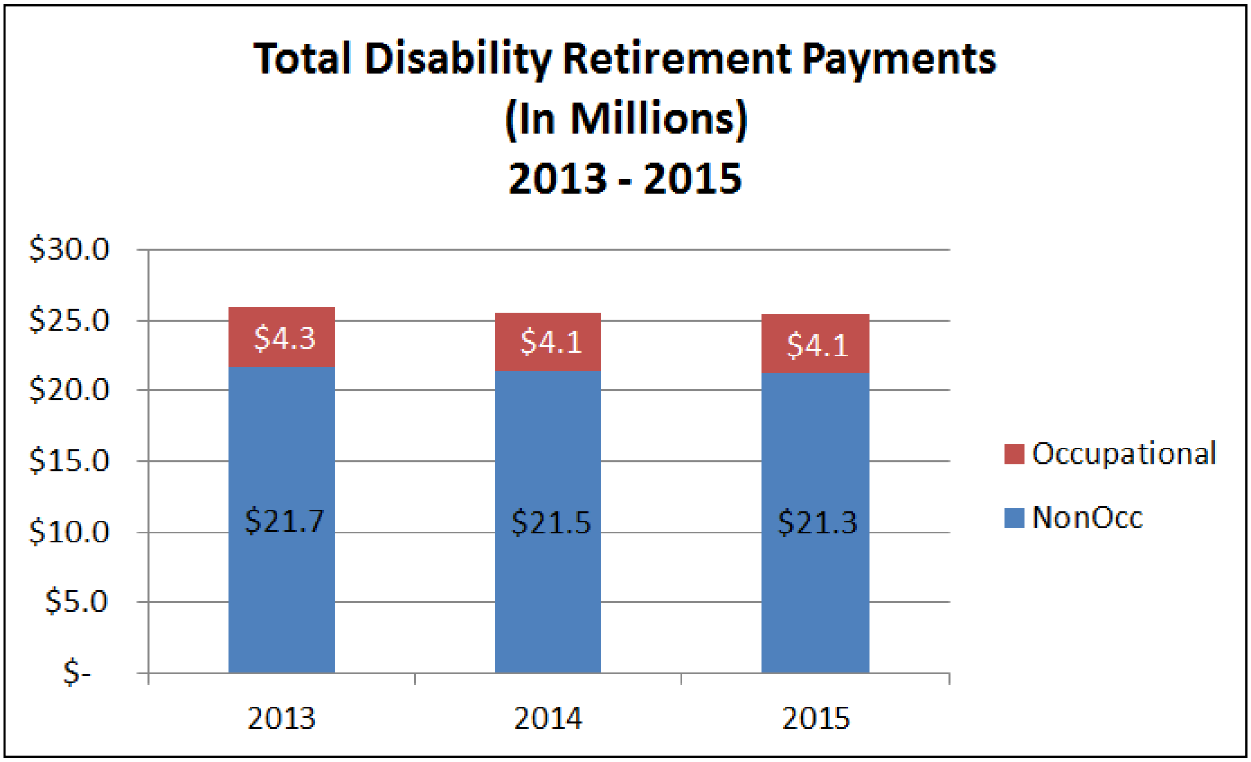
The Customer Service division has established strong controls that can be described as "best practices" for disability retirement:

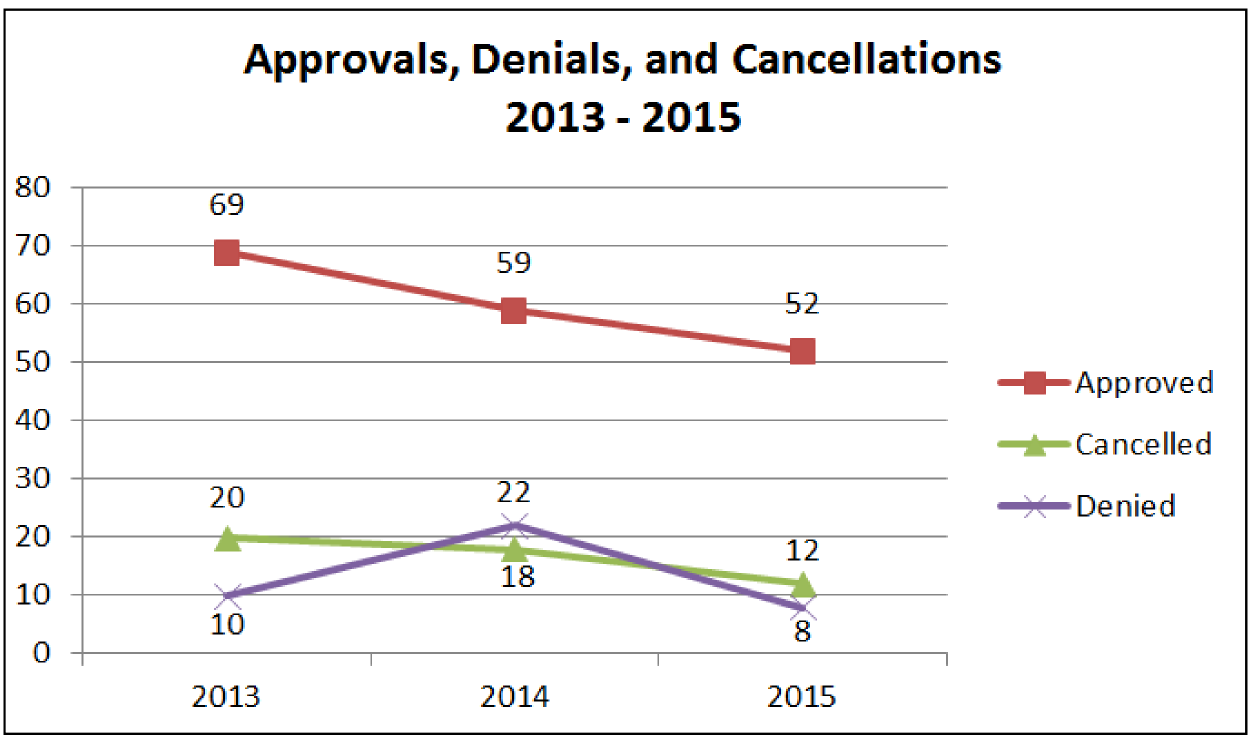
- The wage match process helps identify retirees that have returned to work in the Texas workforce at comparable pay to their previous state salary. 95% of all disability retirees reside in Texas, which allows this control to greatly reduce the risk of annuities paid to ineligible members.
- ERS's medical board reviews all applications, which adds independence and objectivity to the application approval process.

1. Texas Government Code- Chapter 814: Benefits, Subchapter C: Disability

2. Texas Government Code- Chapter 814.203, Certification of Disability, sections b and c

DISABILITY RETIREMENT PROGRAM HIGHLIGHTS





Note: 2015 data is not complete because some 2015 applications were still being processed when data was obtained.

SCOPE AND METHODOLOGY

We performed this audit in accordance with the Fiscal Year (FY) 2016 annual audit plan. Internal control activities reviewed include those in place during FY 2015 and at the time of audit fieldwork testing that ended on April 12, 2016.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

The audited period covered disability retirement applicants approved between calendar years 2014-2015

A defined set of control objectives was utilized to focus on operational goals for the identified scope. The Committee of Sponsoring Organizations of the Treadway Commission Internal Control Integrated Framework. Control was the basis for internal control assessment. Our Internal Audit opinion is an assessment of the condition of the overall control environment based on the effectiveness of internal control activities through the audit period and the degree to which defined control objectives are being met. Our Internal Audit opinion is not a guarantee of operational effectiveness or regulatory compliance, particularly in areas not included in the scope of this audit.

This audit included a review of internal controls considered relevant to audit objectives including review of statutes, policies and procedures, interviews with management and staff, data analysis and testing procedures.

RELATED AUDIT

Internal Audit Report 2015-05 Service Credit Purchases (July 2015)

1. Monitoring activities provide limited assurance for continued participation in disability program (Moderate)

Inherent Risk Factors with Continued Disability Monitoring:

- Incentive for participates to act dishonest
- Predisposition that participants will act in good faith
- Emphasis of internal controls on initial application process
- Limited visibility to changes in medical condition
- Limited financial benefit statistics

Disability retirement benefits are indefinite and will continue as long as retirees are determined to be disabled. As of May 2016, there were approximately 630 disability retirees under age 60 (not eligible for regular service retirement) with an average annual annuity payment of $8,750 each ($5.6 million in total). Current monitoring control activities include the following:

1. Wage match reviews to identify disability retirees who have returned to work within the state of Texas
2. Medical re-evaluation of select disability retirees that requires submission of information to support continued disability.

Review of monitoring activities identified the following:

- Control activities do not include monitoring of disability retirees who have returned to work out-of-state. Analysis of disability retirees identified 12 high risk out-of-state retirees to review. Results of the review indicated that 2 of the 12 retirees may no longer be disabled, including one retiree who possibly returned to work in a similar field from previous state employment.
- Re-evaluation procedures provide limited assurance over disability retirees who are no longer disabled and choose not to return to work.
    - ◊ As of February 2016, only 22 out of 2,335 (1%) disability retirees were scheduled to receive a re-evaluation.
    - ◊ Selection of applicants for re-evaluations is not consistent. Review of 30 applications identified three applicant's whose last day physically at work was after the day the physician certified the applicant as permanently disabled. This could indicate that the applicant may not be permanently disabled or disability is likely to improve. However, none of the three were identified for future medical re-evaluations. Specific timelines for performance of re-evaluations are not always communicated, including one instance in which a disability retiree was scheduled for review a "few" years after retirement. Communication of specific timelines would ensure procedures are properly followed with intended objectives.

Best practice from the United States Office of Inspector[1] General has identified full medical continuing disability reviews (CDR's) as highly effective guards against social security disability program fraud[1]. After an individual is determined to be disabled, the Social Security Administration is required to conduct periodic CDRs to determine whether the individual continues to be disabled. Frequency of review is based on likelihood that a retiree's condition may improve. The CDR process may consist of

1. September 2014 OIG Report—The Social Security Administration's Ability to Prevent and Detect Disability Fraud

completing a full medical re-examination of retirees, or simply sending the retiree a mailer to respond to. Legislative authority[1] is available to ERS to periodically examine the continued disability of retirees, including the discontinuation of benefits for non-responsiveness.

A more robust re-evaluation program in-line with the SSA's risk profiling system would assist in providing greater assurance and a more consistent process. The frequency of reviews should align with risk levels management is willing to accept.

Legislative Authority[1] for Medical Examination of Disability Retirees:

- Once each during the first five years after a member retires for disability
- Once in each three-year period after first five years

SSA continuing disability review schedule:

- Six to 18 months when improvement is **expected**
- Up to three years when improvement is **possible**
- Five to seven years when improvement is **not expected**

RECOMMENDATIONS

Customer Benefits should coordinate with executive management to evaluate and determine if current risk exposure caused by control gaps identified are at an acceptable level. Risk appetite analysis should include financial impact to ERS and regulatory compliance.

If management determines risk exposure is not within acceptable levels, controls to assist in the detection of changes in medical condition should be expanded, including:

- Development of a risk profile rating that will be used to determine frequency of medical re-examinations in accordance with Government Code[1]
- Development of risk profile attributes to assist in evaluating and assessing risk profile ratings
- Inclusion of a location of residence risk profile attribute as current controls provide for lesser assurance to detect changes in medical condition for out-state disability program participants than in-state participants
- Utilization of additional information to assist with risk profile assessment such as Medical Board assessments
- Application of risk profile rating assessments to individuals currently in the disability program to mine further reevaluation procedures

MANAGEMENT ACTION PLAN

1. A control risk self-assessment will be conducted to identify risks associated with certain groups of individuals that may no longer be eligible for disability retirement to determine what additional controls should be put in place if any.
2. Add information on the initial application that requires members to certify that they understand that they may be subject to reevaluation and/or be required to provide proof of earnings capacity.
3. Add a box on the Medical Board Certification form requiring the Medical Board to indicate if they recommend reevaluation and when.
    - If we (ERS) determine that we need to reevaluate someone due to additional information received, the reason will be clearly documented.
4. Require members that retired under disability that are living out of state to submit a form annually providing a statement on earnings. Customer Benefits will work with Legal Services on the appropriate language for the forms.

Responsible Position: Robin Hardaway, Director—Customer Benefits

Implementation Date: #1—December 31, 2016; #2-4—August 31, 2016

1. Texas Government Code- Chapter 814.208

2. Follow-up not performed on information in application packets that may impact eligibility. (Moderate)

All applicants for disability retirement are required to submit physician's statements and a departmental statements. Physician's statements are completed by applicants' physicians and assert if applicants are permanently disabled and unable to perform current job duties or any other job. Departmental statements are completed by Human Resources of each applicant's agency and include a job description, as well as the date the applicant was last physically present at work.

Documentation required in application packet:

- Application
- Physician Statement
- Departmental Statement
- Previous 2 years' medical records

For 3 of 30 application packets reviewed, departmental statements indicated that the applicant's last day physically at work was after the date the physician's statements were notarized. This could indicate that there is an error in the departmental or physician's statement, or that the applicant may not be permanently disabled and ineligible for disability retirement according to statute[1]. Information that may impact eligibility should be investigated before approval is recommended; however, no actions were taken to address the conflicting information.

RECOMMENDATIONS

To help ensure that applicants applying for disability retirement are permanently disabled, Customer Benefits should develop formal procedures to identify and follow up on details in applications that call into question if the applicant is permanently disabled. Follow-up items should include applications that indicate that the applicant's last physical day at work was after the day his / her physician indicated that the applicant was permanently disabled.

MANAGEMENT ACTION PLAN

We will review the date of disability and the date of the applicant's last physical date of work.

- If that is within 30 days, no additional action will be taken unless something stands out as needing additional follow-up. If follow up is required, the reason will be clearly documented.
- If it is outside a 30 day window, we will follow up with the agency and/or applicant for additional information and document the outcome.

Responsible Position: Robin Hardaway, Director—Customer Benefits

Implementation Date: July 31, 2016

1. Texas Government Code—Chapter 814.203—Certification of Disability

ERS
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

200 E. 18TH STREET, AUSTIN, TEXAS 78701 | P. O. BOX 13207, AUSTIN, TEXAS 78711-3207 | (877) 275-4377 TOLL-FREE | WWW.ERS.STATE.TX.US

July 25, 2016

Members of the ERS Board of Trustees
Mr. Porter Wilson, Executive Director
Mr. Tom Tull, Chief Investment Officer

Re: Quarterly Investment Agreed-upon Procedures

Internal Audit has completed quarterly procedures to test compliance with ERS' Investment Policy in accordance with the Fiscal Year 2016 Annual Audit Plan.

We have performed the procedures listed in the attached Appendix A, which were agreed to by ERS management, to assist in monitoring Investment Policy compliance for the quarter ended June 30, 2016. This agreed-upon procedures engagement was performed in accordance with generally accepted government auditing standards contained in the Government Auditing Standards issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

We were not engaged to and did not conduct an examination, the objective of which would be to determine whether internal controls are effectively designed and operating to comply with ERS' Investment Policy. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use by the Board of Trustees and ERS management, and is not intended to be and should not be used by anyone other than the specified party. This report is a matter of public record and its distribution is not limited.

Sincerely

Anthony Chavez, CIA, CGAP, CRMA
Director, Internal Audit Division

APPENDIX A – AGREED-UPON PROCEDURES AND RESULTS

Portfolio Compliance – *Proper Investment risk maintained based on approved investment strategy and asset allocation*		
Procedures Agreed-Upon	Finding Description	Management Response
Investment Custodian Bank *Diversification Reports* reviewed to ensure beneficial ownership in a single security is within Investment Policy diversification thresholds.	No exceptions were found as a result of applying this procedure.	Noted
Investment Custodian Bank *Fixed Income Quality Reports* reviewed to ensure fixed income and short-term securities credit ratings above Investment Policy limits.	No exceptions were found as a result of applying this procedure.	Noted
FactSet *Daily Tracking Error Reports* reviewed to ensure risk tolerance within established constraints per Investment Policy.	One (1) instance occurred where the tracking error was not within established constraints, and was resolved within one (1) business day.	Noted
Review the daily report provided by BNY Mellon to identify instances of investments in prohibited countries.	No exceptions were found as a result of applying this procedure.	Noted

APPENDIX A – AGREED-UPON PROCEDURES AND RESULTS

Personal Trading – *Employees may not have an interest in or financial gain from investments by ERS*		
Procedures Agreed-Upon	Finding Descriptions	Management Responses
At quarter-end, Covered Persons list pulled from personal trading system and compared to designated Covered Persons division listing for completeness.	No exceptions were found as a result of applying this procedure	Noted
Covered Persons personal brokerage trading confirmations reconciled to compliance system executed personal trades for completeness.	No exceptions were found as a result of applying this procedure	Noted
Reported compliance system executed trades reviewed to verify existence of pre-approval from designated party.	No exceptions were found as a result of applying this procedure	Noted
Confirm all quarterly affirmations to be submitted by Covered Persons affirming understanding of Investment Policy personal transactions rules including submission of all required personal trading information.	No exceptions were found as a result of applying this procedure	Noted

APPENDIX A – AGREED-UPON PROCEDURES AND RESULTS

Proxy Voting – *Votes should be cast in accordance with ERS' economic best interest*		
Procedures Agreed-Upon	Finding Description	Management Responses
Review Institutional Shareholder Services (ISS) system *Un-voted Report* for missing votes.	No exceptions were found as a result of applying this procedure	Noted
Review Institutional Shareholder Services (ISS) system Voted Against Report for votes made against ERS proxy voting guidelines. Verify any votes against ERS guidelines are appropriately documented as to rationale.	Seven votes were noted as against ERS guidelines. Six votes included documented rationale for decision. One vote was determined not to include sufficient documented rationale. Seven votes noted below.	The Portfolio Manager originally voted with ERS policy, requiring no specific rationale. Subsequently, ISS updated the policy recommendation thus resulting in the PM's original vote now being inconsistent with the new policy recommendation. Staff did not note the change. Additional procedures will be established to ensure changes are noted and proper rationale is provided, if necessary.

Votes Against ERS Proxy Voting Guidelines	
Vote Instruction	Proposal Description
Against	Amend Articles/Bylaws/Charter – Routine
For	Eliminate Preemptive Rights
For	Elect Director
For	Elect Director
Against*	Approve Stock Option Plan Grants
For	Eliminate Preemptive Rights
Against	Approve/Amend Employment Agreements

* Vote did not include sufficient documented rationale.

APPENDIX A – AGREED-UPON PROCEDURES AND RESULTS

Securities Lending – *Lendable securities base and individual securities are not under-collateralized or over-utilized per program policies*		
Procedures Agreed-Upon	Finding Description	Management Responses
Review the monthly *Securities Lending and Performance Summary* to ensure the ERS utilization rate for Securities Lending is below 25% of the lendable base.	No exceptions were found as a result of applying this procedure.	Noted
Review the daily report provided by Deutsche Bank to identify instances of collateralization falling below 100% based on end-of-day market values.	No exceptions were found as a result of applying this procedure.	Noted
Review the daily report provided by Deutsche Bank to identify instances where more than 95% of any single security is loaned out.	One (1) instance was identified during the quarter where more than 95% of any single security is loaned out. This instance was resolved within one (1) business day.	Noted
Review the daily report provided by Deutsche Bank to identify instances where the rebate rates for loans are above the Federal Funds Open rate.	No exceptions were found as a result of applying this procedure.	Noted
Review the daily report provided by Deutsche Bank to identify instances where counterparties are above the 10% diversification limit for Eurozone borrowers.	Three (3) instances were identified during the quarter where the diversification limit for Eurozone counterparties was above 10%. One instance went unresolved for twenty-six (26) consecutive business days. All other instances were resolved within three business days.	See **Appendix B** for further details
Review the daily report provided by Deutsche Bank to identify instances where counterparties are above the 20% diversification limit for non-Eurozone borrowers	Four (4) instances were identified during the quarter where the diversification limit for non-Eurozone counterparties was above 20%. One instance went unresolved for eleven (11) consecutive business days and another forty-one (41) consecutive business days. Another instance went unresolved seven (7) business days. All other instances were resolved within three business days.	See **Appendix B** for further details

APPENDIX B – SECURITY LENDING PROGRAM SUSPENSION

Impact to Investment Compliance Monitoring

Beginning in January 2016, the credit default swap (CDS) spread, an indicator of solvency risk, began to rise sharply for ERS's securities lending counterparty, Deutsche Bank. The spread continued to increase dramatically into February 2016, which caused the Securities Lending program to be temporarily suspended. Investments Division does not believe that Deutsche Bank will face any solvency issues, but they determined that the returns the securities lending program generates were not worth the risks. The recall was done in steps, first causing the borrowed exposure to decrease from $400 million to $26 million in February, with the last borrowed security returning at the beginning of April. Since the total number of borrowed securities decreased significantly, daily audit flags were triggered from February to the beginning of April 2016 for the diversification limits in the Investment Compliance Program.

On April 22 of 2016, the securities lending program began lending ETF's only. Since then, the program has been deliberately run at a low utilization rate, which has caused audit flags for diversification limits throughout April, May, and June 2016.

ERS
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

ERS INTERNAL AUDIT DIVISON

To provide independent and objective assurance on the effectiveness of controls and operations to meet ERS' strategic direction.

Status of Audit Recommendations

FROM THE DIRECTOR

JULY 7, 2016

Internal Audit (IA) has completed semi-annual procedures to monitor and report on the status of management action plans (MAPs) to address open audit recommendations as of June 30, 2016. Implementation status was based on individual MAP owner's self-assessment and IA's review of supporting documentation to corroborate self-assessment. Supporting documentation included, but was not limited to, revised documented policies/procedures, worksheets, management status reports, and reconciliations. Audit work was not performed to verify the effectiveness of management actions implemented to determine if controls were working as intended. Future audit engagements in these areas will confirm the effectiveness of the controls implemented.

Results are detailed in the subsequent pages. We will continue reporting on the status of MAP's semiannually for periods ending June 30 and December 31.

Sincerely

Anthony Chavez, CIA, CGAP, CRMA
Director, Internal Audit Division

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MAP IMPLEMENTATION STATUS

MAP implementation status is designated by the following levels:

- **Implemented** – Sufficient and appropriate evidence to support all reported management action items
- **Partially Implemented** – Management has implemented some management action items but not all to fully address reported risk
- **No Action Taken** – No management action taken and/or evidence provided to support management action
- **Management Acceptance** – Executive management has accepted the risk of not fully implementing reported management action plan.

The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

Institute of Internal Auditors standard 2500.A1

SUMMARY STATUS OF AUDIT REPORT RECOMMENDATIONS AND SUMMARY

Audit Engagement	MAP Owner	MAPs Implemented	MAPs Partially Implemented
Database Administration	Information Systems Division	1	N/A
Service Credit Purchases	Information Systems Division	1	N/A

DATABASE ADMINISTRATION —INFORMATION SYSTEMS (REPORT #2015-03)

When the chief audit executive believes that senior management has accepted a level of residual risk that may be unacceptable to the agency, the chief audit executive must discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive must report the matter to the board for resolution.

Institute of Internal Auditors standard 2600

Observation 1

Governance practices related to database administration are not formally established to ensure consistent implementation of procedures. (MEDIUM)

Recommendations

The following recommendations were noted:

- Documentation should be developed for the practices that should govern the database administration processes. The documentation should outline significant processes and controls related to the environments.
- The account access and configuration review process should continue to be performed on at least an annual basis going forward, and include all accounts on each of the databases, and documentation regarding the review and results should be maintained.
- As part of developing documentation for the environment, change management practices should be documented.

Management Action Plan Status

Status	Clarification
Implemented	A governance document for database administration has been developed and communicated to database staff. The database access process was reviewed and updates were implemented. Database and server access removals for terminated personnel will occur at the same time, after notification from Human Resources is received by IS. IS staff assigned for processing access removals have been trained on these procedures. Information security manual chapter 9.1 User Access Management" was clarified. All access to databases, and servers were audited in Shark Week (February) and is scheduled each year thereafter. The change implementation approval documentation was updated to require the Quality Control Manager and Development Manager to provide their approval via email. IS implemented a notification change release system to remedy late approvals. Tickets without full change approvals will not be implemented in the future. Vendor patch justification will be documented in the weekly Production Control & Operations and Information Security coordination.

SERVICE CREDIT PURCHASES FOLLOW-UP—INFORMATION SYSTEMS (REPORT #2015-05)

Observation 2

Reports used in annual user access review do not include all roles in which each user has access (Moderate)

Recommendations

Information systems should ensure that the report used in the annual user access review has a complete list of all roles that each user has access to, in order for Division Directors to be able to determine if access is appropriate.

Management Action Plan Status

Status	Clarification
Fully Implemented	Information Systems completed a refresh and quality review to identify all “missing” roles in February 2016. Procedures and documentation were updated to reduce the likelihood of future changes not being properly reflected in the access reviews

PUBLIC AGENDA ITEM -#2c

Presentation, Discussion and Consideration of Audit Committee Items:

2c. Internal Audit Administrative Items

August 16, 2016

BACKGROUND:

Fiscal 2017 ERS Internal Audit Plan

The Board of Trustees (Board) of the Employees Retirement System of Texas (ERS) adopted an Internal Audit Charter executed on February 23, 2016. The Charter provides that the Internal Auditor shall submit, through the ERS Executive Director, to the Board an annual Internal Audit Plan (Audit Plan) for review and approval. The *Texas Internal Auditing Act (Govt. Code 2102)* and *Standards for the Professional Practice of Internal Auditing* require the Internal Auditor to create an annual audit plan using risk assessment techniques which identifies the individual audits to be conducted during the year.

Internal Audit, through the Executive Office, submits the Internal Audit Risk Assessment and Proposed Internal Audit Plan for Fiscal Year 2017 included in the agenda item as Exhibit A. The proposed FY 2017 Audit Plan includes audit engagements of key operational and regulatory processes that were assessed lower risk ratings, but periodic review of the business function and auditable unit is deemed necessary and appropriate.

Execution of the FY 2017 Audit Plan includes the use of external audit resources through a co-source partnership with an independent CPA firm and one audit engagement scheduled to be contracted out.

Internal Audit Independence Confirmation

To formalize the independence of the internal audit activity and in accordance with the approved ERS Internal Audit Charter, the Director of the Internal Audit Division will annually confirm to the Board the organizational independence of the internal audit activity. The annual independence confirmation is included as Exhibit B.

STAFF RECOMMENDATION:

Staff recommends that the ERS Board of Trustees approve the Proposed Fiscal Year 2017 ERS Internal Audit Plan as shown in Exhibit A of this agenda item.

A proposed motion is included with this agenda item following the exhibits.

ATTACHMENTS – 2

Exhibit A – Internal Audit Risk Assessment and Proposed Internal Audit Plan for Fiscal Year 2017

Exhibit B – Internal Audit Independence Confirmation

PUBLIC AGENDA ITEM - # 3

3. Executive Session

August 16, 2016

EXECUTIVE SESSION – In accordance with Section 551.076, Texas Government Code, the Audit Committee of the Board of Trustees, a committee of the whole of the Board, will meet in executive session to deliberate: (1) the deployment, or specific occasions for implementation, of security personnel or devices; and (2) a security audit. Thereafter, the Board may consider appropriate action in open session.

PUBLIC AGENDA ITEM - # 4

4. Adjournment of the ERS Board of Trustees Audit Committee and Recess of the Board of Trustees

August 16, 2016

Following a temporary recess, the Board of Trustees will reconvene with the Investment Advisory Committee to take up the following Joint Board of Trustees and Investment Advisory Committee agenda items.

PUBLIC AGENDA ITEM - #5

5. Review and Approval of the Minutes to the May 17, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee

August 16, 2016

BACKGROUND:

Attached under separate cover, are the minutes to the May 17, 2016 Joint Meeting of the Board of Trustees (Board) and Investment Advisory Committee (IAC). These minutes are submitted to the IAC and Board for review and, if no amendments, are recommended for approval.

PROPOSED MOTIONS:

The ERS staff recommends the following motion to the **Investment Advisory Committee**:

> I move that the Investment Advisory Committee of the Employees Retirement System of Texas approve the minutes to its Joint Meeting with the Board of Trustees held on May 17, 2016.

Contingent upon adoption of the above motion by the IAC, staff recommends the following motion to the **Board of Trustees**:

> I move that the Board of Trustees of the Employees Retirement System of Texas approve the minutes to its Joint Meeting with the Investment Advisory Committee held on May 17, 2016.

ATTACHMENT – 1

Exhibit A – Minutes of the May 17, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee

Joint Meeting of the Investment Advisory Committee and Board of Trustees

ERS

Employees Retirement System of Texas

Presented for Review and Approval
August 16, 2016

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

May 17, 2016
ERS Auditorium
200 E. 18th Street
Austin, Texas 78701

<u>COMMITTEE MEMBERS PRESENT</u>
James “Jim” Hille, Chair
Robert “Bob” Alley, Member
Ken Mindell, Member
Lenore Sullivan, Member
Vernon Torgerson, Member

<u>COMMITTEE MEMBERS ABSENT</u>
Caroline Cooley, Vice-Chair
Monty Jones, Member
Laura Starks, Member

<u>TRUSTEES PRESENT</u>
I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Brian Ragland, Member
Ilesa Daniels, Member

<u>TRUSTEES MEMBERS ABSENT</u>
Cydney Donnell, Member
Frederick E. (Shad) Rowe, Jr., Member

<u>ERS STAFF PRESENT</u>
Porter Wilson, Executive Director
Tom Tull, Chief Investment Officer
Catherine Terrell, Deputy Executive Director
Sharmila Kassam, Deputy Chief Investment Officer
Paula Jones, General Counsel and Chief Compliance Officer
William Nail, Special Projects and Policy Advisor
Tony Chavez, Director of Internal Audit
DeeDee Sterns, Director of Human Resource
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits
Machelle Pharr, Chief Financial Officer
Pablo de la Sierra Perez, Investments
Leah Erard, Governmental Affairs
Robin Hardaway, Customer Benefits
Neil Henze, Investments
Andrew Hodson, Investments
Robert Lee, Investments
Jonathan Puckett, Internal Audit
Tim Reynolds, Investments
Tanna Ridgway, Investments
Leighton Shantz, Investments
Robert Sessa, Investments
John Streun, Investments

Chris Tocci, Investments
Mary Jane Wardlow, Governmental Affairs
Karla West, Investments
Keith Yawn, Office of Management Support
Betty Martin, Investments
Gabrielle Stokes, Director of Procurement and Contract Management
Brannon Andrews, Legal
Amanda Burleigh, Legal
Cheryl Scott Ryan, Legal
Wesley Gipson, Investments
Tony Cardona, Investments
Annie Xiao, Investments
Ken McDowell, Investments
Amy Cureton, Investments
Tom Roberts, Investments
Andrew Okun, Investments
Benjamin Bowman, Investments
Adam Cibik, Investments

ALSO PRESENT
Kristen Doyle, Aon Hewitt
Andrew Clark, Office of Speaker Joe Straus
Bryan Burrham, Pension Review Board
Joseph Halbok, Office of Senator Schwertner
Bobby Wilkinson, Office of the Governor
Laura Zarate, TCEQ
Dan Krivinskas, RVK
Mark Bartmann, RVK

Mr. Jim Hille, Chair of the Investment Advisory Committee (IAC) for the Employees Retirement System of Texas (ERS), called the meeting to order and read the following statement:

> “A public notice of the Joint Meeting of the Board of Trustees and Investment Advisory Committee containing all items on the proposed agenda was filed with the Office of the Secretary of State at 9:03 am on Thursday, May 5, 2016 as required by Chapter 551, Texas Government Code, referred to as ‘The Open Meetings Law.’”

IV. REVIEW AND APPROVAL OF THE MINUTES TO THE FEBRUARY 23, 2016 JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE

Ms. Lenore Sullivan introduced a revision in the minutes to the Board of Trustees (Board) and Investment Advisory Committee. The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Bob Alley, seconded by Ms. Lenore Sullivan and carried unanimously by the members present that the Investment Advisory Committee approve the amended minutes of the February 23, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The Board of Trustees then took the following action:

> **MOTION** made by Mr. Doug Danzeiser, seconded by Mr. Brian Ragland, and carried unanimously by the members present that the Board of Trustees approve the amended minutes of the February 23, 2016 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

V. REVIEW AND DISCUSSION OF THE INVESTMENT PERFORMANCE FOR FIRST CALENDAR QUARTER 2016

Ms. Sharmila Kassam, Deputy Chief Investment Officer, and Ms. Kristen Doyle, consultant from Aon Hewitt, presented the review and discussion of the investment performance for the first calendar quarter of 2016.

Ms. Kassam reminded the Board of the new performance presentation format and that staff continues to seek Board's input on their thoughts on effective reporting. Ms. Doyle began the presentation of the Fund's performance. In accordance with the contract for performance evaluation services and Section 3 of the Employees Retirement System (ERS) *Investment Policy*, Aon Hewitt (Aon) reviews and evaluates, on a quarterly basis, the ERS investment performance as calculated by ERS custodian BNY Mellon.

Ms. Doyle focused on performance at a Trust level. She mentioned that the markets have been volatile and short-term performance was difficult the past couple of quarters. Absolute returns in particular for public markets have been fairly muted.

The performance for the total fund for the calendar year to date was 0.4% compared to the benchmark of 1.5%, and the fiscal year to date total fund performance was 0.9% compared to the benchmark of 2.4%. Ms. Doyle explained that 2016 was actually the third most volatile year in markets since the 1930s. After much market volatility, global equities ended up basically flat for the first quarter of 2016, and rates continue to fall.

Ms. Doyle presented the long term public benchmarks. The Fund has outperformed the policy benchmark over the 10- and 15-year period. The comparison of other benchmarks showed the importance of diversification, especially to combat volatility, as well as the current low return environment.

During this quarter, $220 million was deducted from the Fund through net additions/withdrawals and $98.7 million in investment returns was added. The Trust started the quarter at about $24.9 billion and ended the period with a market value of $24.8 billion. The Trust underperformed by 103 basis points (bps) for the quarter, and underperformed by 81 bps for the trailing 12-month period.

Ms. Doyle discussed the performance of the asset classes. During the trailing 12-month period, there was an underperformance and negative allocation effect in global public equity. The negative allocation effect was driven by an overweight to global public equities and an underweight to U.S. Treasuries in a period of time where equities were performing poorly and U.S. Treasuries were performing well.

In terms of global public equity, domestic equity and international equity underperformed their respective benchmarks for the quarter and the one-year period. Regional equity returns were notably varied over the quarter, with U.S. equities performing better relative to other developed regions. Both the internal and external portfolios underperformed, specifically, the internal large cap core portfolio and Barrow Hanley, which is an external advisor within the domestic equity component of the portfolio. The international component underperformed as well, driven mainly by the internal portfolios, but also the external advisors. Lazard was the one manager to outperform during this period.

Ms. Doyle continued to discuss risk metrics of the Fund. The three-year tracking error increased, which shows that increase active risk has been paying off in excess returns.

Ms. Doyle concluded the presentation with market trends and next steps for portfolio management to increase returns. She recommended maintaining diversification of the asset allocation as it has been effective over the long-term and to continue to increase active risk for stronger risk-adjusted returns.

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

VI. REVIEW AND DISCUSSION OF THE FISCAL YEAR 2015 GLOBAL INVESTMENT PERFORMANCE STANDARDS COMPLIANCE PERFORMANCE REPORT

Ms. Betty Martin, Director of Investment Services, presented the review and discussion of the fiscal year 2015 Global Investment Performance Standards (GIPS). The GIPS standards are voluntary ethical standards set for the calculation and presentation of an investment firm's performance results.

These standards were advanced globally to encourage investment managers to present their performance history in a fair and comparable way. Verification assesses whether or not the firm has complied with all the composite construction requirements of the GIPS standards, and also that the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. But it is not like an audit, where they are looking at the accuracy of the numbers.

Ms. Martin presented and explained a summary report that showed the difference is custodian reports and reporting under GIPS standards. In a custodian report, net of fees is net of just the external manager fees. Under GIPS standards, net of fees includes internal costs and overhead. The difference between the numbers showed a trend of between eight and ten bps for ERS internal management costs.

Ms. Martin pointed out that the externally managed assets percentage has grown, which is a reflection primarily of the increase in the private market allocation that is considered to be externally managed.

This report is as of August 2015 due to the time required to accumulate data from the last five years. One of the requirements of the standards is the report be presented to the governing body annually. Going forward, the GIPS compliance performance report will be presented at the December meeting for the previous fiscal year end.

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

VII. REVIEW, DISCUSSION AND CONSIDERATION OF THE ERS INVESTMENT POLICY

Ms. Sharmila Kassam, Deputy Chief Investment Officer, presented the review, discussion and consideration of the ERS *Investment Policy.* The ERS *Investment Policy* is determined by the Board of Trustees (Board), and in accordance with Section 2.3 of the *Policy*, staff will recommend changes as needed to the Investment Advisory Committee (IAC) and Board.

Ms. Kassam stated the changes to the ERS *Investment Policy* were proposed to acknowledge the growth of tradeable investments. The main changes include expanding personal trading exemptions to include the trading of closed-end funds, which are regulated like mutual funds. Also, proposed changes are to exclude derivatives of closed-end funds and exchange traded funds (ETFs). Separately, direct investment plans were also proposed for exemption from personal trading preclearance guidelines.

Mr. Hille asked why closed-ended funds and ETFs should not receive preclearance. Ms. Kassam replied that like mutual funds, closed-ended funds are similarly regulated. Furthermore the broad based nature of closed-end funds and ETFs as defined in the proposed policy revision are routinely traded with high trading volumes such that staff does not believe that personal trades will have an impact. Ms. Kassam also noted that the CFA Code of Ethics requires staff to put investment decisions for the benefit of ERS as the priority over any personal trading for their own accounts. Staff also certifies on a regular basis that they attest to these requirements.

The second proposed revision was to Section 5.1B.i. Code of Ethics and Personal Investment Activities; Gifts, Benefits or Favors. This revision stated that certain books, pamphlets, articles or other such materials given to staff to be used in performing official ERS duties provided must be less than $50 in value. Ms. Kassam also noted that this is already the current practice and this is merely a clarification for the policy.

The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Vernon Torgerson, seconded by Mr. Ken Mindell and carried unanimously by the members present that the Investment Advisory Committee approve the proposed revisions to the ERS Investment Policy as presented in this agenda item.

The Board of Trustees then took the following action:

> **MOTION** made by Mr. Doug Danzeiser, seconded by Ms. Ilesa Daniels, and carried unanimously by the members present that the Board of Trustees approve the proposed revisions to the ERS Investment Policy as presented in this agenda item.

VIII. REVIEW, DISCUSSION AND CONSIDERATION OF THE FIXED INCOME PROGRAM:

a. Market Update and Program Overview - Mr. Leighton Shantz, Director of Fixed Income, Ms. Leticia Davila, Rates Portfolio Manager and Mr. Peter Ehret, Director of Internal Credit, presented the review, discussion and consideration of the Fixed Income program.

Fixed Income as an asset class is an extremely diverse group of assets, all of which have contractually fixed cash flows. The ERS' fixed income program, is comprised of two separate and distinct mandates, Rates and Credit. The Rates Portfolio is comprised primarily of securities issued by the U.S. Treasury which are currently viewed as having no credit risk.

The Credit Portfolio is comprised primarily of below investment grade bonds whose value is derived from their perceived credit worthiness and liquidity. It may also include securities issues from other government-backed agencies and some legacy transition assets. This portfolio is the primary component of the risk reducing portion of the asset allocation as well as the principal source of liquidity for the Trust. Its current AUM is $4 billion and is entirely internally managed.

Mr. Shantz introduced the Fixed Income team and new member Mr. Andrew Okun. Mr. Shantz and Mr. Ehret discussed the experience of the team and emphasized the difficulty to the Board and IAC of hiring high caliber investment professionals to the public sector.

Mr. Shantz presented the performance of the fixed income mandates. As of March 2016, the Rates portfolio has generated about 705 bps in return versus 651 bps for the benchmark. And Credit outperformed its benchmark with a performance of 749 bps versus 586 bps. Mr. Shantz further discussed the performance of the Rates portfolio. It is not a return-seeking mandate, but rather is utilized to provide liquidity for the Trust.

The internally managed portfolio has a 50 bps tracking error budget and has produced a rolling average 1-year return 12 bps greater than the benchmark (2.36% vs. 2.14%). To date its highest 1-year return was 24 bps greater than the benchmark's highest (3.63% vs. 3.39%) and 15 bps higher for its lowest 1-year period (1.25% vs. 1.10%). Effectively, higher average, higher highs, and higher lows. As of the end of March, its year-to-date performance was 228 bps compared to the benchmark of 224 bps.

Rates excess return decline is partially the result of relatively lower returns in government agency mortgage backed securities (MBS) than Treasuries during January 2016. MBS are pools of home mortgages guaranteed by government sponsored entities. In that month underlying interest rates fell dramatically, creating strong performance in U.S. Treasuries and relatively lower performance in MBS. Staff believed this made MBS relatively attractive and expects them to more than regain the performance differential via additional yield and price moves. MBS generally out-perform in flat or modestly rising interest rates environments, and under-perform in strongly declining ones like January. Subsequently the portfolio is up an additional 54 bps, and has been outperforming on a cumulative basis. ERS had approximately 15% of the Rates portfolio invested in government agency MBS as of the end of March 2016.

Mr. Shantz presented a chart that showed the performance for the two fixed income mandates to emphasize how Rates and Credit are each unique asset classes, even though they both are fixed income portfolios. Rates' 1-year returns have had an approximate 200 bps range, whereas credit has a range of approximately 2,000 bps.

Mr. Hester inquired about the amount of risk in investing in credit in a down market cycle. Mr. Shantz replied that staff believes it is late in the cycle, but the team considered the current spreads attractive relative to the risks. Mr. Ehret concurred and stated that the team is cautious about the risks they take late in this market cycle.

Mr. Shantz discussed the external Credit mandates. The external mandates make up 15% of the Credit portfolio and equal to approximately $250 million. All four of the current external strategies are limited partnership structures: two are private equity type draw structures with finite investment periods (one already completed), one is a collateralized loan obligation (CLO) based strategy, and one is a long/short special situations strategy. The last two each have an evergreen investment period.

Overall, the Credit portfolio is currently $1.7 billion, or 7% of total assets, scheduled to grow to 10% of the Trust over the next 18 months. It holds 63% of its assets, equal to $1.1 billion, in the internally managed high yield portfolio (IHY), another 22%, equal to $380 million, in credit-based Exchange Traded Products (ETPs), and the remaining 15%, the aforementioned external mandate.

The credit benchmark in March returned 4.44% and the external investments returned approximately -2.5% in February which the Agency recognized in March, creating a -700 bps relative performance deficit for them. That equates to approximately -105 bps of total credit under-performance for the month. Since inception, however, the Credit portfolio has produced 7.48% of total return compared to 5.86% for its benchmark.

The IHY portfolio, as noted earlier, is 63% of Credit's assets, and it continues to perform well. Its total return for the fiscal year through March was 0.00% vs. the benchmark's -1.37%. Over the last 12 months, IHY lost -1.04% while the benchmark fell -3.49%. From inception IHY has produced 13.90% of return compared to 5.86% for the benchmark.

Relative performance for both Rates and Credit has been positive for the past two years. Staff believes it will be able to continue to outperform its benchmarks over the long term.

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

b. Review of Securities Lending Program - Mr. Leighton Shantz, Director of Fixed Income, presented the review of the securities lending program.

In accordance with the ERS *Investment Policy*, Section 4.15, and Texas Government Code §815.303, on February 22, 2011, the Board of Trustees authorized staff to negotiate a contract with Deutsche Bank AG (DB) to act as its securities lending agent. ERS hired DB to implement an intrinsic value program that employs a strategy focused on lending only highly sought-after securities to a diversified group of borrowers. The resulting contract took effect on September 1, 2011 and DB initiated activity for ERS as an actively managed third-party lending-agent separate from ERS' custodian bank on September 6, 2011.

Mr. Shantz explained the suspension of the securities lending program in 2016 due to the market placing an increased risk of default of its lending agent. Early this year the team noticed that their CDS spread and implied default rate of its agent was rising quickly. Staff, in consultation with the Executive Director, believed revenues from the program were no longer sufficient for the risks implied by DB's credit spread level. ERS decided to enact contingency plans to reduce risks. Staff reduced the risk until late

April when the securities lending agent's CDS spread stabilized around 150 basis points, or about a 3% one-year implied default rate.

Mr. Shantz presented the credit default swap spread of ERS' securities lending agent from implementation to suspension of the program. He discussed the double indemnification obligation of the agent, which protects ERS against losses by both the counterparties that borrow from them as well as collateral investments. As a consequence of that double indemnification, the Trust's counterparty risk for lending narrows down to just its securities lending agent. Staff at no time, felt the counterparty was going to have immediate default issues.

Mr. Hester asked if a new lending vendor was needed. Mr. Shantz replied he did not believe so; and the decision to suspend activity was a result of the program revenue not being worth the risk at the time.

Mr. Shantz continued that the consequence to suspending the program is the decline in monthly revenue. ERS currently had $350 million in ETFs on loan and continues to monitor its agents' spreads. Staff intends to re-implement the program when it believes it is appropriate to do so.

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

IX. REVIEW, DISCUSSION AND CONSIDERATION OF THE REAL ESTATE PROGRAM

a. Market Update and Program Overview - Mr. Bob Sessa, Director of Real Estate, Ms. Amy Cureton, Real Estate Portfolio Manager, and Tony Cardona, Real Estate Analyst, and Mr. Dan Krivinskas, consultant at RVK, presented the market update and program overview.

Mr. Sessa gave an overview of the real estate portfolio. At the August 19, 2008 Joint Meeting of the Employees Retirement System of Texas Board of Trustees and the Investment Advisory Committee , an asset allocation was adopted that included investing 8% of the Trust's assets in real estate. At that time, approximately 2% of the Trust's assets were invested in real estate listed securities (Real Estate Investment Trusts or "REITs" and/or Real Estate Operating Companies or "REOCs") which were part of the public equity portfolio. With the approval of the asset allocation, Real Estate was deemed its own asset class. Consequently, the real estate listed securities portfolio was moved to the real estate asset class.

Subsequently, at the February 26, 2013 Joint Meeting of the Board and IAC, the Board approved an increase the real estate allocation from 8% to 10% of the Trust's assets.

As of March 31, 2016, the total portfolio was valued at $2.6 billion, or 10.4% of the Trust's assets compared to a target weight of 10%. Due to the illiquid nature of the investments along with the factors outside of staff's control which are mentioned above, the private real estate weighting will vary from quarter to quarter and year to year. As the private real estate portfolio is at its "steady state", it should be emphasized that maintaining a precise constant weight for private real estate is extremely challenging.

Mr. Sessa concluded this portion by introducing the real estate team. He discussed the importance of the legal team in closing deals and negotiating fees. He also noted the importance of the day-to-day functions of the investments operations team and investments administrative team.

Mr. Tony Cardona detailed the REIT Portfolio. The overall portfolio is comprised of two sub-portfolios: domestic and international. Risk controls include a tracking error limit of 300 bps to the FTSE EPRA/NAREIT Global Index. The real estate portfolio is comprised of publicly traded real estate securities (REITs/REOCs) and private real estate investments. Investments in REITs are approximately $730 million. 54% of the portfolio are U.S. REIT and the remaining 46% are in the international REIT portfolio. He described the international exposure to real estate as a percentage of the total portfolio, with Asia comprising 25% of the portfolio, Continental Europe at 12%, the UK at 5% and other at 4%.

Due to the build out of the private real estate program, the risk in the internal portfolio had been reduced. Historically, the global composite portfolio averaged over 150 bps of tracking error. A majority of the tracking error was taken in the domestic portfolio. The last several years, the global composite portfolio was tracking around 30 to 40 bps, but currently stands at close to 130 bps.

He also discussed the performance of the domestic portfolio. The performance has done well, especially due to stock selection in the domestic portfolio. One change pertains to Wells Street, a long/short hedge fund focused on global real estate securities. Unfortunately, the manager did not perform as expected and the strategy was defunded in two tranches with the last funds redeemed in early March 2016.

Mr. Cardona also presented for context the global adoption of the REIT structure. Most recently in 2015, Iran, Saudi Arabia and Vietnam have adopted this structure. The structure assists in transparency for international real estate investing and also sets a standard and reduces risk.

Mr. Sessa provided details about the private real estate portfolio. As of March 31, 2016, the net asset value of the private real estate program was $1.9 billion representing 45 investments, $2.9 billion worth of commitments and $770 million in uncalled commitments. Through March 31, 2016, commitments made for fiscal year 2016 stand at eight investments totaling $191 million. Capital called for the fiscal year through March 31 totals $325 million with distributions of close to $215 million. As has been discussed by staff in the past, liquidity in the portfolio is actively monitored.

The private real estate portfolio's net internal rate of return (IRR) was 12.74% since inception through March 31, 2016. This is unusual as typically a new portfolio will experience negative returns in the first few years due to the J-Curve effect. 85% of the portfolio is in equity type investments and 15% is in debt investment.

ERS has very little committed capital left to invest in the core space with the majority of future dollars invested devoted to the non-core strategies of value added and opportunistic. As a percent, core represents only 3% of total unfunded capital.

Mr. Mindell asked how the real estate staff decided the core/non-core allocation. Mr. Sessa replied that it is based on the ERS Investment Policy. Mr. Sessa also explained that there has been a decrease in attractive core opportunities so staff has decided to seek investments in niche strategies and non-core investments. As will be explained further in the tactical plan, which is a separate agenda item, RVK and ERS staff proposes no hard commitments for fiscal year 2017, but with the potential to commit up to $250 million.

Ms. Cureton began her portion of the presentation. She discussed metrics of the private real estate portfolio. She presented the total portfolio by risk and return, which is 32% core and 68% non-core. The portfolio was also detailed by region. The portfolio is 80% U.S. exposure and 20% international exposure. The current portfolio is overweight industrial, multifamily and hotels while underweight office and retail. The industrial overweight is a tactical decision to invest in a property type with secular drivers at an attractive entry point. The overweight will naturally diminish as future commitments are made to other property types and as the industrial investments are liquidated.

Ms. Cureton discussed amenity metric tracking. There has been a change in what certain tenants look for in the market. Leadership in Energy and Environmental Design (LEED) indicated sustainability features and considers improving operating cost through energy saving methods. 40% of the portfolio report LEED and 12% are LEED certified. Another metric is Walk score which indicates the walkability and convenience in the area to retail spaces. 45% of the portfolio scored above a 70 and 32% scored the highest score. Ms. Cureton further discussed that staff is not tracking these metrics for certain targets; however, this data is helpful in underwriting investments.

Mr. Sessa concluded the presentation with accomplishments of the real estate program. The real estate team, along with the ERS legal staff, negotiated an estimated $45 million in savings for the private real estate portfolio since inception and also improved terms regarding corporate governance. The team invested in two co-investments and closed on a co-investment separate account. In 2016, ERS successfully co-hosted the 3rd Bi-Annual Real Estate Emerging Manager (REEM) conference.

Additionally, Mr. Cardona and Ms. Annie Xiao assisted in increasing the tracking error for the domestic and international real estate portfolios, which resulted in increased relative performance.

Mr. Krinvinkas and Mr. Mark Bartmann presented an overview of the Real Estate Market and discussed domestic and international growth and trends.

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

b. Proposed Private Real Estate Annual Tactical Plan for Fiscal Year 2017- Mr. Robert Sessa, Director of Real Estate, and Adam Cibik, Real Estate Portfolio Manager, and Mr. Dan Krivinskas, Director of Real Estate, Principal, RVK presented the Private Real Estate Annual Tactical Plan for fiscal year 2017.

Mr. Sessa gave a further overview of the real estate portfolio. The proposed Plan will be incorporated into the ERS *Investment Policy* as Appendix A of Addendum II: ERS Private Real Estate Policies and Procedures. The tactical plan is meant as a guideline and does not overrule prudent real estate investment decision-making.

As of March 31, 2016, the current private real estate portfolio stands at 7.5% of the overall System's assets with an allocation target of 7% yet within an acceptable policy range. Currently, the value of the private portion of the Real Estate Portfolio is approximately $1.9 billion. Staff will continue committing capital to private real estate on a selective basis, but currently targets $0 to $250 million in commitments for fiscal year 2017.

Mr. Cibik discussed the tactical plan. He explained how the team strategically allocates assets based upon opportunities in core and non-core. For fiscal year 2017, ERS Real Estate staff and RVK believe that opportunities to target non-core real estate will be the most attractive area to focus on similar to the strategy for the current fiscal year.

Mr. Cibik discussed strategy and possible opportunities for fiscal year 2017. Staff is interested in special deals with a small group of like-minded investors, where these investors can really promote better governance and be impactful on key decisions. Niche-type funds such as medical office, self-storage and manufactured housing are also areas of interest to staff. Staff is still looking at co-investments and separate accounts. Additionally, select international investments may be vetted in fiscal year 2017.

The Investment Advisory Committee then took the following action:

> **MOTION** made by Mr. Bob Alley, seconded by Ms. Lenore Sullivan and carried unanimously by the members present that the Investment Advisory Committee approve the proposed ERS Private Real Estate Portfolio Annual Tactical Plan for Fiscal year 2017, as presented in Exhibit A.

The Board of Trustees then took the following action:

> **MOTION** made by Mr. Brian Ragland, seconded by Mr. Doug Danzeiser, and carried unanimously by the members present that the Board of Trustees approve the proposed ERS Private Real Estate Portfolio Annual Tactical Plan for Fiscal year 2017, as presented in Exhibit A.

X. RECOGNITION OF INVESTMENT ADVISORY COMMITTEE MEMBERS

Mr. Tom Tull, Chief Investment Officer, presented the recognition of Investment Advisory Committee (IAC) members.

Mr. Tull explained the background and purpose of the IAC. The IAC was established in Texas Administrative Code §63.17(b) at the discretion of the Board of Trustees (Board) and is composed of at least five and not more than nine members. The members are selected on the basis of experience in the management of a financial institution or other business in which investment decisions are made or as a prominent educator in the fields of economics, finance or other investment-related area. The IAC members serve at the pleasure of the Board.

The IAC reviews investment strategies and related policies of ERS to provide comments and recommendations to assist the Board in adopting prudent and appropriate investment policies. The IAC assists the Board in carrying out its fiduciary duties with regard to the investment of the assets of the system and related duties.

Mr. Tull discussed investment milestones attributed to the guidance of the IAC. The IAC was instrumental in adding additional asset classes and creating additional diversity in the Trust asset allocation. The IAC also contributed and encouraged an increase in internal management to approximately 60%, which resulted in decreases in management fees with internal assets currently being managed at less than ten basis points, a fraction of the cost of externally managed funds. These industry leaders, in addition to attending quarterly Board Meetings, are in regular communication with the CIO and ERS staff to provide their expertise and assistance to ERS.

Mr. Tull presented the tenure of the IAC members, which shows their commitment and loyalty to ERS. Special recognition was given to members Mr. Vernon Torgerson appointed in 1984, and Ms. Laura Stark appointed in 1990, for serving ERS for over 30 years and 25 years, respectively.

Mr. Hester also thanked the IAC for their commitment to ERS and its beneficiaries.

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

XI. ADJOURNMENT OF THE JOINT MEETING OF THE BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE AND RECESS OF THE BOARD OF TRUSTEES

The May 17, 2016 Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee adjourned at 10:49 pm CT.

PUBLIC AGENDA ITEM - #6*

6.* Review and Discussion of the Investment Performance for the Second Calendar Quarter

August 16, 2016

BACKGROUND:

In accordance with the contract for performance evaluation services and Section 3 of the Employees Retirement System (ERS) *Investment Policy*, Aon Hewitt (Aon) reviews and evaluates, on a quarterly basis, the Employees Retirement System of Texas (ERS) investment performance as calculated by ERS custodian BNY Mellon.

***Summary of Investment Markets*:**

Global equities provided positive returns over the quarter, but there was a notable degree of regional disparity - Though the Reserve Bank of Australia (RBA) was the only major central bank to reduce interest rates over the second quarter of 2016, interest rate hike expectations fell elsewhere. Later in the quarter, focus shifted to the UK's referendum decision to leave the European Union, which met markets with mixed reactions. The MSCI All Country World IMI returned 1.1%. U.S. equities (S&P 1500) returned 2.6% over the quarter. Canada (3.4%) was the strongest performer as commodity prices generally rose. Europe ex-UK (-3.7%) was the weakest performing region as the weakening euro significantly dragged on returns. The UK (-2.1%) also returned negatively in dollar terms as sterling fell sharply on the back of the vote to leave the EU. Japanese equities fell sharply in local currency terms as a continuation of yen strength worsened the outlook for exporters. Emerging Market equities provided a modest 0.6% return in USD terms. 12 month global equity returns (MSCI ACW IMI) were -3.5% and U.S. equities (S&P 1500) returned 3.6% over the 12 months ending June 30, 2016.

The U.S. economy failed to build any substantial economic momentum - U.S. economic growth continued to slow, with first quarter growth of 1.1% (quarter-on-quarter annualized). However, this further slowing was widely anticipated by markets. In contrast, the manufacturing ISM, a widely followed indicator of economic activity, recovered to the crucial level of 50, above which indicates the sector is growing. CPI inflation remained fairly steady, with headline inflation picking up slightly as the impact of the commodity price fall continued to diminish, but core inflation was largely unchanged just above 2%.

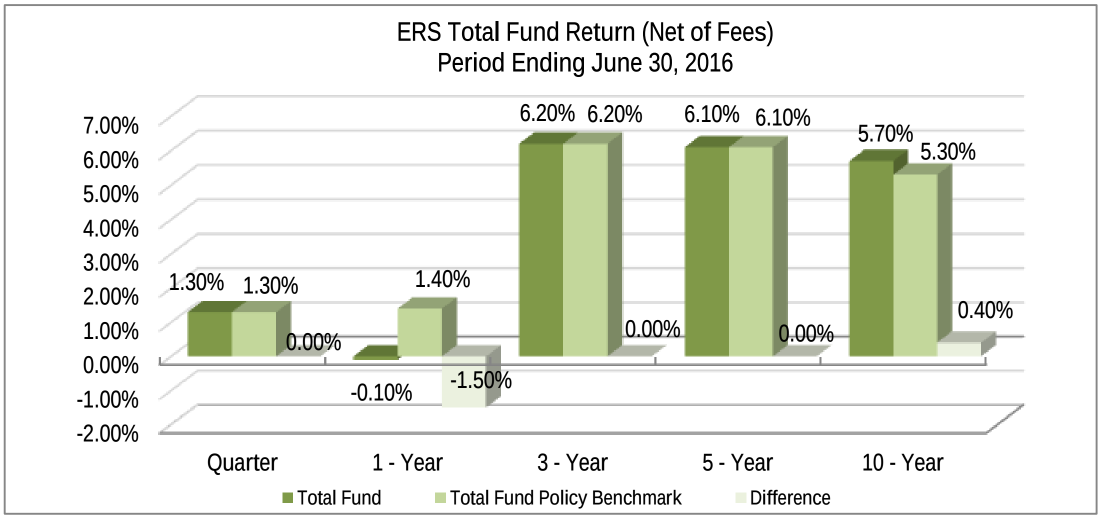
Federal Reserve interest rate hike expectations get pushed back - In the second quarter, the Fed maintained the target for the Federal Funds rate at 0.25-0.5%, in line with market expectations. However, Fed chair Janet Yellen indicated in June that investors should not be expecting the next hike in short-term rates until the outlook for the US economy looks to be on surer footing. Given the risks that Brexit presents to the global economy, the Fed looks very unlikely to raise interest rates again this year.

Brexit is a risk for European economic growth, and the ECB will likely continue to support economic growth with easy monetary policy - Eurozone GDP growth reached its highest quarterly rate in a year, resulting in a year-on-year growth rate of 1.7%. Germany and Spain continued to perform well, while Hungary and Greece saw contractions in quarterly economic growth. The overall Eurozone unemployment rate fell to a new five-year low, but remains above 10%. However, the UK's referendum decision to leave the European Union presents new challenges to Continental European economies, as the UK is a large net consumer of EU produced goods. The European Central Bank sounded cautiously optimistic when referring to the economic outlook in the Eurozone, but also emphasized the Bank's willingness to act in terms of more accommodative monetary policy, should inflation keep struggling to gain momentum. However, uncertainty created by Brexit has increased the likelihood of an accommodative shift in monetary policy by the ECB. Meanwhile, the European political landscape has the potential to become more fragmented as anti-immigration parties have been given a fresh dose of support following the UK's vote to leave the EU.

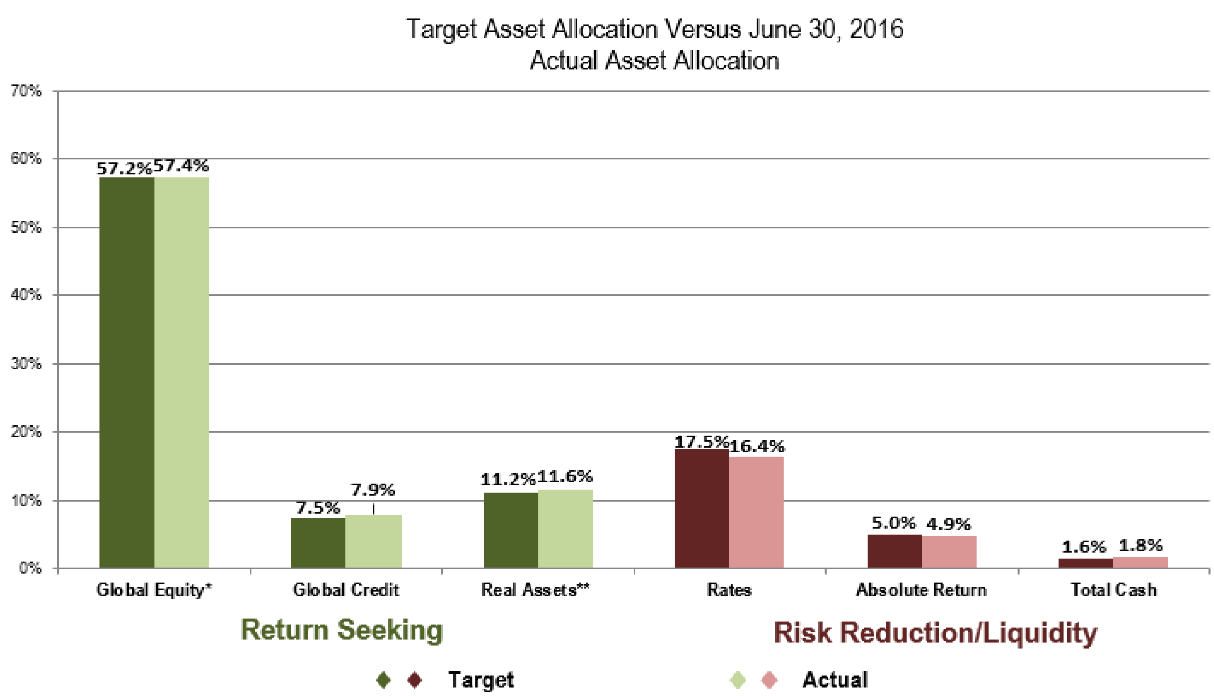
** We are accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. This agenda item may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees.*

Yields hit historic lows - 10 year U.S. treasury yields fell over the second quarter by 29bps to 1.49%, near an all-time low as confirmation of the UK's referendum decision to leave the EU forced investors into safe haven assets. The Barclays Long Government index returned 6.4%, while the Barclays Intermediate Treasury Index returned 1.3%. In the corporate sector, high yield outperformed credit on a global basis, returning 5.5% (Barclays High Yield Index), versus 3.5% for investment grade credit (Barclays Credit Index).

***Summary of ERS Performance*:**



ERS continues to work toward its strategic and long-term allocation targets as reflected in the following chart.



*Includes Domestic and International Equity, along with Global Equity Tactical, Directional Growth Portfolio, Global Public Special Situations, and Private Equity
**Includes Public Real Estate, Private Real Estate, and Infrastructure

STAFF RECOMMENDATION:

This agenda item is provided for informational and discussion purposes only. No action is required.

ATTACHMENT – 1

Exhibit A – Employees Retirement System of Texas Performance Report, Second Calendar Quarter Ending June 30, 2016 by Hewitt EnnisKnupp *(Included under separate cover)*

Employees Retirement System of Texas | Second Quarter 2016

Quarterly Investment Review

Visit the Aon Hewitt Retirement and Investment Blog *(http://retirementandinvestmentblog.aon.com); sharing our best thinking.*

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Empower Results®

Total Fund

Being Comfortable with Being Uncomfortable

To clients of Aon Hewitt Investment Consulting:

When buying furniture, the best decision is often to buy what is most comfortable. In investing, the best decision is often the most uncomfortable. For example, it may be comfortable to increase allocations to the asset classes and investment managers that have done well over recent history, but the best decision might be to buy low—increasing allocations to strategies that have done poorly and are now cheap, and primed to perform well. Contrarian investing is an approach touted by many in theory, but utilized by few because it can feel so uncomfortable. There are ways to create an environment in which this type of behavior is more comfortable. For example:

- Review rebalancing procedures and consider forward-looking Medium-Term Views on asset allocation, in comparison to your own portfolio positions, to motivate rebalancing (and possibly even overweighting) positions that have recently performed poorly.
- Reorient methods for monitoring and evaluating investment managers (such as watch lists) to emphasize longer term measures of performance, in order to become less susceptible to terminating managers due to short-term performance,
- Consider dynamic investment policies that automatically reduce risk as the portfolio performs well, a natural buy-low, sell-high behavior.

Creating decision-making structures to give a nudge in the right direction is one key to success. The way to be comfortable with being uncomfortable may be to create an environment in which the decisions that used to be overly comfortable, no longer are. Successful investing isn't easy, and recognizing behavioral tendencies can help investors.

Aon Hewitt Investment Consulting

Market Highlights

Global equities provided positive returns over the quarter, but there was a notable degree of regional disparity

Though the Reserve Bank of Australia (RBA) was the only major central bank to reduce interest rates over the second quarter of 2016, interest rate hike expectations fell elsewhere. Later in the quarter, focus shifted to the UK's referendum decision to leave the European Union, which met markets with mixed reactions. The MSCI All Country World IMI returned 1.1%. U.S. equities (S&P 1500) returned 2.6% over the quarter. Canada (3.4%) was the strongest performer as commodity prices generally rose. Europe ex-UK (-3.7%) was the weakest performing region as the weakening euro significantly dragged on returns. The UK (-2.1%) also returned negatively in dollar terms as sterling fell sharply on the back of the vote to leave the EU. Japanese equities fell sharply in local currency terms as a continuation of yen strength worsened the outlook for exporters. Emerging Market equities provided a modest 0.6% return in USD terms. 12 month global equity returns (MSCI ACW IMI) were -3.5% and U.S. equities (S&P 1500) returned 3.6% over the 12 months ending June 30, 2016.

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The European Central Bank sounded cautiously optimistic when referring to the economic outlook in the Eurozone, but also emphasized the Bank's willingness to act in terms of more accommodative monetary policy, should inflation keep struggling to gain momentum. However, uncertainty created by Brexit has increased the likelihood of an accommodative shift in monetary policy by the ECB. Meanwhile, the European political landscape has the potential to become more fragmented as anti-immigration parties have been given a fresh dose of support following the UK's vote to leave the EU.

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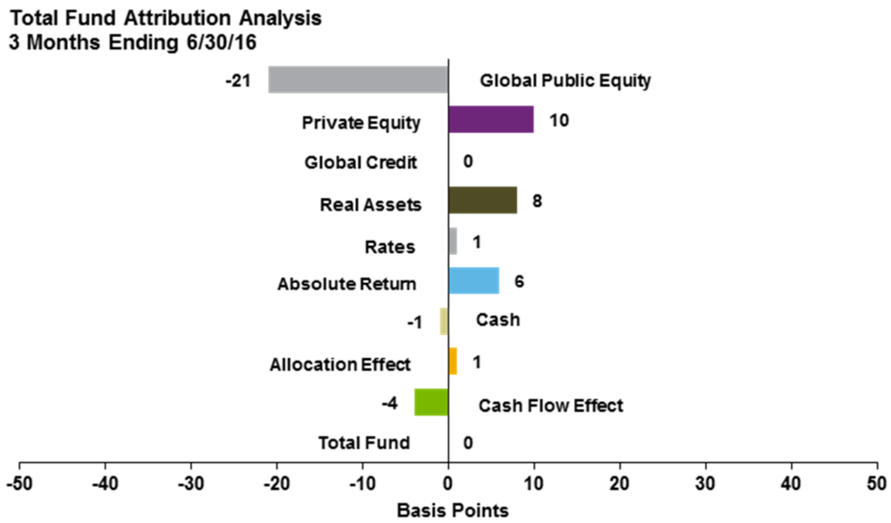
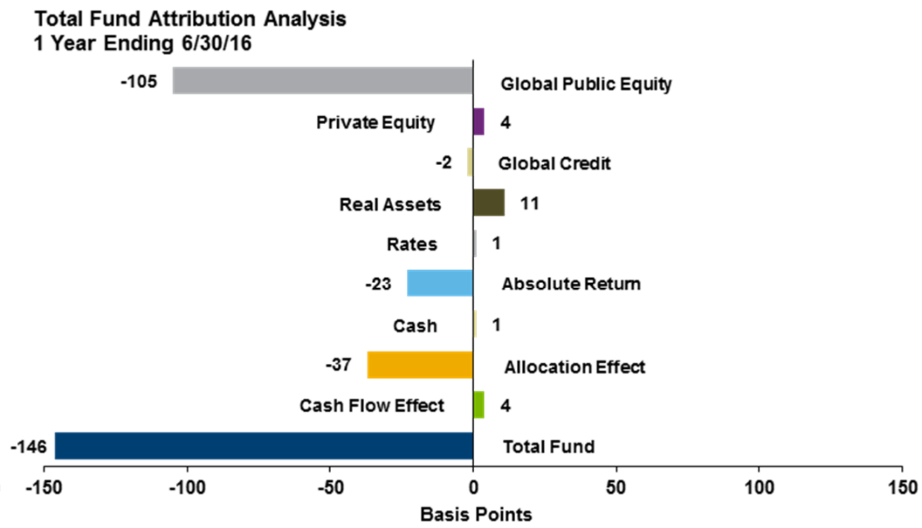
Attribution





Plan Performance

The attribution graphs above illustrate the Fund's performance by asset class during the quarter and one-year periods. The "Asset Class Effects" (Global Public Equity, Private Equity, Global Credit, Real Assets, Rates, Absolute Return, and Cash) are based on the weight of each asset class multiplied by the amount of its outperformance (or underperformance).

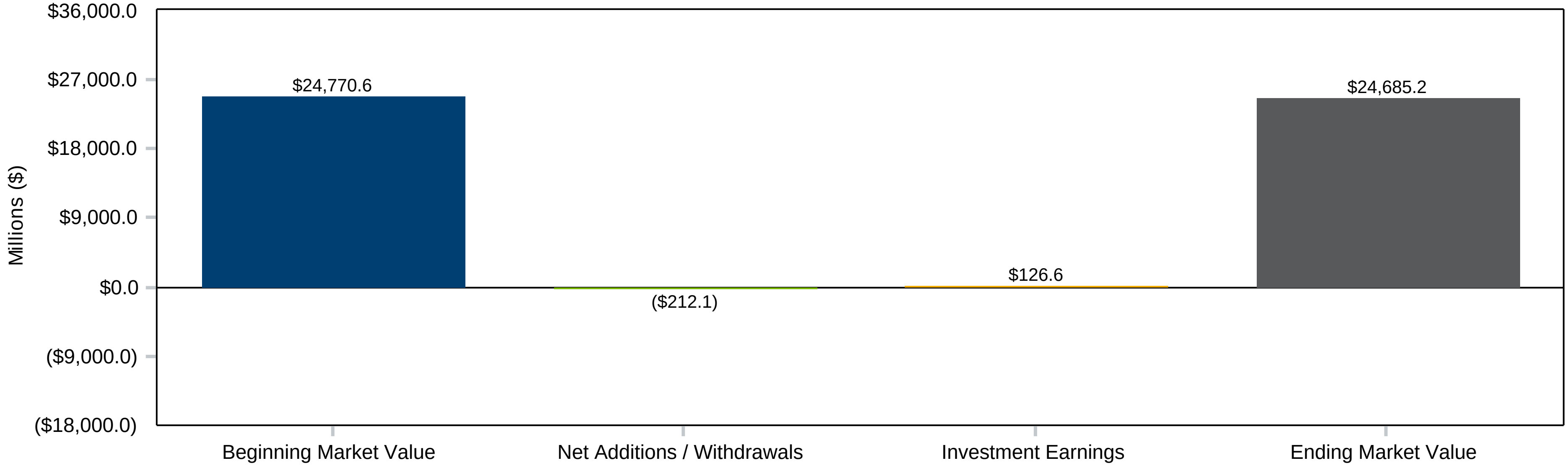
The bar labeled "Allocation Effect" represents the impact of actual allocation deviations from the policy targets on the Total Fund's relative performance.

The bar labeled "Cash Flow Effect" illustrates the effects on the Fund's performance from the timing of cash contributions, withdrawals, and asset movements between accounts. Performance for the remainder of a month following a contribution will be magnified to reflect a larger allocation. The opposite is true for withdrawals, as performance will be diminished with a reduced allocation.

During the second quarter, the Total Fund performed in line with the Total Fund Policy Benchmark. For the quarter, the private equity, real assets, rates, and absolute return components contributed positive relative value. The public equity component detracted from relative performance during the period. The Total Fund underperformed the Total Fund Policy Benchmark by 146 basis points over the previous 1-year period.

Total Plan Asset Summary

Change in Market Value
From April 1, 2016 to June 30, 2016

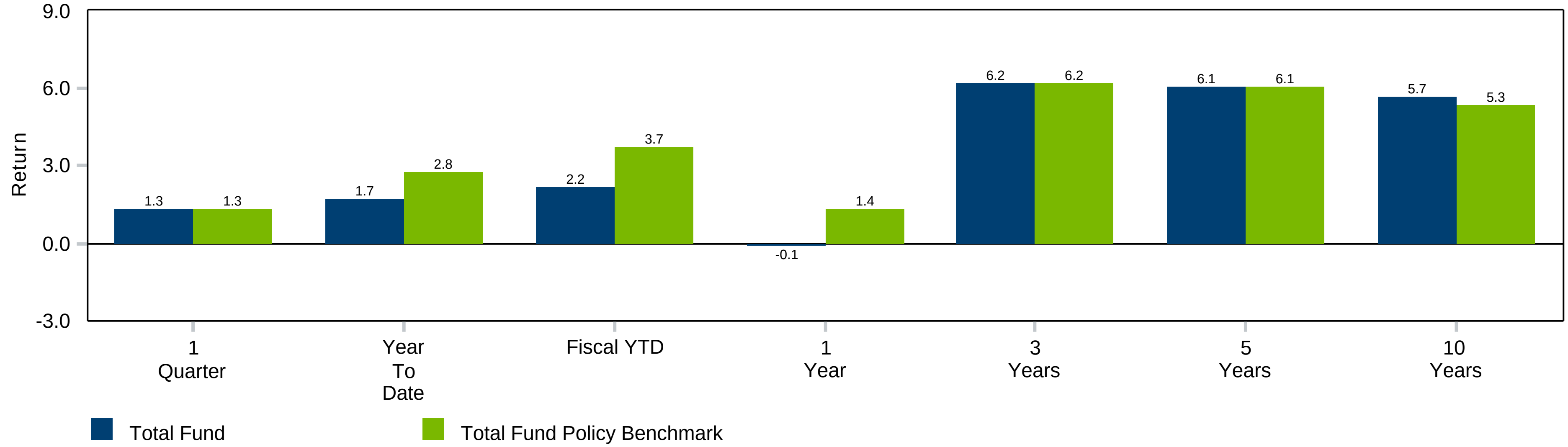


Summary of Cash Flow

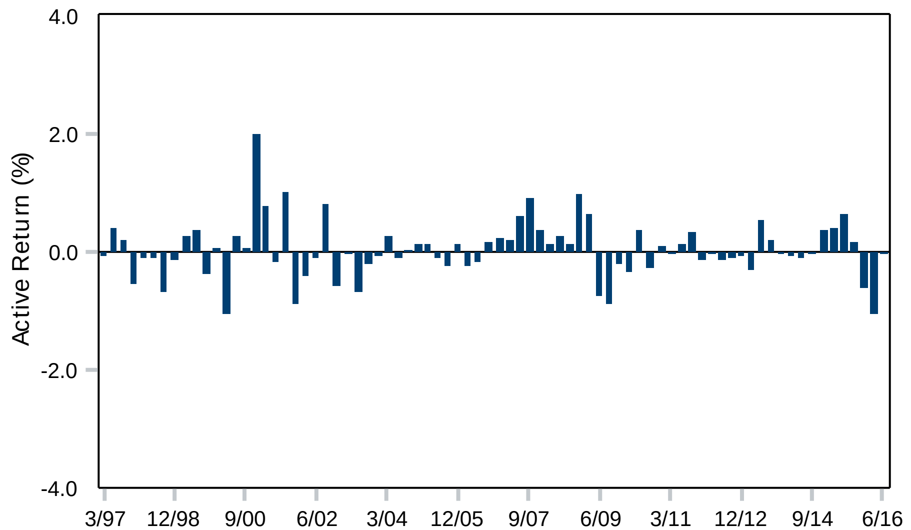
	1 Quarter	Fiscal YTD	1 Year
Total Fund			
Beginning Market Value	24,770,637,779	25,177,941,024	25,896,309,479
+ Additions / Withdrawals	-212,054,065	-755,883,016	-967,802,640
+ Investment Earnings	126,620,704	263,146,411	-243,302,421
= Ending Market Value	24,685,204,418	24,685,204,418	24,685,204,418

Total Plan Performance Summary

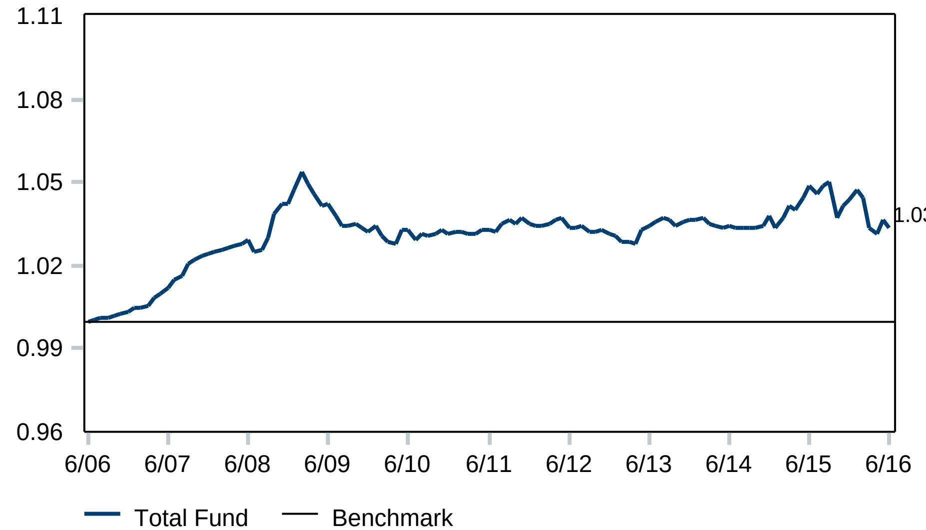
Return Summary



Quarterly Excess Performance



Ratio of Cumulative Wealth - 10 Years



As of June 30, 2016

Asset Allocation & Performance

	Allocation		Performance(%)						
	Market Value ($)	%	1 Quarter	Year To Date	Fiscal YTD	1 Year	3 Years	5 Years	10 Years
Total Fund	24,685,204,418	100.0	1.3	1.7	2.2	-0.1	6.2	6.1	5.7
Total Fund Policy Benchmark			1.3	2.8	3.7	1.4	6.2	6.1	5.3
Return Seeking	18,989,558,012	76.9	1.3	1.4	2.0	-1.1	7.1	-	-
Global Public Equity	11,512,612,259	46.6	0.7	-0.4	0.1	-5.6	-	-	-
Global Public Equity Benchmark			1.1	1.5	2.7	-3.5	-	-	-
Domestic Equity	5,451,626,747	22.1	2.4	2.3	4.4	-0.1	10.6	11.2	7.1
Domestic Equity Benchmark			2.6	4.2	8.2	3.6	11.5	11.9	7.5
ERS S&P 500 Index Fund	1,061,081,420	4.3	2.4	3.7	8.2	3.8	11.6	12.1	7.5
S&P 500 Index			2.5	3.8	8.4	4.0	11.7	12.1	7.4
ERS Large Cap Core	2,282,089,516	9.2	2.1	1.1	3.5	-0.8	10.5	11.4	7.5
S&P 500 Index			2.5	3.8	8.4	4.0	11.7	12.1	7.4
Large Cap Growth Quant	291,411,413	1.2	1.9	2.0	6.9	4.3	14.1	-	-
S&P 500 Growth			1.0	1.5	7.1	4.2	13.4	-	-
Barrow Hanley Mewhinney & Strauss	657,019,748	2.7	3.2	1.8	3.2	-2.2	9.2	10.4	-
S&P 500 Value			4.0	6.2	9.5	3.4	9.7	11.2	-
ERS Mid Cap Core	693,092,576	2.8	3.1	5.3	3.2	-2.4	9.7	10.0	-
S&P MidCap 400			4.0	7.9	7.2	1.3	10.5	10.5	-
ERS Small Cap Core	369,697,005	1.5	3.5	2.8	2.5	-2.0	9.9	10.5	7.9
S&P SmallCap 600			3.5	6.2	6.3	0.0	10.2	11.2	7.9
Emerging Manager Composite	91,197,569	0.4	1.5	0.4	2.3	-2.7	8.9	10.1	-
S&P Composite 1500			2.6	4.2	8.2	3.6	11.5	11.9	-
Domestic Risk Management	6,037,500	0.0							
International Equity	4,899,292,525	19.8	-1.6	-3.2	-4.3	-11.4	1.0	0.5	1.9
International Equity Benchmark			-0.6	-1.0	-2.5	-10.2	1.2	0.1	1.3
ERS International EAFE Composite	2,187,993,988	8.9	-1.9	-5.3	-5.7	-10.8	1.7	1.9	2.2
MSCI EAFE Index (Net)			-1.5	-4.4	-5.0	-10.2	2.1	1.7	1.6
ERS Canada	272,881,044	1.1	3.7	15.5	4.6	-5.5	1.0	-1.8	-
MSCI Canada (Net)			3.4	15.1	4.0	-6.3	0.1	-2.8	-
Fisher Investments	541,781,201	2.2	-2.0	-4.0	-3.1	-10.9	2.1	0.7	3.0
Fisher Performance Benchmark			-0.6	-1.0	-2.5	-10.2	1.2	0.1	1.4

Asset Allocation & Performance

	Allocation		Performance(%)						
	Market Value ($)	%	1 Quarter	Year To Date	Fiscal YTD	1 Year	3 Years	5 Years	10 Years
Templeton	689,559,102	2.8	-3.5	-6.0	-8.1	-13.6	0.9	1.3	2.3
Templeton Performance Benchmark			-0.6	-1.0	-2.5	-10.2	1.2	0.1	1.4
Lazard Asset Management	386,542,390	1.6	-2.0	-2.4	-3.1	-9.0	4.2	-	-
MSCI EAFE Index (Net)			-1.5	-4.4	-5.0	-10.2	2.1	-	-
Blackrock International Focus	359,009,933	1.5	-2.4	-6.1	-7.5	-12.0	-	-	-
MSCI AC World ex USA Index (Net)			-0.6	-1.0	-2.5	-10.2	-	-	-
ERS Emerging Markets	676,165,475	2.7	2.1	4.4	3.3	-10.8	-0.7	-3.2	-
MSCI EM (Net)			0.7	6.4	3.9	-12.1	-1.6	-3.8	-
JP Morgan Emerging Markets	1,816	0.0							
International Risk Management	-214,642,423	-0.9							
Global Public Equity Special Situations	677,380,733	2.7	2.2	3.9	5.6	0.1	-	-	-
Directional Growth Portfolio	314,612,015	1.3	9.5	0.0	-0.3	0.7	-	-	-
Global Equity Tactical	169,700,238	0.7	-5.5	-11.8	-12.6	-18.3	-	-	-
Private Equity	2,551,794,694	10.3	2.2	3.5	3.9	8.3	12.9	11.2	-
Total Global Credit	1,956,372,761	7.9	5.4	7.2	3.3	1.5	-	-	-
Barclays U.S. High Yield 2% Issuer Cap			5.5	9.1	4.1	1.7	-	-	-
ETF Fixed Income Emerging Markets	32,742,410	0.1	5.6	11.1	12.5	12.7	9.1	-	-
ETF Fixed Income EM Performance Benchmark			5.5	9.1	4.1	1.7	3.5	-	-
ETF Fixed Income High Yield	369,037,455	1.5	5.2	7.9	3.5	1.7	4.0	-	-
Barclays U.S. High Yield 2% Issuer Cap			5.5	9.1	4.1	1.7	4.2	-	-
ERS Internal High Yield	1,234,423,463	5.0	4.9	8.2	4.9	2.9	-	-	-
Barclays U.S. High Yield 2% Issuer Cap			5.5	9.1	4.1	1.7	-	-	-
Private Credit	312,216,726	1.3	8.3	1.8	-4.0	-5.6	-	-	-
Barclays U.S. High Yield 2% Issuer Cap (1 month lag)			9.2	5.3	1.3	-0.8	-	-	-
High Yield Risk Management	7,952,707	0.0							

As of June 30, 2016

Asset Allocation & Performance

	Allocation		Performance(%)						
	Market Value ($)	%	1 Quarter	Year To Date	Fiscal YTD	1 Year	3 Years	5 Years	10 Years
Total Real Assets	2,868,778,297	11.6	0.5	3.5	7.4	9.6	9.9	-	-
Real Estate	2,556,457,886	10.4	3.3	6.6	11.1	13.1	11.4	10.4	5.0
Global Public Real Estate	706,298,059	2.9	3.8	8.3	13.2	10.2	7.5	7.7	3.9
Public Real Estate Performance Benchmark			3.6	9.2	14.2	11.4	8.6	8.4	3.7
Internal Public Real Estate	706,298,059	2.9	3.8	9.0	15.9	13.0	8.9	8.7	4.4
Internal Public Real Estate Performance Benchmark			3.6	9.2	15.4	12.3	8.7	8.5	3.7
Domestic REIT	387,144,046	1.6	6.7	12.5	25.1	24.8	13.9	12.8	7.9
Domestic Real Estate Performance Benchmark			6.4	12.4	24.3	23.3	13.3	12.3	6.9
International REIT	319,154,014	1.3	0.3	5.0	5.8	0.8	3.7	4.7	-
FTSE EPRA/NAREIT Global ex-U.S. Index			0.7	5.9	6.3	1.4	4.3	5.0	-
Private Real Estate	1,850,159,827	7.5	3.1	6.1	10.4	14.7	13.5	12.7	-
Private Real Estate Performance Benchmark			2.0	5.1	8.7	12.6	8.9	-	-
Total Infrastructure	312,320,412	1.3	-21.4	-20.6	-20.5	-16.7	-2.1	-	-
Private Infrastructure	312,320,412	1.3	-21.4	-20.6	-20.5	-16.7	-3.1	-	-
Special Situations	100,000,000	0.4							
Risk Reduction	5,695,646,406	23.1	1.4	2.8	2.7	2.9	2.6	-	-
Total Rates	4,057,389,057	16.4	1.3	3.7	3.6	4.1	2.6	-	-
Barclays U.S. Treasury Float Adjusted: Intermediate			1.3	3.7	3.6	4.0	2.4	-	-
Absolute Return	1,199,559,870	4.9	2.3	1.2	0.6	-0.3	3.6	-	-
91 Day T-Bill + 4% (1 month lag)			1.1	2.1	3.5	4.2	4.1	-	-
Total Cash	438,697,479	1.8							

* Please see Appendix for benchmark descriptions

As of June 30, 2016

Asset Allocation & Performance

	Allocation		Performance(%)											
	Market Value ($)	%	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012	Fiscal 2011	Fiscal 2010	Fiscal 2009	Fiscal 2008	Fiscal 2007	Fiscal 2006	Fiscal 2005	Fiscal 2004
Total Fund	24,685,204,418	100.0	0.4	14.6	9.9	8.0	12.4	6.5	-6.7	-4.7	13.8	8.8	12.6	11.6
Total Fund Policy Benchmark			-1.0	15.0	9.5	8.1	12.0	6.8	-7.5	-5.5	12.1	9.0	12.5	11.8
Return Seeking	18,989,558,012	76.9	-0.2	18.1	12.7	9.3	-	-	-	-	-	-	-	-
Global Public Equity	11,512,612,259	46.6	-3.5	20.0	-	-	-	-	-	-	-	-	-	-
Global Public Equity Benchmark			-6.3	21.4	-	-	-	-	-	-	-	-	-	-
Domestic Equity	5,451,626,747	22.1	1.5	24.2	19.2	17.5	19.6	5.9	-18.4	-11.6	14.9	8.3	15.2	11.2
Domestic Equity Benchmark			0.5	24.9	19.4	17.5	19.1	5.6	-18.4	-11.1	15.1	8.9	12.6	11.5
ERS S&P 500 Index Fund	1,061,081,420	4.3	0.5	25.2	18.8	18.0	18.6	4.8	-17.8	-10.8	15.1	9.2	12.8	11.5
S&P 500 Index			0.5	25.2	18.7	18.0	18.5	4.9	-18.3	-11.1	15.1	8.9	12.6	11.5
ERS Large Cap Core	2,282,089,516	9.2	0.7	26.2	18.9	18.3	18.6	6.4	-17.7	-10.0	15.3	10.4	12.7	10.2
S&P 500 Index			0.5	25.2	18.7	18.0	18.5	4.9	-18.3	-11.1	15.1	8.9	12.6	11.5
Large Cap Growth Quant	291,411,413	1.2	5.7	28.7	-	-	-	-	-	-	-	-	-	-
S&P 500 Growth			3.9	27.5	-	-	-	-	-	-	-	-	-	-
Barrow Hanley Mewhinney & Strauss	657,019,748	2.7	1.0	21.8	24.7	16.1	-	-	-	-	-	-	-	-
S&P 500 Value			-3.3	22.8	22.9	17.3	-	-	-	-	-	-	-	-
ERS Mid Cap Core	693,092,576	2.8	0.8	23.3	25.9	12.3	21.5	13.9	-17.5	-	-	-	-	-
S&P MidCap 400			0.0	23.2	23.7	12.7	22.9	11.9	-18.2	-	-	-	-	-
ERS Small Cap Core	369,697,005	1.5	5.8	17.5	26.7	14.6	26.4	10.6	-20.8	-8.4	15.1	6.3	32.7	15.5
S&P SmallCap 600			1.8	18.7	26.7	16.9	24.4	7.8	-20.7	-6.2	14.3	7.1	26.5	14.8
Emerging Manager Composite	91,197,569	0.4	0.4	21.8	20.7	16.7	-	-	-	-	-	-	-	-
S&P Composite 1500			0.5	24.9	19.4	17.5	-	-	-	-	-	-	-	-
Domestic Risk Management	6,037,500	0.0												
International Equity	4,899,292,525	19.8	-10.0	16.1	13.8	-0.1	11.8	2.2	-14.3	-12.3	19.5	20.8	23.5	21.3
International Equity Benchmark			-12.4	17.7	13.0	-1.9	10.3	2.9	-14.4	-14.4	18.7	24.3	23.6	22.6
ERS International EAFE Composite	2,187,993,988	8.9	-6.3	14.5	18.3	2.0	11.1	-0.3	-14.3	-12.4	18.1	24.5	22.7	21.5
MSCI EAFE Index (Net)			-7.5	16.4	18.7	0.0	10.0	-2.3	-14.9	-14.4	18.7	24.3	23.6	22.6
ERS Canada	272,881,044	1.1	-24.9	24.5	3.5	-4.5	17.4	-	-	-	-	-	-	-
MSCI Canada (Net)			-25.3	23.2	2.0	-5.7	17.0	-	-	-	-	-	-	-
Fisher Investments	541,781,201	2.2	-7.3	15.7	14.2	-2.4	17.8	4.2	-13.2	-10.5	18.8	-	-	-
Fisher Performance Benchmark			-12.4	17.7	13.0	-1.9	10.3	2.9	-13.8	-14.4	18.7	-	-	-

Empower Results®

As of June 30, 2016

Asset Allocation & Performance

	Allocation		Performance(%)											
	Market Value ($)	%	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012	Fiscal 2011	Fiscal 2010	Fiscal 2009	Fiscal 2008	Fiscal 2007	Fiscal 2006	Fiscal 2005	Fiscal 2004
Templeton	689,559,102	2.8	-8.0	15.6	19.5	3.6	10.0	-0.7	-14.3	-15.1	25.2	22.5	25.4	21.5
Templeton Performance Benchmark			-12.4	17.7	13.0	-1.9	10.3	2.9	-13.8	-14.4	18.7	24.3	23.6	22.6
Lazard Asset Management	386,542,390	1.6	-5.0	18.8	23.3	-	-	-	-	-	-	-	-	-
MSCI EAFE Index (Net)			-7.5	16.4	18.7	-	-	-	-	-	-	-	-	-
Blackrock International Focus	359,009,933	1.5	-	-	-	-	-	-	-	-	-	-	-	-
MSCI AC World ex USA Index (Net)			-	-	-	-	-	-	-	-	-	-	-	-
ERS Emerging Markets	676,165,475	2.7	-19.2	18.8	1.3	-7.0	9.6	19.9	-	-	-	-	-	-
MSCI EM (Net)			-22.9	20.0	0.5	-5.8	9.1	18.0	-	-	-	-	-	-
JP Morgan Emerging Markets	1,816	0.0												
International Risk Management	-214,642,423	-0.9												
Global Public Equity Special Situations	677,380,733	2.7	-1.7	-	-	-	-	-	-	-	-	-	-	-
Directional Growth Portfolio	314,612,015	1.3	20.2	-	-	-	-	-	-	-	-	-	-	-
Global Equity Tactical	169,700,238	0.7	-	-	-	-	-	-	-	-	-	-	-	-
Private Equity	2,551,794,694	10.3	11.0	20.8	17.1	2.3	14.7	-3.7	-23.6	-2.6	-	-	-	-
Total Global Credit	1,956,372,761	7.9	-1.4	11.2	-	-	-	-	-	-	-	-	-	-
Barclays U.S. High Yield 2% Issuer Cap			-2.9	10.6	-	-	-	-	-	-	-	-	-	-
ETF Fixed Income Emerging Markets	32,742,410	0.1	1.4	16.4	-7.5	-	-	-	-	-	-	-	-	-
ETF Fixed Income EM Performance Benchmark			-2.9	10.6	-2.8	-	-	-	-	-	-	-	-	-
ETF Fixed Income High Yield	369,037,455	1.5	-2.6	10.0	5.2	-	-	-	-	-	-	-	-	-
Barclays U.S. High Yield 2% Issuer Cap			-2.9	10.6	7.6	-	-	-	-	-	-	-	-	-
ERS Internal High Yield	1,234,423,463	5.0	-1.6	-	-	-	-	-	-	-	-	-	-	-
Barclays U.S. High Yield 2% Issuer Cap			-2.9	-	-	-	-	-	-	-	-	-	-	-
Private Credit	312,216,726	1.3	2.3	-	-	-	-	-	-	-	-	-	-	-
Barclays U.S. High Yield 2% Issuer Cap (1 month lag)			0.4	-	-	-	-	-	-	-	-	-	-	-
High Yield Risk Management	7,952,707	0.0												

As of June 30, 2016

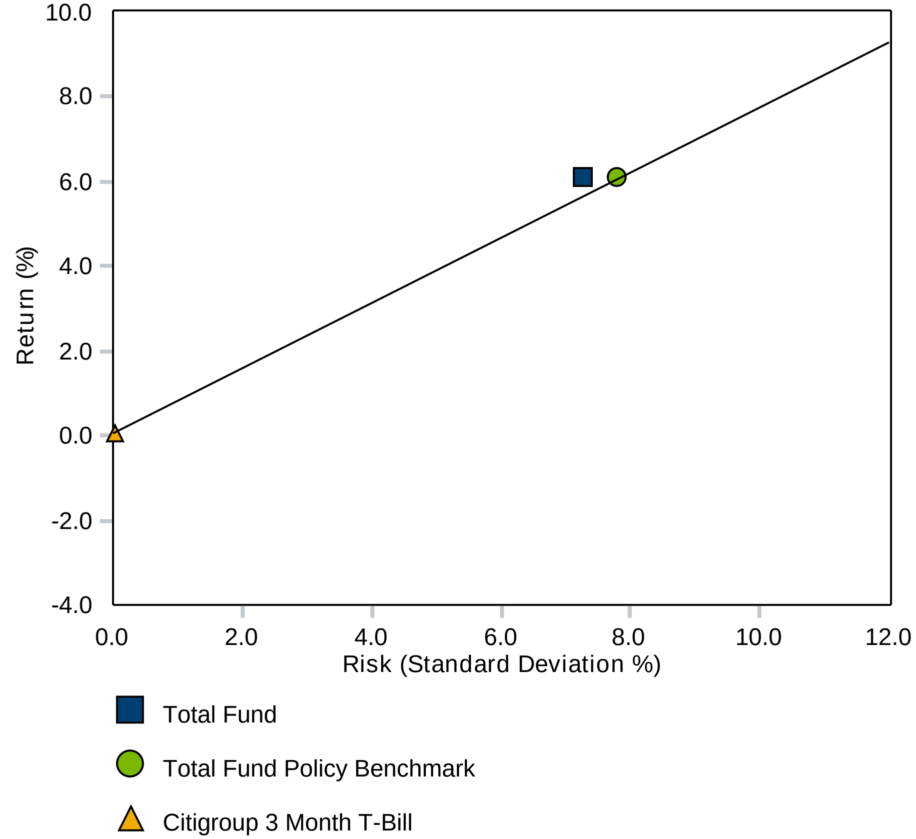
Asset Allocation & Performance

	Allocation		Performance(%)											
	Market Value ($)	%	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012	Fiscal 2011	Fiscal 2010	Fiscal 2009	Fiscal 2008	Fiscal 2007	Fiscal 2006	Fiscal 2005	Fiscal 2004
Total Real Assets	2,868,778,297	11.6	6.2	14.7	9.6	11.2	-	-	-	-	-	-	-	-
Real Estate	2,556,457,886	10.4	7.2	14.9	8.7	11.2	18.2	15.0	-22.0	-17.4	4.5	26.4	-	-
Global Public Real Estate	706,298,059	2.9	-5.6	19.6	6.5	12.6	15.0	15.4	-22.0	-17.4	4.5	26.4	-	-
Public Real Estate Performance Benchmark			-3.6	20.1	6.6	12.6	15.5	15.1	-23.1	-19.9	2.7	24.8	-	-
Internal Public Real Estate	706,298,059	2.9	-3.9	19.7	6.9	12.6	15.4	15.4	-22.0	-17.4	4.5	26.4	-	-
Internal Public Real Estate Performance Benchmark			-4.2	20.1	6.6	12.6	15.5	15.1	-23.1	-19.9	2.7	24.8	-	-
Domestic REIT	387,144,046	1.6	0.8	24.3	1.0	20.0	18.6	33.1	-33.0	-4.8	4.3	26.4	-	-
Domestic Real Estate Performance Benchmark			0.1	24.3	0.7	20.0	18.5	32.6	-33.8	-8.7	2.3	24.8	-	-
International REIT	319,154,014	1.3	-8.6	15.9	12.2	6.7	13.0	6.0	-14.0	-24.2	-	-	-	-
FTSE EPRA/NAREIT Global ex-U.S. Index			-8.1	16.6	12.0	6.8	13.2	5.7	-15.6	-24.8	-	-	-	-
Private Real Estate	1,850,159,827	7.5	14.1	12.5	10.1	10.7	13.0	-	-	-	-	-	-	-
Private Real Estate Performance Benchmark			13.4	4.0	4.1	-	-	-	-	-	-	-	-	-
Total Infrastructure	312,320,412	1.3	0.7	12.0	17.9	-	-	-	-	-	-	-	-	-
Private Infrastructure	312,320,412	1.3	0.3	9.0	17.9	-	-	-	-	-	-	-	-	-
Special Situations	100,000,000	0.4												
Risk Reduction	5,695,646,406	23.1	2.5	2.9	-1.0	3.0	-	-	-	-	-	-	-	-
Total Rates	4,057,389,057	16.4	2.1	2.5	-	-	-	-	-	-	-	-	-	-
Barclays U.S. Treasury Float Adjusted: Intermediate			1.9	2.2	-	-	-	-	-	-	-	-	-	-
Absolute Return	1,199,559,870	4.9	4.8	5.8	8.0	-	-	-	-	-	-	-	-	-
91 Day T-Bill + 4% (1 month lag)			4.0	4.0	4.1	-	-	-	-	-	-	-	-	-
Total Cash	438,697,479	1.8												

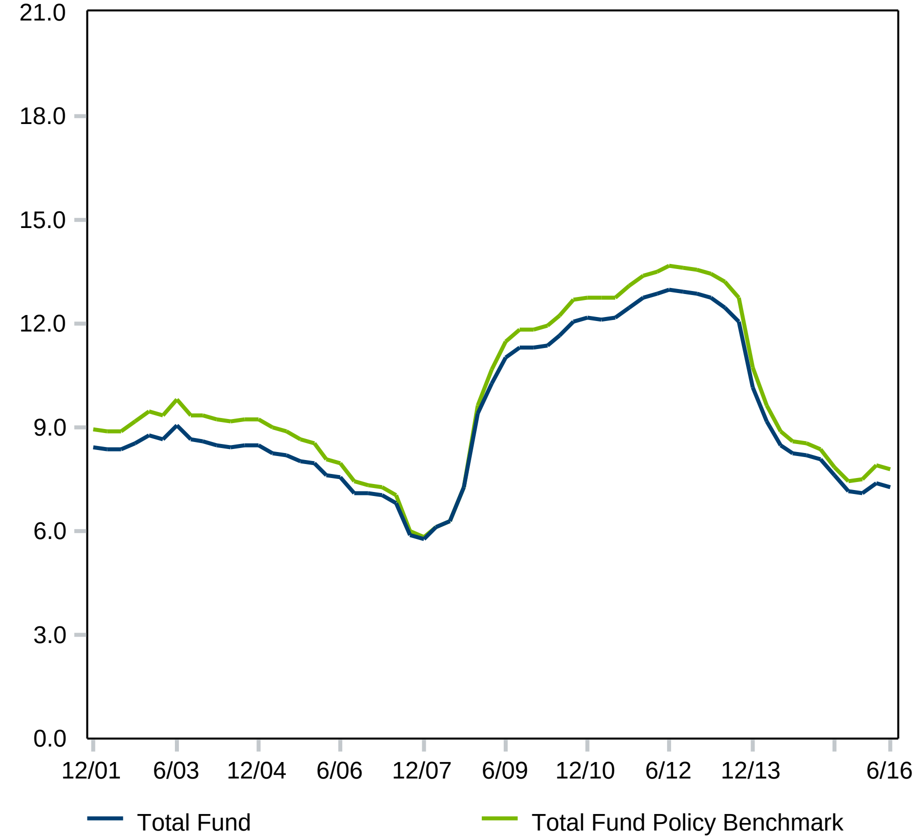
*Please see Appendix for benchmark descriptions

Total Fund Risk Profile

Annualized Return vs. Annualized Standard Deviation
5 Years



Rolling 5 Years Standard Deviation



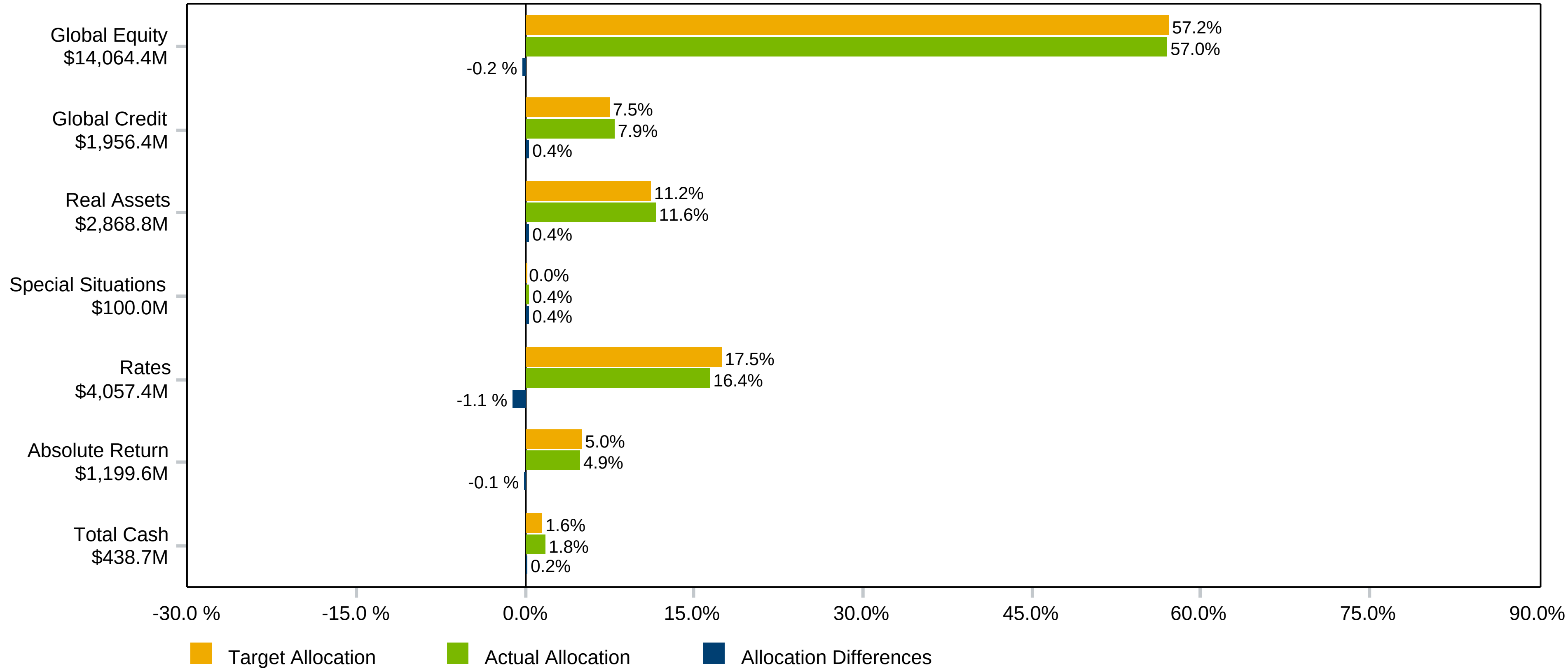
5 Years Historical Statistics

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Total Fund	-0.03	1.06	-0.03	0.99	0.84	0.43	0.93	6.08	7.29	0.99
Total Fund Policy Benchmark	0.00	0.00	N/A	1.00	0.79	0.00	1.00	6.07	7.80	1.00
Citigroup 3 Month T-Bill	-6.15	7.80	-0.79	0.01	N/A	0.06	0.00	0.06	0.02	0.08

Empower Results®

Asset Allocation Compliance

	Market Value ($)	Current Allocation (%)	Target Allocation (%)	Minimum Allocation (%)	Maximum Allocation (%)
Total Fund	24,685,204,418	100.0	100.0	N/A	N/A
Global Equity	14,064,406,953	57.0	57.2	47.2	67.2
Global Credit	1,956,372,761	7.9	7.5	0.0	14.5
Real Assets	2,868,778,297	11.6	11.2	5.5	15.5
Special Situations	100,000,000	0.4	0.0	0.0	0.0
Rates	4,057,389,057	16.4	17.5	15.0	25.0
Absolute Return	1,199,559,870	4.9	5.0	0.0	10.0
Total Cash	438,697,479	1.8	1.6	0.0	1.6

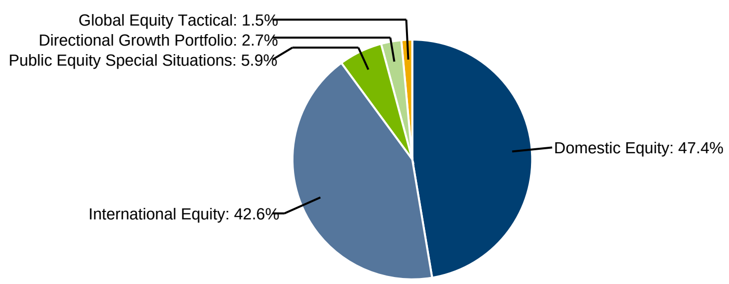


Global Public Equity

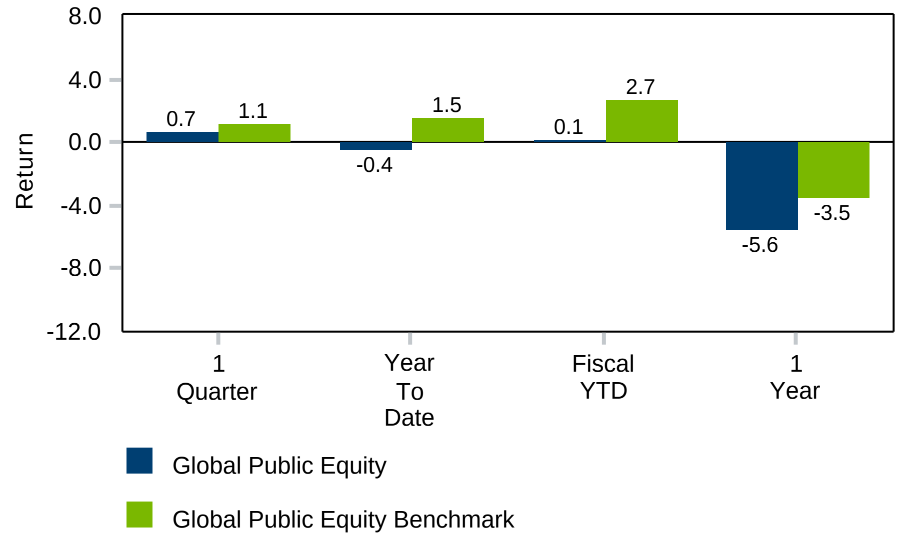
Empower Results®

Global Public Equity Portfolio Overview

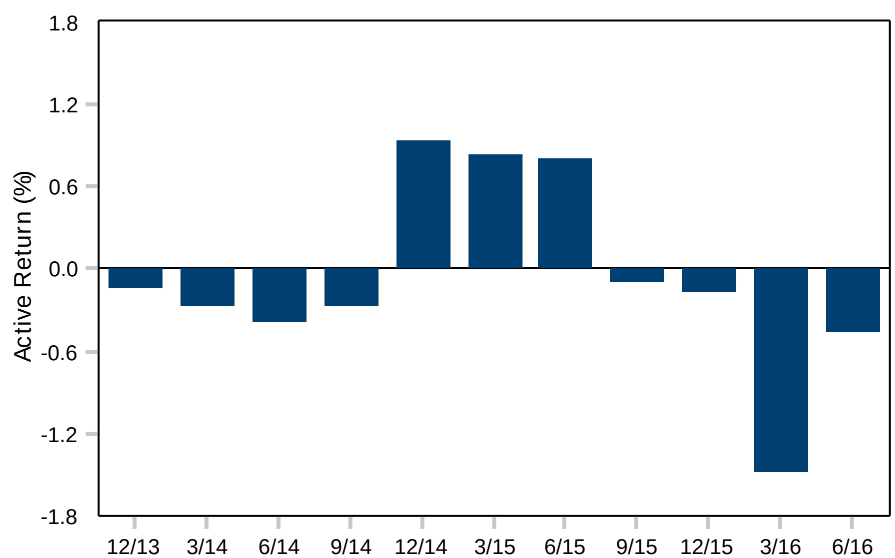
Current Allocation
June 30, 2016 : $11,513M



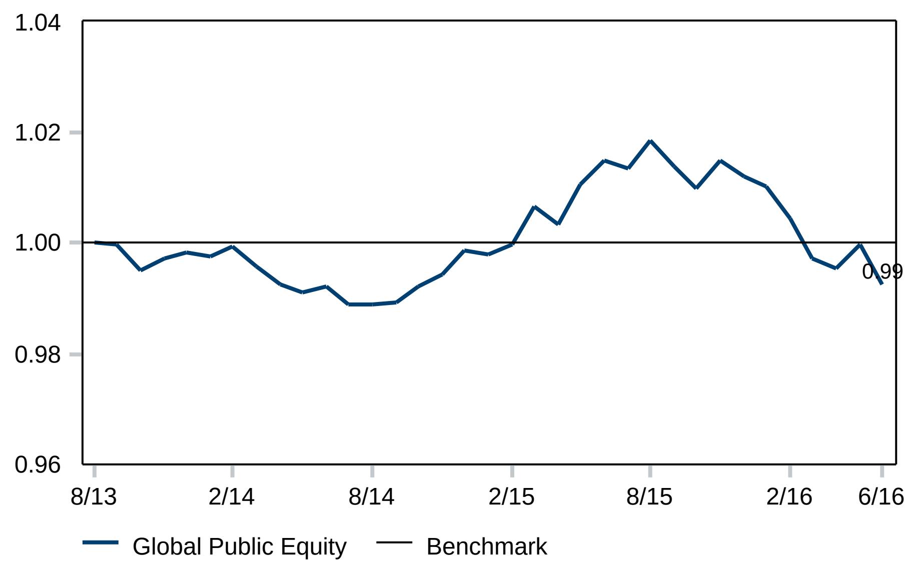
Return Summary



Quarterly Excess Performance



Ratio of Cumulative Wealth - Since Inception

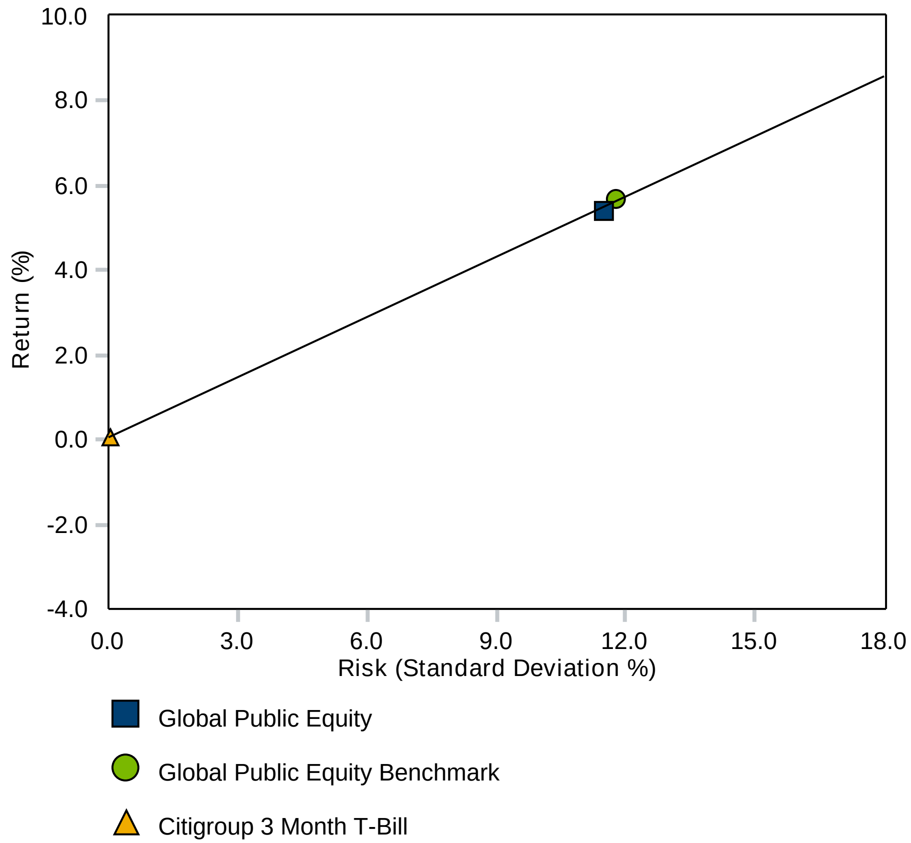


*During the quarter Barclays changed pricing sources for the Barclays U.S. High Yield 2% Issuer Cap (the primary benchmark for the Total Global Credit component), the source change resulted in a 0.13% increase in the return relative to the legacy pricing source.

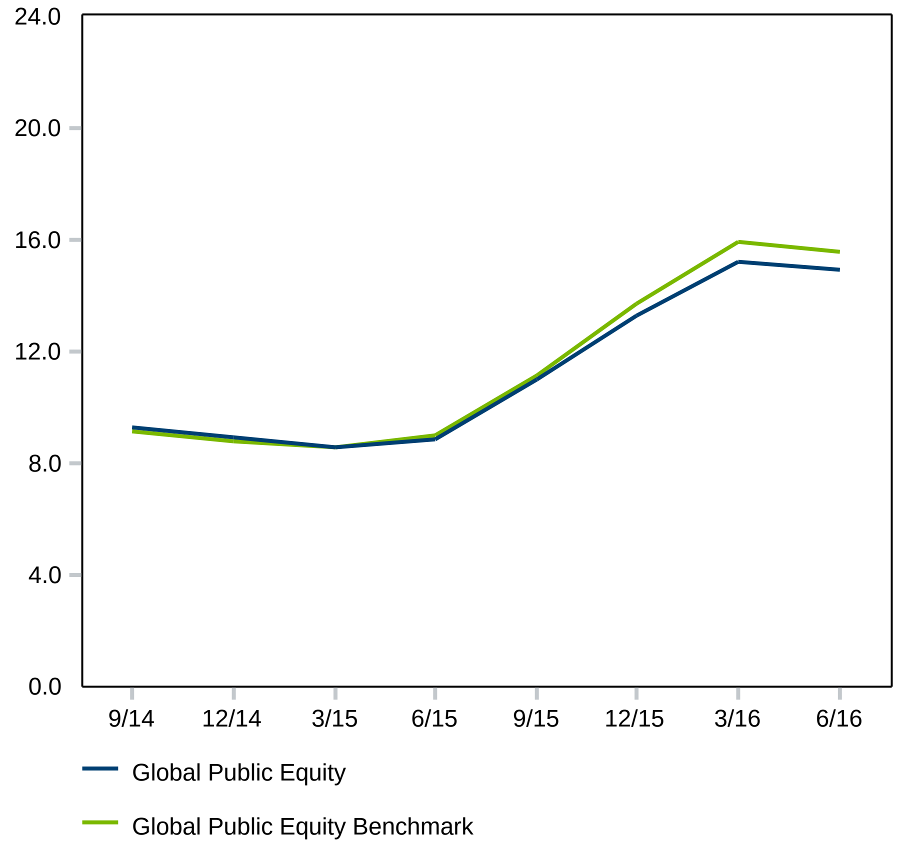
Empower Results®

Global Public Equity Risk Profile

Annualized Return vs. Annualized Standard Deviation Since 9/1/2013



Rolling 1 Year Standard Deviation



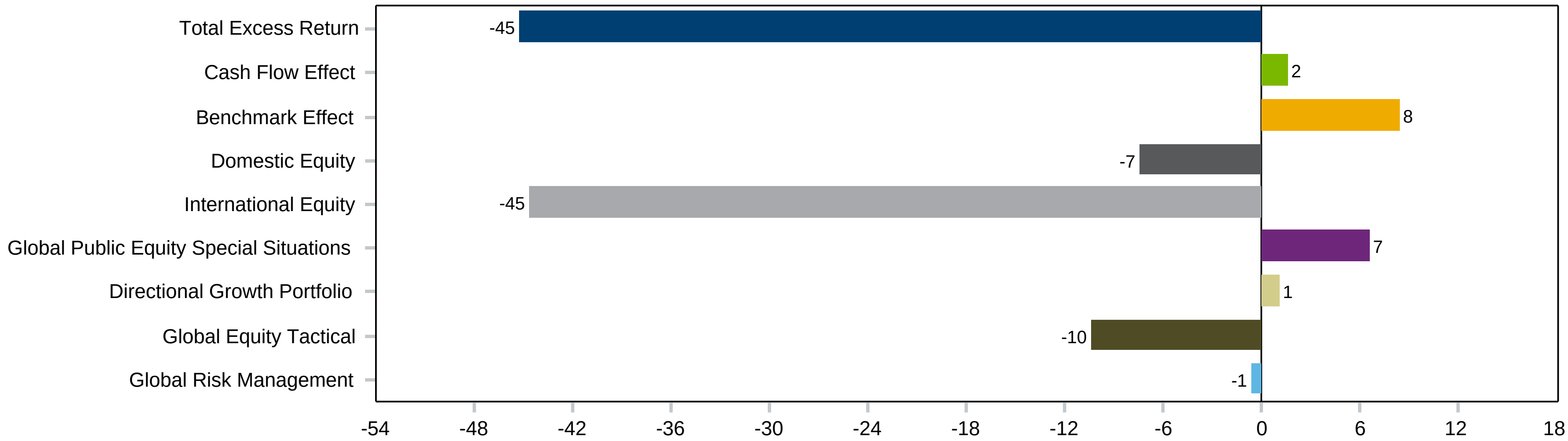
Historical Statistics Since 9/1/2013

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Global Public Equity	-0.29	1.34	-0.22	0.99	0.51	-0.10	0.97	5.38	11.54	0.99
Global Public Equity Benchmark	0.00	0.00	N/A	1.00	0.52	0.00	1.00	5.65	11.82	1.00
Citigroup 3 Month T-Bill	-6.12	11.82	-0.52	0.00	N/A	0.06	0.00	0.06	0.02	0.06

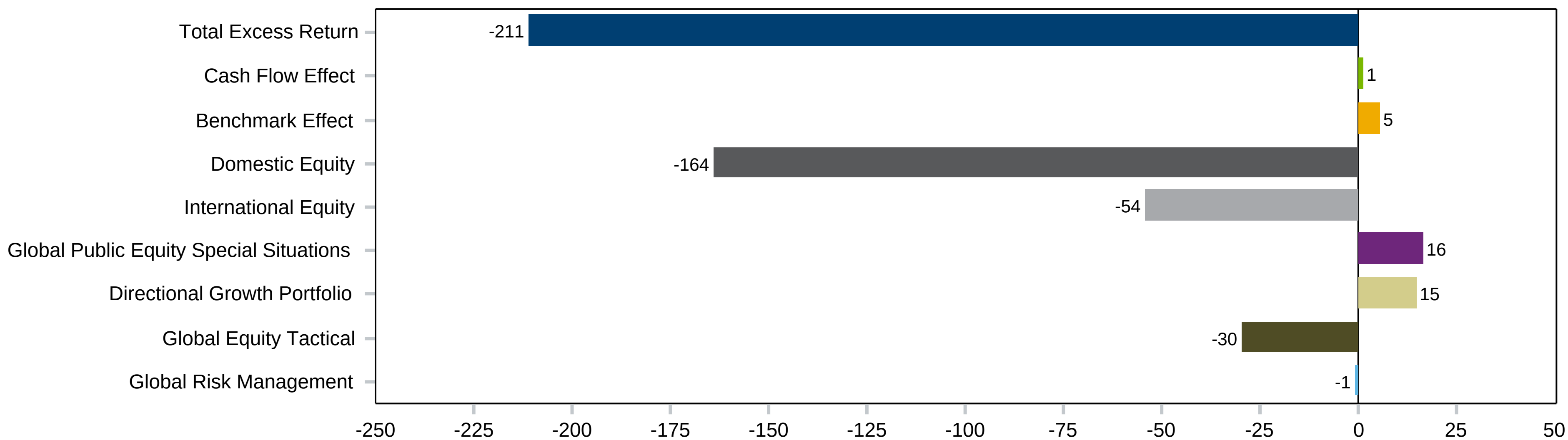
Empower Results®

Asset Class Attribution

1 Quarter



1 Year

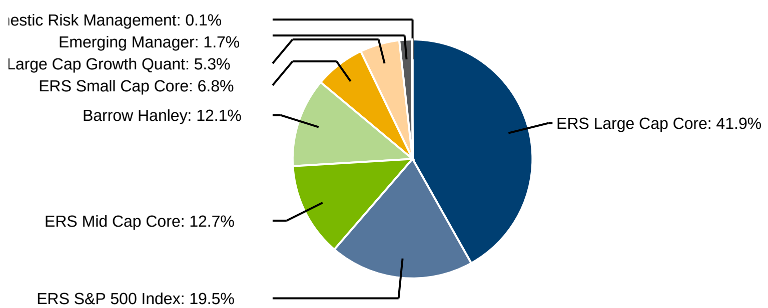


While the Special Situations, Directional Growth, and Global Equity Tactical component's underlying managers may have domestic or international equity benchmarks, the components are not included in the attribution for domestic and international equity.

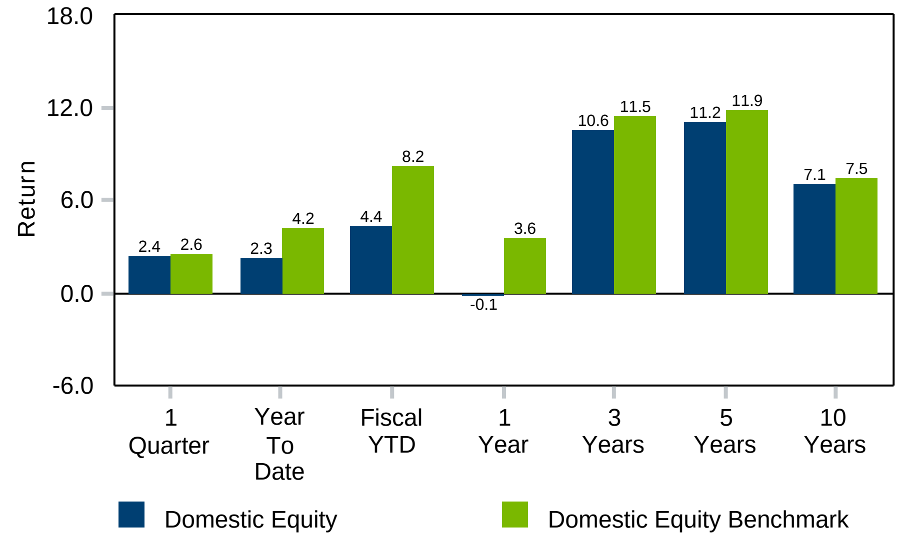
Domestic Equity

Domestic Equity Portfolio Overview

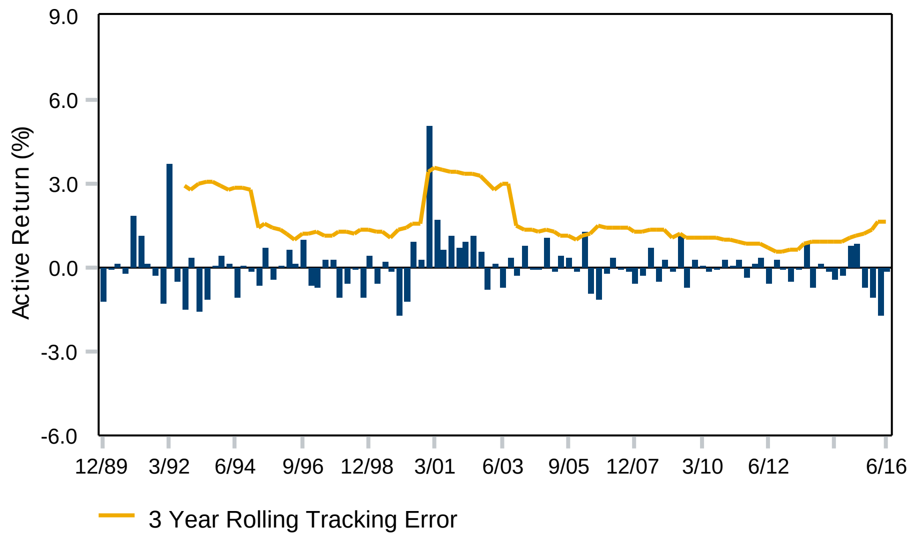
Current Allocation
June 30, 2016 : $5,452M



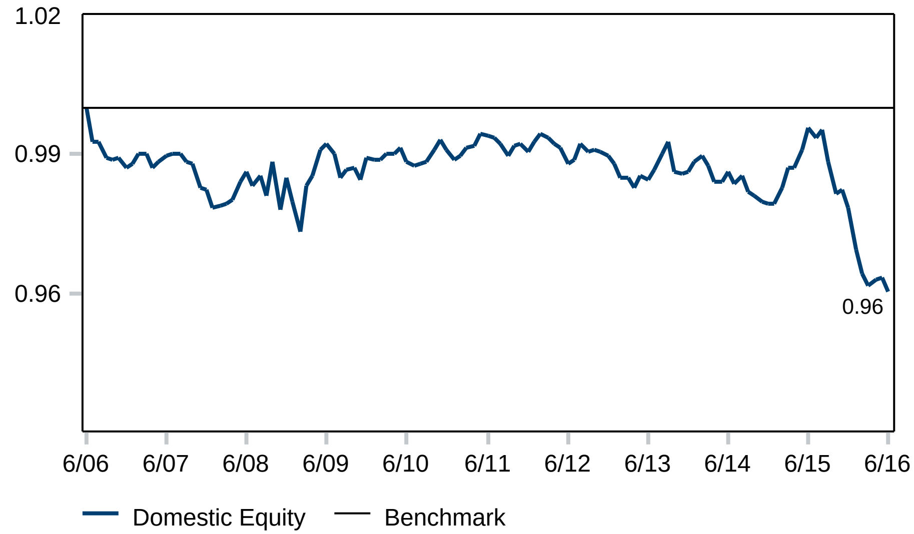
Return Summary



Quarterly Excess Performance

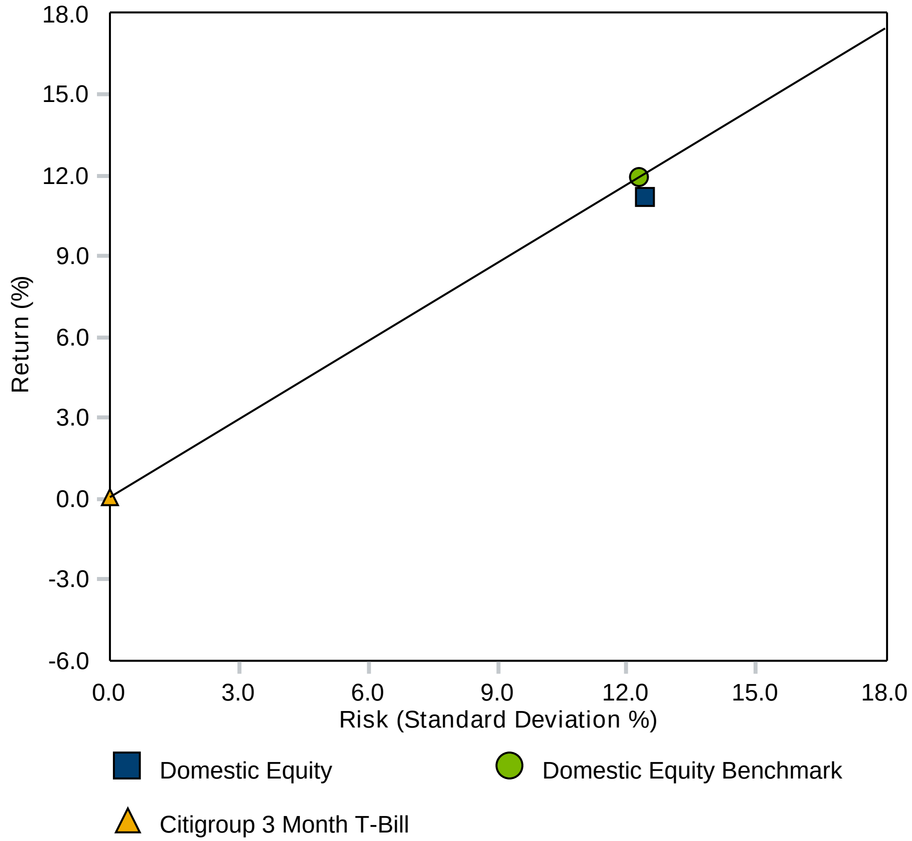


Ratio of Cumulative Wealth - 10 Years



Domestic Equity Risk Profile

Annualized Return vs. Annualized Standard Deviation 5 Years



Rolling 5 Years Standard Deviation

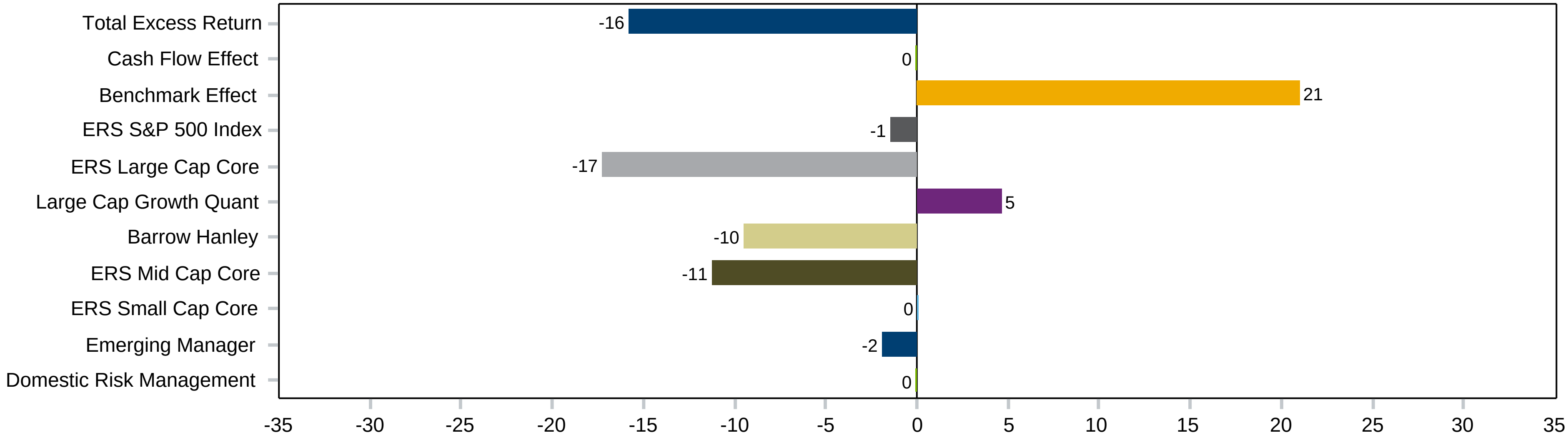
5 Years Historical Statistics

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Domestic Equity	-0.68	1.02	-0.66	0.99	0.91	-0.79	1.01	11.17	12.45	1.00
Domestic Equity Benchmark	0.00	0.00	N/A	1.00	0.98	0.00	1.00	11.94	12.29	1.00
Citigroup 3 Month T-Bill	-12.01	12.29	-0.98	0.00	N/A	0.06	0.00	0.06	0.02	0.03

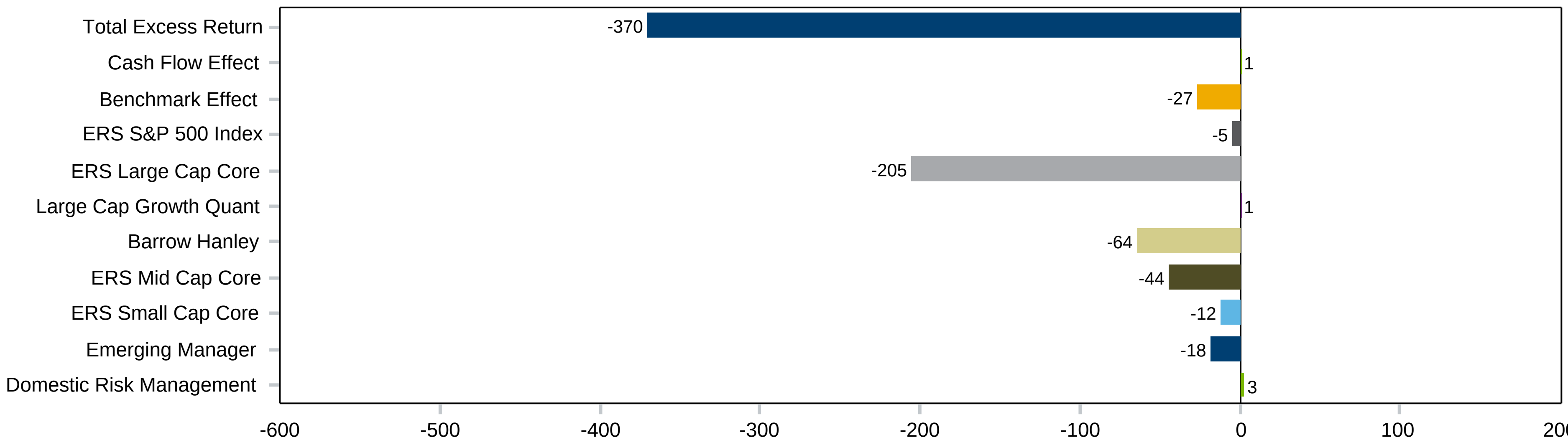
Empower Results®

Asset Class Attribution

1 Quarter



1 Year

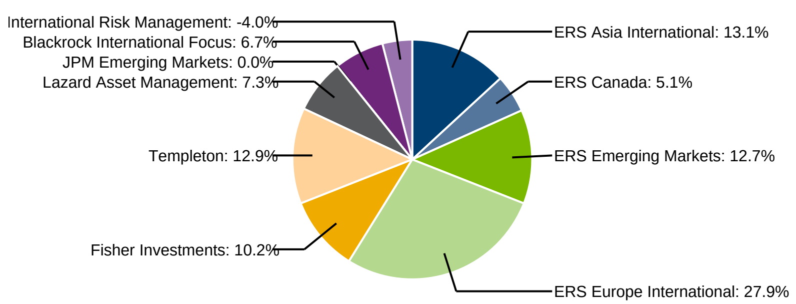


International Equity

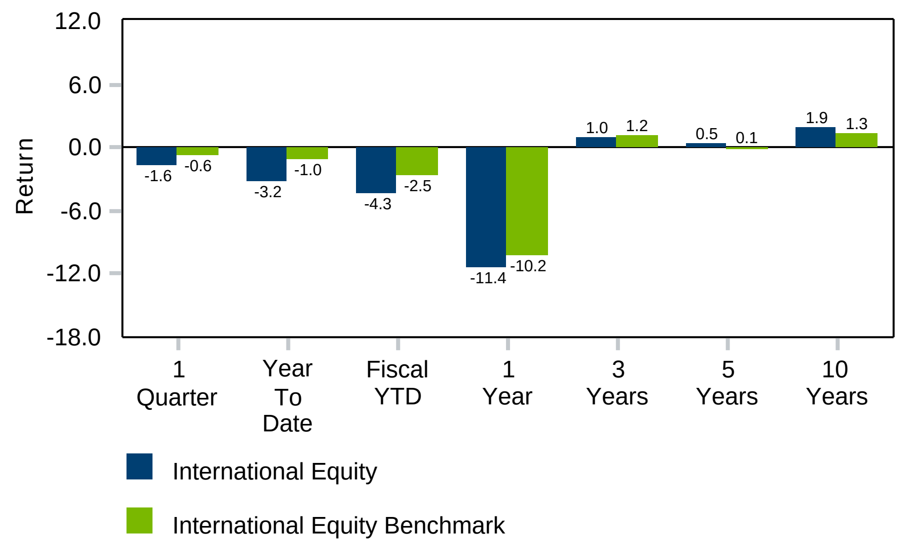
Empower Results®

International Equity Portfolio Overview

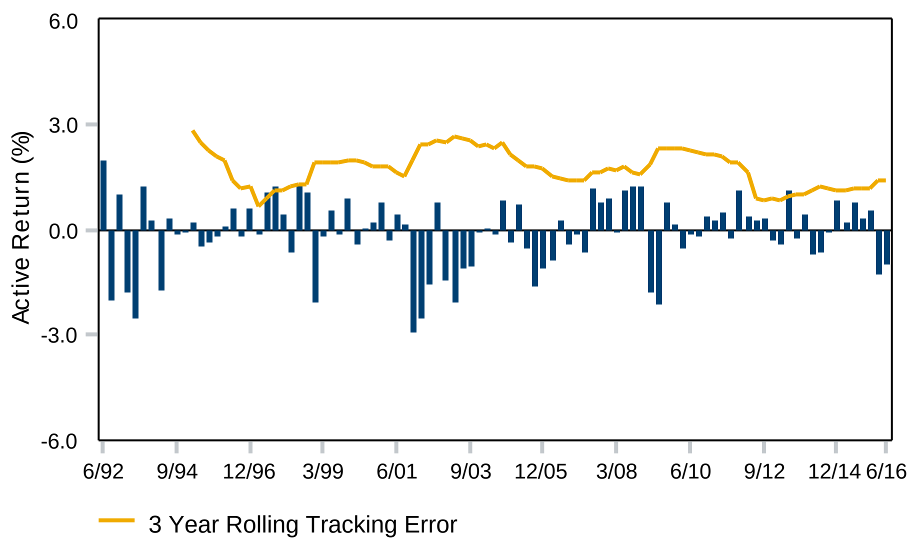
Current Allocation
June 30, 2016 : $4,899M



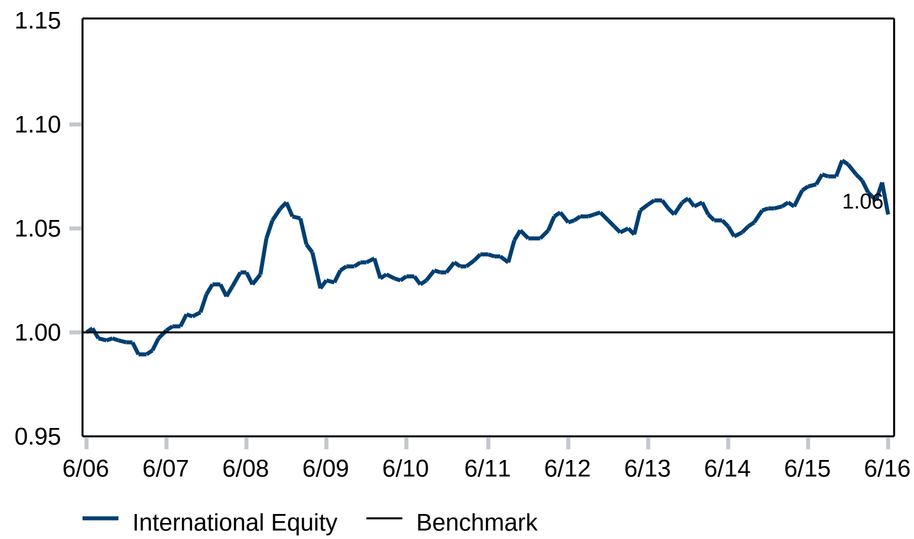
Return Summary



Quarterly Excess Performance



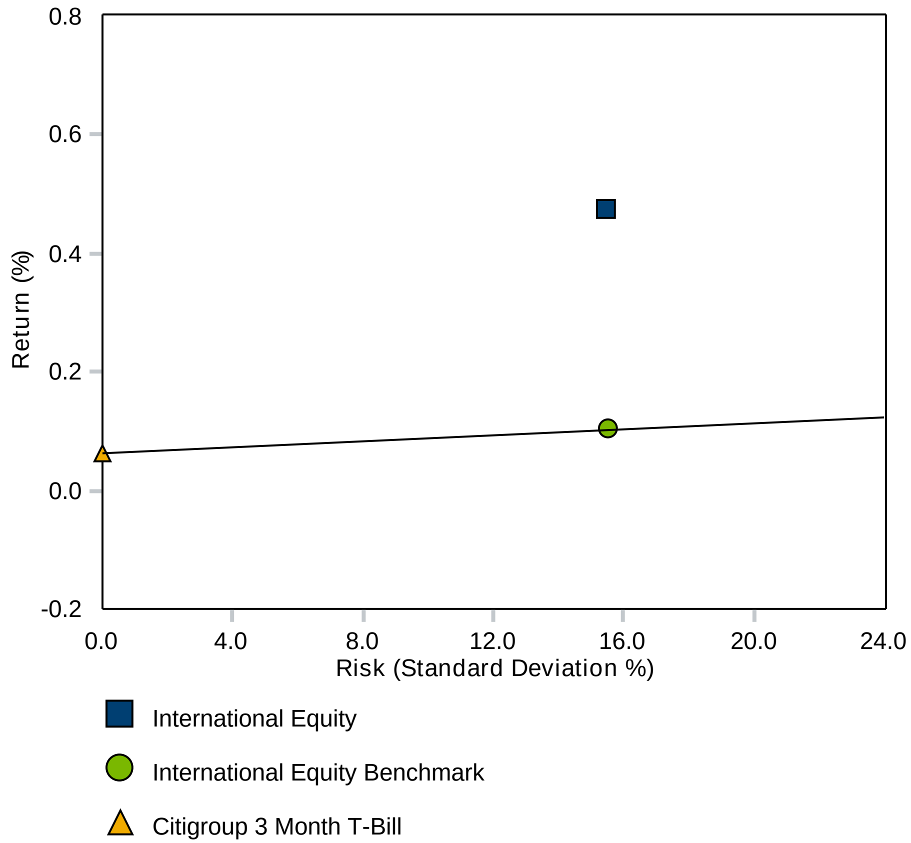
Ratio of Cumulative Wealth - 10 Years



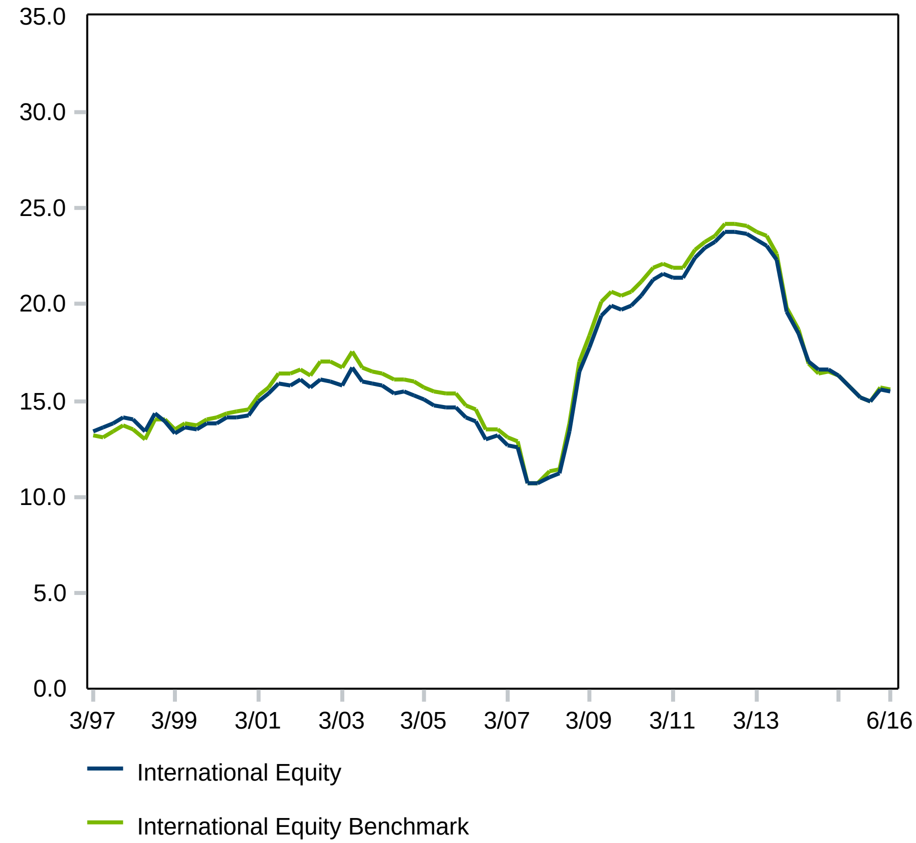
*JP Morgan Emerging Markets was defunded in August 2015.

International Equity Risk Profile

Annualized Return vs. Annualized Standard Deviation 5 Years



Rolling 5 Years Standard Deviation



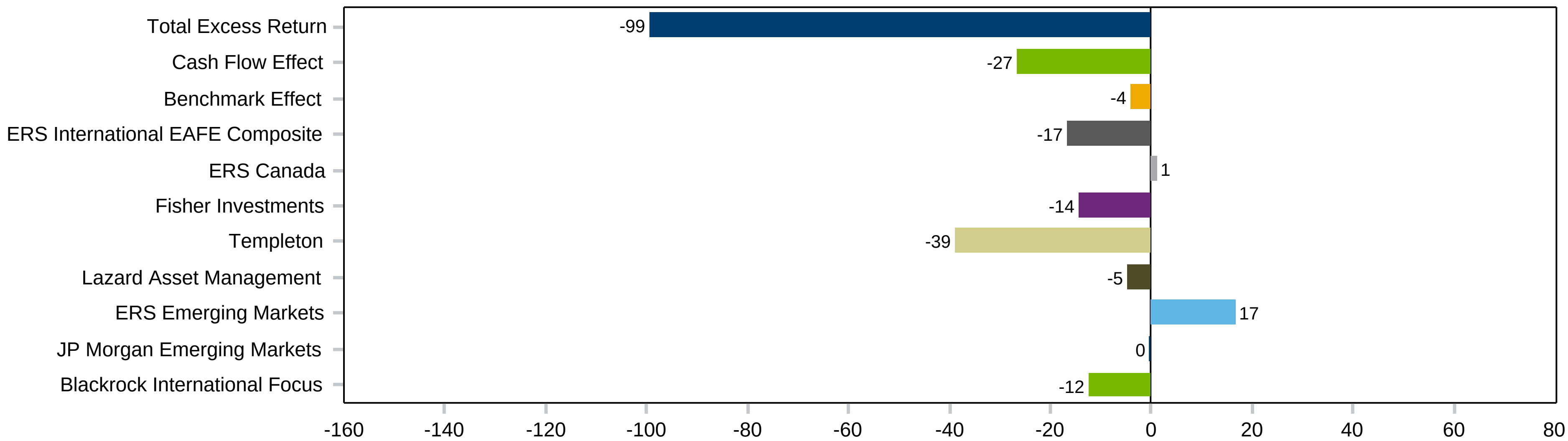
5 Years Historical Statistics

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
International Equity	0.36	1.45	0.25	0.99	0.10	0.37	0.99	0.47	15.49	1.00
International Equity Benchmark	0.00	0.00	N/A	1.00	0.08	0.00	1.00	0.10	15.54	1.00
Citigroup 3 Month T-Bill	-1.24	15.54	-0.08	0.01	N/A	0.06	0.00	0.06	0.02	0.09

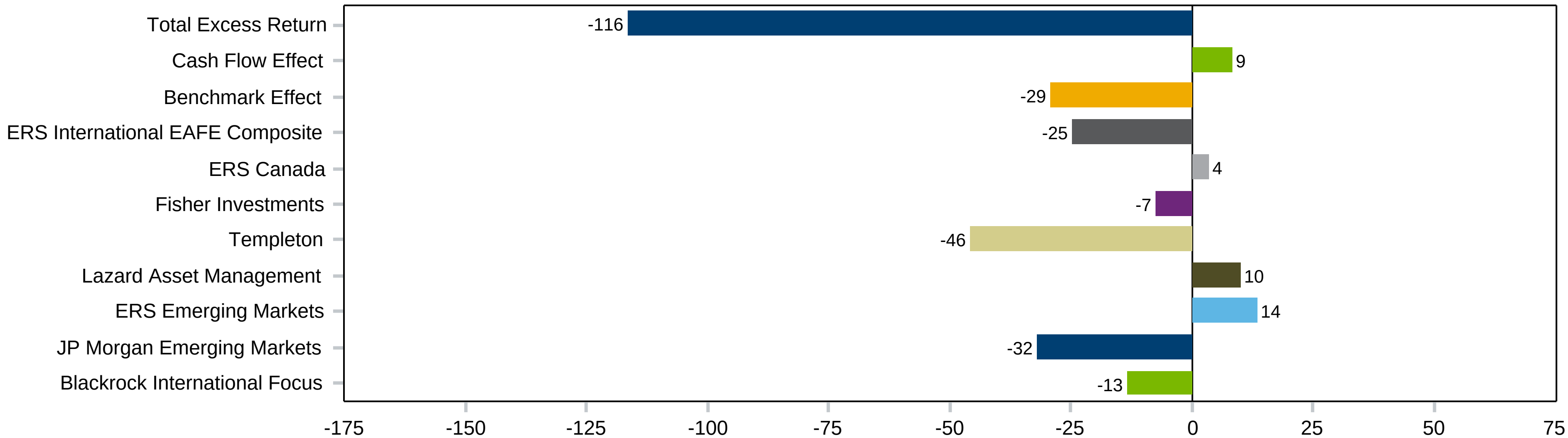
Empower Results®

Asset Class Attribution

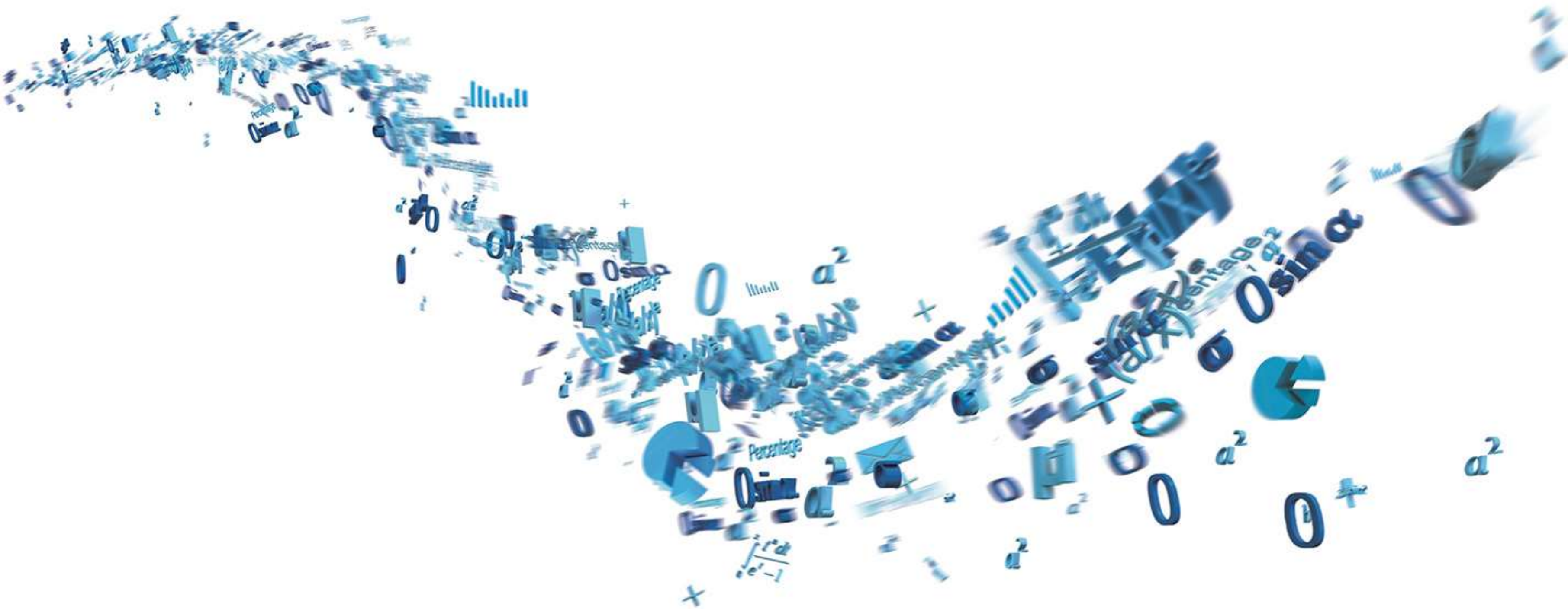
1 Quarter



1 Year



*JP Morgan Emerging Markets was defunded in August 2015.



Private Equity

Overview

	Internal Rate of Return(%) 1 Year	3 Years	5 Years	Since Inception
Private Equity	3.6	11.6	11.4	10.7

Private Equity Program Summary by Fiscal Year as of 6/30/2016

ERS FY	# of Deals	Capital Committed	Capital Called	Distributions	Market Value
1999	1	$100,000,000	$88,405,114	$129,578,992	$0
2007	1	$60,585,106	$57,227,107	$113,638,553	$1,391,937
2008	3	$196,630,000	$230,422,948	$288,396,750	$78,750,184
2009	12	$907,753,700	$988,058,789	$1,017,055,242	$366,841,194
2010	7	$456,885,000	$471,353,883	$424,460,105	$151,366,014
2011	9	$648,850,000	$582,710,607	$262,092,698	$422,356,111
2012	7	$501,734,787	$371,312,498	$168,818,131	$378,472,277
2013	7	$433,162,102	$298,933,554	$83,120,935	$240,547,362
2014	13	$1,191,311,539	$580,160,833	$42,634,071	$568,973,644
2015	11	$934,485,000	$208,999,521	$39,763,409	$191,439,208
2016	9	$744,139,176	$112,104,857	$230,543	$112,178,379
Total	**80**	**$6,175,536,410**	**$3,989,689,711**	**$2,569,789,430**	**$2,512,316,310**

*Internal Rate of Return figures include market value adjustments made after 6/30/2016.
*Total portfolio market value includes FX contracts and STIF balance.

Overview

Private Equity Program Summary By Fund as of 6/30/2016

Deal #	Fund Name	ERS FY	Commitment Date	Capital Committed	Capital Called	Distributions	Market Value
1	Texas Growth Fund II	1999	December-98	$100,000,000			
2	Southwest Opps Partners LP	2007	May-07	$60,585,106			
3	New Mountain Partners III, L.P.	2008	November-07	$60,000,000			
4	Carlyle Partners V, L.P.	2008	March-08	$100,000,000			
5	Advent International GPE VI-C, L.P.	2008	March-08	$36,630,000			
6	Brazos Equity Fund III, L.P.	2009	September-08	$37,500,000			
7	Wind Point Partners VII, L.P.	2009	October-08	$65,000,000			
8	Charterhouse Capital Partners IX, L.P.	2009	December-08	$58,830,000			
9	CVC European Equity Partners V (B) LP	2009	December-08	$87,323,700			
10	Hellman & Friedman Capital Partners VII, L.P.	2009	January-09	$100,000,000			
11	Navis Asia Fund VI, L.P.	2009	February-09	$60,000,000			
12	TA Subordinated Debt Fund III, L.P.	2009	April-09	$50,000,000			
13	TA XI, L.P.	2009	April-09	$100,000,000			
14	Riverside Capital Appreciation Fund V, L.P.	2009	April-09	$100,000,000			
15	Triton Fund III, LP	2009	July-09	$66,600,000			
16	Lexington Capital Partners VII, L.P.	2009	August-09	$100,000,000			
17	Littlejohn Fund IV, L.P.	2009	August-09	$82,500,000			
18	Quantum Energy Partners V, L.P.	2010	September-09	$75,000,000			
19	HG Capital 6	2010	October-09	$60,300,000			
20	LGT Crown Global Secondaries II PLC	2010	February-10	$75,000,000			
21	Mason Wells Buyout Fund III, L.P.	2010	February-10	$65,000,000			
22	Advent Latin America Fund V-H ,L.P.	2010	March-10	$50,000,000			
23	Riverside Europe Fund IV, L.P.	2010	March-10	$81,585,000			
24	Southern Cross Latin America PE Fund IV, L.P.	2010	July-10	$50,000,000			
25	Baring Asia Private Equity Fund V, L.P.	2011	November-10	$50,000,000			
26	ERS Private Equity Emerging Manager Fund I, L.P.	2011	December-10	$50,000,000			
27	Euroknights VI No. 1 LP	2011	January-11	$38,850,000			
28	Gores Capital Partners III L.P.	2011	January-11	$100,000,000			
29	Private Equity International Fund I, LP	2011	March-11	$165,000,000			
30	KSL Capital Partners III L.P.	2011	July-11	$95,000,000			
31	Summer Street Capital III, LP	2011	July-11	$50,000,000			
32	Longitude Venture Partners II LP	2011	August-11	$50,000,000			
33	RLH Investors III, LP	2011	August-11	$50,000,000			
34	LGT Crown Global Secondaries III PLC	2012	October-11	$100,000,000			
35	HitecVision VI, L.P.	2012	November-11	$70,000,000			
36	Frontier Fund III LP	2012	December-11	$50,000,000			
37	Advent International GPE VII-C LP	2012	June-12	$100,000,000			
38	Castlelake II, LP	2012	July-12	$75,000,000			
39	Court Square Capital Partners III, L.P.	2012	August-12	$75,000,000			
40	Private Equity Co-Investments 2012	2012	Various	$31,734,787			

Overview

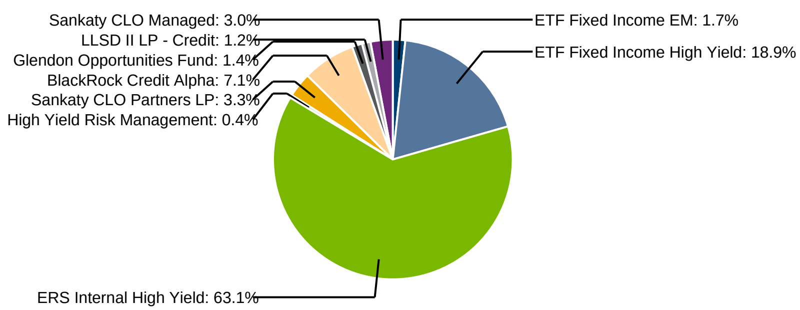
Private Equity Program Summary By Fund as of 6/30/2016

Deal #	Fund Name	ERS FY	Commitment Date	Capital Committed	Capital Called	Distributions	Market Value
41	Southern Cross Latin America Fund IV, L.P. (Secondary)	2013	September-12	$25,000,000			
42	Riverside Capital Appreciation Fund VI, L.P.	2013	December-12	$100,000,000			
43	HGCapital 7 A L.P.	2013	March-13	$40,200,000			
44	Blue Wolf Capital Fund III, LP	2013	April-13	$50,000,000			
45	Triton Fund IV LP	2013	April-13	$77,700,000			
46	CVC Capital Partners VI (B) L.P.	2013	July-13	$78,810,000			
47	Private Equity Co-Investments 2013	2013	Various	$61,452,102			
48	Industry Ventures Secondary VII	2014	October-13	$40,000,000			
49	Industry Ventures Special Opportunities II	2014	October-13	$47,500,000			
50	KSL Credit Opportunities Fund I	2014	December-13	$50,000,000			
51	Navis Asia Fund VII LP	2014	December-13	$125,000,000			
52	Triton Debt Opportunities Fund I US LP	2014	January-14	$41,070,000			
53	Castlelake III LP	2014	February-14	$100,000,000			
54	HitecVision VII LP	2014	April-14	$70,000,000			
55	Cotton Creek Capital Partners II LP	2014	May-14	$31,500,000			
56	Energy & Minerals Group Fund III LP	2014	June-14	$80,471,000			
57	Carlyle Global Financial Services Partners II LP	2014	June-14	$100,000,000			
58	ERS Private Equity International II, L.P	2014	June-14	$300,000,000			
59	Quantum Energy Partners VI LP	2014	June-14	$100,000,000			
60	Private Equity Co-Investments 2014	2014	Various	$105,770,539			
61	Hellman & Friedman Capital Partners VIII, L.P	2015	September-14	$82,500,000			
62	Baring Asia Private Equity Fund VI, L.P.	2015	October-14	$75,000,000			
63	Landmark Equity Partners XV LP	2015	October-14	$175,000,000			
64	Landmark TX ERS Co-Investment Fund I, L.P.	2015	October-14	$125,000,000			
65	ERS Private Equity Emerging Manager Fund II LP	2015	December-14	$50,000,000			
66	KSL Capital Partners IV, LP	2015	January-15	$125,000,000			
67	Frontier Fund IV, L.P.	2015	February-15	$60,000,000			
68	Carlyle Energy Mezzanine Opportunities Fund II, LP	2015	March-15	$85,000,000			
69	ERS TA XII- A, L.P.	2015	June-15	$62,500,000			
70	Private Equity Co-Investments 2015	2015	Various	$69,485,000			
71	TA Subordinated Debt Fund IV, L.P.	2015	July-15	$25,000,000			
72	Castlelake IV, L.P.	2016	September-15	$100,000,000			
73	Private Equity Co-Investments 2016	2016	Various	$36,639,176			
74	Southern Cross Latin America Private Equity Fund V, LP	2016	October-15	$60,000,000			
75	Advent International GPE VIII-B-1, L.P.	2016	February-16	$110,000,000			
76	Crown Global Secondaries IV PLC	2016	April-16	$200,000,000			
77	Crown Secondaries Special Opportunities plc	2016	April-16	$100,000,000			
78	Industry Ventures Secondary VIII, L.P.	2016	April-16	$40,000,000			
79	Industry Ventures Special Opportunities Fund III-A, L.P.	2016	April-16	$47,500,000			
80	The Energy & Minerals Group Fund IV, LP	2016	April-16	$50,000,000			
Total				**$6,175,536,410**	**$3,989,689,711**	**$2,569,789,430**	**$2,512,316,310**

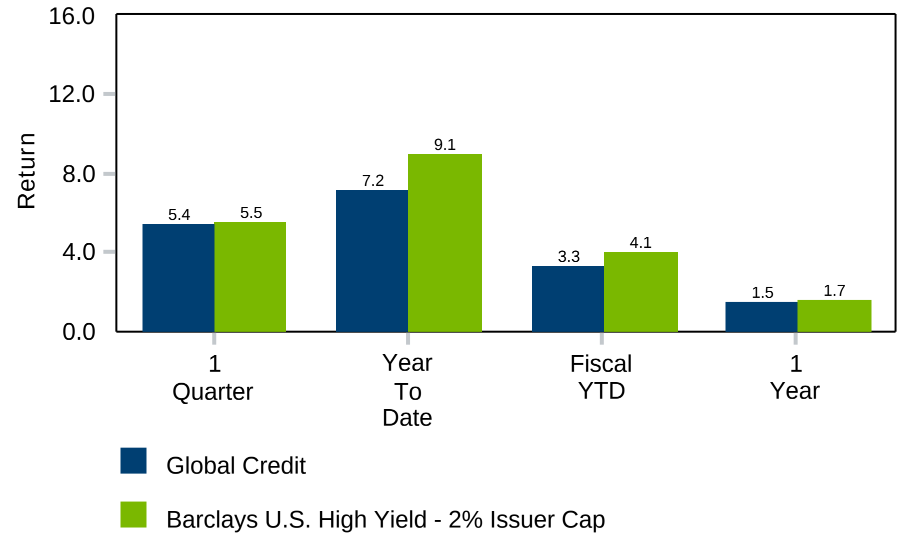
Global Credit

Global Credit Portfolio Overview

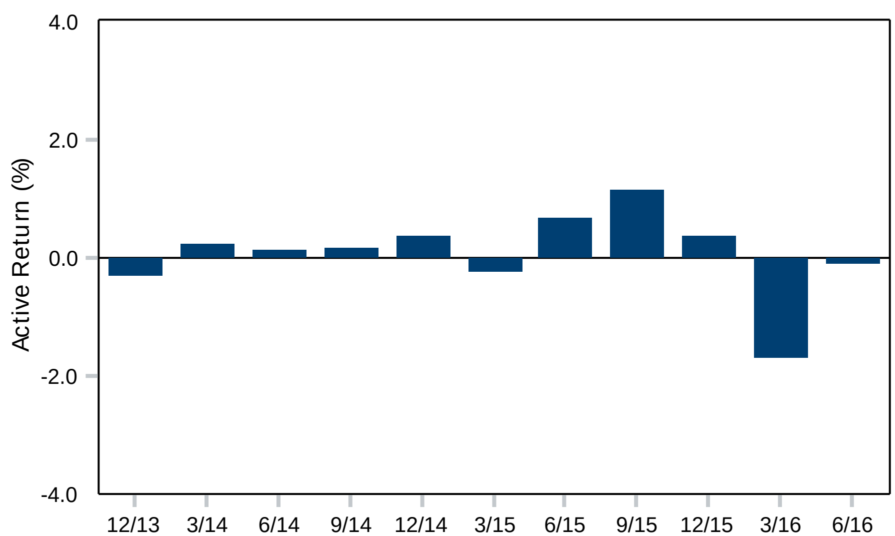
Current Allocation
June 30, 2016 : $1,956M



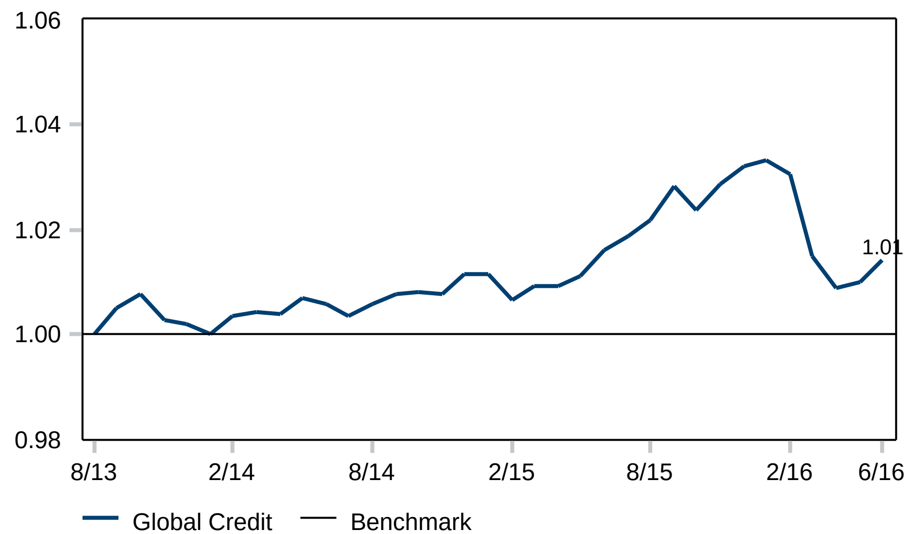
Return Summary



Quarterly Excess Performance



Ratio of Cumulative Wealth - Since Inception

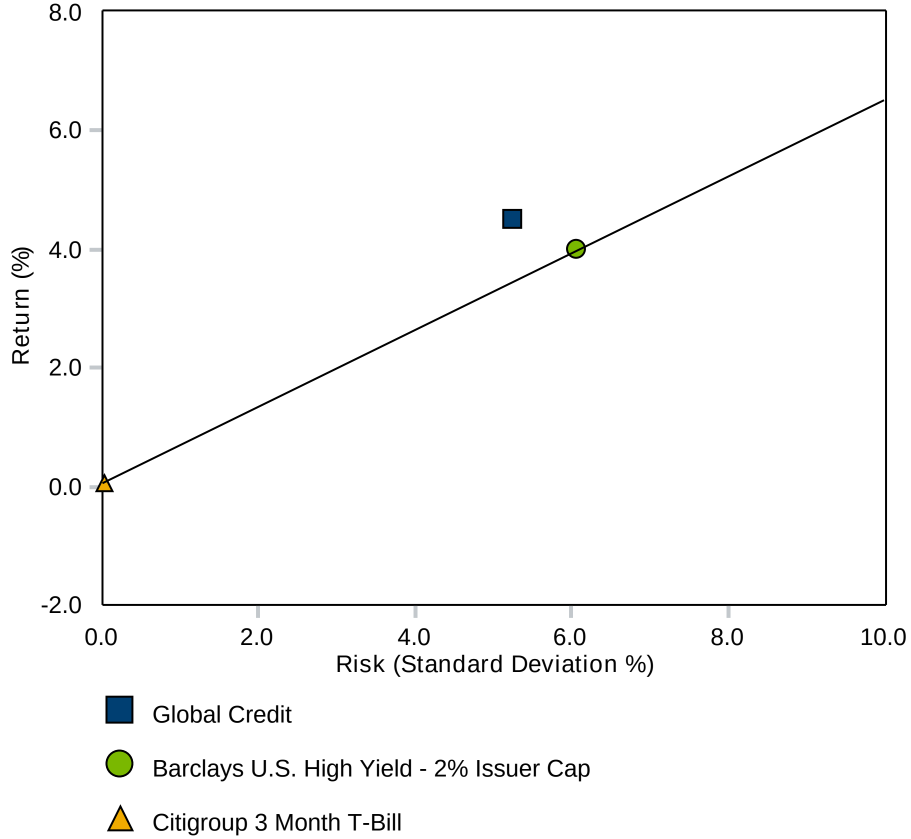


*During the quarter Barclays changed pricing sources for the Barclays U.S. High Yield 2% Issuer Cap (the primary benchmark for the Total Global Credit component), the source change resulted in a 0.13% increase in the return relative to the legacy pricing source.

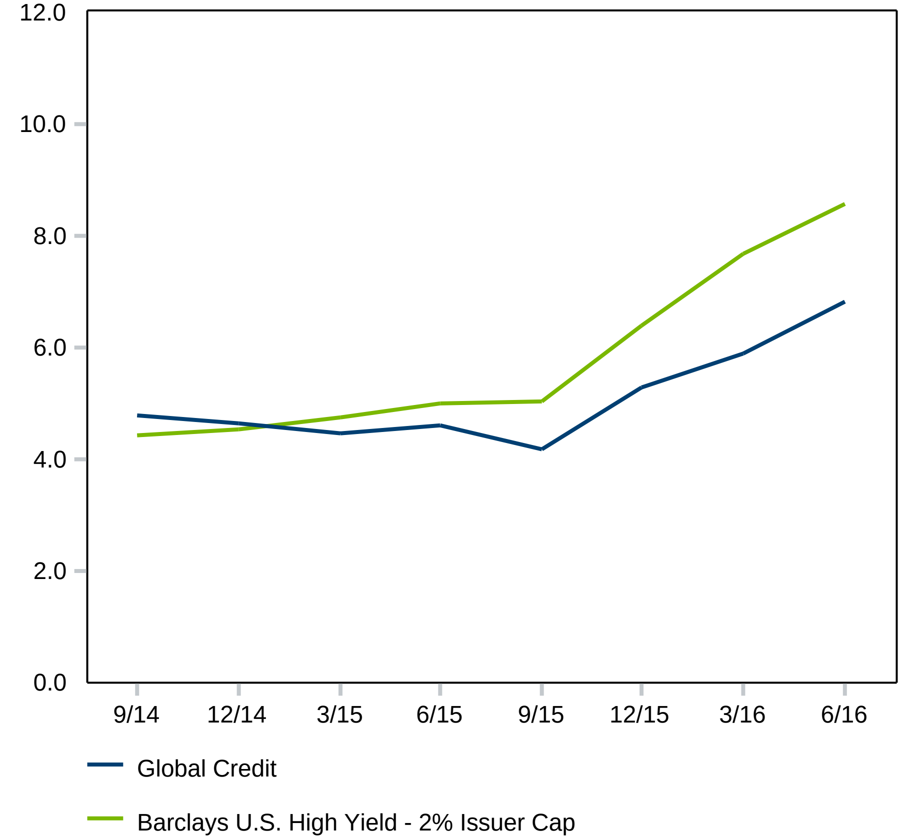
Empower Results®

Global Credit Risk Profile

Annualized Return vs. Annualized Standard Deviation Since 9/1/2013



Rolling 1 Year Standard Deviation



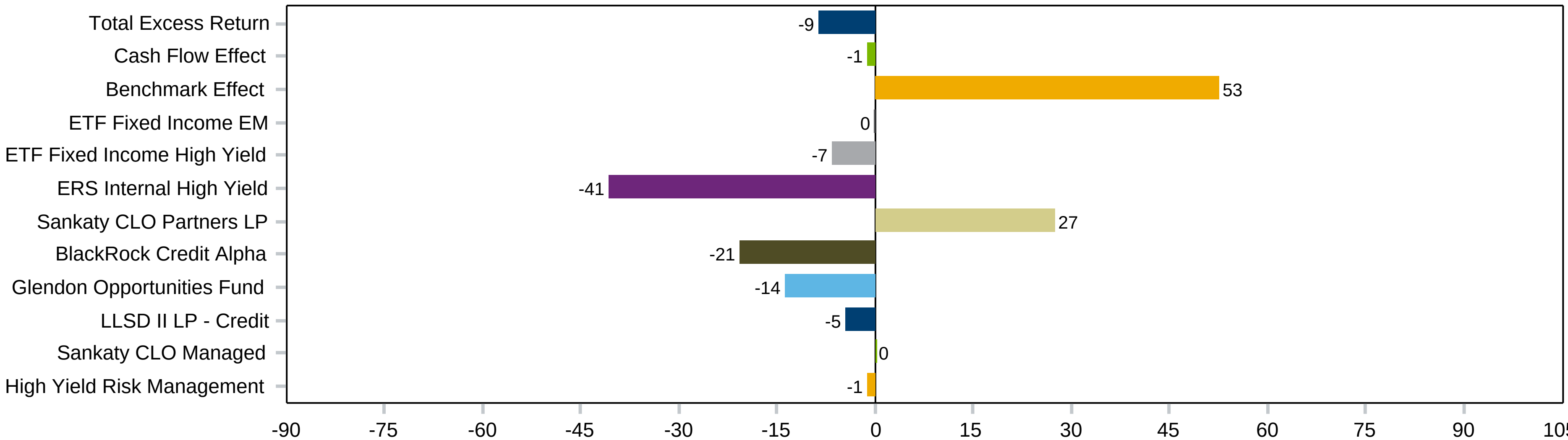
Historical Statistics Since 9/1/2013

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Global Credit	0.46	1.46	0.32	0.95	0.85	1.10	0.85	4.51	5.26	0.98
Barclays U.S. High Yield - 2% Issuer Cap	0.00	0.00	N/A	1.00	0.66	0.00	1.00	3.98	6.07	1.00
Citigroup 3 Month T-Bill	-4.03	6.06	-0.66	0.12	N/A	0.06	0.00	0.06	0.02	0.35

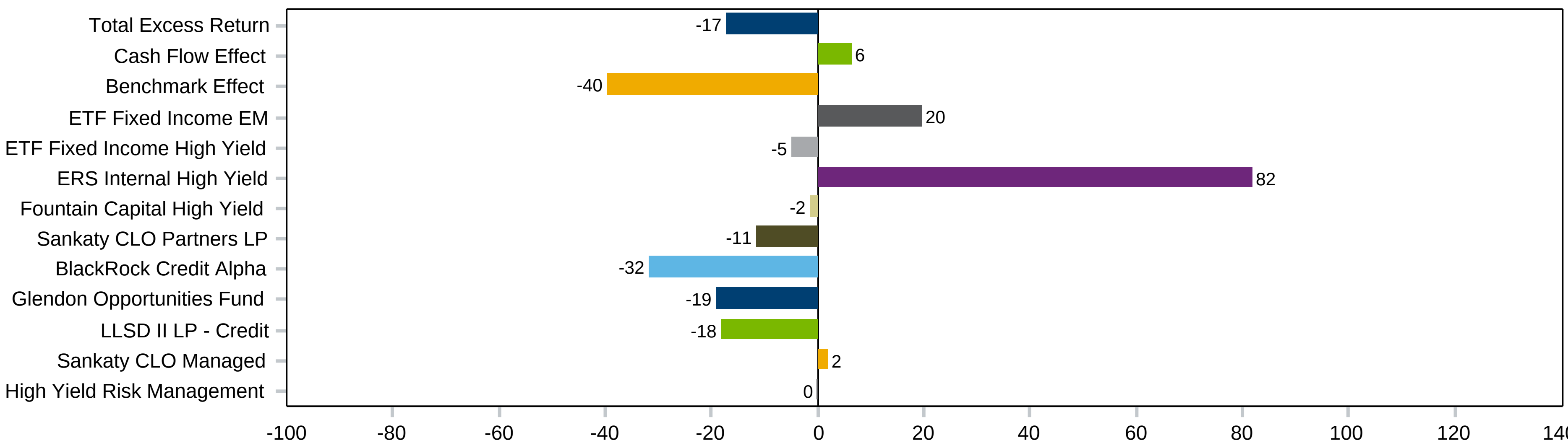
Empower Results®

Asset Class Attribution

1 Quarter



1 Year

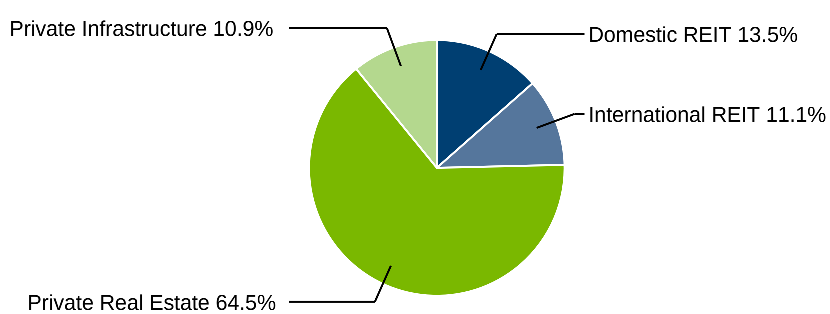


*During the quarter Barclays changed pricing sources for the Barclays U.S. High Yield 2% Issuer Cap (the primary benchmark for the Total Global Credit component), the source change resulted in a 0.13% increase in the return relative to the legacy pricing source.

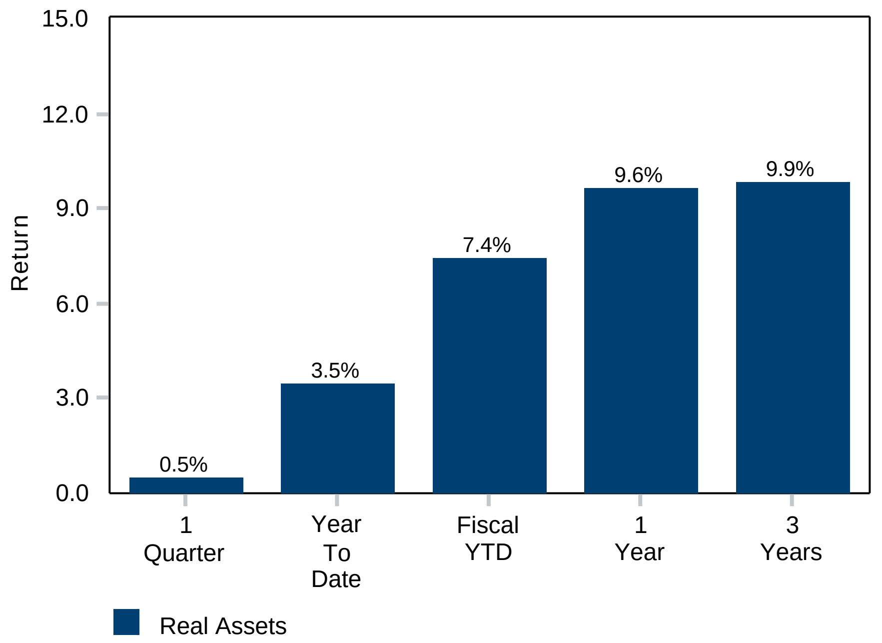
Real Assets

Real Assets Portfolio Overview

Current Allocation
June 30, 2016 : $2,869M



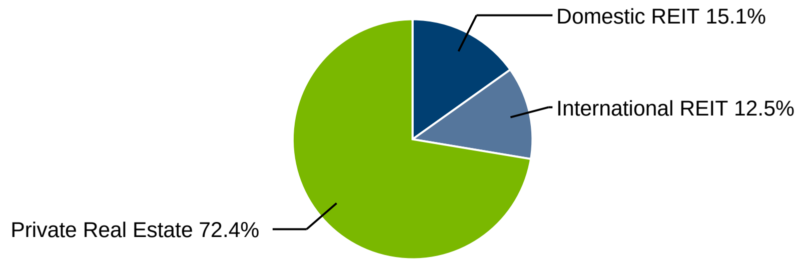
Return Summary



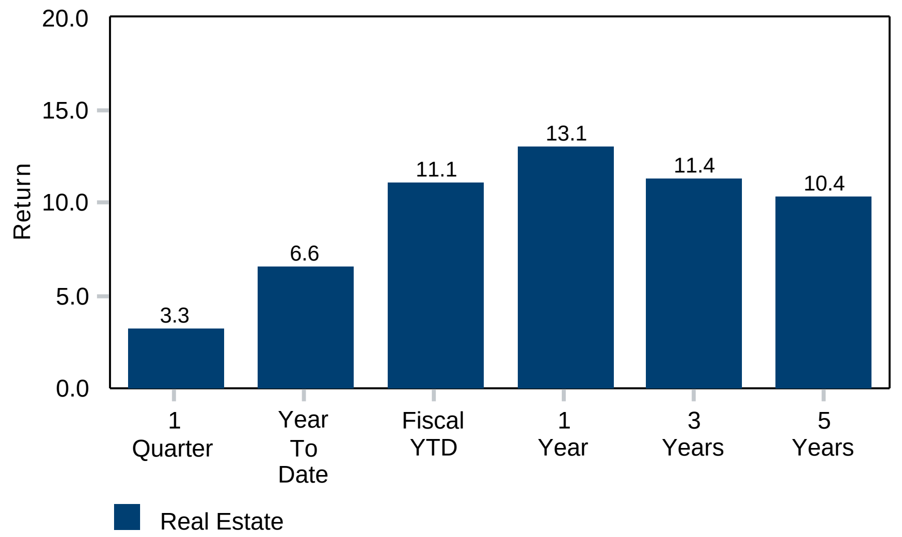
*Actual performance since 8/31/13, longer performance history was created synthetically

Real Estate Portfolio Overview

Current Allocation
June 30, 2016 : $2,556M

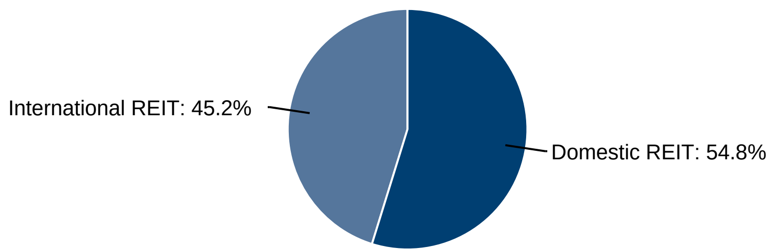


Return Summary

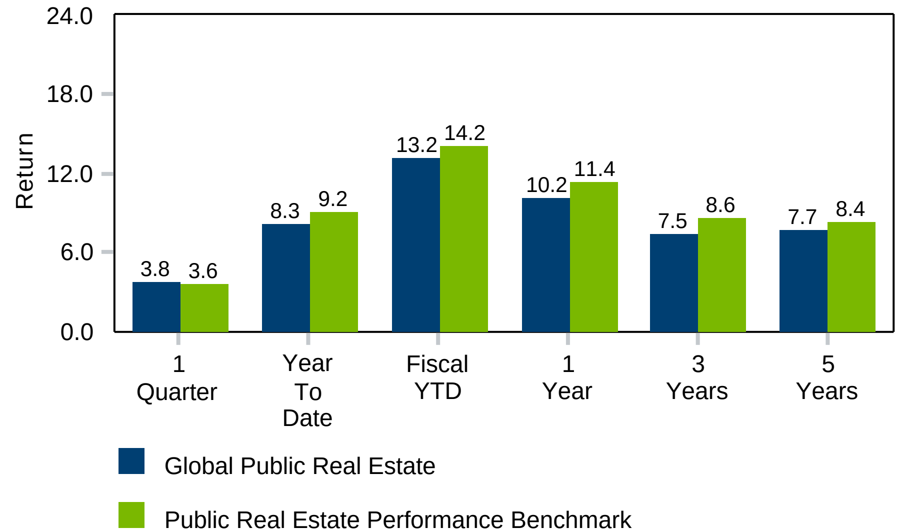


Global Public Real Estate Portfolio Overview

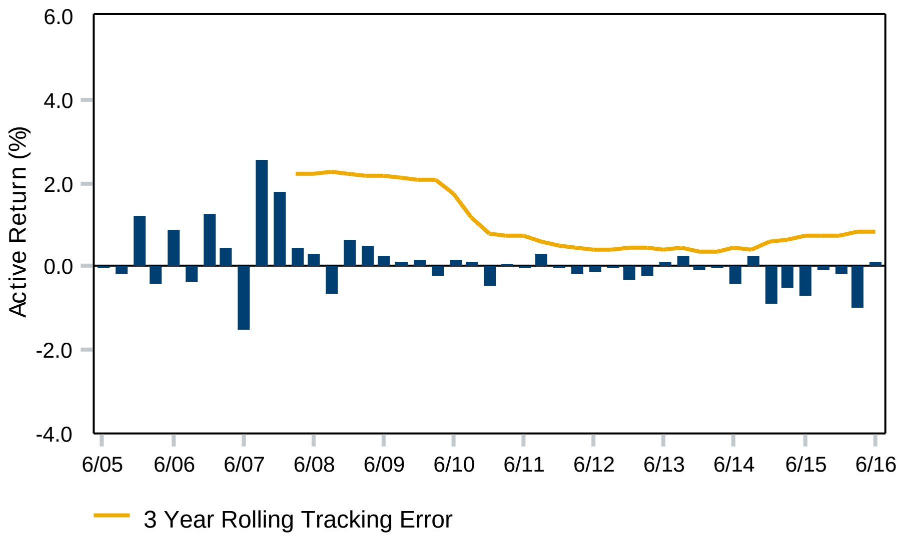
Current Allocation
June 30, 2016 : $706M



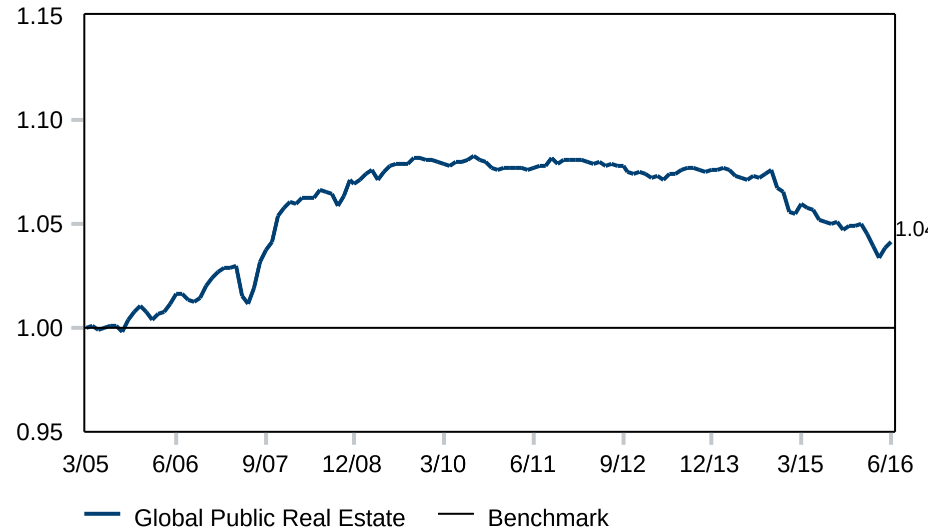
Return Summary



Quarterly Excess Performance

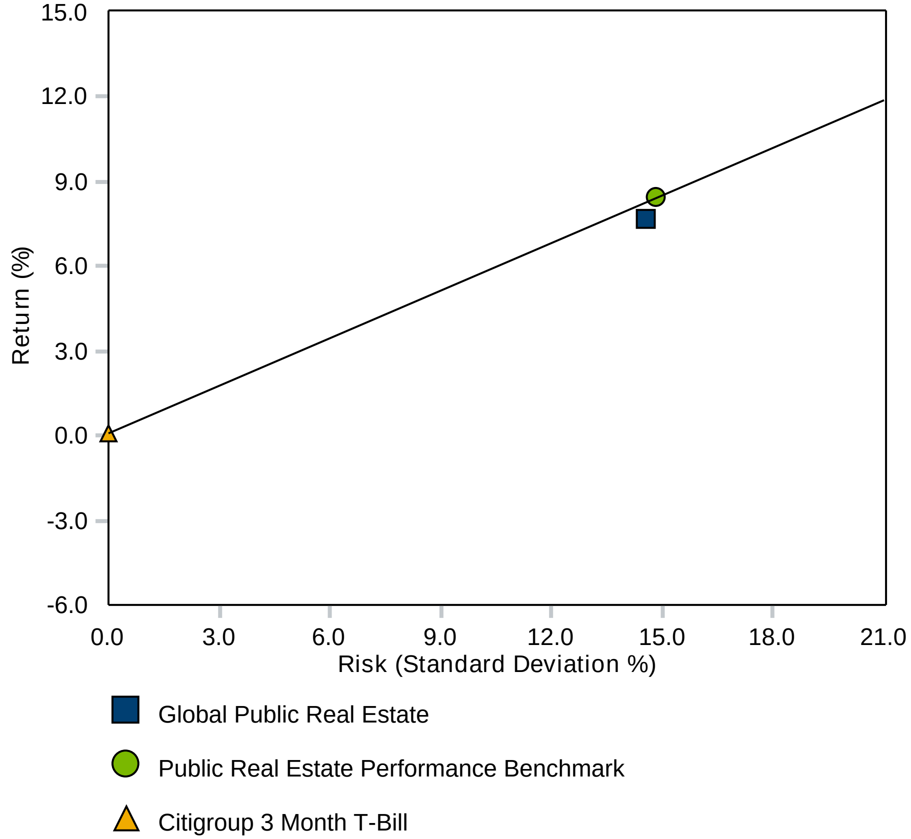


Ratio of Cumulative Wealth - Since Inception

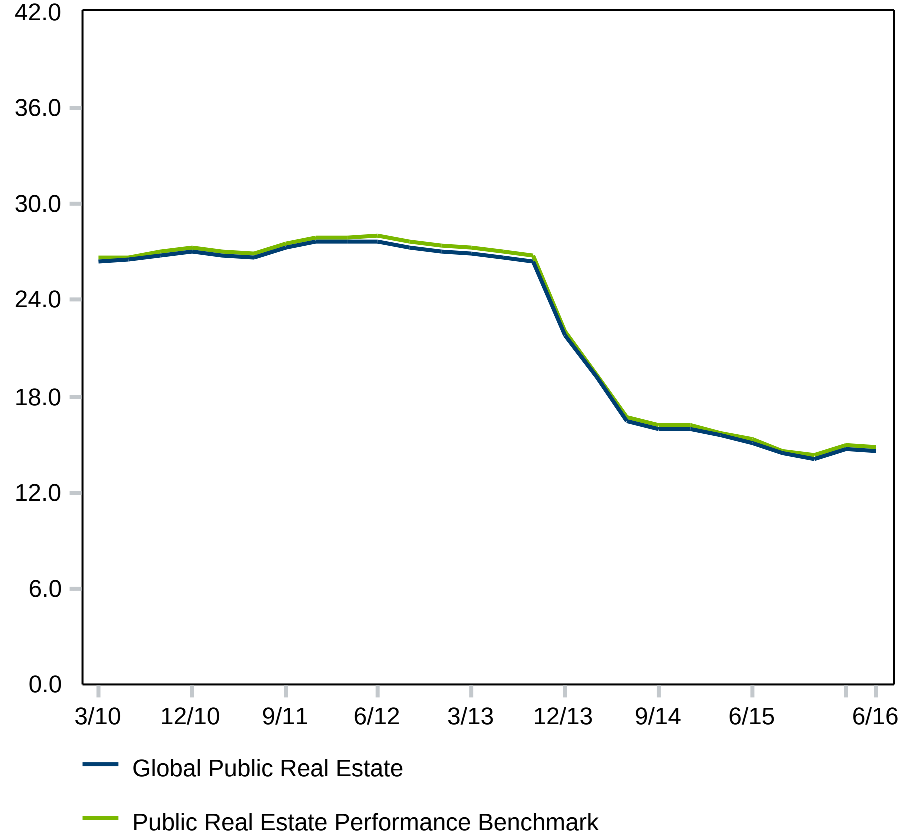


Global Public Real Estate Risk Profile

Annualized Return vs. Annualized Standard Deviation 5 Years



Rolling 5 Years Standard Deviation



5 Years Historical Statistics

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Global Public Real Estate	-0.73	0.88	-0.83	1.00	0.58	-0.55	0.98	7.67	14.57	1.00
Public Real Estate Performance Benchmark	0.00	0.00	N/A	1.00	0.62	0.00	1.00	8.42	14.85	1.00
Citigroup 3 Month T-Bill	-9.13	14.85	-0.62	0.02	N/A	0.06	0.00	0.06	0.02	0.14

AON Empower Results®

Overview

	Internal Rate of Return(%)			
	1 Year	3 Years	5 Years	Since Inception
Private Real Estate	9.6	12.7	12.4	12.8

Private Real Estate Program Summary by Fiscal Year as of 6/30/2016

ERS FY	# of Deals	Capital Committed	Capital Called	Distributions	Market Value
2010	2	$136,300,000	$135,214,916	$52,477,215	$144,911,125
2011	7	$598,850,000	$621,470,780	$438,360,258	$499,650,046
2012	7	$494,350,000	$517,475,108	$261,731,387	$442,266,721
2013	5	$410,540,000	$331,493,995	$188,459,447	$230,672,193
2014	10	$491,920,000	$381,296,497	$105,608,352	$298,777,298
2015	8	$500,800,075	$148,621,604	$21,127,844	$153,713,076
2016	6	$245,000,000	$58,634,080	$7,258,349	$49,014,218
Total	**45**	**$2,877,760,075**	**$2,194,206,980**	**$1,075,022,851**	**$1,819,004,676**

Overview

Private Real Estate Program Summary By Fund as of 6/30/2016

Deal #	Fund Name	ERS FY	Commitment Date	Capital Committed	Capital Called	Distributions	Market Value
1	LaSalle Property Fund	2010	January-10	$100,000,000			
2	Cornerstone Core Mortgage Fund	2010	May-10	$36,300,000			
3	TIAA CREF Asset Management Core Property Fund	2011	September-10	$125,000,000			
4	Madison International Real Estate Liquidity Fund IV	2011	October-10	$60,000,000			
5	Invesco Core Real Estate	2011	January-11	$100,000,000			
6	Texas ERS Private Real Estate Emerging Manager I, LP	2011	December-10	$50,000,000			
7	Waterton Residential Property Venture XI	2011	February-11	$100,000,000			
8	M&G Real Estate Debt Fund LP*	2011	June-11	$38,850,000			
9	Prudential US Real Estate Debt Fund	2011	July-11	$125,000,000			
10	Private Real Estate Emerging Manager I-Abacus	2012	January-12	$20,000,000			
11	Aberdeen European Opportunities Property Fund of Funds, LLC*	2012	February-12	$94,350,000			
12	Private Real Estate Emerging Manager I-Exeter	2012	May-12	$20,000,000			
13	Prologis Targeted U.S. Logistics	2012	April-12	$125,000,000			
14	Rockpoint Real Estate Fund IV, LP	2012/13	March-12 & March-13	$137,500,000			
15	Latitude Management, Real Estate Capital III	2012/13	August-12 & August-13	$100,000,000			
16	Northwood Real Estate Partners, LP	2012	August-12	$50,000,000			
17	KTR Industrial Fund III	2013	November-12 & August-13	$120,000,000			
18	Madison International Real Estate Liquidity Fund V	2013	December-12	$80,000,000			
19	Brookfield Strategic Real Estate Partners B LP	2013	August-13	$60,000,000			
20	M&G Real Estate Debt Fund II LP*	2013	May-13	$60,300,000			
21	Prologis European Properties Fund II*	2013/14	August-13 & September-13	$51,060,000			
22	Lone Star Real Estate Fund III	2014	September-13	$70,000,000			
23	Torchlight Debt Opportunity Fund IV LLC	2014	October-13	$35,000,000			
24	Orion European Real Estate Fund IV*	2014	November-13	$66,600,000			
25	Pennybacker Fund III	2014	December-13	$15,000,000			
26	Invesco Real Estate Asia Fund	2014/15/16	Jan-14, Feb-15, & Sept-15	$50,000,000			
27	Campus-Clarion Student Housing Partners, LP	2014	February-14	$65,000,000			
28	Hammes Partners II, L.P.	2014	February-14	$50,000,000			
29	Wheellock Street Capital Fund II, LP	2014	April-14	$47,000,000			
30	True North Real Estate Fund III LP	2014/15	May-14 & August-15	$100,000,000			
31	DRA Growth & Income Fund VIII, LLC	2014	June-14	$50,000,000			
32	Abacus Multi-Family Partners III LP	2015	December-14	$50,000,000			
33	Rockpoint Real Estate Fund V LP	2015	January-15	$100,000,000			
34	Waterton Residential Property Venture XII	2015	January-15	$75,000,000			
35	U.S. Self Storage Value Fund I, LLC**	2015/16	February-15 & March-16	$50,000,000			
36	BPE Asia Real Estate	2015	March-15	$75,000,000			
37	Brookfield Strategic Real Estate Partners II LP	2015	March-15	$75,000,000			
38	SRE Opportunity Fund II, L.P.	2015	April-15	$15,000,000			
39	AMFP II Bartz Co-Invest	2015	July-15	$5,800,075			
40	Horizon MH Communities Fund I, LP	2016	September-15	$35,000,000			
41	Alliance Co-Investment, LP	2016	November-15	$15,000,000			
42	Madison NYC Core Retail Partners, LP	2016	December-15	$20,000,000			
43	Aviva Inv Re Cap Global Co-Investment***	2016	January-16	$60,000,000			
44	ERS Private Real Estate Emerging Manager II, L.P.	2016	January-16	$50,000,000			
45	Xander Investment Management Pte Ltd.	2016	February-16	$50,000,000			
Total				**$2,877,760,075**	**$2,194,206,980**	**$1,075,022,851**	**$1,819,004,676**

*Amounts in USD as of report date.

**U.S. Self Storage Value Fund I is a separate account, whereby ERS has the choice of whether or not to invest in each deal. Max commitment is $50,000,000.

***Aviva Inv Re Cap Global is a co-investment mandate, whereby ERS has the choice of whether or not to invest in each deal. Max commitment is $60,000,000.

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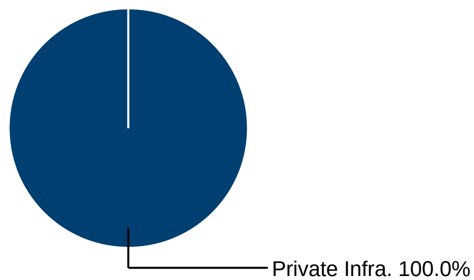
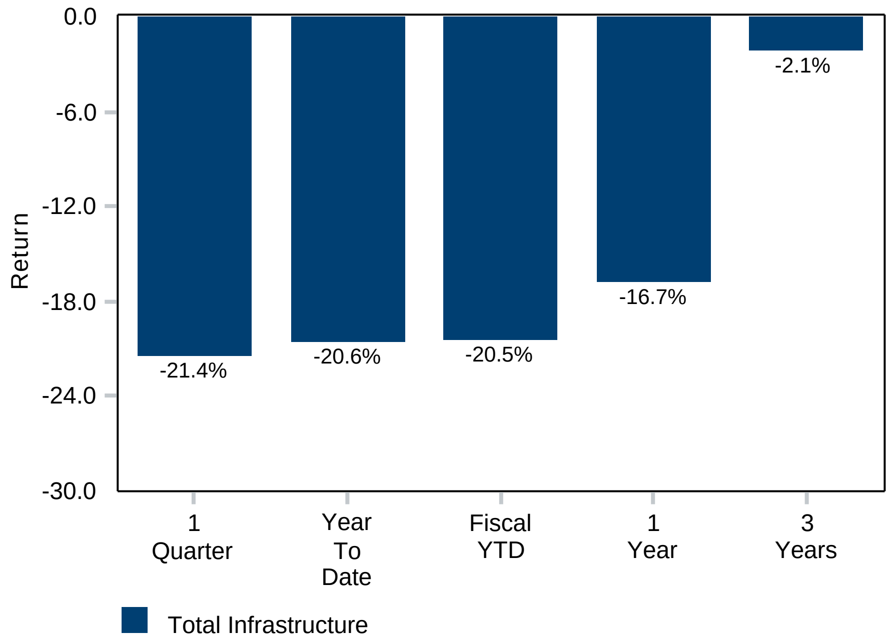
Infrastructure Portfolio Overview

Current Allocation
June 30, 2016 : $312M



Return Summary[1]



[1] Includes returns from Public Infrastructure through 6/30/15.

Overview

	Internal Rate of Return(%) 1 Year	3 Years	Since Inception
Private Infrastructure	-21.8	-7.6	-3.3

Private Infrastructure Program Summary by Fiscal Year as of 6/30/2016

ERS FY	# of Deals	Capital Committed	Capital Called	Distributions	Market Value
2012	1	$70,000,000	$70,000,000	$0	$50,908,000
2013	2	$205,000,000	$140,771,860	$2,445,614	$139,470,042
2015	2	$105,000,000	$54,935,598	$10,675,346	$40,158,771
2016	2	$177,380,000	$89,838,767	$7,619,796	$81,783,599
Total	**7**	**$557,380,000**	**$355,546,226**	**$20,740,756**	**$312,320,412**

Private Infrastructure Program Summary By Fund as of 6/30/2016

Deal #	Fund Name	ERS FY	Commitment Date	Capital Committed	Capital Called	Distributions	Market Value
1	Infrastructure Co-Investments 2012	2012	June-12	$70,000,000			
2	Infrastructure Co-Investments 2013	2013	September-12	$130,000,000			
3	Actis Energy 3 R L.P.	2013	August-13	$75,000,000			
4	ISQ Global Infrastructure Fund	2015	January-15	$75,000,000			
5	Infrastructure Co-Investments 2015	2015	March-15	$30,000,000			
6	Infrastructure Co-Investments 2016	2016	September-15	$109,380,000			
7	Stonepeak Infrastructure Fund II, LP	2016	November-15	$68,000,000			
Total				**$557,380,000**	**$355,546,226**	**$20,740,756**	**$312,320,412**

*The Market Values above do not include adjustments between June 30, 2016 and the preparation date of this report.
*The IRRs above include all adjustments effective June 30, 2016 that were received from the general partners by the time this report was prepared.

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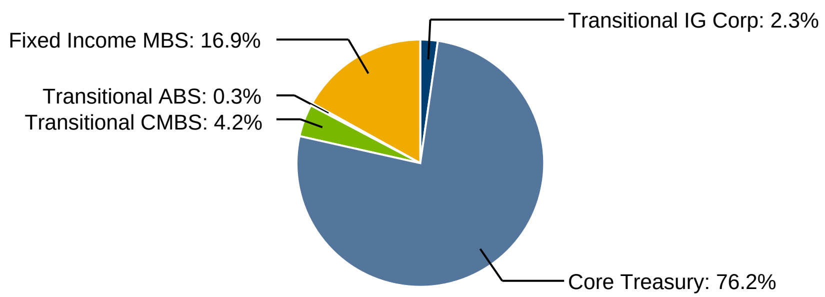
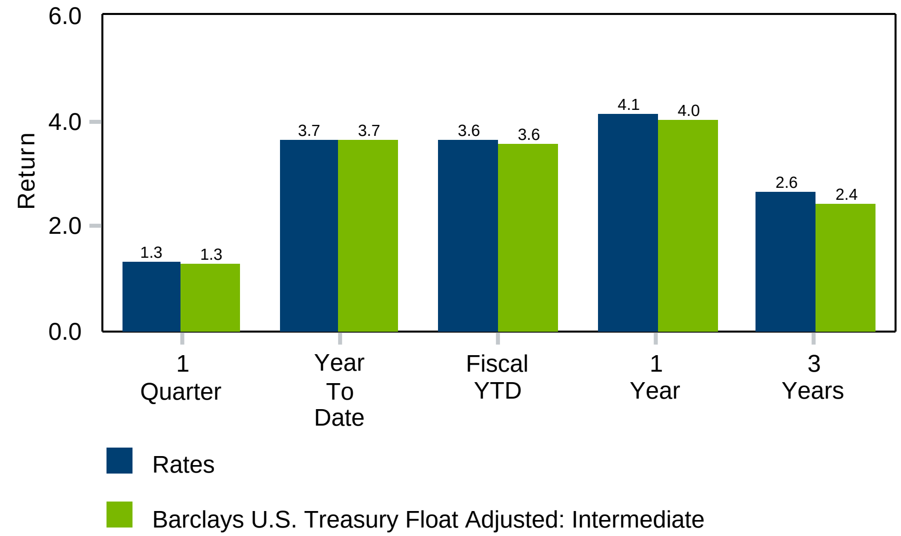
Rates

Total Rates Portfolio Overview

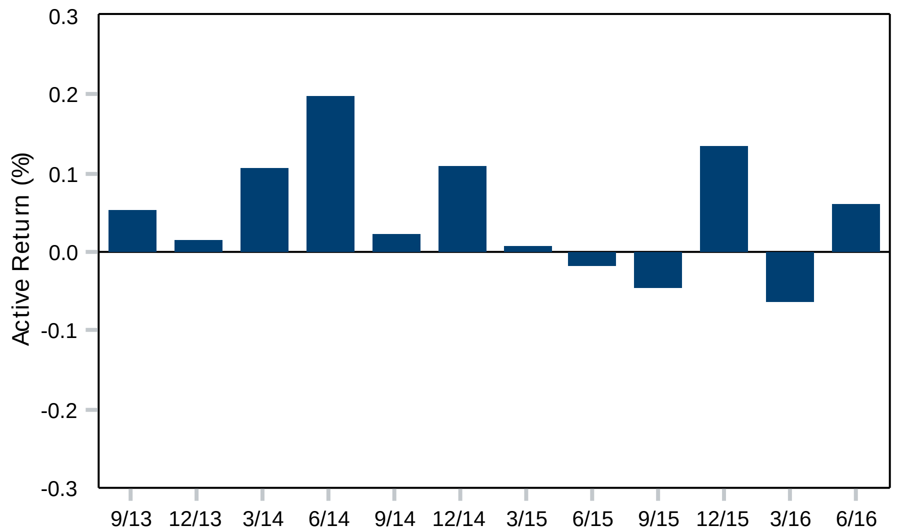
Current Allocation
June 30, 2016 : $4,057M



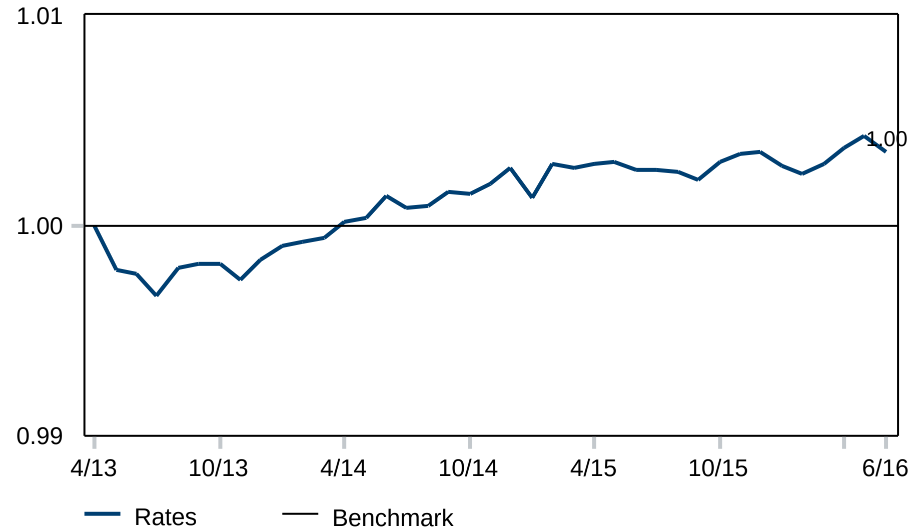
Return Summary



Quarterly Excess Performance

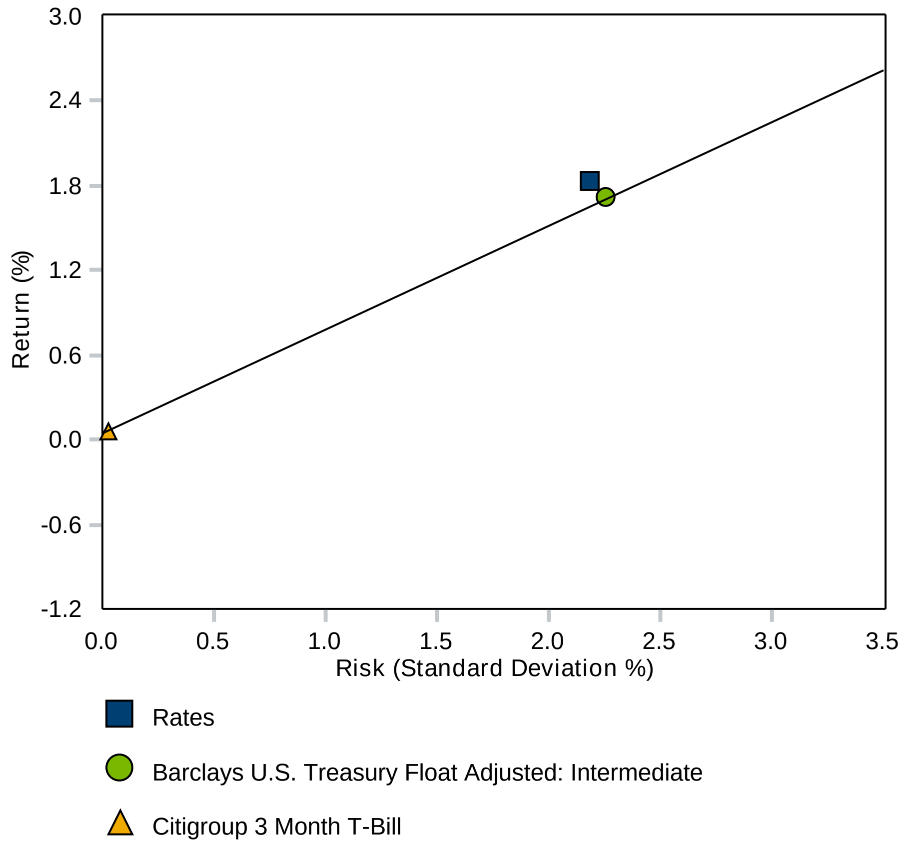


Ratio of Cumulative Wealth - Since Inception

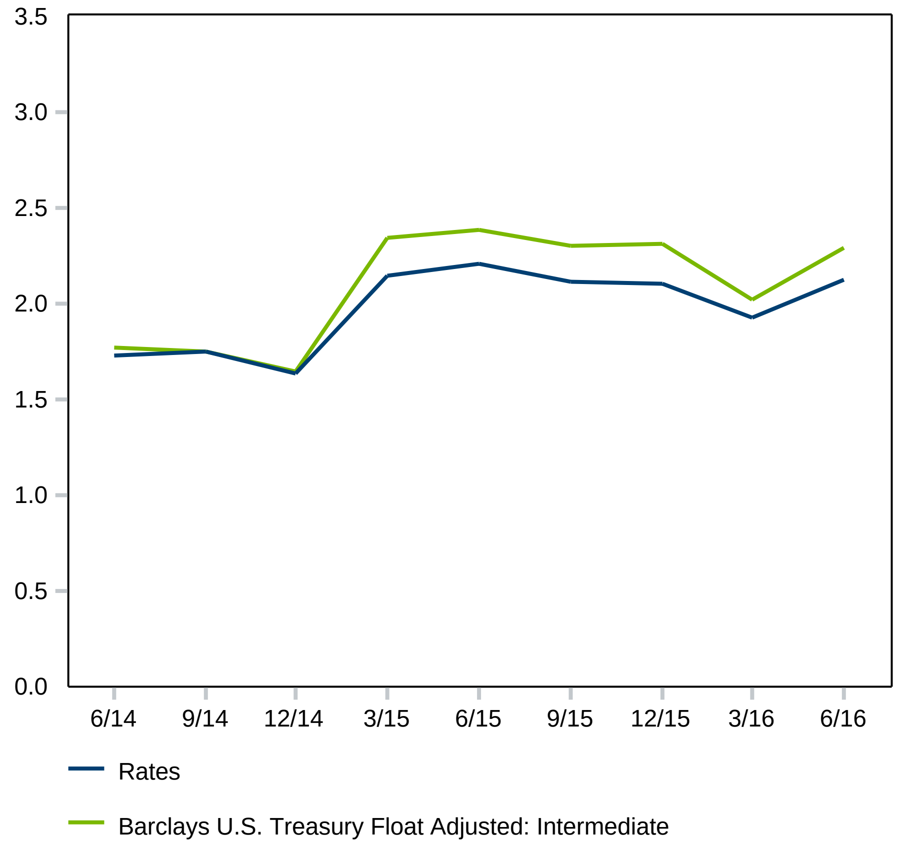


Rates Risk Profile

Annualized Return vs. Annualized Standard Deviation Since 5/1/2013



Rolling 1 Year Standard Deviation



Historical Statistics Since 5/1/2013

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Rates	0.11	0.26	0.43	0.99	0.81	0.17	0.96	1.82	2.19	0.99
Barclays U.S. Treasury Float Adjusted: Intermediate	0.00	0.00	N/A	1.00	0.74	0.00	1.00	1.71	2.26	1.00
Citigroup 3 Month T-Bill	-1.66	2.25	-0.74	0.02	N/A	0.06	0.00	0.06	0.02	0.16

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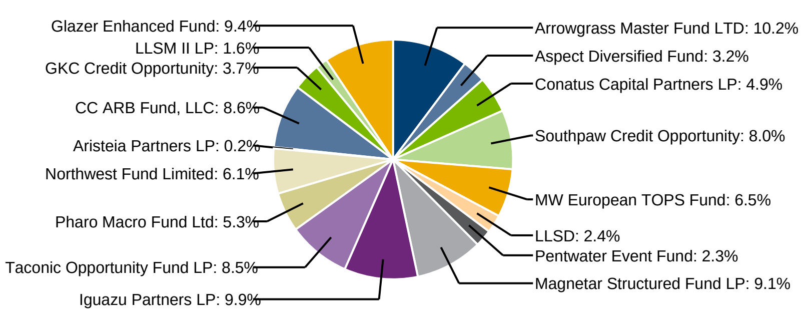
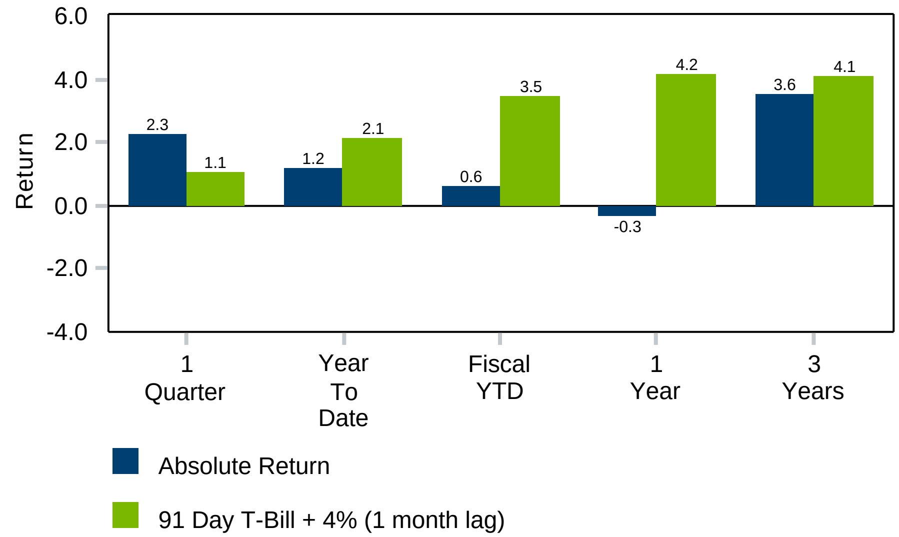
Absolute Return

Absolute Return Portfolio Overview

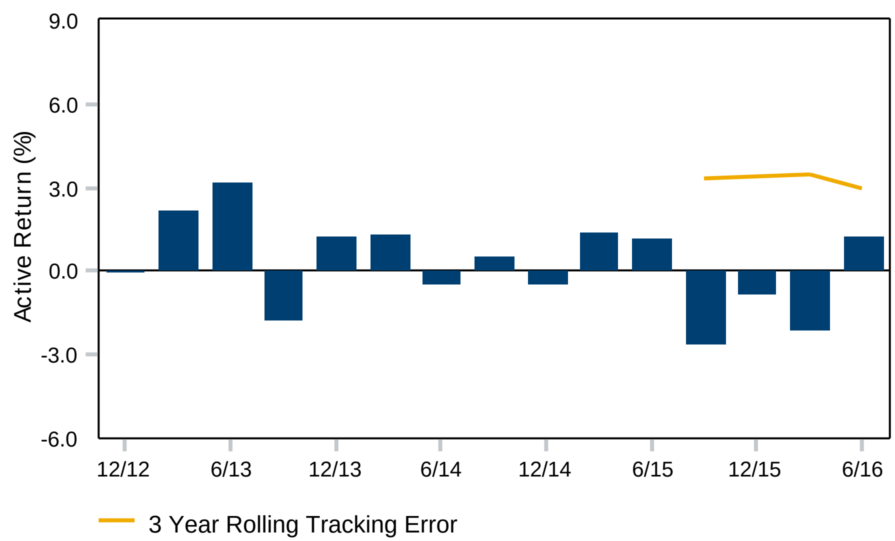
Current Allocation
June 30, 2016 : $1,200M



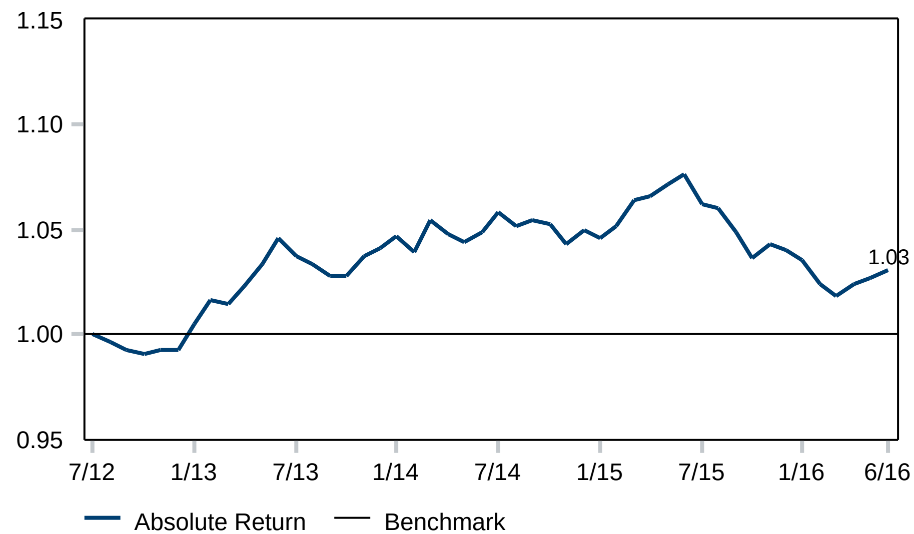
Return Summary



Quarterly Excess Performance



Ratio of Cumulative Wealth - Since Inception



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Asset Allocation & Performance

	Allocation		Performance(%)			
	Market Value ($)	%	1 Quarter	Year To Date	Fiscal YTD	1 Year
Absolute Return	1,199,559,870	100.0	2.3	1.2	0.6	-0.3
91 Day T-Bill + 4% (1 month lag)			1.1	2.1	3.5	4.2
Arrowgrass Master Fund LTD	122,610,497	10.2	-1.0	0.6	1.1	0.1
Southpaw Credit Opportunity	95,965,740	8.0	2.8	2.4	0.8	-0.6
Aspect Diversified Fund	38,089,122	3.2	-10.0	-6.5	-0.1	3.7
Conatus Capital Partners LP	58,920,051	4.9	7.5	0.6	-0.5	2.4
MW European TOPS Fund	78,030,058	6.5	1.7	2.9	4.3	7.0
Pentwater Event Fund	27,643,734	2.3	0.9	-3.1	-11.2	-20.1
LLSD	29,293,289	2.4	6.1	6.3	4.9	9.3
Magnetar Structured Fund LP	109,410,337	9.1	4.7	1.8	-2.2	-2.4
Iguazu Partners LP	118,907,532	9.9	5.1	5.0	6.2	6.5
Taconic Opportunity Fund LP	101,751,248	8.5	4.1	2.9	0.3	-1.0
Pharo Macro Fund Ltd	63,913,638	5.3	3.2	1.0	2.6	2.4
Northwest Fund Limited	72,683,920	6.1	-0.2	-4.8	-3.4	-10.6
Aristeia Partners LP	2,278,650	0.2	1.0	-2.6	-5.2	-7.2
CC ARB Fund, LLC	103,713,072	8.6	2.4	0.3	0.6	0.6
GKC Credit Opportunity	44,513,594	3.7	2.7	4.5	7.1	7.8
LLSM II LP	19,026,087	1.6	6.6	3.9	-1.7	-11.4
Glazer Enhanced Fund	112,809,302	9.4	-	-	-	-

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Appendix

Total Fund Benchmark 6/30/2016

Total Fund Policy Benchmark		
Asset Class	**Policy Index**	**Weight**
Global Public Equity	MSCI All Country World IMI Index	47.2%
Global Private Equity	MSCI All Country World IMI Index Plus 300 BPS	10.0%
Global Credit	Barclays U.S. High Yield 2% Issuer Cap Index	7.5%
Public Real Estate	FTSE EPRA/NAREIT Developed Net	3.0%
Private Real Estate	NCREIF ODCE Net Index (1 month lag)	7.0%
Private Infrastructure	Actual Return	1.2%
Rates	Barclays Intermediate Treasury Index	17.5%
Absolute Return	90 Day T-bill + 4% (1 month lag)	5.0%
Cash	Merrill Lynch 3 Month Treasury Bill	1.6%
Total		100.0%

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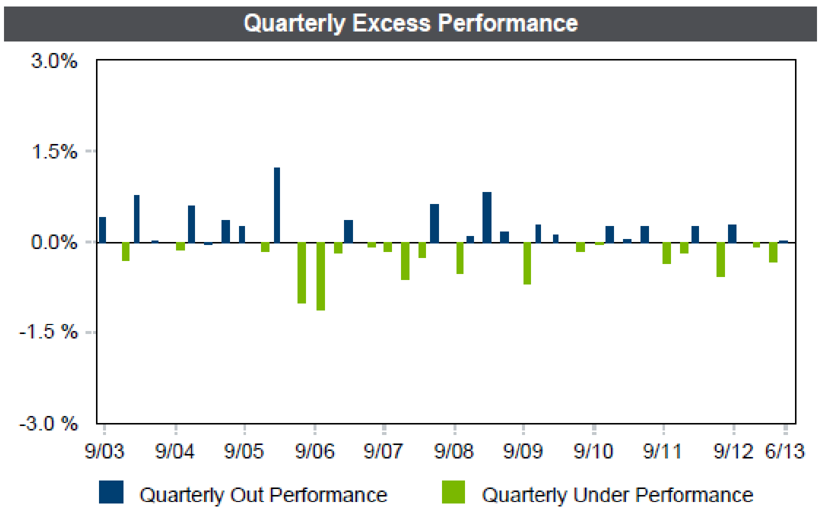
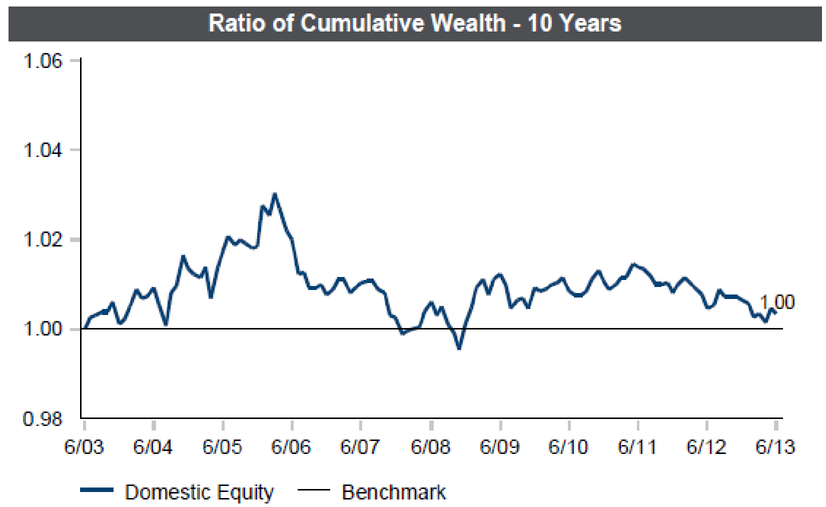
EXPLANATION OF EXHIBITS

Quarterly and Cumulative Excess Performance - The vertical axis, excess return, is a measure of fund performance less the return of the primary benchmark. The horizontal axis represents the time series. The quarterly bars represents the underlying funds relative performance for the quarter. The ratio of cumulative wealth represents the fund's cumulative relative performance versus its primary benchmark. An upward-sloping line indicates superior fund performance versus its benchmark. Conversely, a downward-sloping line indicates underperformance by the fund. A flat line is indicative of benchmark-like performance.



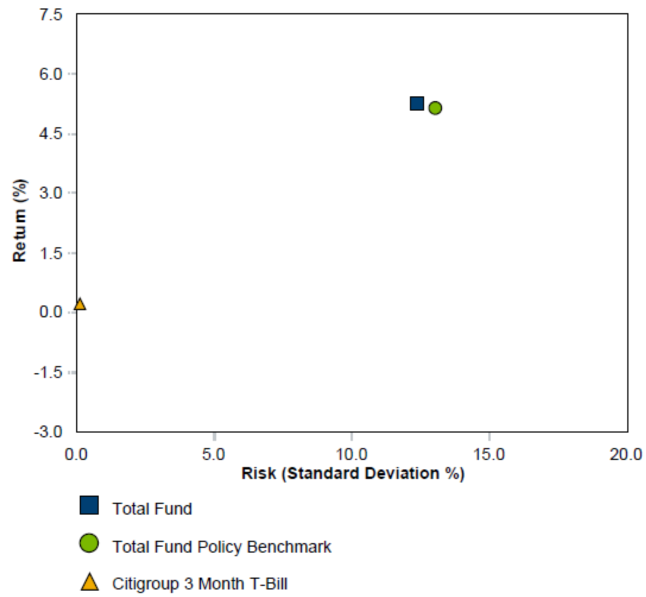


Risk-Return Graph - The horizontal axis, annualized standard deviation, is a statistical measure of risk, or the volatility of returns. The vertical axis is the annualized rate of return. As investors generally prefer less risk to more risk and always prefer greater returns, the upper left corner of the graph is the most attractive place to be.

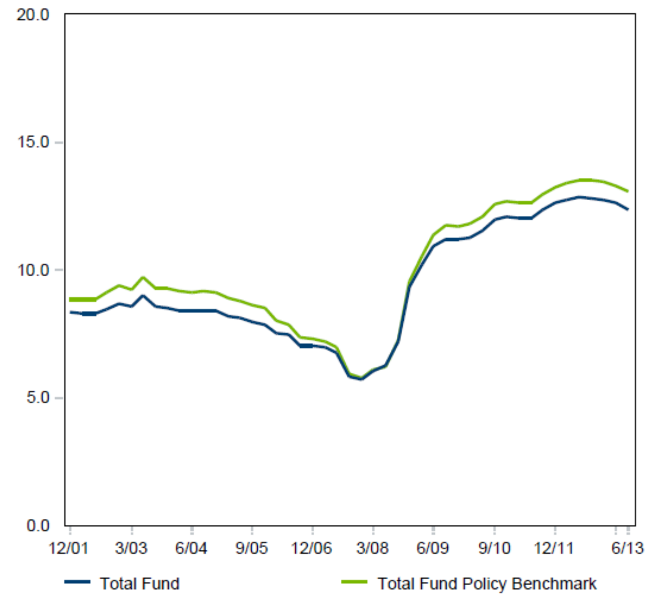
Rolling 5 Years Standard Deviation - The vertical axes measures standard deviation for the 5 year period prior to the corresponding time series date on the horizontal axis for both a fund and its respective benchmark.

Total Fund Risk Profile

Annualized Return vs. Annualized Standard Deviation 5 Years



Rolling 5 Years Standard Deviation



5 Years Historical Statistics

	Active Return	Tracking Error	Information Ratio	R-Squared	Sharpe Ratio	Alpha	Beta	Return	Standard Deviation	Actual Correlation
Total Fund	0.01	0.86	0.02	1.00	0.46	0.34	0.95	5.24	12.38	1.00
Total Fund Policy Benchmark	0.00	0.00	N/A	1.00	0.43	0.00	1.00	5.13	13.08	1.00
Citigroup 3 Month T-Bill	-5.66	13.12	-0.43	0.14	N/A	0.25	0.00	0.23	0.12	-0.37

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Statistics Definition

Statistics		Definition
Active Return	-	Arithmetic difference between the managers return and the benchmark return over a specified time period.
Actual Correlation	-	It is a measure of the correlation (linear dependence) between two variables X and Y, giving a value between +1 and -1 inclusive. It is widely used in the statistics as a measure of the strength of linear dependence between two variables. Also called coefficient of correlation.
Alpha	-	A measure of the difference between a portfolio's actual returns and its expected performance, given its level of risk as measured by beta. It is a measure of the portfolio's historical performance not explained by movements of the market, or a portfolio's non-systematic return.
Beta	-	A measure of the sensitivity of a portfolio to the movements in the market. It is a measure of a portfolio's non-diversifiable or systematic risk.
Information Ratio	-	Measured by dividing the active rate of return by the tracking error. The higher the Information Ratio, the more value-added contribution by the manager.
R-Squared	-	The percentage of a portfolio's performance explained by the behavior of the appropriate benchmark. High R-Square means a higher correlation of the portfolio's performance to the appropriate benchmark.
Return	-	Compounded rate of return for the period.
Sharpe Ratio	-	Represents the excess rate of return over the risk free return divided by the standard deviation of the excess return. The result is the absolute rate of return per unit of risk. The higher the value, the better the product’s historical risk-adjusted performance.
Standard Deviation	-	A statistical measure of the range of a portfolio's performance, the variability of a return around its average return over a specified time period.
Tracking Error	-	A measure of the standard deviation of a portfolio's performance relative to the performance of an appropriate market benchmark.

Appendix

Total Fund	**Total Fund Policy Benchmark** is currently comprised of the MSCI All Country World IMI, MSCI AC World IMI Index Plus 300 basis points, Barclays US High Yield 2% Issuer Cap, FTSE EPRA/NAREIT Blend, NCREIF ODCE NET (1 month in arrears), Barclays Intermediate Treasury, BofA Merrill Lynch 3 Month Treasury Bill + 4% (lagged 1 month), BofA Merrill Lynch 3 Month Treasury Bill, and actual returns for Private Infrastructure.
Universe	**Universe** - The rankings are based on a universe of 68 total public pension plans with greater then $1.0 billion in assets compiled by BNY Mellon Performance & Risk Analytics.
Global Equity	**MSCI All Country World Index** - A capitalization-weighted index of stocks representing 46 stock markets in Europe, Australia, the Far East, the Middle East, Latin America and North America.
Global Public Equity	**Global Public Equity Benchmark –** The benchmark consists of the S&P 1500 and MSCI ACWI ex U.S. using actual portfolio weights until 8/31/14, the MSCI All Country World Index until 8/31/15 and the MSCI All Country World IMI Index thereafter.
Domestic Equity	**Domestic Equity Benchmark** - The benchmark consists of the S&P 500 until 8/31/08 and the S&P 1500 Index thereafter. The S&P 1500 Index is a combination of the S&P 500, S&P MidCap 400, and S&P SmallCap 600 indices, and represents 85% of the total U.S. stock market.
ERS S&P 500 Index Fund & **ERS Large Cap Core**	**S&P 500 Stock Index** - A capitalization-weighted index representing stocks chosen by Standard & Poor's, Inc. for their size, liquidity, stability and industry group representation. The companies in the S&P 500 Index are generally among the largest in their industries.
Large Cap Growth Quant	**S&P 500/Citigroup Growth Index** - An index of approximately 286 stocks in the S&P 500 Index covering all pure growth stocks and the growth distribution of those having both growth and value characteristics
Barrow Hanley Mewhinney & Strauss	**S&P 500 Value Index**- A capitalization-weighted index representing publicly traded U.S. value stocks. Value is determined by the stocks' book value to price ratio, sales to price ratio and dividend yield.
ERS Mid Cap Core	**S&P Mid Cap 400 Index** - A market-capitalization-weighted index of stocks in all major industries in the mid-range of the U.S. stock market.
ERS Small Cap Core	**S&P 600 Index** - Focuses on the small-cap segment of the market, including companies from a variety of different sectors/industries. In order for a stock to be added to the S&P 600 Index, it must be a U.S. company, have adequate liquidity and reasonable per-share price, and have a market cap of $300 million to $1 billion.
Emerging Manager Composite	**S&P 1500 Index** is a combination of the S&P 500, S&P MidCap 400, and S&P SmallCap 600 indices, and represents 85% of the total U.S. stock market.
International Equity	**International Equity Benchmark-** The Benchmark consists of the MSCI EAFE Net January 1999 through August 2008 and the MSCI ACWI ex US Net thereafter. **MSCI All Country World ex-U.S. Index** - A capitalization-weighted index consisting of 22 developed and 23 emerging countries, but excluding the U.S. Covers approximately 85% of global equity opportunity set outside of the U.S.
ERS International EAFE Composite	**MSCI EAFE Index** - An equity index which captures large and mid cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. With 900 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

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Appendix

ERS Canada	**MSCI Canada** - A market capitalization-weighted index that captures broad Canadian equity market coverage including over 680 constituents across large, mid, small and micro capitalizations. The index covers approximately 85% of the free float-adjusted market capitalization in Canada.
Fisher Investments	**Fisher Performance Benchmark -** The benchmark consists of the MSCI EAFE Net from July 2006 through September 2008 and MSCI ACWI ex US Net thereafter. **MSCI All Country World ex-U.S. Index** - A capitalization-weighted index consisting of 22 developed and 23 emerging countries, but excluding the U.S. Covers approximately 85% of global equity opportunity set outside of the U.S.
Templeton	**Templeton Performance Benchmark-** The benchmark consists of the MSCI EAFE Net from April 2003 through September 2008 and MSCI ACWI ex US Net thereafter. **MSCI All Country World ex-U.S. Index** - A capitalization-weighted index consisting of 22 developed and 23 emerging countries, but excluding the U.S. Covers approximately 85% of global equity opportunity set outside of the U.S.
Lazard Asset Management	**MSCI EAFE Index** - An equity index which captures large and mid cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. With 900 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Blackrock International Focus	**MSCI All Country World ex-U.S. Index** - A capitalization-weighted index consisting of 22 developed and 23 emerging countries, but excluding the U.S. Covers approximately 85% of global equity opportunity set outside of the U.S.
ERS Emerging Markets	**MSCI Emerging Markets Index** - A capitalization-weighted index of stocks representing 23 Emerging Markets. With 833 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Total Global Credit	**Barclays U.S. High Yield - 2% Issuer Cap-** An index comprising US corporate, fixed-rate, noninvestment-grade debt with at least one year to maturity and at least $150 million in par outstanding. Index weights for each issuer are capped at 2%.
ETF Fixed Income Emerging Markets	**ETF Fixed Income EM Performance Benchmark-** The benchmark consisted of the Barclays Emerging Market from July 2012 through August 2013 and the Barclays U.S. Corporate High Yield 2% Issuer Capped thereafter.
ETF Fixed Income High Yield	**Barclays U.S. High Yield 2% Issuer Cap-** The Benchmark consists of the Barclays U.S. High Yield from July 2012 through August 2013, and the Barclays U.S. High Yield 2% Issuer Capped thereafter.
Private Credit	**Barclays U.S. High Yield 2% Issuer Cap (1 month lag)-** An index comprising US corporate, fixed-rate, noninvestment-grade debt with at least one year to maturity and at least $150 million in par outstanding. Index weights for each issuer are capped at 2%.

Appendix

Real Estate	**The benchmark** consists of the FTSE EPRA/NAREIT Global Index through August 31st, 2010 and a combination of the Global Real Estate Performance Benchmark and the return of the Private Real Estate subsequent to August 31, 2010.
Global Public Real Estate	**Public Real Estate Performance Benchmark-** consists of the MSCI REIT from March 2005 - March 2007, a floating weight benchmark comprised of the EPRA/NAREIT US and EPRA/NAREIT US Global ex US from April 2007 through December 2007, the EPRA NAREIT Global Index from January 2008 through August 2013, the FTSE EPRA/NAREIT Developed Net from September 2013 through August 2014, and a MV weighted blend of the Total Internal Public RE Benchmark and the Wells St. Partner custom benchmark from September 2014 through March 2016. Effective April 2016, the benchmark is 100% FTSE EPRA/ NAREIT Developed Net.
Private Real Estate	**Private RE Performance Benchmark** - consists of the 91 Day T-Bill + 4% RE benchmark from 9/1/2012 through 8/31/14 and the NCREIF NFI-ODCE Net 1 month lagged beginning 9/1/14.
Internal Public Real Estate	**Public Real Estate Performance Benchmark**- The benchmark consists of the MSCI REIT from March 2005 - March 2007, a floating weight benchmark comprised of the EPRA/NAREIT US and EPRA/NAREIT US Global ex US from April 2007 through December 2007, the EPRA NAREIT Global Index from January 2008 through August 2013, and the FTSE EPRA/NAREIT Developed Net thereafter
Domestic REIT	**Domestic REIT Performance Benchmark-** The benchmark consists of the MSCI REIT from May 2000 - March 2007 and the FTSE EPRA/NAREIT thereafter. FTSE NAREIT Index - Includes all tax-qualified equity real estate investment trusts (REITs) meeting certain size and liquidity criteria that are listed on the New York Stock Exchange, the American Stock Exchange or the NASDAQ National Market List. Equity REITs include those firms that own, manage and lease investment-grade commercial real estate. Specifically, a company is classified as an Equity REIT if 75% or more of its gross invested book assets is invested in real property.
International REIT	**FTSE EPRA NAREIT Global ex-U.S. Index** - Designed to represent general trends in eligible real estate equities worldwide. Relevant real estate activities are defined as the ownership, disposure and development of income-producing real estate.
Total Rates	**Barclays Intermediate Treasury Index-** Consists of fixed-rate debt securities with maturities from one up to (but not including) 10 years from the U.S. Government Bond indices.
Absolute Return	**91 Day T-Bill +4% (1 month lag)**- The benchmark consists of the 91 Day T-Bill + 4% through 8/31/14 and the 91 Day T-Bill + 4% 1 month lagged beginning 9/1/14.

AHIC Thought Leadership Highlights

White Papers	
All Investors: The Small Cap Alpha Myth Revisited	Link
All Investors: Brexit	Link
All Investors ex-DC: Real Estate Beta: Understanding the Power of Core	Link
All Investors ex-DC: Risk Parity – Looking at Risk Through a Different Lens	Link
DB & DC: Hot Topics in Retirement and Financial Well-Being	Link
DB & DC: Real Deal Study	Link
Private DB: Pension Funding Strategy	Link
DC: Stable Value in the Spotlight	Link
DC: If You Offer It, Participants Will Use It (Roth Usage in DC Plans)	Link
DC: Final Fiduciary Regulations – Overview for Plan Sponsors	Link
Healthcare Industry: Redefining Retirement in the Health Care Industry (Part Five of Five Part Series)	Link

Current Topics of Interest	
Private DB: Bipartisan Budget Act of 2015	Link
Private DB: U.S. Corporate Pension Liability Hedging Views	Link
DC: 2016 Universe Benchmarks – Research Highlights	Link
DC: Mythbusters: The Case for Retirement Income in DC Plans	Link

Aon Hewitt Retirement and Investment Blog

https://retirementandinvestmentblog.aon.com/

Events	
Replay recent webinars, including the most recent session on "The Shifting Retirement Benefits Landscape."	Link

Disclaimers and Notes

Disclaimers:

- Please review this report and notify Aon Hewitt Investment Consulting (AHIC) with any issues or questions you may have with respect to investment performance or any other matter set forth herein.
- The client portfolio market value data presented in this report have been obtained from the custodian. AHIC has compared this information to the investment managers' reported returns and believes the information to be accurate. AHIC has not conducted additional audits and cannot warrant its accuracy or completeness.
- The mutual fund information found in this report is provided by Lipper Inc. and AHIC cannot warrant its accuracy or timeliness.
- Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.

Notes:

- The rates of return contained in this report are shown on an after-fees basis unless otherwise noted. They are geometric and time weighted. Returns for periods longer than one year are annualized.
- Universe percentiles are based upon an ordering system in which 1 is the best ranking and 100 is the worst ranking.
- Due to rounding throughout the report, percentage totals displayed may not sum up to 100.0%. Additionally, individual fund totals in dollar terms may not sum up to the plan totals.

PUBLIC AGENDA ITEM – #7a*

Review, Discussion and Consideration of ERS Private Equity Program:

7a.* Market Update and Program Overview

August 16, 2016

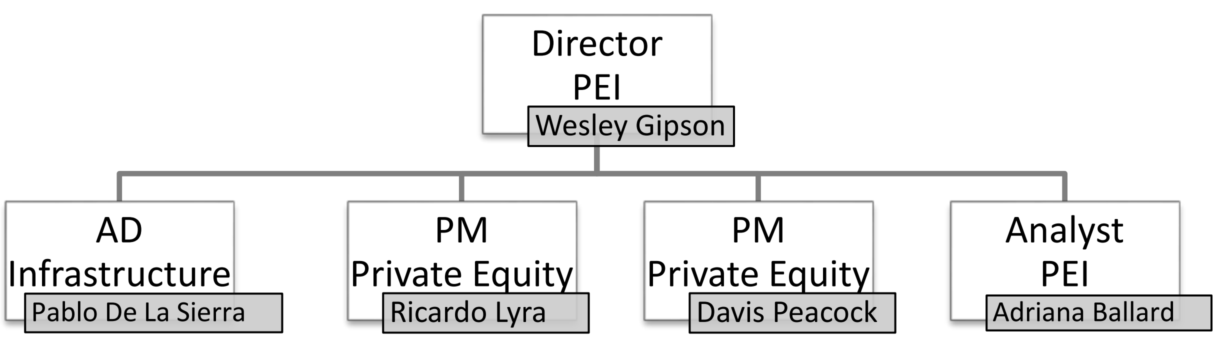
BACKGROUND

The Employees Retirement System of Texas ("ERS") determined that, over the long term, the inclusion of private equity and debt investments (referred to collectively as "private equity") would enhance ERS' expected portfolio investment characteristics. Specifically, with as a result of the possibility of enhanced rates of return over publicly traded securities and returns that have low correlation with those associated with other major asset classes; the use of private equity investments tends to increase the portfolio's overall long-term expected real return, and reduce year-to-year portfolio volatility.

At the Joint Meeting of the Board of Trustees ("the Board") and Investment Advisory Committee ("IAC") on August 19, 2008, the Board approved a target allocation of eight percent (8%) for private equity. Subsequently, at the February 26, 2013 Joint Meeting of the Board and IAC, the Board approved an increase to the private equity allocation from 8% to 10% of the Trust's assets. Staff will continue to provide a review of ERS' Private Equity program at least annually.

PRIVATE EQUITY AND INFRASTRUCTURE ("PEI") TEAM

The Private Equity and Infrastructure Team, ("PEI") functions as a single organization covering Private Equity and Infrastructure. All team members contribute to both asset classes. However Pablo De La Sierra is heavily focused on Infrastructure and Davis Peacock is heavily focused on Private Equity. Ricardo Lyra joined the team this year as a portfolio manager.



PRIVATE EQUITY PROGRAM REVIEW

During the August 2015 Joint Meeting of the Board of Trustees ("Board") and Investment Advisory Committee ("IAC"), the Board approved ERS' fiscal year 2016 private equity commitment target of $950 million with a commitment range of +/- 25% ($712.5 – 1,187.5 million).

Prior to fiscal year 2016, ERS committed to 66 private equity funds and 20 co-investments with commitments totaling $5.43 billion (adjusted for currency exchange rates). Fiscal year to date through June 30, 2016, ERS Private Equity has closed on eight fund investments and five co-investments totaling $744 million.

** We are accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. This agenda item may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees.*

Since inception through June 30, 2016, ERS has closed on 74 private equity funds and 24 co-investments with commitments totaling $6.17 billion (adjusted for currency exchange rates). Since inception through June 30, 2016, cash distributions total $2.5 billion, $1.1 billion[1] of which came in the past 12 months. Of the 74 fund commitments, ERS has LP Advisory Committee seats in 44 active funds and LP Observer rights in two funds.

For the full Fiscal Year 2017, ERS is targeting commitments totaling $750 million with a range of +/- 25% ($563 - 934 million).

Please refer to the summary tables in **Exhibit B** regarding private equity fund commitments and portfolio metrics.

ERS Private Equity had a Net Asset Value ("NAV") of $2.55 billion as of June 30, 2016. This represents a decrease of $134 million in NAV over the previous year, maintaining private equity exposure nearly flat at 10.3% of Trust assets versus 10.4% as of June 30, 2015.

PORTFOLIO DIVERSIFICATION.

While the portfolio remains highly diversified, the sale of $884 million of Buyout exposure ($553 million NAV plus $330.7 million in uncalled commitments) has shifted current exposure toward the other strategies. Buyout remains the dominant strategy in the portfolio at 45% of NAV and 36% of economic exposure and should increase going forward as the buyout portfolio is reconstructed. As seen in the summary tables in **Exhibit B**, the private equity portfolio is balanced across geographies and strategies with larger exposures to more established markets of the US and Europe and Buyouts. However Asia, Special Situations, and Growth Equity/Venture Capital saw marked increases as a function of the sale.

ERS' private equity staff has continued to work closely with Altius Associates to identify optimal funds for ERS investments, including buyout, growth equity, mezzanine, secondary, distressed debt, venture capital and turnaround/restructuring funds. During fiscal year 2016, staff's main focus was on commitments to "re-ups" or funds, expanding an existing relationship to additional strategies and the secondary sale of primary fund investments. New commitments include seven "re-ups" and one expanded relationship.

COST SAVINGS

The PEI team is intently focused on improving the economics of its investments by utilizing co-investments and deal structuring (segregated accounts and negotiations). This focus led to a significant reduction in third party economics and much greater portfolio efficiency. Private equity terms include both management fees and carried interest (which is not a fee but the share of the Private Equity Manager's profit from the total profits earned). An important distinction between the fees paid in private equity versus other asset classes is that all fees charged to investors must be repaid before the Private Equity Manager shares in any investment profits.

For perspective, the Private Equity program averaged 1.7% in management fees and 18.5% carried interest from FY2007 through FY2011; while Buyouts averaged 1.8% in management fees and 20.2% carried interest for the same period. From co-investments inception in FY2012 through 6/30/16, the Private Equity program has averaged a reduction of 1.2% in management fees and 14.2% carried interest. During this time, Buyouts have averaged a reduction of1.3% in management fees and 15.8% in carried interest.

Through June 30, 2016, ERS PEI staff has executed 24 Private Equity co-investments (not including nine Infrastructure co-investments), five of which closed in fiscal year 2016. The 24 deals account for $313 million in committed capital and ultimately $106 million in estimated fee and carry savings. To date, four

[1] Includes $368 million deferred payment from secondary sale

co-investments have been substantially or fully exited, returning $91.8 million on $29.3 million invested or a 3.1x multiple of cost. No fees or carried interest have been paid on these investments which have resulted in $19 million in savings. The co-investment portfolio age averages two years, and fee and carry savings realized to date total $21.4 million. The realization of the total estimated savings will depend on the outcome of the investments and resulting carried interest savings.

Savings through negotiation of fund economic terms has also been a productive source of savings. $1.56 billion of committed capital has gone into funds in which ERS bilaterally negotiated reduced management fees and carried interest. Fee offsets and waterfall parameters are an economically important part of negotiations as well, but ERS is not currently able to track the impact. These negotiations have led to an estimated $203 million in total savings, of which $26.9 million has been realized to date. As with co-investments, the realization of the total savings will depend on the ultimate outcome of the funds and the resulting carried interest savings.

PORTFOLIO STATUS AND PERFORMANCE

As of June 30, 2016, private equity has produced a Total Value to Paid In Capital ("TVPI") of 1.27x, Distributed to Paid in Capital ("DPI") of 0.64x, and an Internal Rate of Return ("IRR") of 10.96% since inception.[2] The average age of ERS' active commitments is 3.2 years and the average age of underlying investments is 2.7 years. Period specific returns are listed below.

Period in years (as of 6/30/16)	IRR
1	4.59%
2	7.24%
3	11.87%
5	11.47%

As of March 31, 2016 ERS' private equity portfolio holdings consisted of 672 portfolio companies (not including underlying investments in fund of funds vehicles) with an unrealized value 1.3x cost and a TVPI of 1.5x cost . Since 2007 through March 31, 2016, ERS has returned 2.4x cost on its realized portfolio company investments. For perspective, the long term assumption for ERS private equity's Buyout transactions is 1.8x cost.

The private equity team continues to evaluate methodologies to compare private equity asset class performance against public markets. Utilizing a Private Market Equivalent ("PME") comparison method, ERS' private equity portfolio has outperformed its benchmark, the MSCI ACWI IMI, by 717 basis points.

Private Equity PME Performance Comparison Summary
As of March 31, 2016

Measure	ERS PE Portfolio*	MSCI ACWI IMI PME
IRR	11.68%	4.51%
TVPI	1.34x	1.20x
DPI	0.35x	0.33x

*Due to limited history of index total returns (including dividends) the PME analysis was limited to the PE program's relevant history beginning in 2007 and excludes the prior years consisting only of the legacy investment in Texas Growth Fund II. For this reason there are slight differences in the PME analysis PE Portfolio metrics and the actual cumulative metrics dating back to 1998.

[2] TVPI = (NAV + Distributions) / Paid in Capital
DPI = Distribution / Paid in Capital

STAFF RECOMMENDATION:

The agenda item is presented for information and discussion purposes only. No action is required.

ATTACHMENTS – 2
Exhibit A – Altius Associates Private Equity Market Review
Exhibit B – Private Equity Portfolio Commitments and Summary Tables

ALTIUS ASSOCIATES®

EMPLOYEES RETIREMENT SYSTEM OF TEXAS
GENERAL PRIVATE EQUITY OVERVIEW

AUGUST 2016

Table of Contents

I. U.S. Market

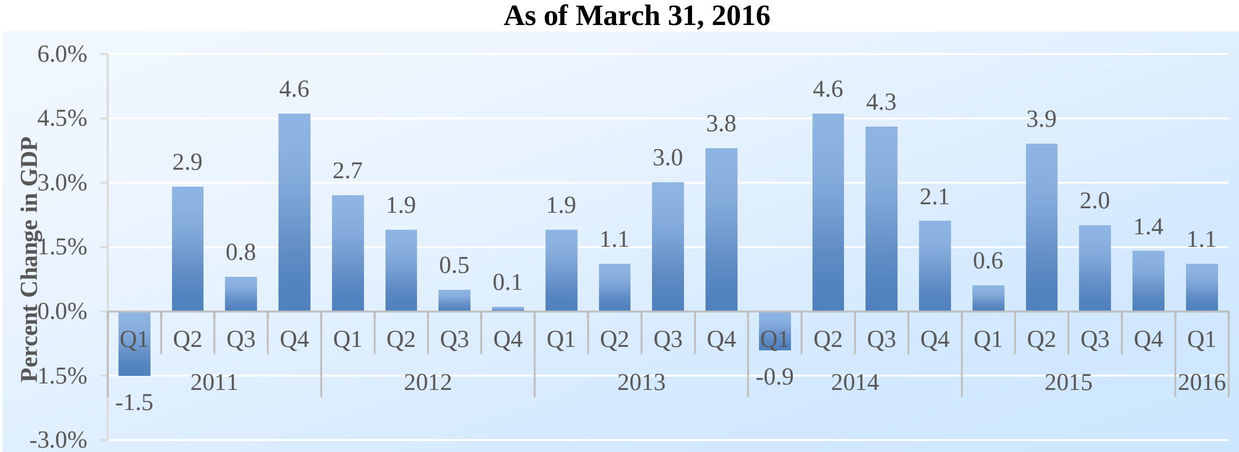
U.S.: Market Overview

With the U.S. economy barely growing and the IPO market almost completely shut down, it would be easy to be pessimistic about private equity and venture capital. However, both of those asset classes have shown surprising strength. U.S. private equity deal flow has been consistently strong as has been the ability for private equity fund managers to raise capital. Particularly noteworthy is the attractive level of exits private equity fund managers have been able to generate recently. By contrast, the exit market for U.S. venture capital fund managers has weakened significantly. However, venture capital deal flow remains strong and there has been a shift in emphasis from late stage to early stage venture capital investment. That there are signs of strength in a low growth environment is comforting, nevertheless there are areas of concern. The high prices being paid in private equity markets could prove problematic and the lack of a public exit alternative for technology companies could have an impact on expected returns from venture capital.

Economy

The U.S. Bureau of Economic Analysis (BEA) recently released the final revision of fourth quarter GDP. Although the BEA revised GDP up from the previous official figures, the 1.4% growth in GDP was slightly below that of the consensus forecast of 1.5%. The consistent decline in GDP growth following the second quarter of 2015 is concerning and provides evidence consistent with a slowing U.S. economy potentially on the brink of recession. Those concerns, as well as the volatility of public equity markets at the beginning of the year, were likely major considerations in the decision of the Federal Reserve not to raise interest rates following their March meeting. On a positive note, U.S. public equity markets have come roaring back from the sell-off at the beginning of the first quarter of 2016. Whether the increase in public valuations is due to improvements in the fundamentals of companies, or is being driven primarily by monetary pressures, is an open question.

U.S. Real GDP Growth
As of March 31, 2016

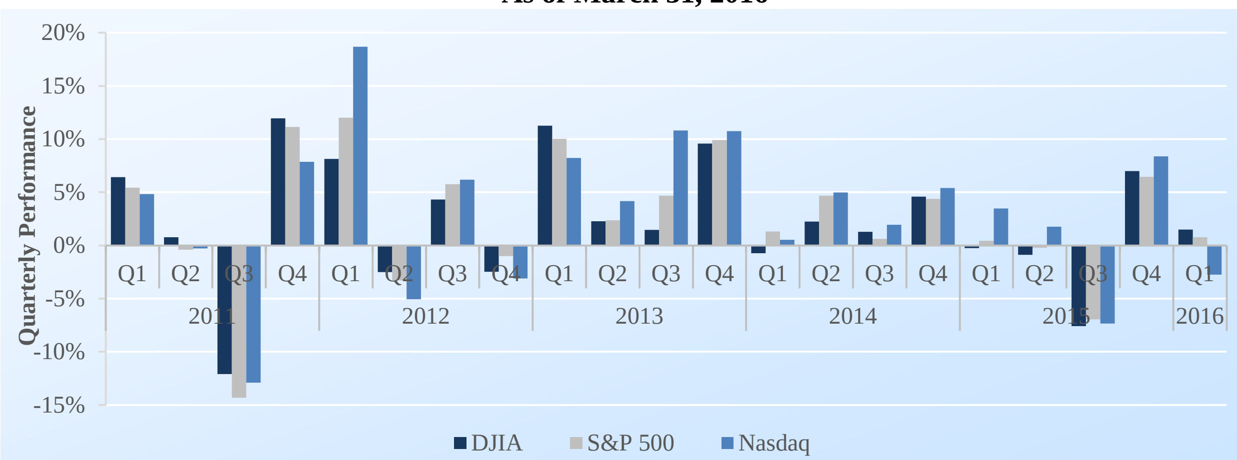


Source: Federal Reserve Bank of Atlanta.

Public Equity

The chart below presents the performance of three primary public equity benchmarks (Dow Jones 30, S&P 500, and the Nasdaq) as measured from the beginning of the respective quarter to the beginning of the next. The data is presented in this way so as to make it more equivalent to the performance presented on private equity. While the solid performance of public markets from mid-2012 through the beginning of 2015 generated attractive returns to investors it also demonstrates why limited partners had a difficult time increasing or even, in some cases, maintaining their private equity allocations at target levels. An interesting observation from the chart below is the importance of the measurement time period. Although public equity markets began selling off in December 2015, the sell-off accelerated significantly throughout January. As the data presented is the return calculated from the beginning of the respective quarter to the beginning of the following one, intraquarter volatility does not manifest itself in the chart. The overall performance in the first quarter of 2016 is certainly impressive, but would have been even more dramatic had it been measured from the low point reached during the quarter.

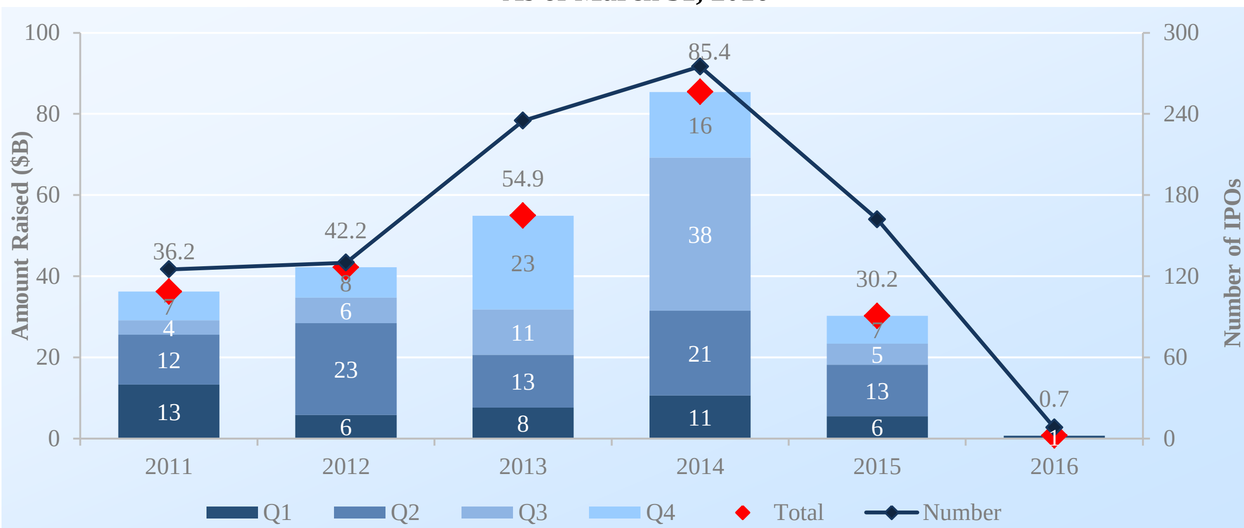
U.S. Public Equity Market Performance
As of March 31, 2016



Source: Yahoo Finance.

An additional measure of the health of public equity markets is the receptivity of investors to Initial Public Offerings (IPOs). The chart below presents the proceeds from IPOs by quarter as well as the number of IPOs through the first quarter. Relative to recent history, 2015 showed a marked deterioration of investors’ interest in participating in IPOs. The decline in the proceeds raised is especially concerning. If 2015 was a weak IPO market, 2016 thus far is proving to be a non-existent one. Only eight companies went public in the first quarter of 2016 and collectively raised a meagre USD0.7 billion. Technology companies have had a particularly difficult time in making the transition from private to public markets and there have not been any technology IPOs this year to date. If this trend continues, it may have long-term ramifications for the ability of venture capital fund managers to generate attractive returns.

U.S. IPOs
As of March 31, 2016

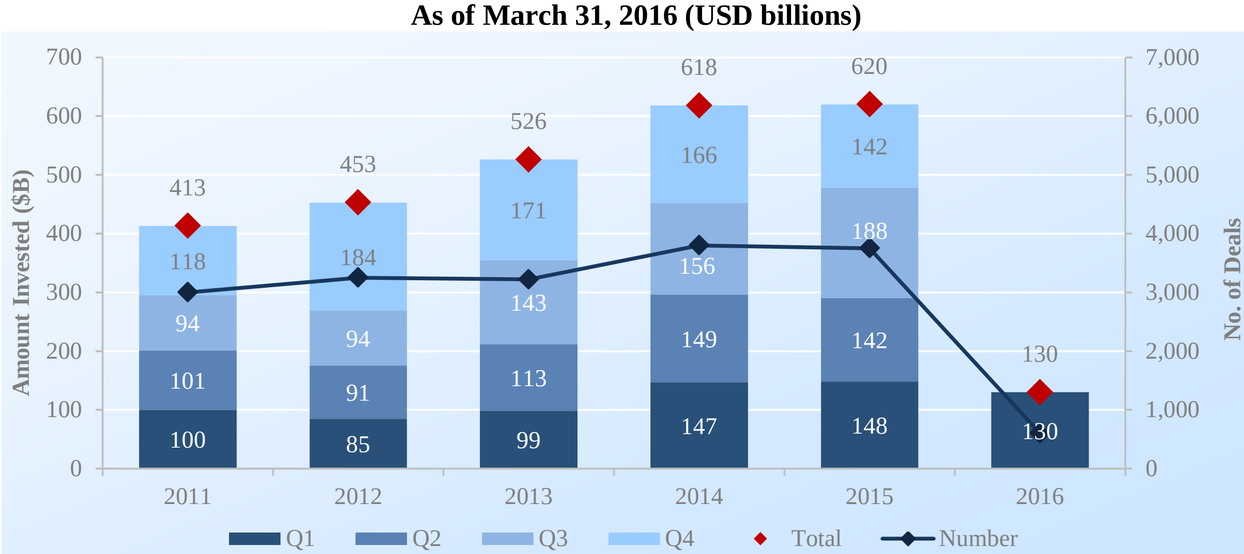


Source: Renaissance Capital.

U.S.: Private Equity

As more complete results have been gathered for the fourth quarter of 2015, it is even clearer that 2014 and 2015 were virtually identical in terms of the number and value of the private equity deal flow. While private equity deal flow has consistently increased over the last six years following the 2009 crisis results, it is still below the high water mark of USD914.6 billion set in 2007 (not shown in graph). While significantly below the high water mark, private equity deal flow has been resilient across recent years and 2016 is off to a strong start. In the first quarter of 2016 there were USD130 billion in transactions and that number is likely to be revised upwards as additional transactions are reported. It does not appear that the U.S. public market gyrations at the beginning of the year had much, if any, impact on the private equity sector.

U.S. Private Equity Deal Flow Volume
As of March 31, 2016 (USD billions)

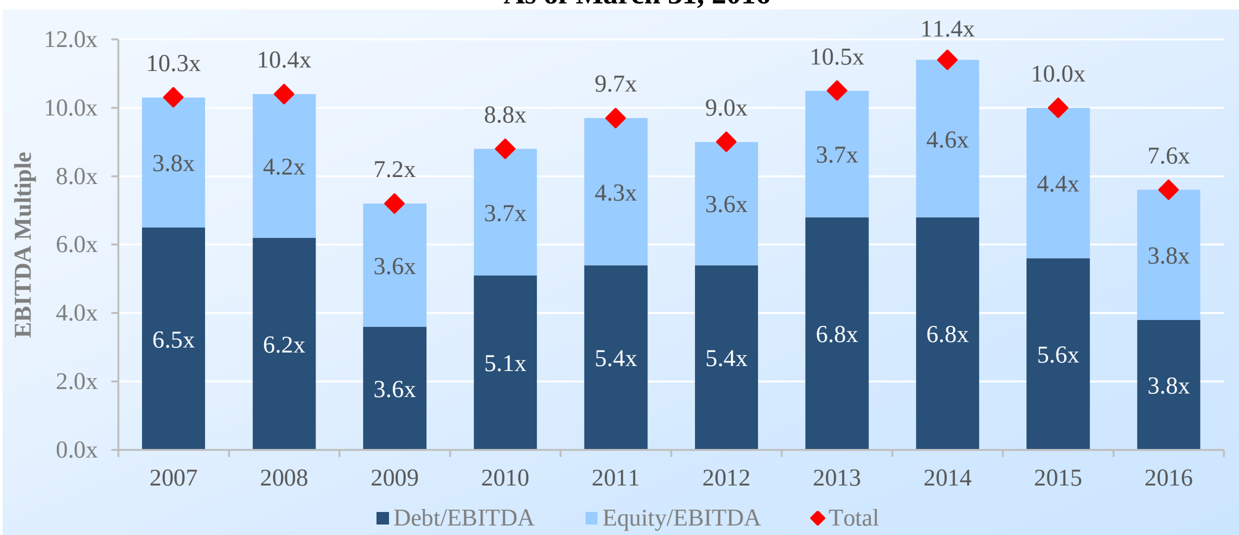


Source: Pitchbook

The 2015 total EBITDA multiple shown in the graph below of 10.0x is a significant upward revision from the 9.1x in the third quarter report and 8.3x in the second quarter report. Although it is possible that the pricing of late year transactions pulled this statistic upwards, it is more likely that a more complete dataset throughout the year is finally reflecting the phenomena observed by fund managers. Of note is that both the debt (5.6x) and equity (4.4x) components of the total EBITDA multiple saw increases from the previous quarterly report. The 2015 total EBITDA multiple of 10.0x is below that of 2014 (11.5x), but still high and near that of the pre-crisis years (not shown in graph).

Statistics for 2016 reflect the first quarter only, but are substantially below levels observed in 2015 and 2014. However, these figures will likely increase as fund managers are reporting continued upward pricing pressure from both private equity sponsors and, more importantly, from strategic buyers that will often incorporate "synergies" into their higher-priced offers.

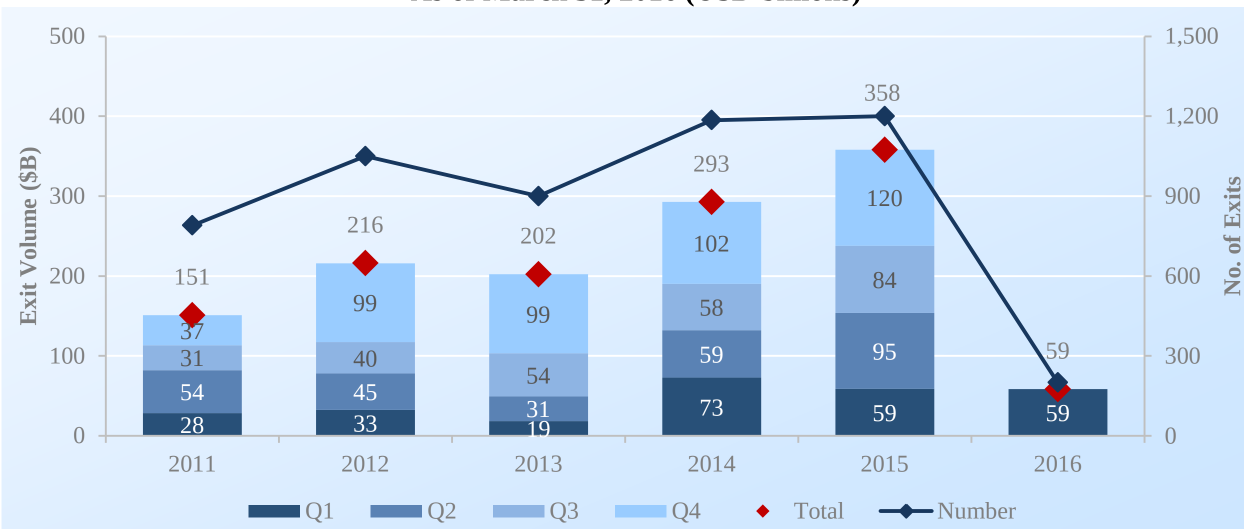
U.S. Private Equity Median EBITDA Valuation Multiples
As of March 31, 2016



Source: Pitchbook

The dominant statistic for private equity in 2015 is the record USD358.0 billion that fund managers were able to realize from their portfolio companies. This represents an increase of USD37.0 billion from the initial fourth quarter reports, and raises the new benchmark that much higher. Though the fourth quarter alone generated an impressive USD119.9 billion in exits, the exit activity remained strong in the first quarter of 2016 (USD58.5 billion) by historical standards.

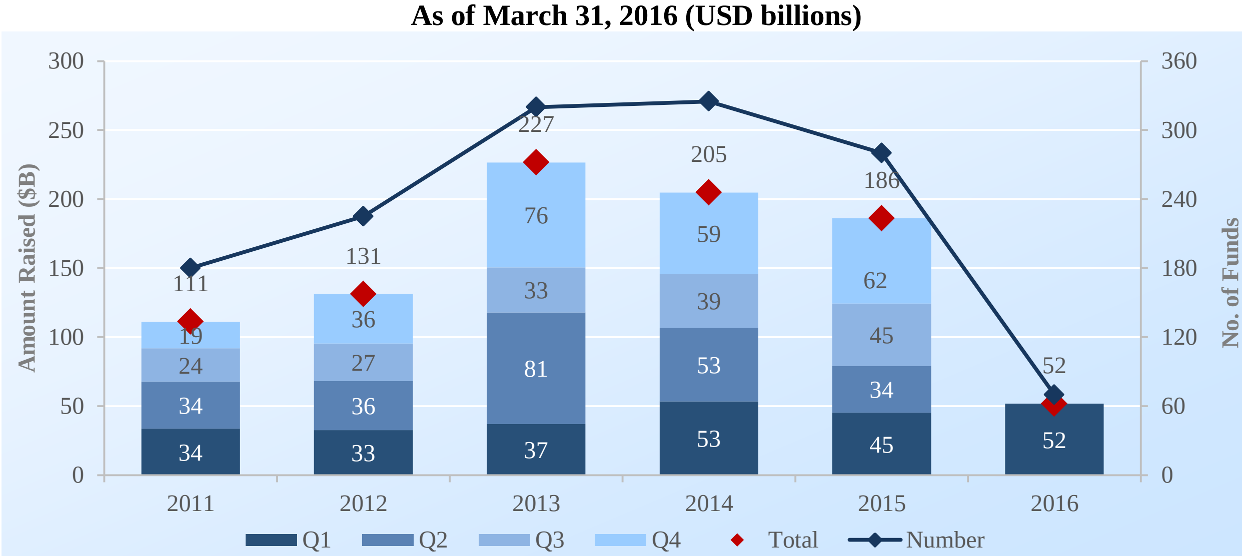
U.S. Private Equity Exit Volume
As of March 31, 2016 (USD billions)



Source: Pitchbook.

The USD186.1 billion raised by private equity fund managers in 2015 represents the third straight year of decline in the annual amount raised. However, it was still a very healthy year and the USD51.8 billion raised in the first quarter of 2016 is the second best first quarter in the last five years. What is particularly notable is that it could have been expected that limited partners would have curtailed commitments to private equity as a result of the significant drop in public equity markets at the beginning of 2016. It may well be that the drop and subsequent recovery happened quickly enough that it did not have time to be incorporated into long-term portfolio plans, especially as the recovery was well underway at the end of the first quarter of 2016. Thus, any potential over allocation issues were resolved prior to the end of the quarterly reporting period.

U.S. Private Equity Fundraising Volume
As of March 31, 2016 (USD billions)

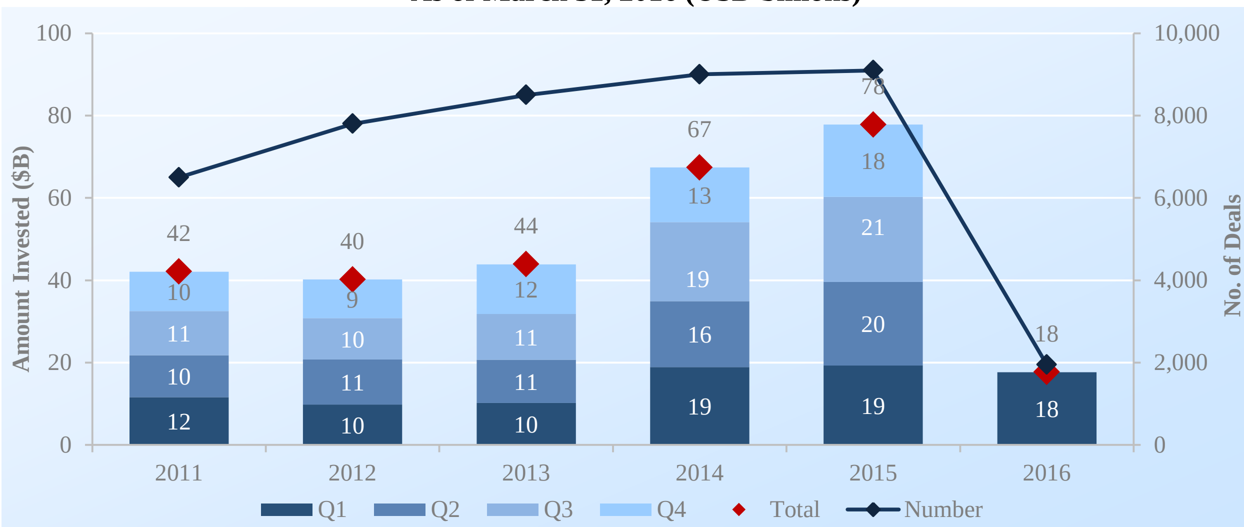


Source: Pitchbook.

U.S.: Venture Capital

The first quarter of 2016 saw U.S. Venture Capitalists continuing the brisk investment pace established over the past two years. Venture capitalists invested USD17.7 billion in the first quarter of 2016, the second strongest first quarter and only exceed by the USD19.3 billion invested in 2015. Clearly, both venture capitalists, and the limited partners that they raise capital from, see the dearth of technology IPOs as a temporary issue that will be resolved in due course.

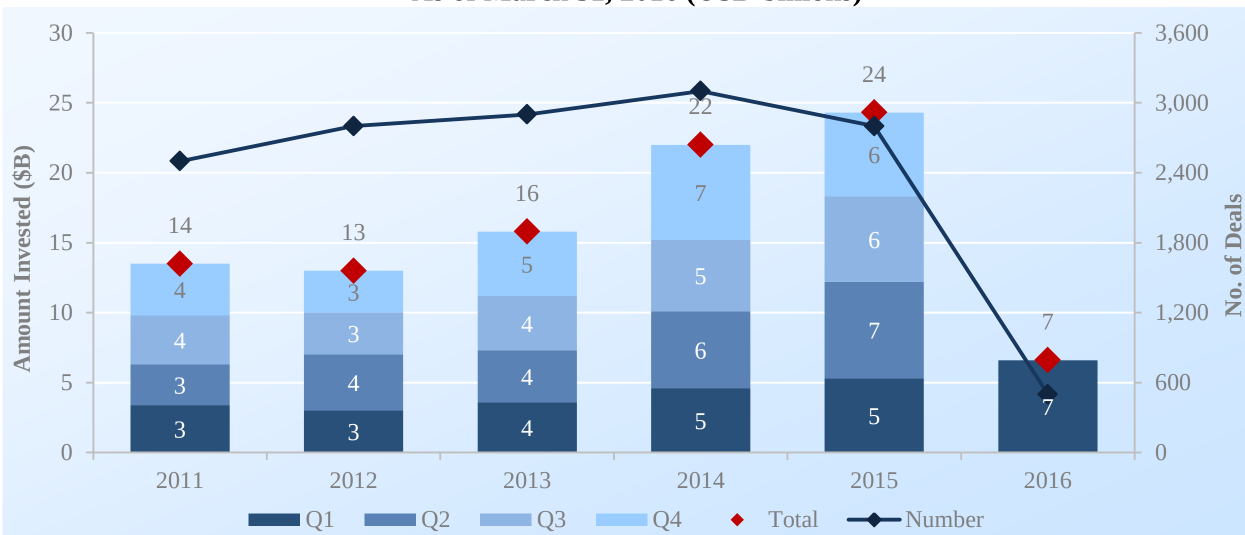
U.S. Venture Deal Flow
As of March 31, 2016 (USD billions)



Source: Pitchbook.

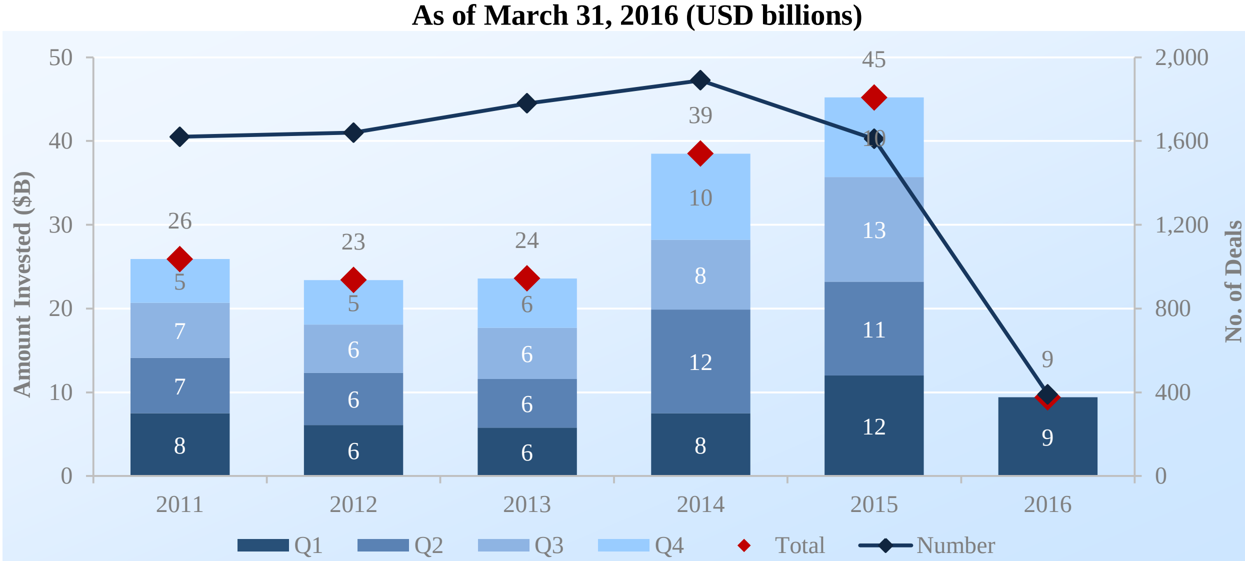
When the deal flow is dissected into Early Stage (graph below) and Late Stage (second graph below), an interesting pattern develops. The USD6.6 billion invested in the first quarter of 2016 in Early Stage companies is significantly higher than any other first quarter over the past five years. Whereas the USD9.4 billion invested in Late Stage companies in the first quarter of 2016 is well below that of 2015. However, the first quarter 2016 Late Stage investment level is also notably above other first quarter results. The lack of an active IPO market for tech stocks appears to have cooled, but not quenched, the investment activity by late stage investors. The shift from Late Stage to Early Stage investments may be one method venture capital fund managers are using to provide some insulation from the unreceptive technology IPO market.

U.S. Early Stage Venture Deal Flow
As of March 31, 2016 (USD billions)



Source: Pitchbook.

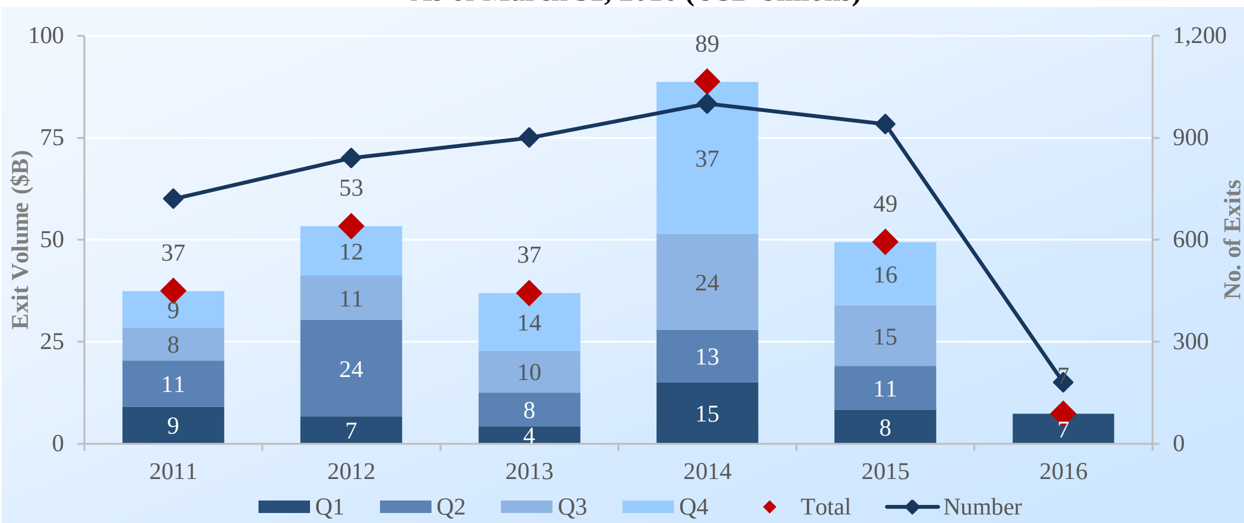
U.S. Late Stage Venture Deal Flow
As of March 31, 2016 (USD billions)



Source: Pitchbook.

The decline in tech IPOs that began in the second half of 2015 does appear to have had a significant impact on overall exit activity in the technology sector. For the full year of 2015 USD49.3 billion was generated through exits (note that the 2015 exit numbers were revised substantially downward by Pitchbook from their previous data release) versus the USD88.6 billion exited in 2014. As to 2016, the USD7.3 billion in exits is unremarkable. While it is below the results for both 2014 and 2015, it is also approximately at the mid-point of the last five years. As there have been no technology IPOs this year, the first quarter 2016 result would seem to indicate that strategic acquirers remain active. Given the softness of the technology IPO market, it will be interesting to see how many of the "unicorns" opt to remain private rather than testing either the market or their private valuations.

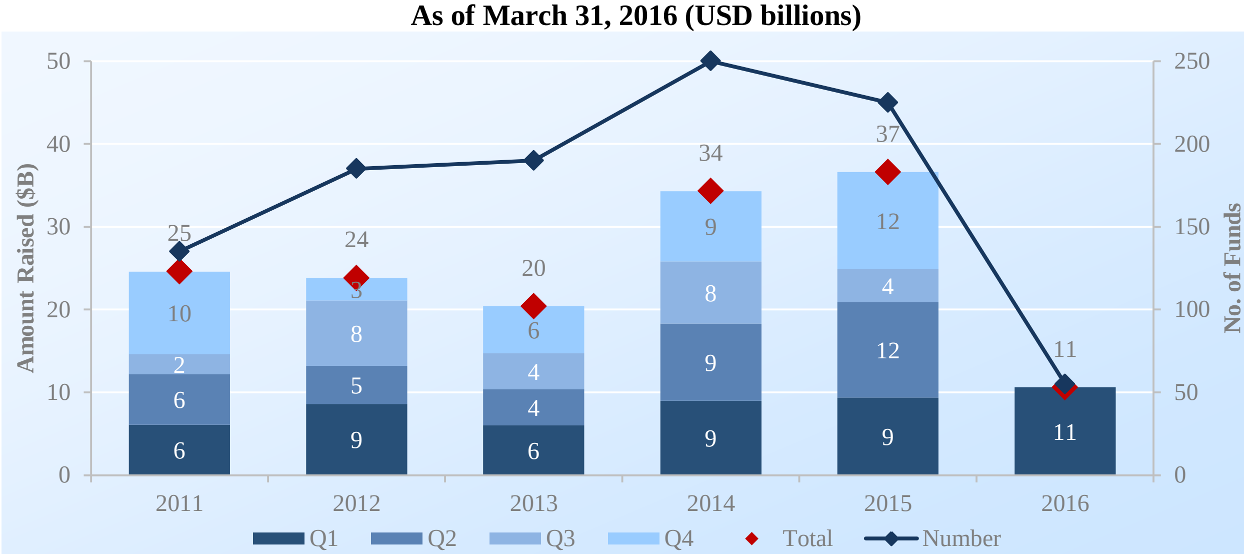
U.S. Venture Exit Volume
As of March 31, 2016 (USD billions)



Source: Pitchbook.

The strong returns generated by venture funds over the past several years has renewed interest in the asset class for many limited partners. The USD34.3 billion raised in 2014 and the USD36.5 billion raised in 2015 show a sustained recovery from the post-crisis years and are more consistent with the amounts raised in the 2006-2008 pre-crisis time period (not shown in graph). The USD10.6 billion raised in the first quarter was the largest amount raised in any first quarter over the last five years and was particularly notable in that it followed the strongest quarter of all -- the USD11.7 billion raised in the fourth quarter of 2015.

U.S. Venture Fundraising Volume
As of March 31, 2016 (USD billions)



Source: Pitchbook.

U.S.: Summary

Despite a slow-growth U.S. economy, the lack of an active IPO market, and the uncertainty associated with a U.S. presidential election year (which is arguably much higher this year than in a normal election cycle), private equity and venture capital markets appear to be doing well. Private equity fund managers, while continuing to pay high prices, are also generating an attractive level of exits and are seeing good deal flow. Even with the poor IPO market, venture capital fund managers still have strong deal flow and have been able to attract investor capital. The recent recovery of U.S. public equity markets was certainly a timely development, but it remains to be seen if the higher valuations are being driven by economic fundamentals, monetary policy, or a combination of both.

II. European Market Overview

Europe: General Overview

In March The European Central Bank cut its benchmark interest rate to 0%, from 0.05%, and reduced the deposit rate to -0.4%. In a further effort to stimulate the European economy, the ECB increased the size of its quantitative easing program by EUR20 billion a month, to EUR80 billion a month.

GDP growth in the UK stood at 0.6% in the fourth quarter of 2015, up from 0.4% the previous quarter. The labor market remains robust with unemployment remaining at 5.1% in January 2016 and the number of employed people reaching an all-time high. Annual inflation measured 0.5% in March 2016, its highest level since December 2014, but still below the 2% target. The IMF has downgraded its estimate of growth in 2016 from 2.2% to 1.9%, but left the 2017 estimate unchanged at 2.2%.

Europe's main indices all suffered during the first quarter of 2016. Spain's IBEX was the worst performer, losing 8.6% of its value. Germany's DAX lost 7.2% while the CAC in France fell 5.4%. The FTSE in the UK lost 1.1%.

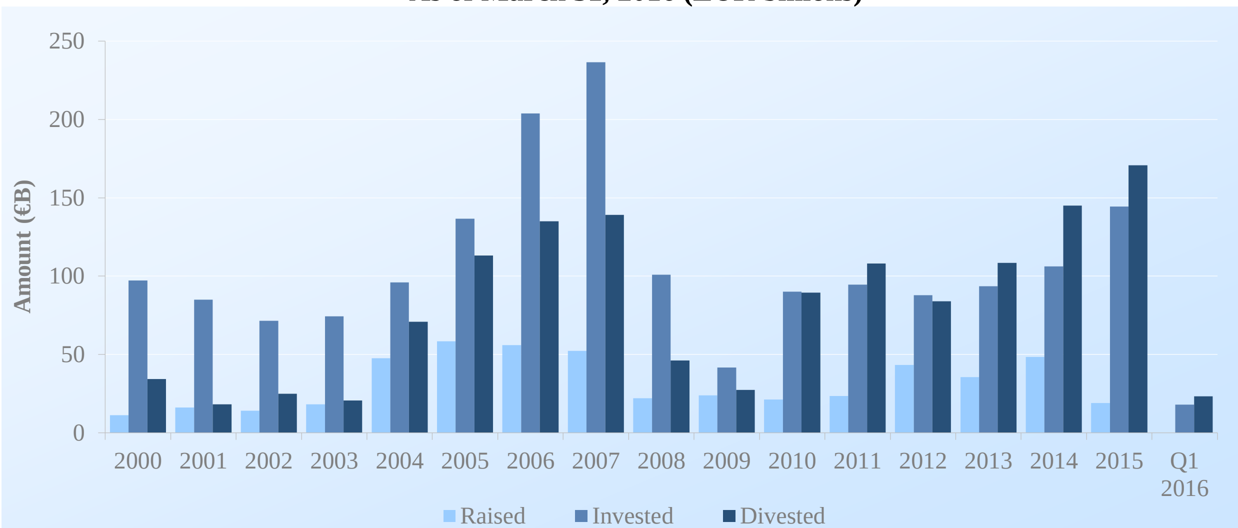
Brexit

The largest concern facing Europe today is the UK's recent decision to leave the European Union ("EU") after 43 years of membership. The result of the referendum reveals the near-equal divide with 51.9% voting to leave the EU and the remaining 48.1% voting to remain a member. The majority in England and Wales voted to leave whilst Scotland and Northern Ireland voted to remain. This is the first time a country has opted to exit the EU, and has sparked discussions of other possible referendums. Following the UK referendum, Prime Minister David Cameron announced he would step down in October 2016, further adding to the uncertainty. The new Prime Minister, who is yet to be determined, will be responsible for negotiating the UK's exit from the EU. Once Article 50 of the Treaty of Lisbon is triggered, indicated the formal notification of the UK's intention to withdraw from the EU, the UK will have two years to negotiate the terms of the exit.

In addition to the political and economic uncertainty following the 'Brexit', the Pound Sterling has declined to its lowest value in 30 years, and depreciated against all major trading partners. This depreciation will make imports more expensive (increasing the cost of living in the UK) but will have a positive effect on exporters. Most economists have reduced their forecasts for UK GDP growth during this time of uncertainty, although expect growth to resume thereafter.

Europe: Private Equity

Europe Private Equity Fundraising, Investments and Divestments
As of March 31, 2016 (EUR billions)



Source: Unquote.
Note: ‘Invested’ amount is aggregate deal value (not equity value).

General Fundraising

Fundraising levels remain strong as a result of several large Pan-European managers returning to the market, a trend that is expected to continue throughout the first half of 2016. In the first quarter of 2016, 16 funds reached their final close, up from 11 in the fourth quarter of 2015, totaling EUR19.0 billion; an 8% increase over the fourth quarter of 2015. This was the largest amount raised in any given quarter since the second quarter of 2013. The largest fund to close was Advent VIII, reaching its hard cap of USD13.0 billion, despite having been in the market for only six months. Of the 16 funds raised, seven funds reached their hard cap.

General Exit Activity

Divestments totaled EUR23.2 billion in the first quarter of 2016, a 44% decrease compared to the fourth quarter of 2015, as the number of exits fell from 204 to 142. The most common exit route was Secondary Buyouts, which accounted for 40% of transactions. Conversely, Trade Sales accounted for 51% of exits by value. The quarter also saw the continued trend of exits exceeding investment levels. The largest exit was completed by Bain Capital, who sold Brake Brothers, a food service business, to North American competitor Sysco for EUR2.9 billion.

Other notable exits included the highly contested sale of AIG Highstar Capital’s and Global Infrastructure Partners’ stake in London City Airport to a consortium of Alberta Investment Management Corporation, Ontario Teacher’s Pension Plan and the Kuwait Investment Authority, at a transaction value of EUR2.6 billion. In addition Advent International sold The Priory Group, a psychiatric healthcare services provider, for EUR2.0 billion to U.S. trade buyer Arcadia Healthcare Company.

General Deal Activity

Overall investment activity fell considerably during the quarter, with the total amount invested down 50% compared to the fourth quarter of 2015. However, the number of deals only decreased by 15%, meaning that the sharp fall in value was being driven by a lack of large transactions, something which is confirmed in the charts below.

Qtr.	Buyout		Growth		Venture	
	No.	Value (€bn)	No.	Value (€bn)	No.	Value (€m)
2014 Q1	132	15.9	299	4.1	115	187.5
2014 Q2	166	28.3	282	2.6	132	556.4
2014 Q3	153	21.0	235	2.5	95	279.2
2014 Q4	155	25.1	271	3.2	112	301.0
2015 Q1	148	18.6	305	4.2	128	212.1
2015 Q2	150	42.5	216	3.6	75	354.7
2015 Q3	148	34.6	236	6.2	118	480.4
2015 Q4	155	30.5	185	5.4	113	336.6
2016 Q1	137	15.3	151	2.1	94	617.1

Source: Unquote.

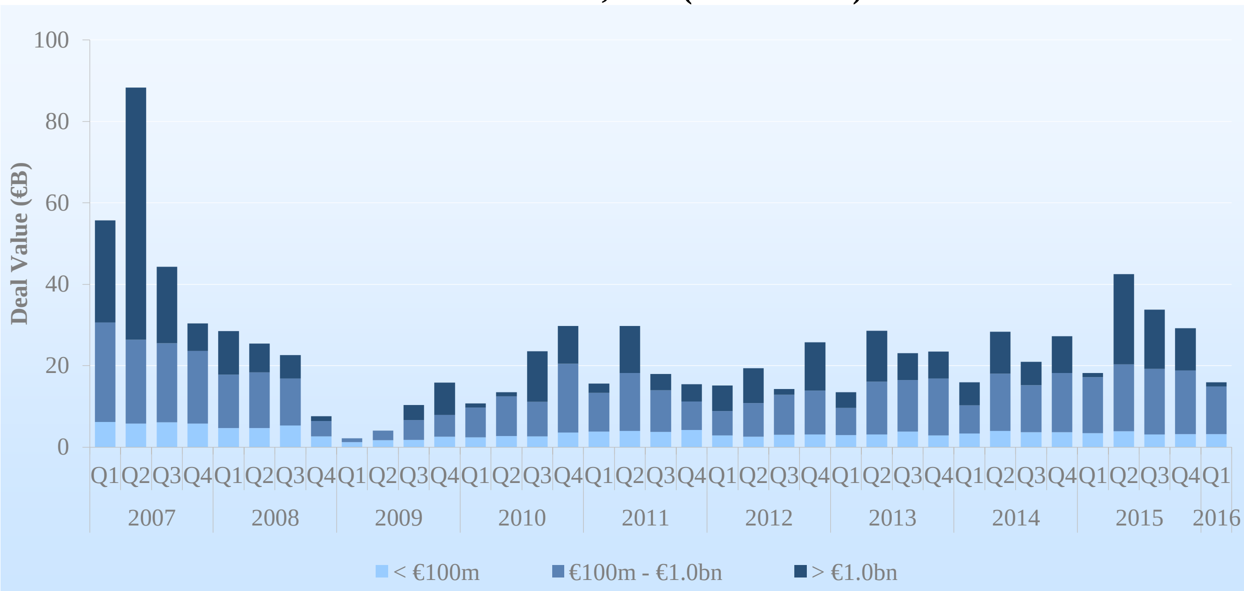
Buyouts

Over the last quarter the number of buyouts decreased by 12% to 137 deals and the aggregate value fell from EUR30.5 billion to EUR15.3 billion. The primary factor behind the 50% fall in deal value – the largest percentage decrease since the third quarter of 2007 – was due to only one deal above EUR1.0 billion being completed during the quarter, down from six in the fourth quarter of 2015.

Across Europe, all regions saw a decline in buyout activity in value terms between the first quarter of 2016 and the fourth quarter of 2015, bar the DACH region. Although the number of deals decreased by two to 16 in the first quarter of 2016, the DACH region saw a 10% uptick in value to EUR2.3 billion. The slight increase in value is due to the acquisition of Defense Electronics by KKR for EUR1.1 billion, the only large-market deal (above EUR 1.0 billion) completed during the quarter in Europe. Conversely, the Nordic region saw the largest decline in deal value, a 72% fall to EUR1.7 billion, comprised of 21 deals. This large fall is not reflective of a lack of activity, but rather the significant number of high value transactions that closed during the third quarter of 2015.

Buyout activity overall in the UK and Ireland reached its lowest levels since the second quarter of 2009, with 25 deals closing at a value of EUR2.1 billion. Although the number of deals completed in the Benelux region remained relatively flat, with only a decrease of one to ten deals in the first quarter of 2016, deal value decreased by 63% to EUR1.1 billion. Dominating the buyout market in terms of both volume and value was France, accounting for 28% and 32%, respectively. France saw a 22% increase in the deal volume, as 39 deals were completed at a value of EUR4.9 billion.

Value of European Buyout Deals by Size
As of March 31, 2016 (EUR billions)



Source: Unquote.

Growth Capital

Growth transactions continued the downward trend, falling 16% to 155 deals. The aggregate value decreased by more than half to EUR2.1 billion, the lowest amount invested since the third quarter of 2013. Of the 155 deals completed, almost all were below EUR100.0 million. The largest deal completed was a EUR173.8 million investment in Skyscanner, a travel search engine, by Artemis and Vitruvian Partners. The UK & Ireland remains the most active region, both in terms of volume and value, with 53 deals completed at a value of EUR1.1 billion.

Venture Capital

In the first quarter of 2016, venture capital activity reached its highest level since the second quarter of 2008, totaling EUR617.1 million. This quarter saw a shift to larger deals as total value increased by 83%, despite the number of transactions falling to 94, a 17% decline from the fourth quarter of 2015. During the quarter, the four deals completed were valued at or above EUR36.0 million. The largest deal saw Woodford Patient Capital Trust invest EUR78.9 million in Mission Therapeutics, a British biotechnology business. The UK & Ireland was the most active region, accounting for 42% and 59% of deal volume and value respectively.

Europe: Other Geographical Areas

Central and Eastern Europe

CEE, Russia and Turkey are all still impacted by various crises. Talks in Paris between Ukraine and Russia seemed to stall during the first quarter and there are regular ceasefire violations in Eastern Ukraine, in what seems to have become a frozen conflict. The Deep and Comprehensive Free Trade Areas ("DCFTA") agreement between Ukraine and the EU came into force in January, which should lead to increased trade.

There have been some significant developments in the Syrian conflict. In February, the UN Security Council adopted a resolution that demanded all parties comply with a U.S.-Russian deal on a cessation of hostilities and at the end of March, the Syrian government with support from Russian and Iranian forces, successfully regained Palmyra from the Islamic State.

The CEE region remains at the forefront of a migrant crisis. Large numbers of refugees are fleeing Syria, traveling through Turkey and seeking asylum in EU countries. More than one million migrants crossed into the EU in 2015, and there were 561,000 registered arrivals between January and mid-March 2016 (mainly in Greece, Croatia, Serbia, Macedonia, Italy and Hungary). In March, a deal was agreed between the EU and Turkey: migrants arriving illegally in Greece are now expected to be sent back to Turkey. For each illegal migrant returned to Turkey, a legal migrant will be resettled in the EU. In exchange, the EU has allocated EUR3.0 billion in aid to Turkey to help migrants.

Despite the instability in the region, and the increased macroeconomic volatility, the number of buyouts across CEE, Russia and Turkey remained fairly strong in the first quarter with eight transactions, and an aggregate value of EUR1.1 billion.

In Poland, the EU's sixth largest economy and the largest in CEE (including in terms of private equity activity), there were five reported buyouts in the first quarter of 2016 for a total value of EUR350 million. The outlook for Poland remains positive: according to the OECD, Poland's GDP will grow by 3.4% in 2016 and by 3.5% in 2017.

Russia remains in recession, with annual GDP down 3.8% as of December 2015. Private equity activity remains minimal, with no deals reported in the first quarter of 2016. Russia is expected to remain in a difficult economic situation as long as oil prices remain low. However, the Economic Development Ministry of Russia revised up its 2016 GDP growth rate from 0.3% to 0.8% and expects stronger GDP growth again in 2017 provided oil prices remain above USD45/barrel.

In Turkey, despite the clear result of the November general election, some instability remains: namely recurring terror attacks (from Kurd extremist or the Islamic State) and the 2.8 million Syrian refugees that the country hosts. There were no buyouts reported by Unquote for the first quarter of 2016 in Turkey. In April, the International Monetary Fund revised up its 2016 growth forecast for Turkey from 3.2% to 3.8%. Turkey is one of the few emerging economies that benefits from a drop in oil prices. In USD terms, the current account deficit declined by 24% in February, compared to January. This provided the Turkish central bank with the confidence to lower interest rates; in March it cut the overnight lending rate from 10.75% to 10.5%, which was the first cut in more than a year. Turkey's new central bank Governor Murat Cetinkaya, appointed in April, is expected to announce further interest-rate cuts, signaling a willingness to further ease policy.

Israel

GDP growth measured 0.96% in Israel during the fourth quarter of 2015, building on the third quarter where growth was 0.6%. Prices fell by 0.2% in February 2016, bringing the total to 18 consecutive months of deflation. The central bank has kept interest rates at historical lows of 0.1% to fight slowing growth and expectations of low inflation. Bank of Israel growth forecasts for 2016 and 2017 are 2.8% and 3.1%, respectively.

2015 was a record year for the Israeli high-tech industry, with 708 deals completed amounting to USD4.43 billion, the highest amount and number ever recorded. The total represented a 30% increase on the previous record year of 2014. In the fourth quarter alone, 202 companies attracted USD1.2 billion of investment. The average deal size peaked at USD6.3 million in 2015, the highest on record. Israeli venture capital funds were very active, investing USD653 million compared to 2014's total of USD568 million. International investors have also been increasingly active, which has pushed Israeli venture capital funds' share of activity down to a record low of 15%. Software was the leading sector in 2015, where 181 deals took place for a combined value of USD1.3 billion. Internet deal activity was only marginally behind, with 172 deals raising just under USD1.3 billion.

2015 was almost a record year for Israeli private equity investment, with the total of USD3.4 billion of investment only marginally below the 2012 record of USD3.5 billion. However, in terms of number of deals 2015 was the highest ever with 90 transactions completed, up from 80 in 2014. In the final quarter of the year, 20 deals were completed totaling USD841 million. Israeli private equity funds represented 27% of the total invested in 2015, a notable increase over the past two years.

III. Asian Market Overview

Asia: Market Overview

Asia Private Equity markets generally enjoyed an increase in investment pace and performance for the year of 2015, however, concerns about the economic climate within the region remain. The following comments are primarily based on data from the Asia Private Equity Review ("APER"), Asia Venture Capital Journal ("AVCJ"), as well as Altius' proprietary research. Note that the data from various sources may differ.

China

Economic growth slowed to 6.9% in 2015, and is expected to remain around 6% to 7% in 2016 as China rebalances its economy towards sustainable growth, while facing domestic and external headwinds. The IMF's inclusion of the RMB in the SDR currency basket is a strong positive indication of Chinese economic reform efforts. On August 24, led by the instability of the Chinese stock market, global stock market indices declined. In a matter of three months, private equity investors with exposure to public listed shares of Asia-based assets saw USD26.3 billion of their holdings erased, from USD94 billion on June 1 to USD67.7 billion on August 24. Additionally, in January 2016, China's top securities regulator, Xiao Gang, resigned due to the highly criticized circuit breaker mechanism introduced. The mechanism, which referenced the CSI 300 index, aimed at controlling stock market volatility by halting trading when the index rises or falls by 7%, was perceived to exacerbate the sell-off and was removed 4 days after implementation. Overall, the slowdown of the Chinese economy and the instability of its stock market remain a large issue within the region, and its impact has been felt across the Globe.

India

India's real GDP growth is expected to improve from 7.5% in fiscal year 2015 to 7.8% in fiscal year 2016, overtaking China as the fastest-growing Asian economy. The national fiscal deficit has been under control, with inflation hitting a record low of 3.6% in August, mainly due to the global commodities rout. The Reserve Bank of India cut rates by a cumulative 125 bps in 2015, with currently limited scope for further reduction. Policy and legislative reforms are taking longer to implement, such as the rejection so far of Prime Minister Modi's unified sales tax proposal.

Japan

Weaker overseas demand, including from China, has hindered the Japanese economy, resulting in an annual GDP growth of 0.7% in 2015, with 1.2% forecast for 2016. Implementation of pro-growth reforms remains slow-moving, and differences within the Japanese Government on monetary and fiscal policy implementation has surfaced. The Japanese Government surprised markets by adopting a negative interest rate policy, in response to the derailment of its economic expansion as well as sluggish private consumption. Additionally, the Japanese Yen has surged about 11% against the U.S. Dollar since the beginning of 2016, which has triggered warnings on the competiveness of Japanese exports, as well as indicating the ineffectiveness of the anti-deflationary strategy. This surge was mainly attributable to the Federal Reserve's cautionary stance on raising U.S. rates, as well as the lack of a response by the Bank of Japan, leading to an outflow from the U.S. Dollar to the Yen.

South Korea

Korea's growth rebounded in the last quarter of 2015, supporting an annual GDP growth rate of 2.6%, mainly driven by strong domestic factors, with 2.9% forecast for 2016. Consumer confidence reached a one-year high in November, and domestic demand is expected to drive growth. External demand remains weak, especially in the face of slowing emerging economies such as China, with exports contracting in November. The Government's stimulus package to boost weak exports has seen its impact fade, with business confidence stuck in pessimistic territory. Investment activity surged in the third quarter of 2015, mainly due to the large USD6.5 billion buyout of Home Plus Co., Ltd by MBK Partners, Temasek Holdings and CPPIB.

South-East Asia

The Asian Development Bank further reduced the GDP growth outlook of the region to 4.9% in 2016, after achieving a GDP growth of 4.6% in 2015, as Thailand, Indonesia, and Singapore's economies continue to disappoint. Indonesia's growth forecast has been reduced slightly given below expected budget disbursements, as well as likely delays in export recovery. Singapore also saw its growth forecasts trimmed from 2.1% to 2.0%, given contracting manufacturing and sluggish growth across other sectors. As a whole, the region remains affected by the slowing Chinese economy given its link through regional and global value chains, as well as inflationary pressures, with inflation projections revised from 3.1% to 3.4% for both years.

Australia

The strength of the services sectors is continuing to positively support growth of the overall economy. Australia's GDP composition has a strong services bias supporting a healthy 2015 GDP growth of 3% which is expected to be stable for 2016. Gloomy labor market conditions could affect consumption, and the rate in growth of annual wages still falls short of the growth enjoyed in previous years. Additionally, new Prime Minister Turnbull is likely to revisit select government policies, with a proposed reduction in tax rates. FDI figures remain healthy, with large increases in inflow from countries such as China. Australia became the second-largest M&A market in Asia, behind China in volume and value terms. Investment activity surged as a result of a takeover of GE Capital's consumer lending business in Australia and New Zealand, by a consortium of investors including KKR, Varde Partners, and Deutsche Bank at USD6.3 billion, in the first half of 2015.

Asia: Private Equity

In 2015, private equity fundraising in Asia dropped 17% compared to 2014, with USD40.4 billion of capital raised during the period. Performance results have generally improved, prompted by strong exits. Total investments continued to rise, with a total of USD93.6 billion being invested, a 0.9% increase compared to the prior year. The surge in capital deployed continues to be led by an increase in commitments to tech-related transactions in China among others. Total divestments declined 30% to about USD34.5 billion in 2015 compared to 2014. The decrease was partly due to challenging public market exits as a result of volatile stock markets experienced in the second half of 2015.

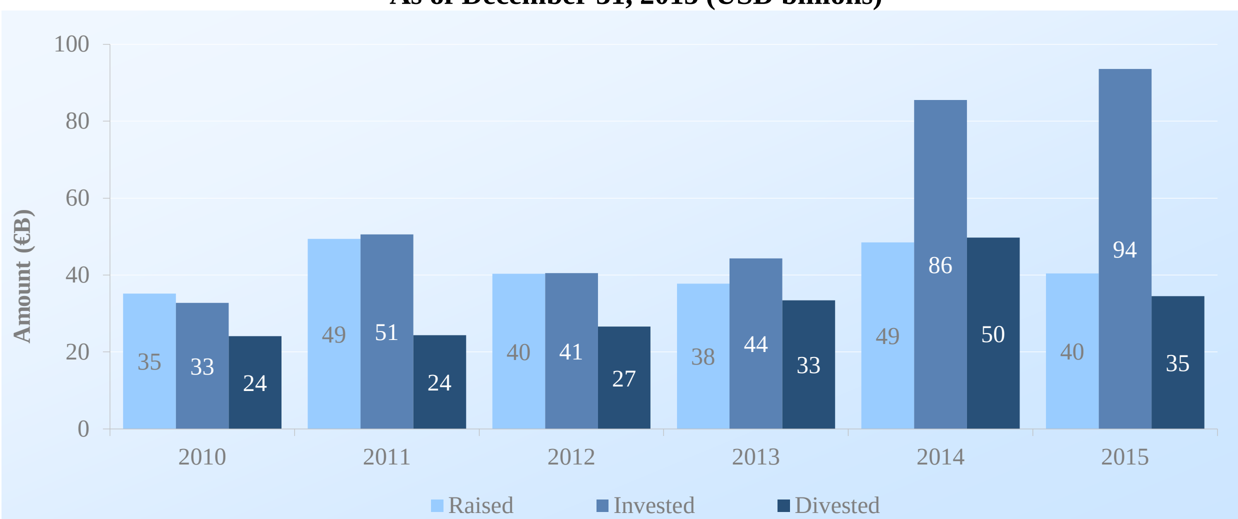
Fundraising

Private equity fundraising declined slightly to USD40.4 billion of fresh capital raised in 2015 compared to 2014, a decrease of 17%. Buyout funds accounted for USD8.7 billion, a 33.6% decline compared to 2014. Growth/Expansion formed the majority of capital raised, leading with USD16.3 billion, while Seed/Early stage funds followed at USD10.2 billion. From a geographical perspective, Pan-Asian funds continue to lead in terms of volume, at USD15.8 billion, with China funds closely behind at USD13.8 billion, and with India funds third at USD4.3 billion raised, but with an impressive 54% increase relative to 2014.

Deal Activity

A total of USD93.6 billion was invested in 2015, a 9.5% increase compared to 2014. Tech-related deals accounted for the majority of the increase. Buyout deals continued to form the majority of investments made, leading with USD73.1 billion. Growth/expansion deals declined by 21% to USD34.1 billion, suggesting that the economic slowdown in China had an effect on capital deployment on minority growth investments. However, China continues to record the highest levels of capital deployment in Asia accounting for USD39.9 billion. South Korea was second at USD12.9 billion, mainly attributable to the USD6.5 billion Home Plus Co., Ltd buyout, which sets a new record in that geography, in terms of deal size. India followed in third place, tied with Australia/New Zealand, with USD12.4 billion worth of deals completed.

Asia Private Equity Fundraising, Investments and Divestments
As of December 31, 2015 (USD billions)



Source: Asia Private Equity Review.

Exit Activity

A total of USD34.5 billion was returned in Asia in 2015, a 30.5% decline compared to 2014. Buyouts led in terms of distributions at USD18.6 billion, but experienced a 30% decline as compared to the previous year. Most markets saw a decline in capital return, with China leading exits at USD13.5 billion, including the large USD2.0 billion exit of Focus Media, followed by Japan and India, at USD6.7 billion and USD5.8 billion in exit volumes, respectively. India posted an impressive 60.2% increase in distributions, the highest jump across the region, as compared to 2014. Public Markets remain the favored exit route, contributing USD16.7 billion worth of exits, a 37.4% decline as compared to 2014 due to volatile public markets, followed by trade sales with a 13.0% increase at USD11.9 billion, and Secondaries at USD2.9 billion.

IV. REAL ASSETS MARKET SUMMARY

Real Assets: Market Overview

"Just as, during the super cycle, people imagined prices would go up forever, people now imagine the market will never recover. Neither extreme represents the truth. What is true, however, is that our cycle times are lengthening. That means it could take years to adjust to current market forces – but it's still a cycle."

- November 30, 2015; Philip Hopwood, Global Leader – Mining, Deloitte Touche Tohmatsu Limited

Energy

In the first quarter of 2016, West Texas Intermediate (WTI) crude jumped to nearly USD42 per barrel before settling back to USD37 per barrel to close out the quarter. OPEC once again failed to reach a production freeze agreement at its April meeting in Qatar. Industry optimists are hopeful that shrinking global production and continued growth in demand will prevent prices from revisiting their recent lows.

The crash in oil prices since 2014 has certainly taken its toll. Today's rig count is at the lowest level in more than 75 years and production has declined, albeit slowly. Rigs and technology today are much more efficient, and as a result, the U.S. is still producing oil at a relatively high rate despite the dramatic drop in rig counts.

The price of U.S. natural gas continued to drop through the first quarter of 2016 ending the quarter at USD1.93 per MMBtu. Warmer temperatures throughout the winter, high inventory levels, and production growth have driven sustained low natural gas prices. The EIA forecasts monthly average Henry Hub spot prices to remain below USD3.00 per MMBtu through to the end of the year.

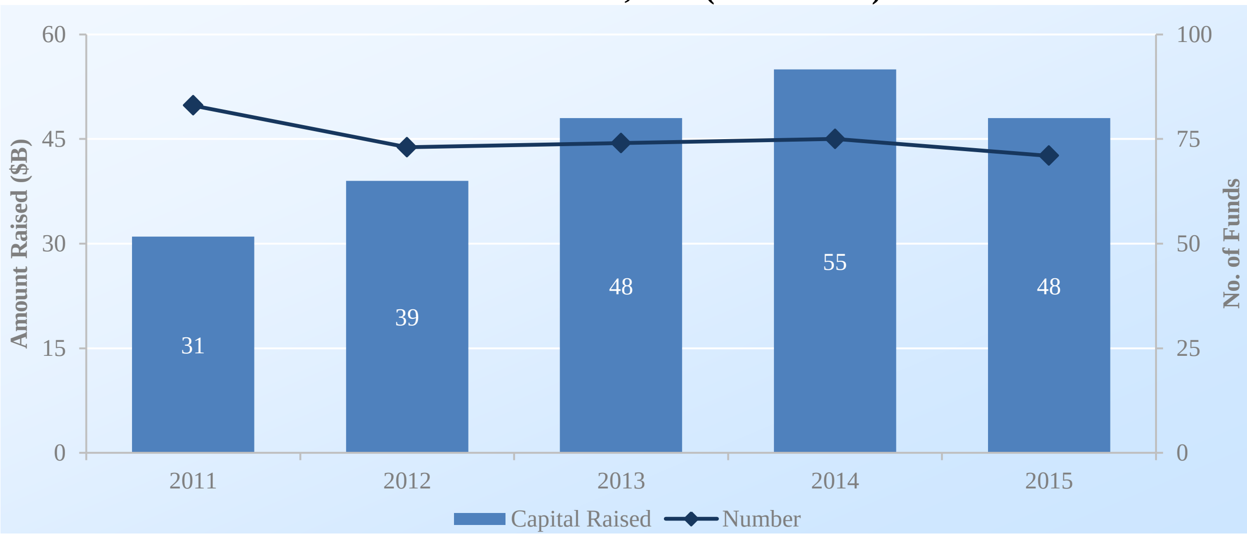
The dramatic drop in commodity prices has certainly created distress, especially with producers who find themselves over-extended and over-leveraged. Over 50 North American oil-and-gas producers have filed for bankruptcy since January 2015. The Chapter 11 filings are expected to grow with over 150 companies at risk of defaulting on loan covenants. Banks are taking a more conservative approach to lending practices, and as a result, opportunities are opening for investors to fill a liquidity void at oil and gas companies seeking capital.

Infrastructure

Infrastructure demand and access to debt financing, along with significant dry powder available to fund managers, has generated a high level of competition for infrastructure assets. As a result, pricing is on the rise and deal activity has slowed while investors continue to search for attractive investment opportunities. Altius believes that both mid-market and greenfield deals are less competitive and worthy of investor attention.

The following chart illustrates the growth in global infrastructure fundraising over the last five years. In 2015, USD48 billion was raised by 72 unlisted infrastructure funds. This was the sector's second largest fundraise in the last six years. At year-end 2015, there were 280 unlisted infrastructure funds globally in the market fundraising with a combined target size of USD197 billion.

Global Infrastructure Fundraising
As of December 31, 2015 (USD billions)



Source: Pitchbook.

Timber

The NCREIF Timberland Index rose 1.86% in the fourth quarter of 2015, continuing its impressive trend of 17 consecutive quarters of positive returns for timber.

Southern Yellow Pine exports more than doubled over the past five years and finished 2015 at 7% above the 2014 export total. During 2015, the top Southern Yellow Pine export destinations remained consistent: China, the Dominican Republic, and Mexico.

Global production of all major wood products is showing its strongest growth since the 2008 - 2009 global financial crisis. The wood-based panels category exhibited the fastest growth in production primarily as a result of strong growth in China which accounts for 49% of global production.

U.S. housing starts climbed by a higher-than-expected 5.2% in February 2016 compared to the prior month. It was the highest reading since September 2015 amid strong demand for housing. Year-over-year, housing starts increased by 30.9%. This bodes well for future timber prices.

Mining

Despite the gloom of the commodity price plunge over the past several years, most industry experts recognize that this is just another cycle, if more painful and longer than expected. China's economic slowdown has directly impacted the mining sector, influencing dramatic price drops for iron ore, coal, aluminium, nickel, copper, zinc, and lead. Hope has fled the sector; however, we believe the bottom is near. We recommend that investors explore the mining sector, as it remains, in our opinion, as one of the most exciting and contrarian investment opportunities today.

V. PRIVATE EQUITY MARKET SUMMARY

Through the first quarter of 2016, U.S. Private Equity exhibited strong deal flow. Pricing has abated somewhat from the levels seen in 2014 and 2015, but is still high by historical standards. Private Equity firms are actively monetizing their portfolios and investors are rewarding successful managers with continued commitments in subsequent, and often larger, funds. U.S. venture capital funds are demonstrating an attractive risk-return profile on both a realized and unrealized basis and, as a result, have been able to attract the largest amount of capital in several years. Through early 2016, however, IPO markets exhibited a notable slow down, substantially reducing a common exit path for mature venture capital-backed companies. Late stage valuations have declined substantially and it remains to be seen how companies that raised capital at high valuations will navigate the new valuation landscape. Although there remains some concern over market valuations, U.S. private equity and venture capital markets appear to be healthy and directional.

Europe is facing much uncertainty following the U.K.'s Brexit decision to leave the EU. As this marks the first country to ever withdraw from the EU, there is much ambiguity about how effective terms will ultimately be negotiated, a process that will likely take two years. The overall immediate response is conservatism, by consumers and investors alike, and economists predict slowed growth for the UK while the terms of the Brexit are completed. Other countries are also contemplating holding similar referendums, adding to the general uncertainty over the future of the EU and Europe.

Asia continues to show attractive growth rates and has also benefited from the recent decline in oil rates, although the slowdown in China has impacted neighboring and dependent economies – most notably Japan. However, investors have continued to show interest in Asian Private Equity enabling well-known and/or top-performing private equity managers to raise funds quickly, usually reaching or exceeding their target. Fundraising in 2015 surpassed the record amount raised in 2014, although both investments and exits were comparably lower.

Important Notice

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EXHIBIT B

ERS Private Equity Investments *as of June 30, 2016*				
Fund #	**Fund Name**	**ERS FY**	**Geography/Strategy**	**Commitment MM USD (1)**
1	Texas Growth II - 1998 Trust	FY'99	U.S. - Buyout / VC	$ 100
2	Southwest Opportunity Partners	FY'07	U.S. - Buyout	61
3	New Mountain Partners III	FY'08	U.S. - Buyout	60
4	Carlyle Partners V	FY'08	Global - Buyout	100
5	Advent International GPE VI	FY'08	Europe / U.S. - Buyout	37
6	Brazos Equity Fund III	FY'09	U.S. - Buyout	38
7	Wind Point Partners VII	FY'09	U.S. - Buyout	65
8	CVC European Equity Partners V	FY'09	Europe - Buyout	87
9	Charterhouse Capital Partners IX	FY'09	Europe - Buyout	59
10	Hellman & Friedman Capital Partners VII	FY'09	U.S. / Europe - Buyout	100
11	Navis Asia Fund VI	FY'09	Asia - Growth Equity	60
12	TA XI	FY'09	U.S. / Europe / India - Growth Equity	100
13	TA SDF III	FY'09	U.S. / Europe / India – Sub. Debt	50
14	Riverside RCAF V	FY'09	U.S. - Buyout	100
15	Triton III	FY'09	Europe - Turnaround/Restructuring	67
16	Lexington Capital Partners VII	FY'09	Global - SS - Secondaries	100
17a	Littlejohn IV	FY'09	U.S. - Turnaround/Restructuring	72
18	Quantum Energy Partners V	FY'10	U.S. / Canada - SS - Energy	75
19	HgCapital VI	FY'10	Europe - Buyout	60
20	Mason Wells III	FY'10	U.S. - Buyout	65
21	LGT Crown Global Secondaries II	FY'10	Europe / U.S. - SS - Secondaries	75
22	Advent Latin America V	FY'10	Latin America - Buyout	50
23	Riverside Europe IV	FY'10	Europe - Buyout	82
17b	Littlejohn IV	FY'10	U.S. - Turnaround/Restructuring	18
24a	Southern Cross IV	FY'10	Latin America - Buyout	50
25	ERS PE Emerging Manager Fund I	FY'11	U.S. - SS - Emerging Manager	50
26	Baring Asia V	FY'11	Asia - Growth Equity	50
27	Argos Soditic - Euroknights VI	FY'11	Europe - Turnaround/Restructuring	39
28	Gores Capital Partners III	FY'11	U.S. - Turnaround/Restructuring	100
29a	Altius-ERS Int'l Funds of Funds	FY'11	Asia - SS - Int'l Funds	75
30	KSL Capital Partners III	FY'11	U.S. - SS - Resort	95
31	Summer Street Capital Partners III	FY'11	U.S. - Buyout	50
32	RLH Investors III	FY'11	U.S. - Growth Equity / Buyout	50
33	Longitude Capital III	FY'11	U.S. - Venture Capital	50
29b	Altius-ERS Int'l Funds of Funds I	FY'12	Int'l – Diversified - Int'l Funds	75
34	Hitec Vision VI	FY'12	Europe - SS - Energy	70
C1	Co-investment #1	FY'12	Europe - Turnaround/Restructuring	8
35	Frontier Capital Partners III	FY'12	U.S. - Growth/Buyout	50
C2	Co-investment #2	FY'12	U.S. - Turnaround/Restructuring	10
36	LGT CGS III	FY'12	Global - SS - Secondaries	100
C3	Co-investment #3	FY'12	U.S. - Turnaround/Restructuring	10
C4	Co-investment #4	FY'12	U.S. - Buyout	8
37	Advent Global VII	FY'12	U.S. / Europe - Buyout	100
38	Castlelake II	FY'12	U.S. / Europe - Distressed	75
39	Court Square III	FY'12	U.S. - Buyout	75
24b	Southern Cross IV (Secondary)	FY'13	Latin America - Buyout	25
40	Riverside RCAF VI	FY'13	U.S. - Buyout	100
C5	Co-investment #5	FY'13	U.S. - Buyout	10
C6	Co-investment #6	FY'13	U.S. - Buyout	15
41	Hg Capital VII	FY'13	Europe - Buyout	40
42	Blue Wolf III	FY'13	U.S. - Buyout	50
43	Triton IV	FY'13	Europe - Buyout	78
C7	Co-investment #7	FY'13	U.S. - SS - Other	20
C8	Co-investment #8	FY'13	U.S. - Buyout	15
44	CVC Capital Partners VI (B)	FY'13	Europe - Buyout	79

ERS Private Equity Investments *as of June 30, 2016*				
Fund #	**Fund Name**	**ERS FY**	**Geography/Strategy**	**Commitment MM USD (1)**
45	Industry Ventures Secondary VII	FY'14	Global - SS - Secondaries	$ 40
46	Industry Ventures Special Opp II-A	FY'14	Global - SS - Secondaries	48
47	Navis Asia VII	FY'14	Asia - Growth Equity	125
48	KSL Credit Opportunities	FY'14	U.S. - Mezzanine	50
C9	Co-investment #9	FY'14	U.S. - Buyout	30
C10	Co-investment #10	FY'14	U.S. - Buyout	15
49	Triton Debt Opportunities I	FY'14	Europe – Distressed Debt	51
C11	Co-investment #11	FY'14	U.S. - SS - Energy	25
50	Castlelake III	FY'14	U.S. / Europe - Distressed	100
51	Hitec Vision VII	FY'14	Europe - SS - Energy	70
C12	Co-investment #12	FY'14	Europe - SS - Energy	15
52	Cotton Creek Capital Partners II	FY'14	U.S. - Buyout	30
C13	Co-investment #13	FY'14	U.S. - Buyout	10
53	The Energy & Minerals Group III	FY'14	U.S. - SS - Energy	80
C14	Co-investment #14	FY'14	U.S. - SS - Energy	3
C15	Co-investment #15	FY'14	U.S. - SS - Energy	10
54	Carlyle Financial Services Partners II	FY'14	Global – Buyout	100
55	Quantum Energy Partners VI	FY'14	U.S. - Buyout	100
56	Altius-ERS Int'l Funds of Funds II	FY'14	Int'l – Diversified - Int'l Funds	300
57	Hellman & Friedman Capital Partners VII	FY'15	U.S. / Europe - Buyout	82
58	Baring Asia V	FY'15	Asia - Growth Equity	75
59	Landmark Equity Partners XV	FY'15	Global - SS - Secondaries	175
60	Landmark TX ERS Co-Investment	FY'15	Global - SS - Secondaries	125
C16	Co-investment #16	FY'15	U.S. - Buyout	15
C17	Co-investment #17	FY'15	U.S. - Buyout	5
61	ERS Private Equity Emerging Manager II	FY'15	U.S. - SS - Emerging Manager	50
62	KSL Capital Partners IV	FY'15	U.S. - SS - Resort	125
63	Frontier Capital Partners IV	FY'15	U.S. - Growth/Buyout	60
64	Carlyle Energy Mezzanine Opps II	FY'15	U.S. – SS – Energy Debt	85
C18	Co-investment #18	FY'15	U.S. - Buyout	10
C19	Co-investment #19	FY'15	U.S. – SS - Energy	20
65	TA XII, L.P.	FY'15	U.S. / Europe / India - Growth Equity	67
66	TSD IV, L.P.	FY'15	U.S. / Europe / India - Deb	25
C20	Co-investment #20	FY'15	U.S. - Buyout	20
67	Castlelake IV,	FY'16	U.S. / Europe - Distressed	100
68	Southern Cross V	FY'16	Latin America - Buyout	60
C21	Co-investment #21	FY'16	U.S. - Buyout	4
C9b	Co-investment #9b	FY'16	U.S. – SS - Energy	11
69	Advent GPE VIII	FY'16	U.S. / Europe - Buyout	110
C22	Co-investment #22	FY'16	U.K. - Buyout	6
C23	Co-investment #23	FY'16	U.S. - Buyout	6
70	Industry Ventures Secondary VIII	FY'16	Global - SS - Secondaries	40
71	Industry Ventures Special Opp III-A	FY'16	Global - SS - Secondaries	48
72	LGT CGS IV	FY'16	Global - SS - Secondaries	200
73	LGT CGSO	FY'16	Global - SS - Secondaries	100
74	The Energy & Minerals Group IV	FY'16	U.S. - SS - Energy	50
C24	Co-investment #24	FY'16	U.S. - Buyout	10

(1) Adjusted for exchange rates as of June 30, 2016 (EUR/USD: 1.11; GBP/USD: 1.34)

Summary Tables

Commitments by Period	MM USD
Total Commitments - Inception through FY 2008	$ 357
Total Commitments - FY 2009	890
Total Commitments - FY 2010	474
Total Commitments - FY 2011	559
Total Commitments - FY 2012	578
Total Commitments - FY 2013	431
Total Commitments - FY 2014	1,203
Total Commitments - FY 2015	935
Total Commitments - FY 2016 Inception through June 30, 2016	744
Total Commitments - Inception through June 30, 2016	6,172

Aggregate Portfolio Metrics	MM USD
Total Commitments	$ 6,172
Called Capital	3,990
Uncalled Commitments	2,570
Net Asset Value	2,552
Economic Exposure (1)	5,072
Distributions (3)	2,569

(1) Economic Exposure is the sum of Uncalled Commitments and Net Asset Value
(2) Sum of Called Capital and Uncalled Capital may not equal Total Commitments due to timing of foreign exchange transactions and commitment conversion
(3) Includes secondary sale deferral

Geographic Diversification	Policy Guideline (%)	Net Asset Value (%)	Economic Exposure (%)
U.S. / North America	>= 50%	65%	60%
Europe	<= 50%	17%	21%
Asia		15%	15%
Latin America		3%	3%

(4)

Strategy Diversification	Policy Guideline (%)	Net Asset Value (%)	Economic Exposure (%)
Buyouts	45-70%	45%	36%
Special Situations	5-30%	22%	32%
Growth Equity & Venture Capital	10-30%	21%	23%
Credit Strategies	0-15%	11%	9%

PUBLIC AGENDA ITEM - # 7b

Review, Discussion and Consideration of ERS Private Equity Program:

7b. Proposed Private Equity Annual Tactical Plan for Fiscal Year 2017

August 16, 2016

BACKGROUND:

In accordance with ERS' Private Equity Policies and Procedures, Section III.A.2, staff is charged with preparing and presenting to the Board for its review and approval an Annual Tactical Plan ("Plan"). The Plan reviews the current status of the private equity portfolio, recent historical and prospective market conditions and proposes steps to be taken over the next twelve months to implement the private equity program. These steps include the types and number of investments to be pursued, as well as any other actions or considerations germane to the success of the program.

Specifically, staff recommends the Private Equity Annual Tactical Plan for Fiscal Year 2017 target a commitment of $750 million (with a range of +/- 25% or $563 - 934 million). This targeted commitment decreased $200 million versus the Fiscal Year 2016 targeted commitment. The reduction in commitments reflects the lack of growth in Trust assets over the past year and projected into the future at 4% versus 8%.

Staff will target six to ten new fund commitments and opportunistic co-investments in strategies, including buyouts, turnaround/restructuring, growth equity, venture capital, media and communications, and energy. Geographic focus will principally be in the US, Europe and Asia.

The Fiscal Year 2017 Tactical Plan has been reviewed by and is supported by ERS' private equity consultant, Altius Associates.

STAFF RECOMMENDATION:

The staff recommended motion is attached to this agenda item.

ATTACHMENTS – 1

Exhibit A – Private Equity Annual Tactical Plan for Fiscal Year 2017

EXHIBIT A

PRIVATE EQUITY
ANNUAL TACTICAL PLAN FOR FISCAL YEAR 2017

Prepared for
The Employees Retirement System of Texas

August 2016

This document outlines the proposed Private Equity Annual Tactical Plan (the "Tactical Plan") for the Private Equity Program (the "Program") of the Employees Retirement System of Texas ("ERS" or the "System"). The Tactical Plan period covers ERS' fiscal year 2017 that commences on September 1, 2016 and ends on August 31, 2017.

In March 2016, ERS agreed to the secondary sale of 14 funds in the private equity portfolio representing USD951 million of economic exposure[1] (adjusted for exchange rates). As of June 30, 2016, 13 funds totaling USD858 million of economic exposure were transferred and one remaining fund is scheduled to close in January 2017. The portfolio and projections were adjusted to reflect post-sale reality.

I. FUNDING LEVEL

Annual Tactical Plan Period: September 1, 2016 through August 31, 2017

Table I: Funding Positions

The following tables outline the Program's current funding position as of June 30, 2016 as well as the projected funding positions in FY 2020 and target commitment allocations assuming three scenarios of annual Trust Growth: 8.0%, 4.0%, and 0.0%.

Projected funding commitments are based on Altius' Projected Private Equity Portfolio Model. The full output of results is in the Appendix.

Current Funding Position As of June 30, 2016 (USD thousands)	
ERS Total Market Value	24,886,300
Total PE Allocation at 10.0%	2,488,630
Current Net Asset Value	2,551,795
Current Net Asset Value Deficit/(Surplus)	(63,165)

[1] Economic Exposure = NAV + Uncalled Commitments.

Projected Funding Position[2] FY 2020 (USD thousands)	
8% Trust Growth:	
Five-Year Projected Market Value (2020) @ 8% Trust Growth	36,541,636
Total PE Allocation at 10.0%	3,654,164
Projected Net Asset Value (2020) @ 8% Trust Growth	4,280,317
Projected Net Asset Value Deficit/(Surplus)	(626,154)
4% Trust Growth:	
Five-Year Projected Market Value (2020) @ 4% Trust Growth	29,878,667
Total PE Allocation at 10.0%	2,987,867
Projected Net Asset Value (2020) @ 4% Trust Growth	3,508,016
Projected Net Asset Value Deficit/(Surplus)	(520,150)
0% Trust Growth:	
Five-Year Projected Market Value (2020) @ 0% Trust Growth	24,238,463
Total PE Allocation at 10.0%	2,423,846
Projected Net Asset Value (2020) @ 0% Trust Growth	2,676,118
Projected Net Asset Value Deficit/(Surplus)	(252,271)

New Commitment Allocation FY 2017 (USD thousands)	
8% Trust Growth:	
Target Commitment for FY 2017 (+/-25%) @ 8% Trust Growth	950,000
4% Trust Growth:	
Target Commitment for FY 2017 (+/-25%) @ 4% Trust Growth	750,000
0% Trust Growth:	
Target Commitment for FY 2017 (+/-25%) @ 0% Trust Growth	350,000

[2] Per Appendix A Projected Private Equity Portfolio Model assuming fund-level target returns. Initial underlying fund valuations as of December 31, 2015 adjusted for positions sold in the secondary sale (effective April 1, 2016).

Appendix A projects the following commitment requirements over the next five years.

Table II: Annual Projected Commitments (4% Trust Growth Scenario Assumed)

Projected Commitment Requirements (USD thousands)			
Year	**Target Commitment**[3]	**Range**	
2017	750,000	562,500	937,500
2018	750,000	562,500	937,500
2019	750,000	562,500	937,500
2020	800,000	600,000	1,000,000
2021	800,000	600,000	1,000,000
5-Year Total	**3,850,000**		
Yearly Average	**770,000**		

Commentary

As outlined in the model provided in Appendix A, ERS is currently slightly over its targeted Private Equity allocation of 10.0%. The current proposed pacing plan projects ERS to maintain a constant allocation between 10.0-11.0% over the next 10 years of the Program while incorporating a smooth and natural increase in annual commitments. The targeted commitments going forward provide a degree of flexibility to accommodate varying market opportunities and the resources available to ERS. As the portfolio continues to develop, it will be possible to adjust forward commitment levels to achieve or maintain the desired Private Equity investment level.

[3] Targeted commitments (and relevant ranges) are inclusive of capital for potential co-investment opportunities. The model assumes that 20% of total commitments per year are allocated to co-investments.

Table III: Funding by Strategy

The following table displays the current fund allocations by strategy. A comprehensive categorization of each fund's strategy can be found in Appendix B.

Strategy Allocation Analysis
As of December 31, 2015 (USD thousands)

Strategy	No. of Funds	% Target Allocation[4]	Target Allocation	Uncalled Commitments	Current NAV	Current Exposure (NAV + Unfunded)	Target Variance Deficit/(Surplus)[5]
Buyouts	43	70.0%	1,742,041	713,060	1,137,831	1,850,891	(108,850)
Funds	29	49.0%	1,219,429	686,098	989,794	1,675,892	(456,463)
Co-Investments	14	21.0%	522,612	26,962	148,037	174,999	347,613
Venture Capital & Growth	8	5.0%	124,431	214,699	281,070	495,769	(371,338)
Funds	8	5.0%	124,431	214,699	281,070	495,769	(371,338)
Co-Investments	0	0.0%	-	-	-	-	-
Senior, Sub., & Distressed Debt	7	5.0%	124,431	210,672	236,475	447,147	(322,716)
Funds	7	5.0%	124,431	210,672	236,475	447,147	(322,716)
Co-Investments	0	0.0%	-	-	-	-	-
Special Situations[6]	23	20.0%	497,726	958,050	693,023	1,651,074	(1,153,348)
Funds	17	16.0%	398,181	941,331	571,008	1,512,339	(1,114,159)
Co-Investments	6	4.0%	99,545	16,719	122,015	138,734	(39,189)
Total (Funds)	**61**	**75%**	**1,866,472**	**2,052,800**	**2,078,347**	**4,131,148**	**(2,264,675)**
Total (Co-Investments)	**20**	**25%**	**622,157**	**43,681**	**270,052**	**313,733**	**308,424**
Total (All)	**81**	**100%**	**2,488,630**	**2,096,481**	**2,348,400**	**4,444,881**	**(1,956,251)**

Note: Excludes Texas Growth Fund II (1998 vintage).

Commentary
ERS completed four commitments through December 31, 2015 of fiscal year 2016 to two funds and two co-investments. Fund commitments included one U.S. and European distressed buyout fund and one Latin American buyout fund, both re-ups with existing managers.[7] The System completed two co-investments alongside one U.S. Buyout and one U.S. Energy manager, both of whom are existing relationships for ERS.

Following the secondary sale, the Program is underweight in Buyouts, which constituted the majority of the NAV sold. Current target allocations and investment pacing project the portfolio to be slightly over its target allocation for the next fiscal year for all strategies except buyout. As the portfolio continues to develop over the coming years, diversification by strategy will continue to materialize while uncalled commitments and invested NAV grow towards targeted levels.

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[4] Target Allocations have been adjusted following ERS' secondary sale and changes to the investment policy, specifically regarding co-investment. The current allocation assumes 30% of dollars invested in all Buyout funds, 20% of dollars invested in Special Situations funds, and 0% of dollars invested in Venture Capital, Growth, and Debt funds will be completed through co-investments.

[5] Target Variance is equal to Target Allocation less Current Exposure. As noted, Total Target Variance (shaded) includes both fund and co-investment exposure, with subtotals listed above.

[6] Special Situations strategy includes: Energy (Real Assets), Resort, Secondaries, and other Special Situations funds.

[7] Fund commitments through December 31, 2015 by strategy included (i) Distressed: Castlelake IV, L.P. and (ii) Buyout: Southern Cross Latin American Fund V, L.P.

Table IV: Proposed Funding Strategy

Proposed Funding by Strategy for ERS Fiscal Year 2017 (USD thousands)			
	No. of	Range	
Strategy	Funds	%	$
Buyouts	5 - 10	50% - 100%	375,000 - 750,000
Venture Capital & Growth Equity	0 - 1	0% - 10%	0 - 75,000
Subordinated, Senior, & Distressed Debt	0 - 1	0% - 10%	0 - 75,000
Special Situations	0 - 3	0% - 30%	0 - 225,000
Total	**5 - 10**	**100%**	**375,000 - 1,125,000**

Note: Excludes co-investments and ERS fund-of-funds.

Commentary

We expect there will continue to be a robust pipeline of quality investment opportunities over the next twelve months. The chart above provides estimated ranges for the anticipated number of fund commitments as well as the targeted range of total commitment sizes for each of the Private Equity sub-strategies. It is likely that actual commitments made will be closer to the top-end of ranges identified above; particularly for Buyouts considering this comprised the majority of NAV sold through the secondary offering. Special situations include hybrid partnerships, industry focused funds (e.g. energy funds), secondary funds, and other miscellaneous strategies.

Subsequent to December 31, 2015, ERS negotiated a secondary sale of positions in 12 funds in the Private Equity portfolio. While this transaction will temporarily reduce the allocation to Private Equity, the capital should be redeployed to other Private Equity funds and the program will continue to work towards the targeted 10.0% allocation.

II. DIVERSIFICATION

Table V: Strategy Diversification

Diversification by Strategy: Funds Only
As of December 31, 2015 (USD thousands)

Strategy	% Target Allocation	% Current NAV	% Current Exposure
Buyouts	70.0%	47.6%	40.6%
Venture Capital & Growth Equity	5.0%	27.5%	36.6%
Subordinated, Senior, & Distressed Debt	5.0%	13.5%	12.0%
Special Situations	20.0%	11.4%	10.8%
Total	**100.0%**	**100.0%**	**100.0%**

Note: Excludes Co-investments.

Diversification by Strategy: Funds & Co-Investments
As of December 31, 2015 (USD thousands)

Strategy	% Target Allocation	% Current NAV	% Current Exposure
Buyouts	70.0%	48.5%	41.6%
Venture Capital & Growth Equity	5.0%	29.5%	37.1%
Subordinated, Senior, & Distressed Debt	5.0%	12.0%	11.2%
Special Situations	20.0%	10.1%	10.1%
Total	**100.0%**	**100.0%**	**100.0%**

Note: Includes Co-investments.

Commentary

ERS continues to build the portfolio's economic exposure towards targeted long-term targets. Through December 31, 2015, ERS made four commitments in fiscal year 2016 to two funds and two co-investments, which moved the portfolio toward its targeted strategy allocations. Currently, several investments are in various stages of the investment evaluation process, particularly buyouts, growth capital, and secondaries investments. If considered appropriate for investment, these commitments should provide further diversification to ERS' Private Equity program.

The targeted allocations outlined above reflect the needs of the portfolio following the secondary sale and are consistent with ERS' revised target to increase its co-investment activity. These allocations are designed to appropriately balance potential risk and return within the various sub-strategies in consideration of the Program's capacity and allocation constraints. While fund inclusions under Buyouts, Venture Capital & Growth Equity, and Subordinated, Senior, & Distressed Debt strategies are self-evident, Special Situations includes the following: hybrid partnerships, industry-focused funds (e.g. energy funds), secondary funds, and other miscellaneous strategies.

Table VI: Sector Diversification

Diversification by Sector
As of December 31, 2015 (USD thousands)

Sector	Net Cost	NAV ($)	NAV (%)
Industrials	260,370.0	349,106.0	18.2%
Financials	322,883.0	337,825.5	17.7%
Consumer Discretionary	270,867.8	306,782.1	16.0%
Information Technology	230,032.5	294,907.3	15.4%
Healthcare	129,346.2	193,305.0	10.1%
Energy	205,127.3	190,839.4	10.0%
Materials	52,947.0	111,339.8	5.8%
Consumer Staples	49,341.0	52,576.4	2.7%
Opportunistic	35,273.7	40,346.7	2.1%
Telecommunication Services	10,579.2	19,205.9	1.0%
Utilities	14,628.3	16,712.0	0.9%
Total	**1,581,396.1**	**1,912,946.0**	**100.0%**

Note: Figures calculated at the underlying company level as of December 31, 2015 and exclude co-investment.

Diversification by Sub-Sector
As of December 31, 2015 (USD thousands)

Sub-Sector	Net Cost	NAV ($)	NAV (%)
Software & Services	240,258.8	301,391.7	15.8%
Opportunistic	230,684.9	286,617.5	15.0%
Energy	199,860.4	226,764.9	11.9%
Diversified Financials	120,244.5	133,228.8	7.0%
Commercial & Professional Services	83,084.6	114,513.9	6.0%
Healthcare Equipment & Services	97,550.2	98,787.1	5.2%
Capital Goods	80,228.0	94,930.0	5.0%
Pharmaceuticals, Biotechnology & Life Sciences	67,768.3	86,252.9	4.5%
Materials	65,724.5	77,643.8	4.1%
Consumer Services	50,845.3	64,076.0	3.3%
Retailing	65,246.6	59,080.1	3.1%
Food, Beverage & Tobacco	43,645.4	58,865.6	3.1%
Media	43,409.9	48,553.2	2.5%
Consumer Durables & Apparel	44,311.9	46,993.5	2.5%
Transportation	37,771.0	41,095.1	2.1%
Automobiles & Components	20,611.2	39,708.4	2.1%
Telecommunication Services	14,590.5	26,504.0	1.4%
Real Estate	12,712.4	20,562.3	1.1%
Food & Staples Retailing	14,892.9	20,099.7	1.1%
Utilities	11,679.2	14,097.2	0.7%
Insurance	9,765.3	13,888.9	0.7%
Household & Personal Products	9,223.7	12,505.1	0.7%
Banks	9,103.5	12,347.4	0.6%
Semiconductors & Semiconductor Equipment	2,798.9	8,117.0	0.4%
Technology Hardware & Equipment	5,384.3	6,321.8	0.3%
Total	**1,581,396.1**	**1,912,946.0**	**100.0%**

Note: Figures calculated at the underlying company level as of December 31, 2015 and exclude co-investment.

Commentary
A long-term goal of the ERS Private Equity Program is to create a portfolio with broad diversification across industry sectors. As displayed in tables above, all sector-wide exposures are below 20.0% NAV and all sub-sector exposures are below 16.0% NAV, representing a well-diversified portfolio. Although there are currently three sector exposures over 10.0%, Software & Services (15.8%), Opportunistic (15.0%), and Energy (11.9%); these areas are inherently broad and the current values are not subsequently viewed as excessive concentration.

Furthermore, many of the program's fund commitments remain relatively young and in various stages of capital deployment. While exits at the portfolio-company level could cause industry diversification to consolidate over time, anticipated new fund commitments and the continued investment of capital should offset any consolidations and further improve the program's sector diversification.

Table VII: Geographic Diversification

Diversification by Region
As of December 31, 2015 (USD thousands)

Region	Net Cost	NAV ($)	NAV (%)
United States	845,089.9	1,082,564.7	56.6%
Other (37)	296,724.7	324,463.2	17.0%
Germany	80,736.5	90,497.8	4.7%
United Kingdom	65,093.4	78,438.4	4.1%
China	47,755.1	59,044.2	3.1%
Australia	43,988.6	56,087.6	2.9%
Spain	47,043.8	53,386.9	2.8%
India	40,272.4	46,794.3	2.4%
Norway	42,852.8	43,763.0	2.3%
Canada	37,570.5	40,451.8	2.1%
Singapore	34,268.3	37,454.0	2.0%
Total	**1,581,396.1**	**1,912,946.0**	**100.0%**

Note: Figures calculated at the underlying company level as of December 31, 2015 and exclude co-investment.

Commentary
The table above shows the geographic spread of ERS' investments across all active funds. A long-term goal of the program is to create a Private Equity portfolio that is well-diversified by the geographical location of underlying fund investments. The current portfolio has exposure to companies in 47 countries and regions, with no single location accounting for more than 4.7% of NAV except for the United States. The United States is the sole exception and accounts for over half of the portfolio's geographic exposure. The program's portfolio is purposefully weighted more heavily towards the United States with a target concentration of 50.0%. Currently, this exposure is slightly above target and represents 56.6% of remaining portfolio NAV.

Table VIII: General Partner Diversification

General Partner Diversification (Top 10 by Committed Capital)
As of December 31, 2015 (USD thousands)

Rank	General Partner	No. of Funds	Committed Capital ($)	Committed Capital (%)
1	Altius Associates	2	465,000.0	10.0%
2	Landmark Partners	2	400,000.0	8.6%
3	Carlyle Group	3	285,000.0	6.1%
4	Castlelake	3	275,000.0	5.9%
5	KSL Capital Partners	3	270,000.0	5.8%
6	TA Associates	4	237,500.0	5.1%
7	Quantum Energy Partners	4	220,000.0	4.7%
8	Triton	3	209,834.9	4.5%
9	Riverside Company	2	200,000.0	4.3%
10	Advent International	3	194,567.8	4.2%
Top 10 Total		**29**	**2,756,902.7**	**59.4%**
Other Commitments		**52**	**1,880,540.2**	**40.6%**
Total Commitments		**81**	**4,637,442.9**	**100.0%**

Note: Excludes Co-investments.

Commentary
The above table presents the top ten exposures to General Partners calculated by total committed capital. Altius Associates is listed as the top manager exposure due to two fund-of-funds commitments dedicated to gaining international exposure. The two fund-of-funds commitments of USD165 million and USD300 million were completed in March 2011 and June 2014, respectively. As these are both fund-of-funds investments, the exposure is spread across numerous underlying General Partners in each portfolio.

A 10% General Partner concentration is typically advised, and most of the Program's exposures are well below this threshold; although the largest exposure, Altius Associates, is currently at this threshold. Landmark Partners is the second largest exposure equal to 8.6% of total commitments. Both funds with Altius Associates and Landmark Partners represent commitments to fund-of-funds. Two funds with Altius Associates target international exposure and two funds with Landmark Partners represent secondary fund-of-funds. A fund-of-funds portfolio is essentially a portfolio of individual fund investments with a variety of general partners. Subsequently, the effective exposure to each general partner in the fund-of-funds portfolio is well below the targeted 10% threshold.

As of December 31, 2015, no single general partner exposure exceeded the targeted 10% concentration threshold. As ERS continues to make commitments through fiscal year 2017 and beyond, the portfolio will continue to be diversified. As of December 31, 2015, ERS had 72 active fund commitments across 31 managers. Altius will periodically recommend reducing or adding new relationships in order to avoid manager proliferation.

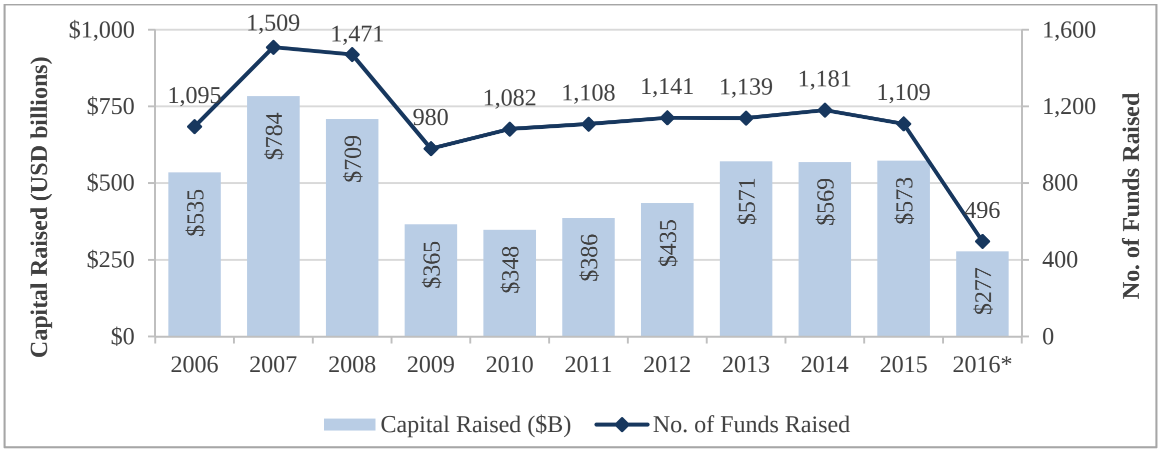
III. MARKET CONDITIONS

Market Conditions: Discussion of Partnership Market

Private Equity funds remain in high demand by investors and existing funds continue to demonstrate strong performance. The following charts and commentary provide a high-level overview of the fundraising environment and performance exhibited in recent years.

Table IX: Private Equity Fundraising

Global Private Equity Fundraising

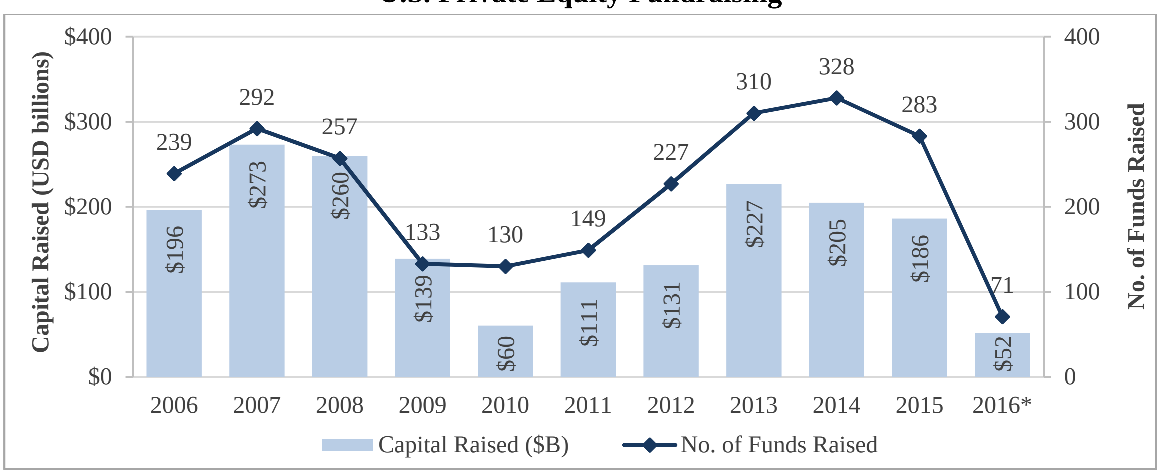


Source: Pitchbook as of March 31, 2016.

Global

According to Pitchbook, global fundraising remained relatively stable from 2014 to 2015 with approximately USD570 billion raised each year. However, 2015 fundraising included approximately 70 fewer funds as compared to 2014, which suggests that although fewer funds were raised, fund sizes were comparably larger on average. This is consistent with GP commentary and Altius' observations over the past year.

U.S. Private Equity Fundraising



Source: Pitchbook as of March 31, 2016.

United States

When compared to 2014, fundraising declined in 2015 by both aggregate capital raised (USD186 billion vs. USD205 billion) and number of funds raised (283 vs. 328). This represents a continuation of the downward trend experienced since the fundraising surge in 2013. Although fundraising was strong in the first quarter of 2016, there has been less variation in Q1 fundraising figures in comparison to other calendar quarters, which makes it difficult to predict what the remainder of 2016 will bring.

Europe

European fundraising in the first quarter of 2016 totaled EUR10.2 billion, in line with both the prior quarter (with EUR10.2 billion raise in Q4 2015) and the same quarter from the prior year (with EUR10.2 billion raised in Q1 2015). However, capital rose during 2015 increasing year-over-year with EUR52.6 billion raised vs. the EUR42.6 billion raised in 2014. This amount was over fewer funds, 94 vs. 72, suggesting larger fund sizes. Demand for high-quality funds in the European market remains strong, with access once again becoming an issue.

Asia

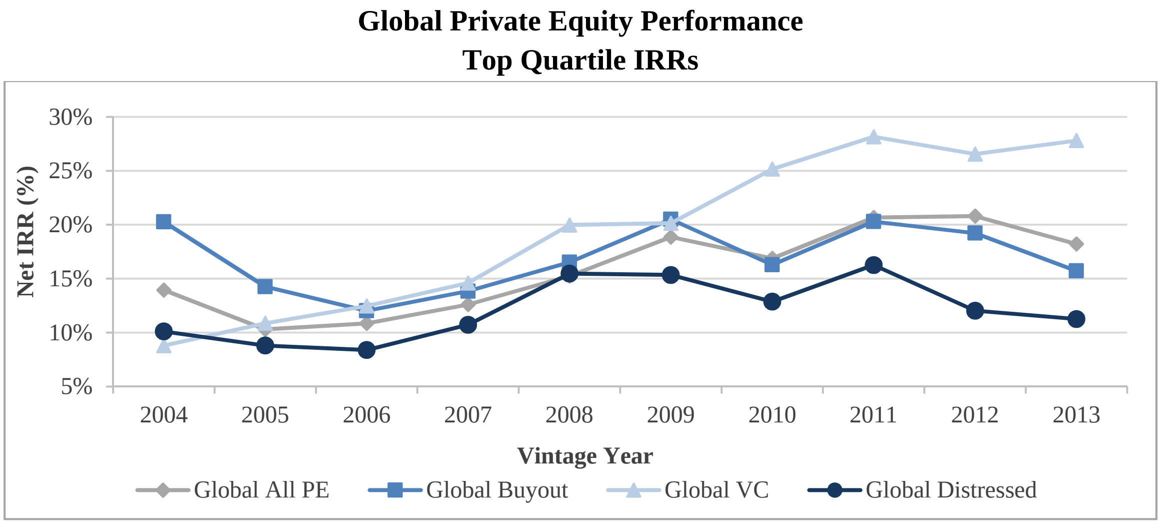
Asian private equity fundraising totaled USD5.4 billion during the first quarter of 2016 representing a 21% increase over the same quarter the prior year (USD4.4 billion in Q1 2015). Total capital raised in 2015 amounted to USD31.4 billion, slightly below the record amount raised in 2014 of USD34.0 billion and below industry expectations. The vast majority of funds and capital raised in Asia were dedicated to private equity funds (USD26 billion across 102 funds), with less fundraising by private credit funds (USD3.2 billion raised across 10 funds) and private infrastructure / real asset funds (USD2.0 billion raised across 5 funds).

Asian fundraising continues to be split with a number of GPs finding it relatively easy to secure LP commitments; while other GPs struggle to reach their target fund sizes. We should note that in Asia, as well as in Europe, large U.S.-based managers generally play a significant role in many of the large transactions, which often tend to be global in nature.

Latin America

In the first quarter of 2016, Latin American private equity fundraising totaled USD676 million, approximately half of the USD1.3 billion raised during the same period last year (Q1 2015). Brazil has historically accounted for the largest portion of Latin American private equity and subsequently, the drop in fundraising is primarily a result of Brazil's political instability. Political instabilitycreated economic and investor uncertainty leading up to and following the suspension and consequent impeachment trial of the country's president in the spring of 2016.

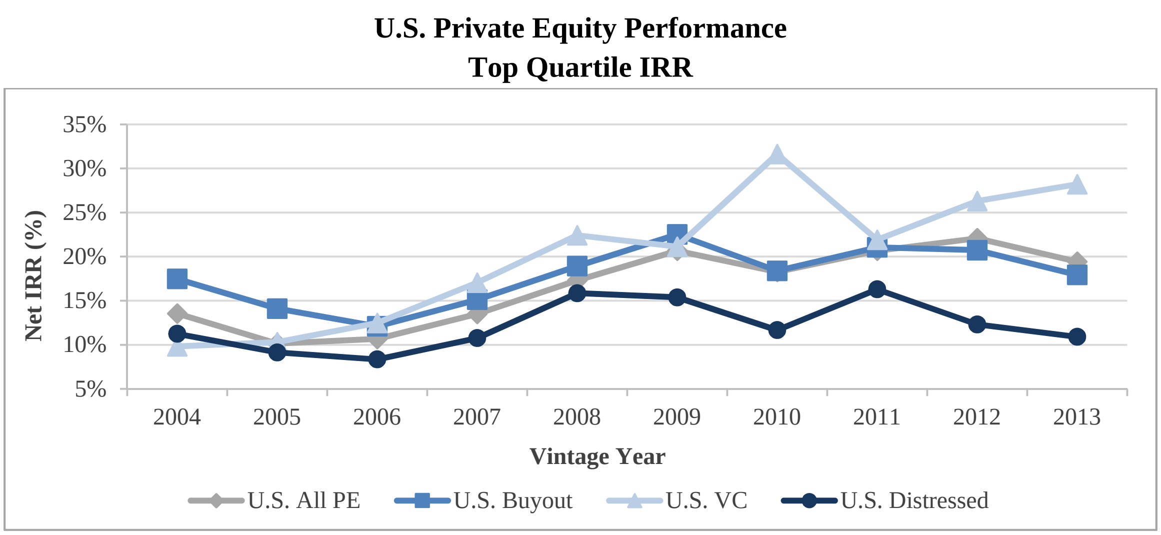
Table X: Private Equity Performance



Source: Private iQ as of March 31, 2016.

Global

Private equity funds continue to consistently generate net IRRs upwards of 10%. Top quartile venture funds have typically outperformed both buyout and distressed funds (especially in younger vintages generating IRRs upwards of 20-25%. Similarly, buyout funds have consistently generated higher returns than distressed funds, typically by a margin of 200-1,000 bps. According to Private iQ data through March 31, 2016, median global buyout returns over 3, 5, 10, and 15 year horizons were equal to 2.49%, 7.50%, 10.98%, and 10.58%, respectively, and top quartile returns were equal to 13.77%, 15.84%, 20.34%, and 20.51%, respectively, over the same time horizons.



Source: Private iQ as of March 31, 2016.

United States

U.S. private equity funds continue to generate positive IRRs primarily between 10-25% in the short term and 5-20% in the longer term. Similar to global private equity performance, top quartile venture funds typically exhibit the highest returns, followed by buyout funds and then distressed funds. This is consistent with the returns targeted by each of these strategies, and the difference is - overstated during the early years of a fund's life. The following paragraphs outline - the detailed performance exhibited by U.S. buyout, venture capital, and distressed funds.

- *Buyouts:* According to Private iQ data through March 31, 2016, U.S. buyout funds exhibited a pooled median return of -9.95% over the one-year period, with top quartile funds returning at least 0.0% and bottom quartile funds generating -22.81% or less. Median U.S. buyout returns over longer-term horizons of 3, 5, 10, and 15 years were equal to 3.69%, 8.02%, 11.30%, and 10.95%, respectively, and top quartile returns were equal to or greater than 15.05%, 16.55%, 19.92%, and 21.50%, respectively, over the same time horizons.

- *Venture Capital:* According to Private iQ data through March 31, 2016, U.S. venture funds returned a median -8.87% over a one-year period. Returns for top and bottom quartiles were 0.0% and -18.95%, respectively. Venture funds have the greatest return dispersion of all private equity asset classes (with the potential to gain and lose substantially). Subsequently, for the same one-year period the 95th and 5th percentiles returned 50.51% and -41.60%, respectively. Historical median IRRs for 3, 5, 10, and 15-year horizons equal 1.71%, 2.30%, 4.28%, and 6.10%, respectively; historical top quartile IRRs are 15.71%, 14.23%, 14.75%, and 16.99%, respectively, over the same time horizons. Further, longer term IRRs for the 95th percentile all exceed 65% for time horizons five years and longer.

- *Distressed:* According to Private iQ data through March 31, 2016, U.S. distressed funds[8] generated a median IRR of 1.02% over the one-year period. The range spread was moderate with top and bottom quartile one-year performance equal to 9.35% and 8.98%, respectively. Compared with longer holds, the one-year return marks the only time horizon to generate any negative third quartile results. Longer-term horizons of 3, 5, 10, and 15-years exhibited median IRRs of 8.48%, 9.62%, 10.15%, and 10.87%, respectively, and top quartile IRRs of 14.64%, 15.50%, 16.09%, and 15.28%, respectively, for the same time horizons (third quartile returns all ranged between 3-5%).

Europe

According to Private iQ data through March 31, 2016, European buyouts exhibited a median return of -15.02% for the one-year period. Some funds did manage to exhibit positive one-year performance with top quartile performers generating returns between -0.25% and 35.15%. Median European buyout returns over 3, 5, 10, and 15 year horizons were equal to 0.0%, 6.66%, 11.42%, and 11.55%, respectively, and top quartile European buyout returns were equal to or greater than 11.49%, 14.69%, 22.16%, and 20.09%, respectively, over the same time horizons.

Asia

According to Private iQ data through March 31, 2016, Asian buyouts generated a median -9.32% return over the one-year period amidst a wide range of returns; 75th to 95th percentile performance ranged from 0% to 49.55% compared to 25th percentile performance of -22.68% over the same one-year period. Median Asian buyout returns over 3, 5, 10, and 15 year horizons were equal to 2.63%, 6.11%, 8.05%, and 2.51%, respectively, and top quartile returns were equal to or greater than 13.24%, 13.09%, 18.12%, and 6.20%, respectively, over the same time horizons. Returns in Asia remain more widely dispersed compared to more developed geographies due to the range of manager capabilities as well as an understanding of the local market and investment opportunities.

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[8] U.S. Distressed benchmark includes U.S. Distressed, Mezzanine, and Special Situations funds.

Latin America

According to Private iQ data through March 31, 2016, Latin American buyout funds[9] generated a median -21.37% return over the one-year period. Median Latin American buyout returns over longer investment horizons of 3, 5, and 10 years were equal to -2.68%, -6.10%, and -0.72%, respectively, and top quartile returns were equal to or greater than 1.57%, 3.83%, and 4.09%, respectively, over the same time horizons[10]. Similar to Asia, there is wide variance amongst private equity returns due to the range of manager capabilities. There is less private equity in Latin America, and subsequently the benchmark is comprised of a smaller number of funds.

[9] Latin America buyouts benchmark includes buyout funds located in Central America and South America.
[10] Note: 15 year performance is excluded due to the thinness of data (only four funds sampled); these four funds generated pooled returns of 1.41% (median) and 6.22% (top quartile).

IV. PROSPECTIVE INVESTMENTS: NEXT TWELVE MONTHS

Investment Objectives

Strategic Focus

a. Buyout
b. Venture Capital and Growth Equity
c. Subordinated, Senior, and Distressed Debt
d. Special Situations

Buyout

The targeted commitment to buyout funds for the next twelve months is $375-$750 million (or 50-100.0% of the targeted $750 million commitment amount for the year). This should be achieved through commitments to five to ten funds, with an anticipated average commitment size of $75 million. The buyout allocation also includes control-oriented turnaround and restructuring funds.

Venture Capital and Growth Equity

The targeted venture capital and growth equity commitment for the next twelve months will be zero, although a range of 0-10% is possible. Depending upon opportunities available, venture capital and growth equity will be viewed opportunistically over the coming twelve months.

Subordinated, Senior, and Distressed Debt

The targeted subordinated, senior, and distressed debt commitment for the next twelve months will be zero, although a range of 0-10% is possible. Depending upon opportunities available, subordinated, senior, and distressed debt will be viewed opportunistically over the coming twelve months.

Special Situations

The targeted special situations commitment for the next twelve months will be 20.0%, although a range of 0-30% is possible. Depending upon opportunities available, special situations will be viewed opportunistically over the coming twelve months. It should be noted that special situations includes hybrid partnerships, industry focused funds (e.g. energy funds), secondaries, and other miscellaneous strategies.

Timing of Investments

a. Investment Amount
b. Diversification

Investment Amount

The targeted commitment amount for the next twelve months is $750 million (+/- 25%). As mentioned previously, fiscal year 2017 commitments will be subject to a range of +/- 25% ($562.5 million – $937.5 million) to account for both available market opportunities and ERS resource availability.

Diversification: Strategy, Geography, Industry, and Other Considerations

Strategy diversification for the coming twelve months will be targeted at approximately 50-100% buyouts; 0-30% special situations (including hybrid partnerships, industry focused funds, secondaries, and other miscellaneous strategies); 0-10% venture capital and growth equity; and 0-10% subordinated, senior, and distressed debt. Geographic, industry, and general partner diversification will also be important considerations, with the long-term goal in mind of creating a well-diversified Private Equity portfolio by vintage year, strategy, geography, industry, and general partner.

Summary

Investment Objectives: Summary of Portfolio Goals for the Next Twelve Months

The primary objective for the portfolio over the next twelve months is to develop the program through commitments to a balanced mix of high quality investment opportunities that will be available over that period. During fiscal year 2017, it is expected that a number of the general partners ERS committed to early in the program will be back in the market to raise subsequent funds. ERS and Altius Associates will re-evaluate each existing relationship. ERS staff and Altius Associates will continue to work to identify and build relationships with high quality general partners that may be raising funds in subsequent years. ERS will continue to execute on co-investment opportunities with general partners in order to strengthen relationships with the general partner and enhance returns through reduction in fees and expenses. Beginning in fiscal year 2017, ERS will also evaluate co-investments with non-existing general partners (i.e., managers with whom ERS is not currently invested) on an opportunistic basis. The eleventh year of the program (2017) will serve as an important milestone for the portfolio as the Program rebuilds its exposures post-secondary sale and utilizes added flexibility for increased co-investment activity.

V. APPENDICES:

A) Projected Private Equity Portfolio Model

B) Total Portfolio – Active Partnerships (Listed by Strategy and Vintage Year)

C) Total Portfolio – Chronological Listing (Listed by Vintage Year and Percent Paid-in)

D) Total Portfolio – Summary of Investments (Listed alphabetically)

E) Private Equity Portfolio Sensitivity Analysis

APPENDIX A

Projected Private Equity Portfolio Model

The Private Equity portfolio is modeled using a cash flow model that assigns typical characteristics to Private Equity funds and models market value out over time. The results were compared to actual Altius client cash flows in Private Equity, which were quite similar in profile. The model assumes an opening ERS Plan Asset value of $24.4 billion[11] (as of December 31, 2015) and a projected plan growth rate of 4.0% to calculate the annual Private Equity commitment levels required to reach the 10.0% target allocation.

As the plan assets grow over time, Private Equity commitments will need to grow similarly to mirror the underlying plan growth and maintain a consistent asset allocation. The following charts outline projected Private Equity commitments with a 4.0% growth rate as well as the required commitment levels to reach the targeted Private Equity exposure.

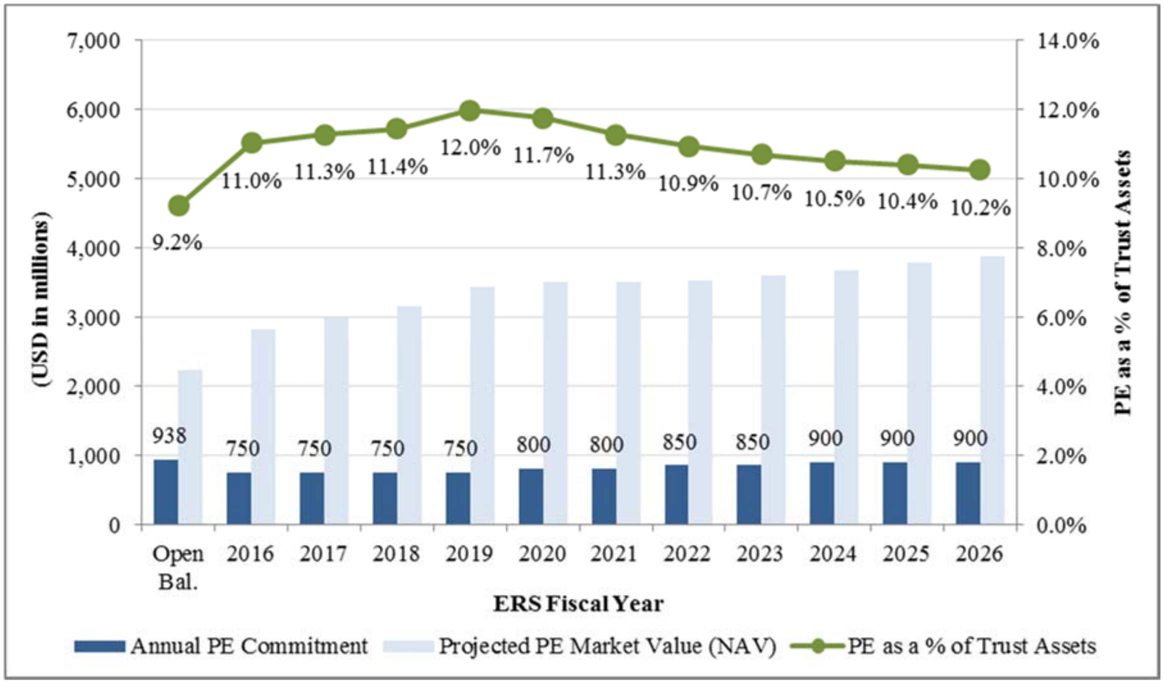
	(USD in Millions)					
Fiscal Year	**Annual PE Commitment**	**Uncalled Commitment**	**Cumulative Distributions**	**Projected PE Market Value (NAV)**	**Projected Total Trust Assets**	**PE as a % of Trust Assets**
Open Bal.	938	1,592	1,243	2,233	24,238	9.2%
2016	750	1,512	1,942	2,813	25,540	11.0%
2017	750	1,536	2,831	2,992	26,562	11.3%
2018	750	1,541	3,822	3,157	27,625	11.4%
2019	750	1,523	4,763	3,436	28,729	12.0%
2020	800	1,532	5,926	3,508	29,879	11.7%
2021	800	1,546	7,215	3,498	31,074	11.3%
2022	850	1,594	8,547	3,531	32,317	10.9%
2023	850	1,630	9,913	3,592	33,609	10.7%
2024	900	1,693	11,350	3,671	34,954	10.5%
2025	900	1,737	12,828	3,779	36,352	10.4%
2026	900	1,764	14,370	3,873	37,806	10.2%

As outlined above, the Program is expected to maintain a consistent Private Equity allocation between 10-12% over the next ten years amidst a moderately increasing annual Private Equity commitment.

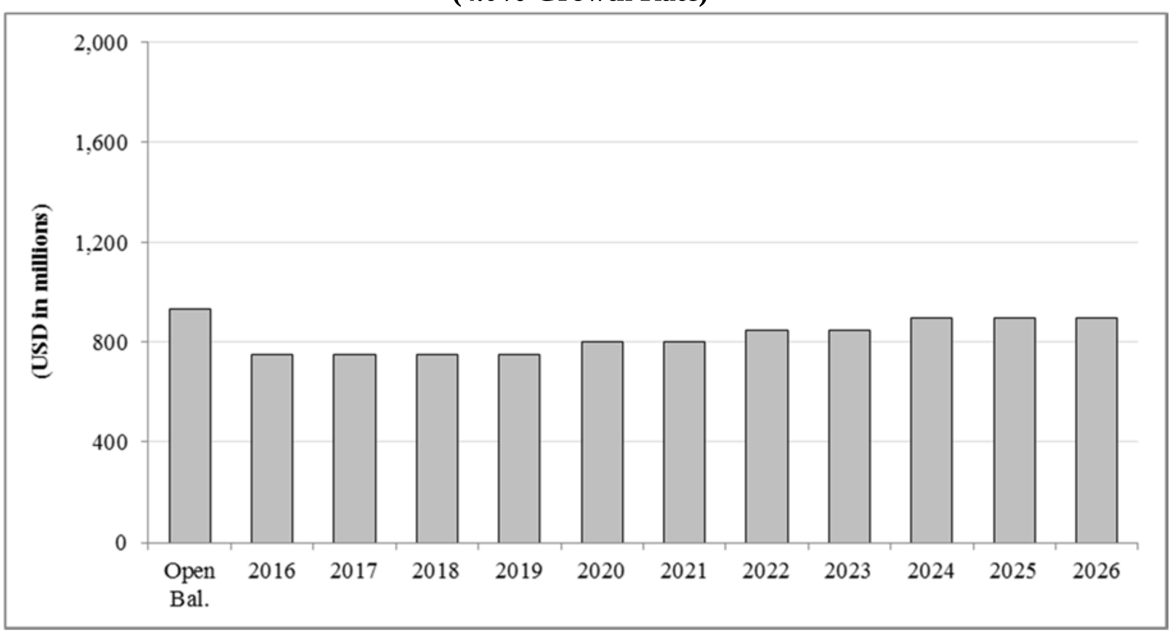
[11] The opening ERS Plan Asset value is estimated based on the December 31, 2015 Plan Asset value of $24.9 billion less the NAV of assets sold in the secondary sale.

The following graphs depict the projected growth in the Private Equity portfolio:

Projected Private Equity Plan Value
(4.0% Growth Rate)



Rolling 10-Year Aggregate Private Equity Commitment
(4.0% Growth Rate)



APPENDIX B

Total Portfolio – Active Partnerships (Listed by Strategy and Vintage Year)

As of December 31, 2015 (USD thousands)

General Partner	Fund Partnership	Vintage
Buyout		
Advent International	Advent International GPE VI-C Partnership	2008
Advent International	Advent International GPE VII-C Partnership	2012
Advent International	Advent Latin America Fund V	2010
Argos Soditic	Euroknights VI	2011
Baring Private Equity Asia Group	Baring Asia Private Equity Fund V	2011
Baring Private Equity Asia Group	Baring Asia Private Equity Fund VI	2015
Blue Wolf Capital	Blue Wolf Capital Fund III	2013
Brazos Private Equity Partners	Brazos Equity Fund III	2008
Carlyle Group	Carlyle Group Financial Services Partners II	2013
Carlyle Group	Carlyle Partners V	2007
Cotton Creek Capital Partners	Cotton Creek Capital Partners II	2014
The Gores Group	Gores Capital Partners III	2011
Hellman and Friedman Capital Partners	Hellman and Friedman Capital Partners VIII	2015
HgCapital	HgCapital 7	2013
KSL Capital Partners	KSL Capital Partners III	2011
KSL Capital Partners	KSL Capital Partners IV	2015
Littlejohn & Co.	Littlejohn Fund IV	2010
Navis Capital Partners	Navis Asia VI	2009
Navis Capital Partners	Navis Asia VII	2014
New Mountain Capital	New Mountain Partners III	2007
Riverside Company	Riverside Capital Appreciation Fund V	2008
Riverside Company	Riverside Capital Appreciation Fund VI	2013
Southern Cross	Southern Cross Latin America PEF IV	2010
Southern Cross	Southern Cross Latin America PEF IV (Secondary)	2010
Southern Cross	Southern Cross Latin America PEF V	2015
Summer Street Capital Partners	Summer Street Capital III	2012
TGF Management	Southwest Opportunity Partners	2007
Triton	Triton III	2009
Triton	Triton IV	2013
Venture Capital & Growth Equity		
Frontier Capital	Frontier Fund III	2011
Frontier Capital	Frontier Fund IV	2015
Industry Ventures	Industry Ventures Secondary VII	2013
Industry Ventures	Industry Ventures Special Opportunities Fund II-A	2014
Longitude Capital	Longitude Capital Partners II	2013
Riordan, Lewis & Haden	RLH III	2011
TA Associates	TA XI	2010
TA Associates	TA XII	2015
Subordinated, Senior, & Distressed Debt		
Castlelake	Castlelake II	2011
Castlelake	Castlelake III	2014
Castlelake	Castlelake IV	2015
KSL Capital Partners	KSL Credit Opportunities Fund	2014
TA Associates	TA Subordinated Debt Fund III	2010
TA Associates	TA Subordinated Debt Fund IV	2015
Triton	Triton Debt Opportunities Fund I	2014

General Partner	Fund Partnership	Vintage
Special Situations		
The Carlyle Group	Carlyle Energy Mezzanine Opportunities Fund II	2015
Energy & Minerals Group	Energy & Minerals Group Fund III	2014
HitecVision AS	HitecVision VI	2011
HitecVision AS	HitecVision VII	2014
Landmark Partners	Landmark Equity Partners XV	2014
Landmark Partners	Landmark TX ERS Co-Investment Fund I	2014
Lexington Partners	Lexington Capital Partners VII	2009
LGT Capital Partners Limited	Crown Global Secondaries II	2009
LGT Capital Partners Limited	Crown Global Secondaries III	2012
Quantum Energy Partners	Quantum Energy Partners V	2008
Quantum Energy Partners	Quantum Energy Partners V (Secondary)	2008
Quantum Energy Partners	Quantum Parallel Partners V	2014
Quantum Energy Partners	Quantum Energy Partners VI	2014
Quantum Energy Partners	Quantum Parallel Partners VI-C	2015
ERS Fund-of-Funds		
Altius Associates	ERS Private Equity International Fund I	2011
Altius Associates	ERS Private Equity International Fund II	2014
GCM Grosvenor	ERS Private Equity Emerging Manager Fund I	2010
GCM Grosvenor	ERS Private Equity Emerging Manager Fund II	2014

APPENDIX C

Total Portfolio – Chronological Listing (Listed by Fund Vintage and Percent Paid-in)

As of December 31, 2015 (USD thousands)

Fund Partnership	Commitment	Capital Called	% Paid-In
2007 Vintage			
New Mountain Investments III, L.P.	60,000.0	64,114.8	100%
Southwest Opps Partners L.P.	60,585.1	57,031.4	94%
2008 Vintage			
Advent International GPE VI-C L.P.	44,567.8	46,103.6	100%
Brazos Equity Fund III, L.P.	37,500.0	36,339.7	97%
Carlyle Partners V, L.P.	100,000.0	115,956.4	100%
2009 Vintage			
Lexington Capital Partners VII, L.P.	100,000.0	103,896.5	100%
Navis Asia Fund VI, L.P.	60,000.0	66,133.3	100%
Quantum Energy Partners V, L.P.	75,000.0	65,025.1	87%
Riverside Capital Appreciation Fund V, L.P.	100,000.0	88,252.9	88%
TA Subordinated Debt Fund III, L.P.	50,000.0	37,875.0	76%
Triton Fund III, LP	84,639.3	98,023.7	100%
2010 Vintage			
Advent Latin America Fund V-H,L.P.	50,000.0	43,850.0	88%
Crown Global Secondaries II PLC	75,000.0	70,140.3	94%
ERS Private Equity Emerging Manager Fund I, L.P.	50,000.0	41,332.2	83%
Littlejohn Fund IV, L.P.	82,500.0	90,230.1	100%
Southern Cross Latin America PE Fund IV, L.P. Secondary	25,000.0	18,699.5	75%
Southern Cross Latin America PE Fund IV, L.P.	50,000.0	41,003.8	82%
TA XI, L.P.	100,000.0	92,552.8	93%
2011 Vintage			
ERS Private Equity International Fund I L.P.	165,000.0	110,800.4	67%
Euroknights VI, L.P.	42,125.7	33,430.6	79%
Frontier Fund III, L.P.	50,000.0	44,656.8	89%
Gores Capital Partners III, L.P.	100,000.0	92,341.1	92%
HitecVision VI, L.P.	70,000.0	43,164.1	62%
KSL Capital Partners III L.P.	95,000.0	85,258.5	90%
RLH Investors III, L.P.	50,000.0	36,819.5	74%
The Baring Asia Private Equity Fund V, L.P.	50,000.0	60,588.6	100%
2012 Vintage			
Advent International GPE VII-C	100,000.0	76,783.7	77%
Castlelake II, L.P.	75,000.0	72,614.9	97%
Crown Global Secondaries III PLC	100,000.0	42,300.0	42%
Summer Street Capital III, L.P.	50,000.0	33,827.5	68%

Fund Partnership	Commitment	Capital Called	% Paid-In
2013 Vintage			
Blue Wolf Capital Fund III, L.P.	50,000.0	11,224.0	22%
HgCapital 7 A L.P.	45,858.4	22,235.6	48%
Industry Ventures Secondary VII, L.P.	40,000.0	23,600.0	59%
Industry Ventures Special Opp Fund II-A, L.P.	47,500.0	-	0%
Longitude Venture Partners II, L.P.	50,000.0	31,155.0	62%
Riverside Capital Appreciation Fund VI, L.P.	100,000.0	53,578.1	54%
Triton Fund IV, L.P.	82,494.0	40,429.1	49%
2014 Vintage			
Carlyle Global Financial Services Partners II, LP	100,000.0	46,738.0	47%
Castlelake III, L.P.	100,000.0	82,043.0	82%
Cotton Creek Capital Partners II, L.P.	31,500.0	10,500.4	33%
ERS Private Equity Emerging Manager Fund II L.P.	50,000.0	8,083.3	16%
ERS Private Equity International Fund II, LP	300,000.0	33,141.7	11%
Hitecvision VII, L.P.	70,000.0	17,005.0	24%
KSL Credit Opportunities Fund, L.P.	50,000.0	5,198.0	10%
Landmark Equity Partners XV, L.P.	175,000.0	59,920.2	34%
Landmark TX ERS Co-Investment Fund I, L.P.	125,000.0	29,695.8	24%
Navis Asia Fund VII, L.P.	125,000.0	36,562.5	29%
Quantum Energy Partners VI, LP	100,000.0	16,713.6	17%
Quantum Parallel Partners V-C, L.P.	25,000.0	9,651.0	39%
The Baring Asia Private Equity Fund VI, L.P.	75,000.0	13,935.7	19%
The Energy & Minerals Group Fund III, LP	80,471.0	65,147.7	81%
Triton Debt Opportunities Fund I, L.P.	42,701.6	17,404.1	41%
2015 Vintage			
Carlyle Energy Mezzanine Opportunities Fund II, L.P.	85,000.0	6,428.1	8%
ERS TA XII, L.P.	62,500.0	-	0%
Frontier Fund IV, L.P.	60,000.0	16,517.1	28%
Hellman & Friedman Capital Partners VIII, L.P.	82,500.0	-	0%
KSL Capital Partners IV, L.P.	125,000.0	-	0%
Quantum Parallel Partners VI-C, LP	20,000.0	1,694.8	8%
TA Subordinated Debt Fund IV, L.P.	25,000.0	-	0%

APPENDIX D

Total Portfolio – Summary of Investments (Listed alphabetically)

As of December 31, 2015 (USD thousands)

Fund Partnership	Vintage	Committed	Called	Distributed
Advent International GPE VI-C L.P.	2008	44,567.81	46,103.59	45,352.50
Advent International GPE VII-C	2012	100,000.00	76,783.66	13,133.66
Advent Latin America Fund V-H,L.P.	2010	50,000.00	43,850.00	7,850.00
Blue Wolf Capital Fund III, L.P.	2013	50,000.00	11,223.99	5,250.23
Brazos Equity Fund III, L.P.	2008	37,500.00	36,339.71	25,862.23
Carlyle Energy Mezzanine Opportunities Fund II, L.P.	2015	85,000.00	6,428.10	4.48
Carlyle Global Financial Services Partners II, LP	2014	100,000.00	46,738.05	5,241.42
Carlyle Partners V, L.P.	2008	100,000.00	115,956.41	119,855.69
Castlelake II, L.P.	2012	75,000.00	72,614.90	18,353.85
Castlelake III, L.P.	2014	100,000.00	82,043.02	-
Castlelake IV, L.P.	2016	100,000.00	16,894.09	-
Cotton Creek Capital Partners II, L.P.	2014	31,500.00	10,500.37	855.80
Crown Global Secondaries II PLC	2010	75,000.00	70,140.27	84,933.87
Crown Global Secondaries III PLC	2012	100,000.00	42,300.00	5,300.00
ERS Private Equity Emerging Manager Fund I, L.P.	2010	50,000.00	41,332.20	20,614.85
ERS Private Equity Emerging Manager Fund II L.P.	2014	50,000.00	8,083.31	3,161.15
ERS Private Equity International Fund I L.P.	2011	165,000.00	110,800.40	28,702.68
ERS Private Equity International Fund II, LP	2014	300,000.00	33,141.72	3,881.06
ERS TA XII, L.P.	2015	62,500.00	-	-
Euroknights VI, L.P.	2011	42,125.71	33,430.60	7,337.73
Frontier Fund III, L.P.	2011	50,000.00	44,656.79	-
Frontier Fund IV, L.P.	2015	60,000.00	16,517.12	-
Gores Capital Partners III, L.P.	2011	100,000.00	92,341.06	53,446.04
Hellman & Friedman Capital Partners VIII, L.P.	2015	82,500.00	-	-
HgCapital 7 A L.P.	2013	45,858.43	22,235.62	151.52
HitecVision VI, L.P.	2011	70,000.00	43,164.15	1,036.51
Hitecvision VII, L.P.	2014	70,000.00	17,004.98	-
Industry Ventures Secondary VII, L.P.	2013	40,000.00	23,600.00	2,091.24
Industry Ventures Special Opp Fund II-A, L.P.	2013	47,500.00	-	-
KSL Capital Partners III L.P.	2011	95,000.00	85,258.47	61,775.35
KSL Capital Partners IV, L.P.	2015	125,000.00	-	-
KSL Credit Opportunities Fund, L.P.	2014	50,000.00	5,197.96	491.59
Landmark Equity Partners XV, L.P.	2014	175,000.00	59,920.16	17,781.09
Landmark TX ERS Co-Investment Fund I, L.P.	2014	125,000.00	29,695.76	3,990.03
Lexington Capital Partners VII, L.P.	2009	100,000.00	103,896.52	89,970.79
Littlejohn Fund IV, L.P.	2010	82,500.00	90,230.05	40,547.02
Longitude Venture Partners II, L.P.	2013	50,000.00	31,155.04	5,188.17
Navis Asia Fund VI, L.P.	2009	60,000.00	66,133.25	6,706.23
Navis Asia Fund VII, L.P.	2014	125,000.00	36,562.50	13.40
New Mountain Investments III, L.P.	2007	60,000.00	64,114.82	42,649.52
Quantum Energy Partners V, L.P.	2009	75,000.00	65,025.10	22,117.50
Quantum Energy Partners VI, LP	2014	100,000.00	16,713.65	5,613.36
Quantum Parallel Partners V-C, L.P.	2014	25,000.00	9,651.02	1,043.06
Quantum Parallel Partners VI-C, LP	2015	20,000.00	1,694.80	729.23
Riverside Capital Appreciation Fund V, L.P.	2009	100,000.00	88,252.89	90,610.70
Riverside Capital Appreciation Fund VI, L.P.	2013	100,000.00	53,578.14	67.99
RLH Investors III, L.P.	2011	50,000.00	36,819.48	11,089.00
Southern Cross Latin America PE Fund IV, L.P. Secondary	2010	25,000.00	18,699.48	664.08
Southern Cross Latin America PE Fund IV, L.P.	2010	50,000.00	41,003.78	3,644.32
Southern Cross Latin America PE Fund V, L.P.	2016	60,000.00	-	-

Fund Partnership	Vintage	Committed	Called	Distributed
Southwest Opps Partners L.P.	2007	60,585.11	57,031.41	113,112.75
Summer Street Capital III, L.P.	2012	50,000.00	33,827.47	914.57
Summer Street Environmental L.P.	2013	15,000.00	15,000.00	-
TA Subordinated Debt Fund III, L.P.	2009	50,000.00	37,875.00	31,125.00
TA Subordinated Debt Fund IV, L.P.	2015	25,000.00	-	-
TA XI, L.P.	2010	100,000.00	92,552.75	52,802.75
The Baring Asia Private Equity Fund V, L.P.	2011	50,000.00	60,588.63	22,396.15
The Baring Asia Private Equity Fund VI, L.P.	2014	75,000.00	13,935.68	-
The Energy & Minerals Group Fund III, LP	2014	80,471.00	65,147.69	4,268.19
Triton Debt Opportunities Fund I, L.P.	2014	42,701.57	17,404.11	3,845.94
Triton Fund III, LP	2009	84,639.30	98,023.73	68,943.43
Triton Fund IV, L.P.	2013	82,493.99	40,429.12	7,476.29

APPENDIX E

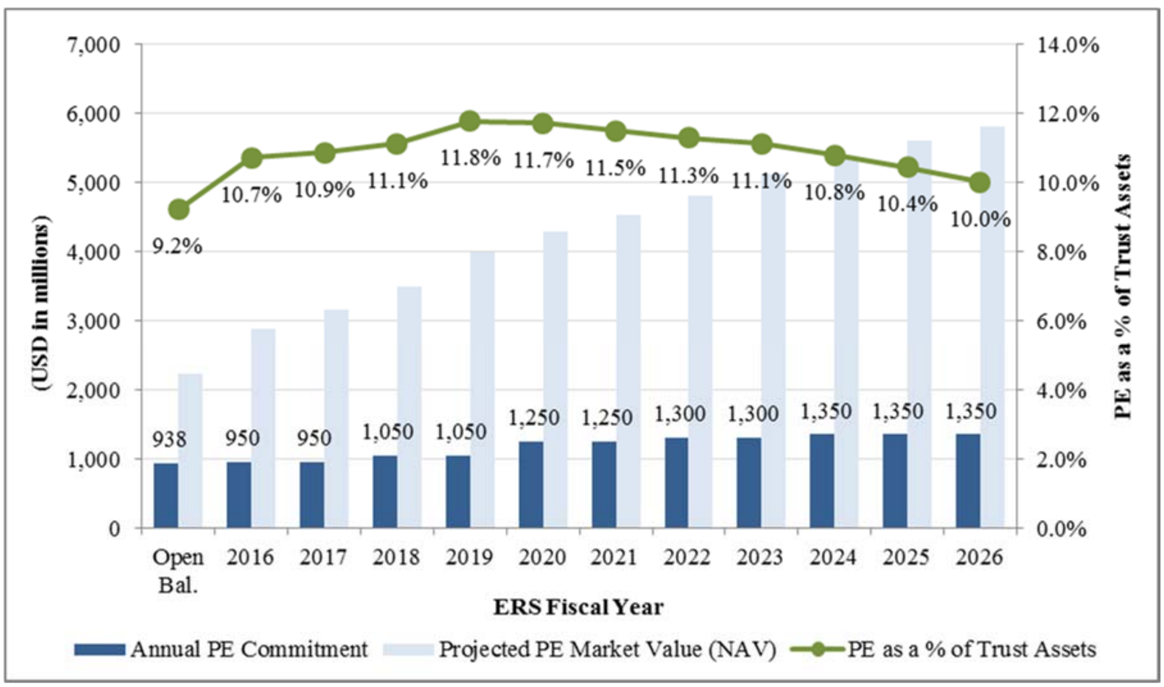
Private Equity Portfolio Sensitivity Analysis – Trust Growth Rate and Return Assumptions

The FY 2017 Private Equity Tactical Plan assumes an annual Trust Growth Rate of 4.0% and Target fund-level return. The following scenarios display the portfolio's sensitivity to a Trust Growth Rate of 8.0%, 4.0% and 0.0% with both Target and Low-Scenario fund-level returns.

Projected Private Equity Portfolio: 8.0% Trust Growth Rate & Target Return Scenario

The following charts outline the estimated commitment levels required to maintain the targeted 10.0% private equity allocation (+/- 5.0%), assuming an underlying projected Trust assets growth rate of 8.0% and targeted fund returns:

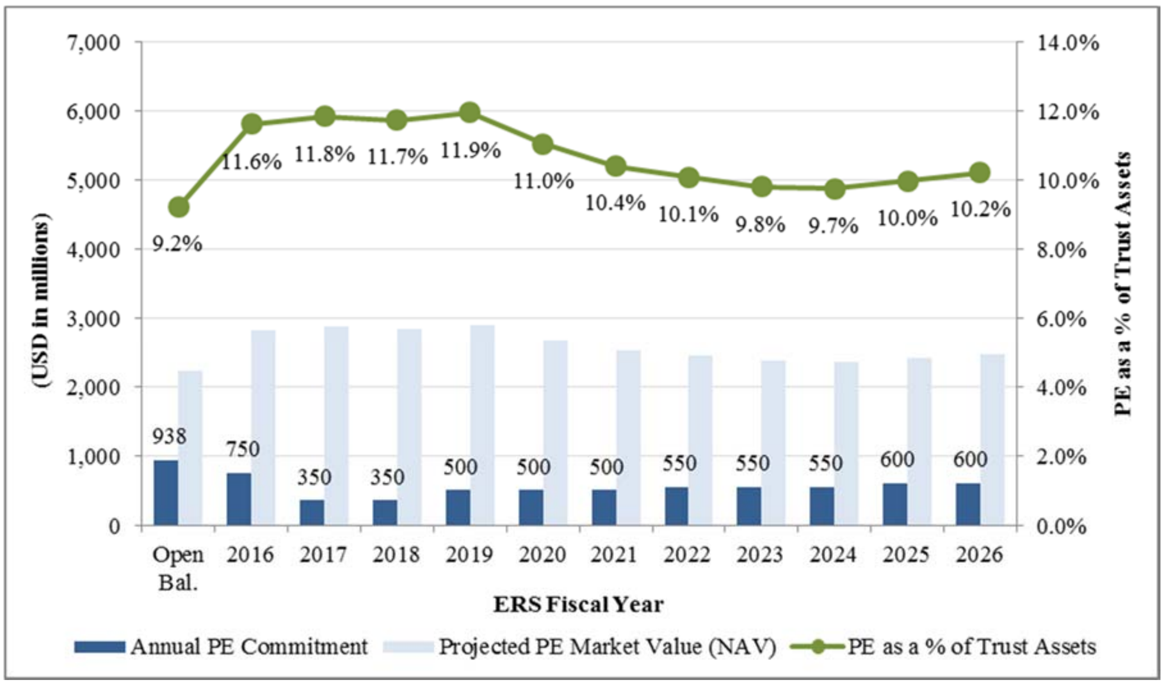
	(USD in Millions)					
Fiscal Year	Annual PE Commitment	Uncalled Commitment	Cumulative Distributions	Projected PE Market Value (NAV)	Projected Total Trust Assets	PE as a % of Trust Assets
Open Bal.	938	1,592	1,243	2,233	24,238	9.2%
2016	950	1,647	1,943	2,876	26,859	10.7%
2017	950	1,774	2,836	3,150	29,008	10.9%
2018	1,050	1,919	3,848	3,481	31,329	11.1%
2019	1,050	1,996	4,834	3,981	33,835	11.8%
2020	1,250	2,163	6,168	4,280	36,542	11.7%
2021	1,250	2,288	7,684	4,532	39,465	11.5%
2022	1,300	2,407	9,361	4,808	42,622	11.3%
2023	1,300	2,484	11,152	5,114	46,032	11.1%
2024	1,350	2,568	13,160	5,361	49,714	10.8%
2025	1,350	2,623	15,290	5,603	53,692	10.4%
2026	1,350	2,656	17,553	5,795	57,987	10.0%



Projected Private Equity Portfolio: 0.0% Trust Growth Rate & Target Return Scenario

The following charts outline the estimated commitment levels required to maintain the targeted 10.0% private equity allocation (+/- 5.0%), assuming an underlying projected Trust assets growth rate of 0.0% and targeted fund returns:

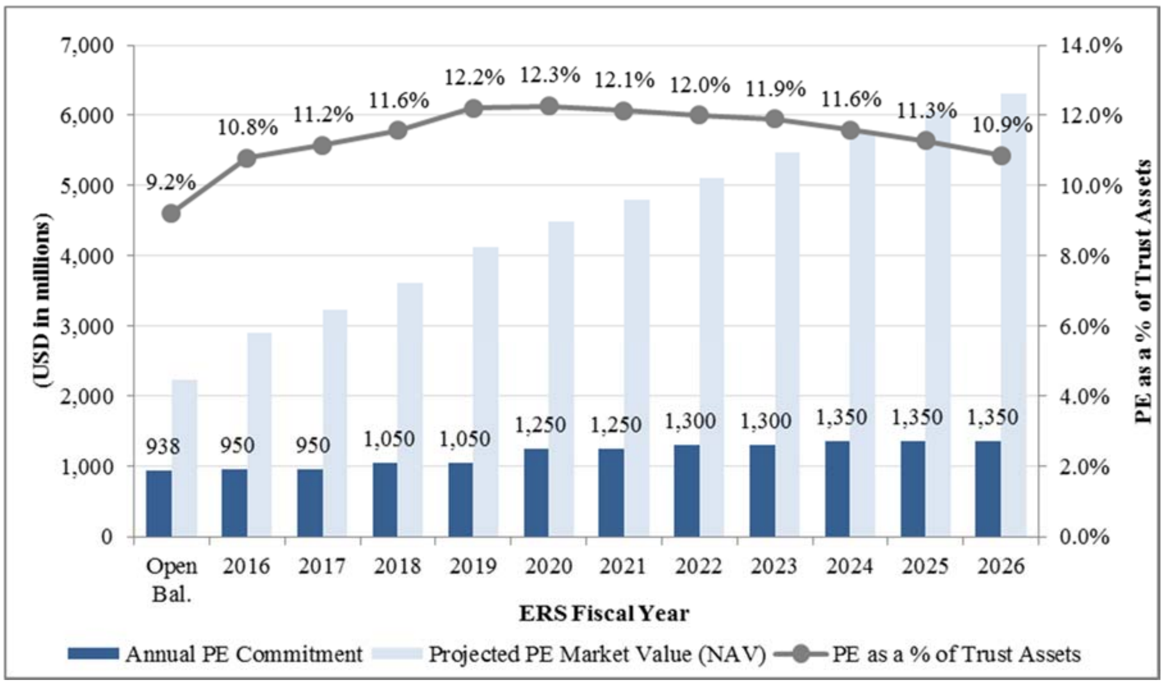
	(USD in Millions)					
Fiscal Year	Annual PE Commitment	Uncalled Commitment	Cumulative Distributions	Projected PE Market Value (NAV)	Projected Total Trust Assets	PE as a % of Trust Assets
Open Bal.	938	1,592	1,243	2,233	24,238	9.2%
2016	750	1,512	1,942	2,813	24,238	11.6%
2017	350	1,267	2,830	2,868	24,238	11.8%
2018	350	1,064	3,813	2,843	24,238	11.7%
2019	500	1,002	4,711	2,896	24,238	11.9%
2020	500	970	5,792	2,676	24,238	11.0%
2021	500	969	6,776	2,520	24,238	10.4%
2022	550	1,009	7,729	2,442	24,238	10.1%
2023	550	1,039	8,708	2,375	24,238	9.8%
2024	550	1,064	9,673	2,362	24,238	9.7%
2025	600	1,114	10,632	2,416	24,238	10.0%
2026	600	1,148	11,618	2,475	24,238	10.2%



Projected Private Equity Portfolio: 8.0% Trust Growth Rate & Low Return Scenario

The following charts outline the estimated commitment levels required to maintain the targeted 10.0% private equity allocation (+/- 5.0%), assuming an underlying projected Trust assets growth rate of 8.0% and low-scenario fund returns:

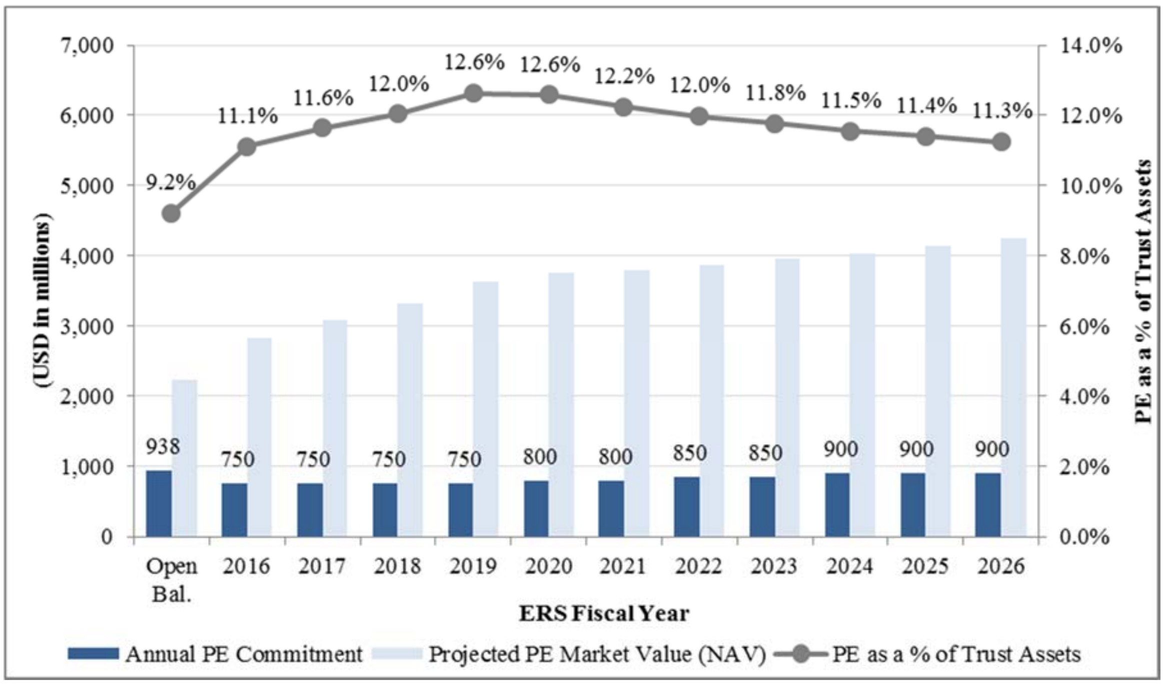
	(USD in Millions)					
Fiscal Year	Annual PE Commitment	Uncalled Commitment	Cumulative Distributions	Projected PE Market Value (NAV)	Projected Total Trust Assets	PE as a % of Trust Assets
Open Bal.	938	1,615	1,147	2,236	24,238	9.2%
2016	950	1,750	1,556	2,899	26,859	10.8%
2017	950	1,956	2,152	3,236	29,008	11.2%
2018	1,050	2,168	2,869	3,623	31,329	11.6%
2019	1,050	2,300	3,562	4,129	33,835	12.2%
2020	1,250	2,488	4,591	4,482	36,542	12.3%
2021	1,250	2,632	5,776	4,793	39,465	12.1%
2022	1,300	2,771	7,096	5,116	42,622	12.0%
2023	1,300	2,873	8,505	5,474	46,032	11.9%
2024	1,350	2,975	10,097	5,765	49,714	11.6%
2025	1,350	3,044	11,790	6,054	53,692	11.3%
2026	1,350	3,087	13,602	6,303	57,987	10.9%



Projected Private Equity Portfolio: 4.0% Trust Growth Rate & Low Return Scenario

The following charts outline the estimated commitment levels required to maintain the targeted 10.0% private equity allocation (+/- 5.0%), assuming an underlying projected Trust assets growth rate of 4.0% and low-scenario fund returns:

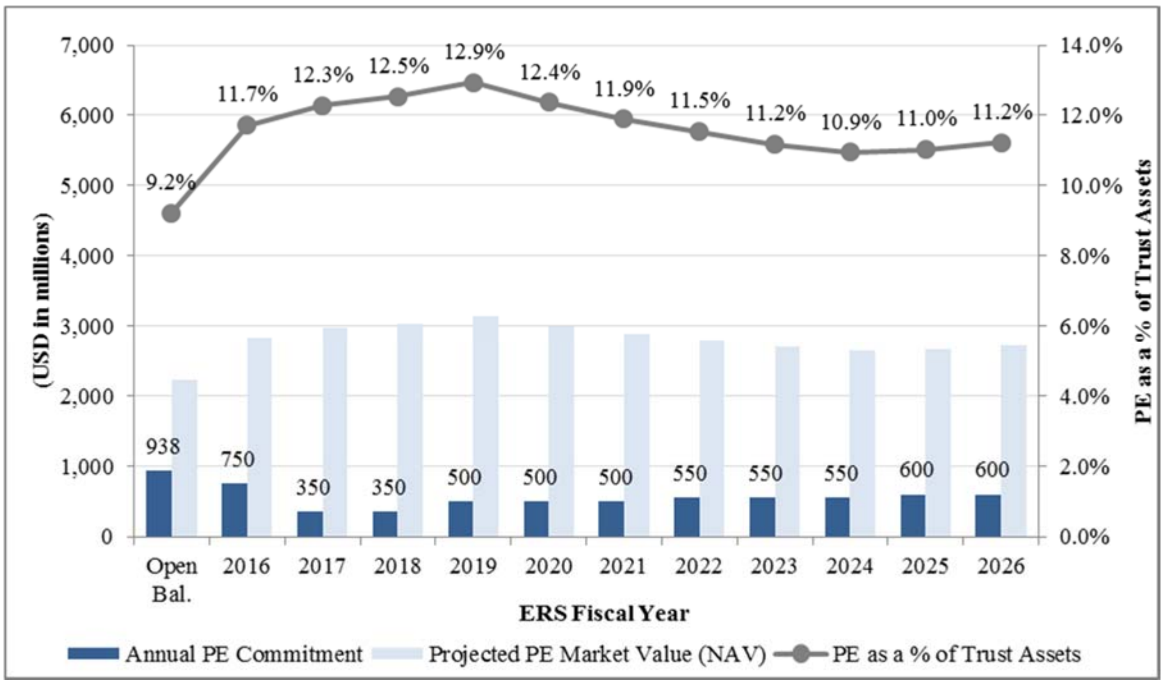
	(USD in Millions)					
Fiscal Year	Annual PE Commitment	Uncalled Commitment	Cumulative Distributions	Projected PE Market Value (NAV)	Projected Total Trust Assets	PE as a % of Trust Assets
Open Bal.	938	1,615	1,147	2,236	24,238	9.2%
2016	750	1,611	1,556	2,841	25,540	11.1%
2017	750	1,704	2,151	3,092	26,562	11.6%
2018	750	1,760	2,857	3,326	27,625	12.0%
2019	750	1,775	3,531	3,628	28,729	12.6%
2020	800	1,784	4,439	3,760	29,879	12.6%
2021	800	1,796	5,475	3,806	31,074	12.2%
2022	850	1,846	6,559	3,869	32,317	12.0%
2023	850	1,889	7,681	3,955	33,609	11.8%
2024	900	1,961	8,861	4,037	34,954	11.5%
2025	900	2,014	10,075	4,146	36,352	11.4%
2026	900	2,049	11,343	4,253	37,806	11.3%



Projected Private Equity Portfolio: 0.0% Trust Growth Rate & Low Return Scenario

The following charts outline the estimated commitment levels required to maintain the targeted 10.0% private equity allocation (+/- 5.0%), assuming an underlying projected Trust assets growth rate of 8.0% and low-scenario fund returns:

	(USD in Millions)					
Fiscal Year	Annual PE Commitment	Uncalled Commitment	Cumulative Distributions	Projected PE Market Value (NAV)	Projected Total Trust Assets	PE as a % of Trust Assets
Open Bal.	938	1,615	1,147	2,236	24,238	9.2%
2016	750	1,611	1,556	2,841	24,238	11.7%
2017	350	1,427	2,151	2,975	24,238	12.3%
2018	350	1,257	2,855	3,037	24,238	12.5%
2019	500	1,203	3,507	3,137	24,238	12.9%
2020	500	1,139	4,378	2,998	24,238	12.4%
2021	500	1,124	5,191	2,882	24,238	11.9%
2022	550	1,166	6,009	2,796	24,238	11.5%
2023	550	1,200	6,875	2,708	24,238	11.2%
2024	550	1,233	7,721	2,654	24,238	10.9%
2025	600	1,290	8,546	2,673	24,238	11.0%
2026	600	1,330	9,377	2,723	24,238	11.2%



PUBLIC AGENDA ITEM - #8a*

Review, Discussion and Consideration of Hedge Fund Program:

8a.* Market Update and Program Overview

August 16, 2016

BACKGROUND

At the August 19, 2008, Joint Meeting of the Board of Trustees (Board) and the Investment Advisory Committee (IAC), the Board adopted an asset allocation plan that included investing 5% of the Trust's assets in hedge funds via an Absolute Return Portfolio. Initial allocations were made in August 2012 to the Absolute Return Portfolio.

At the May 24, 2011, Joint Meeting of the Board and the IAC, Albourne America LLC (Albourne) was selected as the hedge fund consultant for ERS.

At the February 26, 2013, Joint Meeting of the Board and the IAC, the Board adopted an asset allocation plan that provides for the use of hedge funds across asset classes.

The objectives of the System's Hedge Fund Program are (1) to preserve the System's capital, (2) to enhance the System's Total Portfolio risk-adjusted returns, (3) to further diversify the System's Total Portfolio, and (4) to reduce the System's Total Portfolio volatility.

During fiscal year 2015, the Absolute Return Portfolio reached its target allocation of 5%. ERS Hedge Fund staff includes: Robert Lee, Director; Anthony Curtiss, Portfolio Manager; Panayiotis Lambropoulos, Portfolio Manager; and Nicholas Maffeo, Analyst.

INDUSTRY OVERVIEW

The spread across both the performance of hedge fund strategies as well as individual hedge fund managers within strategies has continued to increase. As such, many hedge fund managers and strategies have struggled to remain in positive return territory and in some instances managers needed to close their doors. Indeed, index returns for the period as measured by the HFRI Fund of Fund Composite Index have fallen to -5.89% for the 12 month period ending May 31, 2016. HFRX Global Index returns reached -6.99% over the same period. Given the industry's negative performance, hedge fund closures punctuated the year. In addition, some noteworthy public hedge fund allocators have announced the wind-down of their hedge fund programs.

Industry inflows have continued over the year, albeit at a more moderated pace. Hedge fund total assets have, by some accounts, crested $3.0 trillion in AUM. Investor surveys continue to show a trend toward risk-based asset allocation and away from asset allocation models that mistakenly identify hedge funds as an asset class. Benefactors of such shifts include broader alternative investments, particularly absolute return allocations such as hedge funds.

In contrast, the ERS Hedge Fund program has remained in positive territory for the 12 month period ending May 31, 2016 and remains on target to reach its five year return objectives. As detailed below, both the Absolute Return Portfolio and the Directional Growth Portfolio have exceeded return

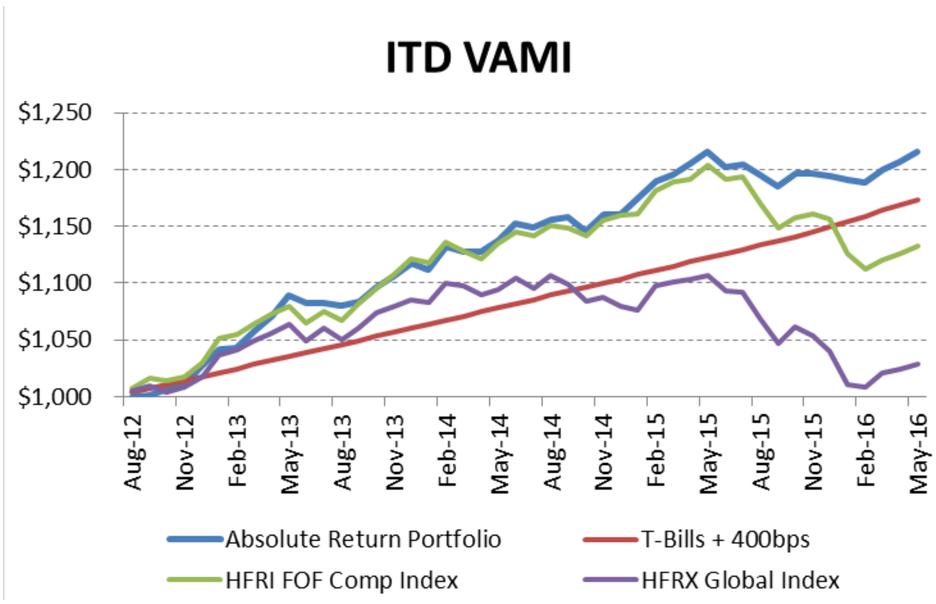
** We are accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. This agenda item may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees.*

expectations for their respective benchmarks while preserving liquidity, high risk adjusted returns, and high risk adjusted excess returns.

PERFORMANCE REVIEW

Absolute Return Portfolio

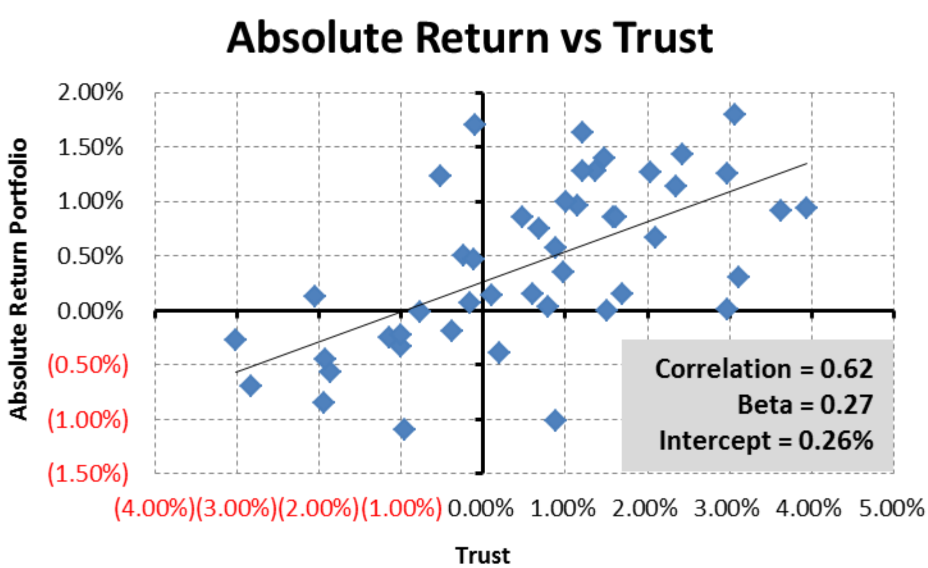
As of May 31, 2016, the annualized inception-to-date return (ITD) for the Absolute Return Portfolio is 5.23%. This return exceeds the portfolio's target return of 90-day T-bills + 400bps which has an annualized return of 4.25% over the same period. Similarly, the Absolute Return Portfolio has outperformed the HFRI Fund of Fund Composite Index and the HFRX Global Index, respectively having achieved 3.30% and 0.76% over the same period. The graph below illustrates the performance. VAMI stands for Value of a Marginal Investment (i.e. the value of $1,000 invested in the Absolute Return Portfolio at inception).



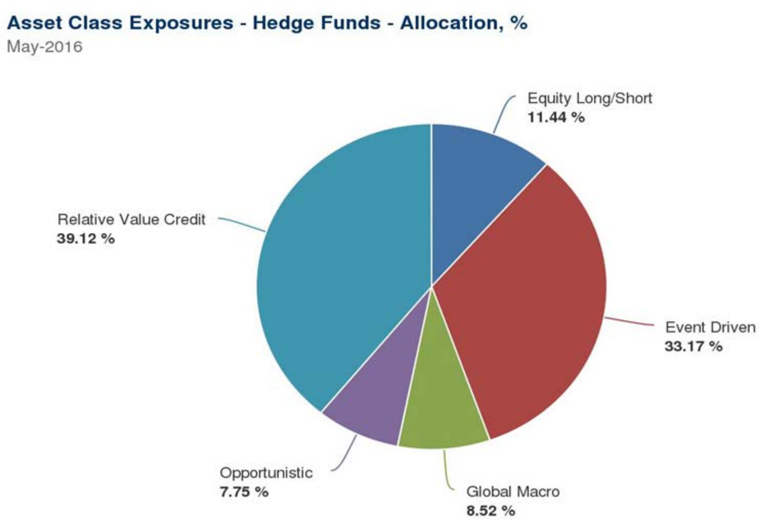
The annualized standard deviation of the Absolute Return Portfolio has not reached its target standard deviation of 4%-8%. To date, the portfolio has achieved an annualized standard deviation 2.63% since its inception. This results in a very high annualized Sharpe Ratio of 1.89. The Sharpe Ratio is a measure of risk adjusted returns. As a risk reducing exposure, a high Sharpe Ratio is preferred as it indicates higher relative returns per units of risk, or equally, lower relative risk per basis point of return. To compare, the HFRI Fund of Fund Composite and HFRX Global Indices have delivered Sharpe Ratios of 0.85 and 0.13, respectively. This information is summarized on the chart below.

Annualized Stats (ITD through 5/31/16)	Return	St.Dev.	Information Ratio	Sharpe Ratio
Absolute Return Portfolio	**5.23%**	**2.63%**		**1.89**
90-day T-Bills + 400bps	4.25%	0.09%	0.42	43.55
HFRI FOF Composite	3.30%	3.58%	0.95	0.85
HFRX Global Index	0.76%	3.72%	1.94	0.13
Directional Growth	**11.20%**	**11.24%**		**0.97**
MSCI ACWI TR	4.75%	10.96%	3.44	0.41

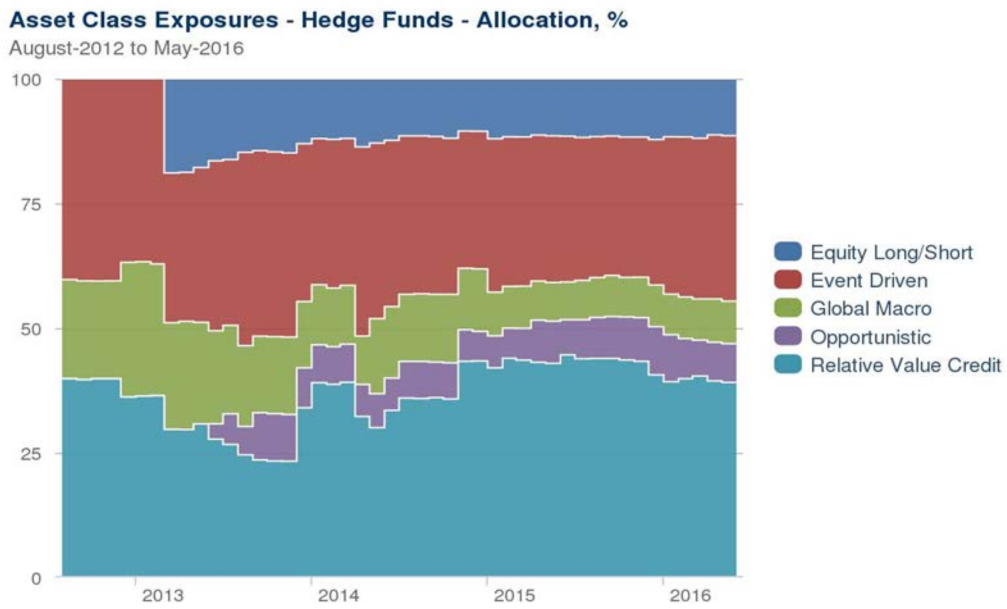
As illustrated in the graph below, the Absolute Return Portfolio has delivered both low correlation and low beta to the Trust. The widely distributed appearance of the datapoints reflects the low correlation of the Absolute Return Portfolio with the Trust. Correlation since inception has been 0.62. The slope of the regression line shows the beta to the Trust. Beta measures the level of systematic risk, where a low beta indicates a diversifying exposure to the Trust. The beta since inception has been 0.27 which is below the cap of 0.4 as mandated in the Policies and Procedures. The intercept, in the context of modern portfolio theory, represents the monthly alpha delivered by the Absolute Return Portfolio against the Trust. The intercept of the Absolute Return Portfolio is 0.26%.



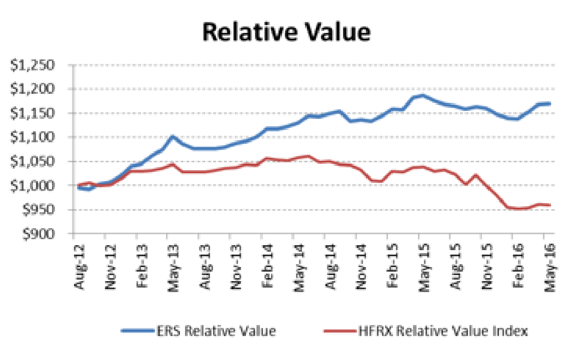
Strategy exposures for the Absolute Return Portfolio have remained diversified and within target strategy bands. The only exception is due to a tactical underweight to Global Macro. A detailed look at the current strategy exposure is shown below.

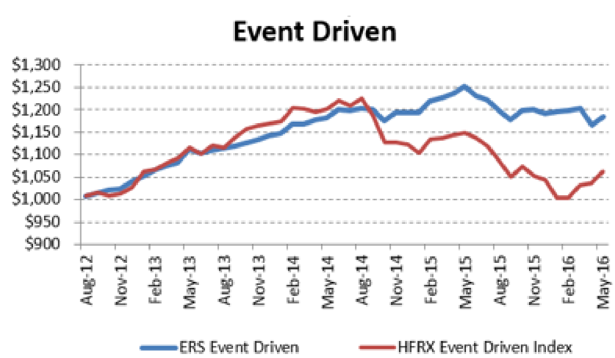


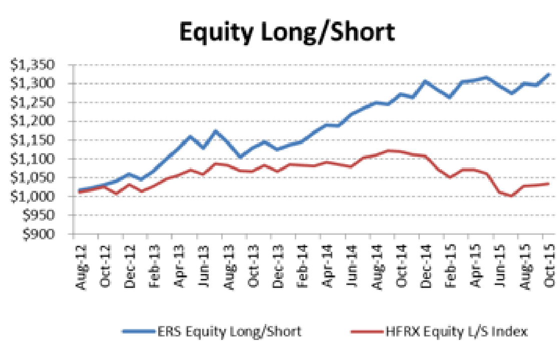
The historical strategy exposures are shown in the chart below.

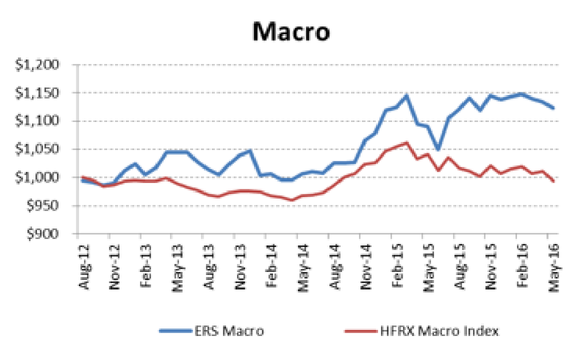


As for strategy performance, all strategies have exceeded index strategy performance on one year, three year, and ITD time periods. The strategies outperformance is due to strong manager selection. This performance is shown on the graphs below.









Strategy correlation remains low, as noted on the next table. Low intra-strategy correlation is a result of portfolio construction focused on risk reduction. It leads to low overall portfolio volatility, as noted previously in the Sharpe Ratio.

Strategy Correlation	Relative Value	Event Driven	Macro	Equity Long/Short	Opportunistic
Relative Value	1.00	0.55	(0.00)	0.18	0.42
Event Driven	0.55	1.00	(0.01)	0.35	(0.04)
Macro	(0.00)	(0.01)	1.00	0.33	(0.26)
Equity Long/Short	0.18	0.35	0.33	1.00	(0.05)
Opportunistic	0.42	(0.04)	(0.26)	(0.05)	1.00

Finally, the performance of the Absolute Return Portfolio has lagged its target return over the prior 12-month period ending May 31, 2016, having achieved 0.04%. The return target of 90-day T-bills + 400bps achieved a return of 4.53% over the same period. Note, however, that the HFRI FoF Composite and HFRX Global Index achieved -5.89% and -6.99% over this same period. This performance is noted on the table below.

Absolute Return Portfolio			
	12-month	**36-month**	**ITD (46 mo)**
Absolute Return Portfolio	0.04%	11.67%	21.60%
90-day T-bills + 400bps	4.53%	13.27%	17.32%
HFRI FOF Composite	(5.89%)	4.93%	13.27%
HFRX Global	(6.99%)	(3.21%)	2.93%
Strategy Breakdown			
ERS Relative Value	(1.47%)	6.17%	16.93%
HFRX Relative Value	*(7.63%)*	*(7.99%)*	*(3.96%)*
ERS Event Driven	(5.43%)	6.48%	18.38%
HFRX Event Driven	*(7.48%)*	*(4.65%)*	*6.27%*
ERS Equity Long/Short*	4.09%	28.42%	32.37%
HFRX ELS	*(7.74%)*	*0.69%*	*3.37%*
ERS Macro	2.91%	7.52%	12.28%
HFRX Macro	*(4.53%)*	*0.41%*	*(0.67%)*
ERS Opportunistic*	4.26%	18.51%	18.51%

*Opportunistic strategies do not have a comparable index.

The Absolute Return Portfolio remains extremely liquid with over 85% of its assets able to be withdrawn within the next 12 months. This analysis does not consider potential withdrawal fees.

Directional Growth Portfolio

As noted in the table below, the Directional Growth Portfolio has outperformed its benchmark over both a one year and inception-to-date time frame.

Directional Growth Portfolio		
	12-month	**ITD (26 mo)**
Directional Growth	0.69%	25.86%
MSCI ACWI TR Index	(5.00%)	10.57%

The risk adjusted returns for the Directional Growth Portfolio remain high. The Directional Growth Portfolio has a Sharpe Ratio of 0.97 and more importantly an Information Ratio of 3.44. The Information Ratio reflects the risk-adjusted excess return of the Directional Growth Portfolio above its benchmark. The benchmark to the Directional Growth Portfolio is the MSCI ACWI Total Return Index. A high Information Ratio indicates a consistent and positive level of excess return.

Annualized Stats (ITD through 5/31/16)	**Return**	**St.Dev.**	**Information Ratio**	**Sharpe Ratio**
Absolute Return Portfolio	**5.23%**	**2.63%**		**1.89**
90-day T-Bills + 400bps	4.25%	0.09%	0.42	43.55
HFRI FOF Composite	3.30%	3.58%	0.95	0.85
HFRX Global Index	0.76%	3.72%	1.94	0.13
Directional Growth	**11.20%**	**11.24%**		**0.97**
MSCI ACWI TR	4.75%	10.96%	3.44	0.41

The Directional Growth Portfolio is comprised of a single allocation to an Equity Long/Short manager. This is within policy guidelines as well as strategy diversification expectations for this particular portfolio.

The liquidiy of this portfolio remains high. 100% of its assets can be redeemed within one month of a redemption notice.

Other Hedge Fund Allocations

One other hedge fund allocation can be found in the Fixed Income portfolio. This allocation is managed by the Fixed Income team and is covered during the Fixed Income portfolio review.

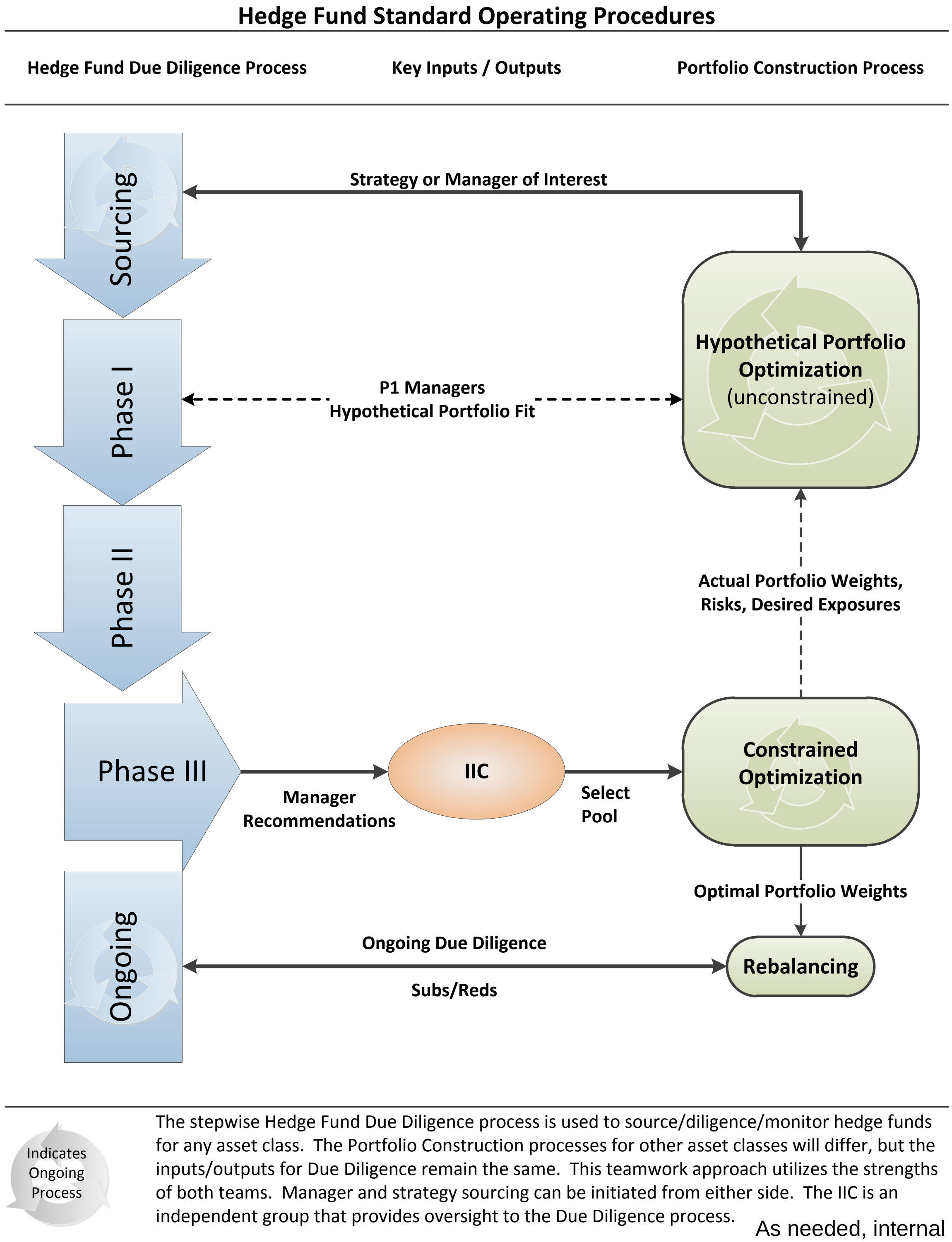
PROGRAM REVIEW

The ERS Hedge Fund program has been structured and implemented with a focus on scalability in order to manage and support multiple hedge fund portfolios and asset classes. The table below shows a summary of current hedge fund investments. Each of the managers have completed hedge fund due diligence and been approved by the Internal Investment Committee, in accordance with the Hedge Fund Program Policies and Procedures.

Manager Summary				Initial Allocation		NAV	Return
Manager	Strategy	Sub-Strategy	Geographic Focus	$ (millions)	Date	5/31/16 (millions)	ITD (5/31/16)
Arrowgrass	Multi	RV/ED	US/Europe	$ 80.00	20120731	$ 122.61	24.21%
Southpaw	Event Driven	Distressed	US	$ 80.00	20120731	$ 95.97	19.96%
Aspect	Macro	CTA	Global	$ 30.00	20121130	$ 38.09	26.96%
Conatus	Equity Long/Short	Equity Long/Short	Global	$ 60.00	20130228	$ 58.92	30.04%
MW TOPS	Equity Long/Short	Equity Long/Short	Europe	$ 60.00	20130228	$ 78.03	35.12%
Pentwater	Event Driven	Merger Arb	US/Europe	$ 50.00	20130531	$ 25.22	3.88%
Stone Lion	Opportunistic	Liquidations	US	$ 80.00	20130531	$ 29.29	25.64%
Glazer Enhanced	Event Driven	Merger Arb	US	$ 45.00	20130731	$ 112.81	32.13%
Iguazu	Relative Value	Credit Long/Short	Emerging	$ 100.00	20131129	$ 118.91	18.91%
Magnetar	Relative Value	Structured Credit	Global	$ 100.00	20131231	$ 109.41	13.28%
Taconic	Event Driven	Multi-ED	Global	$ 100.00	20140331	$ 101.75	1.75%
Pharo	Macro	Global Discretionary	Global	$ 60.00	20140430	$ 63.91	6.52%
Northwest	Relative Value	Convert Arb	Emerging	$ 50.00	20140530	$ 72.68	8.33%
Castle Creek	Relative Value	Convert Arb	US	$ 100.00	20141031	$ 103.71	3.71%
GKC	Opportunistic	Factoring	US/Europe	$ 120.00	20141231	$ 44.51	7.44%
Stone Lion II	Opportunistic	Liquidations	US	$ 40.00	20150227	$ 19.03	-15.57%
Absolute Return Portfolio						**$ 1,194.86**	
MW TOPS World	Equity Long/Short	Equity Long/Short	Global	$250.00	20120428	$314.61	25.58%
Directional Growth Portfolio						**$314.61**	

PROGRAM MANAGEMENT

The ERS Hedge Fund program has been structured and implemented with a focus on scalability in order to manage and support multiple hedge fund portfolios and hedge fund investments within other asset classes. The following illustration visually depicts the processes involved with managing hedge fund portfolios. A complete description is available in the *Hedge Fund Standard Operating Procedures*.



The stepwise Hedge Fund Due Diligence process is used to source/diligence/monitor hedge funds for any asset class. The Portfolio Construction processes for other asset classes will differ, but the inputs/outputs for Due Diligence remain the same. This teamwork approach utilizes the strengths of both teams. Manager and strategy sourcing can be initiated from either side. The IIC is an independent group that provides oversight to the Due Diligence process.

As needed, internal staff will pursue new mandates for the Hedge Fund Select Pool for the Absolute Return portfolio to tactically change strategies and managers. The ERS Hedge Fund team will continue to assist other asset classes and develop the Directional Growth Portfolio. Additional details will be further discussed in the Hedge Fund Tactical Plan agenda item.

STAFF RECOMMENDATION:

This agenda item is provided for informational and discussion purposes only. No action is required.

PUBLIC AGENDA ITEM - #8b

Review, Discussion and Consideration of Hedge Fund Program:

8b. Proposed Revisions to the ERS *Investment Policy* Addendum X: Hedge Fund Policies and Procedures

August 16, 2016

BACKGROUND:

The Employees Retirement System of Texas (ERS) *Investment Policy* is determined by the Board of Trustees (Board). In accordance with Section 2.3 of the ERS *Investment Policy*, staff will recommend changes as needed to the Investment Advisory Committee (IAC) and Board.

The purpose of the Hedge Fund Program Policies and Procedures is to provide a stated guideline to investment staff for managing the ERS Hedge Fund Program. The document is reviewed on an annual basis and changes are made when necessary. As a result of the annual review, ERS staff has determined that it is appropriate to revise the Hedge Fund Program Policies and Procedures at this time.

Staff is seeking approval for the proposed revisions and their implementation into the Hedge Fund Program Policies and Procedures for Fiscal Year 2017. Further discussion regarding the proposed changes is noted below.

Proposed Revisions

Staff is seeking approval for changing targeted bands around Event Driven and Opportunistic asset classes. The proposal includes widening the band from 30% to 40% for the Opportunistic asset class. In addition, the proposal includes lowering the band from 20% to 0% for the Event Driven asset class.

The rationale behind increasing the band to Opportunistic is primarily to provide ERS staff with additional flexibility to allocate to niche and uncorrelated strategies. Some of these strategies may require committed capital to be drawn over time. Additional exposure will provide the needed flexibility to manage exposures around committed versus funded investments.

The rationale behind reducing the band to Event Driven is to provide ERS staff with additional flexibility to significantly reduce the allocation when prudently determined. Event Driven strategies are often cyclical in nature and frequently correlate to traditional equity and fixed income markets. Many of these strategies employ leverage, link to corporate events, and the underlying positions may be held with limited to no hedging. ERS staff sees the proposed reduction as a prudent way to manage the downside scenario frequently associated with Event Driven strategies.

Below is an excerpt from the ERS Hedge Fund Program Policies and Procedures representing the proposed changes.

Strategy Class	Target Range*	
Relative Value	20%	60%
Event Driven	~~20%~~ **0%**	60%
Equity Long/Short	0%	30%
Macro	10%	40%
Opportunistic	0%	~~30%~~ **40%**

*Targets refer to percentage of total Absolute Return Portfolio allocation.

STAFF RECOMMENDATION:

The proposed revisions to the Hedge Fund Program Policies and Procedures for Fiscal Year 2017 have been reviewed by and are supported by ERS' hedge fund consultant, Albourne Partners. Staff recommends it be adopted as presented in Exhibit A and as presented as the ERS Hedge Fund Program Policies and Procedures.

A recommended motion is included with this agenda item following the exhibit.

ATTACHMENT – 1

Exhibit A – Proposed Revisions to the Hedge Fund Program Policies and Procedures for Fiscal Year 2017

EXHIBIT A

EMPLOYEES RETIREMENT SYSTEM OF TEXAS
HEDGE FUND PROGRAM
POLICIES AND PROCEDURES

EFFECTIVE: ~~August 18, 2015~~ August 16, 2016

EMPLOYEES RETIREMENT SYSTEM OF TEXAS

HEDGE FUND PROGRAM
POLICIES AND PROCEDURES

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EMPLOYEES RETIREMENT SYSTEM OF TEXAS

HEDGE FUND PROGRAM
POLICIES AND PROCEDURES

EFFECTIVE
August 18, 2015

I. HEDGE FUND INVESTMENT OBJECTIVES

A. INVESTMENTS IN HEDGE FUNDS

The Employees Retirement System of Texas ("ERS" or "the System") utilizes hedge funds to enhance ERS' total portfolio ("Total Portfolio") investment characteristics. The objectives of the System's Hedge Fund Program are (1) to preserve the System's capital, (2) to enhance the System's Total Portfolio risk-adjusted returns, (3) to further diversify the System's Total Portfolio, and (4) to reduce the System's Total Portfolio volatility. The underlying philosophy of the program will be to attain risk adjusted returns that are aligned with these objectives.

Consistent with Section 2.2 of the ERS Investment Policy, hedge funds may be utilized within individual portfolios including the Global Equity, Global Credit, Real Assets, Special Situations portfolios, and specifically, will be utilized within Hedge Fund Portfolios such as the Absolute Return Portfolio and the Directional Growth Portfolio.

The System's investment policies are determined by ERS' Board of Trustees ("Board" or "Board of Trustees"). In general, ERS' long-term goal for the Total Portfolio is to earn a return that will insure the payments due to members of the System's retirement plans and their beneficiaries at a reasonable cost to the System's members and the taxpayers of the State of Texas.

ERS' hedge fund investments shall be made in a manner consistent with the whole portfolio approach and the exclusive benefit requirements of the Texas Constitution. The selection and management of hedge fund investments will be guided to maintain prudent diversification of assets with regard to the selection of hedge funds and to preserve the System's investment capital. The diversification objective is required to manage overall market risk and the specific risks inherent to any single investment strategy or single manager.

For purposes of these *Policies and Procedures*, hedge funds differ from traditional investment strategies in that they derive a particular return from the skill of the hedge fund manager and allow the use of investment vehicles not otherwise utilized for the Trust, whereas traditional investment strategies derive a return that captures a traditional risk premium associated with a particular asset class/sub-asset class, e.g., domestic large cap equities and fixed income securities. While there are many different hedge funds available, ERS categorizes the various hedge fund strategies into four broad classes:

1. Relative Value
2. Event Driven
3. Equity Long/Short
4. Macro
5. Opportunistic

ERS' investments in hedge funds are designed to enhance long-term investment performance, diversify the asset base and enhance the risk adjusted returns for the entire ERS investment portfolio. The ultimate objectives are to preserve capital, provide competitive returns, enhance risk adjusted returns and act as a diversifier to the total ERS portfolio.

The ERS investment approach is one of active participation in the investment decision process with ERS retaining control over the selection of hedge funds. Such an active approach will require the necessary Staff involvement in addition to accessing third-party professional expertise.

Hedge fund investments will be subject to the Procedures for Investment as detailed in these *Hedge Fund Program Policies and Procedures.* Each year, the hedge fund program will be implemented and modified in accordance with an *Annual Tactical Plan* prepared by hedge fund Staff and approved by the Board of Trustees.

B. ASSET ALLOCATION

ERS' allocation to hedge fund investments shall remain within the limits authorized by the Board of Trustees in its allocation as established in Section 2.2B of the ERS *Investment Policy* based on invested net asset value.

An important goal for the System is to make hedge fund allocations in a prudent manner, while maintaining a flexible investment strategy that allows ERS to take advantage of opportunities as capital market conditions change.

C. PROGRAM MANAGEMENT

The selection and management of assets within the Hedge Fund Program will be structured to generate returns that meet or exceed the benchmark with prudent diversification of assets. Specific considerations of importance in the construction and management of the program are as follows:

1. The following overall principles shall guide the selection of investment managers:

    a. Diversify across managers to mitigate idiosyncratic and organizational risk.
    b. Diversify by strategy and geography to mitigate systematic risk and decrease correlations within the program.
    c. Emphasize qualitative evaluation of managers, as a manager's quantitative characteristics may change over time and in different market conditions.
    d. Fees and incentives charged by managers must be reasonable and provide an alignment of interest with ERS.

2. **Due Diligence**. The due diligence process for each hedge fund investment will include both operational and investment due diligence. Areas of review will include at a minimum: an evaluation of the organization, business culture, background checks on key people, governance, analysis of performance, analysis of exposures, investment process, risk management and control, position review, compliance, operational infrastructure, document review, trade operations, custody and counterparties, financing, valuation practices, legal, reporting, auditors, information technology capabilities, and disaster recovery.

3. **Institutional Quality**. All underlying hedge fund investments must be of institutional investment quality. Institutional quality is defined as being of a quality whereby the investment would be considered acceptable by other prudent institutional investors of comparable size to ERS when considering an investment in a similar size and strategy hedge fund.

4. **Leverage** is a condition where the net potential monetary exposure of an obligation exceeds the value of the underlying assets, which support the obligation. Net leverage is calculated as the difference between (A) the sum of (i) the market value of all long cash market positions, (ii) the notional value of all long derivative positions, and (B) the sum of (i) the absolute market value of all short cash market positions, and (ii) the absolute notional value of all short derivative positions divided by (C) the net market value of the fund. Gross Leverage is the total of (A) the sum of (i) the market value of all long positions, (ii) the notional value of all long derivative positions, (iii) the absolute market value of all short cash market positions, and (iv) the absolute value of all short positions divided by (B) the net market value of the fund.

   The underlying funds in the hedge fund portfolio may use leverage in a prudent manner that is consistent with leverage applied in similar hedge fund strategies.

5. **Liquidity/Redemption**. Staff will seek to maintain a relatively liquid portfolio of hedge funds and will typically favor managers offering more favorable liquidity terms. However, Staff is conscious of, and will seek to avoid, potential asset liability mismatches. In each case, Staff will evaluate the appropriateness of allowing longer term redemption periods. Factors considered in this determination will include, but not be limited to, potential fee concessions, availability of capacity, and consistency with terms offered by similar funds. Notwithstanding a fund's stated redemption schedule, Staff recognizes that such timetables for liquidity may be suspended under certain circumstances, such as periods of unusual financial stress within markets or within underlying hedge funds.

6. **Transparency**. To meet fiduciary obligations, Staff will demand as much transparency as necessary with respect to underlying hedge fund investments. At a minimum, this transparency shall include information with respect to all underlying hedge fund names, hedge fund strategies, background information on hedge fund principals, and historical performance information. All information shall be subject to the respective hedge fund's confidentiality provisions to the extent permitted under applicable state law. Furthermore, transparency for the sake of transparency will not be the goal, but rather, it would be for transparency to provide insight regarding the integrity of the hedge fund manager's investment process and for Staff to monitor and manage the risk of ERS' hedge fund investments.

7. **Emerging Fund Managers**. ERS will make a good faith effort to award contracts to or acquire services from qualified emerging fund managers when acquiring private financial services pursuant to Section 4.16 of ERS' *Investment Policy* Statement and as set forth in Section 815.301 (g), (h), and (i) of the Texas Government Code.

   An emerging fund manager is defined as a private professional investment manager with assets under management of not more than $2 billion. Private financial services include pension fund management, consulting, investment advising, brokerage services, private equity fund management, and real estate investment.

   ERS must report to its Board of Trustees the methods and results of its efforts to hire emerging fund managers, including data disaggregated by race, ethnicity, gender, and fund size.

D. RISK MANAGEMENT AND MONITORING

Staff and the Consultant will monitor the quantitative risk characteristics of hedge funds both at the fund and portfolio level. ERS may utilize a third party risk measurement service, as well as internal risk management tools, monitoring and ongoing due diligence services of its Consultant. Risk management will be integrated in every step of ERS' investment process. The four constituent parts to be focused on will include operational risk, management risk, strategy risk and portfolio risk.

II. PROCEDURES FOR INVESTMENT

A. GENERAL ALLOCATION OF RESPONSIBILITIES

The Hedge Fund Program shall be implemented and monitored through the coordinated efforts of the Board, Investment Advisory Committee ("IAC"), Executive Director, Hedge Fund Internal Investment Committee ("IIC"), Hedge Fund Staff ("Staff"), and the Hedge Fund Consultant ("Consultant"). The Hedge Fund Program will be internally managed by ERS Board and Staff. Delegation of responsibilities for each participant is described in the following sections.

1. **Board of Trustees ("Board").** The Board shall approve the investment policies and objectives that are judged to be appropriate and prudent to implement the strategic plan for the investment of Trust assets; review the performance criteria and policy guidelines for the measurement and evaluation of the Hedge Fund Portfolio and investments; and supervise the investment of the Trust's assets to ensure that the investments remain in accordance with intended strategic plans and the Employees Retirement System of Texas *Investment Policy* and these *Hedge Fund Program Policies and Procedures* documents. The Board will guide the long-term execution of the Hedge Fund Program through approval of these *Hedge Fund Program Policies and Procedures*, which will be updated and revised as appropriate. The Board will hire the hedge fund Consultant. The Board will guide the short-term execution of the Hedge Fund Program through approval of an *Annual Tactical Plan* prepared by Staff and the Consultant, which details goals and objectives for the upcoming twelve month-period or longer, as reasonable. The Board will monitor the Hedge Fund Program's progress and results through a performance measurement report prepared quarterly by the Consultant and Staff.

2. **Investment Advisory Committee ("IAC").** The IAC shall review the System's investments to ensure that they conform to the investment objectives and policies adopted by the Board. Staff may utilize the expertise of IAC members in assessing investment strategies and may request IAC members to participate on ad-hoc project committees and provide insights from such participation to the Board.

3. **Executive Director.** The Executive Director is granted full authority and responsibility by the Board in the implementation and administration of its investment programs subject to Board policies, rules, regulations, and directives consistent with constitutional and statutory limitations. The Executive Director shall participate and review investment decisions and, together with the other members of the IIC, shall make the fiduciary investment decisions regarding investments in hedge funds, based on information provided by and recommendations offered by Staff.

4. **Hedge Fund Internal Investment Committee ("IIC").** The IIC shall review the Trust's hedge fund prospective investments to ensure that they conform to the investment objectives outlined by these *Hedge Fund Program Policies and Procedures* and *Annual Tactical Plan* approved by the Board and to ensure they are appropriate given current and anticipated

hedge fund market dynamics. The IIC shall be comprised of the Executive Director, Chief Investment Officer and other members of ERS Investments Staff or IAC, and it shall review investment recommendations forwarded by Hedge Fund Staff. The IIC shall make the fiduciary investment decisions regarding investments in hedge funds based on information provided by and recommendations offered by Staff. The IIC has authority to authorize individual investments up to the lesser of $250 million or 1.00% of the System's assets as determined at the time of the IIC meeting.

5. **Hedge Fund Staff ("Staff").** Staff will develop investment objectives and policy language that includes a long-term strategic plan. Hedge Fund Program documentation will be updated and revised annually or as appropriate. Staff will prepare an *Annual Tactical Plan*, which details goals and objectives for the upcoming twelve-month period. Staff will review the quarterly Hedge Fund Program performance reports prepared by the Consultant.

   Staff, assisted by the Consultant, will identify eligible hedge funds for investment and, as appropriate, other investment vehicles that are in compliance with ERS' investment policies and current *Annual Tactical Plan*, which details goals and objectives for the next twelve months. Staff will review the quarterly hedge fund performance reports prepared by the Consultant.

6. **Hedge Fund Consultant ("Consultant").** In cooperation with Staff, the Consultant will advise on hedge fund compliance and will assist in the implementation of the hedge fund program. Additionally, as requested, the Consultant will assist in developing the long-term hedge fund strategic plan, composed of the *Hedge Fund Program Policies and Procedures* and *Annual Tactical Plan*, and will review and annually update hedge fund documentation. The Consultant will also assist Staff in investment identification, screening, due diligence evaluation, monitoring and documentation activities; prepare the quarterly performance measurement reports; advise on investment amendments; and provide special project research as requested by ERS.

B. INVESTMENT PROCEDURES

Hedge fund investments in compliance with ERS' Investment Objectives (Section I) and Hedge Fund Asset Allocation Decisions (Section II) shall be acquired through the following process:

1. **Annual Tactical Plan.** Each year, Staff will work with the Consultant to prepare an *Annual Tactical Plan* which reviews the current status of the hedge fund program and recent historical and prospective market conditions. The *Annual Tactical Plan* will propose the steps to be taken over the next twelve-month period to further implement the long-term strategic plan. The *Annual Tactical Plan* will develop a dollar commitment target for the upcoming twelve-month period. The *Annual Tactical Plan* will be provided to the Board for review and approval. The *Annual Tactical Plan for Fiscal Year 2017* is provided in Appendix A.

2. **Hedge Fund Portfolio Investments.** Staff, with the assistance of the Consultant, will identify and evaluate hedge fund investments, as appropriate, that are in compliance with these *Hedge Fund Program Policies and Procedures* and *current Annual Tactical Plan*.

Hedge Fund Staff, with assistance of the Consultant, will be responsible for the due diligence evaluation of the prospective investments. Hedge Fund Staff and/or the Consultant will prepare a written summary analysis and investment recommendation based on findings from due diligence. Recommendations will include background checks and criminal checks. For investments approved by the IIC, Hedge Fund Staff will be responsible for all aspects of negotiation, documentation, and legal reviews and closings. All hedge fund investment vehicle structures will be subject to review by ERS' legal counsel. Staff may request the Consultant to assist in various aspects of its duties.

C. HEDGE FUND STAFF RESPONSIBILITIES

1. **Implementation and Administration.** Staff is responsible for the following implementation and administration responsibilities. This section designates certain hedge fund portfolio management responsibilities that the Staff will perform or cause to be performed.

a. Investment Selection. Hedge Fund Staff ("Staff") will be responsible for evaluating investment opportunities and submitting their recommendations for investment to be approved by the IIC.

The screening and selection of hedge fund investments will be made with a view to meet or exceed the policy benchmark, within the parameter constraints and allocations as set by the Board of Trustees in these *Hedge Fund Program Policies and Procedures*.

The *Annual Tactical Plan* process will be used for determining targets for the number and types of investments to be made for a given year. Staff will also take into consideration relevant overall portfolio diversification considerations as set forth in the Investment Objectives and Investment Policies statement of these *Hedge Fund Program Policies and Procedures*. The process will include, but not be limited to, the following duties:

(1) Prepare the *Annual Tactical Plan*. This *Annual Tactical Plan* outlines the steps ERS will take during the upcoming twelve-month period to further implement ERS' adopted Hedge Fund Program strategic plan. *The Annual Tactical Plan* will include a review of the current status of the Hedge Fund Program, perceived hedge fund investment environment, the types and number of hedge funds to be sought and underlying rationale, and goals for other management responsibilities (e.g., situations being monitored and planned refinements to the Hedge Fund Program management process).

(2) Review and maintain records of hedge fund opportunities available and reviewed in the market over time.

(3) Screen and evaluate hedge fund opportunities to identify investments that provide attractive risk and return characteristics and are a fit with the Hedge Fund Program's long-term and short-term objectives.

(4) Conduct full and proper due diligence on prospective hedge fund investments and document the due diligence process. Prospective investment due diligence will include evaluating areas such as: (a) organization and personnel, (b) research, (c) due diligence and underwriting, (d) internal investment decision process, (e) documentation, (f) monitoring, (g) track record, (h) investment terms and conditions, (i) investor reporting, (j) corporate governance protections, (k) background checks and other investment specific items as determined by Staff and the Consultant. On-site visits at a manager's office by Staff will be a mandatory part of investment due diligence.

(5) Summarize findings of the due diligence process on each prospective hedge fund investment in a formal investment recommendation and present those findings to the IIC for approval.

(6) Negotiate investment terms and conditions, limited partnership and limited liability company agreements, and other closing documents on ERS' behalf, for investments approved by the IIC. Staff will coordinate legal, tax, and any other required professional reviews. Although ERS is not subject to ERISA, Staff should obtain terms and conditions in such negotiations for ERS investments to operate in the same manner as investments made by "employee benefit plans" under ERISA, to the extent such terms and conditions (a) are not in conflict with applicable laws/regulations to which ERS is subject, (b) are not in conflict with these *Hedge Fund Program Policies and Procedures*, (c) do not interfere with ERS maintaining its favorable tax qualification status, and (d) are not opted out of by the IIC because to do so would be in ERS' best interest.

b. Ongoing Operations. Staff will conduct or supervise the following services with respect to each hedge fund investment:

(1) Monitoring and Voting. Maintain communication with the managers of hedge fund investments and maintain an awareness of the progress and level of performance of each hedge fund investment. This will include, as appropriate, meeting with managers, attendance at investment meetings, and when possible sitting on advisory boards. This maintenance will also involve voting on hedge fund matters. Material voting issues will be brought to the IIC for approval.

Staff will stay informed of the overall market conditions relative to hedge fund investments and their competitive position. Staff will also be responsible for attending to amendments, resolutions, and other investment-related matters. All such activities will be undertaken with a view toward maximizing the hedge fund investment's value.

(2) Disbursement, Receipt, and Cash Management. Fund commitments on a timely basis and coordinate the receipt of cash distributions from hedge fund investments.

(3) Books and Records. Maintain, or cause to be maintained, records regarding the management of the hedge fund investments. These will include receipts, disbursements, and other investment-related records, including limited partnership and limited liability company agreements, amendments, correspondence, and other documentation as appropriate. Books and records will be made reasonably available to ERS auditors as reasonably required.

(4) Manager Review/Redemption. Staff and Consultant will review each manager on an ongoing basis. Reasons for a manager to be placed on the watch list for possible redemption include:

a) Persistent underperformance relative to specified benchmarks or peer groups.
b) A significant change in the firm's ownership and/or structure.
c) A loss of one or more key personnel.
d) Significant loss of assets under management and loss of clients.
e) A shift in the firm's investment philosophy or process.
f) Persistent lack of responsiveness to ERS request for information.
g) Regulatory investigations.
h) A violation of the *Investment Policy*, investment guidelines or instructions.
i) Any issue or situation of which either Staff or Consultant become aware of that is deemed material.

Staff will have the authority to terminate a manager relationship upon approval by the IIC.

2. Reporting Requirements

a. Investment Financial Statements. On at least a quarterly basis, Staff and the Consultant will receive from hedge funds unaudited financial statements and, on an annual basis, audited financial statements. Valuations shall be computed using the values provided by the managers in the most recent financial statements.

b. Quarterly Report. As soon as is practicable after quarter-end, the Consultant will produce a report on the hedge fund investments which will address activities that occurred during the quarter, including an industry review, strategy review, portfolio review (e.g., performance, risk, portfolio composition, Consultant ratings), fund review, and all other items of which ERS should be apprised. Because of the time-lag associated with hedge fund valuation processes, these quarterly reports are typically produced with a one-quarter lag.

c. Custodian. The custodian shall collect information regarding the System's account cash flows and valuations and any other information reasonably requested.

D. HEDGE FUND CONSULTANT RESPONSIBILITIES

The hedge fund Consultant will provide hedge fund consulting services to the Board, Executive Director and Staff to assist in the management of hedge fund assets. These services shall be subject to reasonable deadlines, and the Consultant will be responsible to and take direction from the ERS Executive Director, CIO, the Hedge Fund Portfolio Manager and/or designated Staff. ERS will not provide workspace, furniture, computer terminal access or telephone services.

The scope of work will include providing advice and assistance to ERS on developing a long-term hedge fund investment strategy that is consistent with and integrated into the ERS *Investment Policy* as well as an annual implementation plan. It will encompass all aspects of the program, including program development, identification of investment opportunities, screening and partnership due diligence, and general assistance related to the program. The Consultant will also provide investment and economic research with respect to the hedge fund asset class, which will include domestic and international hedge funds. Additionally, the Consultant will provide other such related hedge fund consulting services as requested by the ERS Executive Director, CIO, or the Hedge Fund Portfolio Manager and agreed upon by the Consultant.

The Consultant shall provide deliverables/services and staff, and otherwise do all things reasonably necessary to perform the work, as set forth below:

1. Work with Staff to develop a long-term hedge fund investment strategy and related policies and procedures utilizing best practices and highest fiduciary standards for entities of a similar type to ERS and consistent with existing ERS *Investment Policy*.

2. Develop an annual plan to implement the hedge fund allocation, including:

    a. Assess overall plan allocations and objectives;
    b. Assist staff with the documentation of investment guidelines, determination of optimal program size and strategy mix;

c. Assist in the development of the hedge fund implementation plan (including policies, procedures and tactical plan), incorporating best practice recommendations; and
d. Analysis and prioritization using such factors as prospective levels of risk and return, current and near term investment opportunities based on preferred managers or market environment, and other relevant investment factors.

3. Assist Staff with search activities including the identification, screening, and due diligence (front office and back office) of prospective "best in class" hedge fund investments.

4. Assist Staff with risk models on the proposed portfolio for ongoing quantitative assessment and validation of portfolio characteristics.

5. Work with Staff, as needed, to analyze available investment managers and investment products, including but not limited to providing access to a broad database of hedge fund managers/partnerships, including their investment strategy, performance, organizational characteristics, etc.

6. Work with Staff to develop a due diligence process for analyzing prospective investments and managers utilizing best practices and maintaining the highest fiduciary standards.

7. Assist in the interview process of prospective managers and provide research and analysis to evaluate prospective investment opportunities and hedge fund managers/partnerships consistent with the services provided by the Consultant.

8. Assist Staff in the preparation of written investment recommendations for the Internal Investment Committee (“IIC”), providing investment recommendations in writing for the IIC and required disclosures for the ERS *Placement Agent and Political Contributions Policies and Procedures*.

9. Provide information, research and analysis related to emerging hedge fund investment concepts or strategies, which may be of benefit to ERS.

10. Monitor portfolio performance against the designated benchmark(s) and provide peer comparisons. Provide quarterly and annual quantitative and qualitative assessment of each partnership/hedge fund investment and the hedge fund portfolio as a whole. Performance data will be provided by custodian. Consultant will report timely on key events that may materially impact the portfolio’s value such as market changes, geo-political, political, personnel issues with a manager (to the extent Consultant is aware of such change), or regulatory changes.

11. Periodically review the existing benchmark(s) for the hedge fund program and recommend changes as appropriate.

12. Assist Staff with ongoing due diligence, monitoring, and evaluating performance relative to appropriate benchmarks.

13. Work with Staff in providing advice and feedback on strategic initiatives, policies, counterparty risk, and risk analysis, including but not limited to monthly calls and quarterly meetings which may be conducted by telephone conference, if appropriate.

14. Provide customized monthly risk models at the total portfolio level and customized Board reporting on ERS' hedge fund investments.

15. The Consultant may also be requested to perform special projects which shall be mutually agreed upon by Consultant and ERS.

16. Upon reasonable advance notice to Consultant, attend ERS Board, IIC meetings or legislative hearings as requested.

17. Maintain regular communications with the Chief Investment Officer or the Hedge Fund Portfolio Manager, which would include reasonably frequent telephone consultations as well as a reasonable number of on-site consultations as required by ERS, in order to effectively accomplish all of the services required by this Contract.

III. HEDGE FUND PORTFOLIOS

Hedge fund allocations are made either individually within asset classes, i.e. Public Equity, Credit, Public Real Estate, or within dedicated hedge fund portfolios, i.e. Absolute Return Portfolio, as defined in Section 2.2 of the Investment Policy.

A. INDIVIDUAL HEDGE FUND ALLOCATIONS

Hedge funds may be used tactically within asset classes to complement internal capabilities and as an alternative to traditional external managers. Individual Hedge Fund Allocations are made within the framework of the asset class' performance objectives. As outlined in these Policies and Procedures, the hedge fund team will manage and monitor the hedge fund exposure to the objectives of the asset class in conjunction with the asset class' staff.

B. ABSOLUTE RETURN PORTFOLIO

The Absolute Return Portfolio is a Risk-Reducing Hedge Fund Portfolio with the mandate described below.

1. PORTFOLIO CONTRUCTION METHODLOGY

ERS manages the Absolute Return Portfolio using a Core/Satellite approach:

a. Core Investments**.** Core investments will include low correlation and low volatility managers implementing a single or multiple strategies that, in aggregate, are expected to achieve a stable return in line with the Absolute Return Portfolio's target return.

b. Satellite investments. Satellite investments typically utilize higher beta and/or implement a single strategy with a sub-strategy or regional focus. They are used opportunistically to augment the risk/return/beta profile of the *core* managers such that the Absolute Return Portfolio, in aggregate, is expected to achieve a stable return in line with its performance objectives.

At the hedge fund strategy level, ERS will determine tactical allocations of the hedge fund broad classes defined below. These tactical allocations will be based on the performance expectations of Staff and those of its Consultant for the underlying hedge fund strategy. These tactical allocations will be reviewed, and where necessary, modified on an annual basis in the *Annual Tactical Plan*.

2. PORTFOLIO PERFORMANCE

Performance of ERS' Absolute Return Portfolio will be monitored at the portfolio level. The performance objective of the Absolute Return Portfolio is to achieve a total time weighted rate of return over rolling–five year periods of at least the annualized U.S. 3-month Treasury bill yield plus 400 basis points, net of all investment management fees and expenses. The program's value-added return will be primarily derived from strategy selection, and to a lesser degree, manager selection.

In addition, ERS will monitor the performance of the Absolute Return Portfolio relative to the HFRI Fund-of-Funds Diversified Index.

From a risk perspective, the portfolio will be structured to provide diversification to the Trust with returns that are relatively uncorrelated with other asset classes. Volatility, defined as the annualized standard deviation of monthly hedge fund portfolio returns, should fall within a 4% to 8% range. Beta will be no more than 0.40 relative to the Trust.

At the fund level, Staff will monitor the performance of individual investments versus the Consultant's database of peer group hedge fund investments. Quartile rankings will be calculated and monitored for each ERS investment over various look back periods and against both broad and sub-strategy hedge fund peer groups. Rankings based on risk adjusted measures (e.g., risk, return, correlation and beta) to ERS' Absolute Return Portfolio and the ERS Trust will be monitored.

3. STRATEGIC ALLOCATIONS

The target ranges and upper policy limits for the Absolute Return Portfolio strategy allocations are specified to ensure that the portfolio remains sufficiently diversified by strategy.

Staff is required to notify the Board if strategy allocations violate the approved target ranges. The Board may approve a request from Staff to allow exceeding target ranges for a limited time with a strategy proposed by Staff and consistent with the *Annual Tactical Plan* to move the Absolute Return Portfolio strategy in compliance within a reasonable period of time, depending on market conditions.

The target range is determined based on the expected return, risk, market exposure of each strategy and the strategic objectives of the Absolute Return Portfolio:

Strategy Class	Target Range*	
Relative Value	20%	60%
Event Driven	~~20%~~ **0%**	60%
Equity Long/Short	0%	30%
Macro	10%	40%
Opportunistic	0%	~~30%~~ **40%**

*Targets refer to percentage of total Absolute Return Portfolio allocation.

The *Annual Tactical Plan* will specify a tactical allocation to each strategy class within the approved target ranges. These tactical allocations will be opportunity weighted to take account of short to medium-term expectations for the performance of the underlying strategies.

Opportunistic Investments. This strategy is differentiated from the rest of the hedge fund portfolio because it is designed to accommodate investments in a variety of strategies which share a very specific set of investment objectives. At any given time, the opportunistic investments sub-portfolio may have a 0% allocation. Maximum capital that would be committed to the sub-portfolio is limited to **40%** ~~30%~~ of total Absolute Return Portfolio assets. The maximum allocation of 30% of the Absolute Return Portfolio will apply to the percent of current and uncalled capital commitments to the opportunistic investments sub-portfolio.

C. DIRECTIONAL GROWTH PORTFOLIO

The Directional Growth Portfolio is a Return-Seeking Hedge Fund Portfolio with the mandate described below.

1. PORTFOLIO CONSTRUCTION METHODOLOGY

In FY2014, the Directional Growth Portfolio is comprised of two individual hedge fund allocations. Each allocation is benchmarked to an appropriate equity index. The portfolio is managed as a collection of individually benchmarked investments. With increased diversification the portfolio will be managed using a Core/Satellite approach as described above.

2. PORTFOLIO PERFORMANCE

In FY2014, the Directional Growth Portfolio is comprised of two individual hedge fund allocations. Each allocation is benchmarked to an appropriate equity index. Therefore, the portfolio is expected to meet or exceed the underlying equity indices over a market cycle.

3. STRATEGIC ALLOCATIONS

The target ranges and upper policy limits for the Directional Growth Portfolio allocations are specified to ensure that the portfolio remains sufficiently diversified by strategy.

Staff is required to notify the Board if strategy allocations violate the approved target ranges. The Board may approve a request from Staff to allow exceeding target ranges for a limited time with a strategy proposed by Staff and consistent with the Annual Tactical Plan to move the Directional Growth Portfolio strategy in compliance within a reasonable period of time, depending on market conditions.

The target range is determined based on the expected return, risk, market exposure of each strategy and the strategic objectives of the Directional Growth Portfolio:

Strategy Class	Target Range*	
Relative Value	0%	30%
Event Driven	0%	30%
Equity Long/Short	30%	100%
Macro	0%	50%
Opportunistic	0%	50%

*Targets refer to percentage of total Directional Growth Portfolio allocation.

The Annual Tactical Plan will specify a tactical allocation to each strategy class within the approved target ranges. These tactical allocations will be opportunity weighted to take account of short to medium-term expectations for the performance of the underlying strategies.

Opportunistic Investments. This strategy is differentiated from the rest of the hedge fund portfolio because it is designed to accommodate investments in a variety of strategies which share a very specific set of investment objectives. At any given time, the opportunistic investments sub-portfolio may have a 0% allocation. Maximum capital that would be committed to the sub-portfolio is limited to 50% of total Directional Hedge Fund Portfolio assets. The maximum allocation of 50% of the Directional Hedge Fund Portfolio will apply to the percent of current and uncalled capital commitments to the opportunistic investments sub-portfolio.

IV. DEFINITIONS OF APPROVED HEDGE FUNDS

ERS categorizes the various hedge funds into five broad classes:

1. Relative Value Strategies
2. Event Driven Strategies
3. Equity Long/Short Strategies
4. Macro Strategies
5. Opportunistic

Described below are representative underlying hedge fund sub-strategies, which fall into the above four hedge fund broad classes. (These approved hedge funds do not constitute the entire universe of potentially suitable hedge funds.)

1. **Relative Value Strategies.** *Relative value* strategies seek returns by capitalizing on the mispricing of related securities or financial instruments. Generally, *relative value* strategies avoid taking a directional bias with regard to the price movement of particular securities or markets. Representative *relative value* strategies include *convertible arbitrage*, *fixed income arbitrage* and *equity market neutral* strategies.

   a) **Convertible Arbitrage.** Classic *convertible arbitrage* involves buying undervalued convertibles in order to gain exposure to stock volatility at cheap levels and/for credit improvement or revaluation, while hedging out unwanted risks like equity directional risk (delta), interest rate risk (rho) and currency risk (chi).

   Traditionally, the source of value has been cheap new issuance of convertible bonds, which has permitted the manager to move the portfolio towards lower levels of implied volatility. Secondary market opportunities also occur due to the appetite of different types of investors for convertible bonds as their premium and yield vary over their life.

   In response to less attractive conditions for *convertible arbitrage*, some managers have become “multi-strategy”, incorporating synergistic strategies such as *capital structure arbitrage* and *relative credit*. Other managers are placing an increasing emphasis on fundamental stock research, and not just credit research, to take a more “bottom-up” approach to avoid volatility and event driven situations, by taking limited views on the individual names within the portfolio (by under- or over-weighting equity hedges).

   As a result, *convertible arbitrage*, as practiced today, may overlap with *capital structure arbitrage*, *equity long/short*, *event driven*, and *distressed* investing to some degree. In addition, some of the managers may take directional interest rate bets, by under- or over-weighting the interest rate exposures within the portfolio.

b) **Fixed Income Arbitrage.** In general, *fixed income arbitrage* traders do not aim to profit from expected movements in the general level of interest rates. The following are broadly common characteristics of the *fixed income arbitrage* managers.

Fixed income arbitrage managers take long and short positions in fixed income assets and derivatives to profit from arbitrage, mean-reversion or positive carry. Most traders aim to be either duration neutral or "risk-neutral", i.e., matching the U.S. dollar value of a basis point across long and short positions.

Most *fixed income arbitrage* traders use a significant amount of leverage as an integral part of their trading. One risk faced by fixed income managers stems from the liquidity mismatch between long and short positions. A manager may own (be long) more illiquid securities and hedge with shorts in more liquid securities. There is the risk of a break from the past mean-reverting relationship between particular securities. There is also the risk that lenders will withdraw the funding that supports the strategy's leverage.

In the past, managers have concentrated on developed markets in the U.S., Japan, and Western Europe, but the strategy space now encompasses all fixed income sovereign issues. There are many variations on the fixed income theme, with managers trading mortgage backed securities, municipal securities and other investment grade credits.

c) **Equity Market Neutral Strategies.** These strategies can be fundamental and/or quantitative in nature. Traditional *quantitative equity market neutral* takes fundamental data, in the form of analyst earnings estimates, balance sheet and cash flow statement statistics, etc., and ranks or scores stocks against several of these metrics in varying proportions. These proportions may be fixed or dynamic. The characteristics are generally described as factors, or more accurately as attributes, so as not to confuse them with risk factors, which have historically been found to correlate to excess return or alpha.

Portfolios may be constructed using an optimizer or by the application of simpler rules combined with risk constraints. The objective in either case is to create a portfolio, which is dollar and/or beta neutral, has minimal sector exposures, and is tilted towards these favorable stock attributes, without being style-biased.

The main risks to these strategies include evolution in the attributes that are rewarded by the market, misspecification of or the emergence of new risk factors, changes in investor behavior and risk appetite, corporate events and increasing competition.

2. Event Driven Strategies. *Event driven* strategies focus on identifying and analyzing securities that can benefit from the occurrence of an extraordinary corporate transaction or event, e.g., restructurings, takeovers, mergers, spin-offs, bankruptcy. Representative *event driven* strategies include *merger arbitrage*, *event driven equity* and *distressed* investing.

(1) Merger Arbitrage. *Merger arbitrage* (sometimes called *risk arbitrage*) involves taking 'long' positions in the securities of a company being acquired in a merger or an acquisition. The arbitrageur is able to buy securities at a discount of the consideration to be received when the deal actually closes. If the acquisition consideration is in the form of cash, any discount to the amount of the cash bid will be taken as a profit on conclusion of the deal. If the acquisition consideration is in the form of shares of the acquirer, the merger arbitrageur will short stock of the acquirer in the correct proportions and extract the spread, assuming the bid goes through successfully.

The merger arbitrageur may adjust stock ratios or use options to account for the possibility that the deal may not go through, which would result in a fall in the target company's price, and potentially a rally in the stock of the failed acquirer.

The strategy's main risk is that of deal failure as this is difficult to completely hedge. A deal may fail for many reasons. For example, shareholders may have voted against it or not tendered their shares to the bidder, a government agency or regulatory body may have refused to approve the transaction, or one of the companies might pull out of the agreement unexpectedly. The bidder may withdraw for a variety of reasons, e.g., if equity markets fall, or interest rates rise making deal financing more costly. This is an indirect source of market risk.

Sector risk can be high because merger activity may be concentrated in certain sectors. Typically, leverage is employed and this magnifies the impact of losses. Note that the manager is in competition with other merger arbitrageurs to secure borrowing facilities in the shares of the acquirer. In addition, companies targeted for acquisition become widely held among arbitrageurs.

b) **Event Driven Equity.** Event driven equity investing is typically a value-oriented, event driven investment strategy focusing on companies considering or implementing strategic change. It involves purchasing securities of companies involved in extraordinary corporate transactions. These types of situations can act as a catalyst to drive the price toward a valuation target. The opportunities for *event driven* investing are:

- **(1)** Inefficient Markets: *Event driven* situations are often mispriced and misunderstood by mainstream investors and analysts.
- **(2)** Unlimited Idea Flow: Corporate events are always plentiful and the broad based strategy does not go "out of favor." In other words, *event driven* managers are not solely dependent on merger and acquisition activity or the frequency of bankruptcies.
- **(3)** *Event driven* situations have an advantage that this strategy responds more to catalysts and less to market swings so overall there is a modest correlation to the market.

Extraordinary corporate transactions include: going private transactions, corporate takeovers, restructurings, tender offers, liquidation processes, Dutch auction tender offers, recapitalizations, public LBOs, liquidations and busted deals.

New and under-followed securities quite often emerge as a result of some of these types of corporate transactions. Examples include: spin-offs, reorganizations, demutualizations and late-stage distressed/post-bankruptcy.

Other examples might be a company involved in a pending litigation or regulatory matter, which could have an impact on its share price, or a company being the subject of a proxy war, or some form of shareholder activism.

Some managers will hedge all holdings using a peer company, a basket of stocks or an exchange traded fund (ETF). Other managers do not actively hedge if they feel that their investment process provides them a margin of safety on each of their investments. Because most *event driven* managers are usually long-biased, performance is prone to suffer during market downturns, albeit with much less volatility than the overall market.

c) **Distressed/Restructuring.** Performing corporate debt appeals to "real money" investors due to its seniority, certainty of cash flow and lower volatility. Such investors are often ill-equipped to deal with debt when it trades substantially below par due to stress, and often become price insensitive sellers. Accordingly, as companies stumble, the composition of creditors often changes from passive "real money" to aggressive "distressed" buyers looking to capitalize on uneconomic selling, with a view to a higher ultimate recovery.

The appeal of the strategy is that by buying at cheap valuations, downside is limited. In addition, each situation is idiosyncratic; meaning that returns of a portfolio should be relatively independent of the market (although in reality the strategy does correlate with general credit markets).

The basis for evaluation is the interplay between the company's sustainable cash flow, debt load (at current prices) and residual asset values. Enterprise valuation (i.e., combined value of debt and equity less cash) is commonly measured as a multiple of cash flow or EBITDA.

Distressed buyers look to buy a company at a low implied multiple. The art of the strategy is forecasting cash flow, particularly in light of all of the business and legal uncertainty the company faces in reorganization. *Distressed* managers vary widely in terms of style. For example, some focus on liquidity, seniority, diversification, passivity, and/or hedging. Others are purely long, seeking to maximize upside by playing lower in the capital structure, "playing" for illiquid restructured equity, or taking concentrated bets in a small number of activist situations.

3. **Equity Long/Short Strategies.** *Equity long/short* strategies will maintain some level of market exposure (either net long or net short); however, the level of market exposure may vary through time.

   a) Equity Long/Short. This strategy seeks to combine long and short equity positions to benefit from security selection, while offsetting systematic market risk (to varying degrees). Portfolios are typically constructed using a "fundamental, bottom-up approach" encompassing detailed financial modeling, industry research and company due diligence.

   b) Some managers will include macro and/or quantitative screens to focus idea generation and help manage risk.

   c) The main components of risk management are (in general order of importance):

      (1) Diligent security selection

      (2) Managing exposures to specific industries, factors, market caps, and positions.

      (3) Portfolio scenario analysis and stress testing.

   d) Several trends that have emerged recently include:

      (1) An increased reliance on internal networks and boutique consultants to generate ideas, as street research currently seems to be primarily used for "gauging consensus."

      (2) The utilization of individual shorts as pure "alpha generators", rather than hedges. The difficulty of finding good shorts has led many managers to utilize synthetic solutions, such as ETFs, to offset long exposures.

      (3) Portfolios have become more systematically net long and, to some extent mid-cap biased, as shorting has become increasingly difficult and large cap stocks have underperformed.

   e) Please note that it is common to classify *equity long/short* managers by regional exposure, sector focus, investment style (value/growth), market capitalization and/or market exposure [i.e., to differentiate between "long biased" funds (+/-50% or more net long, 75% of the time), "market indifferent" (+/- 35%, 75% of the time), and market neutral (+/- 10%, 75% of the time)].

4. **Macro Strategies.** The tactical/directional classification is a catch-all, but generally refers to strategies that are more directional in nature although they can shift opportunistically between those strategies having a directional bias and a non-directional bias. Representative tactical/directional strategies include *Global Tactical Asset Allocation* ("*GTAA*") and *global macro* strategies, where the manager tends to invest at the asset class level such as fixed income, equities and commodities rather than individual corporate securities.

a) **Macro–Discretionary.** These funds take directional positions in currencies, bonds, equities and commodities. The investment decisions are based on a manager's top-down or macro views of the world: analysis of the economy, interest rates, inflation, government policy and geopolitical factors. The relative valuations of financial instruments within, or between asset classes, can also play a role in investment decisions.

   The trades can be classified broadly as outright directional trades or macro relative value, (e.g., U.S. bonds vs. European bonds) although some funds also have exposure to micro relative value strategies (arbitraging anomalies between similar instruments).

   Primarily, the area of focus is in the liquid instruments of the G10 countries; however, some funds will also tend to have a bias towards emerging markets positions. Many *macro* managers have only a handful of themes in the portfolio at any one time. Successful managers have been those who know how to size their bets and manage their risk.

b) **Macro–Systematic–Global Asset Allocation.** *Global Asset Allocation* ("*GAA*") is a quantitative style of trading, which takes in a lot of information based on economic data, as well as some price related information.

   Many of the GAA models used in building portfolios are usually tailored to specific sectors or asset classes in which they trade, and take into account the economic and fundamental differences that apply. These sectors will include global stock markets, global bond markets and money markets, foreign exchange, and occasionally commodity markets.

   GAA funds tend to be relative value in nature and may encompass many of the arbitrage styles. Most models are built on economic principles rather than price action; however, some momentum models may be included. Large amounts of data are collected and correlations as well as cross correlations are calculated. Most participants have large research teams and considerable technology resources. The infrastructure required to process such large quantities of information means that many *GAA* funds are offered by large investment firms including investment banks. Some of the smaller funds concentrate on fewer models and/or sectors.

c) **Macro–Systematic–CTA.** *Commodity Trading Advisor* ("*CTA*") is a term defined by the Commodity Futures Trading Commission ("CFTC") as "a personal firm, who for compensation profit, directly or indirectly advises as to the advisability of buying or selling commodities, futures or option contracts". In most cases the *CTA* has to register with the CFTC and the National Futures Association ("NFA").

   Generally *CTA* trading is systematized and orders are generated by computer programs, but this is not always the case. Trading can vary in style from discretionary, systematic price based and fundamental based. Trading can also vary in time horizon, from a holding period covering a matter of minutes to well over a year.

   The *CTA* usually trades a wide spectrum of markets and is by no means restricted to the commodity markets. For the most part, the information taken in is price based. Many of the large *CTAs* restrict themselves to the very liquid financial markets, where they will be able to execute large orders. Most *CTAs* trade cash, foreign exchange contracts and forwards as well.

   The median *CTA* is a medium-term systematic trend follower, who takes directional trades in any market when a trend establishes itself. These trends are often identified through break out or moving average systems, often waiting for the trend to reverse somewhat before exiting the trade.

5. **Opportunistic Investments.** Opportunistic investments should generally satisfy the following conditions: (1) enhance returns of the hedge fund portfolio, (2) display a positive asymmetric return profile (i.e., upside potential with limited downside), (3) have an identifiable exit point (typically five years or less, likely achieved through investment in a limited-life vehicle structure), and (4) be sourced primarily, though not exclusively, through existing relationships. The investments may be in any sub-strategy or niche strategy, but are likely to result from a market dislocation and display greater illiquidity, beta and volatility than other investments in the hedge fund portfolio. The vehicles may be funded with one-time investments or via a commitment/capital call drawdown mechanism. The opportunistic investments sub-portfolio is not meant to be viewed as a diversified stand-alone portfolio; rather, it is a collection of opportunistic investments with unique characteristics.

Total capital commitments to the *opportunistic investments* sub-portfolio may not exceed **40%** ~~15%~~ of total hedge fund portfolio assets. There is no minimum required allocation to the *opportunistic investments* category; it is anticipated that at times the allocation to this sub-portfolio will be 0%.

It is anticipated that the equity beta of the *opportunistic investments* sub-portfolio may be measurably higher than the rest of the hedge fund portfolio. Volatility, as measured by standard deviation, is a less applicable metric given the longer time horizon and illiquid nature of these investments. These investments will likely be subject to short-term unrealized losses (volatility), though the principal risk is the permanent impairment of capital.

PUBLIC AGENDA ITEM - #8c

Review, Discussion and Consideration of Hedge Fund Program:

8c. Proposed Hedge Fund Annual Tactical Plan for Fiscal Year 2017

August 16, 2016

BACKGROUND

In accordance with the *Hedge Fund Program Policies and Procedures*, Section II.E.5, staff is charged with preparing and presenting an Annual Tactical Plan ("Plan") to the ERS Board of Trustees for its review and approval. The Plan reviews the current status of the Hedge Fund Program, recent historical and prospective market conditions, and proposes steps to be taken over the next twelve months to implement the Hedge Fund Program. These steps include strategies, as well as any other actions or considerations germane to the success of the program. The Plan is intended to be a planning document and a reference guide and is not intended to overrule prudent hedge fund investment decision-making.

The approved Plan will be incorporated into the ERS *Hedge Fund Program Policies and Procedures* document as Appendix A.

FISCAL YEAR 2017 TACTICAL PLAN

Staff is recommending that the Annual Tactical Plan for Fiscal Year 2017, included with this agenda item as Exhibit A, be approved with the target allocations summarized below. While the proposed Plan is considered prudent and effective for the implementation of the Hedge Fund Program, it may require amendment based upon the opportunities available in the market.

Under the proposed Plan, staff will target up to four new hedge fund commitments. The bulk of these new commitments are to maintain required exposures and replace existing managers. Additional consideration is being given to strategies that either exhibit lower betas to the market or are less correlated (i.e. Global Macro). Geographic focus will not be constrained and may include U.S., Europe, Asia, and/or other Emerging Markets.

The following portfolio summaries provide guidance on the anticipated hedge fund allocations within the hedge fund portfolios and by asset class.

Absolute Return Portfolio

As a fully allocated portfolio, the Absolute Return Portfolio is expected to remain within policy guidelines via rebalancing and rotating managers. New managers will be added opportunistically and/or as replacements to existing managers. Additional allocations may be made to existing managers. The Absolute Return Portfolio will rebalance as necessary to remain at a 5% total allocation for the Trust.

Directional Growth Portfolio

Expectations are for up to two new allocations for Fiscal Year 2017. Currently, the Directional Growth Portfolio remains focused on allocating to extension strategies (i.e. 130/30), but other strategies may be considered. These types of strategies would be classified as Equity Long/Short, but are managed as a collection of individually benchmarked allocations. The portfolio is expected to complement existing long-only external advisors and also provide tactical and opportunistic exposures that are appropriate within a return-seeking context. This portfolio's objective is to complement internal management and capture exposures and/or strategies that we cannot execute internally.

Other Hedge Fund Strategies

Hedge funds will be considered as an alternative to traditional external managers where appropriate.

Global Credit

At this point, the Global Credit portfolio has no expectations to make any additional hedge fund allocations for Fiscal Year 2017. Currently, staff for the Global Credit portfolio is sourcing Opportunistic Credit strategies that are less liquid and require capital to be locked/committed beyond a traditional hedge fund investment. Hedge Fund staff will work closely with Fixed Income staff to identify and evaluate potential hedge fund exposures and will continue to support Fixed Income staff in respective portfolio management decisions.

Real Estate

At this point, all hedge fund exposure within the Real Estate portfolio has been liquidated. It was determined in late 2015 by ERS Real Estate staff that the remaining amount of the investment should be redeemed. The redemption was based on the fact that the investment was not providing ERS with an attractive return profile given its continued underperformance to its benchmark, FTSE EPRA / NAREIT Developed Index.

STAFF RECOMMENDATION:

The proposed Hedge Fund/Absolute Return Annual Tactical Plan for Fiscal Year 2017 has been reviewed by and is supported by ERS' hedge fund consultant, Albourne Partners. Staff recommends it be adopted as presented in Exhibit A and as an appendix to the ERS *Hedge Fund Program Policies and Procedures*. A recommended motion is included with this agenda item following the exhibit.

ATTACHMENT – 1

Exhibit A – Proposed ERS Hedge Fund Program Annual Tactical Plan for Fiscal Year 2017

EXHIBIT A

HEDGE FUND PROGRAM

ANNUAL TACTICAL PLAN FOR FISCAL YEAR 2017

EFFECTIVE August 16, 2016

I. EXECUTIVE SUMMARY

The Employees Retirement System of Texas (“ERS” or “the System”) utilizes hedge funds to enhance ERS’ total portfolio (“Total Portfolio”) investment characteristics. The objectives of the System’s Hedge Fund Program are (1) to preserve the System’s capital, (2) to enhance the System’s Total Portfolio risk-adjusted returns, (3) to further diversify the System’s Total Portfolio, and (4) to reduce the System’s Total Portfolio volatility. The underlying philosophy of the program will be to attain risk adjusted returns that are aligned with these objectives.

This Hedge Fund Program Annual Tactical Plan for Fiscal Year 2017 (“Annual Tactical Plan”) has been prepared by ERS staff and the hedge fund consultant to ERS, Albourne America LLC (“Albourne” or “Consultant”). It is intended to be a planning document which outlines the steps to be taken over the next twelve (12) months to further the Hedge Fund Program objectives and to address considerations relevant to the administration and success of the Hedge Fund Program. This Annual Tactical Plan is a guiding reference only. It is not intended to overrule prudent hedge fund investment allocation decisions.

While this Annual Tactical Plan is considered prudent and effective for the implementation of the Hedge Fund Program, it may require amending based upon the opportunities available in the market. Importantly, while this Annual Tactical Plan highlights significant capital commitments during the 2017 fiscal year, not all of the capital committed may be invested by ERS due to factors beyond ERS’ control. The ranges given provide flexibility to the targeted commitment amount to provide for varying market opportunities as well as availability of ERS’ resources. Moreover, Hedge Fund staff and the Consultant may request a change of pace of investment in subsequent Annual Tactical Plans in order to better take advantage of market opportunities.

II. GENERAL ALLOCATION OVERVIEW

Consistent with Section 2.2 of the ERS *Investment Policy*, hedge funds may be utilized within both Return Seeking and Risk Reducing portfolios. Hedge funds are utilized within asset classes and their underlying portfolios to complement external managers and support the asset class in achieving its individual objectives. The Directional Growth Portfolio, a Return Seeking portfolio, and the Absolute Return Portfolio, a Risk Mitigating portfolio, are two unique portfolios comprised solely of hedge funds as described below. All hedge fund allocations are subject to the Hedge Fund Program Policies and Procedures.

Risk-Reducing

<u>Absolute Return Portfolio</u>

Initial allocations for the Absolute Return Portfolio were made August 1, 2012. The portfolio has reached its target allocation of 5% of the System’s Total Portfolio as of FY2015. The Absolute Return Portfolio is a diversified portfolio by strategy, region, and by the number of managers. Factors influencing the number of managers include the following: fund and/or strategy capacity, conviction, alignment of interests, risk management, and transparency. It is anticipated that the portfolio will consist of 15 to 20 allocations. The current number of managers is 15. Target allocations by geographic region are not specified because allocations are strategy driven.

Other Risk-Reducing Hedge Fund Allocations

No other Risk-Reducing hedge fund allocations are anticipated.

Return-Seeking

Directional Growth Portfolio

As a Return-Seeking counterweight to the Absolute Return Portfolio, the Directional Growth Portfolio is comprised of individually benchmarked hedge fund allocations with significant market beta. The Directional Growth Portfolio is comprised of one hedge fund allocation that is benchmarked to an appropriate equity index. As described in the Hedge Fund Program Policies and Procedures, the portfolio will be managed as a collection of individually benchmarked allocations. With increased diversification, the portfolio may be managed using a Core/Satellite approach similar to the Absolute Return Portfolio. The portfolio is expected to either meet or exceed the asset-weighted benchmarks of the underlying allocations over a market cycle.

Other Return - Seeking Hedge Fund Allocations

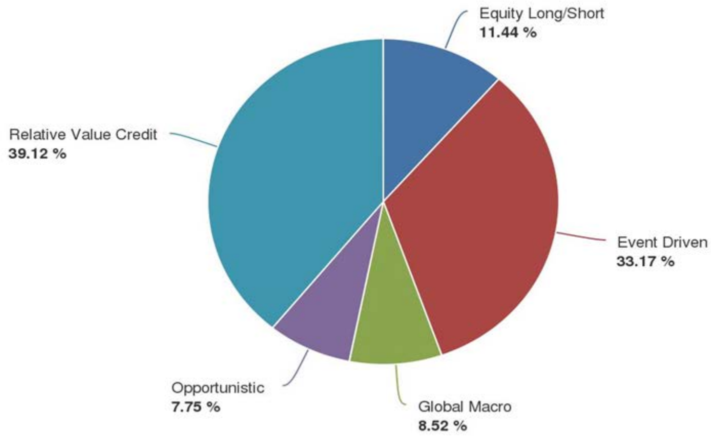
Global Credit

Global Credit may seek to increase exposure to High Yield, Leveraged Loans, and Emerging Markets as approved in the Global Credit mandate. Hedge funds will be considered to complement long-only exposures as well as opportunistically to capture credit-related market opportunities. For example, hedge fund strategies that tactically utilize lower net exposures are capable of minimizing significant drawdowns in volatile market conditions that are often observed in emerging markets. Such strategies are expected to result in a higher tracking error, but be accretive to fund performance over a market cycle by mitigating losses and enhancing the compounding effect. Hedge Fund staff will work closely with Fixed Income staff in identifying and evaluating potential hedge fund exposures and will continue to support Fixed Income staff and the ERS Risk Committee with respective portfolio management decisions.

III. FUNDING TABLES

Absolute Return Portfolio

Asset Class Exposures - Hedge Funds - Allocation, %
May-2016



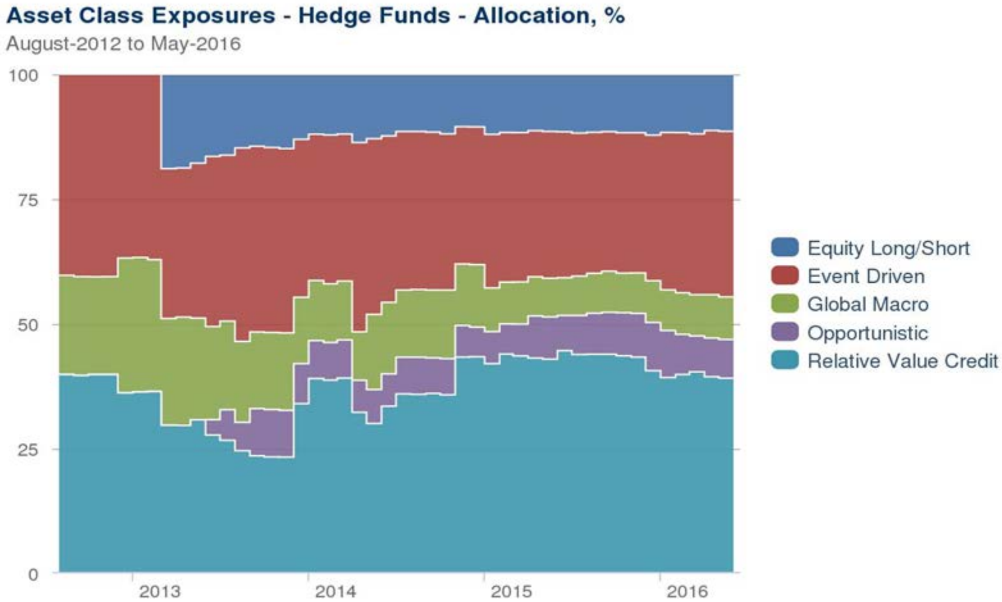
Employees Retirement System of Texas

Asset Class Targets

Asset Class Targets	
Relative Value Credit	
Minimum	20%
Maximum	60%
Event Driven	
Minimum	20%
Maximum	60%
Equity Long/Short	
Minimum	0%
Maximum	30%
Global Macro	
Minimum	10%
Maximum	40%
Oppportunistic	
Minimum	0%
Maximum	30%

As of May 31, 2016, the Absolute Return Portfolio is within guidelines for each strategy classification except Global Macro. Global Macro has been a volatile asset class with no clear persistency in returns given the consistent headwinds to the strategy. Expectations are for a potential allocation to the strategy during FY2017 which would bring the strategy within the exposure guidelines of the Absolute Return Portfolio.

The Absolute Return Portfolio remains overweight both Relative Value and Event Driven strategies. These allocations fall within the proposed guidelines for the Absolute Return Portfolio. Expectations are for these strategies to remain overweight within the near-term.



Returns and Risk

Return	Account	T-Bills + 400 bps	HFRI FOF: Diversified Index
Annualized Return	5.08%	4.25%	3.31%
Cumulative Return	20.91%	17.28%	13.27%
Largest Month Gain	1.79%	0.44%	2.05%
Largest Month Loss	-1.07%	0.31%	-1.98%
% Positive Months	71.74%	100.00%	65.22%

Risk	Account	T-Bills + 400 bps	HFRI FOF: Diversified Index
Standard Deviation	2.67%	0.09%	3.36%
Sharpe Ratio*	1.87	53.28	0.96
Max Drawdown	-2.66%	0.00%	-6.52%
Months in Maximum Drawdown	12	0	12
Months to Recover	3	0	3

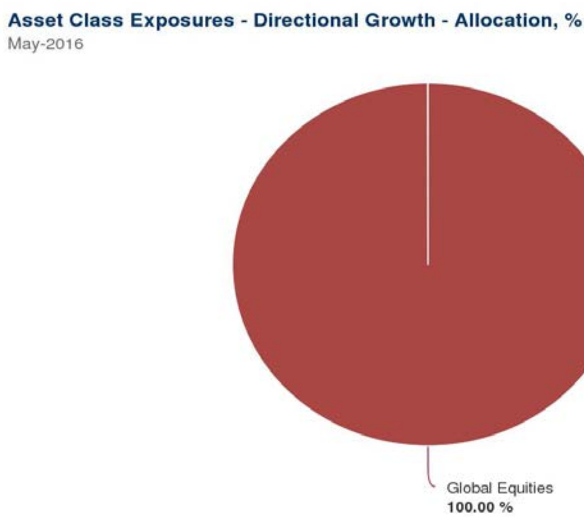
Benchmarks Comparison	T-Bills + 400 bps	HFRI FOF: Diversified Index
Beta	-2.80	0.65
Correlation	-0.10	0.82
R-Squared	0.01	0.67

Risk Free Rate: TreasuryConstant3Month

The Absolute Return Portfolio continues to outperform its stated benchmark of T-Bills + 4%. The standard deviation of the portfolio remains below the stated minimum risk guideline of 4%. The maximum standard deviation for the Absolute Return Fund is 8%.

The Absolute Return Portfolio has approximately reached its target allocation of 5% of Trust assets and will maintain its target allocation while rebalancing and replacing managers within the portfolio as necessary. As of May 31st, 2016, the current AUM for the Absolute Return Portfolio is $1,197,136,528. This amount equates to around 4.80% of the Trust.

Directional Growth Portfolio



Returns and Risk

Return	Account	MSCI AC World Daily Net Local (Total Return)
Annualized Return	11.19%	4.75%
Cumulative Return	25.84%	10.57%
Largest Month Gain	7.82%	7.63%
Largest Month Loss	-6.69%	-6.64%
% Positive Months	65.38%	57.69%

Risk	Account	MSCI AC World Daily Net Local (Total Return)
Standard Deviation	11.24%	10.96%
Sharpe Ratio*	0.99	0.42
Max Drawdown	-8.98%	-12.01%
Months in Maximum Drawdown	10	12
Months to Recover	3	3

Benchmarks Comparison	MSCI AC World Daily Net Local (Total Return)
Beta	1.01
Correlation	0.98
R-Squared	0.97

Risk Free Rate: TreasuryConstant3Month

As of May 31, 2016, the Directional Growth Portfolio is comprised of a single allocation to Marshall Wace World 150-50 benchmarked against MSCI All Country World Total Return Index (ACWI TR). The strategy allocation remains 100% Equity Long/Short. Expectations are for up to two new allocations for Fiscal Year 2017. Currently, the Directional Growth Portfolio remains focused on allocating to extension strategies (i.e. 130/30), but other strategies may be considered. The portfolio is expected to complement existing external managers and also provide tactical and opportunistic exposures that are appropriate within a Return-Seeking context.

Other Hedge Fund Allocations

Hedge funds will be considered as an alternative to traditional external managers where appropriate.

Global Credit

At this point, the Global Credit portfolio has no expectations to make any additional hedge fund allocations for Fiscal Year 2017. Currently, Global Credit staff is sourcing more Opportunistic Credit strategies that are less liquid and require capital to be locked/committed beyond a traditional hedge fund investment.

IV. STRATEGY ALLOCATION COMMENTS

Forward-looking strategy forecasts are inherently state-of-the-world dependent, where some strategies and sub-strategies are more sensitive to state-of-the-world assumptions than others. The commentary below will highlight the key assumptions by strategy and provide guidance on the expected use of strategies and sub-strategies in FY2017.

Relative Value

Relative value sub-strategies typically demonstrate a high degree of dispersion in return forecasts due to the various underlying factors that drive the differing sub-strategy performance. A common characteristic among relative value sub-strategies, however, is a typically low baseline net exposure that helps moderate risk and market exposure. Relative value sub-strategies can benefit from heightened or increasing intra-market volatility, spreads, rates, as well as from sideways markets. ERS, therefore, expects relative value sub-strategies to preserve capital in many baseline/down market scenarios.

In FY2017, Relative Value strategies will remain an overweight core allocation in the Absolute Return Portfolio. New Relative Value strategies will be considered against current allocations and will be substituted where appropriate.

Event Driven

Through their primary exposure to idiosyncratic corporate events, event driven strategies typically provide a moderate and positive long-term beta to equity markets. Sub-strategies such as distressed/high yield typically have higher beta than others such as merger arbitrage. Event driven sub-strategies can provide a lower volatility exposure since leverage is typically not a key characteristic of the strategy. Event driven sub-strategies can perform well in calm markets as deals close, or in recovery markets where distressed risk premium is cheaply available.

In FY2017, Event Driven strategies will be reduced within the Absolute Return Portfolio. New Event Driven strategies will be considered against current allocations and will be substituted where appropriate.

Equity Long/Short

Equity long/short provides the highest correlation and beta of the four main strategies. While rarely providing absolute returns above equity benchmarks in bull markets, equity long/short strategies typically provide lower net exposure with lower overall volatility, as well as varying degrees of downside protection in sharply negative markets. A high degree of liquidity and market efficiency in all but the smallest frontier markets enable a variety of niche strategies and industry/region specialists. Equity long/short strategies are not characterized by typical leverage bands or net exposures; rather, they typically reflect the overall risk-on/risk-off market environment.

In FY2017, Equity Long/Short strategies will remain an underweight allocation in the Absolute Return Portfolio. New Equity Long/Short strategies will be considered against current allocations and will be substituted where appropriate.

Macro

There is a diverse array of macro sub-strategies which, for purposes of this discussion, are broken into systematic (often generically referred to as CTA) and discretionary strategies. In summary, systematic strategies are often negatively correlated to other hedge fund sub-strategies and often exhibit very low correlation to individual markets. Systematic sub-strategies typically provide a high level of diversification within a hedge fund portfolio and provide their highest value-add in extended downward trending markets wherein other strategies and sub-strategies typically suffer. Discretionary macro sub-strategies are often used to provide specific directionality or a specific hedge to macroeconomic events or misalignments. They can be used to provide diversification or directionality to a hedge fund portfolio. Both strategies typically use a higher degree of leverage through futures.

Macro strategies have been an underweight allocation for the Absolute Return Portfolio. For FY2017, expectations are for an increase to Macro strategies which will bring the Absolute Return Portfolio within its policy guidelines.

Opportunistic

Opportunistic strategies are likely to result from a market dislocation and can have a core strategy resembling any single strategy mentioned or may also be long-only in nature. Opportunistic strategies can be used as core or satellite exposures depending on the dislocation and opportunity set of the strategy. An opportunistic strategy is expected to provide an asymmetric risk/return that helps the portfolio achieve returns within the risk constraints of the portfolio.

In FY2017, new Opportunistic strategies will be considered individually.

V. SUMMARY

- The Absolute Return Portfolio has reached its steady-state allocation of 5% and will consider new allocations against current allocations as replacements where necessary.

- The Absolute Return Portfolio remains overweight Relative Value and is reducing its exposure Event Driven strategies. Expectations are for an increase to Global Macro. Overall, the Absolute Return Portfolio remains broadly diversified.

- The Directional Growth Portfolio will remain focused on Return Seeking exposures that complement Public Equity.

- Additional hedge fund opportunities will discussed with Fixed Income staff as need.

PUBLIC AGENDA ITEM - # 9*

9.* Review and Discussion of Asset Allocation Study

August 16, 2016

BACKGROUND:

The most important investment decision of the ERS Board of Trustees (Board) is determining the asset allocation, which is a key component of an investment policy. Section 2.2 of the ERS *Investment Policy* states that formal asset allocation studies will be conducted at least every five years, with annual reviews of the adopted asset allocation. The Board sets long-term asset allocation targets with acceptable ranges to prudently meet the needs of plan beneficiaries.

Formal asset allocation studies are conducted by the Board with the advice of the Investment Advisory Committee (IAC) and supported by ERS staff and ERS' pension plan consultant, Aon Hewitt Investment Corporation (AHIC). The most recent asset allocation study was completed and adopted as of February 26, 2013.

Asset Allocation and the ERS *Investment Policy*
The asset allocation is part of a comprehensive investment policy and the foundation for the investment strategy of the Trust. Pursuant to Tex. Gov't Code Section 815.301(e), the Board develops written investment objectives of the assets of the retirement system, otherwise referred to as the ERS *Investment Policy*. A comprehensive investment policy defines the Trust's primary investment goal, investment risk tolerance, investment objectives, investment governance structure and performance evaluation.

> ***Trust's Primary Investment Goal.*** The Trust's primary investment goal is to earn an appropriate risk-adjusted return, net of fees, that provides for the benefit payments due to or on behalf of ERS members, retirees and beneficiaries of the retirement plans.
>
> ***Investment Risk Tolerance***. This asset allocation study will survey the Board and IAC to determine their collective risk tolerance to identify both the ability and willingness to bear investment risk. Risk can be defined in multiple ways. From a trustee's vantage point, it can be summarized in terms of market risk, liquidity risk and active management risk, and all of which will be considered as part of the asset allocation study.
>
> ***Investment Objectives/Asset Mix.*** Investment objectives should be unambiguous and measureable, specified in advance, actionable and attainable, reflect the Board's risk tolerance and support the Trust's investment goal. In determining these investment objectives and the final asset mix, the asset allocation study will involve:
>
> - a current macro review of market and economic assumptions, including inflation
> - a review of the dynamic relationship between plan assets and liabilities
> - a review of different asset mixes to see the relative impact to the Trust under a range of different macro-economic scenarios
>
> ***Investment Governance and Performance Evaluation.*** The Board has prudently set up the governance and performance evaluation (as further detailed in Sections 3 and 4 of the ERS *Investment Policy*) with the implementation of prior asset allocation studies. Staff expects that this will be adapted as needed for the implementation of the results of the current asset allocation study.

** We are accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. This agenda item may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees.*

The Board asked ERS staff to develop a timeline to coordinate the asset allocation study with the pension experience study, both of which are scheduled for Board approval in February 2018. The asset allocation adopted by the Board impacts both the short term return expectations that guide investment decisions and the long term return assumption ERS' retirement actuaries can recommend during the pension experience study.

ERS' consulting actuary for retirement, Gabriel Roeder Smith (GRS), has indicated that the long term return assumption adopted by the Board during the pension experience study is one of the most important assumptions. By concurrently conducting these two studies, ERS staff and the actuaries can determine pertinent information to execute the process in the most time efficient way.

The timeline has been discussed during prior Board meetings and is detailed below.

Asset Allocation Study	Dates	Pension Experience Study
Orientation with staff and distribution of risk survey to Board and IAC	August - October 2016	
Presentation of risk survey results and steps in the asset allocation study	December 2016 Board Meeting	Actuary will provide inputs or data to AHIC as needed for asset allocation
Presentation on macro view of market and economic assumptions	February 2017 Board Meeting	
Conduct Asset Allocation Working Session #1 - General Discussion	May 2017 Board Meeting	
	June 2017	Evaluate 2017 legislative actions; begin primary work on experience study
Conduct Asset Allocation Working Session #2	August 2017	Background or preliminary results presentations as needed
Conduct Asset Allocation Working Session #3	December 2017 Board Meeting	
Present Asset Allocation and Investment Policy Changes for Board Adoption	February 2018	Present Experience Study and Funding Policy for Board Adoption

STAFF RECOMMENDATION:

This agenda item is provided for informational and discussion purposes only. No action is required.

** We are accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. This agenda item may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees.*

PUBLIC AGENDA ITEM - #10

10. Adjournment of the Investment Advisory Committee and
Recess of the Board of Trustees

May 17, 2016

Following a temporary recess, the Board of Trustees will reconvene to take up the remaining Board of Trustee agenda items.

PUBLIC AGENDA ITEM - # 11

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

August 16, 2016

BACKGROUND:
The minutes to the Employees Retirement System of Texas Board of Trustees meeting held on May 17, 2016 are included with this agenda item as Exhibit A. The minutes are submitted to the Board for review and approval.

PROPOSED MOTION:

Staff recommends the following motion to the Board of Trustees:

> I move that the Board of Trustees of the Employees Retirement System of Texas approve the minutes to the meeting held on May 17, 2016.

ATTACHMENT – 1

Exhibit A – Proposed Minutes to the Board of Trustees Meeting of May 17, 2016

Meeting of the Board of Trustees

May 17, 2016

ERS

EMPLOYEES RETIREMENT SYSTEM OF TEXAS

Presented for Review and Approval

August 16, 2016

Table of Contents

BOARD OF TRUSTEES MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

May 17, 2016
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701

TRUSTEES PRESENT
I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Ilesa Daniels, Member
Brian Ragland, Member

TRUSTEES NOT PRESENT
Cydney Donnell, Member *(Excused by the Board)*
Frederick E. Rowe, Jr., Member

IAC PRESENT
Ken Mindell, Member

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 Enterprise Planning Office
Robin Hardaway, Director of Customer Benefits
Robert Kukla, Director of Benefit Contracts
Machelle Pharr, Chief Financial Officer
DeeDee Sterns, Director of Human Resources
Gabrielle Stokes, Director Office of Procurement & Contract Oversight
Tom Tull, Chief Investments Officer
Nora Alvarado, Benefit Contracts
Michelle Barron, Benefit Contracts
Georgina Bouton, Benefit Contracts
Leena Chaphekar, Legal Services
Kyla Cloutier, Benefit Contracts
Ashley Collier, Legal Services
Anthony Curtiss, Investments
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits
D'Ann DeLeon, Benefit Contracts
Blaise Duran, Benefit Contracts
Peter Ehret, Investments
Mike Ewing, Governmental Affairs
Beth Gilbert, Internal Audit
Ginger Grissom, Procurement & Contract Oversight
Adrianne Henderson, Procurement & Contract Oversight
Megan Hunter, Benefit Contracts
Jennifer Jones, Governmental Affairs
Deborah Legg, Enterprise Planning Office
Sharmila Kassam, Investments
Michelle Moore, Procurement & Contract Oversight
Lauren Russell, Benefit Contracts

Randi Schultz, Procurement & Contract Oversight
Bernely Tharp, Benefit Contracts
Angelica Torres, Benefit Contracts
Keith Yawn, Enterprise Planning Office
Martha Zottarelli, Enterprise Planning Office

ALSO PRESENT
Steve Alexander, UnitedHealthcare
Nick Arnold, Humana
Amy Chamberlain, Texas Public Employees Association
Chris Cronn, UnitedHealthcare
David Dorman, Active Health Management
Katy Fallon, Legislative Budget Board
Lynn Gordon, Minnesota Life
Joseph Halbert, Senator Schwertner's Office
Kris Hefner, Caremark
Kirk Lavalle, Delta Dental Insurance Company
Tom Luchetta, Superior Vision
Brittany McCollum, Caremark
Emily Morganti, Legislative Budget Board
Toni Parsley, Texas Commission on Environmental Quality
Laura Pinkard, Humana
Tom Quirk, United Healthcare
Dawn Richards, Eye Med
John Thompson, UnitedHealthcare
Amy Vandervost, OptumRx
Tim Wicks, OptumRx
Bobby Wilkinson, Office of the Governor

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 9:03 a.m. on Thursday, May 5, 2016 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 these following Board agenda items. The minutes to the May 17, 2016 Audit Committee Meeting are located under the Audit Committee agenda minutes.

XII. Review and Approval of the minutes to the February 23, 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 February 23, 2016.

> **MOTION** made by Ms. Ilesa Daniels, seconded by Mr. Brian Ragland 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 February 23, 2016.

XIII. Review, Discussion and Consideration of the Rules of the Board of Trustees, Texas Administrative Code, Title 34, Part IV, Required Rule Reviews and Amendments to:

a. Chapter 71 (Creditable Service) – Rule 71.31

Robin Hardaway, Director of Customer Benefits, reviewed the history of service credit purchase since 2003. From 2003 to 2015, new employees were required to wait 90 day before they started contributing to their retirement account with ERS. Effective September 1, 2015, new employees became contributing members of ERS immediately upon employment. Rule 71.31 governs the purchase of the 90-day waiting period and currently only allows contributing members of ERS to purchase the service credit for this 90 day waiting period. The proposed amendment removes the requirement that a person must be a contributing member to purchase waiting period service. Ms. Hardaway and the Board discussed the neutral actuarial cost to the plan. Notice of proposed amendment published April 1, 2016 with the Texas Register, and ERS did not receive any comments.

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

MOTION made by Mr. Doug Danzeiser, seconded by Mr. Brian Ragland and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas adopt the proposed amendments to Chapter 71, Creditable Service, §71.31 concerning the Credit Purchase Option for Certain Waiting Period Service as presented in Exhibit A to this Agenda Item.

b. Chapter 85 (Flexible Benefits) – Rule Amendments to §§85.1, 85.3, and 85.5

Robert Kukla, Director of Benefit Contracts and Georgina Bouton, Assistant Director of Benefit Contracts proposed amendments to the Chapter 85 dealing with flexible benefits. The proposed amendment would expand the voluntary benefits available to active employees under the State of Texas Flexible Benefit Program, TexFlex^{SM}. TexFlex is a flexible spending account (FSA) funded with pre-tax salary contributions that are used to reimburse participants for eligible health and day care out-of-pocket expenses. ERS expanded these voluntary benefits to include a Qualified Transportation Benefits Plan to pay for eligible expenses associated with employee's daily commute and parking fees.

In response to Texas HB966, ERS will be instituting a new voluntary consumer directed health plan. Starting September 1, 2016, the Consumer Directed HealthSelect^{SM} plan will include a High Deductible Health Plan (HDHP) and a Health Savings Account (HSA) benefit option. If members participate in this plan, the Internal Revenue Code precludes participation in a general-purpose health care flexible spending account (FSA). Using pretax contributions, members are able to participate in a Limited Flexible Spending Account (LFSA) to be limited in reimbursement to eligible dental/orthodontia and vision expenses. Three amendments to Chapter 85 are proposed:

- §85.1 (Introduction and Definition) defines the general healthcare flexible spending account and the limited purpose flexible spending account
- §85.3 (Eligibility and Participation) allows participants in the CDHP to also participate in the LFSA in compliance with the Internal Revenue Code. If a participant enrolls in the CDHP, a carryover provision will allow any monetary balance (up to $500) remaining in their general healthcare FSA at the end of the plan year to move to an LFSA.
- §85.5 (Benefits) – clarifies only qualifying dental and vision expenses be reimbursed through the LFSA.

Mr. Kukla, Ms. Bouton and the Board discussed amendments, timing of FSA transfers to LFSA accounts and communicating the new programs including Consumer Directed HealthSelect^{SM}.

Notice of these proposed amendments published April 1, 2016 in the Texas Register and ERS did not receive any comments.

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

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 take the following actions with regard to the Rules of the Board of Trustees, promulgated in 34 Texas Administrative Code, Part IV, as set forth in Exhibit A, which is attached to and incorporated by reference into this Agenda Item:

• Adopt the proposed amendments to Chapter 85, concerning Introduction and Definitions; Eligibility and Participation; and Benefits, as reflected in Exhibit A and this agenda item.

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

a. Selection of the Pharmacy Benefit Managers for the HealthSelect℠ of Texas Prescription Drug Plan and the HealthSelect℠ of Texas Medicare Pharmacy Plan beginning January 1, 2017 -

Mr. Kukla, Director of Benefit Contracts, described the request for proposal (RFP) to select a new pharmacy benefit manager. Under the Texas Employee Group Benefits Program (GBP), ERS provides Texas state employees and retirees with prescription drug benefits through services provided by pharmacy benefit managers (PBM). The current contract for pharmacy benefit under HealthSelect Medicare Rx℠ expires December 31, 2016 and the pharmacy benefit for HealthSelect of Texas expires on August 31, 2017. However, because deductibles are based on calendar year, ERS will start both new contracts on January 1, 2017. The RFP, issued in December 2015, resulted in four vendors submitting a proposal for both the HealthSelect of Texas and HealthSelect Medicare Rx PDP services.

Mr. Kukla discussed the evaluation process and its phases. During Phase One, all proposals were evaluated to ensure they were compliant and met the minimum requirements. Mr. Kukla detailed the minimum requirements. All eight proposals were compliant and met the minimum requirements and passed Phase One. Mr. Kukla explained the elements of Phase Two. Phase Two included an evaluation of Financial Considerations and Price Proposals, which accounted for 50% of the overall score, and Operational Capabilities and Services, which accounted for 40% of the overall score. ERS staff in conjunction with Rudd and Wisdom analyzed the proposals' Financial Considerations and Price Proposals, which included a review of each vendor's administrative fee, retail, mail service, and specialty prescription reimbursements, rebates and subsidies and the impact of the vendor's formulary. The Operational Capabilities and Services included a review of legal requirements, plan design, communication requirements, operational specifications, information system requirements, financial specification and requirements, and the administrative benefit of offering proposals for both services. Based on this review, ERS selected three finalists for each service. During Phase Three, the finalists participated in face-to-face interviews and site visits, and offered best and final offers. ERS conducted reference checks. The face-to-face interviews, site visits, and reference checks accounted for 10% of the overall score. Contractibility was reviewed on a pass/fail basis. Ms. Gabriella Stokes, Director of Office of Procurement and Contract Oversight (OPCO), reviewed the development of the RFP and the evaluation process, and was able to sign off on best value. Mr. Kukla advised the Board that OPCO and Benefit Contracts worked to ensure adherence to SAO guidelines. The Contract Advisory Team and the Texas Attorney General's office reviewed the RFP and proposed contracts.

Total projected net costs were based on calculations by Rudd & Wisdom using a common set of assumptions for utilization and prescription price increases over the six years of the contract. Rudd & Wisdom, Mr. Kukla and Mr. Blaise Duran, Manager of Underwriting, Data Analysis and Reporting, analyzed costs. Mr. Philip S. Dial, Rudd and Wisdom, Inc. actuary, reviewed the analysis and explained price assumptions based on enrollment, prescription drug utilization, and average wholesale drug costs.

Using a common set of assumptions for utilization and prescription price increases over the contract's six-year term, the total net cost was significantly different. The total net costs represent 50% of the evaluation criteria. UnitedHealthcare (UHC)/Optum's discounts, rebate guarantees, inflation protection and administration fees produced an estimated program cost substantially less than the other bidders. All bidders demonstrated skills in the administration of the drug program which represented 40% of the evaluation. Staff recommended the contract award for the Pharmacy Benefit Manager for the both plans be awarded to UHC and Optum. Mr. Kukla noted that changes such as new ID cards would be required. Mr. Duran noted that the pharmacy access networks are similar and disruption would be minimal. The vast majority of drugs that are in the plans' formulary were represented in every therapeutic class. The Board asked questions and a discussion ensued concerning total net contract costs and potential savings to the plan. Mr. Kukla, Mr. Duran and Mr. Dial also provided explanations concerning pricing trends for drug costs, inflation protection guarantees, and enrollee disruption and transition protection. The Board commented on the success of the new contract process and congratulated ERS staff on a job well done.

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

MOTION made by Mr. Doug Danzeiser, 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 ERS in response to the Request for Proposal, the evaluation process and results presented to the Board at this meeting, we have received sufficient information to determine the best value to the Retirement System for the selection of Pharmacy Benefit Managers for the HealthSelect^{SM} of Texas Prescription Drug Plan and the HealthSelect Medicare Rx^{SM} Plan. Therefore, I move that the Board of Trustees of ERS approve:

1) The selection of UnitedHealthcare to act as the pharmacy benefit manager for the HealthSelect^{SM} of Texas prescription drug plan (HealthSelect PDP).
2) And I move to approve UnitedHealthcare as the pharmacy benefit manager for the HealthSelect Medicare Rx^{SM} pharmacy plan (Medicare Rx PDP) under a contract which will cover an initial six-year term beginning January 1, 2017 through December 31, 2022.
3) I further move that the Board of Trustees of ERS authorize the Executive Director to negotiate and execute a contract with UnitedHealthcare with terms that are fully acceptable to ERS and to authorize the Executive Director to administer the contract agreed to by the parties.

In the event that a contract fully satisfactory to ERS is not timely executed with UnitedHealthcare or if it appears to the Executive Director during the term of the contract that UnitedHealthcare will not be capable of performing the required HealthSelect PDP or Medicare Rx PDP/PBM services to ERS's satisfaction, then the Board authorizes the Executive Director to resume the due diligence process and contract negotiations with the next top-ranked qualified respondent and to negotiate and execute contract terms with the next top rate -- top-ranked qualified respondent that are fully acceptable to ERS and to authorize the Executive Director to thereafter administer the contract agreed to by the parties.

b. Selection and Contract Award Recommendation for Vision Care Services Administration beginning September 1, 2016 –

Mr. Kukla reviewed background and the current basic vision care benefit offered under the GBP, explaining that a majority of surveyed state employees expressed a strong interest in the addition of a vision care plan. Beginning September1, 2016, a group vision care plan will be an optional benefit for members (employees, retirees, and eligible dependents). The plan called State of Texas Vision is fully funded by employee contributions. A Vision Care RFP was issued in December of 2015 and received proposals from four vendors.

Mr. Kukla discussed the evaluation process and its phases. During Phase One, all proposals were evaluated to ensure they were compliant and met the minimum requirements. Mr. Kukla detailed the minimum requirements. All four proposals were compliant and met the minimum requirements and passed Phase One. Mr. Kukla explained the elements of Phase Two. Phase Two included an evaluation of Financial Considerations and Price Proposals, which accounted for 40% of the overall score, and Operational Capabilities and Services, which accounted for 50% of the overall score. ERS staff in conjunction with Rudd and Wisdom analyzed the proposals' Financial Considerations and Price Proposals, which included a review of the each vendor's administrative fee and network reimbursement rates, and its claims funding and payment methodology. The Operational Capabilities and Services incuded a review of legal requirements, plan provisions and eligibility, provider network requirements, communication requirements, operational specifications, and information system requirements. Based on this review, ERS selected three finalists. During Phase Three, the finalists participated in face-to-face interviews and site visits, and offered best and final offers. ERS conducted reference checks. The face-to-face interviews, site visits, and reference checks accounted for 10% of the overall score. Contractibility was reviewed on a pass/fail basis. Gabriella Stokes, Director of Office of Procurement and Contract Oversight (OPCO), reviewed the development of the RFP and the evaluation process, and was able to sign off on best value.

Based on the review, Superior Vision had the most comprehensive network (and the strongest network in rural Texas). Superior's costs were essentially equal to or better than other bidders. Based on the evaluation, staff's recommendation is the Group Vision Care Services Administrator contract be awarded to Superior Vision.

The Board and staff discussed estimated participation, network adequacy, the value of the contract and coverage. The Board thanked the staff for listening to the membership and adding this benefit.

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

MOTION (14b 1) made by Mr. Brian Ragland, seconded by Ms. Ilesa Daniels and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas that

Based on the information provided to ERS in response to the Request for Proposal, the evaluation process and results presented to the Board at this meeting, we have received sufficient information to determine the best value to the retirement system for the selection of a third party administrator for the self-funded group vision care plan. Therefore, I move that the Board of Trustees of the Employees Retirement System of Texas approve the selection of Superior Vision to provide administrative services for the self-funded group vision care plan under the Texas Employees Group Benefits Program under a contract that will cover an initial four year term beginning September 1, 2016 through August 31, 2020.

I further move that the Board of Trustees of the Employees Retirement System of Texas authorize the Executive Director to negotiate and execute a contract with Superior Vision with terms that are fully acceptable to ERS, and to authorize the Executive Director to thereafter administer the contract agreed to by the parties. In the event that a contract fully satisfactory to ERS is not timely executed with Superior Vision or if it appears to the Executive Director during the term of the contract that Superior Vision will not be capable of performing the required group vision care administrative services to ERS' satisfaction, then the Board authorizes the Executive Director to resume the due diligence process and contract negotiations with the next top-ranked qualified respondent, and to negotiate and execute contract terms with the next top-ranked qualified respondent that are fully acceptable to ERS, and to authorize the Executive Director to thereafter administer the contract agreed to by the parties.

Following the selection of the Administrator for the Group Vision Care Services, Mr. Kukla discussed rates. Based on the RFP evaluation information and enrollment and utilization estimates, Mr. Kukla then proposed rates for the Vision Care Services Administration to be effective September 1, 2016. The proposed rates should be adequate to support the plan. Mr. Dial noted there is some uncertainty and variation with a new plan. Provisions for additional utilization early in the contract term as well as margins for adverse results and administrative expense have been taken into consideration. The Board and staff discussed vision care coverage, copays and use of flexible spending accounts.

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

MOTION (14b 2) made by Mr. Doug Danzeiser, seconded by Mr. Brian Ragland and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas approve the proposed Group Vision Care Services member contribution rates for Fiscal Year 2017 as presented to the Board effective September 1, 2016.

Based on the recommendation and analysis provided by ERS' consulting actuary for insurance, Rudd and Wisdom, Staff recommends the following motion to the Board of Trustees in connection with the new self-funded group vision care plan and contract award:

I move that the Board of Trustees of the Employees Retirement System of Texas approve the proposed Group Vision Care Services member contribution rates for Fiscal Year 2017 as presented to the Board effective September 1, 2016.

XV. Review and Discussion and Consideration of the Texas Employees Group Benefits Program for Fiscal Year 2017:

a. Basic and Optional Term Life, Accidental Death and Dismemberment Proposed Rates

The Group Benefit Plan Life and Accidental Death and Dismemberment (AD&D) insurance rates are set by the Board. Employee and retiree basic term life and AD&D benefits are paid for by the State of Texas through the biennial insurance appropriation. The basic life insurance for active employees ($5,000) and retirees ($2500) is funded by the State and all state employees participate. Additional Optional Life and AD&D insurance are funded through member contributions. The last rate increase was in 2012. Administrative costs are low and the financial experience reflects the adequacy of the current rates. Program is running well and staff recommends no increase in the current rates.

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

MOTION (15a) made by Ms. Ilesa Daniels, seconded by Mr. Doug Danzeiser 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 proposed Fiscal Year 2017 member contribution rates for the Basic Life, Optional Life, and Accidental Death and Dismemberment plans as presented in this agenda item effective September 1, 2016.

b. Texas Income Protection Plan Proposed Rates –

Under the Texas Employees Group Benefits Program (GBP), the Employees Retirement System of Texas (ERS) provides short and long-term disability coverage through the Texas Income Protection Plan℠ (TIPP). The disability coverages available within TIPP are available to active employees as an optional benefit and offered under a self-funded arrangement.

ERS does not receive appropriated funds from the State of Texas for the costs associated with the administration of the TIPP benefit. Disability benefits are funded by contributions from participating employees. Contribution rates are set annually by the ERS Board of Trustees. The GBP retains the risk for the self-funded plans. Approximately 52% of eligible GBP employees were enrolled in short-term disability coverage and 40% were enrolled in long-term disability coverage as of March 31, 2016.

Member contribution rates for the disability plans were developed based on a reasonable expectation of future claims, anticipated claim patterns, expected investment income and the administrative fees associated with TIPP benefit administration. Overall, member enrollment in the TIPP benefit has been relatively stable year over year. Based on staff analysis, current member contribution rates are adequate to provide for short and long-term disability coverage costs for FY 2017.

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

MOTION (15b) 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:

I move that the Board of Trustees of the Employees Retirement System of Texas approve the proposed Fiscal Year 2017 member contribution rates for the Texas Income Protection Plan Proposed Rates as presented in this agenda item and effective September 1, 2016.

c. State of Texas Dental Discount Plan, Dental Choice and Dental Health Maintenance Organization Proposed Rates –

Mr. Kukla reviewed the Dental Care Plans. The State of Texas Dental Choice Plan^{SM} (Dental Choice) is a self-funded PPO plan with HumanaDental Insurance Company serving as the Third Party Administrator.

The Dental Health Maintenance Organization (DHMO) plan is a fully-insured DHMO plan with DentiCare, Inc., a wholly owned subsidiary of Humana, Inc. underwriting the DHMO plan. The State of Texas Dental Discount Plan^{SM} is a non-insurance discount plan administered by Careington International.

The Dental Choice plan continues to increase enrollment year to year. Plan design changes exceeded the cost expectations. Even with a rate increase in FY2016, the plan is projected to lose funds again this year. Based on the actuarial analysis, the current member contribution rates require a 9.6% increase for FY2017 in order to be financially sound. The Board and staff discussed a rate increase or reduction in benefits to sustain the plan. Enrollment numbers reflect the popularity of this plan and a rate increase of 9.6% without a reduction in benefits is proposed.

The DHMO has stable enrollment. Staff negotiated a reduction in DHMO rates from September 2015 through August 31, 2018. Premiums are paid in full by member contributions. Member contribution rates for FY17 should be set equal to the contractual premium rates. No rate change is recommended.

The State of Texas Dental Discount Plan is not an insurance program. Participating dentists contract with Careington and agree to accept a discounted rate for payment-in-full. Administrative fees are paid entirely by participants. Rate is dependent on the number of participants enrolled. Enrollment has been lower than expected but rates remain the same.

The Board and staff discussed enrollment numbers, rate increases and changes in benefits communications.

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

MOTION (15c) 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:

I move that the Board of Trustees of the Employees Retirement System of Texas approve the proposed member contribution rates for Fiscal Year 2017 for the State of Texas Dental Choice^{SM} plan, the Dental Health Maintenance Organization plan, and the dental discount program as presented in this agenda item effective September 1, 2016.

d. Health Maintenance Organizations Proposed Rates –

Mr. Kukla explained that the Texas Employees Group Benefits Program (GBP) offers health maintenance organizations (HMOs) as a comprehensive medical and prescription drug benefit options in certain Texas counties. There are no out of network benefits. The benefits provided by GBP-participating HMOs are funded by the contributions paid by the enrolled members and by the State of Texas through the biennial legislative appropriation and are based on contribution rates adopted by the Employees Retirement System of Texas (ERS) Board of Trustees (Board). The State pays 100% of the contribution rate for eligible employees and retirees and 50% of the contribution rate for dependent coverage.

There are currently three HMOs:

- **Community First Health Plans, Inc.** provides services in an eight county service area of the San Antonio Region
- **Scott and White Health Plan** provides services in a 45 county service area of Austin, San Angelo, Temple and Waco regions
- **KelseyCare powered by CHC** provides services in a five county service area in the Houston region.

Mr. Duran and Mr. Dial reviewed the financial evaluation for the HMOs rate determination. Mr. Kukla then reviewed the proposed rates for all three HMOs. The Board and staff discussed questions about theoretical cost index and the rate analysis. There being no further questions or discussion, the Board took the following action:

MOTION (15d) made by Mr. Doug Danzeiser, seconded by Mr. Brian Ragland and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas:

The following motion to the Board of Trustees is for the Health Maintenance Organzations (HMOs) and applicable rates to be available under the Texas Employees Group Benefits Program (GBP) for fiscal year 2017. I move that the Board of Trustees of the Employees Retirement System of Texas approve the extension of the incumbent HMO Carrier plans at the the applicable contribution rates as presented in this agenda item be made available for participation in the Texas Employees Group Benefits Program in Fiscal Year 2017 beginning September 1, 2016 and ending August 31, 2017:

- **Community First Health Plans, Inc.** to provide services in the application area of San Antonio which includes the counties indicated in Exhibit A-1 of this agenda item.
- **Scott and White Health Plan** to provide services in the application areas of Austin, San Angelo, Temple and Waco which include the counties indicated in Exhibit A-2 of this agenda item.
- **KelseyCare powered by CHC** to provide services in the application areas of Houston which include the counties indicated in Exhibit A-3 of this agenda item.

e. GBP Financial Status Update and Rate Proposals for HealthSelect of Texas℠ and Consumer Directed HealthSelect –

Mr. Kukla reviewed the background of HealthSelect of Texas which is funded by member and state contributions. The State pays 100% of full-time employee/retiree contributions (50% of dependent coverage contribution). The State pays 50% of the part-time employee/retiree contributions (25% dependent coverage contribution). Members share costs through copayments, deductibles and coinsurance. About 83% of GBP members are enrolled in HealthSelect of Texas. Total membership is 435,000+.

He discussed the effects of the Affordable Care Act on HealthSelect of Texas benefits and fees. ERS has success with Patient-Centered Medical Homes. Mr. Duran updated the Board on the HealthSelect of Texas cost reduction strategies.

Mr. Kukla recapped the plan design for Consumer Directed HealthSelect previously reviewed and approved by the Board. HealthSelect of Texas contribution Rate Analysis for FY 2017 included factors such as the revenue requirements, state funding, historical enrollment, ACA cost increases, contingency fund balance, cost containment practices, claims experience, the impact of HMOs and the funding of basic life and AD&D coverage. The medical benefit cost trend continues at a rate of 6.5% through FY16 and the prescription drug trend is projected to be 16%, giving a total health plan benefit cost trend of 9%. Benefits will stay at the same level.

ERS staff recommends a 7.1% increase in HealthSelect of Texas contribution rates. Member contributions for Consumer Directed HealthSelect dependents are 90% of the cost of HealthSelect of Texas dependents to ensure revenue neutrality. Mr. Dial explained the rate increase combined with increased subsidies and rebates under the pharmacy program will have a positive effect on the program costs.

The Board and staff discussed the necessity of the rate increase and future cost trend projections. Drug cost and utilization increases are driving rising costs. Mr. Kukla reviewed the proposed contribution rates for Consumer Directed HealthSelect for FY 2017, noting it is revenue neutral.

The Board and staff deliberated a number of issues such as the contingency reserve fund amount, the PBM contract, rate increase effects and future funding challenges. There being no further questions or discussion, the Board took the following action:

MOTION (15e) made by Mr. Brian Ragland, 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 proposed HealthSelect of Texas[SM] and Consumer Directed HealthSelect contribution rates for Fiscal Year 2017 as presented in this agenda item be effective September 1, 2016.

f. TexFlex Program Proposed Fees and Rates –

Mr. Kukla reviewed the TexFlex[SM] program for health care and dependent care reimbursement plans. ERS enacted an administrative fee holiday and the new vendor provides TexFlex branded debit card at no additional charge. Premium conversion generated approximately $40 million in FICA tax savings in FY 2015. Plan forfeitures, while declining, continue to fund the plan fees. The TexFlex program also includes the commuter spending accounts, whose participants pay a $3.00 monthly administrative fee. ERS maintains a balance of funds more than adequate to cover the administrative costs and staff recommends the Board approve an administrative fee holiday for FY2017 for the health care and dependent care reimbursement plans.

The Board and staff discussed the forfeiture balance and projected funding. There being no further questions or discussion, the Board took the following action:

MOTION (15f) made by Ms. Ilesa Daniels, seconded by Mr. Doug Danzeiser and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas.

Staff recommends the Board approve an administrative fee holiday for TexFlex participants for FY 2017.

I move that the Board of Trustees of the Employees Retirement System of Texas approve an administrative fee holiday for the TexFlex program for Fiscal Year 2017 for the Flexible Spending Health Care Reimbursement and Dependent Care Reimbursement plans.

I further move that the Board of Trustees approve the proposed rates for Fiscal Year 2017 for the Commuter Spending Account as presented in this agenda item effective September 1, 2016.

XVI. Review, Discussion and Selection of Contract Award Recommendation for Actuarial Services for Insurance:

Bernie Hajovsky, Director of the Enterprise Planning Office, and Gabriella Stokes, Director of the Office of Procurement and Contract Oversight presented the background and the Request for Proposal (RFP) evaluation process for actuarial services for the GBP. ERS contracts with a qualified actuarial firm for services related to the GBP pursuant to §1551.210, Texas Insurance Code. The actuaries assist ERS in the administration of the GBP with experience reporting and studies; trend, claims, reserves and financial analyses; and GASB and valuation reporting. The current benefits actuarial contract expires August 31, 2016. ERS published the RFP for actuarial services for the GBP in January 2016. ERS received two proposals.

Mr. Hajovksy and Ms. Stokes explained the evaluation process. First, both proposals were evaluated to ensure compliance with the RFP and that minimum requirements were met. Both proposals passed this preliminary review. Both proposals were then evaluated based on price proposal and financial considerations (40% of the overall score) and then on qualifications and experience (50% of the overall score). Contractibility and legal disclosures were evaluated on a pass/fail basis. On the basis of this evaluation, both vendors became finalists. During the finalists evaluation, the vendors participated in a face-to-face interview and ERS checked references. ERS determined site visits were unnecessary. The face-to-face and references accounted for 10% of the overall score. Both vendors submitted a best and final offer. Based on the comprehensive analysis performed by the evaluation team, the Director of Procurement and Contract Oversight was able to sign off on the solicitation process and the recommended vendor for best value. Staff recommends the contract award go to Rudd & Wisdom, Inc. to provide actuarial services for insurance for the six-year term beginning September 1, 2016. The Board and staff discussed the selection of Rudd & Wisdom, Inc. Rudd & Wisdom, Inc. demonstratedimpressive qualifications and experience with similar organizations. Also, Rudd & Wisdom's proposed staff is overall more qualified for this type of service than the proposed staff of the other vendor. Furthermore, Rudd & Wisdom offered more favorable pricing compared to that of the other vendor.

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

MOTION made by Mr. Doug Danzeiser, 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 ERS in response to the Request for Proposal, the evaluation process and the results presented to the Board at this meeting, I move that the Board of Trustees approve the selection of Rudd & Wisdom, Inc. to provide actuarial services for insurance under the GBP pursuant to terms and conditions in the governing contract.

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

DeeDee Sterns, Director of Human Resources, presented the annual review of the Incentive Compensation Plan (ICP). No action is required and plan revisions will be reviewed and recommended for approval at the August Board of Trustees meeting. The ICP was last revised and approved in August 2015. The ICP communicates strategic performance priorities established by the Board. Proposed plan revisions are:

- Reconsideration of Qualitative Metric
- Modify eligibility dates for new hires
- Various plan process improvements

Prior to 2015, a qualitative measurement was used only when a quantitative measurement could not be established. In 2015, a 25% qualitative performance measure was added for all the eligible ICP participants. The Investments Division requested the removal of the qualitative performance measure from all investment professionals' goals because of the subjective nature and administrative challenges. Modification of the eligibility date for participation in the ICP would make the ICP eligibility requirements consistent with existing ERS policies. Additional language has been proposed to reaffirm and increase Human Resources oversight and management of the ICP as well as other plan process improvements, segregation of duties and calculations, and the salary basis for the ICP calculation. Mr. Porter Wilson, Executive Director, asked the Board to consider these proposals for action at the August meeting. The Board and staff discussed revision impacts and the current ERS performance evaluation and how it correlates with the ICP.

This agenda item is provided for informational and discussion purposes only. No action is required.

XVIII. Review and Discussion of Sunset Commission Report Findings

Keith Yawn, Office of Management Support, serves as the ERS liaison to the Sunset Commission and presented an overview of the Sunset Commission's review process and a summary of the Report's findings and recommendations. The Sunset review is a statutorily required legislative evaluation process. As a constitutional entity, ERS is not reviewed regularly and has not undergone a review since 1992. Given the changes in Agency structure and benefit offerings during this period, the review was well-timed to provide an independent perspective on the Agency's operations and identify improvements in how ERS serves the state workforce. The Sunset Review Team worked closely with ERS staff to understand not only what we do, but also gain an understanding of the complexity of public benefits administration.

The Sunset Review process started with an ERS generated Self-Evaluation Report, published September 2015. The next step was a General Agency Review from October through December, 2015. Sunset Commission staff conducted a detailed review of targeted programs and operations on site from January to March 2016 and issued a Staff Report in April 2016.

The Sunset Staff Report identified findings in five issue areas and made proposed recommendations for both statutory changes and management directives. Recommendations are:

- ERS needs to make additional improvements to ensure its contracts adhere to best practices and provide best value to the state.
- ERS does not strategically manage the group benefits program to ensure its effectiveness and plan for the future.
- ERS' benefit decision process lacks balanced treatment of, and full information for, members.
- ERS does not adequately track or report all costs associated with alternative investments.
- ERS' statute does not reflect standard elements of Sunset Reviews, commonly referred to as Across the Board (ATBs) recommendations.

ERS continues to improve contracting operations at ERS. To implement new statewide contracting requirements, the agency created a dedicated contracts division to manage contract consistency and quality. Sunset recommended the ERS Board of Trustees establish a new health insurance advisory committee to solicit stakeholder input on benefit design decisions, evaluate benefit changes, and enhance reporting of GBP operations and outcomes.

Communication related Sunset recommendations primarily focused on member communications and interactions related to the appeals and grievance review processes and several special benefit applications, such as disabled dependents and Chapter 615 Survivor Benefits. Member education and communication is a core focus at ERS. Staff works continuously to improve and enhance website and print communications. All Agency divisions directly serving member populations work cooperatively to achieve this goal. ERS staff agrees with the report's finding that member communications and education efforts can continue to be improved. The Agency is committed to implementing changes that increase member awareness and knowledge of benefit programs, especially within the areas, processes, and member populations identified in the report.

The recommendations dealing with investment operations recommend a statutory change to enhance reporting of profit sharing fees related to alternative investments. Staff continues to research industry standards and best practices for profit sharing results reporting and will improve reporting to ensure these reports are readily available to the public and transparent.

As a standard part of most Sunset reports, statutory changes called ATBs are recommended to standardize government operations and structures across state agencies. For ERS these recommendations relate to Board member training requirements and rulemaking process. Working collaboratively with Sunset Staff and legislative offices, ERS staff will ensure the recommendations are implemented appropriately to achieve their desired effect. ERS has not estimated the cost of fully implementing the Report's recommendations, but some of the recommendations may require budgetary increases.

The Sunset Commission will begin public hearings in June to seek input from all interested stakeholders. While ERS is already working to address some of the Report's findings, we expect to begin implementation of the remaining management directives as soon as they are approved later this year. Recommendations requiring statutory changes will be reviewed and implemented beginning in June 2017 following the legislative session.

This agenda item is provided for informational and discussion purposes only. No action is required.

XIX. Review and Discussion of Board Policy on Pension Funding Priorities and Guidelines

Ms. Jennifer Jones presented research on pension funding policies and a draft policy document for board discussion. The agenda item was informational in nature and not an action item.

Ms. Jones guided the board through the draft policy and highlighted key policy decisions included in the policy. Key policy components that staff addressed in the draft document included:

- **Actuarial cost method**: Allocates the total present value of benefits (TPV) between past service (actuarial accrued liability) and future service (normal cost). The current method, in place since 2009, is a variation of the ultimate entry age normal cost method, which reflects the normal cost of a new hire. There were no recommended changes to this method;

- **Asset smoothing**: The technique used to recognize pension assets gains and losses over time - to reduce the effects of market volatility and stabilize year-to-year contributions. Currently, ERS uses a method that recognizes 20% of gains/losses over time. Ms. Jones mentioned that while staff would not recommend a change at this time, a methodology change might be recommended as part of the experience study in 2017. In particular, ERS struggles with a misconception that all asset losses are recognized within a five-year period, which is incorrect. So the ERS consulting actuary may recommend a change to the smoothing during the experience that is easier to communicate;

- **Amortization period**: The length of time and the structure selected to increase or decrease contributions to systematically eliminate any unfunded actuarial accrued liability or surplus. Staff presented two options, but discussed others that would ultimately result in a 20-year rolling amortization and

- **Benefit enhancements**: A policy on how and when to incorporate benefit enhancements. Ms. Jones noted that ERS is not designed to have regular benefit enhancements. Staff recommended that plans have achieved a funding period of 20 years and a funded ratio of 90% before any benefit enhancements are granted.

Mr. Danzeiser and Mr. Ragland asked several clarifying questions about how these components work and the limitations for an ERS funding policy given that the Legislature sets both the contribution rates and benefit design.

After discussion, the board members directed staff to revise the draft policy for possible adoption at the August 2016 board meeting. This agenda item is provided for informational and discussion purposes only. No action is required.

XX. Executive Director Agency Update:

Mr. Porter Wilson, Executive Director proceeded with the next agenda item, Executive Director Agency Update. His report[1] to the Board is included with these minutes.

This agenda item is provided for informational and discussion purposes only. No action is required.

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

The dates for the 2016 meetings of the ERS Board of Trustees and Investment Advisory Committee, the Meeting of the Board of Trustees and the Meeting of the Audit Committee are as follow:

Tuesday, February 23, 2016
Tuesday, May 17, 2016
Tuesday, August 16, 2016

2 Day Workshop:
Thursday – Friday, December 1 & 2, 2016

XXII. Adjournment of the Board of Trustees:

The May 17, 2016 Meeting of the Board of Trustees adjourned at 4:22 p.m.

[1] Executive Director Agency Update Report

PUBLIC AGENDA ITEM - # 20

20. Executive Director Agency Update

May 17, 2016

Legislative Updates

The agency has been busy performing research, preparing presentations, and testifying before House and Senate interim committees. On March 30, ERS testified to the House Insurance Committee on the subject of acquired brain injuries, to the Senate Finance Committee on state debt and to the House Pensions Committee with a general overview. The following week, ERS appeared before the House Public Health Committee. We provided information on chronic health conditions, their cost to the state, and ideas on how to reduce that cost.

On April 13, ERS had two committee hearings on the same morning. We returned to the House Pensions Committee to discuss global investments. The Senate State Affairs committee also conducted its general oversight hearing that morning. Finally, on April 20, ERS testified before the House Appropriations Committee on the great work done by the legislature last session to increase contributions and put the trust fund on a path to actuarial soundness.

Thanks to Tom Tull and Rob Kukla for attending hearings and providing testimony. Also our thanks to Machelle Pharr, Shar Kassam and the staff of the Governmental Affairs division for doing prep work, research and preparing all of our presentations, with help from Benefits Communications.

At the invitation of the Lt. Governor and Senator Nelson, the Executive Director, CFO and Board Member Brian Ragland attended a presentation on zero-based budgeting. In Senator Nelson's address to the audience, she stated that select agencies would be asked to provide additional detail on specific programs so that a more in-depth review could be conducted. Senator Nelson introduced Teresa MacCarthy to present how Zero-Based Budgeting works in Georgia. Ms. MacCarthy is the Director of the Governor's Office of Budget and Planning in Georgia. Ms. MacCarthy discussed how Zero-Based Budgeting is integrated with other forms of budgeting in Georgia and how it might be utilized in Texas. Senator Nelson advised the audience to eliminate the assumption that current funding level is the starting point for the next biennial budget.

ERS' Office of Procurement and Contract Oversight

On April 1, ERS created a new division the Office of Procurement and Contract Oversight to assist the entire agency with procuring and managing contracts. Gabrielle Stokes, the Director of Procurement is directing the new team which combines staff from the legal and benefit contracts divisions. The Division has two managers: Carol Stueler, Contract and Procurement Manager, and Ginger Grissom, Proposal Activity Manager.

The new Division will work closely with the appropriate business division to develop solicitation documents and oversee all steps of the procurement and contract management processes. The business units will continue to make business decisions related to their procurements and contracts, with oversight and guidance from Procurement and Oversight. The new division is busy drafting consistent agency policies and procedures, ensuring compliance with Senate Bill 20 provisions and issuing a number of RFPs, including one of our biggest procurements – a third party administrator for HealthSelect.

This division will report to Paula Jones, who will continue to oversee legal services, in addition to these new responsibilities. Her title will be Deputy Executive Director and General Counsel.

DeeDee Sterns – Named Director of Human Resources

DeeDee has worked at ERS for 21 years. Except for a short stint as Technical Training Coordinator in Customer Benefits, she has devoted her career to Human Resources. She has earned important human resource professional certifications, including the Senior Professional in Human Resources (SPHR®) certification. In June 2013, as part of succession planning, she attended leadership training and shadowed Ralph Salinas until his retirement last December. For the last few months she has served as the Acting Director of Human Resources.

DeeDee brings a wealth of institutional knowledge to this position, along with analytical and collaborative skills. Her goals include working with each division to help them attract and grow staff, and to identify and develop new strategies to make ERS an even better place to work.

Machelle Pharr – Named as the ERS Chief Financial Officer

Machelle joined ERS in June 2014 as the Assistant Director of Finance. When Mike Wheeler, the previous CFO, retired in August 2015 Machelle stepped in as Interim CFO, leading the division through the recent publication of the CAFR, Sunset review, and implementation of new legislation from the 84th session.

Machelle has held CFO and other senior-level positions at Texas agencies for over 20 years. During her time at agencies including Comptroller of Public Accounts, Department of Public Safety and Texas Commission on Environmental Quality Machelle gained a wealth of knowledge about Texas financial reporting, budgeting, purchasing and accounting systems.

Annual Enrollment for Plan Year 2017

Summer Enrollment for Plan Year 2017 will take place over a five-week period from July 11 – August 12, 2016. Summer Enrollment will be divided into four phases. Each phase will span a two-week period in which members can make enrollment changes. (See phase chart below.)

Annual Enrollment for Plan Year 2017 July 11, 2016 – August 12, 2016				
	Monday July 11	**Sunday July 17**	**Sunday July 24**	**Sunday July 31**
Phase 1 (July 11 – July 23)				
Phase 2 (July 17 – July 30)				
Phase 3 (July 24 – August 6)				
Phase 4 (July 31 – August 12)				

ERS will have new and complex information to communicate to our members this summer as we prepare to implement the new Consumer Directed HealthSelect (CDHS) plan and a new vision plan for September 1, 2016. We will communicate the details of these plans and other benefit information to our members throughout Summer Enrollment. We plan to host 35 Summer Enrollment fairs across the State and conduct 10 webinars, from July 5 through August 10. The fairs provide us an opportunity to share important benefit information and allow members to make their desired benefits changes. The fairs are a great way for ERS to directly interact with our members.

Fall Enrollment for our Medicare-eligible retirees will be in the October – November timeframe to coincide with the federal Medicare enrollment period.

Consumer Directed HealthSelect℠ Communications

Communications are underway to introduce members to Consumer Directed HealthSelect, the high-deductible health plan with health savings account being offered as a new health insurance option to Texas Employees Group Benefits Program participants.

The ERS implementation team worked with an outside consultant and ERS leadership to create the brand name and logo. Articles about the plan have run in *News About Your Benefits*, the monthly email newsletter for active employees, and *Update-express*, the biweekly email newsletter for benefits coordinators. Articles will continue to run in those newsletters, as well as in *Your ERS Connection*, the quarterly retiree newsletter, throughout Summer Enrollment and beyond. ERS also worked with an outside production company to develop a five-minute video that provides an overview of the plan and how its coverage compares to the existing HealthSelect of Texas plan and the regional HMOs.

In addition, ERS and the plan's third-party administrators – UnitedHealthcare, Caremark and Optum Bank will conduct pre-Summer Enrollment seminars and webinars for members and benefits coordinators. There will also be comprehensive information available at the Summer Enrollment fairs and on the ERS website.

Our goal is to help members understand the potential costs and benefits of Consumer Directed HealthSelect, so they can make informed choices about their health coverage.

HealthSelect Innovation Day

On March 29, HealthSelect℠ of Texas administrator UnitedHealthcare hosted two Innovation Day events in Austin, with the goal of highlighting value-added programs that can help HealthSelect of Texas participants make the most of the health plan and live healthier lives. One event was for legislators and their staff, with about 50 attendees. The second event, for agency and institution benefits coordinators, had 90 attendees. Both events featured presentations about UnitedHealthcare programs – such as Virtual Visits online urgent care, the Real Appeal weight loss program, the Health4Me app and the myHealthcare Cost Estimator. The benefits coordinators were especially appreciative of the information and seemed eager to share it with employees at their agencies and institutions. In a survey conducted after the benefits coordinator event, 100% of respondents said they found it informative and useful, and more than 90% said they shared the information at their agency or institution.

2016 Get Fit Challenge

BACKGROUND:

The 2016 Get Fit Texas! Challenge kicked off January 17 with a challenge to "bring home the gold" and regain bragging rights as the #1 Fittest State Agency.

Since Get Fit's inception in 2013, ERS has dominated the mid-size agency category. In 2013 and 2014, ERS earned #1 Fittest State Agency and took home second place honors in 2015.

RESULTS:

ERS' participation rate in this year's Get Fit Challenge was incredible. Two hundred fifty six employees, or 71%, registered to participate.

Two hundred eighteen employees completed the six-week challenge. The results of the challenge were announced on April 20. ERS accomplished its goal of regaining bragging rights as the #1 Fittest State Agency in our category. Additionally, we completed the competition with the greatest margin of victory ever.

Congratulations to the other agencies that placed in our category: Texas Legislative Council and Texas Department of Licensing and Regulation.

Results from the 2016 Survey of Employee Engagement (SEE)

ERS participated in its 8th organizational assessment survey in March 2016. The employee engagement measurement tool is prepared and given by the Institute for Organizational Excellence at the University of Texas. ERS has participated every even numbered year since 2002.

The purpose of the SEE is to:

- Assess the organizational climate
- Serve as a measurement tool for employee engagement
- Focus on the key drivers relative to the ability to engage employees towards successfully fulfilling the vision and mission of the organization

The employee response to the survey was again exceptional, with an 89.4% response rate, exceeding our agency goal of 85%. Survey scores measure employee perceptions of agency success and areas of improvement. State agencies overall survey scores typically range from 325 to 375. ERS scored **391,** compared to its 2014 score of 401.

As a reminder, survey questions were rated on a 1-5 scale, from strongly disagree, disagree, neutral, agree and strongly agree. A score above 375 in an area, or 3.75 on an individual question, is viewed as an area of substantial strength.

The Texa$aver SM 401(k) / 457 Program continues its winning streak

Texa$aver submitted award entries for its “Pump Up Your Savings” video and was awarded the following:

Pension & Investments announced Texa$aver received a 2nd place 2016 Eddy Award in the category of Special Projects.

The P&I Eddy Awards were created over 20 years ago to identify and reward the best practices in providing investment education to defined contribution plan participants. The awards are judged by an independent panel of plan sponsors and consultants. Awards are given out in seven categories, which are broken down by corporate employee size and/or type of firm.

AVA Digital Awards announced Texa$aver won two 2016 AVA Digital Awards. The Program won the Platinum Award, the highest honor in the competition, in the category Video for the Web Government, and won the Gold Award in the category Video for the Web: Informational.

AVA Digital Awards is an international competition that recognizes excellence by creative professionals responsible for the planning, concept, direction, design and production of digital communication. Work ranges from digital engagement campaigns – to audio and video production – to website development – to social media interaction – to mobile marketing.

Association of Marketing and Communication Professionals (AMCP) announced Texa$aver is the winner of four Platinum Hermes Creative Awards, the highest honor in the competition, in the following categories: Communication/Marketing Campaign, Video for the Web, Benefits Video, Marketing (Service). The Program was also awarded two Gold Hermes Creative Awards in the Government and Video Script categories.

AMCP is an international organization consisting of marketing, communication, advertising, public relations, media production, web and freelance professionals. As part of its mission, AMCP fosters and supports the efforts of marketing and communication professionals who contribute their unique talents to public service and charitable organizations.

National Association of Government Communicators (NAGC) announced Texa$aver is the winner of a 2016 Blue Pencil & Gold Screen (BP&GS) Award in the category of Internal Communications. The First Place, Second Place and Awards of Excellence will be announced at the Blue Pencil & Gold Screen Awards Ceremony and Reception to be held on June 7.

The custom, “Pump Up Your Savings” video targeted enrolled participants on how increasing their contribution, in conjunction with compound growth, could result in even more savings at retirement.

The video, released on June 17, 2015, was promoted from **www.texasaver.com** via a clickable web banner and a targeted email which resulted in a 40% open rate, well above the industry average. From the video’s release through September 28, an additional 4.4% of eligible participants enrolled in Texa$aver and 10,148 participants increased their contribution percentage in Texa$aver. This is a 123% increase from the same time as last year.* The “Pump Up Your Savings” video educated and informed current and prospective participants of how Texa$aver can help close the savings gap and help them PUMP UP THEIR SAVINGS.

* Contribution percentage may include individuals automatically enrolled at 1% in the 401(k) plan.

Investments Update

Honorable Mentions:

The Fixed Income team won the Best Institutional ETF User award. ERS has been a vocal and significant adopter of ETFs, particularly Fixed-Income ETFs. The firm showed how the liquidity that ETFs offer allowed it to efficiently migrate capital to adjust for a changing fixed-income environment.

Tom Tull was awarded the Young Jewish Professionals Leadership and Achievement Award at the Young Jewish Professionals CIO Forum in March of 2016. The organization provides business networking and mentoring sessions for the new generation of business leaders.

Anthony Curtiss, ERS’ Hedge Fund Portfolio Manager was named 2016 Forty Under Forty by Chief Investment Officer Magazine. This prestigious honor is comprised of nominations from asset managers and allocators.

PUBLIC AGENDA ITEM - #12

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

August 16, 2016

BACKGROUND:

In accordance with the Employees Retirement System of Texas (ERS) *Investment Policy,* Section 4.3, ERS' Investment Advisory Committee (IAC) was established at the discretion of the Board of Trustees in Texas Administrative Code §63.17(b). The IAC is made up of at least five and not more than nine members with a current composition of eight members. Members are selected on the basis of their experience making investment decisionsand managing financial institutions or other business, , or as a prominent educator in the fields of economics or finance. IAC members serve at the pleasure of the ERS Board of Trustees (Board) for staggered three-year terms. Members are subject to compliance with the ERS Investment Policy and Texas Government Code §815.509 and §§815.5091 through 815.5092.

A quorum of the IAC meets at least quarterly with the Board. The IAC assists the Board of Trustees in carrying out its fiduciary duties with regard to the investment of assets of the System and related duties. From time to time, together with ERS' staff and investment consultants or advisors, the IAC recommends asset mix, portfolio strategy, investment policy, and eligible securities to the Board. Furthermore, ERS staff utilizes the expertise of IAC members in assessing investment advisors and strategies, and may request IAC members to participate in selection and review committees, including the deferred compensation program offered by the State to its employees. This involvement with staff allows IAC members to provide further insights to the Board on staff and the overall investment program.

The current term of IAC member Ken Mindell expires on August 31, 2016. ERS believes Mr. Mindell is a valuable member of the commitee and he has expressed the desire to continue to serve. His biographical and professional background information is included with this agenda item as Exhibit A.

STAFF RECOMMENDATION:
Staff recommends the Board reappoint Ken Mindell for a three-year term ending August 31, 2019. The staff's recommended motion is included with this agenda item following the exhibit.

ATTACHMENTS – 1

Exhibit A – Biographical information for Ken Mindell

RESUME OF

KEN D. MINDELL

August 1, 2007

PROFESSIONAL EXPERIENCE:

ROSEWOOD MANAGEMENT CORPORATION, Dallas, Texas — 1987 to Present

(A financial and investment management company , or "Family Office", formed to management the assets of Caroline Rose Hunt and her family.)

* Senior Vice President, Treasurer and Director of Investments	2003 to Present
* Senior Vice President and Director of Investments	1999 to Present
* Senior Vice President and Treasurer	1997 to 1999
* Vice President and Treasurer	1991 to 1997
* Vice President and Director of Taxes	1988 to 1991
* Tax Supervisor (a tax manager position), Rosewood Resources Corporation	1987 to 1988

Current responsibilities include managing, planning and reporting for a multiple-entity, institutional investment program that includes public equities, fixed income, hedge funds, real estate. venture capital and private equity investments. Treasury cash management and financing services for over 90 entities are additional responsibilities.

- Designed, implemented, and managed an institutional investment management program including investment policy formulation, risk assessment, asset allocation and optimization, manager selection, and performance review and monitoring.
- Analyzed, invested in and monitored various venture capital and private equity funds and direct private equity deals.
- Analyzed, invested in, financed and monitored various direct real estate projects, real estate funds, and oil and gas deals.
- Researched, implemented, managed or assisted with various hedging strategies including exchange funds, equity "collars", forward sales, short sales, and a Tactical Asset Allocation (TAA) overlay program using futures contracts.
- Contributed to significant income tax, estate planning and wealth transfer transactions resulting in hundreds of millions in tax savings.
- Successfully hired, managed and supervised the tax, investment, treasury and accounting departments.

KEN D. MINDELL, CPA, Dallas, Texas — 1986-1987

(A public accounting sole proprietorship.)

* Sole Proprietor: Provided services for tax and estate compliance and planning, financial reporting, trust accounting and reporting, management consulting, and personal financial and investment planning. Clients included several high-net worth families and estates.

EDWIN L. COX AND BARRY R. COX, Dallas, Texas — 1985

(Independent oil and gas operators and investors.)

* Tax Manager: Responsible for managing all federal and state tax compliance, research, planning, and audits for an independent oil and gas company, trusts, estates, individuals and various companies engaged in oil and gas, real estate, ranching, timber and other business and investment activities. Managed the final preparation of the estate tax return for a principal's spouse and saved significant estate taxes. Directed significant estate planning transactions and revised the estate plan and will for the principal's mother and saved significant estate taxes.

JERRY V. SMITH PROFESSIONAL CORPORATION, Dallas, Texas — 1981-1984

(A local public accounting firm formed to administer the assets of the Estate of John D. Murchison, his family, and others.)

* Vice-president and Tax Manager: Managed the operations of a public accounting tax practice for entities engaged in real estate, oil and gas, ranching, manufacturing and retail business operations. Responsibilities also included accounting and administration for the estate, and financial and investment planning for various clients. Converted all manual accounting and tax compliance procedures to computer based systems for the estate and other clients. Served as a board of director and officer of various operating companies.

COOPERS & LYBRAND, Dallas, Texas 1977-1981

(One of the former "Big 8" public accounting firms.)

* Tax Supervisor: Supervised, reviewed and prepared tax returns, financial reports, tax research, investment analyses and general accounting functions for a wide variety of entities in various industries. Directly responsible for coordinating all tax compliance, audits, planning and administration for the largest tax client in the Dallas office.
* Staff Auditor: Supervised and provided audit services for emerging businesses in the oil and gas, real estate, construction, ranching, leasing and health care industries.

EDUCATION AND PROFESSIONAL CERTIFICATION:

* Certified Public Accountant 1979

UNIVERSITY OF TEXAS GRADUATE SCHOOL OF BUSINESS, Austin, Texas 1975-1977

* Attended the Master of Business Administration program with a concentration in accounting, finance, investment theory, and portfolio management.

DUKE UNIVERSITY, Durham, North Carolina 1970-1974

* Bachelor of Science degree in Zoology with a background in chemistry, genetics, physics, and calculus.

PUBLIC AGENDA ITEM - #13

13. 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)

August16, 2016

Required Rule Review and Proposed Amendments to Chapter 81, Insurance:

Required Rule Review

Pursuant to Tex. Gov't Code § 2001.039, all state agencies are directed to review their rules every four years in order to assess whether or not the reasons for adopting the rules continue to exist. Pursuant to statute, ERS staff reviewed Chapter 81, Insurance.

As a result of the review, staff has determined that the reasons for adopting the rules in Chapter 81 continue to exist with amendments, as discussed more fully below. Staff also determined that the rules should be amended to implement legislative requirements, and to organize the rules so that they are easier to use and are more streamlined.

Proposed Amendments to Chapter 81, Insurance

Chapter 81 is proposed to be amended to update the rule to use current terminology, clarify existing definitions, define terms that previously existed within the rule, and eliminate definitions that are no longer necessary.

Staff proposes replacing the term "premium" with the term "insurance required contribution" throughout Chapter 81 to reflect that plans within the Group Benefits Program (GBP) are governmental insurance programs that include self-funded benefit plans. A self-funded plan does not have traditional premiums like non-governmental plans subject to state insurance laws. GBP benefits are governed by Chapter 1551, Insurance Code, and have statutory eligibility and enrollment requirements that are different from other insurance benefits offered outside the GBP.

- **Section 81.1 (Definitions)** is proposed to be amended to include a definition for "Consumer Directed HealthSelect[SM]" for the new GBP high deductible health plan, in connection with the new Insurance Code Chapter 1551, Subchapter J. "GBP health coverage" was also included to describe all of the health plans offered through the GBP.

  The definition of "spouse" as a dependent in the GBP was reformatted to add clarity and guidance to GBP participants that a member's spouse must be formally married or informally married with a filed Declaration of Informal Marriage prior to the effective date of the dependent spouse's enrollment in the GBP. The amendment also creates a narrow exception to that requirement based on clear and compelling evidence, deemed sufficient to ERS that the marriage existed prior to enrollment in the GBP.

  The definition regarding dependents is also proposed to be amended to specify the requirements for continuing health insurance eligibility for children over age 26 who are mentally or physically incapacitated in accordance with Texas Insurance Code §1551.004(a)(3).

- **Section 81.3 (Administration)** is proposed to be amended to be titled "Health Maintenance Organizations." The proposed amendments provide clarity regarding the requirements of HMOs in the GBP, with no substantive changes to the HMO provisions. The rules regarding administration of the insurance required contributions and state contributions in the GBP, currently in §81.3(b) and (c), are proposed to be moved to §81.7, in order to aggregate the information within a rule that is relevant to that subject and to make it easier for users to find applicable rules for a particular subject matter.

- **Section 81.5 (Eligibility)** is proposed to be amended to clarify that a former COBRA unmarried child is eligible to enroll a newly acquired dependent child within 30 days of the child's date of birth or placement for adoption. Otherwise, these particular GBP participants cannot add dependents to their coverage. Additionally, subsections of §81.5 were moved within the section to provide better organization of the rule.

  Proposed changes also amend the subsection 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 to provide that married dependents under age 26, who are otherwise eligible dependents, may continue to be enrolled as dependents and are not required to apply for COBRA coverage until they reach age 26.

- **Section 81.7 (Enrollment and Participation)** is proposed to be amended to include subsections moved from §81.3, to address payment of insurance required contributions and state contributions, to aggregate the information within a rule that is relevant to that subject matter and to clarify the payment of insurance required contributions by the type of participant.

  The proposed amendments add language to 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 add requirements related to the new optional coverage for a vision plan and the new Consumer Directed HealthSelect, offered through the GBP, and reflect that Consumer Directed HealthSelect, commuter spending accounts, vision plan, limited purpose flexible spending accounts, and health savings accounts are additional coverages and plans available to certain eligible members and participants.

  The proposed amendments 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 or Consumer Directed HealthSelect instead of another HMO.

  The proposed amendments 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.

  In addition, proposed amendments clarify that annual enrollment opportunities are at times announced by ERS in order to recognize that there are different annual enrollment opportunities for members who are not Medicare-eligible and for those members who are not active employees and are eligible for Medicare.

  Proposed changes also amend the subsection to comply with provisions of the 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 providing that married dependents under age 26, who are otherwise eligible dependents, may continue to be enrolled as dependents and are not required to apply for COBRA coverage until they reach age 26.

  Section 81.7 is also proposed to be amended to repeal subsection (j), the provision reflecting the preexisting conditions exclusion for the GBP disability income insurance plan. The rule is not necessary since the Master Benefit Plan Document for the long- and short-term disability plan already includes such requirements.

- **Section 81.8 (Waiver of Health Coverage)** is proposed to be amended to provide better organization and clarity regarding incentive credits. There are no substantive changes to this section.

- **Section 81.9 (Grievance Procedure)** is proposed to be amended by changing the title of the section to "Grievance Procedures" to reflect that there is more than one type of grievance procedure, depending on the particular GBP plan, to clarify the grievance procedures applicable for the different types of plans in the GBP and to provide details regarding the grievance procedures. The proposed amendments provide clarity regarding available grievance rights for participants whose claims are denied by administering firms or carriers in the GBP, clarify 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, and reflect that the applicable plan documents set forth grievance procedures for denied claims.

- **Section 81.11 (Termination of Coverage)** is proposed to be amended by changing the title of the section to "Cancellation of Coverage and Sanctions," to make a distinction between sanctions and cancellation of coverage; which can be unrelated to sanctions. The proposed amendments reorganize the rule for better clarity regarding the conditions and timeframes for cancellation of GBP coverage for members and participants.

Proposed Amendment to Chapter 85, Flexible Benefits:

- **Section 85.4 (Separate Plans)** is proposed to be amended 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 proposed amendments to Chapter 81 are set forth in the attached Exhibit A and the proposed amendment to Chapter 85 is set forth in the attached Exhibit B, are incorporated herein by reference and are proposed under Tex. Ins. Code § 1551.052, which provides authorization for the ERS Board of Trustees to adopt rules necessary to carry out its statutory duties and responsibilities and under §1551.068, Tex. Ins. Code, which authorizes the Board of Trustees to modify, amend, or interpret rules to the extent necessary to comply with any applicable federal law.

Notice of the proposed rule review for Chapter 81 was published in the February 14, 2014, issue of the *Texas Register* (39 TexReg 1005), as required by statute. ERS did not receive any comments on the proposed rule review.

Notice of the proposed amendments to Chapter 81 was published July 8, 2016, in the *Texas Register* (41 TexReg 4960). ERS received one comment on the proposed changes to Chapter 81.

The Coalition for Nurses in Advanced Practice (CNAP) suggested adding certified nurse-midwife as practitioners who can certify the date of birth for a newborn natural child for purposes of eligibility for life and AD&D coverage in the GBP. ERS staff agrees with the suggested change, and recommends adoption of the proposed rule with the suggested change by CNAP as reflected in this agenda item and Exhibit A.

Notice of the proposed amendment to Chapter 85 was published July 8, 2016, in the *Texas Register* (41 TexReg 4982). ERS did not receive any comments on the proposed change to Chapter 85.

STAFF RECOMMENDATION:

Staff recommends that the Board of Trustees of the Employees Retirement System of Texas take the following actions with regard to the Rules of the Board of Trustees, promulgated in Texas Administrative Code, Title 34, Part IV, as set forth in Exhibit A and Exhibit B, which are attached to and incorporated by reference into this Agenda Item:

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

A proposed motion is included for this agenda item following the exhibit.

ATTACHMENTS – 2

Exhibit A – Chapter 81, concerning Insurance, with the proposed amendments to §§ 81.1, 81.3, 81.5, 81.7, 81.8, 81.9, and 81.11.

Exhibit B – Chapter 85, concerning Flexible Benefits, with the proposed amendment to 85.4(c).

CHAPTER 81. INSURANCE

§81.1. Definitions.

The following words and terms, when used in this chapter, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Accelerated life benefit--A [An amount of] term life insurance benefit to be paid in advance of the death of an insured member [employee, annuitant,] or dependent, as requested by the insured member [employee or annuitant] and approved by the carrier or administering firm, in accordance with the terms of the group term life insurance plan as permitted by §1551.254 of the Act. An accelerated [, Insurance Code. Accelerated] life benefit payment may be requested only if the insured person is diagnosed with [upon diagnosis of] a terminal condition and only once during the lifetime of the insured person. For purposes of this definition, a [employee, annuitant, or dependent. A] terminal condition is an incurable [a non-correctable] health condition that the administering firm or carrier determines with reasonable medical certainty will result in the death of the insured within 12 months.

(2) Act--The Texas Employees Group Benefits Act, [Act of the 77th Legislature, 2001, as amended,] Insurance Code, Chapter 1551, as amended.

(3) Active duty--An employee's [The] expenditure of time and energy in the service of his/her employer, including elected officials of the state of Texas who are eligible for coverage under the Act. An employee is [will be considered to be] on active duty on each day of a regular paid vacation or regular paid sick leave or on a non-working day, if the employee was on active duty on the last preceding workday [working day].

(4) AD&D--Voluntary accidental [Accidental] death and dismemberment coverage.

(5) Age of employee--The age to be used for determining optional term life and AD&D insurance required contributions. For these purposes, the age of the employee is [voluntary AD&D insurance premiums will be] the employee's attained age on September 1 [as of the employee's first day of active duty within a contract year].

(6) Annuitant--A retired person who is eligible under §1551.102 of [authorized by] the Act to participate in the GBP and meets all requirements for retirement from a state retirement program or the Optional Retirement Program [as an annuitant].

(7) Basic plan--The plan of group insurance, including prescription drug coverage, determined by the Board of Trustees [trustee], currently HealthSelect or HealthSelect Medicare Advantage participant-only, as applicable, [participant only] and basic term life insurance coverage, in which every eligible full-time employee and annuitant [, or non-Medicare eligible retiree or dependent who is eligible for group insurance at the time of retirement], is automatically enrolled after meeting any applicable [completion of any required] waiting period or unless participation is expressly waived.

(8) Benefits Coordinator--A person employed by an employer to provide assistance to its employees and their dependents with all aspects of GBP participation. The benefits coordinator for all other GBP participants is ERS.

(9) [(8)] Board of Trustees or Board [or trustee]--The Board of Trustees [board of trustees] of the Employees Retirement System of Texas.

(10) CHIP--Children's Health Insurance Program.

(11) CMS--Centers for Medicare and Medicaid Services or its successor agency.

(12) COBRA--Consolidated Omnibus Budget Reconciliation Act of 1985, Public Law 99-272, and any subsequent amendments.

(13) Consumer Directed HealthSelect[SM]--The self-funded high deductible health benefit plan offered through the GBP and administered by the Employees Retirement System of Texas and qualified carriers or administering firms.

(14) Dependent--With respect to an eligible member, means the member's:

(A) spouse, as recognized by applicable law, which includes only a married spouse as evidenced by a properly issued and completed marriage license or an informally married spouse whose marriage is memorialized by a Declaration of Informal Marriage and filed of record with an appropriate governmental authority. Absent clear and compelling evidence of an informal marriage existing at the time of enrollment and deemed sufficient by ERS, it is a plan design requirement that the licensed marriage or Declaration of Informal Marriage must occur, or be filed, as applicable, prior to the effective date of the dependent spouse's enrollment in the GBP;

(B) child under 26 years of age;

(C) child age 26 and older whom the Board of Trustees or its designee determines is certified by an approved practitioner to be mentally or physically incapacitated from gainful employment, and earns less than the monthly wage standard for enrolling in CHIP in Texas for a family of one at the time of application or reevaluation. If the child earns more than this wage standard for a period of six months or longer in any calendar year, then the child must demonstrate to ERS his/her continued eligibility for dependent coverage by proving he/she is dependent on the member for care or support and either lives with the member or has care provided by the member on a regular basis; and

[(9) Contract year--A contract year begins on the first day of September and ends on the last day of the following August.]

[(10) Department--Commission, board, agency, division, institution of higher education, or department of the state of Texas created as such by the constitution or statutes of this state, or other governmental entity whose employees or retirees are authorized by the Act to participate in the Program.]

[(11) Dependent--The spouse of an employee or retiree and unmarried children under 25 years of age, including:]

[(A) the natural child of an employee/retiree;]

[(B) a legally adopted child (including a child living with the adopting parents during the period of probation);]

[(C) a stepchild whose primary place of residence is the employee/retiree's household;]

[(D) a foster child whose primary place of residence is the employee/retiree's household and who is not covered by another governmental health program;]

[(E) a child whose primary place of residence is the household of which the employee/retiree is head and to whom the employee/retiree is legal guardian of the person;]

[(F) a child who is in a parent-child relationship to the employee/retiree, provided the child's primary place of residence is the household of the employee/retiree, the employee/retiree provides the necessary care and support for the child, and if the natural parent of the child is 21 years of age or older, the natural parent does not reside in the same household;]

[(G) a child who is considered a dependent of the employee/retiree for federal income tax purposes and who is a child of the employee/retiree's eligible child;]

[(H) an eligible child, as defined in this subsection, for whom the employee/retiree must provide medical support pursuant to a valid order from a court of competent jurisdiction; or]

[(I) a child eligible under §1551.004, Insurance Code, provided that the child's mental disability or physical incapacity is a medically determinable condition which prevents the child from engaging in self-sustaining employment, that the condition commences before the date of the child's 25th birthday, and that satisfactory proof of such condition and dependency is submitted by the employee/retiree within 31 days following such child's attainment of age 25 and at such intervals thereafter as may be required by the system.]

[(12) Dependent--EFFECTIVE SEPTEMBER 1, 2010, paragraph (11) of this section, shall apply to an individual claimed as a dependent for a plan year that began before September 1, 2010.]

[(A) In this chapter, "dependent," with respect to an individual eligible to participate in the group benefits program, means the individual's:]

[(i) spouse;]

[(ii) child younger than 26 years of age;]

[(iii) child of any age who the board of trustees determines lives with or has the child's care provided by the individual on a regular basis if the child is mentally or physically incapacitated to the extent that the child is dependent on the individual for care or support, as determined by the board of trustees;]

[(iv) child of any age who is unmarried, for purposes of health benefit coverage under Insurance Code, Chapter 1551, on expiration of the child's continuation coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 (Pub. L. No. 99-272) and its subsequent amendments; and]

(D) [(v)] [a] child under age 26 who is the member's [a] ward, as that term is defined by §1002.030, Texas Estates Code [§601, Texas Probate Code].

(E) [(B)] In this section, "child" includes:

(i) a natural child, adopted child, stepchild, foster child; or a child in the possession of a participant who is designated as managing conservator of the child under an irrevocable or unrevoked affidavit of relinquishment under [Chapter 161 of the] Texas Family Code, Chapter 161; or

(ii) a child who is related to the member by blood or marriage and was claimed as the member's [a] dependent on his/her [the] federal income tax return [of an individual who is eligible to participate in the group benefits program] for the tax [calendar] year preceding the plan year in which the child is first enrolled as the member's [a] dependent in the GBP, [under Insurance Code, Chapter 1551,] and for each subsequent year in which the child is enrolled as the member's [a] dependent. The federal income tax return must have been filed when first due or before any timely extensions expired.

(F) [(C)] The requirement in subparagraph (E)(ii) [(B)(ii)] of this paragraph that a child must be claimed as the member's [a] dependent on his/her [a] federal income tax return [in the calendar year] preceding the child's enrollment does not apply if:

(i) the child is born in the year in which the child is first enrolled; or

(ii) the member [participant] can demonstrate good cause for not claiming the child as a dependent in the preceding tax [calendar] year.

[(D) In this section, "spouse" means a person recognized as a spouse under Texas law and includes only a ceremonially married spouse or an informally married spouse whose marriage is memorialized by a Declaration of Informal Marriage as authorized by Texas law and filed of record with an appropriate governmental authority prior to the date of the dependent spouse's enrollment in the GBP.]

[(13) Eligible to receive an annuity--Refers to a person who, in accordance with the Act, meets all requirements for retirement from a state retirement program or the Optional Retirement Program.]

(15) [(14)] Employee--A person eligible to participate in the GBP under §1551.101 of the Act, which includes an appointed or elected state officer, judicial officer, or employee in the service of the state of Texas. The term also includes an eligible employee of an institution of higher education and any persons required or permitted by the Act to enroll as members. [authorized by the Act to participate in the Program as an employee].

(16) Employer--State of Texas and its agencies, institutions of higher education, and other governmental or quasi-governmental employers within the state whose employees or annuitants are authorized by the Act to participate in the GBP.

(17) ERS--Employees Retirement System of Texas.

[(15) Employing office--For a retiree covered by this Program, the office of the Employees Retirement System of Texas in Austin, Texas or the retiree's last employing department; for an active employee, the employee's employing department.]

(18) [(16)] Evidence of insurability--Evidence [Such evidence] required by ERS, an administering firm, or a qualified carrier for approval of coverage or changes in coverage other than GBP health coverage [in HealthSelect, HMO or Medicare Advantage Plan] pursuant to the enrollment and participation provisions in this chapter [rules of §81.7(i) of this chapter (relating to Enrollment and Participation)].

(19) Executive director--the executive director of the Employees Retirement System of Texas. All references to the executive director also include the person or position designated by the executive director or Board of Trustees to perform the relevant function of the executive director.

(20) [(17)] Former COBRA unmarried child--A member's unmarried child who is at least 26 years of age, who had GBP coverage as a dependent until the child became ineligible, who had continuation coverage under COBRA until that coverage expired, and who reinstates GBP coverage pursuant to §1551.158 of the Act [child of an employee or retiree who is unmarried; whose GBP coverage as a dependent has ceased; and who upon expiration of continuation coverage under the Consolidated Omnibus Budget Reconciliation Act, Public Law 99-272 (COBRA) reinstates GBP coverage].

(21) GBP (Group Benefits Program)--The Texas Employees Group Benefits Program as established and administered by the Board of Trustees pursuant to the Act.

(22) GBP health coverage--includes HealthSelect^{SM} of Texas, Consumer Directed HealthSelect^{SM}, HMOs and Medicare Advantage plans, as applicable.

(23) Health insurance waiting period--The applicable waiting period defined in §1551.1055 of the Act.

(24) [(18)] HealthSelect^{SM} of Texas--The self-funded [statewide] health benefit plan offered in the GBP and administered by the Employees Retirement System of Texas [self-insured by the Employees Life, Accident and Health Insurance and Benefits Fund, as administered by the Employees Retirement System of Texas] and a qualified carrier or administering firm. HealthSelect of Texas also includes a Prescription Drug Plan administered by a Pharmacy Benefit Manager approved by the Board.

(25) [(19)] HealthSelect^{SM} [HealthSelect] Medicare Rx--A plan, approved by the Board of Trustees [Board], that provides prescription drug coverage designed for [Medicare] participants who are eligible for Medicare-primary coverage in the GBP as permitted by CMS [the federal Centers for Medicare and Medicaid Services (CMS) or its successor agency].

(26) [(20)] HMO--A health maintenance organization, as defined by §1551.007 of the Act, and approved by the Board of Trustees [board] to provide health care coverage [benefits] to eligible participants in the GBP [Program in lieu of participation in the Program's HealthSelect of Texas plan].

(27) [(21)] Insurance required contribution [premium expenses]--Any out-of-pocket charge [premium] incurred by a member [participant,] or by a member's [spouse or] dependent [of such participant,] as payment for coverage provided under the GBP [Program] that exceeds the state's or employer's contributions made on behalf of the member [institution's contributions offered as an employee benefit by the employer. The types of premium expense covered by the premium conversion plan include out-of-pocket premium for group term life, health (including HMO premiums), AD&D, and dental, but do not include out-of-pocket premium for long or short term disability or dependent term life].

(28) [(22)] LWOP (Leave without pay) [Leave without pay]--The leave status of an employee who is certified by his/her employer [a department administrator] to be absent from active duty for an entire calendar month, who does not receive any compensation for time absent from active duty, [that month,] and who has not received a refund of retirement contributions based upon the most recent term of employment.

(29) [(23)] Medicare Advantage Plan--A plan, approved by the Board of Trustees [board], that provides health coverage for participants who are eligible for Medicare-primary coverage. The plan is [benefits that are] administered as a Medicare Advantage Plan as permitted by CMS [the federal Centers for Medicare and Medicaid Services (CMS) or its successor agency,] through:

(A) a health maintenance organization; or

(B) any other plan, organization, carrier or administering firm [or organization] approved by the Board of Trustees to provide the coverage [board for Medicare-eligible participants].

(30) [(24)] Medicare-eligible--The status of a participant who is eligible for primary coverage under Medicare Part A and/or Part B [and B in return for a monthly premium]. Eligibility may extend to a dependent that is qualified to receive Medicare benefits as his/her primary coverage as permitted by CMS [or its successor agency].

(31) Member--For purposes of this chapter only regarding insurance plan participation in the GBP, a member is a participant who is an employee, retiree, or other person eligible to participate in the GBP as provided under the Act and who is not a dependent.

(32) Minimum retiree optional life--A standard $10,000 term life insurance policy whose insurance required contribution is set solely on the basis of the benefit rather than on the retiree's age. It is available for retirees at any time during their retirement. If a retiree does not have life insurance, the retiree may apply for this coverage with evidence of insurability. If the retiree has Election 1 or Election 2 optional life, the retiree may elect to reduce the life coverage to this coverage by requesting the change without an application or evidence of insurability.

(33) Optional Coverage--Coverage established by the Board of Trustees in the GBP and as set forth in §81.7(c)(1)(A)-(K).

(34) [(25)] ORP--The Optional Retirement Program as provided in the Government Code, Chapter 830.

(35) [(26)] Participant--An employee, annuitant, or dependent, as defined in the Act, a surviving spouse or child of a deceased member, or any other person eligible for

coverage under the Act and enrolled in any coverage offered under the GBP. [An eligible individual who participates in the group benefits program.]

(36) [(27)] Placement for adoption--The legal status of a child under which a person assumes and retains the [A person's assumption and retention of a] legal obligation for total or partial support of the [a] child in anticipation of the person's adoption of such child.

(37) [(28)] Preexisting condition--Any injury or medical condition [sickness,] for which a participant [the employee] received medical treatment [treatment,] or services, or was [took] prescribed drugs or medicines during the three-month period immediately prior to the effective date of such coverage. However, if the evidence of insurability requirements set forth in §81.7(d) [§81.7(i)] of this chapter must first be satisfied, the three-month period for purposes of determining the preexisting conditions exclusion will be the three-month period immediately preceding the date of the employee's completed application for coverage.

(38) [(29)] Premium conversion plan--A separate plan, under the Internal Revenue Code, §79 and §106, adopted by the Board of Trustees [board of trustees] and designed to provide premium conversion as described in §81.7(b) [§81.7(g)] of this chapter.

[(30) Program--The Texas Employees Group Benefits Program as established by the Board pursuant to the Act and known as the Group Benefits Program (GBP).]

(39) [(31)] Retiree--An employee who retires or is retired and who:

(A) is authorized by the Act to participate in the GBP [Program] as an annuitant [a retiree];

(B) on August 31, 1992, was a participant in a group insurance program administered by an institution of higher education; or

(C) on the date of retirement, meets the service credit requirements of the Act [Insurance Code] for participation in the GBP [Program] as an annuitant; and

(i) on August 31, 2001, was an eligible employee with an employer [a department] whose employees are authorized to participate in the GBP [Program] and, on the date of retirement has three years of service with such an employer [a department];

(ii) on August 31, 2001, had three years of service as an eligible employee with an employer [a department] whose employees are authorized to participate in the GBP; [Program;] or

(iii) is determined by ERS to be eligible as described by §1551.102 and §1551.114 of the Act [, Insurance Code].

(40) [(32)] Salary--The amount of compensation, which includes the employee's regular salary, longevity, shift differential, hazardous duty pay, and benefit replacement pay, received by an employee as of the employee's first day of active duty and as of September 1, for an existing or rehired employee. This amount is [salary to be] used for determining optional term life and disability income limitations [will be the employee's regular salary, including longevity, shift differential, hazardous duty pay, and benefit replacement pay, received by the employee as of the employee's first day of active duty within a contract year. No other

component of compensation shall be included]. Non-salaried elected and appointed [elective and appointive] officials and members of the Legislature may use the salary of a state district judge or their actual salary as of September 1 of each year.

[(33) System--The Employees Retirement System of Texas.]

(41) [(34)] TRS--The Teacher Retirement System of Texas.

§81.3. Health Maintenance Organizations [Administration].

[(a) Health maintenance organizations.]

(a) [(1)] The Board of Trustees [board] may approve a health maintenance organization (HMO) to offer a health care services [benefits] plan to participants in the GBP [Program]. The Board of Trustees [board] may:

(1) [(A)] utilize a bidding process to approve one or more HMOs in areas of the state determined by the Board of Trustees [board] to be regional bidding areas (RBAs);

(2) [(B)] utilize an application process to approve one or more HMOs in areas of the state determined by the Board of Trustees [board] to be non-bidding areas;

(3) [(C)] determine the criteria to be used to approve the HMOs for the RBAs and non-bidding areas;

(4) [(D)] determine the number of HMOs to approve in each RBA and non-bidding area; and

(5) [(E)] determine the length of the contracts with the approved HMOs.

(b) [(2)] In order to seek approval, an HMO must submit to ERS:

(1) [(A)] a separate [submit an] application to provide health care services in each area of interest [benefits in the areas] within the state of Texas determined by the Board of Trustees [board] to be non-bidding areas; or

(2) [(B)] [submit] a proposal, in response to a request for bid, in the format determined by ERS to provide health care services in [the system for] one or more of the designated RBAs. [RBAs; or]

[(C) submit application(s) and bid(s).]

(c) [(3)] An HMO seeking Board of Trustees' [board] approval of its proposal in response to a request for bid in one or more of the RBAs[,] must demonstrate compliance with [satisfy] the following conditions to the satisfaction of the Board of Trustees:

(1) [(A)] the [The] HMO must be licensed by the Texas Department of Insurance to operate in the state of Texas; [Texas.]

(2) [(B)] the [The] HMO must have prior experience [been] providing health care services in the RBA for at least 6 months prior to September 1 of the fiscal year in which the proposal [bid response] is due to be filed with ERS; [the system.]

(3) [Also,] the HMO must have [demonstrate] the capacity to provide adequate health care services [, as determined by the system,] to the GBP participants in the relevant RBAs; [program participants.]

(4) the HMO must propose rates at the time and in the format prescribed by ERS. If the HMO's proposed rates are adopted by the Board of Trustees, the HMO may not modify the rates without the approval of the Board of Trustees;

[(C) The HMO must submit the bid, with rates, to the board at the time and in the format prescribed by the system. Once adopted by the board, the rates may not be modified without the approval of the board.]

(5) the HMO must submit a separate proposal in order to request [A request for] expansion into [of] a non-contiguous service area; [, as described in this section, shall require a separate application.]

(6) [(D)] the HMO must agree to all [The HMO agrees to the] provisions contained in the contract between ERS [the system] and the HMO as adopted for the duration of the contract; [entire time specified in the contract.]

(7) [(E)] the [The] HMO must provide standardized benefits as described in the contract between ERS and the HMO; [the system and the HMO. This document, which is to be considered a part of this section for all purposes, may be obtained from the executive director of the system.]

(8) [(F)] the HMO must agree that if the HMO [If an HMO, approved by the board,] fails to maintain compliance with the contract, ERS [the board] has the right to cancel the [existing] contract with that HMO and seek other remedies [upon proper notice] as specified in the contract; and [contract.]

(9) [(G)] the HMO must agree that if the HMO loses its Texas state license, it [An HMO that loses its state license] will automatically become ineligible to offer its health care services [benefits] plan to participants in the GBP [Program].

(d) [(4)] An HMO, seeking Board of Trustees' [board] approval of its [in response to an] application to provide health care services in one or more of the non-bidding areas[,] must demonstrate compliance with all of the conditions set forth in subsection (c) of this section to the satisfaction of the Board of Trustees. [satisfy the following conditions:]

[(A) The HMO must be licensed by the Texas Department of Insurance to operate in the state of Texas.]

[(B) The HMO must have been providing managed care services in the area for which the application is made for at least 6 months prior to September 1 of the fiscal year in which the application is due to be filed with the system. Also, the HMO must demonstrate the capacity to provide adequate services, as determined by the system, to the program participants.]

[(C) The HMO must submit the application, with rates, to the board at the time and in the format prescribed by the system. Once adopted by the board the rates may not be modified without the approval of the board.]

[(D) The HMO agrees to the provisions contained in the contract between the system and the HMO as adopted for the entire time specified in the contract.]

[(E) The HMO must provide standardized benefits as described in the contract between the system and the HMO. This document, which is to be considered a part of this section for all purposes, may be obtained from the executive director of the system.]

[(F) If an HMO, approved by the board, fails to maintain compliance with the contract, the board has the right to cancel the existing contract with that HMO upon proper notice as specified in the contract.]

[(G) An HMO that loses its state license will automatically become ineligible to offer its health benefits plan to participants in the insurance program.]

[(b) Payment of Premiums.]

[(1) Premiums for coverage provided under the Program are funded from three sources: state contributions, system contributions, and participant contributions. The Legislature appropriates monies to fund group insurance benefits for all employees as defined in the Act. Monies for employees compensated from funds other than the General Appropriations Act are appropriated from the official operating budget of the respective department. In addition, the system may contribute an additional amount, as determined by the trustee, for payment of premiums for participants. A participant who applies for coverage for which the monthly premium exceeds the state's or employing department's and the system's contribution must pay the excess amount.]

[(2) A participant's share of premiums shall be paid through deductions from monthly compensation or annuities or by direct payment, as provided in this paragraph.]

[(A) An employee or annuitant who applies for coverage for which the monthly premium exceeds the state or employing department and the system contributions must authorize on a form prescribed by the system a deduction from his or her monthly compensation or annuity to pay the difference. If the compensation or annuity is insufficient to provide for the appropriate deduction, the participant must pay premiums directly as provided in subparagraph (B)(i) of this paragraph. Failure to make the required payment of premiums by the due date will result in the cancellation of all coverages not fully funded by the state contribution. A participant entitled to the state contribution will retain member only health and basic life coverage provided the state contribution is sufficient to cover the premium for such coverage. If the state contribution is not sufficient for member only coverage in the health plan selected, the participant will be enrolled in the basic plan except as provided for in §81.7(m)(2)(B) of this chapter (relating to Enrollment and Participation).]

[(B) A participant shall pay premiums directly, as provided in this subparagraph, if the participant is not on a payroll or is in a leave without pay status, is not receiving an annuity from a state retirement system from which the appropriate premiums may be deducted, or is not receiving a salary or annuity sufficient to allow for a full required premium deduction.]

[(i) An employee whose salary is insufficient, or who is a non-salaried board member, shall pay monthly premiums in advance through the employing department. Any other participant to whom this subparagraph applies shall pay monthly premiums in advance to the system. Premium payments are due on the first day of the month covered and must be postmarked or received by the system or the employing department, whichever is appropriate, within 30 days of the due date to avoid cancellation of coverage. Failure to make the required premium payment by the due date will result in cancellation of all coverages not fully funded by the state contribution, if applicable. A person entitled to the state contribution will retain member only health and basic life coverage provided the state contribution is sufficient to cover the premium for such coverage. If the state contribution is not sufficient for member only coverage in the health plan selected by the employee or retiree, the employee or retiree will be enrolled in the basic plan except as provided for in §81.7(m)(2)(B) of this chapter.]

[(ii) A person who continues group health and dental benefits as provided in §81.5(k) of this chapter (relating to Eligibility) must pay premiums in advance on a monthly basis. Premiums for such a person will be 102% of the rates charged for other participants in the same coverage category and with the same plan. All premiums due for the election/enrollment period must be postmarked or received by the Employees Retirement System of Texas on or before the date indicated on the continuation of coverage enrollment form. Subsequent premiums are due on the first day of the month covered and must be postmarked or received by the Employees Retirement System of Texas within 30 days of the due date to avoid cancellation of coverage.]

[(iii) A person who continues group health and dental benefits as provided in §81.5(k)(3) of this chapter must pay premiums in advance on a monthly basis. Premiums for such a person for each month of coverage after the 18th month of coverage will be 150% of the rates charged for other participants in the same coverage category and with the same plan. All premiums are due on the first day of the coverage month and must be postmarked or received by the Employees Retirement System of Texas within 30 days of the due date to avoid cancellation of coverage.]

[(c) EFFECTIVE SEPTEMBER 1, 2014, the amount of state contributions for certain retirees will be tiered in accordance with §1551.3196, Texas Insurance Code.]

[(1) Solely for the purpose of determining the applicability of Section 29, Chapter 618 (S.B. 1459), Acts of the 83rd Legislature, Regular Session, 2013, to individuals who are not participating in the Program as a Retiree, an individual is considered grandfathered at the time of retirement and not subject to §1551.3196, Texas Insurance Code if, on or before September 1, 2014, the individual has served in one or more positions for at least five years for which the individual was eligible to participate in the Program as an Employee.]

[(2) Records of the Employees Retirement System of Texas shall be used to determine whether or not an individual meets the grandfathering requirements specified in paragraph (1) of this subsection. ERS may, in its sole discretion, require an individual to provide additional documentation satisfactory to ERS that the individual meets the grandfathering requirements specified in paragraph (1) of this subsection.]

§81.5. Eligibility.

(a) Employees.

(1) Full-time Employees. Eligibility for GBP health coverage for full-time employees begins on the first day of the calendar month following the employee's completion of

the health insurance waiting period. If the employee described in paragraphs (A) or (B) does not enroll in GBP health coverage on or before becoming eligible, he/she will automatically be enrolled in HealthSelect of Texas upon becoming eligible.

(A) [(a)] [Full-time employees.] A full-time employee of an employer other than an institution of higher education [, elected officer, or appointed officer of the state of Texas is eligible for automatic coverage upon completion of the waiting period established in §1551.1055, Insurance Code. A rehired full-time employee, reelected officer, or reappointed officer of the state of Texas, including a new full-time employee, each] with existing, current, and continuous GBP health coverage as of the date the employee begins active duty or the elected or appointed officer is qualified for and begins to hold office, is eligible for GBP health coverage under this subsection [automatic coverage] without a waiting period provided there has been no break in coverage in the GBP. [However, an]

(B) A full-time employee of an institution of higher education is [and the employee's eligible dependents are] eligible for GBP health coverage on the first day that an employee performs services as an employee of an institution of higher education only if:

(i) [(1)] the full amount of insurance required contributions [premiums] are paid for the employee's coverage from the first date of employment through the completion of the health insurance waiting period [defined in §1551.1055(a), Insurance Code];

(ii) [(2)] any insurance required contributions [premiums] paid as provided in clause (i) of this subparagraph [paragraph (1) of this subsection] shall not be paid using money appropriated from the general revenue fund; and

(iii) [(3)] any institution of higher education electing to pay the insurance required contribution [premium] for any employee as described in this subparagraph [subsection] must do so for all eligible similarly situated full-time employees.

(2) [(b)] Part-time employees.

(A) A part-time employee or other employee of an employer other than an institution of higher education who is not eligible for automatic coverage becomes eligible for GBP health coverage upon completion of the health insurance waiting period [established in §1551.1055, Insurance Code,] and upon application to participate in the GBP [Program], subject to the provisions of §81.7(a)(2) [§81.7(b)] of this chapter (relating to Enrollment and Participation). A rehired part-time employee[, reelected part-time officer, or reappointed part-time officer] of the state of Texas, including a new part-time employee, each with existing, current, and continuous GBP health coverage as of the date the employee begins active duty or is qualified for and begins to hold office, who is not eligible for automatic coverage is eligible for coverage without a waiting period provided there has been no break in coverage.

(B) [(1)] A [However, a] part-time employee of an institution of higher education is [and the employee's eligible dependents are] eligible for GBP health coverage on the first day that a part-time employee performs services as a part-time employee of an institution of higher education only if:

(i) [(A)] the full amount of insurance required contributions [premiums] are paid for the part-time employee's coverage from the first date of employment through the completion of the health insurance waiting period [defined in §1551.1055(a), Insurance Code];

(ii) [(B)] any insurance required contributions [premiums] paid as provided in clause (i) of this subparagraph [(A) of this paragraph] shall not be paid using money appropriated from the general revenue fund; and

(iii) [(C)] any institution of higher education electing to pay any portion of the insurance required contribution [premium] for any part-time employee as described in this subparagraph [subsection] or in §1551.101(e)(2) of the Act, [Insurance Code,] must do so for all eligible similarly situated part-time employees.

(C) [(2)] An institution of higher education is also not prohibited from contributing a portion or all of the insurance required contribution [required premium] for certain part-time employees described by §1551.101(e)(2) of the Act, [Insurance Code,] only if:

(i) [(A)] the insurance required contributions [premiums not paid by the general revenue fund are] paid by the institution of higher education shall not be paid with funds that are [not] appropriated from the general revenue fund;

(ii) [(B)] any institution of higher education electing to pay the insurance required contributions [premiums] for any part-time employee as described in §1551.101(e)(2) of the Act, [Insurance Code,] must do so for all eligible part-time employees described therein; and

(iii) [(C)] any insurance required contributions [premiums] paid as provided in clause (i) of this subparagraph [(A) of this paragraph] must be paid from the first date of the part-time employee's initial enrollment.

(b) [(c)] Retirees.

(1) A retiree who is at least 65 years of age with a minimum of 10 years eligible service credit or a retiree whose age and eligible service credit equals or exceeds 80 with a minimum of 10 years eligible service credit, is eligible for GBP health coverage on the day he/she [he or she] becomes an annuitant provided the individual retires directly from state service. If the individual does not retire directly from state service as described in §1551.1055(b) of the Act, [Insurance Code,] eligibility for GBP health coverage begins on the first day of the calendar month following 60 [90] days after the date of retirement.

(2) A retiree who is less than 65 years of age with a minimum of 10 years eligible service credit is eligible for GBP health coverage with the applicable state contribution on the first day of the calendar month following the date on which the individual reaches 65 years of age, subject to meeting the required health insurance waiting period [provided in §1551.1055(b)], if applicable.

(3) ORP Retirees.

(A) A participant in the ORP is eligible for GBP health coverage on the day he/she receives or is eligible to receive an annuity under the ORP program or would have been eligible to receive an annuity had his/her membership been in TRS rather than the ORP, and meets the age, length-of-service, any applicable health insurance waiting period, and other requirements as provided in this subsection.

(B) A participant in the ORP is eligible for additional coverage and plans, which include optional coverage in the GBP, as long as he/she receives or is eligible to receive an annuity under the ORP program or would have been eligible to receive an annuity had his/her membership been in TRS rather than the ORP.

(4) [(3)] Retirees eligible for interim insurance. A retiree with at least 10 [ten] years of eligible service credit who is not eligible for a state contribution for GBP health coverage at the time of retirement is eligible for dental and vision coverage and, except as provided in paragraph (5) [(4)] of this subsection, optional life insurance and dependent life insurance at the time of retirement. A retiree described by this paragraph and by paragraph (2) of this subsection, is eligible for GBP health coverage under the provisions described in [Texas Insurance Code,] §1551.323 of the Act, upon payment of the total cost, as determined by the Board of Trustees. For purposes of §1551.323, the total cost shall be determined by the Board of Trustees based on an actuarial determination, as recommended by ERS' [the system's] consulting actuary for insurance, of the estimated total claims costs for individuals eligible for interim insurance pursuant to §1551.323 of the Act [, Insurance Code]. If an individual who is eligible for this interim insurance is also eligible for COBRA coverage, then COBRA coverage should be exhausted, if possible, before [applying for] the interim insurance begins as described by this subsection.

(5) [(4)] A retiree is eligible for optional life insurance and dependent life insurance coverage if the retiree was enrolled in such coverage on the day before becoming an annuitant. Except as provided in paragraph (6) [(5)] of this subsection, a retiree may not increase the amount of life insurance for which the retiree was enrolled on the day before becoming an annuitant, but may cancel life insurance coverage at any time. Canceled life insurance coverage [coverages] may never be reinstated. A retiree is not eligible for disability or AD&D coverage.

(6) [(5)] A retiree who is not enrolled in [minimum] retiree optional life insurance or dependent life insurance coverage is eligible to apply for minimum retiree optional life insurance or dependent life insurance [such] coverage. Submission of evidence of insurability acceptable to ERS [the system] shall be required for enrollment in such coverage.

(7) [(6)] A retiree who was not enrolled in dependent life insurance coverage on the day before becoming an annuitant becomes eligible for dependent life insurance coverage of a newly acquired dependent on the first day of the month following the date on which the individual becomes a dependent of the retiree.

(8) [(7)] A retiree who returns to work for an employer [a department] may continue coverage [coverages] for which he/she [he] is eligible as a retiree, or, subject to subsection (a) [or (b)] of this section, elect to participate in the GBP [Program] as a full-time or part-time employee. Time spent in an eligible position as a return to work retiree may not be used to meet eligibility requirements for retiree health insurance coverage. A return to work retiree who elected active employee coverage will be re-enrolled in retiree coverage for which he/she is eligible and may elect new retiree coverage for which he/she is eligible at the time of separation from active duty [may elect retiree coverages for which he is eligible at the time of separation from department service].

(9) [(8)] A retiree whose extended life insurance benefits are terminated for reasons other than termination pursuant to §1551.351 of the Act is eligible for retiree life insurance coverage on the first day of the month following the extended life insurance benefits termination date.

(c) [(d)] Dependents of employees and retirees.

(1) The dependents of an employee/retiree [employee or retiree] are eligible for coverage on the same day that the employee/retiree [employee or retiree] becomes eligible. Except as otherwise provided in this paragraph, a newly acquired dependent is eligible for coverage on the first day of the month following the date on which the individual becomes a dependent of a covered employee/retiree [employee or retiree]. The employee/retiree [employee or retiree] must be enrolled for a particular coverage before the employee's/retiree's [employee's or retiree's] dependents are eligible for that type of coverage. An eligible child for whom a covered employee/retiree [employee or retiree] is court-ordered [court ordered] to provide medical support becomes eligible for GBP health coverage upon receipt by the employer [department] of a valid court order. A newborn natural child is eligible automatically on the date of birth. A newly adopted child is eligible automatically on the date of placement for adoption.

(2) Except as otherwise provided in this paragraph, double coverage is not permitted for any participant in the GBP [Program].

(A) A participant may not be simultaneously covered by basic or optional term life insurance as an employee/retiree [employee or retiree] and dependent term life insurance as a dependent. A family member who is covered as an employee/retiree [employee or retiree] is not eligible to be covered as a dependent in the GBP [Program]. Except as provided in subparagraph (B) of this paragraph, a dependent may not be covered by more than one employee/retiree [employee or retiree] for the same coverage.

(B) A child who is an eligible dependent of two employees/retirees [participants] in the GBP [Program] may be enrolled in dependent life insurance coverage and accidental death and dismemberment coverage by both employees/retirees, if otherwise eligible [participants].

(d) [(e)] Former COBRA unmarried children.

(1) A former COBRA unmarried child is eligible to continue the GBP health, dental and vision [and dental] insurance coverage [coverages] in which the child was enrolled upon expiration of the child's continuation coverage under COBRA.

(2) A former COBRA unmarried child continuing health insurance coverage under the provisions of this subsection is eligible for dental and vision insurance coverage if such coverage was not in effect upon the expiration of the child's continuation coverage under COBRA.

(3) A former COBRA unmarried child is eligible to enroll a newly acquired dependent child within 30 days of the child's date of birth or placement for adoption. Otherwise, he/she cannot enroll any other dependents in GBP health coverage.

(e) [(f)] Surviving dependents.

(1) The surviving spouse of a deceased retiree or [the surviving spouse of] an active employee is eligible to continue coverage in the GBP health, dental and vision [and dental benefits] plans in which the surviving spouse was enrolled on the day of death of the employee/retiree provided, however, the deceased active employee must have had at least 10 years of service credit, including at least 3 years on August 31, 2001 or at least 10 years after August 31, 2001 of service as an eligible employee with an employer [a Program participating department], at the time of death. A deceased active employee described by §1551.114 of the Act [, Insurance Code,] must have had at least 10 years of eligible service credit, as determined by ERS, before his/her [his or her] surviving spouse is eligible to continue coverage. A surviving spouse who is also an annuitant or employee [a state retiree or state employee] shall not be eligible for surviving spouse benefits as long as he/she [he or she] is eligible for coverage as an employee/retiree [employee or retiree]. Participants continuing coverage as surviving spouses are not eligible for life insurance coverage [coverages].

(2) The dependent child [Dependent children] of a deceased retiree or an active employee is [or retiree are] eligible to continue coverage in the GBP health, dental and vision [and dental benefits] plans in which the dependent children were enrolled on the day of death of the employee/retiree provided, however, the deceased active employee must have had, at the time of death, at least 10 years of service credit, including at least 3 years on August 31, 2001 or at least 10 years after August 31, 2001 of service as an eligible employee with an employer [a Program participating department], as long as the surviving spouse is eligible and continues to participate in the GBP [Program]. A deceased active employee described by §1551.114 of the Act [, Insurance Code,] must have had at least 10 years of eligible service credit, as determined by ERS, before his/her [his or her] dependent children are eligible to continue coverage. Dependent children of deceased employees/retirees [employees or retirees] will be considered as dependents of the deceased employee's/retiree's [employee's or retiree's] surviving spouse for purposes of the GBP [Program]. Participants continuing coverage as surviving dependents are not eligible for life insurance coverage.

(3) If a retiree or active employee [an active employee/retiree] does not have a spouse covered in the GBP [Program] at the time of his/her [his or her] death, dependent children of the deceased retiree or active employee [employee/retiree] are eligible to continue coverage in the GBP health, dental and vision [and dental benefits] plans in which the dependent children were enrolled on the day of death of the employee/retiree provided, however, the deceased active employee must have had at least 10 years of service credit, including at least 3 years on August 31, 2001 or at least 10 years after August 31, 2001 of service as an eligible employee with an employer [a Program participating department], at the time of death. A deceased retiree or active employee described by §1551.114 of the Act, [Insurance Code,] must have had at least 10 years of eligible service credit, as determined by ERS, before his/her [his or her] dependent children are eligible to continue coverage. A surviving dependent child may continue such coverage until the dependent child becomes ineligible as defined in §81.1 of this chapter (relating to Definitions). Participants continuing coverage as surviving dependents are not eligible for life insurance coverage.

(4) A person who is the surviving spouse or dependent of a member [of an individual described in §1551.155(a), Insurance Code,] may secure GBP [group] health coverage if the individual was eligible to participate in the GBP [group benefits program] under §§1551.101, 1551.102 or 1551.155(a) of the Act [§1551.101 or §1551.102, Insurance Code], but was not participating at the time of the individual's death.

[(5) A person who is a surviving dependent of an annuitant may secure group health coverage after the death of the annuitant if the annuitant was eligible to participate in the group benefits program of a retirement system named in Chapter 1551, Insurance Code, but was not participating at the time of the individual's death.]

(5) [(6)] A surviving spouse or dependent seeking group coverage under paragraphs (1) – (4) [(5)] of this subsection must apply for coverage not later than the 30th day after the date on which the individual who was eligible to participate in the GBP [group benefits program] dies; and shall pay for coverage at the group rate for other participants.

(6) [(7)] A surviving spouse or an eligible dependent child of a paid law enforcement officer employed by the state or a custodial employee of the institutional division of the Texas Department of Criminal Justice who suffers a death in the line of duty as provided by Chapter 615, Government Code, shall be eligible for coverage in the GBP [Program] as provided in subparagraphs (A) - (D) of this paragraph.

(A) Coverage for a surviving spouse under this paragraph shall be at the same rate as the employee-/retiree-only coverage [employee- or retiree-only coverage], and the surviving spouse shall be entitled to the benefit of the state contribution applied to employee-/retiree-only coverage [employee- or retiree-only coverage].

(B) Coverage for a surviving spouse with children shall be at the same rate as the employee-/retiree-with-children [employee- or retiree-with-children] coverage, and the survivors shall be entitled to receive the benefit of the state contribution applied to coverage for an employee-/retiree-with-children [employee or retiree with children].

(C) Where there is no surviving spouse, a surviving child eligible for coverage under this paragraph shall be entitled to the benefit of the state contribution for employee-/retiree-only coverage [employee- or retiree-only coverage].

(D) In order for a surviving spouse or children to receive coverage in the GBP [Program] under this paragraph, they must pay the balance, if any, of all contributions due after applying the state contribution to such coverage. Any out-of-pocket insurance required contributions [premiums] due from the survivor may be deducted by ERS from the survivor's annuity payment, if any, or must be paid to ERS by the survivor through electronic bank deduction or direct payment. The applicable state contributions will be paid to ERS by the employer [state agency or department] that employed the deceased law enforcement officer or custodial employee.

(7) [(8)] A surviving spouse and eligible dependents, and a surviving dependent child, continuing GBP health [insurance] coverage under the provisions of this subsection are eligible for dental and vision insurance coverage if such coverage was not in effect on the date of death of the deceased employee/retiree [employee or retiree]. Any insurance required contributions are the sole responsibility of the surviving spouse and dependents.

[(g) Retiree under ORP.]

[(1) A member of the ORP is eligible for health coverage on the day he or she receives or is eligible to receive an annuity under the ORP program or would have been eligible to receive an annuity had his or her membership been in the Teacher Retirement System rather than the ORP, and meets the age, length-of-service, and other requirements as provided in subsection (c) of this section.]

[(2) A member of the ORP is eligible for additional coverages and plans which include optional and voluntary coverages in the Program as long as he or she receives or is eligible to receive an annuity under the ORP program or would have been eligible to receive an annuity had his or her membership been in the Teacher Retirement System rather than the ORP.]

(f) [(h)] Disability retiree [retirement]. An ORP participant who applies and [applicant who] is approved for disability retirement is entitled to retiree insurance coverage [coverages] as provided in §81.7(a)(3) [§81.7(c)] of this chapter. An ORP participant authorized by the Act with at least 10 years of eligible service credit, and granted ORP disabled retiree status in the GBP [Program], as established by ERS [the disability test used by the system], is eligible to participate in the GBP [Program]. Initial or continued eligibility for insurance coverage for an ORP disabled retiree will be determined by ERS [the system] under the following provisions.

(1) An ORP participant is eligible for ORP disabled retiree status in the GBP [Program] if the ORP participant is not otherwise eligible to participate in the GBP [Program] as an employee/retiree [employee or retiree] and is certified by a licensed physician designated by ERS [the system] as disabled as provided in paragraph (2) of this subsection. An ORP participant may apply for disabled retiree status in the GBP [Program] by filing a written application for ORP disabled retiree status in the GBP [Program] or having an application filed with ERS [the system] by the ORP participant's spouse, employer, or legal representative. In addition to an application for ORP disabled retiree status in the GBP [Program], an ORP participant must file with ERS [the system] the results of a medical examination of the ORP participant. After an ORP participant applies for ORP disabled retiree status in the GBP, ERS [Program, the system] may require the ORP participant to submit additional information about the disability. ERS [The system] will prescribe forms for the information required by this section.

(2) If a licensed physician designated by ERS [the system] finds that the ORP participant is mentally or physically disabled from the further performance of duty and that the disability is probably permanent, the physician will certify the disability. The executive director is authorized to approve ORP disabled retiree status in the GBP [Program] after a certification of disability is made. Once each year during the first five years after an ORP participant enrolls in the GBP [Program] as an ORP disabled retiree, and once in each three-year period after that, ERS [the system] may require an ORP disabled retiree to undergo a medical examination by a physician ERS [the system] designates. If an ORP disabled retiree refuses to submit to a medical examination as provided by this section, ERS [the system] will suspend the ORP disabled retiree's enrollment in the GBP [Program] until the ORP disabled retiree submits to an examination. ERS [The system] will terminate the ORP disabled retiree's coverage in the GBP [Program] and notify the ORP participant in writing if:

(A) ERS [the system] concurs with a certification issued by the designated physician which finds that an ORP disabled retiree is no longer mentally or physically disabled from the further performance of duty; or

(B) an ORP disabled retiree refuses for more than one year to submit to a required medical examination.

(3) The effective date of coverage for an ORP disabled retiree in the GBP [Program] is the first of the month following the date the application for ORP disabled retiree status in the GBP is approved by ERS [Program is received by the system], or the first of the month following the date employment is terminated, whichever is later.

(g) [(i)] Former members of the Legislature. A former member of the Legislature authorized by §1551.108(1) of the Act to continue to participate in the GBP [Program] is eligible for the coverage, other than disability income insurance coverage, in effect on the day before the member leaves office.

(h) [(j)] Former employees of the Legislature. A former employee of the Legislature authorized by §1551.108(2) of the Act to continue to participate in the GBP [Program] is eligible for the coverage, other than disability income insurance coverage, in effect on the day before the employee terminates employment.

(i) Former board members. Subject to the limitations of this subsection, a former member of a board or commission or of the governing body of an institution of higher education, as both are described in §1551.109 of the Act, is eligible to continue the coverage, other than disability income insurance coverage, in effect on the day before the member leaves office if no lapse in coverage occurs after the end of the term of office. Life insurance overage may not exceed Election II.

(j) [(k)] Continuation of GBP health, dental and vision coverage [and dental coverages] only for certain spouses and dependent children of employee/retirees, and for certain terminating employees, their spouses, and dependent children (as provided by COBRA) [the Consolidated Omnibus Budget Reconciliation Act, Public Law 99-272)].

(1) The surviving spouse and/or dependent child/children of a deceased employee/retiree [employee or retiree] who are not eligible to continue coverage under the provisions of the Act [Insurance Code] or subsection (e) [(f)] of this section, who are not entitled to benefits under the Social Security Act, Title XVIII, and who are not covered under any other group health plan, [or who were covered by a plan that subjects them to a preexisting conditions limitation or exclusion that was not satisfied by the service credit provisions of Public Law 104-91 Health Insurance Portability and Accountability Act (HIPAA),] may continue for up to 36 months the GBP health, dental and vision coverage [and dental coverages] only that were in effect immediately prior to the date of death of the employee/retiree. A formal election must be made to continue coverage by the surviving spouse and/or the dependent child/children. The formal election must be postmarked or received by ERS [the system] within 60 days of the date of notice contained in the notice of right to continue coverage form or by the date coverage terminated, whichever is later.

(2) An employee whose employment has been terminated voluntarily or involuntarily (other than for gross misconduct), whose work hours have been reduced such that the employee is no longer eligible for the GBP [Program] as an employee, or whose coverage has ended following the maximum period of LWOP [leave without pay] as provided for in §81.7(g)(2)(A) [§81.7(m)(2)(A)] of this chapter, except for those persons not eligible pursuant to §81.11(f) [§81.11(d)] of this chapter (relating to Cancellation of Coverage and Sanctions) [Termination of Coverage)], and/or his/her [his or her] spouse and/or dependent child/children who are not eligible to continue coverage under the provisions of the Act [Insurance Code] or subsection (f), (g) or (h) [or (i)] of this section, who are not entitled to benefits under the Social Security Act, Title XVIII, who are not covered under any other group health plan, [or who were

covered by a plan that subjects them to a preexisting conditions limitation or exclusion that was not satisfied by the service credit provisions of Public Law 104-91 (HIPAA),] may continue for up to 18 months the GBP health, dental and vision coverage [and dental coverages] only without the basic term life that were in effect immediately prior to the date of the loss of coverage. A formal election must be made to continue coverage by the employee and/or his/her [his or her] spouse and/or dependent child/children. The formal election must be postmarked or received by ERS [the system] within 60 days of the date of notice contained in the notice of right to continue coverage form or by the date coverage terminated, whichever is later.

(3) If an employee, spouse, or dependent child is determined by the Social Security Administration to have been disabled before or during the first 60 days of continuation coverage, all covered individuals may continue GBP health, dental and vision coverage [and dental coverages] extended up to an additional 11 months, for a total of 29 months. Notification of the Social Security Administration's determination must be received by ERS [the system] before the end of the original 18 months of continuation coverage. Continuation coverage will be canceled the month that begins more than 30 days after the date the Social Security Administration determines that the participant is no longer disabled.

(4) A spouse who is divorced from an employee/retiree and/or the spouse's dependent child/children who are not otherwise eligible to continue coverage under the provisions of the Act [Insurance Code] or subsection (c) [(d)] of this section, who are not entitled to benefits under the Social Security Act, Title XVIII, who are not covered under any other group health plan, [or who are covered by a plan that subjects them to a preexisting conditions limitation or exclusion that was not satisfied by the service credit provisions of Public Law 104-92 (HIPAA),] may continue for up to 36 months the GBP health, dental and vision coverage [and dental coverages] only that were in effect immediately prior to the date the divorce decree is signed. The employee/retiree or the divorced spouse or the divorced spouse's dependent child/children must notify ERS [the system] through the [employing department or retiree] benefits coordinator of the divorce within 60 days from the date the divorce decree is signed. A formal election must be made to continue coverage by the divorced spouse and/or the dependent child/children. The formal election must be postmarked or received by ERS [the system] within 60 days of the date of notice contained in the notice of right to continue coverage form or by the date coverage is terminated, whichever is later.

[(5) A dependent child under 26 years of age who marries, who is not entitled to benefits under the Social Security Act, Title XVIII, who is not covered under any other group health plan, or who are covered by a plan that subjects the child to a preexisting conditions limitation or exclusion that was not satisfied by the service credit provisions of Public Law 104-91 (HIPAA), may continue for up to 36 months the health and dental coverages only that were in effect immediately prior to the date of the marriage. The married child or the employee/retiree must notify the system through the employing department or retiree benefits coordinator of the marriage within 60 days from the date of the marriage. A formal election must be made by the married child to continue coverage. The formal election must be postmarked or received by the system within 60 days of the date of notice contained in the notice of right to continue coverage form or by the date coverage is terminated, whichever is later.]

(5) [(6)] A dependent child who has attained 26 years of age, who is not otherwise eligible to continue coverage indefinitely under the provisions of the Act [Insurance Code] or subsection (c) [(d)] of this section, who is not entitled to benefits under the Social Security Act, Title XVIII, who is not covered under any other group health plan, [or who is covered by a plan that subjects the child to a preexisting conditions limitation or exclusion that

was not satisfied by the service credit provisions of Public Law 104-91 (HIPAA),] may continue for up to 36 months the GBP health, dental and vision coverage [and dental coverages] only that were in effect immediately prior to the date of the child's 26th birthday. The child or employee/retiree must notify ERS [the system] through the [employing department or retiree] benefits coordinator within 60 days of the child's 26th birthday. A formal election must be made by the 26-year-old child to continue coverage. The formal election must be postmarked or received by ERS [the system] within 60 days of the date of notice contained in the notice of right to continue coverage form or by the date coverage is terminated, whichever is later.

(6) [(7)] Extension of continuation of coverage for certain spouses and/or dependent child/children of former employees who are continuing coverage under the provisions of paragraph (2) of this subsection is governed by the following provisions.

(A) The surviving spouse and/or dependent child/children of a deceased former employee whose death occurred during the period of continuation coverage, who satisfy the provisions of paragraph (1) of this subsection and who notify ERS [the Employees Retirement System of Texas] within 60 days of the date of death of the former employee are entitled to a total of 36 months of continuation coverage.

(B) A spouse who is divorced from a former employee during the period of continuation coverage and/or the divorced spouse's dependent child/children who satisfy the provisions of paragraph (4) of this subsection are entitled to a total of 36 months of continuation coverage.

[(C) A dependent child under 26 years of age who marries during the period of continuation coverage and who satisfies the provisions of paragraph (5) of this subsection is entitled to a total of 36 months of continuation coverage.]

(C) [(D)] A dependent child who attains the age of 26 years during the period of continuation coverage and who satisfies the provisions of paragraph (5) [(6)] of this subsection is entitled to a total of 36 months of continuation coverage.

(D) [(E)] An employee, spouse, or dependent child determined by the Social Security Administration to be disabled at the time of termination of the employee's employment and who satisfies the provisions of paragraph (3) of this subsection is entitled to not more than [to a total of] 29 months of continuation coverage.

(E) [(F)] No person shall be allowed to continue GBP health, dental and vision coverage [and dental coverages] under the provisions of this subsection for more than 36 months.

(7) [(8)] A person who continues benefits under the provisions of paragraphs (1) – (6) [(7)] of this subsection may change coverage levels or plans during the continuation period on the same basis as an employee/retiree participant, provided, however, that GBP health coverage [and dental coverages] which is [are] canceled during the continuation period may not be reestablished.

(8) [(9)] In all situations deemed applicable by ERS [the Employees Retirement System of Texas] where state or federal laws or regulations mandate specific terms or provisions which are omitted or conflict with specific terms or provisions of the plan documents

or ERS' [group contracts or trustees'] rules, the appropriate plan documents [contracts] and rules shall be interpreted and administered to comply with such laws or regulations.

[(l) Former board members. Subject to the limitations of this subsection, a former member of a board or commission or of the governing body of an institution of higher education, as both are described in §1551.109, Insurance Code, is eligible to continue the coverage, other than disability income insurance coverage, in effect on the day before the member leaves office if no lapse in coverage occurs after the end of the term of office. Life insurance coverage may not exceed Election II.]

§81.7. Enrollment and Participation.

(a) Enrollment Categories.

(1) [(a)] Full-time employees and their dependents.

(A) [(1)] A new employee:

(i) [(A)] who is not subject to the health insurance waiting period and is eligible under the Act and as provided for in §81.5(a)(1) [§81.5(a)] of this chapter (relating to Eligibility) for automatic insurance coverage, shall be enrolled in the basic plan [of health and life insurance] unless the employee completes an enrollment form to elect other coverage [coverages] or to waive GBP health coverage as provided in §81.8 of this chapter (relating to Waiver of Health Coverage). Coverage of an employee under the basic plan, and other coverage [coverages] selected as provided in this paragraph, becomes [become] effective on the date on which the employee begins active duty.

(ii) [(B)] who is subject to the health insurance waiting period and is eligible under the Act and as provided for in §81.5(a)(1) [§81.5(a)] of this chapter for automatic insurance coverage, shall be enrolled in the basic plan [of health and life insurance] beginning on the first day of the calendar month following 60 [90] days of employment unless, before this date, the employee completes an enrollment form to elect other coverage [coverages] or to waive GBP health coverage as provided in §81.8 of this chapter.

(iii) [(2)] who has [A new employee with] existing, current, and continuous GBP health coverage as of the date the employee begins active duty is not subject to the health insurance waiting period [established in §1551.1055, Insurance Code,] and is eligible to enroll as a new employee in health insurance and additional coverage [coverages] and plans which include optional coverage [and voluntary coverages] by completing an enrollment form before the first day of the calendar month after the date the employee begins active duty. Health and additional coverage [coverages] selected before the first day of the calendar month after the date the employee begins active duty are effective the first day of the following month.

(B) [(3)] Dependent enrollment and optional coverage [coverages]:

(i) [(A)] To enroll eligible dependents, to elect to enroll in an approved HMO, and to elect additional coverage [coverages] and plans which include optional coverage [and voluntary coverages], an employee not subject to the health insurance waiting period shall complete an enrollment form within 30 days after the date on which the employee begins active duty. Coverage [Coverages] selected within 30 days after the date on which the employee begins active duty becomes [become] effective on the first day of the month following the date on which the enrollment form is completed. An enrollment form completed after the initial period for enrollment as provided in this paragraph is subject to the provisions of subsection (d) [(i)] of this section.

(ii) [(B)] To enroll eligible dependents or to elect to enroll in an approved HMO, an employee subject to the health insurance waiting period shall complete an enrollment form before the first day of the month following 60 [90] days of employment. Coverage [Coverages] selected before the first day of the month following 60 [90] days of employment becomes [become] effective on the first day of the month following 60 [90] days of employment. An employee completing an enrollment form after the initial period for enrollment as provided in this paragraph is subject to the provisions of subsection (d) [(i)] of this section. The provisions of subparagraph (A)(ii) of this paragraph [(2) of this subsection] apply to the election of additional coverage [coverages] and plans, which include optional coverage [and voluntary coverages], for an employee subject to the health insurance waiting period.

(C) [(4)] Except as otherwise provided in this section, an employee may not change coverage [during a contract year].

(D) [(5)] An eligible employee who enrolls in the GBP [Program] is eligible to participate in premium conversion and shall be automatically enrolled in the premium conversion plan. The employee shall be automatically enrolled in the plan for subsequent plan years as long as the employee remains on active duty.

(E) [(6)] Coverage for a newly eligible dependent, other than a dependent referred to in subparagraph (F) or (H) of this paragraph [(7) or (9) of this subsection], will be effective on the first day of the month following the date the person becomes a dependent if an enrollment form is completed on or within 30 days after the date the person first becomes a dependent. If the enrollment form is completed and signed after the initial period for enrollment as provided in this paragraph, the enrollment form will be governed by the rules in subsection (d) [(i)] of this section.

(F) [(7)] A member's newborn natural child will be covered immediately and automatically for 30 days from the date of birth in the health plan in effect for the employee/retiree [employee or retiree]. A member's newly adopted child will be covered immediately and automatically from the date of placement for adoption for 30 days in the health plan in effect for the employee/retiree [employee or retiree]. To continue coverage for more than 30 days after the date of birth or placement for adoption, an enrollment form for GBP health coverage must be submitted by the member within 30 days after the date of birth or placement for adoption.

(G) [(8)] The effective date of a newborn natural child's life and AD&D coverage [insurance] will be the date of birth, if the child is born alive, as certified by an attending physician or a certified nurse-midwife. The effective date of a newly adopted child's life and AD&D coverage [insurance] will be the date of placement for adoption. The effective date of all other eligible dependents' life and AD&D coverage [insurance coverages] will be as stated in subparagraph (E) of this paragraph [(6) of this subsection].

(H) [(9)] GBP health [Health insurance] coverage of a member's [an] eligible child for whom a covered employee/retiree [employee or retiree] is court-ordered to provide medical support becomes effective on the date on which the member's benefits coordinator [department] receives a valid copy of the qualified medical child support [court] order.

(I) [(10)] The effective date of GBP health [HealthSelect of Texas] coverage for an employee's/retiree's [employee's or retiree's] dependent, other than a newborn natural child or newly adopted child, will be as stated in subparagraph (E) of this paragraph [(6) of this subsection].

(J) [(11)] For purposes of this section, an enrollment form is completed when all information necessary to effect an enrollment has been transmitted to ERS [the system] in the form and manner prescribed by ERS [the system].

(2) [(b)] Part-time employees. A part-time employee or other employee who is not automatically covered must complete an application/enrollment form provided by ERS [the Employees Retirement System of Texas,] authorizing necessary deductions for insurance required contributions [premium payments] for elected coverage. All other rules for enrollment stated in paragraph (1) of this subsection [(a) of this section], other than the rule as to automatic coverage, apply to such employee:

(A) [(1)] If the employee is not subject to a health insurance waiting period, this form must be submitted to ERS either through ERS Online or [the Employees Retirement System of Texas] through his/her benefits coordinator [his or her employing department] on, or within 30 days after, the date on which the employee begins active duty.

(B) [(2)] If the employee is subject to a health insurance waiting period, this form must be submitted to ERS either through ERS Online or [the Employees Retirement System of Texas] through his/her benefits coordinator [his or her employing department] before the first day of the month following 60 [90] days of employment.

(C) [(3)] If the employee has existing, current, and continuous GBP health coverage as of the date the employee begins active duty, the employee is not subject to the health insurance waiting period [established in §1551.1055, Insurance Code,] and is eligible to enroll as a new employee in health insurance and additional coverage [coverages] and plans which include optional coverage [and voluntary coverages] by completing an enrollment form before the first day of the calendar month after the date the employee begins active duty. Health and additional coverage [coverages] selected before the first day of the calendar month after the date the employee begins active duty are effective the first day of the following month.

(3) [(c)] Retirees and their dependents.

(A) [(1)] Provided the insurance required contributions [required premiums] are paid or deducted, an employee's GBP health, dental, vision and term life insurance coverage (including eligible dependent coverage) [coverages)] may be continued upon retirement as provided in §81.5(b) [§81.5(c)] of this chapter. The life insurance will be reduced to the maximum amount which the retiree is permitted to retain under the insurance plan [contract] as a retiree. All other coverage [coverages] in force for an [the] active employee, but not available to a retiree, will automatically be discontinued concurrently with the commencement of retirement status. Except as provided in subparagraph (E) of this paragraph [subsection (a)(6) of this section], if a retiree retires directly from active duty [department service] and is not covered as an active employee on the day before becoming an annuitant, the retiree may enroll [will be enrolled] in the basic plan.

(B) [(2)] A retiree may enroll in GBP health, dental, vision and life insurance coverage [coverages] for which the retiree is eligible as provided in §81.5(b) [§81.5(c)] of this chapter, including dependent coverage [coverages], by completing an enrollment form as specified in clauses (i) – (iii) of this subparagraph [subparagraphs (A) - (C) of this paragraph]. For the purposes of this subparagraph [paragraph], the effective date of retirement of a retiree who is eligible to receive, but who has not yet received [is not actually receiving], an annuity is the date on which ERS [the system] receives written notice of the retirement. An application/enrollment form received after the initial period for enrollment as provided in this subparagraph [paragraph], is subject to the provisions of subsection (d) [(i)] of this section.

(i) [(A)] A retiree who is not subject to the health insurance waiting period on the effective date of retirement as provided in §81.5(b) [§81.5(c)] of this chapter, may enroll in GBP health, dental, vision and life insurance coverage [coverages] or waive GBP health coverage as provided in §81.8 of this chapter for which the retiree is eligible, including dependent coverage, by completing an enrollment form or waiver of coverage as applicable before, on, or within 30 days after, the retiree's effective date of retirement.

(ii) [(B)] A retiree who is subject to the health insurance waiting period on the effective date of retirement as provided in §81.5(b) [§81.5(c)] of this chapter, may enroll in GBP health coverage or waive GBP health coverage as provided in §81.8 of this chapter for which the retiree is eligible, including dependent coverage, by completing an enrollment form or waiver of coverage as applicable, before the first day of the calendar month following 60 [90] days after the date of retirement or before the first day of the calendar month after the retiree's 65th birthday, whichever is later as appropriate. The effective date for such coverage [coverages] shall be the first day of the calendar month following 60 [90] days after the date of retirement or the first day of the calendar month following the retiree's 65th birthday, whichever is later as appropriate.

(iii) [(C)] A retiree who is ineligible for health insurance on the effective date of retirement as provided in §81.5(b) [§81.5(c)] of this chapter, may enroll in GBP health coverage or waive GBP health coverage as provided in §81.8 of this chapter for which the retiree is eligible, including dependent coverage, by completing an enrollment form or waiver of coverage as applicable, before the first day of the calendar month after the retiree's 65th birthday. The effective date for such coverage [coverages] shall be the first day of the calendar month following 60 [90] days after the date of retirement or the first day of the calendar month following the retiree's 65th birthday, whichever is later.

(C) [(3)] A retiree who becomes eligible for minimum retiree optional life insurance coverage or dependent life insurance coverage as provided in §81.5(b)(6) [§81.5(c)(5)] of this chapter, may apply for approval of such coverage by providing evidence of insurability acceptable to ERS [the system].

(D) [(4)] Enrollments in and applications to change coverage become effective as provided in subparagraph (B) of this paragraph [(2) of this subsection] unless other coverage is [coverages are] in effect at that time. If other coverage is [coverages are] in effect at that time, coverage or waiver of coverage becomes effective on the first day of the month following the date of approval of retirement by ERS [the Employees Retirement System of Texas]; or, if cancellation of the other coverage [coverages] preceded the date of approval of retirement, the first day of the month following the date the other coverage was [coverages were] canceled.

[(5) All other enrollment rules stated in subsections (a), (h), and (m) of this section apply to retirees.]

(E) [(6)] A retiree who seeks enrollment in GBP health coverage [coverages] after turning age 65 or is retired and enrolled in a health [the basic] plan and turns age 65 will be automatically enrolled in the Medicare Advantage Plan unless the retiree opts out of the Medicare Advantage Plan and enrolls in other coverage by completing an enrollment form as specified in subparagraph (B)(i) – (iii) of this paragraph [(2)(A) - (C) of this subsection]. If the retiree is determined to be ineligible for Medicare coverage, then he/she will be returned to the coverage in place immediately before turning 65.

(F) [(7)] A [ERS may determine that a] Medicare-eligible retiree who seeks enrollment in GBP health coverage [coverages] or is retired and enrolled in a health [the basic] plan and becomes eligible for Medicare will [may] be automatically enrolled in HealthSelect Medicare Rx. A retiree who declines HealthSelect Medicare Rx loses all GBP prescription drug coverage. If the retiree is determined to be ineligible for Medicare coverage, then he/she will be returned to the coverage in place immediately before turning 65.

(4) [(d)] Medicare-eligible Dependents.

(A) [(1)] A dependent as defined in §81.1 [§81.1(11)(A) - (I) and (12)(A) - (D)] of this chapter (relating to Definitions) who becomes eligible for Medicare-primary [Medicare primary] coverage as specified in §81.1 [§81.1(23)] of this chapter, either through disability, [or] age, or other requirements as set forth by CMS [or its successor agency], will be automatically enrolled in the Medicare Advantage Plan unless the retiree and his/her dependents opt out of the Medicare Advantage Plan and enroll in other coverage by completing an enrollment form as specified in paragraph (3)(B)(i) – (iii) of this subsection [(c)(2)(A) - (C) of this section]. If the dependent is determined to be ineligible for Medicare coverage, then he/she will be returned to the coverage in place immediately before turning 65.

(B) [(2)] A [ERS may determine that a] Medicare-eligible dependent eligible for GBP health coverage will [coverages under the GBP may] be automatically enrolled in HealthSelect Medicare Rx. A Medicare-eligible dependent who declines HealthSelect Medicare Rx loses all GBP prescription drug coverage. If the dependent is determined to be ineligible for Medicare coverage, then he/she will be returned to the coverage in place immediately before turning 65.

(5) [(e)] Surviving dependents.

(A) [(1)] Provided that the insurance required contributions [required premiums] are paid or deducted, the health, [and] dental, and vision insurance coverage [coverages] of a surviving dependent may be continued on the death of the deceased employee/retiree [employee or retiree] if the dependent is eligible for such coverage as provided by §81.5(e) [§81.5(f)] of this chapter.

(B) [(2)] A surviving spouse who is receiving an annuity shall make insurance required contribution [premium] payments by deductions from the annuity as provided in subsection (h)(7) of this section [§81.3(b)(2)(A) of this chapter (relating to Administration)]. A surviving spouse who is not receiving an annuity may make payments as provided in subsection (h)(7) of this section [§81.3(b)(2)(B) of this chapter].

(C) A Medicare-eligible surviving dependent eligible for GBP health coverage will be automatically enrolled in the Medicare Advantage Plan unless the surviving dependent opts out of the Medicare Advantage Plan and enrolls in other coverage.

(D) [(3)] A [ERS may determine that a] Medicare-eligible surviving dependent eligible for GBP health coverage will [coverages under the GBP may] be automatically enrolled in HealthSelect Medicare Rx. A Medicare-eligible surviving dependent who declines HealthSelect Medicare Rx loses all GBP prescription drug coverage.

(6) [(f)] Former COBRA unmarried children. A former COBRA unmarried child must provide an application to continue GBP health, [and] dental and vision insurance coverage within 30 days after the date the notice of eligibility is mailed by ERS [the system]. Coverage becomes effective on the first day of the month following the month in which continuation coverage ends. Insurance required contribution [Premium] payments must [may] be made as provided in subsection (h)(1)(A) [§81.3(b)(2)(B)] of this section [chapter].

(b) [(g)] Premium conversion plans.

(1) An eligible employee participating in the GBP [Program] is deemed to have elected to participate in the premium conversion plan and to pay insurance required contributions [premium expenses] with pre-tax dollars as long as the employee remains on active duty. The plan is intended to be qualified under the Internal Revenue Code, §79 and §106.

(2) Maximum benefit available. Subject to the limitations set forth in these rules and in the plan, to avoid discrimination, the maximum amount of flexible benefit dollars which a participant may receive in any plan year for insurance required contributions [premium expenses] under this section shall be the amount required to pay the participant's portion of the insurance required contributions [premiums] for coverage under each type of insurance included in the plan.

(c) [(h)] Special rules for additional coverage [coverages] and plans which include optional coverage [and voluntary coverages].

(1) Only an employee/retiree [employee or retiree] or a former officer or employee specifically authorized to join the GBP [Program] may apply for additional coverage [coverages] and plans. An employee/retiree may apply for or elect additional coverage [coverages] and plans for which he/she is eligible without concurrent enrollment in GBP health coverage provided by the GBP [Program]. Additional coverage [coverages] and plans, as determined by the Board of Trustees [board], may include:

(A) dental coverage;

(B) optional term life;

(C) dependent term life;

(D) short- and long-term disability;

(E) voluntary accidental death and dismemberment;

(F) long-term care; [or]

(G) health care and dependent care reimbursement; [.]

(H) commuter spending account;

(I) vision;

(J) limited purpose flexible spending account; or

(K) health savings account.

(2) An eligible member [participant] in the GBP [Program] and eligible dependents may participate in an approved HMO if they reside in the approved service area of the HMO and are otherwise eligible under the terms of the contract with the HMO.

(3) An eligible member [participant] in the GBP [Program] electing additional coverage [coverages] and plans and/or Consumer Directed HealthSelect, HMO or Medicare Advantage coverage in lieu of the basic plan [of insurance] is obligated for the full payment of insurance required contributions [premiums]. If the insurance required contributions [premiums] are not paid, all coverage [coverages] not fully funded by the state contribution will be canceled. A person eligible for [entitled to] the state contribution will retain member-only GBP [member only] health coverage as a member provided the state contribution is sufficient to cover the insurance required contribution [premium] for such coverage. If the state contribution is not sufficient for member-only [member only] coverage in the health plan selected by the member employee/retiree, the member employee/retiree [employee or retiree, the employee or retiree] will be enrolled in the basic plan or the Medicare Advantage Plan, as applicable, except as provided for in subsection (g)(2)(B) [(m)(2)(B)] of this section.

(4) An eligible member [participant] in the GBP [Program] enrolled in an HMO and the HMO's [whose] contract is not renewed for the next fiscal year will be eligible to make one of the following elections:

(A) change to another approved HMO for which the member [participant] is eligible by completing an enrollment form during the annual enrollment period. The effective date of the change in coverage will be September 1;

[(B) enroll in HealthSelect of Texas by completing an enrollment form during the annual enrollment period, if the participant is eligible to enroll in another approved HMO. The effective date of the change in coverage for the eligible participant shall be September 1. Eligible dependents may also be enrolled. The effective date of coverage for dependents may be either September 1 or the first day of the month following the date approval is received by the department;]

(B) [(C)] enroll in HealthSelect of Texas, Consumer Directed HealthSelect, or a Medicare Advantage Plan (if eligible) by completing an enrollment form during the annual enrollment period. [Eligible dependents may also be enrolled.] The effective date of the change in coverage will be September 1; or

(C) [(D)] if the member [participant] does not make one of the elections, as defined in subparagraphs (A) or (B) [- (C)] of this paragraph, the member [participant] and covered eligible dependents will automatically be enrolled in the basic plan or the Medicare Advantage Plan, as applicable.

(5) A member [An employee, retiree, or other eligible program participant] enrolled in an HMO whose contract with ERS is terminated during the fiscal year or that [which] fails to maintain compliance with the terms of its contract, as determined by ERS, [with the Employees Retirement System of Texas] will be eligible to make one of the following elections:

(A) change to another approved HMO for which the member [participant] is eligible. The effective date of the change in coverage will be determined by ERS; or [the board;]

(B) enroll in HealthSelect of Texas, Consumer Directed HealthSelect, or a Medicare Advantage Plan (if eligible) [provided the participant is not eligible to enroll in another approved HMO]. The effective date of the change in coverage will be determined by ERS. [the board; or]

[(C) if a participant is eligible to enroll in another HMO, the board may allow the participant to enroll in HealthSelect of Texas. The effective date of the change in coverage will be determined by the board.]

(d) [(i)] Changes in coverage after the initial period for enrollment.

(1) Changes for a qualifying life event.

(A) Subject to the provisions of paragraphs (3) and (4) of this subsection, a member [participant] shall be allowed to change coverage during a plan year within thirty (30) days of a qualifying life event that occurs as provided in this paragraph if the change in coverage is consistent with the qualifying life event.

(B) A qualifying life event occurs when a participant experiences one of the following changes:

(i) change in marital status;

(ii) change in dependent status;

(iii) change in employment status;

(iv) change of address that results in loss of benefits eligibility;

(v) change in Medicare or Medicaid status, or CHIP [Children's Health Insurance program (CHIP)] status;

(vi) significant cost of benefit or coverage change imposed by a third party provider; or

(vii) change in coverage ordered by a court.

(C) A member [participant] who loses benefits eligibility as a result of a change of address shall change coverage as provided in paragraphs (6) - (9) of this subsection.

(D) A member [participant] may apply to change coverage on, or within 30 days after, the date of the qualifying life event, provided, however, a change in election due to CHIP or Medicaid status under subparagraph (B) of this paragraph may be submitted on, or within 60 days after, the change in CHIP or Medicaid status.

(E) Except as otherwise provided in subsection (a)(1)(F) and (H) [(a)(7) and (9)] of this section, the change in coverage is effective on the first day of the month following the date on which the enrollment form is completed.

(F) Documentation may be required [The plan administrator may require documentation] in support of the qualifying life event.

(G) Following a qualifying life event, a member may change applicable coverage, drop or add an eligible dependent if the change is consistent with the qualifying life event.

(2) Effects of change in cost of benefits to the premium conversion plan. There shall be an automatic adjustment in the amount of premium conversion plan dollars used to purchase optional benefits in the event of a change, for whatever reason, during an applicable period of coverage, of the cost of providing such optional benefit to the extent permitted by applicable law and regulation. The automatic adjustment shall be equal to the increase or decrease in such cost. A participant shall be deemed by virtue of participation in the plan to have consented to the automatic adjustment.

(3) An eligible member [participant] who wishes to add or increase optional coverage after the initial period for enrollment must make application for approval by providing evidence of insurability acceptable to ERS, if required [the system]. Unless not in compliance with paragraph (1) of this subsection, coverage will become effective on the first day of the month following the date approval is received by ERS [the employee's benefits coordinator or by the system], if the applicant is a retiree or an individual in a direct pay status. If the applicant is an employee whose coverage was canceled while the employee was on LWOP [in a leave without pay status], the approved change in coverage will become effective on the date the employee returns to active duty if the employee returns to active duty within 30 days of the approval letter. If the date the employee returns to active duty is more than 30 days after the date on the approval letter, the approval is null and void; and a new application shall be required. An employee/retiree [employee or retiree] may withdraw the application at any time prior to the effective date of coverage by submitting a written notice of withdrawal.

(4) The evidence of insurability provision applies only to:

(A) employees who wish to enroll in Elections III or IV optional term life insurance, except as otherwise provided in subsection (f) [(l)] of this section;

(B) employees who wish to enroll in or increase optional term life insurance, dependent life insurance, or disability income insurance after the initial period for enrollment;

(C) employees enrolled in the GBP [Program] whose coverage was waived, dropped or canceled, except as otherwise provided in subsection (f) [(l)] of this section; and

(D) retirees who wish to enroll in minimum optional life insurance [coverage] or dependent life insurance [coverage] as provided in subsection (a)(3)(C) [(c)(3)] of this section.

(5) An employee/retiree [employee or retiree] who wishes to add eligible dependents to the employee's/retiree's [employee's or retiree's] HMO coverage may do so:

(A) during the annual enrollment period [(coverage will become effective on September 1)]; or

(B) upon the occurrence of a qualifying life event as provided in paragraph (1) of this subsection.

(6) A member [participant] who is enrolled in an approved HMO and who permanently moves out of the HMO service area shall make one of the following elections, to become effective on the first day of the month following the date on which the member [participant] moves out of the HMO service area:

(A) enroll in another approved HMO for which the member [participant] and all covered dependents are eligible; or

(B) if the member [participant] and all covered dependents are not eligible to enroll in an approved HMO; either:

(i) enroll in HealthSelect of Texas or Consumer Directed HealthSelect; or

(ii) enroll in an approved HMO if the member [participant] is eligible, and drop any ineligible covered dependent, unless not in compliance with §81.11(c)(3) [§81.11(a)(2)] of this chapter (relating to Cancellation [Termination] of Coverage and Sanctions).

(7) When a covered dependent of a member [participant] permanently moves out of the member's [participant's] HMO service area, the member [participant] shall make one of the following elections, to become effective on the first day of the month following the date on which the dependent moves out of the HMO service area:

(A) drop the ineligible dependent, unless not in compliance with §81.11(c)(3) [§81.11(a)(2)] of this chapter;

(B) enroll in an approved HMO if the member [participant] and all covered dependents are eligible; or

(C) enroll in HealthSelect of Texas or Consumer Directed HealthSelect, provided the eligible member [participant] and all dependents enroll in the same health plan [HealthSelect] at that time.

(8) An eligible member [participant] will be allowed an annual opportunity to make changes in coverage.

(A) Subject to other requirements of this section, a member [participant] will be allowed to:

(i) change or enroll themselves and any eligible dependents in an eligible health, dental or vision plan [from one HMO to another HMO];

[(ii) change between HealthSelect of Texas and an HMO;]

[(iii) apply for coverage in HealthSelect, if eligible;]

[(iv) select in-area or out-of-area coverage in HealthSelect of Texas based on county of residence or county of work;]

[(v) enroll in a dental plan;]

[(vi) change dental plans;]

[(vii) enroll eligible dependents in an HMO or dental coverage;]

[(viii) apply for dependent coverage in HealthSelect of Texas, if the participant is enrolled in HealthSelect of Texas;]

(ii) [(ix)] enroll themselves and their eligible dependents in an eligible health, [HMO and in a] dental or vision plan from a waived or canceled status;

(iii) [(x)] add, decrease or cancel eligible coverage, unless prohibited by §81.11(c)(3) [§81.11(a)(2)] of this chapter;

(iv) [(xi)] apply for coverage as provided in paragraph (3) of this subsection; and

(v) [(xii)] waive any or all GBP [health] coverage including health as provided in §81.8 of this chapter.

(B) Surviving dependents and former COBRA unmarried children are not eligible to add dependents to coverage through annual enrollment. A [for the provisions in subparagraph (A)(iv), (vii), (viii), (ix), (xi) or (xii) of this paragraph, except that a] surviving dependent or former COBRA unmarried child may enroll an eligible dependent in dental or vision insurance coverage if the dependent is enrolled in health insurance coverage.

(C) Annual enrollment opportunities will be scheduled each year at times announced by ERS. [Such opportunity will be scheduled prior to September 1 of each year at times announced by the system. Coverage selected during the annual enrollment period will be effective September 1.]

(9) A participant who is a retiree or a surviving dependent, or who is in a direct pay status, may decrease or cancel any coverage at any time unless such coverage is health insurance coverage ordered by a court as provided in §81.5(c) [§81.5(d)] of this chapter.

[(10) Following a qualifying life event, a participant may enroll in, or add an eligible dependent in, HealthSelect of Texas.]

(10) [(11)] A member [participant] and his/her dependents who are enrolled in the Medicare Advantage Plan may collectively enroll [apply for coverage] in HealthSelect of Texas, Consumer Directed HealthSelect or an HMO.

(A) Such opportunity will be scheduled on at least an annual basis each year, at times announced by ERS [the system].

(B) Additional opportunities will occur each month prior to an annual enrollment period. Coverage selected during these opportunities will be effective on the first of the month following processing by CMS.

(11) [(12)] If a member [participant] drops coverage for his/her [his or her] dependent because the dependent gained other coverage effective the first day of a month, then the effective date of the qualifying life event can be either the last day of the month preceding the gained coverage or on the first day of the month in which the gained coverage is effective.

[(j) Preexisting conditions exclusion. The preexisting conditions exclusion shall apply to employees who enroll in disability coverage. The exclusion for benefit payments shall not apply after the first six consecutive months that the employee has been actively at work or after the employee's disability coverage has been continuously in force for 12 months for a preexisting condition, as defined in §81.1 of this chapter (relating to Definitions). The preexisting conditions exclusion will not apply to a medical condition resulting from congenital or birth defects.]

(e) [(k)] Special provisions relating to term life benefits

(1) An employee or annuitant who is enrolled in the group term life insurance plan may file a claim for an accelerated life benefit for himself or his covered dependent in accordance with the terms of the plan in effect at that time. An accelerated life benefit paid will be deducted from the amount that would otherwise be payable under the plan.

(2) An employee or annuitant who is enrolled in the group term life insurance plan may make, in conjunction with receipt of a viatical settlement, an irrevocable beneficiary designation in accordance with the terms of the plan in effect at that time.

(f) [(l)] Re-enrollment in the GBP [Program].

(1) The provisions of subsection (a)(1) of this section shall apply to the enrollment of an employee who terminates employment and returns to active duty within the same fiscal [contract] year, who transfers from one employer [department] to another, or who returns to active duty after a period of LWOP [leave without pay] during which coverage is canceled.

(2) An employee to whom paragraph (1) of this subsection applies shall be subject to the same requirements as a newly hired employee to re-enroll in the coverage [coverages] in which the employee was previously enrolled. Provided that all applicable preexisting conditions exclusions were satisfied on the date of termination, transfer, or cancellation, no new preexisting conditions exclusions will apply. If not, any remaining period of preexisting conditions exclusions must be satisfied upon re-enrollment.

(3) If an employee is a member of the Texas National Guard or any of the reserve components of the United States armed forces, and the employee's coverage is [coverages are] canceled during a period of LWOP [leave without pay] or upon termination of employment as the result of an assignment to active military duty, the period of active military

duty shall be applied toward satisfaction of any period of preexisting conditions exclusions remaining upon the employee's return to active employment.

(g) [(m)] Continuing coverage in special circumstances.

(1) Continuation of coverage [coverages] for terminating employees. A terminating employee is eligible to continue all coverage [coverages] through the last day of the month in which employment is terminated.

(2) Continuation of coverage [coverages] for employees on LWOP [in a leave without pay] status.

(A) An employee in LWOP [a leave without pay] status may continue the coverage [coverages] in effect on the date the employee entered that status for the period of leave, but not more than 12 months. The employee must pay insurance required contributions [premiums] directly as provided in subsection (h)(1)(A) of this section [§81.3(b)(2)(B)(I) of this chapter].

(B) An employee whose LWOP [leave without pay] is a result of the Family and Medical Leave Act of 1993 will continue to receive the state contribution during such period of LWOP [leave without pay]. The employee must pay insurance required contributions [premiums] directly as defined in subsection (h)(1)(A) of this section [§81.3(b)(2)(B)(I) of this chapter]. Failure to make the payment of insurance required contributions [required payment of premiums] by the due date will result in the cancellation of all coverage [coverages] except for member-only [member only] health and basic life coverage. The employee will continue in the health plan in which he/she [he or she] was enrolled immediately prior to the cancellation of all other coverage. [coverages. If a premium beyond the state contribution for member only health and basic life coverage is owed, the employee must make the required payment of premiums directly to the employing department upon return to active duty.]

(3) Continuation of coverage [coverages] for a former member or employee of the Legislature. Provided that the insurance required contributions [required premiums] are paid, the GBP health, dental, vision and life insurance coverage [coverages] of a former member or employee of the Legislature may be continued on conclusion of the term of office or employment.

(4) Continuation coverage for a former board member. Provided that the insurance required contributions are paid, the GBP health, dental, vision and life insurance coverage of a former member of a board or commission, or of the governing body of an institution of higher education, as both are described in §1551.109 of the Act, may be continued on conclusion of service if no lapse in coverage occurs after the term of office. Life insurance will be reduced to the maximum amount for which the former board member is eligible.

(5) [(4)] Continuation of coverage [coverages] for a former judge. A former state of Texas judge, who is eligible for judicial assignments and who does not serve on judicial assignments during a period of one calendar month or longer, may continue the coverage that was [coverages that were] in effect during the calendar month immediately prior to the month in which the former judge did not serve on judicial assignments. This coverage [These coverages] may continue for no more than 12 continuous months during which the former judge does not serve on judicial assignments as long as, during the period, the former judge continues to be eligible for assignment.

(6) [(5)] Continuation of [health and dental] coverage for a surviving spouse and/or dependent child/children of a deceased employee/retiree [employee or retiree]. The surviving spouse and/or dependent child/children of a deceased employee/retiree, who, in accordance with §81.5(j)(1) [§81.5(k)(1)] of this chapter, elects to continue coverage may do so by submitting the required election notification and enrollment forms to ERS [the system]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the system] on or before the date indicated on the continuation of coverage enrollment form. Continuing coverage will begin on the first day of the month following the month in which the employee/retiree dies, provided all [group] insurance required contributions [premiums] due for the month in which the employee/retiree died and for the election/enrollment period have been paid in full.

(7) [(6)] Continuation of [health and dental] coverage for a covered employee whose employment has been terminated, voluntarily or involuntarily (other than for gross misconduct), whose work hours have been reduced such that the employee is no longer eligible for the GBP [Program] as an employee, or whose coverage has ended following the maximum period of LWOP [leave without pay] as provided in paragraph (2)(A) of this subsection. An employee, his/her [his or her] spouse and/or dependent child/children, who, in accordance with §81.5(j)(2) [§81.5(k)(2)] of this chapter, elect [elects] to continue GBP health, dental and vision coverage [and dental coverages] may do so by submitting the required election notification and enrollment forms to ERS [the system]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the system] on or before the date indicated on the continuation of coverage enrollment form. Continuing coverage will begin on the first day of the month following the month in which the employee's coverage ends, provided all [group] insurance required contributions [premiums] due for the month in which the coverage ends and for the election/enrollment period have been paid in full.

(8) [(7)] Continuation of [health and dental] coverage for a spouse who is divorced from a member [an employee/retiree] and/or the spouse's dependent child/children. The divorced spouse and/or the spouse's dependent child/children [(not provided for by §81.5(a) of this chapter)] of an employee/retiree who, in accordance with §81.5(j)(4) [§81.5(k)(4)] of this chapter, elect [elects] to continue coverage may do so by submitting the required election notification and enrollment forms to ERS [the system]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the system] on or before the date indicated on the continuation of coverage enrollment form. Continuing coverage will begin on the first day of the month following the month in which the divorce decree is signed, provided all [group] insurance required contributions [premiums] due for the month in which the divorce decree is signed and for the election/enrollment period have been paid in full.

[(8) Continuation of health and dental coverage for a dependent child under 26 years of age who marries. A dependent child under 26 years of age who marries and who, in accordance with §81.5(k)(5) of this chapter, elects to continue coverage may do so by submitting the required election notification and enrollment forms to the system. The enrollment form, including all premiums due for the election/enrollment period, must be postmarked or received by the system on or before the date indicated on the continuation of coverage enrollment form. Continuing coverage will begin on the first day of the month following the month in which the dependent child's marriage occurred, provided all group insurance premiums due for the month in which the dependent child's marriage occurred and for the election/enrollment period have been paid in full.]

(9) Continuation of [health and dental] coverage for a dependent child who has attained 26 years of age. A 26-year-old dependent child (not provided for by §81.5(c) [§81.5(d)] of this chapter) of a member [an employee/retiree] who, in accordance with §81.5(j)(5) [§81.5(k)(6)] of this chapter, elects to continue coverage may do so by submitting the required election notification and enrollment forms to ERS [the system]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the system] on or before the date indicated on the continuation of coverage enrollment form. Continuing coverage will begin on the first day of the month following the month in which the dependent child of the member [employee/retiree] attains 26 years of age, provided all [group] insurance required contributions [premiums] due for the month in which the dependent child attained age 26 and for the election/enrollment period have been paid in full.

(10) Extension of continuation of coverage [health and dental coverages] for certain dependents [spouses and/or dependent child/children] of former employees who are continuing coverage under the provisions of paragraph (6) of this subsection.

(A) The surviving dependent [spouse and/or dependent child/children] of a deceased former employee, who, in accordance with §81.5(j)(6)(A) [§81.5(k)(7)(A)] of this chapter, elects to extend continuation coverage may do so by submitting the required election notification and enrollment forms to ERS [the Employees Retirement System of Texas]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the Employees Retirement System of Texas] on or before the date indicated on the continuation enrollment form. The election/enrollment period begins on the first day of the month following the month in which the former employee died.

(B) A spouse who is divorced from a former employee and/or the divorced spouse's dependent child/children, who, in accordance with §81.5(j)(6)(B) [§81.5(k)(7)(B)] of this chapter, elects to extend continuation coverage may do so by submitting the required election notification and enrollment forms to ERS [the Employees Retirement System of Texas]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the Employees Retirement System of Texas] on or before the date indicated on the continuation enrollment form. The election/enrollment period begins on the first day of the month following the month in which the divorce decree was signed.

[(C) A dependent child under 26 years of age who marries, who, in accordance with §81.5(k)(7)(C) of this chapter, elects to extend continuation coverage may do so by submitting the required election notification and enrollment forms to the Employees Retirement System of Texas. The enrollment form, including all premiums due for the election/enrollment period, must be postmarked or received by the Employees Retirement System of Texas on or before the date indicated on the continuation enrollment form. The election/enrollment period begins on the first day of the month following the month in which the dependent child marries.]

(C) [(D)] A dependent child who has attained 26 years of age, who, in accordance with §81.5(j)(6)(C) [§81.5(k)(7)(D)] of this chapter, elects to extend continuation coverage may do so by submitting the required election notification and enrollment forms to ERS [the Employees Retirement System of Texas]. The enrollment form, including all insurance required contributions [premiums] due for the election/enrollment period, must be postmarked or received by ERS [the Employees Retirement System of Texas] on or before the date indicated on the continuation enrollment form. The election/enrollment period begins on the first day of the month following the month in which the dependent child attained age 26.

(11) Continuation coverage defined. Continuation coverage as provided for in paragraphs (6) [(5)] – (10) of this subsection means the continuation of only GBP health, dental and vision coverage which meets [and dental coverage benefits which meet] the following requirements.

(A) Type of benefit coverage. The coverage shall consist of only the GBP health, dental and vision coverage [and dental coverages], which, as of the time the coverage is being provided, are identical to the GBP health, dental and vision coverage [and dental coverages] provided for a similarly situated person for whom a cessation of coverage event has not occurred.

(B) Period of coverage. The coverage shall extend for at least the period beginning on the first day of the month following the date of the cessation of coverage event and ending not earlier than the earliest of the following:

(i) in the case of loss of coverage due to termination of an employee's employment for other than gross misconduct, reduction in work hours, or end of maximum period of LWOP [leave without pay], the last day of the 18th calendar month of the continuation period;

(ii) in the case of loss of coverage due to termination of an employee's employment for other than gross misconduct, reduction in work hours, or end of maximum period of LWOP [leave without pay], if the employee, spouse, or dependent child has been certified by the Social Security Administration as being disabled as provided in §81.5(j)(3) [§81.5(k)(3)] of this chapter, up to the last day of the 29th calendar month of the continuation period;

(iii) in any case other than loss of coverage due to termination of an employee's employment for other than gross misconduct, reduction in work hours, or end of maximum period of LWOP [leave without pay], the last day of the 36th calendar month of the continuation period;

(iv) the date on which the employer ceases to provide any group health plan to any employee/retiree;

(v) the date on which coverage ceases under the plan due to failure to make timely payment of any insurance required contribution [premium required] as provided in subsection (h) of this section [§81.3(b)(2)(B)(ii) and (iii) of this chapter];

(vi) the date on which the participant, after the date of election, becomes covered under any other group health plan under which the participant is not subject to a preexisting conditions limitation or exclusion; or

[(vii) the date on which the participant, covered under any other group health plan that subjects him or her to a preexisting conditions limitation or exclusion that was not satisfied by the service credit provisions of Public Law 104-91 (HIPAA), is no longer subject to the preexisting conditions limitation or exclusion in the other plan;]

(vii) [(viii)] the date on which the participant, after the date of election, becomes entitled to benefits under the Social Security Act, Title XVIII.

(C) Insurance required contribution costs. [Premium requirements.] The insurance required contribution [premium] for a participant during the continuation coverage period will be 102% of the employee's/retiree's GBP health, dental and vision coverage [health and dental coverages only] rate and is payable as provided in subsection (h) of this section [§81.3(b)(2)(B)(ii) of this chapter].

(i) The insurance required contribution [premium] for a participant eligible for 36 months of coverage will be 102% of the employee's/retiree's GBP health, dental and vision coverage rate [and dental coverages only rate for the 19th through 36th months of coverage] and is payable as provided in subsection (h)(1)(A) of this section [§81.3(b)(2)(B)(ii) of this chapter].

(ii) The insurance required contribution [premium] for a participant eligible for 29 months of coverage will increase to [be] 150% of the employee's/retiree's GBP health, dental and vision coverage [and dental coverages only] rate for the 19th through 29th months of coverage and is payable as provided in subsection (h)(1)(A) of this section [§81.3(b)(2)(B)(iii) of this chapter].

(D) No requirement of insurability. No evidence of insurability is required for a participant who elects to continue GBP health [(medical)] coverage under the provisions of §81.5(j)(1) - (6) [§81.5(k)(1) - (6)] of this chapter.

(E) Conversion option. An option to enroll under the conversion plan available to employees/retirees is also available to a participant who continues GBP coverage [health and dental coverages] for the maximum period as provided in subparagraph (B)(i) - (iii) of this paragraph. The conversion notice will be provided to a participant during the 180-day period immediately preceding the end of the continuation period.

[(12) Continuation coverage for a former board member. Provided that the required premiums are paid, the health, dental, and life insurance coverages of a former member of a board or commission, or of the governing body of an institution of higher education, as both are described in §1551.109, Insurance Code, may be continued on conclusion of service if no lapse in coverage occurs after the term of office. Life insurance will be reduced to the maximum amount for which the former member is eligible.]

(h) Payment of Insurance Required Contributions.

(1) A member whose monthly cost of coverage is greater than the combined amount contributed by the state or employer for the member's coverage must pay a monthly contribution in an amount that exceeds the combined monthly contributions of the state or the employer. A member shall pay his/her monthly insurance required contributions through deductions from monthly compensation or annuity payments or by direct payment, as provided in this paragraph.

(A) A member who is not receiving a monthly compensation or an annuity payment, or is receiving a monthly compensation or annuity payment that is less than the member's monthly insurance required contribution, shall pay his/her monthly insurance required contribution under this subparagraph.

(i) An employee whose monthly compensation is less than the employee's monthly insurance required contribution shall pay his/her monthly insurance required contribution through his/her employer. A non-salaried board member of an employer shall pay his/her monthly insurance required contributions through the employer for which he/she sits as a board member.

(ii) A retiree whose monthly annuity payment is less than the retiree's monthly insurance required contribution shall pay his/her monthly insurance required contributions directly to ERS.

(B) If the member does not comply with subparagraph (A) of this subsection by the due date required, ERS will cancel all coverage not fully funded by the state contribution. If the state contribution is sufficient to cover the required insurance contribution for such coverage, the member will retain member-only health and basic life coverage. If the state contribution is not sufficient to cover the member-only coverage in the health plan selected, the member will be enrolled in the basic plan except as provided for in paragraph (2)(B) of this subsection.

(2) An institution of higher education may contribute a portion or all of the insurance required contribution for its part-time employees described by §1551.101(e)(2) of the Act, if:

(A) the institution of higher education pays the contribution with funds that are not appropriated from the general revenue fund;

(B) the institution of higher education electing to pay the contribution for its part-time employees does so for all similarly situated eligible part-time employees; and

(C) the contribution paid as provided in this paragraph is paid beginning on the first day of the month following the part-time employee's completion of any applicable waiting period.

(3) A participant who continues GBP health, dental and vision coverage under COBRA as provided in §81.5(j) of this chapter (relating to Eligibility) must pay his/her monthly insurance contributions on the first day of each month covered.

(A) A participant's monthly insurance required contribution is 102% of the monthly amount charged for other participants in the same coverage category and in the same plan. All insurance required contributions due for the election/enrollment period must be postmarked or received by ERS on or before the date indicated on the continuation of coverage enrollment form. Subsequent insurance required contributions are due on the first day of each month of the participant's coverage and must be postmarked or received by ERS within 30 days of the due date to avoid cancellation of coverage.

(B) A participant's monthly insurance required contribution for continuing coverage as provided in §81.5(j))(3) of this chapter is increased after the 18th month of coverage to 150% of the monthly amount charged for other participants in the same coverage category and in the same plan. The participant's monthly insurance required contribution is due on the first day of each month covered, and must be postmarked or received by ERS within 30 days of the due date.

(4) The full cost for GBP health, dental and vision coverage is required to be paid for a member's unmarried child who is over 26 years of age, whose coverage under COBRA expired, and who has reinstated coverage in the GBP pursuant to §1551.158 of the Act. No state contribution is paid for this coverage.

(5) Survivors of a paid law enforcement officer employed by the state or a custodial employee of the institutional division of the Texas Department of Criminal Justice who suffers a death in the line of duty as provided by Chapter 615, Government Code, are eligible for GBP coverage as provided in subparagraphs (A) - (C) of this paragraph.

(A) The insurance required contribution due under this paragraph for a surviving spouse's GBP coverage is the same amount as a member-only contribution. The state contribution applicable to member-only coverage is applied to the surviving spouse's contribution for the coverage.

(B) The insurance required contribution due under this paragraph for GBP coverage for a surviving spouse with dependent children is the same amount as the member-with-children contribution. The state contribution applicable to member-with-children coverage is applied to the contribution of the surviving spouse with dependent children for the coverage.

(C) The insurance required contribution due under this paragraph for a surviving dependent child's GBP coverage, when there is no surviving spouse, is the same amount as member-only contribution. The state contribution applicable to member-only coverage is applied to the surviving dependent child's contribution for the coverage.

(D) The surviving spouse or surviving dependent child must timely pay his/her insurance required contributions for the GBP coverage. The survivor's contribution must be either deducted by ERS from the survivor's annuity payment, if any, or submitted to ERS via direct payment. Any applicable state contribution will be paid directly to ERS by the employer that employed the deceased law enforcement officer or custodial employee.

(6) If a retiree whose eligibility for health insurance is based on §§1551.102(i), 1551.111(e) or 1551.112(c) of the Act, obtains interim health insurance as provided in §1551.323 of the Act, the retiree must pay the total contribution for such coverage for as long as the retiree wants the coverage or until the first day of the month following the retiree's 65th birthday. The amount of contribution shall be determined by the Board of Trustees based on an actuarial determination, as recommended by ERS' consulting actuary for insurance, of the estimated total claims costs for individuals eligible for such coverage. If a retiree who is eligible for coverage under this paragraph is also eligible for COBRA coverage, then COBRA coverage should be exhausted, if possible, before applying for the coverage under this paragraph.

(7) A member's surviving spouse or surviving dependent who is receiving an annuity shall authorize deductions for insurance required contributions from the annuity as provided in paragraph (1) of this subsection. A member's surviving spouse or surviving dependent who is not receiving an annuity may make payments as provided in paragraph (1)(A) of this subsection.

(i) The amount of state contribution for certain retirees is determined in accordance with §1551.3196 of the Act.

(1) An individual is grandfathered at the time of retirement and not subject to §1551.3196 of the Act, if on or before September 1, 2014, the individual has served in one or more positions for at least five years for which the individual was eligible to participate in the GBP as an employee.

(2) Records of ERS shall be used to determine whether or not an individual meets the grandfathering requirements specified in paragraph (1) of this subsection. ERS may, in its sole discretion, require an individual to provide additional documentation satisfactory to ERS that the individual meets the grandfathering requirements specified in paragraph (1) of this subsection.

§81.8. Waiver of Health Coverage.

(a) Eligibility for waiver. An [individual] eligible member [to participate in the Program] may elect to waive GBP health coverage by [in] the method and form specified by ERS [the System]:

(1) during the initial period of eligibility;

(2) after a qualifying life event; or

(3) during annual enrollment.

(b) Enrollment [Re-enrollment] in GBP health coverage after waiver. An eligible member who previously waived GBP health coverage, may enroll in GBP health coverage subject to the provisions of §81.7 of this chapter (relating to Enrollment and Participation) [individual who has waived health coverage is subject to the eligibility and enrollment provisions of this chapter, should the individual elect to apply for health coverage in the Program].

(c) Incentive Credit based on a waiver.

(1) An eligible member, except for a survivor under Chapter 615, Texas Government Code [employee or retiree eligible to participate in the Program and] who waives GBP health coverage is [may be] eligible for an incentive credit in lieu of the state contribution up to the amount specified in the General Appropriations Act if the member [individual]:

(A) would otherwise have been eligible for [to receive] the state contribution to be made on his/her behalf; and

(B) demonstrates, in a manner specified by ERS, that the member has other health coverage [the System, coverage by another health benefit plan with] substantially equivalent to the GBP health coverage [coverage to the basic plan].

(2) The incentive credit may be applied only toward the cost of certain dental plans or AD&D coverage offered within the GBP [eligible optional coverage, as determined by the System].

[(3) Notwithstanding any other provisions of this chapter, optional coverage is not considered voluntary coverage for purposes of the incentive credit in lieu of the state contribution.]

§81.9. Grievance Procedures [Procedure].

(a) Grievance procedures regarding the denial of claims by administering firms for HealthSelect of Texas, Consumer Directed HealthSelect and the Dental Choice Plans are set forth in the Master Benefit Plan Documents for those plans. Internal and external reviews of claims are subject to federal statutes and rules and §1551.356, of the Act.

(b) The review procedures for a participant in an HMO, dental health maintenance organization, vision plan, or a Medicare Advantage Plan who is denied payment of insurance benefits, or otherwise receives an adverse decision, are set forth in the applicable plan documents. Those decisions are not appealable to ERS.

(c) Grievance procedures regarding the denial of a claim, denial of eligibility for coverage other than dependent eligibility, or other adverse decisions by a carrier or an administering firm for all GBP coverage other than those subject to subsections (a) and (b) are set forth in this subsection. A participant must request the carrier or administering firm to reconsider the denial or other adverse decision prior to seeking grievance review by ERS. Any additional documentation in support of the claim may be submitted to the carrier or administering firm with the request for reconsideration. If the claim is again denied, the claim, accompanied by all related documents and copies of correspondence with the carrier or administering firm, may be submitted by the participant to the executive director for review. A request for grievance review must be filed with ERS by the participant in writing within 90 days from the date the carrier or administering firm formally denies the claim, or provides notice of other adverse decision, and mails notice of the denial and grievance right of appeal to the participant.

[(a) Except for persons enrolled in an HMO, a Medicare Advantage Plan or other fully insured plan as determined by ERS, any person participating in the Group Benefits Program insurance program who is denied payment of insurance benefits, or otherwise receives an adverse decision, may request the carrier or administering firm to reconsider the claim. Any additional documentation in support of the claim may be submitted with the request for reconsideration. If the claim is again denied, the claim, accompanied by all related documents and copies of correspondence with the insurance carrier or administering firm, may be submitted by the person to the executive director of the Employees Retirement System of Texas or the executive director's designee for review. A request for grievance must be filed by the person in writing within 90 days from the date the insurance carrier or administering firm formally denies the claim, or provides notice of other adverse decision, and mails notice of this denial and grievance right of appeal to the person.]

[(b) Any participant with a grievance regarding eligibility or other matters involving the Program may submit a written request to the executive director or the executive director's designee to make a determination on the matter in dispute.]

(d) [(c)] When the executive director [or the executive director's designee] reviews any matter arising under this section, information available to ERS will be considered. When the executive director [or the executive director's designee] completes the review and makes a determination [decision], all parties involved will be notified in writing of the decision.

[(d) Any participant aggrieved by the executive director's or the executive director's designee's decision may appeal the decision to the Board's designee provided the decision grants a right of appeal.]

(e) To the extent allowed by statute, appeals of ERS' determination [Appeals of the Board's designee's decision] will be conducted under the provisions of Chapter 67 of this title (relating to Hearings on Disputed Claims) and the Act [Chapter 1551, Insurance Code]. A notice of appeal [to the Board's designee] must be in writing and filed with ERS within 30 days from the date ERS' determination [the executive director's or the executive director's designee's decision] is served on the participant [in accordance with §67.7 of this title (relating to Filing and Service of Documents and Pleadings)].

(f) Matters initiated or referred to ERS concerning misrepresentations or fraud are not subject to grievance procedures under this rule.

§81.11. Cancellation [Termination] of Coverage and Sanctions.

(a) A participant's coverage will end on the earliest of:

(1) the last day of the month in which insurance required contributions for a participant's coverage are paid in full;

(2) the last day of the month in which a participant becomes ineligible for coverage;

(3) the last day of the month, or other date as specified by ERS, in which ERS instructs the relevant carriers and administering firms to end a participant's coverage; or

(4) the effective date of a participant's expulsion from participation in the GBP or specific coverage plans as provided under §1551.351 of the Act.

(b) In addition to the dates described in subsection (a) of this section, an employee's coverage will end on the earliest of:

(1) the last day of the month in which the employee's employment ends; or

(2) the last day of the month in which the employee retires, unless the employee is eligible for coverage as a retiree.

(c) In addition to the dates described in subsection (a) of this section, a dependent's coverage will end:

(1) on the last day of the month in which the employment or retirement of the member who enrolled the dependent ends;

(2) on the last day of the month in which the dependent ceases to be an eligible dependent as defined in §81.1 of this chapter (relating to Definitions); or

(3) for qualified medical child support court-ordered dependent GBP health coverage only:

(A) on the last day of the month in which the dependent ceases to be an eligible dependent as defined in §81.1 of this chapter; or

(B) the court order is invalidated or terminates.

(d) Cancellation of coverage for a surviving spouse or surviving dependent of a deceased member.

(1) If a surviving spouse or surviving dependent of a deceased member becomes an employee eligible for GBP coverage, the coverage based on the status of surviving spouse or surviving dependent will be cancelled as of the eligibility date of the employee coverage. If the surviving spouse ceases to be an employee, the surviving spouse may re-enroll in GBP coverage based on the status of surviving spouse. If the surviving dependent ceases to be an employee, the surviving dependent may re-enroll in GBP coverage based on the status of surviving dependent for as long as he/she is an eligible dependent.

(2) If a surviving spouse or surviving dependent of a deceased member cancels coverage that was based on the status of surviving spouse or surviving dependent, he/she may not re-enroll in GBP coverage, except as provided in paragraph (1) of this subsection.

(e) Required notice when a dependent loses eligibility for coverage. A member is required to notify his/her benefits coordinator or ERS in writing within 31 days from the date the member's dependent loses eligibility for coverage. If the member fails to comply with this notification requirement, the member and dependent may be subject to sanctions pursuant to §1551.351 of the Act and subsection (f) of this section.

[(a) Cancellation of coverage.]

[(1) Coverage will continue through the last day of the month in which coverage is canceled. Coverage canceled by a surviving spouse or dependent of a deceased retiree may never be reinstated, except as provided in paragraph (4) of this subsection.]

[(2) Court ordered health coverage for a dependent cannot be canceled unless the dependent is no longer eligible as a dependent as defined in §81.1 of this chapter (relating to Definitions), the court order is no longer valid, or comparable coverage has been obtained.]

[(3) Coverage for a dependent, who marries or attains age 26, shall be canceled as of the last day of the month following the date of marriage or attainment of age 26, as the case may be.]

[(4) Surviving spouse and eligible dependent coverage for a person who becomes a state employee shall be canceled as of the effective date of coverage as an active employee. Surviving spouse and eligible dependent coverage may be reinstated when the surviving spouse terminates employment with the state.]

[(5) Coverage shall be canceled for non-payment of premium if a premium is not paid within 30 days of the date payment is due. Coverage will be canceled effective the last day of the month for which timely payment was made.]

[(b) Termination of employment. Coverages for an employee who terminates employment and his or her dependents shall continue through the last day of the month in which employment is terminated.]

[(c) Loss of dependent eligibility. In the event that an employee's or annuitant's enrolled dependent loses eligibility for continued participation in the Program, the employee/annuitant shall notify his benefit coordinator or ERS in writing no later than thirty (30) days from the day the dependent loses his eligibility. A failure to disclose a loss of dependent eligibility required by this rule may result in sanctions being imposed on the employee/annuitant pursuant to §1551.351, Insurance Code and subsection (d) of this section.]

(f) [(d)] Sanctions for Insurance Program Violations.

(1) ERS [The Employees Retirement System of Texas] may rescind any insurance coverage or impose one or more sanctions described by the Act [Insurance Code, Chapter 1551] against any person, including, but not limited to, any current or former participant, employee, annuitant, dependent or insurance claimant who commits any of the violations enumerated in the Act [the Insurance Code, Chapter 1551].

(2) Any person with a grievance regarding eligibility, payment of a claim or other matters for which an appeal is permitted involving the GBP [Program] may submit a written request to the executive director to make a determination on the matter in dispute. Any person who disputes a rescission of coverage, a denial of benefits or sanctions imposed in connection with a determination made under the Act [Insurance Code, Chapter 1551], may appeal the determination in accordance with §81.9 of this chapter (relating to Grievance Procedures [Procedure]). A timely appeal of a determination made pursuant to the Act [Insurance Code, Chapter 1551] shall not stay the imposition of sanctions. At the time such a determination is made pursuant to the Act [Insurance Code, Chapter 1551], no further claims will be paid until the ERS decision is final. Upon final agency action, all eligible claims, if any, will be processed subject to any offsets for overpayments.

(3) Any hearing provided pursuant to this section shall be a contested case under Government Code, Chapter 2001, and be conducted in the manner prescribed by law and by Chapter 67 of this title (relating to Hearings on Disputed Claims).

(4) Any person expelled from the GBP [Texas Employees Group Benefits Program] may not be insured under any benefits plan offered by the GBP [Program] for a period determined by ERS [the Employees Retirement System of Texas].

(5) If a person's insurance coverage is rescinded, it may be rescinded to the date of the inception of the coverage or from the date of the prohibited conduct as found in the determination made in accordance with the Act [Insurance Code, Chapter 1551].

(6) ERS [The Employees Retirement System of Texas] also may deny any claim filed to obtain benefits from the insurance coverage in a manner prohibited under the Act [Insurance Code, Chapter 1551].

§85.4. Separate Plans.

(a) Dependent care reimbursement plan--A separate plan under the Code, §129, adopted by the board of trustees, and designed to provide payment or reimbursement for dependent care expenses as described in §85.5(c) of this title (relating to Benefits). The following sections of this chapter constitute the plan: §§85.1, 85.3(a), 85.5(a), 85.5(c), 85.7, 85.9, 85.11, 85.12, 85.13, 85.15, 85.17, and 85.19.

(b) Health care reimbursement plan--A separate plan, under the Code, §105, adopted by the board of trustees, and designed to provide health care expense reimbursement as described in §85.5(b) of this title (relating to Benefits). The following sections of this chapter constitute the plan: §§85.1, 85.3(b), 85.5(a), 85.5(b), 85.7, 85.9, 85.11, 85.12, 85.13, 85.15, 85.17, and 85.19.

(c) Insurance Premium Conversion Plan--A separate plan under §105(b) of the Code designed to provide insurance premium conversion as described in §81.7 [§81.7(f)]. The Insurance Premium Conversion Plan is intended to comply with the Internal Revenue Code, §79 and §106.

(d) Qualified transportation benefit plan--A separate plan under the Code, §132, approved by the board of trustees, and designed to provide payment or reimbursement for certain transportation expenses. The qualified transportation benefit plan is governed by a plan document as executed and approved by the Executive Director, and as amended hereafter. A copy of the plan document may be obtained from the Employees Retirement System of Texas on request.

PUBLIC AGENDA ITEM -#14a

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

14a. Health Insurance℠ Financial Status Update as of June 30, 2016

August 16, 2016

BACKGROUND:

Texas Employees Group Benefit Program (GBP) Health benefits are HealthSelect of Texas℠ (HealthSelect), a fully insured Health Maintenance Organizations (HMO), HealthSelect Medicare Advantage℠, a Medicare Advantage Preferred Provider Organization (MAPPO), and KelseyCare Advantage, a Medicare Advantage Health Maintenance Organization (MAHMO). 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.

The healthcare benefits and administrative costs provided under the GBP are funded by contributions paid by the enrolled individuals and through the biennial legislative appropriation by the State of Texas.. The State currently pays 100% of the contribution rate for eligible employees and retirees and 50% of the contribution rates for dependent coverage.

The ERS Board of Trustees sets the annual contribution rates based on the plan's benefits, member cost sharing, projected expenses, provider reimbursement arrangements, and available funding from the State of Texas.

HealthSelect benefits include medical and pharmaceutical services. UnitedHealthcare is the current third-party administrator of medical services under HealthSelect. The current contract for the GBP pharmacy benefits manager is held by Caremark and ends December 31, 2016. Beginning January 1, 2017, OptumRx, an affiliate of UnitedHealthcare Services, Inc., will manage the HealthSelect prescription benefits as chosen by the Board of Trustees in the May 2016 meeting.

Internal administrative expenses represent slightly less than 0.5% of total HealthSelect expenses. External administrative fees represent less than 3% of total HealthSelect expenses.

Fiscal Year 2016 Estimated

During FY 2016, total revenue for the GBP health plan is estimated to be $3,382.4 million and total GBP health plan expenditures are estimated at $3,348.8 million. 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 better than expected rebates and Medicare Part D subsidies. These payments can stretch over many years and, as more information on them becomes available, consulting actuaries can adjust projections and in this case, increase amounts. In addition to the increased projections, there have also been gains due to rebates and subsides attributable to prior years that were greater than the accruals established at the end of those years.

Each year the HealthSelect total network out-of-pocket maximum changes with the limits allowed by the Affordable Care Act (ACA). The total maximum for FY 2016 is $6,450 per individual and $12,900 per family, which includes prescriptions and medical services. The overall impact of this benefit change was financially insignificant to the Plan.

ERS focuses on ways to reduce healthcare costs experienced by the GBP. ERS and UnitedHealthcare continue to work with large, clinically-integrated, multi-specialty provider groups to create Patient Centered Medical Homes (PCMH) for the HealthSelect population. The goal of the PCMH model is to deliver high-quality healthcare while reducing overall cost by managing health conditions and utilizing preventive care. To date, ERS has partnered with five clinical groups for this model: Austin Regional Clinic, Austin Diagnostic Clinic, Covenant Health Partners, Kelsey-Seybold, and Trinity Mother Frances.

In addition to our managed care groups, ERS has addressed areas of concern in regard to benefits, namely costly prescription drugs. In FY16, ERS implemented prior authorizations and quantity limitations on topical pain products and dermatological anti-fungal agents to ensure usage aligns with approvals and quantities as set forth by the Federal Drug Administration.

ERS also brought forth a new alternative to in-office visits for our HealthSelect participants. Virtual Visits became available on January 1, 2016. These audio/visual connections allow participants easier access to providers through their smartphone or desktop computer at an in-area copay of $10.

Outlook for Fiscal Year 2017

ACA fees are projected to increase costs by approximately $12.5 million in FY 2017.

Effective January 1, 2017, overall total out-of-pocket maximum which includes network medical and pharmacy copayments, coinsurance, and applicable deductibles will increase to $6,550 per individual and $13,100 per family as allowed by the ACA.

Two additional clinics will join the PCMH group beginning September 1, 2016. Texas Tech Medical Partners and Physicians Network Services, both located in Lubbock, have signed an agreement with UnitedHealthcare for FY17. One additional group in the Texas Panhandle is also slated to begin the shared savings model in FY17. The announcement of which will be made after the contract is finalized.

Currently the GBP is in a good financial position, which allows continuation of the current benefit structure through the end of the FY 17. The fund balance is currently estimated to be $560.1 million at the end of FY 2017 after an estimated gain of $86 million for FY17. This gain is due to the new PBM contract with UnitedHealthcare effective January 1, 2017. This contract is expected to save approximately $100 million over the last 8 months of the fiscal year. ERS staff will continue to monitor the health benefit cost trend closely.

Beginning September 1, 2016, Consumer Directed HealthSelect will be available for GBP participants not eligible for Medicare. This is a new choice for members in addition to HealthSelect and regional HMOs. This plan includes a high-deductible health plan administered by UnitedHealthcare Services, Inc. and a health savings account administered by OptumBank, a subsidiary of United HealthCare Services, Inc.

A summary of actual and projected experience for the GBP health plan is presented below:

Texas Employees Group Benefits Program Summary of Health Plan Experience Based on Experience through June 2016			
$Millions			
	FY15	Projected FY16	Projected FY17
Revenue from State/Members			
State Contribution for State Agencies	$1,653.1	$1,800.3	$1,967.5
State Contribution for Higher Education	706.9	773.6	845.5
State Contribution – Other[1]	67.7	72.8	79.5
State Contribution - Total	$2,427.7	$2,646.7	$2,892.5
Member Contribution	455.1	483.4	528.3
Other Revenue (Includes Rebates, Discount Guarantees, and Part-D Subsidies)	219.9	252.3	365.6
TOTAL REVENUE	**$3,102.7**	**$3,382.4**	**$3,786.40**
HEALTH CARE EXPENDITURES	**$3,041.5**	**$3,348.8**	**$3,700.4**
Net Gain/(Loss)	$61.2	$33.6	$86.0
Fund Balance	$440.5	$474.1	$560.1
Other Expenses Incurred Outside of the GBP Fund			
Member Cost Sharing	$480.4	$486.7	$495.9

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

PUBLIC AGENDA ITEM - #14b

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

14b. Approval of Proposed Rates for Medicare Advantage Health Maintenance Organization Plans for Calendar Year 2017

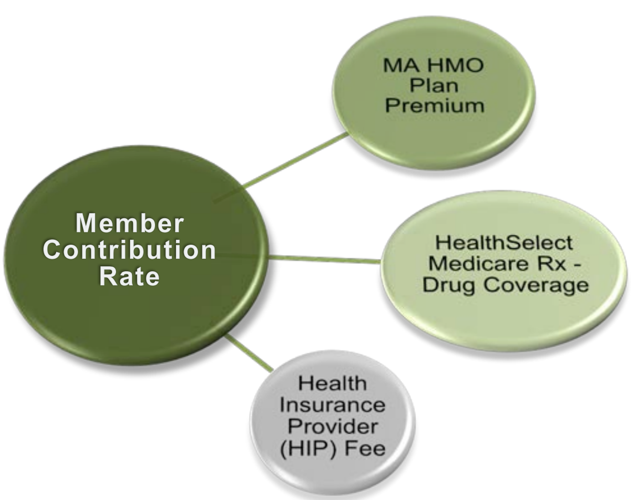
August 16, 2016

BACKGROUND:

A Medicare Advantage Health Maintenance Organization (MA HMO) option has been available through the Texas Employees Group Benefits Program (GBP) since September 1, 2011. The MA HMO option provides medical benefits to certain retirees and their eligible dependents. Similar to all other Medicare Advantage plans, all participants must be eligible for primary coverage under Medicare Part A and Part B (Medicare-primary). The medical benefits provided under the MA HMO are designed to provide coverage that is at least as comprehensive as that provided under HealthSelect of Texas^{SM} (HealthSelect), the GBP's self-funded, point-of-service health benefit plan which coordinates benefits with traditional Medicare for Medicare-primary participants. Medicare-primary participants can choose to enroll in the MA HMO plan and they may elect to opt back into his/her "originating" medical program (i.e. HealthSelect) at the next annual enrollment.

Under the MA HMO plan, medical coverage is provided through a network of doctors and specialists within the Carrier's network. Participants must use a provider within the MA HMO network. Participants do not need to designate a primary care physician (PCP) or obtain referrals to specialists. KelseyCare Advantage (KelseyCare) is the only MA HMO currently offered under the GBP. KelseyCare provides GBP coverage in eight Houston-area counties. KelseyCare has not requested a change in its service area for CY2017. Refer to Exhibit A of this agenda item for the proposed service area map of the KelseyCare MA HMO. Participants receive medical coverage only through KelseyCare. Prescription drug coverage is provided through HealthSelect Medicare Rx^{SM}, a self-funded plan that is administered separately.

MA HMO member contribution rates consist of three components: (1) the premium for the insured medical benefits provided under the MA HMO plan, (2) the Health Insurance Provider (HIP) Fee, and (3) the projected cost of prescription drug coverage under HealthSelect Medicare Rx^{SM}.



1. **MA HMO Premium**

   The MA HMO plan's medical benefits are provided under a fully-insured arrangement. Under this arrangement, ERS pays a monthly premium to KelseyCare to cover the medical claims and administration costs associated with the plan, and KelseyCare bears the full responsibility for paying all incurred claims.

   When determining appropriate premium rates for participating MA HMOs, ERS must comply with a rider in the State's appropriations act which stipulates the following:

"In no event shall the total amount of state contributions allocated to fund coverage in an optional health plan exceed the actuarially determined total amount of state contributions required to fund basic health coverage for those active employees and retirees who have elected to participate in that optional health coverage."

To ensure compliance with the rider, the consulting actuary utilizes a theoretical cost index (TCI) model. The TCI estimates the total cost that would be required to cover the MA HMO's participants if they were enrolled in HealthSelect, the GBP's self-funded health insurance plan. In order to participate in the GBP, the MA HMO must agree to charge premium rates that are no greater than 95% of the TCI in order to ensure savings of at least 5% as compared to the cost of coverage under HealthSelect.

Similar to the other Medicare Advantage plans within the GBP, the premiums for the MA HMO are experience-rated. As such, the premiums are calculated by KelseyCare's underwriters and are based on the claims experience of the plan. ERS staff and its consulting actuaries review the rates and suggest adjustments as necessary.

Member Enrollment

The degree to which the plan's own experience is used in the rate calculation depends on the credibility of the plan. A plan's credibility is based on several factors, including the number of covered lives and the number of years of claims experience available for the underwriter's analysis. The KelseyCare MA HMO plan covers approximately 1,300 participants as of June 2016; therefore, the plan's experience is deemed credible.

Enrollment in the KelseyCare MA HMO plan has increased since the plan's inception in 2012.

Texas Employees Group Benefits Program
KelseyCare MA HMO
Member Enrollment

KelseyCare Advantage*	January 2012	January 2013	January 2014	January 2015	January 2016	June 2016
Members	465	736	832	942	1,025	1,059
Dependents	107	165	182	192	209	217
Total Participants	**572**	**901**	**1,014**	**1,134**	**1,234**	**1,276**

**Medical Coverage only*

ERS staff and the consulting actuary have worked with KelseyCare on the recommended premium rate for medical benefits for CY2017. The proposed rate is reasonably based on plan experience and changes in federal payments.

Changes in Federal Payments & Payment Methodology

The Centers for Medicare and Medicaid Services (CMS) released the Announcement of Calendar Year (CY) 2017 Medicare Advantage Capitation Rates and Medicare Advantage and Part D Payment Policies (also known as the Final Rate Notice) and Final Call Letter on April 4, 2016.

These payment policies include substantial changes to the Medicare Advantage payment system that seek to provide stable payments to plans, and make improvements to the program for plans that provide high quality care to the most vulnerable beneficiaries. The Final Rate Notice includes significant changes to the payment policies proposed in the 45-Day Notice (also known as the Advance Notice and Draft Call Letter) which was issued on February 19, 2016.

- CMS 2017 Rate Announcement
  CMS finalized the updates to the methodologies to pay MA plans sponsors that are intended to improve payment precision and encourage quality, while continuing to protect beneficiaries from significant increases in premiums and out of pocket costs. CMS provided the expected impact of the policy changes on plan payments across seven categories including Effective Growth Rate, Transition to ACA Rules, Rebasing/Repricing, Improved Star Ratings, Risk Model Revision, MA Coding Adjustments, and Normalization. The result is an expected average change in revenue of 0.85%. CMS also disclosed the Coding Trend at 2.2% for a total expected average change in revenue of 3.05%.[1]

  The Rate Notice also provided information on reformulating how rates would be set beginning in 2017 for customized MA products. Under CMS' new payment model, payments for custom MA programs will be based on a bid-to-benchmark ratio for individual MA plans. CMS finalized the methodology for establishing the payment rates with two modifications. CMS will (1) phase this methodology in over a two-year period, and 2) CMS will use the average bid-to-benchmark ratios for non-customized plans from a prior year to calculate the payment rates. For 2017, CMS blended the bid-to-benchmark ratio for custom MA plans at 50% and the bid-to-benchmark ratio for non-custom MA plans at 50%. Preliminary analysis indicates that the new payment methodology will reduce payments for custom MA plans, as well as for the entire Medicare Advantage program.

- CMS 2017 Call Letter
  CMS finalized a number of proposed improvements to the Medicare Advantage programs. These updates are intended to drive quality improvement and more accurately reflect plan performance in Star Ratings. Medicare Advantage plans that achieve high Star Ratings are eligible for Quality Bonus Payments. Plans with a high percentage of dually eligible enrollees and/or enrollees who receive a low income subsidy are limited in their ability to achieve high Star Ratings. Therefore, CMS is adjusting the 2017 Star Ratings used for determining eligibility for quality bonus payments beginning in 2018. The adjustment factor will vary by a plan's proportion of low income subsidy/dually eligible and disability status beneficiaries. Through this interim adjustment, CMS seeks to more accurately capture true plan performance.

2. HIP Fee

KelseyCare, like all insurers, is required to pay the Health Insurance Provider (HIP) Fee mandated under the Affordable Care Act (ACA) and applicable to all covered entities engaged in the business of providing health insurance. However, the Consolidated Appropriations Act of 2016, Division Q, Title II, § 201, suspends collection of the HIP Fee for CY2016. Therefore, health insurance issuers are not required to pay the HIP Fee in 2017. The legislation enacting the HIP Fee Moratorium limits the fee suspension to one year.

3. HealthSelect Medicare Rx Costs

In addition to the premium under KelseyCare, the staff and the consulting actuary have projected the cost of prescription drug coverage under HealthSelect Medicare Rx℠ for CY2017 and have included this cost in the rate proposal below. The medical portion of the rates will decrease by $4.36 in CY2017. Additionally, there was a decrease in the pharmacy costs. These decreases,

[1] https://www.cms.gov/Newsroom/MediaReleaseDatabase/Fact-sheets/2016-Fact-sheets-items/2016-04-04.html

together with the waiver of the HIP Fee, will result in an overall decrease in the rate proposal for the KelseyCare plan for the upcoming plan year.

Setting the MA HMO Contribution Rates

The premium for the insured medical benefits provided under the MA HMO, the projected cost of prescription drug coverage under HealthSelect Medicare Rx, and the HIP Fee provide the basis for state and member contribution rates for the KelseyCare MA HMO plan for CY2017.

The consulting actuary's MA HMO rate analysis is included in this agenda item as Exhibit C.

STAFF RECOMMENDATION:

Based on KelseyCare's renewal rate proposal and the consulting actuary's rate analysis, the ERS staff and consulting actuary recommend the Board of Trustees approve the monthly MA HMO contribution rates for CY2017 as presented in this agenda item and Exhibit B.

A recommended motion is included with this agenda item following the exhibit.

ATTACHMENTS – 3

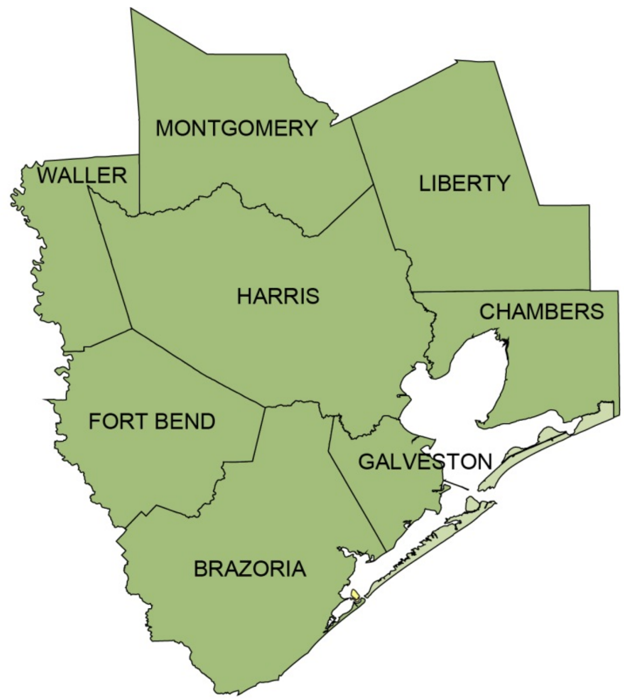
Exhibit A – Proposed GBP Service Area Map for KelseyCare Medicare Advantage HMO, Calendar Year 2017

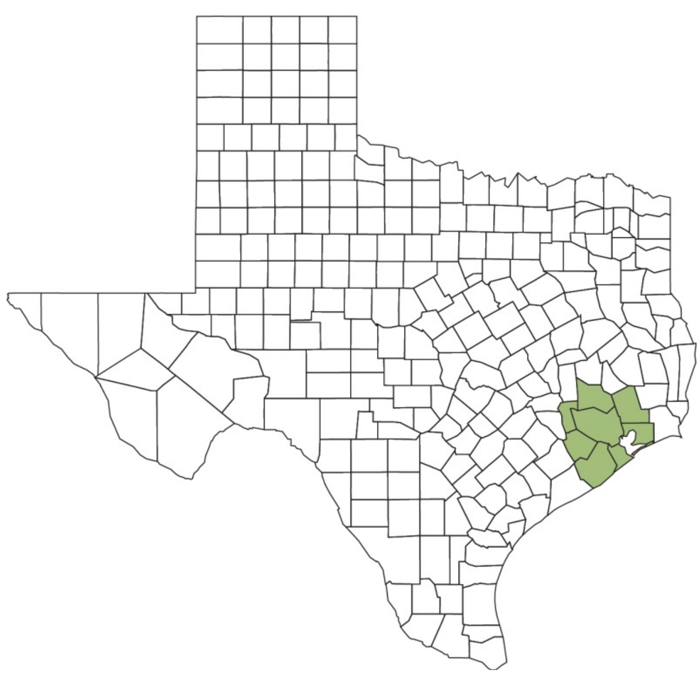
Exhibit B – Proposed Monthly Member Contribution Rates for KelseyCare Medicare Advantage HMO, Calendar Year 2017

Exhibit C – Recommended Medicare Advantage HMO Contribution Rates for Calendar Year 2017, Rudd & Wisdom, Inc.

Exhibit A

KelseyCare Medicare Advantage HMO
Proposed GBP Service Area
Calendar Year 2017





KelseyCare MA HMO Plan
Proposed Monthly Member Contribution Rates
Calendar Year 2017*

	Medicare-Primary Spouse	Medicare-Primary Surviving Spouse
Current MA HMO Rates CY2016	$ 150.22	$ 300.44
Proposed MA HMO Rates CY 2017	131.84	263.68
Increase/(Decrease) from CY2016 Rates	(18.38)	(36.76)
Potential Savings to Retiree		
HealthSelect FY 2017 Rates	$ 353.68	$ 707.36
Member Savings through MA HMO Plan	$ 221.84	$ 443.68

**Contribution Rates include a provision for the HealthSelect Medicare Rx prescription drug coverage. The Consolidated Appropriations Act of 2016, Division Q, Title II, § 201, suspends collection of the HIP FEE for CY2016 which is payable in CY2017.*

Rudd and Wisdom, Inc.

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July 28, 2016

Mr. Porter Wilson
Executive Director
Employees Retirement System
of Texas
Post Office Box 13207
Austin, Texas 78711-3207

Re: Recommended Medicare Advantage HMO Contribution Rates for Calendar Year 2017

Dear Mr. Wilson:

The purpose of this correspondence is to present our analysis of the proposed renewal rates and recommendations for member contribution rates for Calendar Year 2017 (CY17) for the Medicare Advantage HMO (MA HMO) offered under the Texas Employees Group Benefits Program (GBP). The MA HMO provides an optional health plan for GBP participants for whom Medicare is primary (MPPs).

Beginning with Calendar Year 2014 (CY14), ERS has used a contract extension option when appropriate in renewing the MA HMO contract under the GBP. Under the renewal process, each year, the MA HMO is required to provide certain critical information, including renewal rates that meet ERS rating requirements and information regarding any proposed service area expansions.

ERS received a renewal rate proposal for CY17 from KelseyCare Advantage (KelseyCare), the only MA HMO currently participating in the GBP.

Background

The following summarizes the conditions under which the MA HMO is currently operating.

- The contract year for the MA HMO is the calendar year as required under federal Medicare statutes and regulations.
- KelseyCare provides fully insured medical benefits for GBP participants in the MA HMO.

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- KelseyCare is compensated through a premium subject to annual renegotiation under the contract renewal process.
- Prescription drug benefits for GBP participants in the MA HMO are provided through HealthSelect Medicare Rx, the self-funded Employer Group Waiver Plan plus Wrap (EGWP + Wrap) administered by SilverScript.
- MA HMO participants are required to pay Medicare Part B premiums as well as any contributions required under the GBP.

Analysis of Renewal Rate Proposal

KelseyCare's monthly premium for CY16 for MA HMO medical coverage is $114.28 per MPP. KelseyCare has proposed reducing the monthly premium to $109.92 per MPP for CY17, a reduction of 3.8%.

Under the Affordable Care Act (ACA), most insurers and HMOs, including KelseyCare, have been required to pay the Health Insurance Providers Fee (HIP Fee) since CY14. The CY16 HIP Fee for KelseyCare is estimated to be $19.41 per month for each participating MPP. The actual fee will be passed through to the GBP in the fall.

The Consolidated Appropriations Act of 2016 suspends collection of the HIP Fee for CY17. Since KelseyCare will not be required to pay the HIP Fee for CY17, it will not be included in the renewal rate, a savings of $19.41 per month as compared to CY16.

It is important to note that collection of the HIP Fee has been suspended for only CY17; i.e., collection of the fee will resume in CY18.

We and the ERS staff evaluated KelseyCare's renewal rate proposal based on the theoretical cost methodology used to evaluate HMO rates for Fiscal Year 2017 (FY17) as discussed in our letter dated May 5, 2016 (the HMO letter). Under this methodology, we compared KelseyCare's proposed monthly renewal premium ($109.92) to the theoretical cost of providing HealthSelect medical benefits to MPPs in KelseyCare's service area.

We concluded that the proposed renewal rate is less than the theoretical cost. Therefore, we believe that the proposed rate provides a reasonable basis for renewal. Under the proposed rate, the MA HMO would be expected to continue to generate savings for the GBP during CY17.

Recommended Contribution Rates

The recommended CY17 monthly contribution rates for MPPs participating in the MA HMO have been established as follows:

- The medical component was determined based on the $109.92 monthly premium rate proposed by KelseyCare.
- The prescription drug component was determined by projecting the CY17 per capita cost of HealthSelect Medicare Rx coverage for MPPs. The CY17 projected per capita cost is $153.78 per month which is $12.97 per month lower than the projected per capita cost used in developing the CY16 member contribution rates. The reduction is attributable to a somewhat lower than expected prescription drug benefit cost trend and the savings associated with the new PBM contract for CY17.
- The sum of these components, $263.68 ($109.92 + $153.78), adjusted for rounding, provides the total cost basis used in developing the CY17 proposed MA HMO monthly member contribution rates.
- The CY17 total cost is about $37 per month less than the CY16 total cost due to reductions in the KelseyCare premium, the HIP Fee suspension and the lower projected cost of HealthSelect Medicare Rx coverage.
- As provided under the GBP legislative appropriation, the member is not required to contribute toward the cost of the member's health coverage, but the member is required to pay 50% of the cost of dependent coverage.

The current and proposed monthly contribution rates for MA HMO participants are presented in the attachment.

Recommendation

Based on the analysis of the KelseyCare renewal rate for MA HMO medical coverage and our projection of the cost of HealthSelect Medicare Rx coverage for MPPs, we recommend that the CY17 MA HMO monthly member contribution rates be established at the levels presented herein.

We will be pleased to answer any questions and to provide any additional information that may be required.

Sincerely,

Philip S. Dial

PSD:nlg

Enclosure

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Texas Employees Group Benefits Program

CY 2017 Monthly Medicare Advantage HMO Contribution Rates for Medicare-Primary Members

	CY 2016			CY 2017		
HMO	Total	State	Member	Total	State	Member
KelseyCare Advantage						
Member Only	$300.44	$300.44	$ 0.00	$263.68	$263.68	$ 0.00
Member & Spouse	600.88	450.66	150.22	527.36	395.52	131.84

Notes:

a. Contribution rates do not include Basic Life.

b. Rates include cost of medical coverage provided by KelseyCare and prescription drug coverage provided under HealthSelect Medicare Rx.

PUBLIC AGENDA ITEM - #14c

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

14c. Approval of Proposed Rates for HealthSelect Medicare Advantage
for Calendar Year 2017

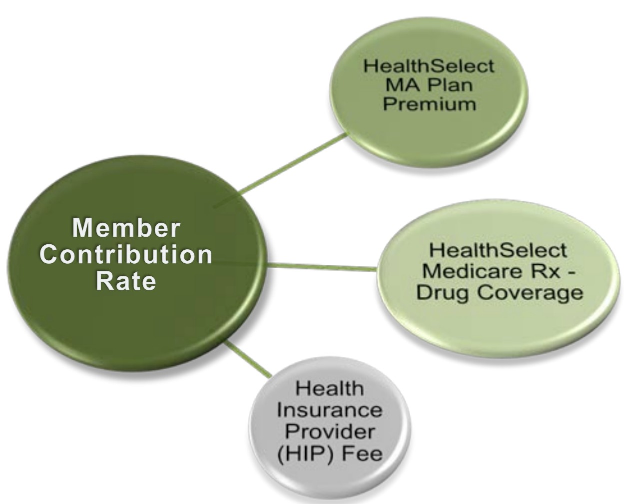
August 16, 2016

BACKGROUND:

Texas Employees Group Benefit Program retired participants who are eligible for Medicare have been able to enroll in a statewide Medicare Advantage Preferred Provider Organization (MA PPO) option since January 1, 2012. The plan, known as HealthSelect Medicare Advantage^{SM} (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 comprable coverage to that provided under HealthSelect of Texas^{SM} (HealthSelect), the GBP's self-funded, point-of-service health benefit plan which coordinates benefits with traditional Medicare for Medicare-primary participants. All Medicare-primary participants are automatically enrolled in the HealthSelect MA plan, but can choose to opt into the traditional HealthSelect plan at the beginning of any month.

Enrollment for Medicare-eligible retirees occurs in the fall. 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 offered on a fully-insured basis by Humana Insurance Company (Humana). Prescription drug coverage for HealthSelect MA participants is provided separately under HealthSelect Medicare Rx^{SM}, a self-funded plan that is administered separately.



As depicted in the graphical representation on the left, the HealthSelect MA member contribution rates are comprised of three elements: (1) the premium for the insured medical benefits provided under HealthSelect MA, (2) the Health Insurance Provider (HIP) Fee, and (3) the projected cost of prescription drug coverage under HealthSelect Medicare Rx^{SM}. A closer review of certain aspects of these elements is provided below.

(1) HealthSelect MA Premium

The HealthSelect MA plan's medical benefits are provided under a fully-insured arrangement, meaning that the insurance company takes the risk as to whether the premium is enough to cover the cost of providing medical care. Under this arrangement, ERS pays a monthly premium to Humana to cover the medical claims and administration costs associated with the plan. Humana bears the full responsibility for paying all incurred claims. The premiums for the HealthSelect MA plan are experience-rated, and, as such, are calculated by Humana's underwriters to be based on the claims experience of the plan. ERS staff and consulting actuaries review the rates and suggest adjustments as necessary.

Member Enrollment
The degree to which the plan's own experience is used in the rate calculation depends on the credibility of the plan. A plan's credibility is based on several factors, including the number of covered lives and the number of years of claims experience available for the underwriter's analysis. The HealthSelect MA plan covers over 65,000 participants as of June 2016; therefore, the plan's experience is deemed credible.

As is evident in the table below, the HealthSelect MA plan's enrollment has steadily increased since the plan's inception in 2012.

Texas Employees Group Benefits Program
HealthSelect Medicare Advantage (MA PPO)
Member Enrollment

HealthSelect Medicare Advantage*	January 2012	January 2013	January 2014	January 2015	January 2016	June 2016
Members	37,953	38,186	42,469	46,258	50,533	51,928
Dependents	9,372	9,964	11,366	12,329	13,419	13,717
Total Participants	**47,325**	**48,150**	**53,835**	**58,587**	**63,952**	**65,645**

**Medical Coverage only*

ERS staff and the consulting actuary have worked with Humana on the recommended premium rate for medical benefits for CY2017. The staff and the consulting actuary believe the proposed rate is reasonably based on plan experience impact and the changes in the federal payments.

Changes in Federal Payments & Payment Methodology
The Centers for Medicare & Medicaid Services (CMS) released the Announcement of Calendar Year (CY) 2017 Medicare Advantage Capitation Rates and Medicare Advantage and Part D Payment Policies (also known as the Final Rate Notice) and Final Call Letter on April 4, 2016. These payment policies include substantial changes to the Medicare Advantage payment system that seek to provide stable payments to plans, and make improvements to the program for plans that provide high quality care to the most vulnerable beneficiaries. The Final Rate Notice includes significant changes to the payment policies proposed in the 45-Day Notice (also known as the Advance Notice and Draft Call Letter) which was issued on February 19, 2016.

- CMS 2017 Rate Announcement
  CMS finalized the updates to the methodologies to pay MA plan sponsors that are intended to improve payment precision and encourage quality, while continuing to protect beneficiaries from significant increases in premiums and out of pocket costs. CMS provided the expected impact of the policy changes on plan payments across seven categories, including Effective Growth Rate, Transition to ACA Rules, Rebasing/Repricing, Improved Star Ratings, Risk Model Revision, MA Coding Adjustments, and Normalization. The result is an expected

average change in revenue of 0.85%. CMS also disclosed the Coding Trend at 2.2% for a total expected average change in revenue of 3.05%.[1]

The Rate Notice also provided information on reformulating how rates would be set beginning in 2017 for customized MA products such as the HealthSelect Medicare Advantage[SM] program. Under CMS' new payment model, payments for custom MA programs will be based on a bid-to-benchmark ratio for individual MA plans. CMS finalized the methodology for establishing the payment rates with two modifications. CMS will (1) phase this methodology in over a two-year period, and 2) CMS will use the average bid-to-benchmark ratios for non-customized plans from a prior year to calculate the payment rates. For 2017, CMS blended the bid-to-benchmark ratio for custom MA plans at 50% and the bid-to-benchmark ratio for non-custom MA plans at 50%. Preliminary analysis indicates that the new payment methodology will reduce payments for custom MA plans, as well as for the entire Medicare Advantage program.

- CMS 2017 Call Letter
  CMS finalized a number of proposed improvements to the Medicare Advantage programs. These updates are intended to drive quality improvement and more accurately reflect plan performance in Star Ratings. Medicare Advantage plans that achieve high Star Ratings are eligible for Quality Bonus Payments. Plans with a high percentage of dually eligible enrollees and/or enrollees who receive a low income subsidy substantially are limited in their ability to achieve high Star Ratings. Therefore, CMS is adjusting the 2017 Star Ratings used for determining eligibility for quality bonus payments beginning in 2018. The adjustment factor will vary by a plan's proportion of low income subsidy/dually eligible and disability status beneficiaries. Through this interim adjustment, CMS seeks to more accurately capture true plan performance.

(2) HIP Fee

Another important aspect of the 2017 CMS Call Letter addressed the Health Insurance Provider (HIP) Fee for CY2016. Section 9010 of the Affordable Care Act (ACA) charges a fee to each covered entity engaged in the business of providing health insurance. The Consolidated Appropriations Act of 2016, Division Q, Title II, § 201, suspends collection of the HIP FEE for CY2016. Therefore, health insurance issuers are not required to pay the HIP Fee in 2017. The legislation enacting the HIP Fee Moratorium limits the fee suspension to one year.

(3) HealthSelect Medicare Rx Costs

In addition to the premium under Humana, the staff and the consulting actuary have projected the cost of prescription drug coverage under HealthSelect Medicare Rx[SM] for CY2017 and have included this cost in the rate proposal below. The medical portion of the rates will increase by $38.18 in CY2017; however, due to the decrease in pharmacy costs and the HIP Fee waiver, the overall proposed CY2017 rate will remain the same as that of CY2016 program rate.

Setting the HealthSelect MA Contribution Rates

The projected cost of coverage for participants in HealthSelect and HealthSelect MA are combined in establishing the state contribution rates for FY2017. Therefore, the state contribution rates for HealthSelect MA will be the same as the state contribution rates for HealthSelect for FY2017.

The consulting actuary's HealthSelect MA rate analysis is included in this agenda item as Exhibit B.

[1] https://www.cms.gov/Newsroom/MediaReleaseDatabase/Fact-sheets/2016-Fact-sheets-items/2016-04-04.html

STAFF RECOMMENDATION:

The state contribution rates for HealthSelect and HealthSelect MA will be the same. The proposed member contribution rates for dependent coverage for the HealthSelect MA plan for CY2017 are presented in this agenda item as Exhibit A.

A recommended motion is included with this agenda item following the exhibit.

ATTACHMENTS – 2

Exhibit A – Proposed Monthly Member Contribution Rates for the HealthSelect Medicare Advantage^{SM} Plan for Calendar Year 2017

Exhibit B – Recommended Contribution Rates for HealthSelect Medicare Advantage for Calendar Year 2017, Rudd & Wisdom, Inc.

Exhibit A

HealthSelect MA Plan
Proposed Monthly Member Contribution Rates
Calendar Year 2017*

	Medicare-Primary Spouse	Medicare-Primary Surviving Spouse
Current HealthSelect MA Rates CY 2016	$ 157.08	$ 314.16
Proposed HealthSelect MA Rates CY 2017	157.08	314.16
Increase from CY 2016 Rates	0.00	0.00
Potential Savings to Retiree		
HealthSelect FY 2017 Rates	$ 353.68	$ 707.36
Member Savings through MA PPO	$ 196.60	$ 393.20

**Contribution Rates include a provision for the HealthSelect Medicare Rx prescription drug coverage. The Consolidated Appropriations Act of 2016, Division Q, Title II, § 201, suspends collection of the HIP FEE for CY2016 which is payable in CY2017.*

EXHIBIT B

Rudd and Wisdom, Inc.

CONSULTING ACTUARIES

August 2, 2017

Mr. Porter Wilson
Executive Director
Employees Retirement System
of Texas
Post Office Box 13207
Austin, Texas 78711-3207

Re: Recommended Contribution Rates for HealthSelect Medicare Advantage for Calendar Year 2017

Dear Mr. Wilson:

The purpose of this correspondence is to present our analysis of the proposed renewal rates and recommendations for member contribution rates for Calendar Year 2017 (CY17) for HealthSelect Medicare Advantage, the Medicare Advantage Preferred Provider Organization option (MA PPO) offered under the Texas Employees Group Benefits Program (GBP).

Background

On August 23, 2011, the Board of Trustees of the Employees Retirement System (ERS) approved a contract with Humana Insurance Company (Humana) to provide an optional MA PPO for GBP participants for whom Medicare is primary (MPPs). The following summarizes the conditions under which the MA PPO is currently operating.

- The MA PPO contract with Humana became effective January 1, 2012, for a four-year term ending December 31, 2015. Under the contract, ERS has the option to renew the contract for up to two more years; i.e., for CY16 and CY17.
- The contract year for the MA PPO is the calendar year as required under federal Medicare statutes and regulations.
- Humana provides fully insured medical benefits for GBP participants in the MA PPO. The medical benefits provided by Humana under the MA PPO are at least as generous as those provided to MPPs under HealthSelect.

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- Humana is compensated through a premium that was initially guaranteed for CY12 and is subject to annual renegotiation for each successive calendar year.
- Prescription drug benefits for GBP participants in the MA PPO are provided through HealthSelect Medicare Rx, the self-funded Employer Group Waiver Plan plus Wrap (EGWP + Wrap) that will be administered by UnitedHealthcare in CY17.
- MA PPO participants are required to pay Medicare Part B premiums as well as any contributions required under the GBP.

Analysis of Renewal Rate Proposal

Humana's monthly premium for CY16 for MA PPO medical coverage is $122.03 per MPP. Humana has proposed increasing the monthly premium to $160.21 per MPP for CY17, an increase of $38.18 per month or about 31%. The large increase is attributable to revisions to the methodology used by the Centers for Medicare and Medicaid Services (CMS) to determine the CMS subsidy for MA plans. These revisions have resulted in a significant reduction in the subsidy for the MA PPO which must be offset by an increase in the monthly premium.

Under the Affordable Care Act (ACA), most insurers and HMOs, including Humana, have been required to pay the Health Insurance Providers Fee (HIP Fee) since CY14. The CY16 HIP fee for Humana is $25.37 per month for each participating MA PPO participant. The HIP Fee paid by Humana is passed through to the GBP as an addition to the premium.

The Consolidated Appropriations Act of 2016 suspends collection of the HIP Fee for CY17. Since Humana will not be required to pay the HIP Fee for CY17, it will not be included in the renewal rate, a savings of $25.37 per month as compared to CY16.

It is important to note that collection of the HIP Fee has been suspended for CY17 only; i.e., collection of the fee will resume in CY18.

We and the ERS staff evaluated Humana's renewal rate proposal based on the theoretical cost methodology used to evaluate HMO rates for Fiscal Year 2017 (FY17) as discussed in our letter dated May 5, 2016 (the HMO letter). Under this methodology, we compared Humana's proposed monthly renewal premium ($162.71) to the theoretical cost of providing medical benefits to MPPs under HealthSelect.

We concluded that the proposed renewal rate is less than the theoretical cost. Therefore, we believe that the proposed rate provides a reasonable basis for renewal. Under the proposed rate, the MA PPO would be expected to continue to generate savings for the GBP during CY17.

Recommended Member Contribution Rates

The recommended CY17 monthly member contribution rates for MPPs participating in the MA PPO have been established as follows:

- The medical component was determined based on the $160.21 monthly premium rate proposed by Humana.
- The prescription drug component was determined by projecting the CY17 per capita cost of HealthSelect Medicare Rx coverage for MPPs. The CY17 projected per capita cost is $153.78 per month which is $12.97 per month lower than the projected per capita cost used in developing the CY16 member contribution rates. The reduction is attributable to a somewhat lower than expected prescription drug benefit cost trend and the savings associated with the new PBM contract for CY17.
- The sum of these components, $313.99 ($160.21 + $153.78) provides the total cost basis used in developing the CY17 proposed MA PPO monthly member contribution rates.
- As provided under the GBP legislative appropriation, the member is not required to contribute toward the cost of the member's health coverage, but the member is required to pay 50% of the cost of dependent coverage.
- The CY17 total cost is $0.17 per month less than the CY16 total cost since (a) the increase in the Humana premium is more than offset by (b) the combination of the HIP Fee suspension and the lower projected cost of HealthSelect Medicare Rx coverage.
- Due to the small decrease in cost, the ERS staff recommends, and we concur, that the member contribution rates for CY17 be maintained at the CY16 levels; i.e., no change.

The current and proposed monthly member contribution rates for MA PPO participants are presented below

	Medicare MA PPO Monthly Member Contribution Rates		
	CY16	CY17 Proposed	Change
Medicare-Primary Spouse	$157.08	$157.08	$0.00
Medicare-Primary Surviving Spouse	$314.16	$314.16	$0.00

The FY17 state contribution rates for MA PPO participants are the same as those applicable to HealthSelect. The savings to the state from the MA PPO have been considered in establishing the HealthSelect state contribution rates.

Recommendation

Based on the analysis of the Humana renewal rate for MA PPO medical coverage and our projection of the cost of HealthSelect Medicare Rx coverage for MPPs, we recommend that the CY17 MA PPO monthly member contribution rates be established at the levels presented herein.
Please let us know if you have any questions or if you need additional information.

Sincerely,

Philip S. Dial

PSD:nlg

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PUBLIC AGENDA ITEM - #15

15. Review, Discussion and Selection of the Money Market Fund for the Texa$aver 401(k) and 457 Program

August 16, 2016

BACKGROUND:

The Texa$aver Program (Program) has two distinct plans: Texa$aver 401(k) Plan and Texa$aver 457 Plan. The 457 plan is authorized by Section 457 of the Internal Revenue Code; the 401(k) plan is authorized by Section 401(k). The Employees Retirement System of Texas (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 (Board). ERS maintains and administers the 401(k) and 457 plans through their respective Plan Documents.

Of the two plans, the 457 Plan is older, having originated in 1974. The 457 Plan is available to employees of both state agencies and higher education institutions. The 401(k) Plan was launched in 1985. The availability of the 401(k) plan is limited to state agency employees because employees of higher education institutions have access to a 403(b) plan administered by their employing institutions. Enrollment in the 401(k) plan continues to increase, which is attributed to the plan's automatic enrollment that went into effect on January 1, 2008. Through automatic enrollment, newly hired state agency employees are enrolled into the Texa$aver 401(k) Plan at 1% of their employee's salary. Employees may opt out of the automatic enrolment, but the majority continue their enrollment.

In addition to being a convenient method of retirement savings, salary deductions allow participants to defer paying taxes on the contributions and earnings until they terminate employment or retire. Participants decide how to invest their pre-tax contributions among the fund choices approved by the Board. The Program also offers a Roth contribution option in both the 401(k) and 457 Plans which became effective January 1, 2012. The Roth option allows employees to designate all or a portion of their monthly Texa$aver contribution as an after-tax contribution, in accordance with Section 402(a) of the Internal Revenue Code of 1986.

Program Participation and Enrollment

The Program has assets totalling over $2.56 billion as of June 30, 2016. The following table features some of the key statistics of the Texa$aver Program.

Texa$aver 401(k) and 457 Program
Enrollment Statistics by Plan
As of June 30, 2016

	Traditional Before Tax Contributions		**Roth** After Tax Contributions	
	401(k) Plan	457 Plan	401(k) Plan	457 Plan
Current Assets	$1,906.8 million	$635.2 million	$13.9 million	$12.3 million
Participant Balances				
Average	$10,757	$20,717	$4,109	$4,321
Median	679	2,179	1,247	741

Table continued on next page

	Traditional Before Tax Contributions		Roth After Tax Contributions	
	401(k) Plan	457 Plan	401(k) Plan	457 Plan
Monthly Deferrals				
Average	$119	$256	$217	$213
Median	35	50	106	50
Total Eligible to Participate	151,866 [1]	250,837 [2]		
Participants with a Balance	177,334	28,794		
Contributing	85,720 or 48.3%	15,910 or 55.3%		
Non-Contributing	91,614 or 51.7%	12,884 or 44.7%		

1 *Includes state employees only*

2 *Includes both state and higher education employees*

Program Investment Funds

The investment funds offered within the 401(k) and 457 Plans are the same. The investment options available to participants are diversified across a range of asset classes and investment strategies to accommodate varying levels of investment risk, thereby providing participants the ability to construct portfolios tailored to meet their particular financial needs and retirement goals. In addition to the core choices in equities, fixed income and cash equivalent investments, the Program offers a self-directed brokerage account (SDBA). The SDBA is available to participants seeking individual stocks and bonds, CD's and mutual funds not offered in the Program's core investment line-up.

The Program endeavors to meet the basic investment needs of participants by offering an easy-to-follow portfolio construction based on the asset classes. The most conservative investments in the Program are the fixed income and cash equivalent funds (i.e. money market fund).

Product Review Committee

A Product Review Committee (PRC) monitors the investment funds offered within the Program. The PRC is a seven-member committee that meets on a semi-annual basis; the last meeting of the PRC was on June 7, 2016. Committee members are ERS' Executive Director, Deputy Executive Director, Director of Benefit Contracts, Chief Investment Officer, Deputy Chief Investment Officer, Director of Fixed Income and one Investment Advisory Committee (IAC) member appointed by the Executive Director. The PRC provides guidance, direction and special expertise in the evaluation and recommendation of Program investments. Additionally, the PRC is responsible for the prudent evaluation and implementation of the Program's funds with specific responsibilities including evaluating the overall adequacy of each fund, taking into consideration its applicable strategy, asset class and benchmark, as well as the fund's investment philosophy.

Money Market Funds and Federal Reform

A money market fund (MMF) is a cash equivalent fund within a designated investment class. As a cash equivalent fund, a MMF invests primarily in high quality, liquid, short-term debt securities to preserve principal. These investments are considered very low risk due to the financial strength of the issuers and ultra short-term maturity of the securities held in the fund. The Program has been offering the BlackRock Liquidity TempFund Mutual Fund TMPXX (TempFund) as its MMF offering since June 2010. As of March 2016, there are 26,134 participant accounts invested in the TempFund with assets totaling over $139.4 million.

On July 23, 2014, the U.S. Securities and Exchange Commission (SEC) approved amendments to Rule 2a-7 of the Investment Company Act of 1940 (herein referred to as *money market reform*), which governs money market funds. The final rules regarding money market reform were published in the Federal Register on August 14, 2014[1], and became effective on October 13, 2014, although the deadline for compliance with the changes is October 14, 2016. The goal of the money market reform is to reduce the susceptibility of money market funds (MMFs) to significant redemption activity during times of economic stress as well as to increase the transparency regarding the potential risk associated with MMFs.

The changes in the reform address three major topics of concern and update several other areas of the regulation. The three major topics are 1) officially defining various types of MMFs, 2) requiring a floating net asset value (NAV), and 3) imposing redemption fees and gates. While not all the rule requirements will impact every type of Money Market Fund in exactly the same way, the money market reform will affect institutional money market funds including the TempFund offered within the Program. The most significant impact from the federal regulation will be the creation of redemption gates which serve to limit withdrawals by participants. Furthermore, withdrawal fees will be established to further prevent any potential run on funds. Although these regulations are intended to increase transparency and provide additional protections to investors during periods of market stress, the enforcement of these provisions are systemically challenging for program administrators and require an effective communication strategy to educate participants on the upcoming changes.

MMF Alternative: Collective Investment Trust

In light of the systemic and communication challenges described above, a pragmatic alternative is available to the defined contribution marketplace: *replace the MMF with a collective investment trust (CIT) fund offering*.

A CIT fund is an investment vehicle similar to a mutual fund that is uniquely available to qualified retirement plans (i.e. 401(k) plans) and governmental plans (i.e. 457(b) plans). As institutional offerings, CITs offer lower investment fees compared to retail MMFs. CITs are sponsored by bank or trust companies under the supervision of the Office of the Comptroller of the Currency (OCC), an independent bureau of the U.S. Department of the Treasury. Since CITs are excluded from the definition of a registered security and an investment company under SEC securities laws, they are not subject to the SEC money market reform regulations. Furthermore, it is unlikely that OCC will develop money market reforms for institutional funds similar to that developed by SEC for the retail marketplace.

The Texa$aver Program has been offering CIT funds since October 2009. Currently, the Program has two CITs: BlackRock 1-3 Year Government Bond Index Fund F and BlackRock US Debt Index Non-Lendable Fund F (BlackRock Bond Index Fund).

The Texa$aver Product Review Committee (PRC) recommended a CIT as a suitable replacement to the MMF offering.

Fund Evaluation Process

ERS provided the Program's third-party administrator (TPA) a list of minimum organization requirements, investment strategy requirements, mandatory licensing requirements and preferred requirements with the intent to provide the best possible candidates to conduct a CIT money market fund search using Morningstar Direct software.

The search resulted in two CIT funds that met all of the specified minimum requirements: *BlackRock Short-Term Investment CIT Fund* and *JP Morgan Liquidity CIT Fund*. Both CIT money market fund managers were interviewed by the PRC on May 23, 2016. Exhibit C provides a summary of key factors reviewed by the PRC. Areas of particular interest to the PRC include the CIT fund's expense ratio, annualized returns, weighted average maturity (WAM), and investment allocation mix. The ideal fund

[1] Securities and Exchange Commission Final Rule: Money Market Fund Reform; Amendments to Form PF. https://www.sec.gov/rules/final/2014/33-9616.pdf

would meet the Program's objective to offer participants a low risk, high quality, liquid, short-term debt securities fund with a focus on preserving principal.

Participant Communication
If the Board approves a change from the TempFund to a CIT offering, ERS and the Program's TPA will conduct participant communications prior to the date that the new money market CIT fund becomes effective. All assets invested in the TempFund will transfer to the new money market CIT. Furthermore, all future participant money market contributions will be directed to the new CIT fund after the transfer date. Participants will be able to move their money market assets among the other Texa$aver investment products or change their fund allocations either prior to or following the blackout period. There will be a brief blackout period during the money transfer period.

STAFF RECOMMENDATION:

Based on the recommendation of the Texa$aver PRC, staff recommends that ERS terminate its contract for the BlackRock Liquidity TempFund (Money Market Mutual Fund – TMPXX) and offer a money market CIT within the Program in order to ensure the Program's compliance with the Securities and Exchange Commission's Final Rule issued on money market reform which becomes effective October 14, 2016. An overview of the comparison between the BlackRock Short-Term Investment CIT Fund and the JP Morgan Liquidity CIT Fund is provided in Exhibit C.

A recommended motion is included with this agenda item following the exhibits.

ATTACHMENTS – 3

Exhibit A – Fact Sheet of BlackRock Short-Term Investment Fund (CIT)

Exhibit B – Fact Sheet of JP Morgan Liquidity Fund (CIT)

Exhibit C - Fund Comparison Overview

BLACKROCK®

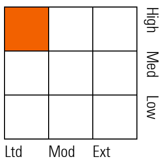
Short-Term Investment Fund

Exhibit A

Benchmark	Morningstar Category	7-Day Yield	30-Day Yield
Citigroup 3 Month Treasury Bill Index	Money Market-Taxable	0.59%	0.59%

Portfolio Analysis

Morningstar Style Box™ as of 03-31-16



Avg Maturity	19 Days

Investment Information

Operations and Management

Product Inception Date	12-31-78
Strategy Inception Date	12-31-78
Total Fund Assets ($mil)	17,066.00
Investment Manager	BlackRock Institutional Trust Company NA

Annual Turnover Ratio %	—

Fees and Expenses as of 12-31-15

Total Annual Operating Expense %	0.00%
Total Annual Operating Expense per $1000	$0.00

Additional Information for Total Annual Operating Expense

The Total Annual Operating Expense ("TAOE") ratio noted above reflects administrative costs that are capped at two (2) basis points (0.02%) per year. The TAOE ratio noted above may also, if applicable, reflect certain third party acquired fund fees and expenses. There may be other fees and expenses, including management fees, not reflected in the TAOE ratio noted above that bear on the value of the investment.

Investment Objective and Strategy

The Fund's investment objective is to seek as high a level of current income as is consistent with liquidity and stability of principal.

The Fund is a collective investment trust maintained and managed by BlackRock Institutional Trust Company, N.A. ("BTC").

The Fund will be invested primarily in short-term debt securities such as variable amount notes, commercial paper, U.S. government securities, repurchase agreements, certificates of deposit of banks and savings institutions, and other short-term obligations.

As an alternative to such short-term debt securities, the Fund may enter into repurchase or reverse repurchase agreements or invest in shares of registered investment companies that invest in similar debt securities, provided that such companies' investments are valued at cost and any income earned by such investments is allocated and credited to shareholders daily. The Fund's dollar-weighted average portfolio maturity will be 60 days or less and the weighted average life of the Fund's portfolio will be no longer than 120 days. In addition the Fund will accrue on a straight-line basis the difference between the cost and anticipated principal receipt on maturity of any asset it holds, and hold assets until maturity under usual circumstances.

The Fund may invest through one or a series of collective investment trusts maintained and managed by BTC.

In the event of a conflict between this summary description of the Fund's investment objective and principal investment strategies and the Trust Document under which the Fund was established, the Trust Document will govern. For more information related to the Fund, please see the Fund's Trust Document, Profile and most recent audited financial statements.

BLACKROCK®

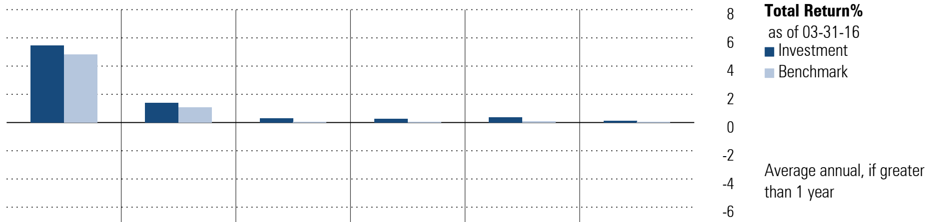
Short-Term Investment Fund

Benchmark	Morningstar Category	7-Day Yield	30-Day Yield
Citigroup 3 Month Treasury Bill Index	Money Market-Taxable	0.59%	0.59%

Benchmark Description

For information about the Benchmark please see the Index Provider Information section of the Disclosure.

Performance



	Since Inception	10 Year	5 Year	3 Year	1 Year	YTD
Investment Return %	5.47	1.40	0.30	0.28	0.36	0.14
Benchmark Return %	4.83	1.07	0.06	0.05	0.08	0.05

Performance Disclosure: Although the Fund's net asset value does include an accrual for fund level administrative costs capped at 0.02% per year, it does not include an accrual for the investment management fee. If the fund's net asset value did include an accrual for the investment management fee, the Fund's returns would be lower. Please contact your service provider for investment management fee information.

Principal Risks

Any of the principal risks summarized below may adversely affect the Fund's net asset value, performance, and ability to meet its investment objective. An investment in the Fund is not a bank deposit, is not guaranteed by BlackRock, Inc. or any of its affiliates, and is not insured by the Federal Deposit Insurance Corporation or any other agency of the U.S. government.

Underlying Fund Risk 1: The investment objective and strategies of a collective investment trust in which the Fund invests ("Underlying Fund") may differ from the Fund, and there is no assurance that an Underlying Fund will achieve its objective.

Foreign Investment Risk 1: The Fund may suffer losses due to political, legal, economic and geographic events affecting a non-U.S. issuer or market. The prices of non-U.S. securities may be more volatile than those of securities issued by U.S. corporations or other U.S. entities. Securities of non-U.S. issuers denominated in non-U.S. currencies will expose the Fund to fluctuations in foreign currency exchange prices.

Repurchase Agreement Risk 1: If the other party to a repurchase agreement defaults on its obligation under the agreement, the Fund may suffer delays and incur costs or lose money in exercising its rights under the agreement. If the seller fails to repurchase the security and the market value of the security declines, the Fund may lose money.

U.S. Government Issuers Risk: Obligations of the U.S. government and its agencies and instrumentalities are supported by varying degrees of credit. Debentures issued by U.S. government agencies are generally backed only by the general creditworthiness and reputation of the government agency issuing the debenture and are not backed by the full faith and credit of the U.S. government. U.S. Treasury obligations may differ in their interest rates, maturities, times of issuance and other characteristics.

Fixed Income for Money Market: An increase in interest rates may cause the value of fixed-income securities held by the Fund to decline, and the Fund may incur a loss if required to sell a fixed-income security prior to its scheduled maturity. The Fund's income may decline when interest rates fall. This decline can occur because the Fund must invest in lower-yielding bonds as bonds in its portfolio mature or the Fund needs to purchase additional bonds. Debt issuers may not honor their obligations.

MORNINGSTAR®

Disclosure

When used as supplemental sales literature, the Investment Profile must be preceded or accompanied by this disclosure statement. The performance data given represents past performance and should not be considered indicative of future results. Principal value and investment return will fluctuate, so that an investor's shares when redeemed may be worth more or less than the original investment. Fund portfolio statistics change over time. The fund is not insured by the Federal Deposit Insurance Corporation ("FDIC"), may lose value and is not guaranteed by a bank or other financial institution.

Fund Structure

The fund described herein is a bank-maintained collective investment fund maintained and managed by BlackRock Institutional Trust Company, N.A. ("BTC"). BTC is a national banking association organized under the laws of the United States and operates as a limited purpose trust company.

In reliance upon an exemption from the registration requirements of the federal securities laws, investments in the fund are not registered with the Securities and Exchange Commission ("SEC") or any state securities commission. Likewise, in reliance upon an exclusion from the definition of an investment company in the Investment Company Act of 1940, as amended (the "Company Act"); the fund is not registered with the SEC as an investment company under the Company Act. The Office of the Comptroller of the Currency is responsible for ensuring that fiduciary powers are exercised in a manner consistent with the best interests of BTC's clients and sound fiduciary principles.

The fund is offered to defined contribution plans ("Plans") that are qualified under Section 401(a) of the Internal Revenue Code of 1986, as amended ("IRC"), and governmental Plans, such as state and municipal government Plans that are described in IRC Section 818(a)(6), such as governmental IRC Section 457(b) Plans. The fund is established and governed by a trust instrument, the Plan of BlackRock Institutional Trust Company, N.A. Investment Funds for Employee Benefit Trusts (the "Plan Document"), which sets forth BTC's powers, authority and responsibilities regarding the administration, investment and operation of the fund. Plans investing in the fund become subject to the terms and conditions of the Plan Document.

Best and Worst 3 Month Performance

Morningstar calculates best and worst 3-month period (in percentage) in-house on a monthly basis.

Best 3-month Period: The highest total return the stock has posted in a consecutive three-month period over the trailing 15 years, or if a fund does not have 15 years of history, it will go back as far as the inception date.

Worst 3-month Period: The lowest total return the stock has posted in a consecutive three-month period over the trailing 15 years, or if a fund does not have 15 years of history, it will go back as far as the inception date.

Morningstar Rating™

Often simply called the Star Rating, the Morningstar Rating brings load-adjustments, performance (returns) and risk together into one evaluation. To determine a fund's star rating for a given time period (three, five, or 10 years), the fund's risk-adjusted return is plotted on a bell curve: If the fund scores in the top 10% of its category, it receives 5 stars (Highest); if it falls in the next 22.5% it receives 4 stars (Above Average); a place in the middle 35% earns 3 stars (Average); those lower still, in the next 22.5%, receive 2 stars (Below Average); and the bottom 10% get only 1 star (Lowest). The Overall Morningstar Rating is a weighted average of the available three-, five-, and 10-year ratings.

Morningstar Return

This statistic is a measurement of a fund's excess return over a risk-free rate (the return of the 90-day Treasury bill), after adjusting for all applicable loads and sales charges. In each Morningstar Category, the top 10% of funds earn a High Morningstar Return, the next 22.5% Above Average, the middle 35% Average, the next 22.5% Below Average, and the bottom 10% Low. Morningstar Return is measured for up to three time periods (three-, five-, and 10-years). These separate measures are then weighted and averaged to produce an overall measure for the fund. Funds with less than three years of performance history are not rated.

Morningstar Risk

This statistic evaluates the variations in a fund's monthly returns, with an emphasis on downside variations. In each Morningstar Category, the 10% of funds with the lowest measured risk are described as Low Risk, the next 22.5% Below Average, the middle 35% Average, the next 22.5% Above Average, and the top 10% High.

Morningstar Risk is measured for up to three time periods (three-, five-, and 10-years). These separate measures are then weighted and averaged to produce an overall measure for the fund. Funds with less than three years of performance history are not rated.

Morningstar Style Box™

The Morningstar Style Box reveals a fund's investment strategy as of the date noted on this report.

For equity funds the vertical axis shows the market capitalization of the long stocks owned and the horizontal axis shows investment style (value, blend, or growth).

For fixed-income funds, the vertical axis shows the credit quality of the long bonds owned and the horizontal axis shows interest rate sensitivity as measured by a bond's effective duration.

For corporate and municipal bonds, Morningstar surveys credit rating information from fund companies on a periodic basis (e.g., quarterly). In compiling credit rating information, Morningstar instructs fund companies to only use ratings that have been assigned by a Nationally Recognized Statistical Rating Organization (NRSRO). If two NRSROs have rated a security, fund companies are to report the lowest rating to Morningstar. If a rating is unavailable or unpublished, then the security or issuer is categorized as Not Rated/Not Available. US Government Securities issued by the US Treasury or US Government Agencies are included in the US Government category. PLEASE NOTE: Morningstar, Inc. is not itself an NRSRO nor does it issue a credit rating on the fund. An NRSRO rating on a fixed-income security can change from time-to-time.

Index Provider Information

Funds with S&P® Benchmark: "Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500®", "500", "Standard & Poor's MidCap 400®", "S&P MidCap", "Standard & Poor's 500® Growth Index", and "Standard & Poor's 500® Value Index" are trademarks of The McGraw-Hill Companies, Inc. These marks have been licensed for use by BlackRock Institutional Trust Company, N.A. The fund is not sponsored, endorsed, sold or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of investing in the fund.

Funds with Dow Jones Benchmark: "Dow Jones", the "Dow Jones U.S. Total Stock Market Index SM" and "Dow Jones U.S. Completion Total Stock Market IndexSM" are service marks of Dow Jones & Company, Inc., and the "Dow Jones-UBS Commodity Index" is a service mark or trademark of Dow Jones & Company, Inc. and UBS AG, and have been licensed for use for certain purposes by BlackRock Institutional Trust Company, N.A. ("BTC"). BTC's Extended Equity Market Index Funds, US Equity Market Index Funds and BlackRock Dow Jones-UBS Commodity Index Funds, based on the Dow Jones U.S. Total Stock Market IndexSM ,the Dow Jones U.S. Completion Total Stock Market IndexSM and the Dow Jones-UBS Commodity Index respectively, are not sponsored, endorsed, sold or promoted by Dow Jones and Dow Jones does not make any representation regarding the advisability of investing in such products.

Funds with a Citigroup Benchmark: "Citigroup 3 Month Treasury Bill Index, Citigroup 1 Month Treasury Bill Index ©2012 Citigroup Index LLC. All rights reserved."

Funds with an MSCI Benchmark: The MSCI World ex-U.S. Index Funds, MSCI ACWI ex-US Index Funds, Emerging Markets Index Funds, Active International Equity Index Funds, EAFE Equity Index Funds, and US Real Estate Index Funds described herein are indexed to an MSCI index. The MSCI Indexes are the exclusive property of Morgan Stanley Capital International Inc. ("MSCI"). MSCI, the MSCI Index Names and EAFE® are trade or service marks of MSCI or its affiliates and have been licensed for use for certain purposes by BlackRock Institutional Trust Company, N.A. Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. NO further distribution or dissemination of the MSCI data is permitted without MSCI's express written consent.

Funds with a Russell Benchmark: The Russell 1000 Index Funds, Russell 1000 Growth Funds, Russell 1000 Value Funds, Russell 2000 Index Funds, Russell 2000 Growth Funds, Russell 2000 Value Funds and Russell 3000 Index Funds are not promoted, sponsored or endorsed by, nor in any way affiliated with Frank Russell Company. Frank Russell Company is not responsible for and has not reviewed the Russell 1000 Index Funds, Russell 1000 Growth Funds, Russell 1000 Value Funds, Russell 2000 Index Funds, Russell 2000 Growth Funds, Russell 2000 Value Funds and Russell 3000 Index Funds nor any associated literature or publications and Frank Russell Company makes no representation or warranty, express or implied, as to their accuracy, or completeness, or otherwise. Frank Russell Company reserves the right, at any time and without notice, to alter, amend, terminate or in any way change the Russell Indexes. Frank Russell Company has no obligation to take the needs of any particular fund or its participants or any other product or person into consideration in determining, composing or calculating any of the Russell Indexes. Frank Russell Company's publication of the Russell Indexes in no way suggests or implies an opinion by Frank Russell Company as to the attractiveness or appropriateness of investment in any or all securities upon which the Russell Indexes are based. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes, including the Russell 1000®, Russell 1000® Growth, Russell 1000® Value, Russell 2000®, Russell 2000® Growth, Russell 2000® Value, Russell 2500® and Russell 3000® Indexes Russell is a trademark of Russell Investment Group®.

Funds with a FTSE EPRA/NAREIT Benchmark: The fund is not in any way sponsored, endorsed, sold or promoted by FTSE International Limited (FTSE), by the London Stock Exchange Plc (the "Exchange"), Euronext N.V. (Euronext), The Financial Times Limited (FT), European Public Real Estate Association (EPRA) or the National Association of Real Estate Investment Trusts (NAREIT) (together the "Licensor Parties") and none of the Licensor Parties make any warranty or representation whatsoever, expressly or impliedly, either as to the results to be obtained from the use of the FTSE EPRA/NAREIT Developed Index, FTSE EPRA/NAREIT Developed ex U.S. Index or the FTSE EPRA/NAREIT United States Index (each, an "Index") and/or the figure at which the said Index stands at any particular time on any particular day or otherwise. Each Index is compiled and calculated by FTSE. However, none of the Licensor Parties shall be liable (whether in negligence or otherwise) to any person for any error in each Index and none of the Licensor Parties shall be under any obligation to advise any person of any error therein. FTSE® is a trademark of the Exchange and the FT, NAREIT® is a trademark of the National Association of Real Estate Investment Trusts and EPRA® is a trademark of EPRA and all are used by FTSE under license.

Funds with a Barclays Benchmark: The index is maintained by Barclays Inc. ("Barclays"). The fund is not sponsored, endorsed, sold or promoted by Barclays. Barclays makes no representation or warranty, express or implied, to the owners of the fund or any member of the public regarding the advisability of investing in securities generally or in the fund particularly or the ability of the Barclays index to track general bond market performance. Barclays is not responsible for and has not participated in the determination of the timing of, prices at, or quantities of the fund to be issued. Barclays has no obligation or liability in connection with the administration, marketing or trading of the fund. Barclays does not guarantee the accuracy and/or the completeness of the Barclays index or any data included therein. Barclays shall have no liability for any errors, omissions or interruptions therein. Barclays makes no warranty, express or implied, as to the results to be obtained by BTC and the fund or owners of the fund, or any other person or entity, from the use of the Barclays index or any data included therein. Barclays makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to the Barclays index or any data included therein. Without limiting any of the foregoing, in no event shall Barclays have any liability for any lost profits or special, punitive, direct, indirect, or consequential damages even if notified thereof.

Additional Information

BlackRock is a premier provider of asset management, risk management, and advisory services to institutional, intermediary, and individual clients worldwide. The firm offers a wide range of investment strategies across asset classes in separate accounts, mutual funds, other pooled investment vehicles, and the industry-leading iShares® exchange-traded funds.

Through BlackRock Solutions®, the firm offers risk management and advisory services that combine capital markets expertise with proprietarily-developed analytics, systems, and technology. BlackRock serves clients in North and South America, Europe, Asia, Australia, Africa, and the Middle East. Headquartered in New York, the firm maintains offices in 24 countries around the world. For more information on BlackRock, please visit www.blackrock.com.

The information provided in the Investment Profile and this disclosure statement should not be considered a recommendation to purchase or sell a particular security. The fund is a collective investment fund and is privately offered. Prospectuses are not required and prices are not available in local publications. To obtain pricing information, please contact your service representative.

This Investment Profile includes investment option-related information prepared in accordance with the requirements of Department of Labor ("DOL") Rule 404a-5 under ERISA ("Rule 404a-5"), but please note that this Investment Profile may not meet all of the disclosure requirements for an ERISA "Section 404(c) plan", as described in the DOL regulations under Section 404(c). Please also note that there may be additional information required to be disclosed under Rule 404a-5 that is not included in this Investment Profile because BlackRock is not the appropriate source for that information (e.g., plan-related information or information related to fees and expenses that are charged to participant accounts rather than to the BlackRock investment option). In addition, please note that BlackRock investment option-related information received from sources other than BlackRock may not be consistent with the BlackRock investment option-related information prepared by BlackRock. The information provided herein does not constitute individual investment advice for a Plan participant or investor, is only informational in nature and should not be used by a Plan participant or investor as a primary basis for making an investment decision.

Please note that many collective investment funds maintained by BTC, including certain underlying funds in which such collective investment funds invest, engage in securities lending.

The American Banking Association's "Sample Glossary of Collective Investment Fund Terms for Disclosure to Retirement Plan Participants" is available from BlackRock upon request.

Accordingly, the "Sample Glossary of Investment-Related Terms for Disclosures to Retirement Plan Participants" prepared by the Investment Company Institute and The SPARK Institute is also available from BlackRock upon request.

For additional terms to assist participants and beneficiaries in understanding BlackRock collective trust funds or BlackRock separate accounts, BlackRock has prepared a glossary that includes certain investment strategy-specific concepts. This BlackRock-specific glossary is available upon request.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

Exhibit B

JPMCB Liquidity Fund†

CF Class

Data as of March 31, 2016

Fund overview

Objective

The Fund seeks to preserve principal, provide liquidity, generate current income and maintain a stable net asset value of $1.00 per unit by investing in a portfolio of high quality, short-term instruments. The Fund's performance is measured against the Citigroup 3-Month U.S. Treasury Bill Index.

Strategy/Investment process

- The Fund invests primarily in a diversified portfolio of fixed and floating rate short-term money market instruments.
- The Fund invests only in U.S. dollar-denominated securities.

Portfolio managers/industry experience

John Tobin, 24 years
Doris Grillo, 31 years
Christopher Tufts, 19 years

Portfolio characteristics	
Number of holdings	253
Fund assets (in billions)	$10.18

Sector allocation (%)**	
CD	47.8
CP	30.9
Time Deposits	16.2
Corporates	4.7
Treasuries	0.5

Maturity breakdown (%)**	
Overnight	15.4
2 - 7 Days	8.5
8 - 30 Days	16.6
31 - 90 Days	30.8
91 - 180 Days	21.9
181 - 365 Days	6.9

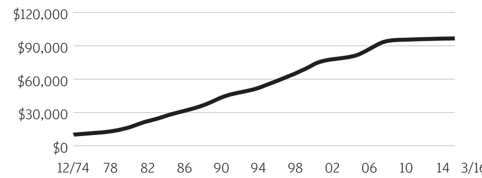
Quality (%)**	
US Government	0.5
A-1+	45.2
A-1	49.7
AA	4.7

The manager receives credit quality ratings on underlying securities of the portfolio from the three major ratings agencies - S&P, Moody's and Fitch. When calculating the credit quality breakdown, the manager selects the highest rating of the agencies when all three agencies rate a security. The manager will use the higher of the two ratings if only two agencies rate a security and will use one rating if that is all that is provided. Securities that are not rated by all three agencies are reflected as such.

**Due to rounding, values may not total 100%.

Fund performance*

A $10,000 investment in JPMCB Liquidity Fund (CF Class)[1] at NAV, with dividends and capital gains reinvested, would have grown to $96,752 from inception on 12/24/74 through 3/31/16. The chart is plotted monthly. There is no direct correlation between a hypothetical investment and the anticipated performance of the Fund.



Performance at NAV (%)	Total returns 3 month	Total returns YTD	Average annual total returns 1 yr	3 yrs	5 yrs	10 yrs
CF Class[1]	0.12	0.12	0.26	0.18	0.19	1.38
Citigroup 3-Month U.S. Treasury Bill Index	0.05	0.05	0.08	0.05	0.06	1.07

Calendar-year returns (%)	2011	2012	2013	2014	2015
CF Class at NAV[1]	0.29	0.34	0.18	0.13	0.18
Citigroup 3-Month U.S. Treasury Bill Index	0.08	0.07	0.05	0.03	0.03

The performance quoted is past performance and is not a guarantee of future results. Collective investment funds are subject to certain market risks. Investment returns and principal value of an investment will fluctuate so that an investor's units of participation, when redeemed, may be worth more or less than original cost. Current performance may be higher or lower than the performance data shown.

Annual operating expenses (%)	CF Class
Investment management fees	0.10
Service fees	None
Other expenses[2]	0.00^

[2]Reflects the operating expenses incurred from the most recent fiscal year.
^Amount rounds to less than 0.01%.

Portfolio statistics	CF Class
Inception date	9/27/2013
Investment minimum	$100M
Fund number	2871
CUSIP	20261N101

Insight + Process = Results℠

†Commingled Pension Trust Fund (Liquidity) of JPMorgan Chase Bank, N.A.

Please refer to the back of the page for important disclosure information including risks associated with investing in the Fund.

J.P.Morgan
Asset Management

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

CF Class

JPMCB Liquidity Fund

The Commingled Pension Trust Fund (Liquidity) of JPMorgan Chase Bank, N.A. is a collective trust fund established and maintained by JPMorgan Chase Bank, N.A. under a declaration of trust. The fund is not required to file a prospectus or registration statement with the SEC, and accordingly, neither is available. The fund is available only to certain qualified retirement and govern-ment plans and is not offered to the general public. Units of the fund are not bank deposits and are not insured or guaranteed by any bank, government entity, the FDIC or any other type of deposit insurance. You should carefully consider the investment objectives, risk, charges, and expenses of the fund before investing.

RISKS ASSOCIATED WITH INVESTING IN THE FUND:

The manager seeks to achieve the stated objectives. There can be no guarantee the objectives will be met. Investing in these strategies carries a certain amount of risk. There can be no guarantee that investing in these strategies will prevent loss of an investment.

RETURNS:

[1]The quoted performance of the Fund includes performance of a predecessor fund/share class prior to the Fund's commencement of operations.

INDEXES DEFINED:

The Citigroup 3-Month U.S. Treasury Bill Index tracks the performance of U.S. Treasury bills with a remaining maturity of three months. The performance of the index does not reflect the deduction of expenses associated with a fund, such as investment management fees. By contrast, the performance of the Fund reflects the deduction of the fund expenses, including sales charges if applicable. An individual cannot invest directly in an index.

J.P. Morgan Asset Management is the marketing name for the asset management businesses of JPMorgan Chase & Co. Those businesses include, but are not limited to, JPMorgan Chase Bank, N.A., J.P. Morgan Investment Management, Inc, Security Capital Research & Management Incorporated, J.P. Morgan Alternative Asset Management, Inc., and J.P. Morgan Asset Management (Canada), Inc.

The information provided in this document is for informational purposes only, does not constitute individual investment advice, and is not intended to be and should not be interpreted as an investment recommendation.

FS-CF-L-CF-0316

J.P.Morgan

Asset Management

Exhibit C

Fund Comparison Overview

Annualized Returns (Gross of Fees) As of March 31, 2016				
	Current Fund	**Proposed Funds**		Benchmark
	BlackRock Liquidity TempFund (Money Market Mutual Fund)	BlackRock Short-Term Investment Fund (CIT)	JP Morgan Liquidity Fund (CIT)	Citigroup 3-Month Treasury Bill Index
1 Year	0.35	0.36	0.34	0.08
3 Year	0.26	0.28	0.27	0.05
5 Year	0.28	0.30	0.28	0.06
10 Year	1.49	1.40	1.48	1.07

Fund Expense Ratios As of March 31, 2016		
Current Fund	**Proposed Funds**	
BlackRock Liquidity TempFund (Money Market Mutual Fund)	BlackRock Short-Term Investment Fund (CIT)	JP Morgan Liquidity Fund (CIT)
0.18	0.0822	0.10

As of March 31, 2016	**BlackRock CIT Fund Overview**	**JP Morgan CIT Fund Overview**
Fund Size	$17.4 billion	$10.2 billion
Weighted Average Maturity	18 days	36 days
Weighted Average Life	57 days	61 days
Certificate of Deposit	2%	48%
Repurchase Agreements	56%	0%
US Agency	18%	0%
US Treasury	4%	1%
Time Deposit Instruments	10%	16%
Commercial Paper	10%	30%
Corporate Bonds	0%	5%

PUBLIC AGENDA ITEM - #16

16. Review and Consideration of
ERS Fiscal Year 2017 Proposed Operating Budget

August 16, 2016

PROPOSED FY 2017 OPERATING BUDGET

The ERS Board of Trustees reviews and approves the operating budget for the system each year in August for a fiscal year that begins September 1st and ends August 31st. ERS administrative expenses are paid from the insurance and retirement trust funds and not from money directly appropriated for the agency's budget. ERS operational costs are paid from the ERS expense account in accordance to §815.208 of the Texas Government Code. .

In addition to using money from the trust funds, ERS receives annual fees of $3.00 collected for each retirement system member designed to offset retirement administration costs. Revenue is also collected from fees paid by participants of programs such as Social Security and deferred compensation. Those fees must be used exclusively for the administrative costs associated with the program for which they were received. ERS formally tracks and documents staff time spent on each program through an online timekeeping system. Data from this system is used to properly allocate the administrative costs of each ERS program.

The FY 2017 Proposed Operating Budget supports the Strategic Plan which was developed though an interactive process involving executive management, division directors and staff representing all functions of the agency. ERS Fiscal Year 2017-2021 Goals include:

- Support Our Members' Retirement Income Security
- Sustain Competitive Group Benefits Programs
- Engage Stakeholders for Informed Decision Making
- Enhance Agency Performance and Accountability

ERS staff identified short and long-term activities to meet these goals. As applicable, funding has been included in the 2017 budget to further these goals. .

The FY 2017 Proposed Operating Budget of $75.5 million represents only 0.29% of the assets in the trust funds that ERS administers, which totaled $25.6 billion as of June 30, 2016.

Budget Request Overview

Comparison of the FY 2017 Budget to the FY 2016 Budget

The FY 2017 Proposed Operating Budget increased $5.9 million or 8.45% over the FY 2016 Operating Budget. A high-level year-to-year comparison is shown in the following table:

	FY 2016 Budget	FY 2017 Budget	FY 2016-2017 INCR (DECR)
Salary Related Expenses	$ 43,613,000	$46,126,000	$2,513,000
Other Expenses	25,997,000	29,363,000	2,905,000
Total Expenses	**$ 69,610,000**	**$75,489,000**	**$5,879,000**
FTEs	**384**	**395**	**11**

Comparison of the FY 2017 Budget to the FY 2016 Forecast

ERS is on target to spend $1.4 million less in FY 2016 than the approved budget. The lapsed funds remain in the trust fund for future use. Personnel costs are always the major part of the agency's budget. The additional 1% salary budget for merits and equity adjustments for non-investment staff contributed to the retention of filled positions throughout FY 2016. Vacancy rates ranging from 3% to 6% are assumed in the FY 2017 Budget. The budget includes requests for additional full-time employees in order to provide better customer service, comply with legislative requirements such as new programs and regulations, and continue to enhance the investment program.

The FY 2017 Proposed Operating Budget is higher than the FY 2016 forecast by $7.3 million, or 10.65 %

	FY 2016 Forecast	FY 2017 Budget	FY 2016-2017 INCR (DECR)	Percent Change
Salary Related Costs	$42,007,000	$46,126,000	$4,119,000	9.80%
Other Expenses	26,214,000	29,363,000	3,149,000	12.01%
Total Expenses	**$68,221,000**	**$75,489,000**	$7,268,000	**10.65%**

Some key budget drivers for ERS are the strategic projects, strengthening of data security and integrity, and enhancement of contract management. The budget also reflects cyclical cost increases due to the legislative session (primarily actuarial costs) and the trustee election. Additional details for the budget trend and the increases in program complexity over the last several years are presented in Exhibit E of the Proposed Operating Budget.

STAFF RECOMMENDATION:

Staff recommends that the ERS Board adopt the ERS *Fiscal Year 2017 Proposed Operating Budget* as presented in Exhibit A of this agenda item. The recommended motion follows Exhibit A.

ATTACHMENT – 1

Exhibit A – ERS Fiscal Year 2017 Proposed Operating Budget *(Provided under separate cover)*

PUBLIC AGENDA ITEM - #17

Review, Discussion and Consideration of the ERS Incentive Compensation Plan

August 16, 2016

ERS INCENTIVE COMPENSATION PLAN BACKGROUND:

On December 13, 2006, the Board of Trustees (Board) approved the ERS Incentive Compensation Plan (Plan or ICP). The Board reviews the Plan annually, and it was most recently amended and approved by the Board on August 18, 2015. The plan communicates strategic performance priorities to certain ERS staff and is designed to drive sustained levels of high investment performance, promote teamwork, support ERS' strategic and operational goals and attract and retain key employees. The goal of the plan is to encourage the highest level of performance and deliver value to ERS and the members, retirees, and beneficiaries of the retirement system.

Staff annually reviews the plan and related processes and recommends revisions to the Board. The revisions seek to simplify and clarify expectations while maintaining the overall objective. 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:

Proposed Revisions to the ICP Plan Document for Fiscal Year 2017

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.

Salary used to Calculate Maximum Incentive Compensation Award
Staff recommends that 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.

Other revisions are included in the proposed Plan document as presented in Exhibit A.

STAFF RECOMMENDATION:
Staff recommends that the Board approve, as part of its annual review of the Plan, the proposed Plan document, as presented in Exhibit A, with the revisions marked in the document. The staff's recommended motion is included with this agenda item following the exhibit.

ATTACHMENTS – 1

Exhibit A – Revised Employees Retirement System of Texas Incentive Compensation Plan for Key Investment Professionals and Leadership Employees.

PUBLIC AGENDA ITEM - # 18

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

August 16, 2016

BACKGROUND:

The term of Trustee Brian Ragland with the Texas Department of Transportation will expire on August 31, 2017. Section 815.003(d) of the Texas Government Code states that before August 31 of each odd-numbered year, the Board of Trustees (Board) of the Employees Retirement System (ERS) of Texas is required to hold an election for the members and retirees of the system to nominate and elect a trustee.

Contributing and non-contributing members of the Employees Retirement System of Texas (ERS) as of January 31, 2017, and retired state employees receiving an annuity from ERS are eligible to vote in the election. A non-contributing member is someone who left their contributions on account at ERS when they left state employment.

Eligible voters may cast their vote in one of two ways – by submitting the paper ballot they receive in the mail from ERS, or by voting online. To streamline the online voting process for the upcoming election, reminder e-mails will be sent to voters with e-mail addresses on file that include a personalized, voter-specific embedded link into the online ballot.

To inform voters and stakeholders of the election, ERS communicates information about the nomination process, candidate forum, voting period, and voting channels through regular mail, e-mail and electronic print available on the ERS website. Communications to voters and stakeholders begin in late December and run through the close of the voting period. All contributing ERS employee class members are eligible to serve on the Board, except for employees of the Texas Health and Human Services Commission and the Texas Department of Insurance, as these agencies already have a representative on the ERS Board of Trustees.

Eligible candidates wishing to serve on the Board must submit a petition with at least 300 unique signatures from eligible voters to be nominated as a candidate. The candidate certification takes place at ERS. Once the candidates have been certified, a candidate forum is held at ERS as an opportunity for ERS members and retirees to ask questions and learn the candidates' positions on state employee benefits and retirement issues. For those who are unable to attend the forum in person, the event is live-streamed, and a recorded version is made available on the website throughout the voting period. An election newsletter, which includes information on the candidates and instructions on the voting process, is included in the paper ballot that is mailed to every eligible voter prior to the voting period. Voters have five weeks to cast their ballot for the candidate of their choice. ERS staff sends an assortment of reminders to voters encouraging them to cast their ballot by the voting deadline.

The election results and announcement of the new Trustee-elect are revealed by ERS' third-party election vendor, Survey and Ballot Systems, at a meeting held at ERS. The three most recent elections yielded participation rates ranging from 10 to 12% of the eligible voters.

The cost of trustee elections is included in the ERS operating budget every other year. As presented in an earlier agenda item, and consistent with the previous trustee election budget item, the proposed ERS Operating Budget for Fiscal Year 2017 includes expenses for a general election. The largest cost is postage for the initial mailing of the newsletter and ballot to home addresses, and the reply postage for people casting their ballot through the mail. To vote online, voters may also use the code on the ballot they receive in the mail.

2017 Trustee Election Budget	
Third Party Administration, General Election	$ 105,000
Postage	156,000
Total	$ 261,000

The Board of Trustee Rules, Texas Administrative Code, Title 34, Part IV, Section 63.3(7) stipulates that the Board adopt a calendar for the trustee election. The new term of office will begin September 1, 2017. The staff recommendation is in line with previous election calendars.

STAFF RECOMMENDATION:

Staff recommends the Board of Trustees adopt the following calendar for the 2017 Trustee Election:

Nomination Period

Distribution of Nominating Petitions	Monday, January 2, 2017
Close Nominations at 5:00 P.M.	Wednesday, February 1, 2017
Certify Candidates; Select Ballot Order	Wednesday, February 15, 2017
Candidate Forum	Thursday, March 9, 2017

General Election

Voting Begins	Friday, March 10, 2017
Close Voting	Friday, April 14, 2017
Executive Director Certifies Results	Wednesday, May 10, 2017

A proposed motion is included with this agenda item on the following page.

PUBLIC AGENDA ITEM - #19

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

August 16, 2016

BACKGROUND:

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.

PROPOSED MOTION:

I move that the Board of Trustees of the Employees Retirement System of Texas elect ___________________________ as Chair and __________________________ as Vice-Chair of the ERS Board of Trustees for one-year terms beginning September 1, 2016 and ending August 31, 2017.

PUBLIC AGENDA ITEM - #20

20. Executive Director Agency Update

August 16, 2016

Sunset Update

The Sunset Commission Staff Report on ERS was published on April 29, 2016 and the included findings and recommendations were presented to the Board during the May quarterly meeting. Since that time, ERS staff has reviewed the findings and recommendations made by Sunset staff and are working to identify operational improvements and organizational changes that would address the findings of the report and improve administrative operations or direct service to constituent groups and agency stakeholders. ERS staff has divided the recommendations into three implementation categories:

1. **Actions:** Recommendations the agency can address fully prior to the next legislative session with no statutory changes and with no new, or minimal, additional resources added to the FY17 budget. These items should be fully implemented by the end of calendar year 2016. [Targeted Recommendations: 1.1, 1.2, 1.3, 2.1, 3.3, 3.4, 3.5, 3.6]

2. **Development:** Formulation of proposals for future implementation of recommendations that may require (1) additional resources, (2) additional clarification from Sunset or direction from the Legislature, or (3) more time to implement effectively in a manner that will satisfactorily address the report findings. ERS will continue to work on, and refine, proposed implementation plans for these recommendations to ensure they are completed according to expectations, and that all necessary parameters and resources are fully understood and identified. [Targeted Recommendations: 2.2, 2.3, 4.1]

3. **Monitoring:** Recommendations that require affirmative approval by the legislature and enacted changes to statutory authorizing language to implement. Implementing these recommendations at the current time might require action counter to existing law or could result in inefficient reversals or corrections if legal requirements change during the legislative process. Such changes could be confusing or disruptive to member interactions and understanding of benefit processes and programs. ERS staff intends to monitor any discussions and debates surrounding these recommendations during the legislative session and will participate in the development of statutory language and bill debates as opportunities allow. [Targeted Recommendations: 3.1, 3.2, 5.1, 5.2]

The full Sunset Commission will hold a public hearing on the ERS Sunset Staff Report on August 22, 2016. During this hearing, Sunset staff will brief the Commission on their findings and recommendations related to the agency, ERS will be asked to respond to the report, and members of the public will be allowed to testify on their thoughts regarding ERS operations and administration of public employee benefits. The public hearing will allow ERS the formal opportunity to update Commission staff and members on agency actions taken to begin addressing the report's findings as well as receive feedback on any plans for future implementations.

Legislative Appropriations Request

The Legislative Appropriations Request (LAR) for ERS is due August 26, 2016, based on instructions provided by the Governor's Office and the Legislative Budget Board (LBB) on June 30, 2016. The LAR is the formal budget request document that each agency submits to state budget policy makers to request program funding.

The due date of the LAR is right before the end of the fiscal year which occurs August 31, 2016. This means that the LAR is based on a trust fund valuation that is almost a year old. It will be updated once the valuation is completed in mid-November. During legislative session years, the trust valuation is updated again as of February. These valuations will provide a better estimate of the retirement plans' funding needs for the 2018-2019 biennium.

The policy letter accompanying the LAR instructions from the Leadership Offices instructed agencies to submit their 2018-19 biennial request at four percent (4%) lower than their base appropriations for 2016-17 with some exceptions. Included in those exceptions were state pension systems and employee group benefits. For these programs, ERS may set the base at fiscal year 2017 budgeted levels. ERS staff worked with the LBB and Governor's Office staff to determine the base level of funding. ERS staff then worked with the actuaries to determine the levels of funding needed to fund the programs administered by ERS for the next biennium.

ERS may request funding for items above the base funding level. These requests are considered "exceptional items" and must be itemized, prioritized and justified in the LAR document.
For retirement, the base request for the ERS retirement plan (state employees and elected officials) is at the FY 17 state contribution level of 9.5% of payroll. Combined with the state employee contribution of 9.5% of salary, and an employer contribution rate of .5%, total contribution rate is 19.5%. The base requests for the Law Enforcement and Custodial Officers Supplemental Retirement Fund (LECOSRF) and the Judicial Retirement System (JRS) Plan II are also at the FY 17 state contributions levels of 0.5% and 15.663% of payroll, respectively.

Exceptional item requests are included for ERS, LECOSRF and JRS Plan II to achieve the actuarially sound contribution rates. Based on the August 31, 2015 actuarial valuations, the projected contribution rates from all sources to achieve actuarial soundness is 20.02%, 3.13% for LECOSRF, and 24.39% for JRS II at the end of fiscal year 2017.

The JRS Plan 1 is a pay-as-you-go plan so the budget request is equal to the amount of annuities expected to be paid during the biennium. The base request for JRS 1 is slightly below the 2016-17 biennium.

The base request for the health and basic life insurance plans under the Texas Employees Group Benefits Program (GBP) is at the fiscal year 2017 level.

Exceptional items for insurance include:

- funding to cover the projected cost trend, and
- in accordance with Texas Insurance Code § 1551.211, a request for the GBP contingency fund at an amount estimated to pay 60 days of claims.

Agencies were also instructed to submit a schedule outlining options for reductions to GR and GR dedicated funds by 10% in five percent (5%) increments and the impact those reductions would have, however, ERS does not have to submit this reduction schedule.

Fiscal Year 2017 Roadmap Development

Beginning in March of each year, in preparation for the next fiscal year, each division proposes projects and initiatives for their respective areas. Projects include those efforts that impact staff across multiple divisions. To gain more insight into the proposed projects, project management and business analysis staff meet with subject matter experts around the agency to determine the scope, timeline and estimated resources necessary to complete the work. Once vetted, each proposed project or initiative is then discussed amongst division leadership and executive management for consideration. The original list included 93 proposed projects and initiatives for Fiscal Year 2017. After further analysis and discussion amongst division leadership and executive management, the list has been reduced to 70, of which 8 are identified as major roadmap items for Fiscal Year 2017 based on their magnitude and impact to staff, members and other stakeholders.

ERS Fiscal Year 2017 Roadmap Items:

- Solicit Benefits Administration Services
- Solicit HealthSelect TPA Services
- Implement Contract Content System
- Conduct Asset Liability Study
- Implement Data Center Move
- Public Website Redesign
- Implement Sunset Recommendations
- Space Planning Implementation

Space Planning Update

Since the May Board Meeting,

- We hired a geotechnical engineering firm to complete a geotechnical study at the ERS location. The purpose of the engineering study was to evaluate the pertinent geotechnical conditions at the ERS site and to develop geotechnical parameters, which will assist in the design and construction of structural improvements and renovations. The engineer took samples for analysis on the structure and soils. They will use this information to determine whether the buildings can support additional floors. They obtained the samples by shallow borings within the Main and Annex buildings, full depth borings at the site corners and a boring at the lower service area between the two buildings. We will receive the results from the geotechnical study and structural analysis in the month of August.

Summer Enrollment Plan Year 2017

Summer Enrollment has concluded for employees, pre-Medicare retirees and their families. The enrollment period was July 11 - August 12. We mailed custom Personal Benefits Enrollment Statement packets to 277,000 all members to provide them with current enrollment, eligible coverage options and information on Plan Year 2017 changes. Summer Enrollment fairs were conducted around the state, along with webinars, to allow members to receive important benefits information, ask questions and share information with us.

We implemented three new plan options for PY17:

- vision insurance, State of Texas Vision, administered by Superior Vision Services, Inc.;
- Consumer Directed HealthSelect, a high-deductible health plan with health savings account (HSA), administered, respectively, by United Healthcare and Optum Bank; and
- the TexFlex limited flexible spending account (LFSA), administered by ADP Inc., available for employees who enroll in Consumer Directed HealthSelect.

Members participated in Summer Enrollment in the following ways:

- 63,046 members made changes to coverage.
- 5,455 people attended 35 fairs across Texas.
- 956 people participated in 10 webinars.
- We received 14,193 phone calls:
    - 1,191 at ERS,
    - 13,002 at ACT.
- 51 people visited ERS in person.
- 56,413 people enrolled in State of Texas Vision.
- 346 people enrolled in Consumer Directed HealthSelect.

ERS Medical Board Retirements

- Dr. Marvin Cressman, a highly regarded neurosurgeon, served on the Medical Board from 2006 until May 2016.
- Dr. William McCarron, a highly regarded cardiologist, served on the Medical Board from 2012 until June 2016.

As we work on replacing these two positions we have enlisted services from two interim Medical Board members:

- Dr. Ace Alsup, internal medicine, joined the Medical Board staff June 2016.
- Dr. William Taylor, orthopedic surgeon, joined the Medical Board staff in July 2016.

SECC Excellence in Philanthropy Award

SECC Excellence in Philanthropy Award received from United Way in May 2016 for the 2015 SECC Campaign. This is the 5th award for the 2015 campaign.

The United Way for Greater Austin (UWATX) is the fiscal agent and campaign manager for the SECC campaign. Each year, UWATX runs hundreds of corporate workplace giving campaigns as well, and hosts an awards event to recognize corporate campaign coordinators for outstanding achievement. Though the SECC campaign is run differently than these corporate campaigns, it shares the same goal of workplace giving.

Because Employees Retirement System of Texas was recognized for all three of the SECC-achievement categories this year: Highest Per-Capita Gift, Greatest Increase in Campaign and Highest Percent Participation, United Way awarded the Employees Retirement System with the *SECC Excellence in Philanthropy Award* in recognition of an outstanding 2015 campaign led by Beth Gilbert, Chair and Carla Lawrence, Co-Chair.

Investments Update

Bob Sessa and the ERS Real Estate Team won the 2016 Investments and Pensions Europe (IPE) Real Estate Award for the best Listed Strategy. They were also short-listed on Indirect Strategy and the regional award for North America. The IPE Awards each year recognize the bar-raising achievements of the diverse pension funds and celebrate excellence by creating a meaningful and broad set of benchmarks.

The Fixed Income Team was featured in an article in *The DESK Magazine* titled Lead Feature: Trading for Retirement Funds. The article highlighted the trend of public pension funds bringing their fixed income investment in-house, and explained some of the associated challenges.

PUBLIC AGENDA ITEM - # 21

21. Executive Session

August 16, 2016

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.

PUBLIC AGENDA ITEM - #22

22. 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

August 16, 2016

2016 Meeting Dates:

Tuesday, February 23, 2016

Tuesday, May 17, 2016

Tuesday, August 16, 2016

2 Day Workshop:
Thursday – Friday, December 1 & 2, 2016

PUBLIC AGENDA ITEM - #23

23. Adjournment of the ERS Board of Trustees

May 17, 2016