



ERS

EMPLOYEES  RETIREMENT
SYSTEM OF TEXAS

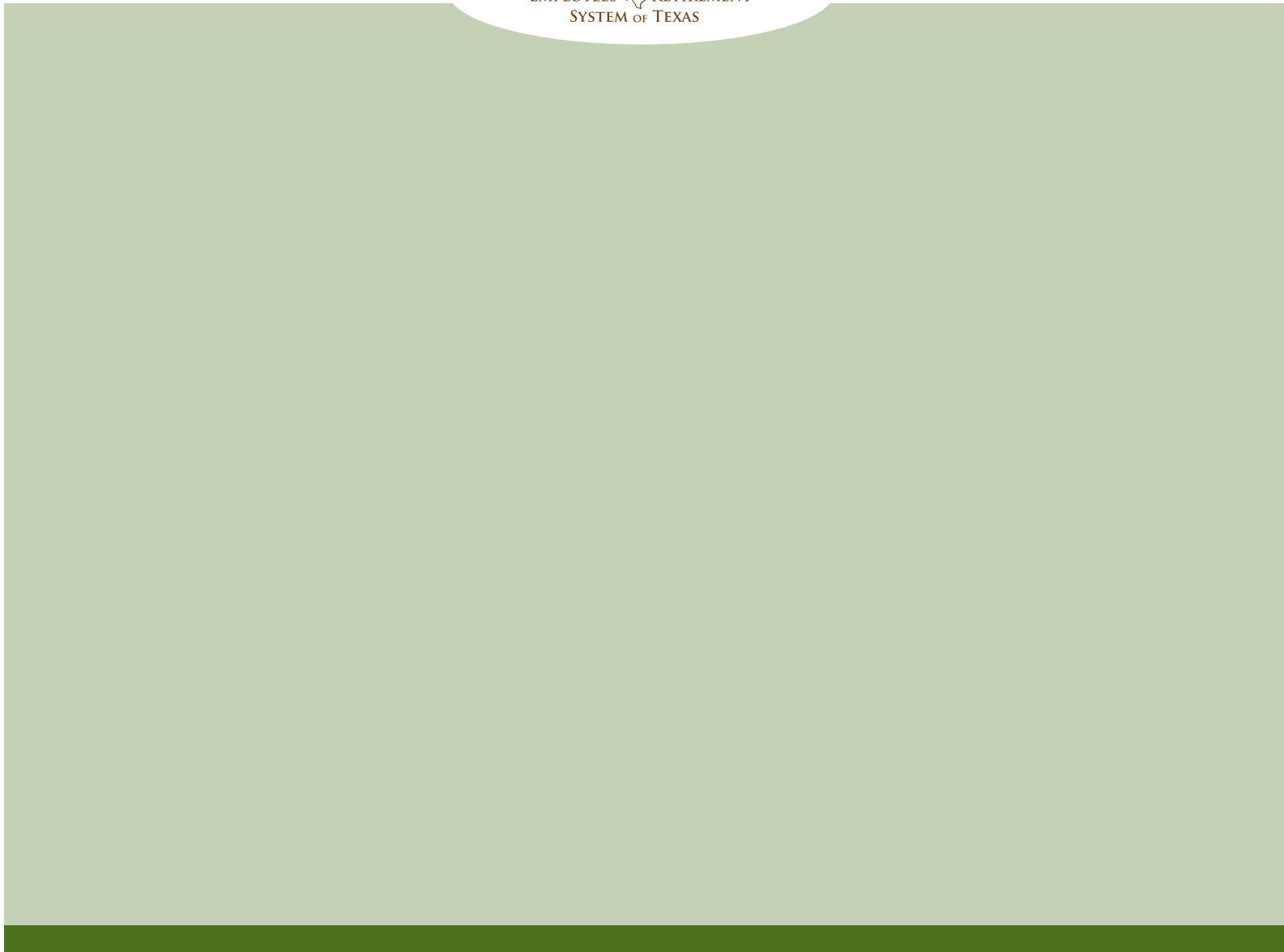


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**BOARD OF TRUSTEES MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS**

**October 27, 2014
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

TRUSTEES PRESENT

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

ERS STAFF PRESENT

Ann S. Bishop, Executive Director
Larry Zeplin, Chief Operating Officer
Paula A. Jones, General Counsel and Chief Compliance Officer
Shack Nail, Deputy Director of Governmental Affairs
Catherine Terrell, Director of Governmental Affairs
Tom Tull, Chief Investment Officer
Kelley Davenport, Executive Office
Bernie Hajovsky, Office Management Support
Dana Jepson, Governmental Affairs
Jennifer Jones, Governmental Affairs
Sharmila Kassam, Investments
Patricia Maugham, Executive Office
MaryJane Wardlow, Governmental Affairs
Keith Yawn, Governmental Affairs

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

“A public notice of the Board of Trustees meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 4:33 p.m. on Thursday, October 16, 2014 as required by Chapter 551, Texas Government Code, referred to as “The Open Meetings Law.”

I. REVIEW AND DISCUSSION OF MARKET UPDATE

Ms. Sharmila Kassam, Deputy Chief Investment Officer, presented to the ERS Board of Trustees (Board) an Investments Market Update as of October 17, 2014 and informed the board that the factors are perceived as being part of the volatility of the markets. ERS investments staff are monitoring markets on a daily basis, in consultation with the Executive Director, to respond as needed and take advantage of market opportunities. The broad range of factors that were likely causes of this recent market volatility include (1) slowing global growth concerns and deflation fears; (2) worries about Federal Reserve exit from Quantitative Easing (“QE”); (3) geopolitical issues; (4) oil prices dropping; (5) strong U.S. dollar; and (6) Ebola fears.

Ms. Kassam concluded her presentation and reported that while the S&P 500 is down about 5%, the Trust is only down 2.03% which is the result of diversification and prudent investment. This is what we expect our asset allocation to provide in these types of markets.

In a response to a question asked by Mr. Hester, Ms. Kassam stated that on the fixed income side, ERS has been taking advantage of volatility by starting its listed options trading program on certain ETFs. On the public equity side, Ms. Kassam stated that staff will be taking off some of the overweight to the domestic markets (particularly small and mid-cap) to look for opportunities to put it in the international markets as valuations become attractive in light of a potential rebound in economic growth.

Mr. Tom Tull, Chief Investment Officer responded via teleconference that markets have been pretty tumultuous over the last several weeks and this week rates and utilities and transportations all bounced heavily while energy and materials sectors continued to experience selling pressure. On the private side, staff is taking every opportunity to continue to use this turmoil to negotiate better economic terms in deals.

In a response to Mr. Hester's question on ERS' use of hedge funds in light of CalPERS announcement of cutting back from hedge funds, Ms. Kassam stated that the ERS main hedge fund portfolio, the Absolute Return Portfolio, is outperforming its benchmark by 138 basis points as of calendar year to date ending 9/30/14. At ERS, hedge funds are being utilized in a very specific manner in the asset allocation. For example, we use the hedge funds in the Absolute Return Portfolio as a risk reducer and in both the Directional Growth Portfolio in Public Equities and a long-short REIT in Real Estate as a return seeking investment.

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

II. LEGISLATIVE UPDATE

Mr. Shack Nail, Deputy Director of Governmental Affairs updated trustees on Legislative issues that have taken place since the last Board of Trustees meeting in August. He gave the board summaries¹ of the Group Benefits Plan and Retirement Program Legislative Appropriations Requests.

The ERS baseline request for the main pension trust fund was an amount equal to a continued annual state contribution of 7.5% and .5% state agency contributions. The Legislative Budget Board (LBB) sets this baseline request and it is never allowed to be an increase of the previous biennium's appropriations. ERS asked the state for additional funding, an average state contribution of 11.94% for each year of the biennium to make the fund actuarially sound. All funding requests above the baseline are considered to be "exceptional" requests.

Mr. Nail reported that the fund has been declining every year for the last 20 years in terms of the funded ratio. Until the contributions to the fund equal the cost of current and projected benefits, the fund will continue to decline. The state constitution requires that the trust be funded on actuarial principles, and the agency must fulfill its fiduciary duty to members by requesting the needed funds.

For the GBP, ERS submitted an exceptional item request in addition to the baseline request set by the LBB. The exceptional item requests enough money, when combined with spending down funds from the insurance contingency fund to fully fund the projected cost of the GBP without benefit changes.

¹Exhibit A – pages 5-6

Ms. Catherine Terrell, Director of Governmental Affairs, proceeded to give the board an update on activities related to the House State Affairs Committee. She stated that ERS was asked to testify on September 4, 2014 in front of the House State Affairs Committee which focused on the performance of the third-party administrator for the HealthSelect of Texassm program. Prior to and following the hearing, ERS received a number of questions from the committee to which ERS has responded.

Ms. Bishop noted that the ERS routinely conducts a number of program audits and reviews and has completed a claims audit within the last year. In addition, ERS has contracted for an independent audit of the insurance actuaries which is currently underway.

The audits and reviews have cost \$270,500 to date. She also reported that the actuary has spent a number of hours on the hearing preparation and responses, which has cost another \$20,000 this month. Ms. Bishop reported that the cost is increased every year because of legislation and the audits.

Mr. Rowe asked about the savings of the third party administration contract. Ms. Bishop reported there are two types of savings; one is the hard savings or fixed dollars saved in the administrative fee. Estimated to save \$25 million over 4 years. The second source of savings are the savings achieved through better medical management, such as health and wellness programs, discounted provider contracts and alternative contracting for networks and medical management.

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

III. OPEN AND EXECUTIVE SESSIONS – IN ACCORDANCE WITH TEXAS GOVERNMENT CODE SECTION 551.074, THE BOARD OF TRUSTEES WILL MEET IN EXECUTIVE SESSION TO CONSIDER AND DELIBERATE THE APPOINTMENT TO FILL THE VACANCY OF AN ELECTED POSITION ON THE BOARD OF TRUSTEES FOR THE UNEXPIRED TERM OF TRUSTEE CHERYL MACBRIDE, AND WILL ALSO DELIBERATE THE APPOINTMENT OF THE ERS EXECUTIVE DIRECTOR DESIGNATE POSITION. THEREAFTER, THE BOARD MAY CONSIDER APPROPRIATE ACTION IN OPEN SESSION.

At 9:03 a.m. on October 27, 2014, Chair Brian Ragland announced that the Board of Trustees will meet in executive session in accordance with Section 551.074, Texas Government Code to consider and deliberate the appointment to fill the vacancy of an elected position on the Board of Trustees for the unexpired term of trustee Cheryl MacBride, and will also deliberate the appointment of the ERS Executive Director designate position. Thereafter, the Board may consider appropriate action in open session.

Upon returning from Executive Session, Mr. Ragland announced that it is 2:43 p.m. on October 27, 2014 and the Board is now in Open Session. No action, decision, or vote was taken by the Board while in Executive Session.

Mr. Ragland announced that before he opens the floor for a motion from the Board he wanted to recognize Ms. Cheryl MacBride for her service on the board and present her with the ERS Resolution². Ms. MacBride thanked the board and staff and also stated that serving on the ERS Board was the most rewarding experience she's had in state government. Mr. Hester responded and stated, "It was an honor and privilege to work with you. Best of luck."

²Exhibit B – Page 7

Ms. Donnell stated that it has been refreshing to have such an extraordinary number of good candidates that applied for the board position and Mr. Ragland noted that it's nice to know that so many people are interested and passionate about the programs that ERS offers and want to give their time to the system. Mr. Ragland then opened the floor for a motion from the board.

MOTION made by Ms. Cheryl MacBride, seconded by Ms. Cydney Donnell and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas to appoint Mr. Doug Danzeiser to fill the unexpired term of elected trustee Cheryl MacBride due to the vacancy created when she retires from the employee class of membership.

I further move that the term will begin immediately following the individual's taking of the constitutional oath and the oath of office provided by Texas Government Code Section 815.004 and continue through August 31, 2019.

Ms. Donnell stated for the record, that she would like to encourage the people that were not selected to run in the next election.

IV. ADJOURNMENT OF THE BOARD OF TRUSTEES

The October 27, 2014 Meeting of the Board of Trustees was adjourned at 2:50 p.m.



STATE OF TEXAS RETIREMENT PLAN LEGISLATIVE APPROPRIATIONS REQUEST SUMMARY

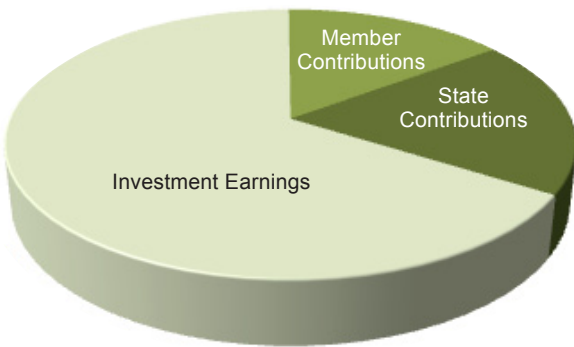
Projected Funding Status as of August 31, 2013

- The fund currently has only 76 cents for every \$1.00 of earned benefits.
- The unfunded liability is \$7.2 billion. Changes to Governmental Accounting Standards Board (GASB) regulations will increase the reported liability to \$14.2 billion if no further funding is received above baseline levels.
- At current funding levels the ERS Retirement Trust Fund will completely deplete by 2052; **approving actuarially sound funding levels will bring the trust to 100% funding by 2046.**

The Cost of Delayed Funding

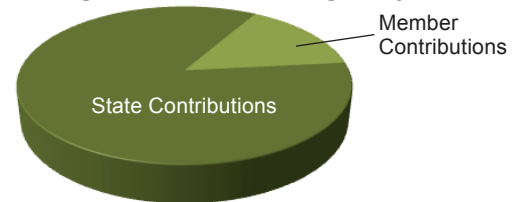
- For every two years the plan is out of balance, the unfunded liability grows by \$1.0 billion.
- Establishing a funding policy that pays off the liability in 31 years will lower the risk of potential negative impacts to larger state financial structures, such as bond costs.
- Current funding provides an inadequate base to leverage future investment earnings. **Lack of investment returns significantly increases the portion of benefits that must be directly funded by the state.**

Benefit Payment Breakdown: At Current Funding Levels

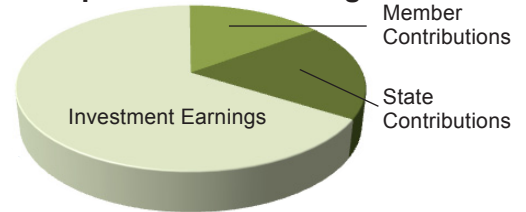


Investment earnings are currently two-thirds of annual trust fund revenue.

2053 Breakdown: Assuming Baseline Funding Only



2053 Breakdown: Baseline & Exceptional Item Funding



2016-2017 Contribution Rate Projections

Projected Contribution Amounts Assuming Current Funding (Baseline Request)

Fiscal Year	Projected Rates				Actuarially Sound Contribution	Rate Shortfall	GR/GRD Request	All Funds Request	Funding Shortfall ¹
	Member	State	Agency	Total					
2016	7.20%	7.50%	0.50%	15.20%	19.79%	-4.59%	\$296 M	\$455 M	(\$278 M)
2017	7.50%	7.50%	0.50%	15.50%	19.79%	-4.29%	\$296 M	\$455 M	(\$260 M)
Total							\$592 M	\$910 M	(\$538 M)

Projected Contribution Amounts for Full Funding (Baseline Request + Exceptional Item #1)

Fiscal Year	Projected Rates				Actuarially Sound Contribution	Rate Shortfall	GR/GRD Request	All Funds Request	Funding Shortfall ¹
	Member	State ²	Agency	Total					
2016	7.20%	12.09%	0.50%	19.79%	19.79%	0.00%	\$471 M	\$724 M	-
2017	7.50%	11.79%	0.50%	19.79%	19.79%	0.00%	\$471 M	\$724 M	-
Total							\$942 M	\$1,448 M	-
Exceptional Item Request							\$350 M	\$538 M	-

¹Amount required to reach actuarial soundness after baseline funding is appropriated.

²The average contribution rate requested for the 2016-17 biennium is 11.94%; this average was used in the calculation of the LAR.

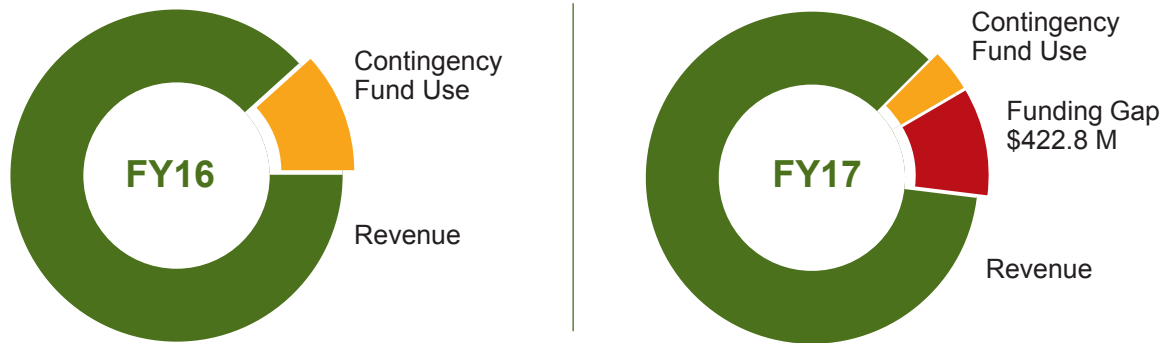
STATE OF TEXAS GROUP BENEFITS PLAN LEGISLATIVE APPROPRIATIONS REQUEST SUMMARY

Projected Average Annual Cost Trends for HealthSelect (FY15-17)

	Increased Use of Service	Industry Price Increases	Maintenance of Member Share	Total
Hospital	2.3%	5.6%	60.0%	8.5%
Other Medical Expenses	0.9%	1.9%	20.0%	3.0%
Pharmacy	4.5%	6.1%	3.5%	14.1%
Total Costs	2.5%	4.8%	1.2%	8.5%

Projected health care cost increases of 8.5% per year will create a funding shortfall in fiscal year 2017. ERS Exceptional Item #4 requests a 6.9% increase in contributions that coupled with drawing down the contingency fund would cover total biennial cost increases. Without appropriation of this exceptional item the funding gap will have to be addressed through member benefit cuts and design changes.

Status Quo Leads to Funding Gap in FY17 (with Baseline Funding Only)



2016-2017 Group Benefit Plan Cost and Funding Projections

Projections Based on Receipt of Baseline Funding Only

Fiscal Year	GR/GRD Request	All Funds Request	Non-Appropriated Revenue	Total Revenue	Health Care Expenditures	Funding Shortfall	Use of Contingency Fund Balance	Benefit Design Changes
2016	\$1,075.4 M	\$1,636.5 M	\$1,550.7 M	\$3,187.2 M	\$3,418.1 M	(\$230.9 M)	\$230.9 M	-
2017	\$1,075.4 M	\$1,636.5 M	\$1,603.8 M	\$3,240.3 M	\$3,763.1 M	(\$522.8 M)	\$100.1 M	(\$422.8 M)
Biennial Total	\$2,150.8 M	\$3,273.0 M	\$3,154.5 M	\$6,427.5 M	\$7,181.2 M	(\$753.7 M)	\$331.0 M	(\$422.8 M)
				Contingency Fund Ending Balance			-	

Projections Based on Receipt of Baseline Funding and Exceptional Item Request #4 (GBP Cost Increases)

Fiscal Year	GR/GRD Request	All Funds Request	Non-Appropriated Revenue	Total Revenue	Health Care Expenditures	Funding Shortfall	Use of Contingency Fund Balance	Benefit Design Changes
2016	\$1,130.3 M	\$1,720.1 M	\$1,616.9 M	\$3,337.0 M	\$3,418.1 M	(\$81.1 M)	\$81.1 M	-
2017	\$1,210.9 M	\$1,842.8 M	\$1,770.4 M	\$3,613.2 M	\$3,763.1 M	(\$149.9 M)	\$149.9 M	-
Biennial Total	\$2,384.1 M	\$3,562.9 M	\$3,387.3 M	\$6,950.2 M	\$7,181.2 M	(\$231.0 M)	\$231.0 M	-
Exceptional Item	\$190.5 M	\$289.9 M		Contingency Fund Ending Balance			\$100.0 M	



RESOLUTION

WHEREAS,

THE HONORABLE CHERYL MACBRIDE

was appointed by the Board of Trustees of the Employees Retirement System of Texas in October 2009 to fill the remainder of the term for retiring Board member Don Green and then elected to the Board of Trustees in 2013 for a new term; and

WHEREAS,

Cheryl MacBride was selected by the Board of Trustees to serve as its Chair for fiscal year 2013; and

WHEREAS,

as an ERS Trustee, Cheryl MacBride was responsible for overseeing the administration of retirement assets and benefits for more than 200,000 state employees, retirees and beneficiaries, and the health and life benefits of more than 500,000 state and higher education employees, retirees and dependents; and

WHEREAS,

Cheryl MacBride's many years of leadership and extensive experience at state agencies provided valuable insight and assistance to the Board and ERS staff during two regular sessions and special sessions of the Texas Legislature; and

WHEREAS,

during her service on the Board, the ERS Trust Fund saw a recovery of investment performance and new asset classes were added to improve diversification; additional funding was obtained for the retirement plan through increased state and member contributions; retirement benefits were modified for new members while preserving benefits for existing members; a new Medicare Advantage plan was offered to retirees; and new administrators were selected for the HealthSelect plan, the TexFlex program and the disability programs; therefore be it

RESOLVED

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

ADOPTED THIS DAY, THE TWENTY-SEVENTH DAY OF OCTOBER 2014.

Board of Trustees
Employees Retirement System of Texas

Brian D. Ragland, Chair

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Frederick E. "Shad" Rowe, Vice Chair

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Cydney Donnell, Member

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Yolanda Griego, Member

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I. Craig Hester, Member

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