ERS
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

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May 13, 2016

Mr. Ken Levine
Director
Sunset Advisory Commission
PO Box 13066
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Dear Mr. Levine:

Thank you for the opportunity to provide the Employees Retirement System of Texas (ERS) response to the findings and recommendations contained in the Sunset staff report on ERS.

On behalf of state workers and their families who benefit from ERS programs, the ERS Board of Trustees, and our staff, I would like to commend the Sunset review team for their work on this review over the last nine months.

The responsibilities that ERS is charged with – providing retirement benefits, administering a group benefits program, investing trust fund assets – are complex and dynamic. The final report is evidence of the diligent research and time expended by the Sunset team in order to understand what our agency does, and more importantly, how and why we operate as we do.

I greatly appreciate your team's ability to achieve this high standard of evaluation and the independent insight and perspective it provides to agencies in helping identify areas in need of improvement.

ERS agrees with the findings and recommendations provided in the Sunset Staff Report, and we stand ready to begin implementing them so our members can feel confident that their interests are being served effectively and efficiently.

In response to the issues identified in the report, ERS provides the following comments:

Issue 1: Contracting and Procurement Operations
State agency procurement and contracting processes have been a growing area of focus for state legislators and oversight entities in recent years. In 2013, audit findings identified several specific ERS procurement process concerns, and in response, the agency began working to improve its contracting operations. While great progress has been made, continuing to identify opportunities for improvement has been a focused priority since I assumed the role of Executive Director last June.

Since that time, the agency has been working to implement new statewide contracting requirements resulting from General Appropriations Act riders and Senate Bill 20. In response to these new requirements, and as a result of internal review and evaluation of contracting operations, ERS identified a variety of issues arising from the agency's decentralized contracting processes.

In August 2015, ERS designated a Director of Procurement to oversee agency-wide contracting activities, and in the months following, we identified additional opportunities for efficiency. As a result, in March 2016, I announced the creation of a dedicated procurement division to centrally manage contracting operations across the agency.

Ideally, such organizational changes would not have been made in the midst of a Sunset review. However, because of several significant ongoing and approaching procurements (including the re-bid of the HealthSelect third party administrator contract), I felt that the associated issues were too important to not address immediately.

Since that time, and with the benefit of input from Sunset staff, we have clarified the new division's authority to include contract oversight. The new Office of Procurement and Contract Oversight (OPCO) has consolidated many functions that had previously been performed by program specific staff throughout the agency. The division personnel include existing employees from both the Legal Services and Benefit Contracts divisions. We continue to review the roles and responsibilities of other ERS staff engaged in contract and procurement related functions to determine if further resource consolidation is appropriate.

ERS recognizes the benefits of the Sunset staff recommendations related to procurement operations and will be working to implement them as part of the agency's ongoing contracting improvement efforts.

Specifically related to Recommendation 1.3, ERS contracts comply with the intent of the recommendation and OPCO employees are updating agency-wide policies and procedures to reflect the recommendation and current operating requirements. Existing contracts without set end dates are now periodically reviewed and documentation justifying the continuance of the contract is required to maintain the relationship

Issue 2: Planning and Development of Group Benefit Program Structures
ERS agrees with Sunset staff that the rigorous planning and development of the Texas Employees Group Benefits Program (GBP) is central to the agency's success in providing a robust benefit package to the employees, employers, and stakeholders of state government – and a key to this process is the direct input and involvement of those groups.

ERS currently performs detailed monthly and annual financial reviews of all benefit programs, evaluates benefit operations, and monitors emerging industry trends and innovations for potential application to the GBP. We agree that taking these internal processes and making them more public and transparent would be beneficial. To this end, the recommendation to expand the annual *Cost Management and Fraud Report* to summarize these activities and report more broadly on GBP operations and the strategic alignment with state workforce needs will be implemented in the next published report in January 2017.

Additionally, ERS will enhance existing formal and informal stakeholder input processes by re-establishing a health insurance advisory committee. Finally, we will immediately begin working to develop clear processes and documentation for evaluating potential changes to benefit offerings and will strengthen the formal structure and transparency of these practices as recommended.

Issue 3: Communications and Interactions with Health Plan Participants
The modern health insurance environment is complex and dynamic. One of the most difficult tasks for any plan sponsor is effectively educating members on the benefits available to them and the insurance processes required to take full advantage of those benefits. Member education and communication, while difficult, is a core focus of the agency. ERS staff throughout the agency works continuously to improve and enhance the clarity of, and assistance provided by, each communication.

ERS agrees with the report's finding that member communications and education efforts can continue to be improved, and the agency is committed to implementing changes that increase member awareness and knowledge of benefit programs. This includes addressing the specific areas, processes, and member populations identified in the report. For example, ERS will continue to regularly update and improve communications to meet member informational needs, make use of diverse and newly available media to reach members in more interactive ways, and review appeals and grievance processes to increase opportunities for direct member input and participation.

As the report notes, ERS can also do a better job of documenting member application and appeal decisions. We will review the composition of the grievance review committee to ensure there is an appropriate balance of plan and member perspectives during deliberations.

A critical component of member education and communication efforts, and the first line of information on benefit programs to state employees, is with the human resource departments of state agencies and institutions of higher education. These offices serve as the primary source of benefit information for the employee workforce. ERS identified weakness in this communication link to employees in its self-evaluation report, and we continue to believe it is an area open for improvement.

Issue 4: Alternative Investment Transparency and Reporting
Costs associated with alternative investments are currently reported to the Board of Trustees in public meetings and included in the Comprehensive Annual Financial Report; however, ERS will increase reporting to ensure that the costs and net returns of alternative investments are more transparent and readily available.

ERS is a relatively new investor in alternative assets. Because of the contractual nature of these investments, and the longer investment horizons associated with them, many of the investments remain active. Portfolio valuations change over the course of an investment, and as a result the costs and profits are not finalized until the partnership is finally closed. As a result, reporting these costs is somewhat complex, and may change over the course of an investment, depending on the market valuations. The institutional investment industry is currently developing reporting standards and best practices that ERS will evaluate.

Issue 5: Across-the-Board Recommendations
ERS understands the desire to seek the standardization of certain organizational structures and operational requirements across state agencies, as well as the potential statewide governance benefits provided by these recommendations. ERS staff looks forward to working with Sunset staff and legislative offices to ensure these recommendations are implemented to achieve their desired result within the unique context of providing competitive and meaningful benefits to state employees.

ERS staff was pleased to see Sunset recommend an adjustment to the publication date of the statutory *Cost Management and Fraud Report*, which we agree will enable more relevant reporting for legislative decision making on health benefit programs administration and funding.

Finally, as it relates to the fiscal impact of the recommendations, ERS has not been able to estimate the costs of implementing the report's recommendations, but believes it is possible that some of the recommendations intended to be implemented through existing resources will require budgetary increases. We appreciate the flexibility currently provided in the recommendation language. It will allow ERS the opportunity to ensure successful implementation of the recommendations while also working to minimize any unintended fiscal impact on the trust fund.

Again, thank you to you and your staff for the significant work and detailed research that went into the development of the Sunset Staff Report on ERS. The Sunset review process is an important element of Texas' continuous work to improve the efficiency and effectiveness of state government and serve the citizens of this state in the best manner possible. I am pleased to commit ERS and its resources to this process of improvement and look forward to working with you to ensure the implementation of the recommendations contained in the report.

Sincerely

Porter Wilson
Executive Director, ERS

cc: Craig Hester, Chair, ERS Board of Trustees
Representative Larry Gonzales, Chair, Sunset Advisory Commission
Senator Van Taylor, Vice-Chair, Sunset Advisory Commission