



Board of Trustees Meeting

July 10, 2017



Presented for Review and Approval

August 23, 2017

BOARD OF TRUSTEES MEETING
Joint Working Session of the Board of Trustees and Investment Advisory Committee
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

July 10, 2017

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BOARD OF TRUSTEES MEETING

**Joint Working Session of the Board of Trustees and Investment Advisory Committee
EMPLOYEES RETIREMENT SYSTEM OF TEXAS**

**July 10, 2017
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701**

Minutes for the reconvened Meeting of the Board of Trustees

TRUSTEES PRESENT

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

IAC MEMBERS PRESENT

Jim Hille, IAC Chair
Bob Alley
Caroline Cooley
Ken Mindell
Gene Needles
Laura Starks

IAC MEMBER NOT PRESENT

Lenore Sullivan

ERS STAFF PRESENT

Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director and General Counsel
William Nail, Director of Governmental Relations
Bernie Hajovsky, Director Enterprise Planning Office
Robin Hardaway, Director of Customer Benefits
Diana Kongevick, Director of Benefit Contracts
Machelle Pharr, Chief Financial Officer
DeeDee Sterns, Director of Human Resources
Gabrielle Stokes, Director of the Office of Procurement & Contract Oversight
Kathryn Tesar, Director of Benefits Communications
Tom Tull, Chief Investments Officer
Brannon Andrews, Office of the General Counsel
Nora Alvarado, Benefit Contracts
Georgina Bouton, Benefit Contracts
Satitpong Chantarajirawong, Investments
Carlos Chujoy, Investments
Anthony Curtiss, Investments
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits

Leah Erard, Executive Office
Mike Ewing, Office of the General Counsel
Liz Geise, Benefits Communications
Andrew Hodson, Investments
Lauren Honza, Investments
Dana Jepson, Executive Office
Jennifer Jones, Executive Office
Sharmila Kassam, Deputy Chief Investment Officer
Ange Kobe, Investments
Panayiotis Lambropoulos, Investments
Nancy Lippa, Office of the General Counsel
Yan Lu, Investments
John McCaffrey, Investments
Pamela Maas, Benefit Contracts
Tim Reynolds, Investments
Tanna Ridgeway, Investments
Robert Sessa, Investments
Leighton Shantz, Investments
Pablo de la Sierra Perez, Investments
Chris Tocci, Investments
Angelica Torres, Benefit Contracts
Keith Yawn, Executive Office

ALSO PRESENT

Brenda Atkins, Texas State Employees Union
Christopher Boyle, Texas State Employees Union
Susan Bradley, Texas State Employees Union
Claire Closmann, AFSCME Retirees
Darryl Collier, Empower
Don Crowder, AFSCME Retirees
Bill Dally, Retired State Employee Association
Yolanda Delgado, Retiree DFPS
Mary Esther Escobedo, Texas State Employees Union
Katy Fallon, Legislative Budget Board
Ryan Falls, Gabriel Roeder Smith
Elaine Fowler, AFSCME Retirees
Phil Kivarkis, Aon Hewitt
Leanne Martin, Retiree TWC
Michael McCormick, Aon Hewitt
Catherine Melvin, Department of Public Safety
Philip Mullins
Christine Monzingo, AFSCME Retirees
Joe Newton, Gabriel Roeder Smith
Katy Reagan, Davis Kaufman
Rose Ann Reese, Retiree OAG
Avery Saxe, Legislative Budget Board
Tyler Sheldon, Texas State Employees Union
Matt Seifer, Black Rock
David Sinclair, GWPOA
Malika Te, House Appropriations Committee
Brad Untiedt, Empower
Brady Vaughn, Senate Finance Committee
Steve Voss, Aon Hewitt
Jerome S. Wold, Texas State Employees Union
Glenn Williams, Retiree DFPS

Meeting of the ERS Board of Trustees

2. Call Meeting to reconvene the ERS Board of Trustees

Members present: Brian Ragland, Craig Hester, Cydney Donnell, Doug Danzeiser, Ilesa Daniels, and Jeanie Wyatt

Meeting called to order at 12:04 PM

1. Call to Order

1.1 Call Meeting to Reconvene the Board of Trustees

Reconvened at 1:08

Mr. Craig Hester, Chair of the Board of Trustees, reconvened the meeting, after a temporary recess, to take up the remaining Board of Trustees agenda items.

2. Texa\$aver

2.1 Review, Discussion and Consideration of the Interim Target Date Funds for the Texa\$aver 401(k) and 457 Plans (Action)

Presenters: Georgina Bouton, Assistant Director of Benefit Contracts
Nora Alvarado, Manager of Account Management Team, Benefit Contracts

Ms. Bouton explained they would be presenting a proposed interim target date fund offering within the Texa\$aver program. The proposal was developed with guidance and direction of the program's Product Review Committee (PRC). Ms. Alvarado reviewed the Texa\$aver program. The Texa\$aver program is comprised of two separate plans.

- The 401(k) plan is available to employees of state agencies. Since 2008, new state employees are automatically enrolled into the 401(k) plan at one percent of their salary. The plan has over 189,000 participants with assets totaling \$2.8 billion.
- The 457 plan is available to employees of state agencies and higher education, has over 29,500 participants with assets approaching \$720 million.

The program was developed to help state and eligible higher education employees with their personal savings. Contributions into the Texa\$aver complement the retirement benefits offered through a participant's state pension, and when applicable, their social security benefits.

Investment offerings are the same across both plans. The investment vehicles used are known as Mutual Funds, which are made up of a pool of funds collected from many investors, as well as the Collective Investment Trusts (CIT) which are investments formed from pooling assets of institutional investors. Because they are exclusive to retirement plans, CITs are not available to the general public. Texa\$aver has been using CITs since 2009.

The program offers investments and equities, fixed incomes, and cash equivalents. These funds are diversified across a range of asset classes and investment strategies to accommodate varying levels of investment risks. These are collectively referred to as the Core Funds. In addition to the Core of Funds choice, the program offers a self-directed brokerage account, and a suite of Target Date Funds. Target Date Funds have served as the program's Qualified Default Investment Alternative (QDIA) since 2007. It is the default fund used when a participant does not make an affirmative investment election. With automatic enrollment, new employees are enrolled into the 401(k) plan with a 1 percent of their salary, invested into the age-appropriate Target Date Fund. As of March 31, 2017, the total invested in the Target Date Fund series was over \$600 million, representing 21.3% of the program's overall investments.

Within the deferred compensation industry, Target Date Funds have been around since 1994 and have served as a QDIA in qualified plans since 2006. They were created to provide an investment strategy for many different participants by aggregating these investors into manageable units organized by years to retirement. The

years to retirement designation is a critical factor in the portfolio construction of a Target Date Fund. From this portfolio construction and design, Target Date Funds are designated a year in which participants are anticipated to retire and begin withdrawing assets. Consequently, a Target Date Fund 2040 is designed for participants who will be retiring in the year 2040.

In order to provide a rational investment strategy for a participant beginning from the first point of participation up until retirement, Target Date Funds were designed with a unique feature: a sliding allocation that would incrementally reduce risks from the early years when the focus is on the capital appreciation to the later years when capital preservation becomes the more dominant characteristic. This sliding allocation is commonly referred to as the *glide path*. Target Date Funds typically start out with similar equity allocations of approximately 95% or more, and then steadily lower the equity allocation becoming more conservative as the funds target year approaches.

On August 21, 2007, the Board of Trustees selected the Wells Fargo Dow Jones Target Date Fund (WFDJTDF) as a program's target date offering. The WFDJTDF featured a conservative design with a declining equity exposure of 28% equity holdings at retirement, transparent benchmark: Dow Jones Target Date Fund IndexesSM, long standing subadvisor team: Global Index Advisors (GIA), and a competitive expense ratio. The low equity exposure of these funds proved to be beneficial to participants during the credit crisis and market downturn in 2008.

On April 21, 2017, Wells Fargo Asset Management provided an informal notice to ERS regarding significant unilateral changes to the fund which were to be effective July 14, 2017. Wells Fargo Asset Management provided less than 90 days' notice.

On June 6, 2017, Wells Fargo Asset Management hosted a webinar to address the changes to the Wells Fargo Dow Jones Target Date fund series. Changes included rebranding the fund as the Wells Fargo Target Funds; replacing its longtime subadvisor, GIA, with an in-house team having less than 18 months experience managing a target date fund offering; revamping the series' asset allocation glide path and underlying investments; and moving to a 40% equity exposure at retirement. In response to these significant changes, ERS requested a carve-out strategy whereby ERS' portfolio would remain in the existing fund under the existing strategy for approximately six months to allow sufficient time for staff to employ a fund search process and present options to the Board in December 2017. Wells Fargo Asset Management was unable to make this accommodation but offered one other alternative fund option for ERS' consideration: the Wells Fargo Dynamic Target Date Funds. The Wells Fargo Dynamic series of funds uses a fairly aggressive glidepath and the portfolios can deviate up to 15 percentage points from its target asset allocations.

Since a change in the Program's target date fund was imminent, Ms. Bouton and Ms. Alvarado explained the strategy formulated to employ an interim product offering from July 2017 through December 2017. Furthermore, at the December Board meeting, a recommendation will be presented to the Board for a long-term product solution for the Program's target date fund offering.

For the interim product offering, ERS staff arranged a meeting whereby Wells Fargo Asset Management provided details on the Wells Fargo Target Date Funds and the Wells Fargo Dynamic Target Date Funds. This meeting was scheduled for June 26, 2017 and included the PRC, Empower Retirement, and members of ERS. Additionally, ERS staff obtained preliminary information on nine (9) Target Date Funds offered through five (5) investment managers with which ERS currently has contracts for Core Funds offered within the Texa\$aver Program.

During the June 26 meeting, both of the target date funds presented by Wells Fargo Asset Management presented challenges to the Program and participants. However, given the two Wells Fargo fund options, PRC opted for the Wells Fargo Dynamic Target Date Fund series since the lack of performance date on the Wells Fargo Target Date Funds and its unproven strategies presented significant risks with no effective mitigation strategies.

ERS Staff continued to follow-up on other target date fund offerings for the PRC which would overcome the high fees, limited management experience, low assets under management associated with Wells Fargo Dynamic Target Date Fund series. On June 27th, Ms. Bouton and Ms. Alvarado reconvened PRC and members of

Empower Retirement to discuss findings and present alternative target date funds for PRC's consideration: BlackRock's LifePath® Index Conservative Fund F Series and BlackRock's LifePath® Portfolio Index Funds F Series.

The PRC revised its initial proposal and recommended BlackRock's LifePath® Portfolio Index Funds F Series based on the fund's historical performance, asset allocation, proven investment strategy, fund manager experience and low fund expense. The transition took place on July 7th. In December of 2017, a new long term replacement will be presented to the Board for consideration and approval.

Members of the Board, the IAC and staff discussed the possible costs resulting from the change in investment. Ms. Paula Jones, Deputy Executive Director and General Counsel, discussed the Wells Fargo meeting and the lack of notice and resulting breach of contract by Wells Fargo. Dr. Laura Starks, IAC member, commended TexaSaver staff, the PRC and Empower for moving quickly to resolve issues resulting from the investment changes.

Based on the recommendation of the PRC and ERS Staff in response to the fund selection criteria, the evaluation process and results presented to the Board at this meeting, Staff recommends that the Board:

- Affirm the selection of the LifePath® Portfolio Index Fund F Series as the TexaSaver Program's interim Target Date Funds and
- Ratify, affirm, and adopt all acts, transactions and agreements undertaken in connection with the selection of and transition to the LifePath® Portfolio Index Fund F Series as the interim Target Date Funds offering on July 7, 2017.

Motion: I move that the Board of Trustees of the Employees Retirement System of Texas affirm the selection of the LifePath® Portfolio Index Funds F series as the TexaSaver Program's interim Target Date Funds, and ratify, affirm and adopt all acts, transactions and agreements undertaken by ERS and the Executive Director in connection with the selection of the LifePath® Portfolio Index Funds F series, as the TexaSaver Program's interim Target Date Funds, including defunding the Wells Fargo Dow Jones Target Date Funds and transitioning to the LifePath® Portfolio Index Funds F series on or about July 7, 2017, and execution of a contractual agreement with BlackRock Institutional Trust Company, N.A. documenting participation in the LifePath® Portfolio Index Funds F series, and authorize the Executive Director to hereafter administer the contractual agreement agreed to by the parties.

Motion by Brian Ragland, second by Doug Danzeiser.

Final Resolution: **Motion Carries**

Aye: Brian Ragland, Craig Hester, Cydney Donnell, Doug Danzeiser, Ilesa Daniels, Jeanie Wyatt

2.2 Review and Discussion of the TexaSaverSM 401(k) and 457 Program's Investment Policy and the Product Review Committee Charter.

Presenters: Georgina Bouton, Assistant Director of Benefit Contracts
Nora Alvarado, Manager of Account Management Team, Benefit Contracts

Ms. Bouton presented information about the updating and restating of the TexaSaver Operating Plan as the TexaSaverSM 401(k)/457 Program Investment Policy (Investment Policy). The updated and restated Investment Policy will be provided to the Board on July 20, 2017 for review prior to being presented for consideration, discussion and approval at the August 23, 2017 Board of Trustees meeting.

The Operating Plan remains in effect for the Program and is designed to assist Staff and the Product Review Committee (PRC) in the supervision, monitoring, management and evaluation of the investment options available within the Program. The updated and restated Investment Policy is designed to better describe and/or define the investment philosophy and strategy of the Program and investment options available to participants, outline the performance-monitoring evaluation measures, and establish the fund selection process to be employed. The Investment Policy may include a defined Code of Ethics. The Investment Policy is designed to allow for sufficient flexibility in the management oversight process while also setting parameters. The Investment

Policy is expected to be presented to the Board for approval at the August 2017 Board meeting. Once approved by the Board, the Investment Policy shall be utilized as a guide for the effective supervision, monitoring and management of the investment options available under the Program.

ERS Staff is formulating a draft charter for the PRC, the TexaSaverSM 401(k)/457 Program Product Review Committee Charter (Charter). The Charter is designed to define the PRC's purpose, composition and membership, service and applicable term limits, duties and responsibilities, meeting schedules, meeting agendas and minutes, as well as to document the processes to be employed for committee voting. The drafted Charter will be provided to the Board on July 20 for review. The Charter will be provided to the Board on July 20, 2017 for review prior to being presented for consideration, discussion and approval at the August 23, 2017 Board of Trustees meeting. Once approved by the Board, the Charter shall be utilized as a guide for duties, responsibilities, and operations of the PRC in support of the Program.

3. Adjournment

Procedural: 3.1 Adjournment of the ERS Board of Trustees

Mr. Wilson mentioned one of the best practices is conducting a board assessment. ERS would like to do this again. This assessment will go out and be returned prior to the August meeting.

Mr. Hester adjourned the meeting at 1:51