

TEXA\$AVERSM

401(k) / 457 Program

Investment Policy

ERS

EMPLOYEES  RETIREMENT
SYSTEM OF TEXAS

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EMPLOYEES RETIREMENT SYSTEM OF TEXAS

TEXA\$AVERSM 401(k) / 457 PROGRAM
INVESTMENT POLICY

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INVESTMENT POLICY

Section 1: Introduction

The State of Texas established the TexaSaverSM 401(k) Plan in 1985 and the TexaSaver 457 Plan in 1991. The State of Texas established the 401(k) and 457 plans (collectively referred to as the Plans) independently but with a common purpose to attract and retain state employees and officials by offering an opportunity for voluntary and systematic investment to provide a measure of additional retirement security for Program participants and their beneficiaries.

The assets of each Plan are held in a separate trust for the beneficiaries of such Plan and may not be diverted for any other purpose. As used herein, "TexaSaver Program" or "Program" means the Plans collectively.

Administrative control and supervision of the TexaSaver Program was transferred to the Employees Retirement System of Texas (ERS) effective January 1, 1991. Section 609.502 of the Texas Government Code stipulates that "the board of trustees of the Employees Retirement System of Texas is the trustee and the plan administrator of the 401(k) and 457 plans, collectively known as the TexaSaver Program..." Furthermore, as the Program administrator, the ERS Board (as hereinafter defined) may delegate responsibility for all or part of its duties to another entity or person. The Program's administration duties and advisory service duties are performed by a qualified Third Party Administrator (TPA) and Advisor Service provider, respectively. These services are procured through ERS' competitive bid process as referenced within Section 2.9 herein.

- 1.1 Objectives of the Program.** The Plans are voluntary tax-deferred supplemental retirement programs. The Program operates solely in the interest of participants. The goal is to provide Program participants with investment choices that are diversified across a range of risk levels, asset classes, and investment strategies to meet the varying levels of needs and risk tolerance of the Program's participants in constructing portfolios to meet their particular financial goals. In doing this, the Program provides participants with a means to bridge a potential retirement income deficit.

The objectives of the Program are to:

- Assist participants in accumulating supplemental assets for retirement, as allowable under Sections 401(k) and 457(b) of the Internal Revenue Code (IRC) and other governing rules and regulations;
- Provide a menu of high-quality, diversified investment options that will allow participants of varying risk tolerance to construct portfolios tailored to meet their particular financial goals;
- Afford participants interested in investments other than core menu options access to a broad range of investment opportunities through a self-directed brokerage window; and
- Minimize investment management and administrative expenses without compromising quality, performance, and service.

- 1.2 Purpose of the TexaSaver 401(k)/457 Program Investment Policy.** The TexaSaver 401(k)/457 Program Investment Policy (Policy) has been developed to outline roles and responsibilities, define the investment philosophy of the Program, describe the types of investment options which may be available to participants, outline the performance monitoring and evaluation processes, and describe the fund selection process. As such, this Policy is a guide to the effective supervision, and monitoring of the investment options available under the Program. This Policy is designed to allow for sufficient flexibility in the oversight process while also setting parameters to promote the exercise of appropriate prudence and care with respect to the investment options available under the Program.

This Policy applies to the Program offered on or after January 1, 2000, and supersedes any prior TexaSaver Investment Policy, formerly called the TexaSaver Operating Plan.

- 1.3 Program Governance.** A Plan Document serves as a formal written instrument under which the Plan is established and provides a statement of governance for the operational provisions for the respective Plan.
- The ***State of Texas TexaSaver 401(k) Plan Amended and Restated*** is attached as Appendix A.
 - The ***Deferred Compensation Plan The State of Texas TexaSaver 457 Plan*** is attached as Appendix B.

The Plans are established in accordance with the applicable IRC Sections 401(a) and 401(k) or 457(b), Title 34, Part 4, Chapter 87 of the Texas Administrative Code, and Chapter 609 of the Texas Government Code. It is the intention of ERS that each of the Plans and the corresponding trust meet the requirements of applicable state and federal legal and tax requirements, including the applicable provisions of the IRC.

- 1.4 Fiduciary Duty.** The members of the Board of Trustees, the PRC, and ERS staff recognize they serve as fiduciaries of the Program. They are charged with certain fiduciary duties in fulfilling their responsibilities, including the duties of care and loyalty, and must act for the exclusive benefit of the Program's participants.

Section 2: Roles and Responsibilities

- 2.1 ERS Board of Trustees (ERS Board or Board).** Under Subchapter C, Chapter 609, Texas Government Code, the ERS Board is designated as trustee of the TexaSaver Program and is given authority to administer all aspects of each Plan. As stipulated under § 609.505(d), the Board shall select vendors or investment products based on the pre-selected criteria established by the Board and the Board shall determine the minimum and maximum number of vendors and investment products that may be offered by a Plan at any particular time. The Board shall administer all aspects of each Plan, but the Board has the ability to designate a person to assist in the execution of the Board's authority and responsibilities as the plan administrator (§ 609.502(c)). The Board is responsible for maintaining this Policy. In accordance with section 7.1 of this Policy, the provisions of this Policy shall be reviewed by the Board.
- 2.2 Executive Director.** As stipulated under § 815.202 of the Texas Government Code, the Executive Director is appointed by majority vote of all members of the ERS Board and is entrusted with the authority to carry out the duties of the office.
- 2.3 Deputy Executive Director.** Texas Government Code § 815.202(f) provides that the ERS Board may delegate any right, power or duty imposed or conferred on the Executive Director by law to another employee of the retirement system. If not so specifically delegated, the Executive Director may delegate to another employee of the retirement system any right power, or duty assigned to the Executive Director.

Within the scope of this Investment Policy, the Deputy Executive Director shall serve as the designate of the Executive Director in the absence of the Executive Director unless specified otherwise by the Executive Director.

- 2.4 The Investment Advisory Committee (IAC).** Pursuant to the authority provided by Texas Government Code § 815.509, the IAC was established at the discretion of the ERS Board in Texas Administrative Code § 63.17(b). The IAC, and its roles and responsibilities, are further described in the *Employees Retirement System of Texas Investment Policy* (ERS Investment Policy) and Texas Government Code §§ 815.5091 et. seq. Under the direction of the Executive Director, IAC members may be responsible hereunder for:

- Participating as members on the Product Review Committee (PRC, described in Section 2.5, herein); and
- Assisting with the evaluation and implementation of Program funds as stated in the PRC's responsibilities.

2.5 Product Review Committee (PRC). The PRC is established at the discretion of the Executive Director to serve in a consultative capacity regarding the investment options, fund managers, and investment advisory services provided to participants of the Program. The roles, responsibilities, composition, and standard protocols of the PRC are addressed within Product Review Committee Governance Charter.

2.6 PRC sub-committee (sub-committee). PRC sub-committees are discussed below in section 6.2. The roles, responsibilities, composition, and standard protocols of the PRC are addressed within Product Review Committee Governance Charter.

2.7 ERS Staff (staff). ERS staff oversees the day-to-day Program administration of the Program, monitors the Program's contracted service providers (e.g., Third Party Administrator and Investment Advisor Service) and facilitates strategies to communicate the importance of supplemental savings through different media. Staff shall be responsible for, but not limited to, the following duties:

- Providing fund performance reporting to the PRC;
- Working with the Program's TPA or Advisor Service provider to keep the PRC informed about investment manager updates and regulatory changes;
- Monitoring the Program's fund expenses and fees;
- Facilitating formal performance reviews with the investment managers;
- Coordinating with the Program's TPA or Advisor Service provider for delivery of an semi-annual performance review and evaluations; and
- Monitoring the implementation and removal of funds approved by the Board.

2.8 Investment Consultants or External Advisors. ERS may, from time to time, retain professional external consultants to assist and advise the PRC and ERS staff on specific matters relating to one or more fund classes. The consultant may be asked to assist the PRC in establishing investment policy objectives and guidelines specific to a fund or asset class; recommending funds; reviewing such funds over time; measuring and evaluating fund performance; other tasks as the PRC deems appropriate, and as otherwise provided through a contractual agreement between the parties.

2.9 Contracted Program Vendors. ERS is authorized to contract with external vendors for certain responsibilities related to the Program. These vendors serve as professional experts in various fields. These include, but are not limited to:

- A. Third Party Administrator (TPA).** The TPA is procured through a competitive bid process. As part of the services performed under the contract between ERS and the TPA, the TPA shall assist in the fund administration of the Program. The TPA will maintain individual participant investment account records and provide participants and beneficiaries with sufficient information to manage their investments. The services may include: enrollment, education, advice, exchanges, transfers, periodic individual statements and distributions. The responsibilities of the TPA are set forth in a contract between ERS and TPA.
- B. Investment Managers.** Investment managers provide investment options for the Program. The funds within the Program are categorized under a 3-Tier Investment design as described in section 4.2. All of the investment offerings are expected to offer participants reasonable expense ratios and fees.

- C. Investment Advisory Service Provider (Advisor Service).** The Advisor Service is procured through a competitive bid process. As part of the services performed under a contract between ERS and the Advisor Service, the Advisor Service provides individualized investment advice for Program participants to help them in managing their investment selections to meet their identified retirement goals.

Additionally, the Advisor Service will serve in a consultative capacity to the PRC and ERS staff by providing investment advice and quarterly investment reviews of the Program's funds. The Advisor Service shall assist the PRC in establishing investment policy objectives and guidelines; conducting fund searches; selecting funds; reviewing such funds over time; measuring and evaluating fund performance; and other tasks as mutually agreed.

- 2.10 Participants.** Under a deferred compensation program like the Texa\$aver Program, the participants decide the amount of current compensation to contribute and, the allocation of contributions among investment options.

The Program offers a spectrum of investments including a self-directed brokerage account and target date funds to (a) enable a participant to build his/her own investment strategy and (b) allow each participant the opportunity to invest for retirement based on his/her unique situation and individual needs. Participants are responsible for reading Program communications, establishing financial goals for themselves, addressing investment risk by diversification, and reviewing their respective account activity.

The Board and program administrators are not liable for any losses arising from the performance of any investment option selected by any participant.

Section 3: Investment Philosophy

- 3.1 Investment Philosophy.** In order to meet the Program's objectives as defined in section 1.1, Trustees, IAC members, PRC members, and staff are duty-bound to put participants' interests first in selecting and monitoring investments for the Program.

Participants are informed to maximize the Program's value for their individual circumstances, which include personal investment objectives, risk tolerances and time horizons. Participants who elect to participate in the Program are establishing individual accounts and are responsible for directing investment of the assets in their accounts utilizing the investment options available under the Plans. The investment options available within the Program may include mutual funds, collective investment trusts (CITs, which may include commingled and collective funds), real estate investment trusts, target date funds and a self-directed brokerage account option. The investment options currently available within the program are more fully described in section 4.

Consistent with the objectives previously cited, the Program's investment policy, selection processes, and strategy are designed to support participants by providing access to competitive investment choices while maintaining access to the principles of diversification, asset allocation, inflation, and downside considerations.

- 3.2 Market Timing and Excessive Trading Policy.** The Board may adopt market timing and excessive trading policies, which may be those of the Program's TPA or investment managers, in order to protect the interest of the Program's long-term investors from potential adverse impact of excessive trading by participants. The purpose is to eliminate excessive trading and that activity's potential detriment to the Program.

Section 4: Investment Options

The Program is designed to offer a range of investment options to meet the Program Objectives as defined in section 1.1 of this Policy and to enable participants to develop a portfolio suited to individual preferences and risk tolerance. The investment options made available within the Program's core investment fund line-up are intended to encourage employee participation, avoid undue complexity, and provide diversification.

- 4.1 Risk Tolerances.** Achieving each participant's objectives may be difficult in light of the uncertainties and complexities of the investment markets. The Program is intended to provide participants access to a wide range of investment choices covering a broad range of risk and return characteristics in order to accommodate the varying levels of needs and risk tolerance of the Program's participants in constructing portfolios to meet their personal financial goals.
- 4.2 Investment Option Structure.** The criteria used to determine the material difference between and among potential investment options with exposure to the various asset classes include:
- A distinct definable market;
 - A distinct risk and return profile; or
 - Use of a distinct management style that is definable in terms of the investment strategies/methodologies utilized (possibly including but not limited to, passive versus active management, large versus small capitalization, domestic versus international, or style investing such as growth versus value).

The Program provides investments under a tiered investment design: (1) professionally managed target date funds; (2) professionally-managed core funds; and a (3) self-directed brokerage account.

- **Tier 1: Professionally Managed Target Date Funds (Target Date Funds).** The Program provides a series of Target Date Funds for participants who wish to invest in a collection of funds that seek to gradually reduce investment risk and equity exposure as the fund's designed target year approaches. Each fund is designated with a year in which participants are anticipated to retire, stop contributing and begin withdrawing assets. This is called a participant's *time horizon to retirement*. Target date funds gradually reduce their equity exposure and market risk as the target date [year] approaches.

Target Date Funds are the Program's Qualified Default Investment Alternative (QDIA). The function of the Program's QDIA is referenced in Section 4.3.

Philosophy objective: Target Date Funds allow participants to choose an option that offers a diversified investment portfolio that suits their time horizon, risk tolerance, and investment goals. Target Date Funds are designed for investors who want a streamlined approach to investing and a professionally managed asset allocation.

- **Tier 2: Professionally Managed Core Funds (Core Funds).** The Program makes a core set of funds available to participants, allowing them to create their own portfolios based on the asset classes such as stocks, bonds or cash equivalents that suit their time horizon, risk tolerance and investment objectives. These funds include actively-managed and passively-managed investment funds.

Philosophy objective: Core Funds provide participants the ability and flexibility to create their own diversified portfolios based on the asset classes (or types of investments) that suit their time horizon, risk tolerance and investment goals.

- **Tier 3: Self-Directed Brokerage Account (SDBA).** The SDBA is offered to participants as an investment option and provides a means for those participants who wish to invest their contributions in investment options not included in Tiers I and II. Transfers into the SDBA may be subject to a minimum dollar amount. Participants in the SDBA may be required to maintain a minimum balance with the Program's core investment funds.

The SDBA is intended for participants who are interested in a wider array of investment options and are willing to accept the additional risks that may be associated with those options. Investments in a SDBA may include stocks, bonds, money market instruments, exchange-traded funds, certificate of deposits, socially responsible funds and other types of investments. The PRC, ERS, and the TexaSaver Program have no responsibility for selecting, monitoring or evaluating the investment options available through the SDBA. Under the SDBA the participant is responsible for the ongoing research, monitoring their choice of investments, trading and risk management responsibilities associated with their specific investment choices. Therefore, participants will have sole discretion in regards to the investment options that they select through the SDBA. The SDBA is procured through a competitive bid process. As part of the SDBA services, the provider of the SDBA administers the individual participant accounts. The provider of the SDBA will maintain individual participant investment account records and provide participants and beneficiaries with information regarding their investment account to include, but will not be limited to, account activity statements and trade confirmations. The responsibilities of the provider of the SDBA are set forth in a contract between ERS and the provider of the SDBA.

Philosophy objective: The SDBA provides participants with the opportunity to invest in a broad array of additional mutual funds, stocks, bonds and other investment alternatives based on their time horizon, risk tolerance, investment goals and/or preferences.

The Program's tiered investment structure is designed to (1) provide participants a means to establish investment strategies appropriate for their individual investment objectives and risk tolerance; (2) reduce the potential for participant confusion leading to investment choices inconsistent with a participant's investment objectives and risk tolerance; (3) promote clearer visibility of investment choices as they represent various asset categories; and (4) leverage Program assets to maximize opportunities for reduced investment management costs for Program participants.

- 4.3 Qualified Default Investment Alternative (QDIA).** The Board has designated the Target Date Funds as the Program's QDIA. Unless a participant takes action to direct their payroll contributions, the participant's contributions are placed into the Program's QDIA. The selected QDIA shall comply with all federal and state laws governing a QDIA offering.

Section 5: Performance Evaluation and Fund Objectives

- 5.1 Performance Reviews.** To ensure that the investments remain suitable for the Program, ERS will review the investment with each of the fund's managers on at least an annual basis, or as circumstances warrant. This annual performance review with the investment manager will consist of a review of the performance data for Tier I and Tier II funds, net of expenses, presented over reasonable periods of time, calculated in a reasonable and consistent manner. Failure to meet or exceed the benchmark performance may require explanation from the investment manager, an in-depth investment manager review, or some other action.

An overview of the investment performance for each of the funds within the Program may be prepared and presented to the Board on an annual basis. Investment Managers may make presentations to the Board upon the Board's request.

5.2 PRC Performance Evaluations. Ongoing review and analysis of the Program's investment funds is just as important as the due diligence conducted during the investment fund selection process. Therefore, the Program's TPA or Advisor Services provider will prepare a performance review and evaluation of the Program's funds for the PRC. The frequency of PRC meetings is addressed within the PRC Governance Charter Section 4.

The information contained in the performance evaluations may be used to determine the following:

- Whether performance remains within the standards established by the Policy (e.g., poor relative performance);
- Whether the investment manager's investment strategy or category has remained consistent (e.g., material change in investment style, change in investment strategy);
- Whether the investment manager's investment team has experienced significant changes (e.g., departure of key investment personnel);
- Whether the investment firm has had any operational problems or significant changes (e.g., operational problems affecting the investment management process);
- Whether changes in benchmarks and objectives have been made and the impact of these changes on future results and performance monitoring criteria (e.g., changes in fund characteristics; change in peer group or benchmark);
- Changes in the regulatory requirements that may necessitate changes in the monitoring criteria.

The review shall attempt to include sufficient information on the following for each of the funds within the Program:

- Performance comparison of the fund to its respective benchmark;
- Degree of adherence to its stated management style (style drift);
- Discipline of its investment decision-making process, as appropriate; and
- Stability of staff and organization.

5.2 Staff Investment Monitoring. ERS staff is responsible for monitoring the performance of the Program's funds on an ongoing basis and reporting findings to the PRC. The suitability of an investment option is not determined solely by reference to investment performance in any single quarter. The investment option's performance relative to its appropriate benchmark named within this Policy is a basis for further due diligence by staff in collaboration with the TPA.

The following fund monitoring factors may be incorporated into the staff Investment Review.

- Investment objective and benchmark;
- Investment performance and returns;
- Management or sub-advisor changes;
- Market capitalization;
- Sector concentrations and weightings;
- Credit quality of fixed income products;
- Average duration and maturity of fixed income products;
- Percentage of non-U.S. Securities in the fund;
- Country and regional allocations for international products;
- Investment fees and expenses;
- Violation of securities laws;
- Compliance with the Texa\$aver Investment Policy;

- Ability to work with the Program's TPA and staff; and
- Other factors as determined by staff which may include, but would not be limited to, a review of:
 - Quarterly Investment Review provided by the TPA;
 - Fund fact sheets provided by the fund company;
 - Most recent Annual Fund Review;
 - Morningstar Workstation Reporting, when applicable;
 - Prospectus, Statement of Additional Information (SAI) from the investment manager, or Declaration of Trust, as applicable; and
 - Information obtained through ad hoc reports.

5.3 Benchmarks. As part of the overall performance evaluation and monitoring process, each investment will be evaluated and monitored against its appropriate benchmark and/or peer universe of funds with a long-term view. Performance benchmarks are specifically established for each investment option and include a comparison to its peer group average, an appropriate index measurement, and an internal benchmark identified by the investment manager.

The benchmarks provided within Section 5.4 are examples of acceptable benchmarks and by no means constitute an exhaustive list of acceptable benchmarks for the identified asset classes and fund types represented within the Program. Suitable asset class benchmarks may also be determined in the fund's prospectus or investment guidelines. PRC may recommend changes to an investment's benchmark or asset class at any time. If a benchmark is discontinued, modified or changes ownership, the PRC may select a new benchmark in its discretion.

5.4 Investment-specific Characteristics. The Program offers investments having different investment characteristics in stocks (domestic or international), bond, cash and specialty funds.

- Cash Fund (i.e., Money Market Fund)
- Bond Fund
- Balanced Fund
- Domestic Equity Large Cap Fund
- Domestic Equity Mid Cap Fund
- Domestic Equity Small Cap Fund
- International Fund
- Target Date Retirement Funds
- Specialty Fund

The Board may, in consultation with staff and the PRC (or of its own initiative,) alter these options and/or include other investment categories that allow participants to build diversified portfolios that suit their time horizon, risk tolerance and investment goals.

A. Cash Fund (i.e., Money Market Fund or equivalent investments). Cash Funds invest in very liquid securities with short-term durations and high credit quality.

Benchmarks:

- 91-day United States of America (U.S.) Treasury bill rate;
- Citigroup 3-Month Treasury Bill rate;
- Morningstar Money Market Index;
- Merrill Lynch 3-Month Treasury Bill rate; or
- Prospectus or Declaration of Trust benchmark.

- B. Bond Fund.** Bond funds are funds that invest solely or primarily in bonds or other debt securities. Bond funds primarily invest in fixed income securities that are of high credit quality, and seek income, with growth as a secondary consideration. Government bond funds seek current income by investing in securities backed by the U.S. Government or its agencies. An investor who purchases a bond fund generally seeks current income along with the preservation of capital. Since bond funds are typically comprised of individual bonds, they are subject to the same types of risks associated with bonds, such as credit risk, call risk, interest rate risk, and reinvestment risk. The levels of risk and return on bond funds are generally expected to be lower than that of other investment options.

Benchmarks:

- Bloomberg Barclays Aggregate Bond Index;
- Bloomberg Barclays 1-3 Year Government Bond Index; or
- Prospectus or Declaration of Trust benchmark.

- C. Balanced Fund.** Balanced funds are funds that divide their assets among stocks, bonds, and cash investments thereby providing a mixture of lower relative risk, income and modest capital appreciation with less volatility than an all-stock fund. The proportions that a balanced fund invests into each asset class usually must remain within a set minimum and maximum and will vary with market conditions. Generally, the goal of a balanced mutual fund is to even out market advances and declines with the decisions for these investments being made by the fund's portfolio manager.

Benchmarks:

- S&P 500 Index;
- Barclays U.S. Credit A or Better Bond Index;
- A composite index comprised of an appropriate mix of other common indices designed to represent the investment characteristics of the Fund's strategic asset allocation
- Wellington Composite Index; or
- Prospectus or Declaration of Trust benchmark.

- D. Domestic Equity Large Cap Fund.** Domestic equity large cap fund options reflect investments in securities of larger U.S. companies. Large cap funds are expected to offer stable and sustainable returns over a period of time, but might be outperformed by small and mid cap funds, which have higher risk exposure.

Benchmarks:

- S&P 500 Index;
- Russell 1000 Indexes (Value, Growth or Blend);
- MSCI US Prime Market Growth Index;
- CRSP US Large Cap Index (Value or Growth); or
- Prospectus or Declaration of Trust benchmark.

- E. Domestic Equity Mid Cap Fund.** Domestic equity mid cap fund options reflect investments in medium-sized U.S. companies. Mid cap equity funds are expected to have better growth prospects than large cap funds and are more sensitive to market sentiment, meaning investors are expected to have a better chance of picking up the shares at a discount to their fair value. However, mid cap funds can also be more volatile than large cap investments.

Benchmarks:

- S&P Mid Cap 400 Index (Value, Growth or Blend);
- Russell Mid Cap Indexes (Value, Growth or Blend);
- CRSP US Mid Cap Index (Value or Growth); or
- Prospectus or Declaration of Trust benchmark.

F. Domestic Equity Small Cap Fund. Domestic equity small cap fund options reflect investments in small-sized U.S. companies. These companies are less well-known, meaning that there can be greater opportunity for active managers to make informed decisions within the sector and outperform an index. These funds may deliver higher returns over the long term but they are generally more volatile. Due to their exposure in high beta stocks, they are generally positioned on a high risk return trade-off plane compared to a large cap fund.

Benchmarks:

- Russell 2000 Indexes (Value, Growth or Blend);
- CRSP US Small Cap Index (Value or Growth); or
- Prospectus or Declaration of Trust benchmark.

G. International Fund. International funds invest primarily in the companies located outside of the U.S, as well as companies that derive a majority of their income from foreign operations and seek long-term growth of capital. Currency risks may make these investment options more volatile than the domestic equity fund options. Historically, over full market cycles, these investment options have offered potential diversification benefits compared to some of the other investment fund options, but they often also offer higher risk.

Benchmarks:

- MSCI EAFE Index;
- MSCI All Country World Index ex US (ACWI ex US); or
- Prospectus or Declaration of Trust benchmark.

H. Target Date Retirement Funds. More fully described in Section 4.2, target date funds (also known as retirement date funds) have the primary objective of providing asset allocation strategies for retirement investors using a *fund of funds* approach. Target date funds use a methodology that allows for a gradual re-allocation of assets to more conservative strategies as the participant approaches the fund's stated retirement date, commonly referred to as a *glide path*. The glide path may continue after the target date and may use different methodologies than the pre-retirement date glide path. Participants may choose the target date fund that most closely matches their projected retirement date.

Benchmarks:

- Prospectus or Declaration of Trust benchmark.

I. Specialty Fund. A specialty fund serves as an alternative investment solution designed to help participants achieve returns and add diversification while meeting a specific investment objective within their retirement savings portfolios.

Benchmarks:

- Shall follow the benchmark most closely representing the investment objective of the fund;
- Comparable universe of similar funds; or
- Prospectus or Declaration of Trust benchmark.

Section 6. Selection of Investment Options

In accordance with provisions set forth under this Policy, the PRC is responsible for performing investment fund oversight and consultative duties for the Texa\$aver Program. These duties may lead to the PRC formulating a recommendation to the Board to add, remove or replace investment funds so that the array of funds available supports the Program's objectives. The PRC recommendation shall comply with § 609.505(d) of the Texas Government Code that requires the selection of vendors or investment products based on the quality of investment performance, proven ability to manage institutional assets, minimum net worth requirements, fee structure, compliance with applicable federal and state laws, and other established criteria. The selection process will involve a disciplined approach that reflects a procedural due diligence in selecting vendors or investment products.

The fund selection process for the Texa\$aver Program will employ a due diligence practice whereby the TPA and Advisor Service Provider will generate a set of investments from a research platform using minimum and preferred criteria (or data query attributes) defined by the PRC or a sub-committee. Using its research platform, the Advisor Service Provider will perform in-depth investment analysis to include sophisticated holdings- and returns-based style analysis, insightful peer/competitive analysis, thorough manager performance evaluation and investment monitoring and reporting specific to the fund search. The data query attributes will be input into the research platform to generate a set of investments that meets the criteria defined by the PRC or its sub-committee. This research platform is expected to provide a robust fund search across investment types and provide differential reporting among selected investments from the PRC-defined data query attributes.

6.1 Identifying a Potential Need. A member of the Board, PRC, TPA, or ERS staff may make a recommendation for consideration by the entire PRC specific to a fund addition, removal or replacement within the Program's fund line-up. Recommendations may be delivered to the PRC in the form of gap analysis, investment fund strategic plan or other format. Recommendations for fund changes generally occur during the course of the PRC's regularly scheduled semi-annual investment meetings, but may also originate outside this context of the PRC meeting. A quorum of the PRC shall deliberate on any recommendation to add, remove or replace a fund in the Program. The PRC's recommendation will be decided by a simple majority vote of the quorum. This PRC's recommendation will be evidenced by the authorized signature of the Executive Director or designee signing on behalf of the PRC.

The PRC's recommendation regarding fund additions, removals, and replacements must be presented to the Board for approval as described within Section 6.6.

6.2 Sub-committee. A sub-committee may be appointed by the PRC for purpose(s) to include, but may not be limited to:

- (a) Evaluating fund(s) and/or investment manager(s) as a result of
 - Poor relative performance;
 - Material change in investment style;
 - Departure of key investment personnel;
 - Operational problems affecting the investment management process;
 - Changes in fund characteristics or investment strategies; or
 - Organizational issues.
- (b) Determining an initial set of fund search criteria for a fund search; or
- (c) Evaluating an initial set of investment products derived from a due-diligence fund search; or
- (d) Determining finalists to be recommended to the full PRC for further consideration; or
- (e) Undertaking tasks, research, duties, and/or responsibilities delegated from the PRC.

The roles, responsibilities, composition, and standard protocols of the PRC are addressed within the Product Review Committee Governance Charter.

- 6.3 Identifying Fund Search Criteria (or data query attributes).** The PRC will define the Investment Option/Style for the desired fund and the performance, quality, and risk characteristics of the investment manager that will be required and provide these to a designated PRC sub-committee to carry out the search. The designated sub-committee may revise or otherwise amend the data query attributes to affect optimal search results as described in Section 6.4.

The PRC will classify each of the identified criteria as either minimum requirements or preferred criteria. Once formulated, the Minimum Requirements represent the criteria that will serve as the qualifications an investment manager must meet in order to be considered for the Program's fund selection process. Any identified Minimum Requirements must represent valid query data points or *searchable criteria* for the research platform.

Examples of these search criteria may include, but are not limited to, the following:

- **Investment Strategy**
 - Utilize a recognized and appropriate benchmark when applicable and demonstrate a suitable performance history, including a history of reasonable tracking error to the specified benchmark;
 - Employ a sound, repeatable and understandable investment process that is consistent with the Program's investment objectives;
 - Have sufficient assets under management, such that the Program would not represent a significant percentage of total assets of the fund;
 - Have ample remaining capacity within the strategy to accommodate Program assets (and future asset growth) without impairing the manager's ability to effectively manage the strategy;
 - Meet any additional requirements specified by PRC or its sub-committee with regard to management strategy: (i.e. actively or passively managed).

- **Organizational Requirements and Demonstrated Experience**
 - Be an established investment firm with a minimum of three years of operational history;
 - Demonstrate minimum experience of three years of investment management experience in requisite strategy for key personnel and investment team;
 - Demonstrate that it has met those performance and risk characteristics criteria specified under live, not modeled, conditions and over an appropriate time period;
 - Maximize return within reasonable and prudent levels of risk;
 - Maintain style consistency through a variety of market conditions and provide returns comparable to returns for similarly investment options.
 - Must not be subject to any major enforcement activities or formal complaints by federal or any state regulators (i.e. such as the SEC, OCC, DOL, etc.) or been involved in any significant litigation surrounding investment management-only activities over the last three (3) years;
 - Must not be a broker or any third party selling another company's funds.
 - Must demonstrate a commitment to client service by agreeing to provide the Plan with other relevant information that may include, but not be exclusive to, fund holdings, operational and performance data, investment style, geographic asset allocation data and other specific data deemed relevant by the Plan;

- Must be willing to provide access to investment personnel on a periodic basis (at least annually) and on an ad-hoc basis, as requested by the PRC and as circumstances reasonably require.
- **Fund-Specific and Asset Class Criteria**
 - Generally accepted benchmarks for the fund selection process are listed in Section 5 of this Policy. Selected managers will utilize a benchmark from Section 5 unless the Board, the PRC or PRC Sub-committee mutually agrees with the asset manager that another benchmark is a better representation of the fund's investment style and is consistent with the intended asset class exposure;
 - Generally accepted asset classes for the fund selection process are listed in section 5 of this Policy.
- **Fund Management**
 - Consistent and disciplined application of proposed investment style;
 - A well-defined investment process compatible with the investment's objective/strategy;
 - A verifiable track record that demonstrates consistent adherence to the stated investments approach and benchmark;
 - Historical risk and return characteristics that are consistent with the proposed fund's role;
 - Performance that is generally competitive over long-term periods when compared to the stated benchmark of the fund.
 - Express a reasonable criteria for determining the maximum investment capacity of a fund and a willingness to control asset growth beyond that point.
- **Staff**
 - Professional and demonstrated investment knowledge;
 - Continuity of key personal and low staff turnover.
- **Expenses**
 - No transfer fee, redemption fee (with the exception of a frequent trading fee), deferred sales charge, front-end or back-end sales loads (or be willing to reduce/waive or refund such fees or charges);
 - Expenses shall be reasonable for similar funds;
 - Institutionally priced (where applicable); and
 - Any redemption gates and/or frequent trading policies must be disclosed.
- **Historical Investment Performance**
 - For passive strategies, minimal tracking error to the specified benchmark over various market cycles;
 - Where applicable, shall exhibit a NAV volatility reasonably close to peer funds and/or benchmark over various market cycles;
 - Where applicable, shall exhibit an R^2 (*R-Squared*) reasonably close to its peer funds and/or benchmark over various market cycles.
- **Qualitative Criteria.** The PRC may use qualitative selection criteria that it believes are predictive of the future success of a fund. These factors may include focusing on assessing the strength and quality of the investment company and investment manager's capabilities. Areas emphasized may include:
 - Depth and competency of investment personnel;

- Degree to which the structure of the investment team is conducive to success;
- Investment team's skills at sourcing high value investment ideas;
- Knowledge of the investable universe; and
- Depth and quality of supporting functions such as compliance, risk management and trading.

6.4 Fund Query and Initial Review. The PRC's finalized criteria (herein referred to as set of requirements) for the fund search shall be provided to the TPA and/or Advisor Services provider (collectively referred to as Program Providers). Working in conjunction with the designated PRC sub-committee, the Program Providers shall then query for funds using investment analysis tools with access to data, analytics and research (herein referred to as fund search) using the PRC's set of requirements.

In the event that query results do not result in an optimal listing of three funds, the sub-committee will make the determination to (a) either proceed forward in the fund selection process with the investment funds from the initial query or (b) amend the original criteria to achieve an optimal search result to identify sufficient fund finalists.

6.5 Finalist Interviews and Fund Selection. Once the finalists have been identified, the PRC or its designated sub-committee will then conduct interviews of each finalist's management teams. The Program Providers may be asked to provide additional information about the finalists' fund and/or investment managers during the investment selection process. Following the conclusion of the interviews, the designated PRC sub-committee will present its findings to the PRC. Finalist candidates will then be asked to present to the PRC, which will conduct a vote to select the investment fund to recommend for the Program. A simple majority vote of the quorum will determine the investment fund to be presented to the Board. The PRC's recommendation will be evidenced by the authorized signature of the Executive Director or designee signing on behalf of the PRC.

In the event that the PRC determines that none of the investment managers interviewed is an appropriate choice for the Program, then the Program Providers and/or the PRC's designated sub-committee may be required to provide the next group of investment managers from the query list for consideration.

6.6 Board Recommendation and Approval. Once the PRC has determined the investment fund finalist and, when appropriate, an alternate or runner-up fund, ERS staff will formulate a formal recommendation to be presented to the Board consistent with the PRC determination that will include how the proposed fund best meets the Program's objectives.

6.7 Blackout Period. With regard to a fund addition, deletion or change, ERS will provide plan participants with advance notice of a "blackout period" affecting their rights to direct investments, make contributions, take loans (if available) or obtain distributions. A blackout period may occur when the Plans change investment options, but may also apply with changes in the TPA or TPA's recordkeeping systems (or administration platform).

6.8 Participant Notifications. Notifications on fund changes and applicable black out period will be provided to Plan participants either electronically (Texa\$aver website) or via paper notice (quarterly statement or direct mailing) and will include the following information:

- Reasons for the blackout period;
- Description of the rights that will be suspended or affected during the blackout period; and
- Start and end dates of the blackout period.

6.9 Applications, Negotiations, and Administrative Functions. The TPA often negotiates fees and rebates with investment fund providers; however, ERS may negotiate a better deal on fees and rebates. The TPA will work with ERS and the investment manager to complete administrative responsibilities in a timely and prudent manner which may include, but not be limited to, coordinating account openings and/or completing applications following the Board's approval.

6.10 New Investment Vehicles. In the event that the PRC makes the determination to recommend to the Board the use of other investment vehicles not listed herein, then the PRC would formulate a business justification to the Board on the benefits of including a new investment vehicle in addition to the recommended fund that best meets the Program's objectives. If approved by the Board, this Policy would be amended to reflect any changes in the available investment vehicles.

Section 7. Policy Review and Evaluation

7.1 PRC Review of Investment Policy. The PRC shall review this Policy periodically for recommend changes. Based on the PRC's review of this Policy, the PRC may deem that revisions to this Policy may be necessary to appropriately reflect the current needs of the TexaSaver Program. Proposed changes to this Policy will be presented to the Board for consideration. At a minimum, the provisions of this Policy shall be reviewed by the Board every three years, with ERS staff providing recommendations for revisions. Changes to the Policy must be approved by the Board in an open meeting.

7.2 Investment Policy Interpretation and Approval. It is intended that this Investment Policy be construed and administered such that it complies with all applicable federal and state laws and regulations and may be amended from time to time. ERS' Executive Director is authorized to approve from time to time variances from the policies set forth herein in furtherance of such compliance as he deems to be in the best interest of ERS and consistent with both ERS' fiduciary responsibilities and the purpose and scope of this policy. The Executive Director must report any variances to the Board of Trustees at the next quarterly meeting.

If the Executive Director believes any revisions to this Investment Policy would be prudent, the Executive Director shall inform the Board of such suggested revisions. Proposed changes to this Investment policy will be presented to the Board for consideration and review; the Board may vote to amend this Investment Policy accordingly.

Section 8. Ethics Policy

8.1 Code of Ethics. PRC members and ERS staff recognize that each individual is governed by and subject to a strict Code of Ethics contained within the ERS Investment Policy.