Joint Meeting of
The Board of Trustees
And
Investment Advisory Committee Minutes

March 10, 2021

ERS

EMPLOYEES RETIREMENT SYSTEM OF TEXAS

Presented for Review and Approval

May 26, 2021

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

The March 10, 2021 meeting of the ERS Board of Trustees was held by video conference call as authorized under Section 551.127 of the Texas Government Code, in accordance with the governor's authorization concerning suspension of certain open meeting law requirements in response to the covid-19 (coronavirus) disaster. A quorum of members of the Board participated in the meeting remotely and will be visible and/or audible to the public.

TRUSTEES PRESENT
Craig Hester, Chair
Catherine Melvin, Vice Chair
Brian Barth, Member
Ilesa Daniels, Member
James Kee, Member

INVESTMENT ADVISORY COMMITTEE (IAC) PRESENT
Bob Alley, Chair
Gene Needles, Vice-Chair
Caroline Cooley, Member
Laurie Dotter, Member
James Hille, Member
Milton Hixson, Member
Ken Mindell, Member

ERS DIRECTORS PRESENT
Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director and General Counsel
Tony Chavez, Director of Internal Audit
Bernie Hajovsky, Director of Strategic Initiatives
Diana Kongevick, Director of Group Benefits
Machelle Pharr, Chief Financial Officer
Gabrielle Schreiber, Director of Procurement and Contract Oversight
DeeDee Sterns, Director of Human Resource
Tom Tull, Chief Investment Officer
Chuck Turner, Information Systems

ERS STAFF PRESENT
Nora Alvarado, Group Benefits
Georgina Bouton, Group Benefits
Carlos Chujoy, Investments
Kelley Davenport, Executive Office
Blaise Duran, Group Benefits
Angelica Harborth, Group Benefits
Aaron Ismail, Investments
Tiffani Jenkins, Benefits Communications
Lanesia Jones, Investments
Panayiotis Lambropoulos, Investments
Tressie Landry, Internal Audit
David Law, Investments
Ricky Lyra, Investments
Nicholas Maffeo, Investments
Greg Magness, Internal Audit
Betty Martin, Investments

Bruce Marton, Information Systems
John McCaffrey, Investments
Simon Mok, Investments
Matt Riemersma, Information Systems
Tanna Ridgway, Investments
Bob Sessa, Investments
Leighton Shantz, Investments
Pablo de la Sierra Perez, Investments
John Streun, Investments
Ariana Whaley, Government Relations

VISITORS PRESENT
Sam Austin, NEPC
Tom Cawkwell, Albourne Partners
John Claisse, Albourne Partners
David Glickman, Meketa
Stuart Greenfield, self
Michael Kennedy, Korn Ferry
James Kokoza, Albourne Partners
Michael Malchenko, NEPC
Thomas Nun, Great West Investments
Jason Ostroski, CliftonLarsonAllen LLP
Trae Titus, AV Vendor
Richard Whymark, AV Vendor

Call to Order the Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee

7. Call Meeting of the Board of Trustees to Order

Mr. Craig Hester, Chair of the Board of Trustees (Board) for the Employees Retirement System of Texas (ERS), called to reconvene with the Investment Advisory Committee (IAC) to take up the following Joint Meeting of the Board of Trustees and Investment Advisory Committee agenda items.

A public notice of the ERS Board of Trustees containing all items on the proposed agenda was filed with the Office of the Secretary of State at 11:39 a.m. on Monday, March 01, 2021 as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law".

8. Call Meeting of the Investment Advisory Committee to Order

Mr. Bob Alley, Chair of the IAC for ERS, called the meeting to order and read the following statement:

A public notice of the ERS Board of Trustees containing all items on the proposed agenda was filed with the Office of the Secretary of State at 11:39 a.m. on Monday, March 01, 2021 as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law".

9. Review and Approval of the Minutes to the December 9, 2020 Joint Meeting of the Board of Trustees and Investment Advisory Committee – (Action)

Mr. Bob Alley, IAC Chair, opened the floor for a motion on the approval of the minutes from the December 9, 2020 Joint Meeting of the Board of Trustees and Investment Advisory Committee.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas approve the minutes of the Joint Meeting of the Board and IAC held on December 9, 2020.

Motion by Gene Needles, seconded by Caroline Cooley
Final Resolution: Motion Carries
Aye: Robert G. Alley, Gene Needles, James R. Hille, Milton Hixson, Ken Mindell, Caroline Cooley, Lauri Dotter

The Board of Trustees then took the following action:

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas approve the minutes of the Joint Meeting of the Board and IAC held on December 9, 2020.

Motion by Brian Barth, seconded by Ilesa Daniels
Final Resolution: Motion Carries
Aye: Ilesa Daniels, James Kee**,** Craig Hester, Brian Barth, Catherine Melvin,

There were no questions or further discussion.

10. Review, Discussion and Consideration of the Texa$aver 401(k)/457 Program Updates – (ACTION)

Diana Kongevick, Director of Group Benefits, Georgina Bouton, Assistant Director of Group Benefits, Nora Alvarado, Voluntary Income Plans, Group Benefits, Blaise Duran, Actuarial and Reporting Services, Group Benefits, and Thomas Nun, Portfolio Strategist, Great West Investments, presented Texa$aver[SM] 401(k)/457 Program Updates.

Porter Wilson, Executive Director, explained that ERS has a Product Review Committee (PRC) which has been delegated some oversight by the board for responsibility specific to the Texa$aver 401(k)/457 Program (Texa$aver or program), The PRC includes several Investment Advisory Committee (IAC) members. The IAC members provide additional expertise on the types of products offered within Texa$aver. Mr. Wilson noted that input from the full IAC could be a benefit to the Board and to the program. Therefore, Texa$aver agenda items will be presented during the joint session for comments and consideration by both the Board and IAC. However, the action will be a Board only action.

Ms. Kongevick explained that the presentation would include an annual performance overview of Texa$aver, a recommendation from the PRC, and a recommendation to restructure participant fees. She further explained that at the end of the presentation, motions will be presented for Board consideration and action.

Ms. Bouton provided an overview of Texa$aver. She explained that the program is a tax-deferred supplemental retirement program with of a 401(k) and a 457 plan. The program is marketed to participants as an important part of a three-legged stool approach for retirement saving. Each leg of the stool is a separate source of income – state pension, Social Security, and personal savings. Together they work to provide a balanced financial plan and a stable income flow throughout retirement. As part of the *personal savings* income source, Texa$aver is designed to assist in overcoming a retirement savings shortage and promote financial stability in retirement. The 401(k) plan is available to employees of state agencies. The 457 plan is available to employees of state agencies, as well as eligible institutions of higher education.

Ms. Bouton said that the assets under management (AUM) for the 401(k) were reported just over $3.1 billion with just under 216,000 accounts. The Roth balances represented $72 million or 2.3% of the overall plan assets. Of the plan accounts, 48% were actively contributing at the end of the plan year. For the 457 plan, the AUM was approaching $1.2 billion at just over 33,500 accounts. Roth balances were $61 million or 5.3% of the plan's assets with 57% actively contributing at the end of the plan year.

Ms. Bouton provided an overview of the investment offerings available within Texa$aver by asset class. She explained the function and structure of the PRC, a nine-person committee whose members include ERS leadership, ERS investment staff, and external investment professionals. The PRC actively provides fiduciary responsibilities over the Texa$aver portfolio's quality and diversification through their collective experiences, expertise, and insight. Ms. Bouton explained that the PRC may appoint a sub-committee for a specific purpose to assist the PRC in fulfilling its duties. The sub-committee is made up of no more than four PRC members, and ERS staff with subject matter expertise. Ms. Bouton then introduced Mr. Nun to provide further details market updates, fund performance and the passive international equity fund search.

Mr. Thomas Nun began his presentation with an explanation of the capital market performance through December 31, 2020. He explained that overall in 2020, growth dominated value in the equity markets. However, an interesting and prevalent trend emerged in the fourth quarter (Q4) 2020 with news and progress in the developments of the COVID-19 vaccines. Markets reacted favorably to this news, and the results were trend reversals in Q4 2020. Specifically, value began outperforming growth in the last three months in 2020. Likewise small cap and mid cap underperformed to large cap throughout the pandemic. However, in Q4 2020, this trend began to reverse to some degree. Mr. Nun highlighted these trends in the quarter to date (QTD) returns and year to date (YTD) returns for large cap, mid cap and small cap equities.

Mr. Nun explained the same trends were also evident in the fixed income markets. In his review by returns by equity style, he reported that large growth equities performed the best in 2020. However, a closer look at the Q4 2020 period the trend reversed and small cap value equities outperformed. Mr. Nun reviewed S&P 500 sector returns for 2020, highlighting that those sectors which were most under pressure throughout the pandemic have reversed in Q4 2020 (e.g., energy and information technology). The capital markets update provided context for the next part of his presentation.

Mr. Nun did an overview of the investment funds available to participants under the plans and some of the changes in the funds that took place in 2020. He explained that the program provides a diversified menu of options for participants. He noted that the wide range of funds produce an acceptable range of asset class exposure.

Mr. Nun presented an overview of the 2020 fund changes, beginning with the mid cap offerings. As discussed at previous board meetings, First Eagle and Victory Munder were subject to enhanced due diligence as a result of the funds' performance. Mr. Nun recapped the due diligence process undertaken by the PRC and the appointed sub-committee. Mr. Nun explained that he participated in the due diligence process and discussions. Following the due diligence, these funds were removed and replaced March 6, 2020 with the BlackRock Mid Cap fund.

The BlackRock Mid Cap fund, a collective trust fund, now serves as the program's mid cap offering. The fund's performance is competitive, tracking well to the S&P 400 Index benchmark. The expense ratio for this fund is -two basis points (bps) making it extremely competitive. Program assets are $204.3 million, which is 5% of the program's overall assets.

Mr. Nun reported on another change in the mid cap space. The Wellington WTC-CIF II Mid Cap Opportunities Series 1 (Mid Cap Opportunities) fund was added in May 2020 as the active strategy fund. Mid Cap Opportunities has just under $30 million invested, which is less than 1% of Texa$aver participants. No participant funds were automatically transferred to this fund from other investment options. Mid Cap Opportunities is a collective trust fund with an expense ratio of 66 bps, which is competitively priced for an actively managed fund. Mr. Nun explained that recent performance had been somewhat challenged as compared to its benchmark and peer group, which is most likely a function of its Growth at a Reasonable Price (GARP) orientation. With the market's trend "rotation" which occurred in Q4 2020, this fund's performance recovered nicely in the last three months of 2020.

Mr. Nun reported that the Davis New York Venture A (NYVTX) fund, the program's large cap fund was removed following Board approval at the Joint IAC and Board meeting held on December 9, 2020. Fund assets were approved to transition to the Vanguard Institutional Index (VIIIX) fund, Texa$aver's large cap blend fund. The effective date for the large cap fund transition from Davis to the Vanguard Institutional Index fund was March 5, 2021.

Mr. Nun proceeded with the performance overview for the Vanguard Institutional Index fund, the large cap blend offering which received the transfer of assets from the Davis fund removal. The amount of this transfer was approximately $170 million. This fund is a passively managed mutual fund with total assets totally over $604 million. It is benchmarked to and tracks closely to the S&P 500. This fund offers an extremely low cost at -two bps. Mr. Nun commented that the fund is highly rated by Morningstar, and is a highly-utilized fund in the deferred compensation (DC) industry.

Next, Mr. Nun gave an overview of the Vanguard Growth Index Institutional fund, the large cap growth offering. He noted its low expense ratio of four bps. The fund is designed to give exposure to a large US growth option and tracks to the US Large Growth Index. The fund has excellent tracking to that designated benchmark. He commented that this is another strongly utilized option in the DC industry and marketplace.

Mr. Nun then provided an overview of the BlackRock Short Term Investment fund, the program's money market offering. He reported that this fund offers competitive pricing at eight bps. The fund has been in the program since 2006 and has over $167 million in assets. The fund has no performance issues. It is in the top quartile in all measured periods and is benchmarked to the three month T-bill index. One interesting note: during 2Q 2020, cash options in many plans had an increase in assets. However, with only a 4.5% increase in assets, Mr. Nun commented that Texa$aver participants did not appear to be reacting to the pandemic economic stresses.

The BlackRock 1-3 Year Government Bond Index Fund, the short-term bond offering, has total assets approaching $56 million. As a collective trust fund, the net expense ratio is competitive at six bps. The fund has been in the program since 2014. Mr. Nun reported that this fund has had no performance issues. The fund tracks well to its benchmark: 1-3 year Government Bond Index. ERS met with the BlackRock fund management team in November 2020. Overall, fund performance is consistent with expectations.

Mr. Nun continued with the BlackRock Bond Index, intermediate bond offering, organized as a collective trust fund, which has been in the program since 2009. Assets total over $291 million, or 7% of program assets. Mr. Nun reported no performance issues, very tight tracking being at +/- 1 bps of its index benchmark over most periods.

Mr. Nun then reported on the Vanguard Wellington Admiral fund (VWENX), a balanced investment fund within the program. He explained that a balanced fund attempts to maintain a 60% equity, 40% bond allocation, but has flexibility to move +/- 10% beyond these bounds. At present, the fund has a 55% equity, 45% bond allocation. This fund is the second largest utilized balanced fund used by DC plans across the country; it is the oldest existing balanced fund in the US. Mr. Nun reported that the fund has superior long term performance from a peer perspective. Mr. Nun pointed out that performance has struggled recently with its slant to value, which was a struggle as discussed in the 2020 capital markets update.

Next, Mr. Nun addressed the Lord Abbett Small Cap Value I, the program's small cap offering. The fund has $160 million in assets. Mr. Nun explained that this fund has had performance and style issues, which have been discussed by PRC members, and during the last performance update with the Board in March 2020. The most recent annual performance review with the portfolio management team took place in July 2020. Mr. Nun pointed out that a new portfolio management team moved into place in 2018, putting the fund back to its value roots. The new portfolio team needs additional time to make an impact on the fund. The portfolio has some concentrations on seven core stocks, but no sector concentrations. PRC and staff continue to monitor the fund. In September 2020, the firm named a new CIO. Mr. Nun said that the transition has been handled very well by the firm.

The AB All Market Real Return Portfolio Fund is a very small holding within Texa$aver. Program assets total $2.4 million. Mr. Nun explained that this specialty fund is designed to provide participants with a way to hedge some inflation risk. This fund is being monitored by PRC given some performance issues. The fund invests in asset classes that are not easily benchmarked, either by stated indices or by peers. Mr. Nun explained that the stated benchmark, MSCI ACWI Commodity Producers Index, is a volatile benchmark, providing large movements in commodities in Q4 2020. Performance itself is somewhat difficult to measure in isolation. Mr. Nun further explained this fund, by design, invests a significant portion of its assets in real estate equities, commodity futures, and resource-related equities. The portfolio management team presented to the PRC in July 2020 to represent their strategy.

Mr. Nun provided an overview of the Fidelity Diversified International (FDIVX) fund, the program's international fund. This is the fund that provides participants with exposure and ability to invest in international equities. This fund is benchmarked to the MSCI EAFE Growth and is an actively managed option. Mr. Nun commented that performance has been adequate given its tough peer group to compete within. Some notable points for this fund include occasional sector overweights (e.g., technology) and underweights, aggressive tracking error, and emerging market holdings (up to 20% economic exposure). The fund is well-diversified with 150-170 holdings and has a low turn-over strategy. Overall, Mr. Nun noted this as a strong, active option for participations.

Dr. Kee commented on the opportunity to have a passive international option for the line-up. He also noted that the actively managed funds are not outperforming benchmarks on a 10-year basis. Mr. Nun commented that the Fidelity Diversified has outperformed its benchmark by 145 bps. However, he also noted that the next performance review would address 10 year performance against the fund's benchmark. Mr. Nun also reported that the next segment of the presentation was the PRC's recommendation regarding a passive international option.

To conclude on the program's fund performance presentation, Mr. Nun provided an overview on the BlackRock LifePath® Index Target Date funds. Target date funds are a highly-utilized investment fund within the program. Approximately 25% of the program assets are invested in these funds. The target date funds offer solid performance and are competitively priced at 8 bps. Mr. Nun pointed out that this fund series has been somewhat aggressive as compared to peers early in the glide path. ERS met with the fund management team in November 2020 to review the fund strategy and underlying asset class exposures.

Mr. Nun then explained that the next portion of the presentation is the recommendation for a passive international equity fund option, a new offering for Texa$aver. He reminded the Board that the PRC identified enhancement opportunities for the program's investment line-up during its strategic planning session held in Q3 2020. The PRC determined that a passive international fund would provide participants greater choice with the opportunity for a lower expense ratio and provide greater diversification with a high quality rated fund. The proposed new fund would not replace the existing Fidelity Diversified International fund but would be offered as an additional fund option. Ultimately, Texa$aver would offer both an actively managed and passively managed international fund, which is a common practice in the marketplace for large government plans. Mr. Nun reported that a high yield bond fund was also identified as an opportunity for the program. Due diligence for this fund is scheduled to begin in Q3 2021.

Mr. Nun reported that the PRC appointed a sub-committee to perform the required due diligence and fund search duties for the passive international equity fund. The fund search parameters were finalized in early October 2020 and included minimum fund size, net expense ratio, benchmark strategies, firm qualifications and investment strategy qualifications. A dozen initial passive international funds met these criteria and five moved to the next evaluation phase. The Due Diligence Questionnaire (DDQ) was sent to these five funds. DDQ responses were received from all five funds on November 18, 2020. Mr. Nun reported that the sub-committee evaluated firm qualifications including compliance and risk management, asset management personnel, and the firm's leadership team managing, along with their strategy qualifications including investment philosophy, style and process, historical performance and asset flows.

The sub-committee recommended two finalists to PRC: Fidelity International Index (FSPSX) and iShares MSCI EAFE International Index (BTMKX), offered by BlackRock. PRC members agreed with the sub-committee recommendation. Mr. Nun reported that videoconference finalist interviews were held on January 11, 2021, and included a prepared presentation by each finalist. Both funds were extremely competitive in areas of fund size, net expense ratio, returns, portfolio management and firm detail, as well as investment strategy.

Mr. Nun explained that both funds are reputable and managed by reputable firms with extensive experience in the international asset space. The differences are nominal. For instance, the Fidelity fund is structured as a mutual fund, whereas the BlackRock offering is a collective investment trust (CIT) fund. The net expense for Fidelity is 3.5 bps, offering a slight edge to BlackRock's 4.1 bps. Both funds have similar investment returns. Mr. Nun pointed out that the Fidelity fund is managed by Geode Capital Management which is an affiliate of Fidelity, but does stand as an independent manager. Mr. Nun reported that the PRC gave a slight edge to Fidelity following the conclusion of its due diligence.

Mr. Nun then concluded his overall presentation by commenting that the objective for providing a passive international equity fund would be to provide a high quality, well-managed, competitively priced fund with international market exposure. The proposed fund would be offered alongside the existing international fund. There would be no transfer of assets into this option; however, the new fund would be available to participant contributions on or after May 1, 2021.

Ms. Kongevick reminded the board that a full motion and board vote would be presented at the conclusion of the agenda item. At this point in the presentation, Ms. Kongevick presented the joint ERS and PRC recommendation to have the board approve the addition of the Fidelity International Index (FSPSX) fund as the passive international equity fund to the Texa$aver 401(k)/457 Program.

Ms. Nora Alvarado began the participant fee rate restructure portion of the Texa$aver presentation. Ms. Alvarado noted that the legislature does not provide any funds to ERS to administer this program and the participant fees must cover these costs. Costs are assessed to participant accounts as a monthly administrative fee and cover program recordkeeping costs and ERS' internal costs. Fees are assessed to the 401(k) and 457 plans separately.

Ms. Alvarado reported that ERS adopted a tiered fee structure designed by ERS for Texa$aver's administrative fees effective September 1, 2009. The structure and corresponding fees were based on participant account balances. Ms. Alvarado provided an overview of the participant fee reductions that have taken place since September 2009 for certain account balances. More recent changes included the elimination of the low balance account tier in October 2018, a 39.67% rate reduction applied to all tiers in June 2019, and a 15% reduction to all tiers in 2020.

Ms. Alvarado noted that ERS reviewed three fee options including an asset based fee, a flat fee, and continuing the tiered stratification. Staff considered industry practices, participant ease in understanding, surveys, data, and Texa$aver program design.

An asset based fee is based on a percentage of the participant's account balance and could change month-to-month. Ms. Alvarado reported that the program's administrator, Empower Retirement, estimated that of the 39% of plans with asset based fees, only 25% have automatic enrollment. According to the 2019 National Association of Government Defined Contribution Administrators' (NAGDCA) Perspective in Practice (PIP) Survey, annual asset based fees represented 47.8% of plans with assets over $2.25 billion. Ms. Alvarado explained that NAGDCA is a government association that ERS and other state plans can participate in and share information regarding industry practices.

Ms. Alvarado explained that the flat fee structure uses a fixed dollar amount assessed monthly on a per participant account basis. The 2018 Texa$aver Participant Satisfaction Survey indicated that it is easier for participants to understand a flat fee approach than an asset based fee. In the 2019 survey, ERS asked Texa$aver participants their overall preference in the administrative fee structure. Ms. Alvarado explained that 33.7% preferred a flat fee, 29.6% did not have a strong preference, 23.3% preferred the current hybrid tiered structure and 13.4% would rather have an asset-based fee.

Ms. Alvarado reported that according to Empower Retirement's book of business, a flat fee is the most common structure among plans, followed by an asset based fee. Ms. Alvarado explained that the majority of state plans offering automatic enrollment tend to use a flat fee structure due to ease in administration. Ms. Alvarado then introduced Mr. Blaise Duran of ERS' Actuarial and Reporting Services.

Mr. Duran provided an overview of the tiered structure or stratification approach. This is the current approach where a progressively higher fee is charged for each higher tier. Mr. Duran explained there are six balance tiers. The lowest balance tier is structured for balances at $1,000 and less; the highest balance tier is for balances over $64,000. Currently, there is a six-month fee waiver to assist participants in building balances prior to being assessed a fee. Mr. Duran reminded the board that the current approach is a hybrid, customized approach. The unique approach has challenges because there are no easily identifiable benchmarks in the DC marketplace to compare stratification tier design for appropriateness. Also, Mr. Duran reported that the approach can be confusing to participants.

Mr. Duran stated that as a result of its review, ERS is recommending that the board adopt a flat fee structure. The recommended monthly participant fee is $1.50 per account, per participant, to be assessed regardless of account balance. Staff recommends that the six-month fee waiver for new participants continue, to allow a new participant's account balance to build. Mr. Duran explained that this new fee would be effective May 1, 2021, if approved by the Board. At the end of Fiscal Year 2020 the program had an administrative account balance of $6 million across both Texa$aver funds. Mr. Duran reported that staff has established a $1 million target for this administrative fund. At the recommended $1.50 participant fee, the annual spend down of this accumulated balance would be approximately $1 million. Therefore, it would take approximately five to six years to spend down from the $6 million balance to the $1 million target balance. Mr. Duran noted that the $1.50 monthly fee does not have any built in provision for internal costs.

Ms. Catherine Melvin commented that the proposed fee would disproportionally affect those participants in the lower tier with balances less than $1,000. This group is approximately 111,000 participants. However, for all other participants this recommendation would result in a fee reduction. Mr. Duran noted that the low balance participants would have a fee increase to the proposed monthly rate of $1.50, but all others would have a significant monthly fee decrease. Ms. Kongevick pointed out that of that lowest tier, staff determined that 78% of the account holders are not actively contributing.

The Board of Trustees then took the following action:

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas add the Fidelity International Index (FSPSX) Fund to the Texa$aver[SM] 401(k)/457 Program.

Further move that the Board of Trustees of the Employees Retirement System approve a flat $1.50 monthly rate per participant, per account, regardless of account balance for the Texa$aver[SM] 401(k)/457 Program as presented in this agenda item to be effective as soon as administratively possible, but no later than June 1, 2021.

Motion by Jim Kee second by Brian Barth
Final Resolution: Motion Carries
Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

There were no questions or further discussion on this item.

11. *Review and Discussion of the Investment Compliance Annual Report

Mr. Aaron Ismail, ERS Investment Compliance Officer, presented a review of the ERS Investment Compliance Program and the results of the Annual Compliance Review.

Mr. Ismail said the purpose and mission of the Investment Compliance Program is to ensure compliance of applicable laws, regulations, ERS policies, and investment guidelines. Mr. Ismail noted that he has served as the Investment Compliance Officer since 2018.

Mr. Ismail noted that the goals of the program have not changed from the previous year, and the focus has always been to prevent, detect, and address issues of non-compliance. He also stated that other benefits could result from a strong investment compliance program, such as gathering additional information from testing, uncovering information helpful for better decision making, increasing transparency through enhanced governance, and improving efficiencies through streamlining operations and policies and procedures.

Mr. Ismail presented the compliance risk control framework. This framework is based on a model of risk governance developed by the Institute of Internal Auditors called the Three Lines of Defense. He went through each line of defense and discussed how they play a role in the Investment Compliance Program and managing risk. He presented the Board and IAC with a slide that showed the independence of the investment compliance function, as well as a line of communication to the Executive Office and the Board to raise material compliance issues.

Mr. Ismail noted that the lines of defense model has been updated recently, with a strong focus on communication and cooperation across all branches of the organization. These controls were put into place to prevent a weak program that could potentially create risks for ERS, including investment risk, increased regulatory restrictions, loss of investment opportunities, and reputational risk.

Mr. Ismail discussed the intersection between ethics and compliance. Mr. Ismail referenced the Ethics Presentation that the board received from Dr. Robert Prentice. He emphasized the importance of moral ownership, ethical leadership, supervisor reinforcement, and peer commitment in creating an ethical culture, which in turn creates a strong compliance culture.

Mr. Ismail stated that investment compliance reporting is done on a quarterly and annual basis. The Annual Compliance Review provides an overview of ERS's compliance infrastructure and highlights key developments of the program during the year. The compliance reports were recently enhanced to better present highlighted issues and their assigned risk level. Mr. Ismail also noted a recent portfolio compliance issue that will be further addressed by the CIO and investment consultant. This issue was related to a breach of tracking error limits for the Fixed Income Portfolio. Mr. Ismail is not recommending a change to those limits, and he believes that staff properly communicated the issue.

Mr. Ismail discussed key compliance accomplishments for the period which included enhanced compliance testing, updating the ERS Investment Policy, and revising the annual compliance affirmations. He believes that ERS's compliance policies and procedures are effective in preventing, detecting, and curing violations.

Mr. Hester asked for more information on the personal trading issue noted in the report. Mr. Ismail explained that some of the issues were repeat violations that required further scrutiny. Mr. Hester stated that personal trading has come up before and that the Board wants to ensure that covered persons are following the policy.

Dr. Kee stated that in his experience, it is usually the same individuals committing trade violations. He asked Mr. Ismail if he sees the same issues at ERS. Mr. Ismail agreed and said that he believes the overall trade violations were low compared to the total trading activity.

Mr. Barth asked if the transactions in question would have been compliant if they were properly pre-cleared. Mr. Ismail confirmed that he considered it as an inadvertent violation of policy, but it would have been a more serious violation if there had been evidence of trading on material non-public information.

Ms. Melvin asked about the proactive efforts for compliance, such as training. Mr. Ismail stated that it was his intent to expand training from initial onboarding to meeting with investment staff periodically to discuss compliance policy.

Mr. Ismail noted that he currently uses technology to automate the personal trade monitoring and that he plans to expand the capability of those processes.

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

12. Review and Discussion of Eligibility and Compliance of the Investment Advisory Committee

Mr. Aaron Ismail, Investment Compliance Officer, presented a review and discussion of Eligibility and Compliance for Calendar Year 2021 of the Investment Advisory Committee (IAC).

Mr. Ismail began with a reminder that IAC members assist the Board in carrying out its fiduciary duties with regard to investment of the Trust. The IAC works with the staff and investment consultants to review investment strategies and related policies of ERS. The IAC also serve as members of the asset class specific investment committees to review and approve investment recommendations.

Mr. Ismail stated that pursuant to the Texas Government Code 815.5092, the Board shall review the eligibility of IAC members at least annually. He then discussed the criteria for that status, including reviewing potential conflicts of interest and measuring IAC attendance of scheduled meetings.

Mr. Ismail explained that each IAC member completes a compliance affirmation, affirming eligibility and compliance with the Texas Government Code and ERS investment policy, and the criteria is then reviewed. Staff also summarizes the IAC member's experience in a chart, which helps the CIO and Executive Director designate the IAC members to specific asset class committees.

Mr. Ismail thanked the IAC for the work that they do to help support the ERS Investment Program. He affirmed that currently all IAC members have met the annual requirement and are eligible for continued service.

Mr. Hester also thanked the IAC for their service to the Board at the joint meetings, and advising the private asset class investment teams and service on the Texa$aver Product Review Committee.

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

13. *Review and Discussion of Investment Performance for 4th Quarter of 2020 and Risk Update

Mr. Tom Tull, ERS Chief Investment Officer, Mr. Carlos Chujoy, ERS Director of Risk Management and Applied Research, and Mr. Sam Austin, NEPC, presented the Investment Performance Review for the fourth calendar quarter of 2020.

Mr. Austin discussed the ERS Trust Dashboard and noted that the Trust outperformed for the calendar year to date, returning 10% versus 9.1% for the policy benchmark. The Trust also outperformed fiscal year-to-date, at 7.8% versus 6.2% for the policy benchmark.

Mr. Austin noted that the Trust exceeded the actuarial target rate of 7% in the 3-year period with 7.4% and 10-year period with 7.8%, and underperformed the long term public index benchmark (this is passive expression of the risk reducing versus the return seeking portion of the Portfolio) in the 3-year and 10-year period of 2020. The Fund's assets increased to $30.87 billion from $29.41 billion in the last calendar year, which includes investment gains of $2.772 billion for the year, but also accounts for payments of annuity benefits.

Mr. Austin explained that the five-year Sharpe Ratio of 1.08 for the ERS portfolio was in the top quarter compared to the InvestorForce peer universe of Public Funds > $1 billion in AUM. This was also better than the Sharpe Ratio of 0.95 for the ERS Fund Policy Index~~.~~ Similarly, the Sortino ratio, which shows sensitivity to down side risk, was 1.19 for the ERS portfolio compared to 1.11 for the Fund Policy Index. Compared to the peer universe, the Sortino Ratio for the Trust ranked in the top 17 percentile.

Mr. Austin noted that all asset classes were within their respective policy ranges per the investment policy, but some of the asset classes were moderately overweight or underweight versus their long term targets. He stated that Global Public Equity is overweight at 41.6% versus the long term target of 37.0%. Private Equity is overweight at 15.8%, versus the 13.0% long term target.

Asset classes that are underweight were real estate at 7.8% versus the 9% long-term target rate and Infrastructure at 3.7% versus the long-term target rate of 7%. The Absolute Return Portfolio is at 4.3%, slightly underweight compared to the long-term target of 5.0%.

Mr. Austin explained that Private Equity was the largest contributor to returns during the fourth quarter, as well as the year, and noted that it added 0.4% in the fourth quarter and 0.3% for the entire year. Due to the nature of the asset class, Private Equity's valuations are adjusted at least one quarter behind. Mr. Austin reiterated the importance of taking a long term view and not focusing on just one quarter of performance.

Mr. Austin stated that the largest detractor for the quarter was the Rates Portfolio that detracted -0.1%, but Rates was also one of the biggest contributors for the entire year, contributing 0.3% to the overall Portfolio due to being overweight compared to its long term target rate. For the 12 months, Global Public Equity was the largest detractor for the year at -0.4%.

Mr. Austin explained that there was not a significant difference with the management of the Portfolio since the last report, being managed 53% internally and 47% externally. He noted that 18% of the Portfolio is allocated to risk reducing assets and that 82% of the Portfolio is allocated to return seeking assets. The Portfolio is 34% illiquid and 66% liquid.

Mr. Austin noted that the tracking error (measure of active risk in the Portfolio) increased to 2.26% in the fourth quarter from 2.20% in the third quarter. He indicated that ERS had lowered portfolio risk going into the downturn and began adding risk back in during the second quarter.

Mr. Austin explained that the tracking error for the entire Fund is in line with policy, with the exception of the Credit Portfolio, largely due to timing effects with the external portion of that portfolio that has marks that do not come in until after quarter end.

Mr. Tull stated that the ERS Investment Team strives to keep the Board updated on all tracking error violations. He explained that the Credit Portfolio is made up of 70% high yield, 19% externals, and 10% exchange traded funds. He stated that the team saw an unprecedented fall in asset prices in March of 2020, at the onset of the pandemic. The team did not change the fundamental risk of the portfolio, but the portfolio will show tracking errors as they are based on a rolling three-year period and there is a lag of three to four months for those investments. This tracking error will be reported until the rolling average has corrected.

Mr. Shantz added that the Credit Portfolio Team manages the portfolio's risk and is aware of the tracking error. He explained that the violation will be an ongoing issue with compliance until April 2023, until the March 2020 numbers roll off. He stated that the team has not increased the risk in the Portfolio, but that it is a measurement issue.

Ms. Cooley asked if it would make sense to remove the relevant time period from the data to get a more predictive tracking error. Mr. Shantz responded that the tracking error went from 114 in February to 256 by the end of April. He said the two large contributors were correlations and volatility spikes. He added that the daily marked assets did not increase dramatically. He suggested that no changes be made, since the risk budget does a good job of reflecting how much risk should be taken. He stated he just wanted to make sure the Board and IAC were aware of this violation.

Mr. Hille said that he would like to get peer data reported in order to see a clearer picture of how the Fund is doing. Mr. Tull said that ERS has considered this and would evaluate again to determine if there are comparable peer universes to use to give the Board and the IAC more context.

Mr. Austin said that the peer comparison data does not come in time to go into the Board presentation, but he refers to it verbally in the Board meeting. He added that the ERS portfolio is designed to protect better on the downside, which is reflected in the risk adjusted numbers, and to participate, but not as strongly, on the upside. He added that over the three years ended December 31, 2020, the ERS portfolio annualized return of 7.36% ranked in the 54 percentile among the peer universe of public funds greater than $1 billion dollars. Over the five years through Calendar Year-end 2020, the ERS annualized return of 8.4% ranked in the 60th percentile versus the peer universe.

Mr. Mindell asked if the portfolio had a similar tracking error in 2008 based on the volatility of the market at that time. Mr. Shantz responded that this is the first time since he has been at ERS that these assets have had a tracking error.

Mr. Tull added that he would have assumed that during the Great Financial Crisis (GFC) there would have been more issues, but he reiterated that the Fixed Income Portfolio was different then. The portfolio in 2008 was more risk averse and liquid, and had very little in terms of credit or externals.

Mr. Alley commented that this is an ongoing issue with delayed marks for different parts of the portfolio and there sometimes has to be an understanding of what the impact of the delayed pricing marks has on tracking error.

Dr. Kee asked if this issue pertains to all private investments. Mr. Shantz stated that all private portfolios would have this issue, and that the Trust has increased its allocation to them, but in this particular situation the actual amount of risk taken had not dramatically increased. He stated that the expected tracking error has never exceeded the risk limit. He explained that the only thing management can do is take the risk down to flat, but even that might not be sufficient to end the violation, and the Trust would have missed the large excess returns it was experiencing. The cause of the violation has already occurred and cannot be changed. In 2023 the measured tracking error will step back down. Mr. Tull said the team will continue to keep the Board updated on the issue.

Mr. Chujoy discussed some of the headwinds of the quarter which were a resurgence of COVID-19, uncertainties regarding the US election, concerns regarding the market, high correlation, inflation and speculative bubbles.

Some major tailwinds of the quarter were the announcement of public availability of COVID-19 vaccines, broadening in asset participation, global PMI's on the rise, a memorandum of understanding between the United Kingdom and Europe, and an additional federal stimulus relief package.

He discussed the market performance of the fourth quarter stating that many sectors benefited from the stay at home policy put in place to combat COVID-19. He stated that the sectors that delivered the best returns in 2020 were Technology, Discretionary, and Communication Services. The risk-on environment saw the fourth quarter post some of the strongest returns in recent times. The much reduced level of economic activity negatively impacted sectors like Energy and Oil the most.

Mr. Chujoy stated that certain sectors, such as Office and Residential, which had lagged throughout the year, posted their strongest returns in the year during the fourth quarter. A rotation away from large cap stocks to small cap stocks occurred. He added that a decrease in uncertainty regarding the state of the domestic economy and a memorandum of understanding between the United Kingdom and Europe helped to lift investor sentiment around the globe.

Mr. Chujoy showed a heat map of Global Stress Financial Indicators that clearly showed how different the market was between the end of the third quarter and the fourth quarter. The stress indicators subsided a great deal as the market uncertainties receded during the quarter and fund flows came back fueling the risk-on environment.

Mr. Chujoy stated that the RMAR team shares information with the investments team at the monthly Risk Committee meetings and suggests potential plans of action. He stated he wanted to ensure the Board that the risk team was thinking of these risks and strategies to help lower the impact of risk.

Mr. Mindell asked if the investment team is prepared to combat inflationary risks Mr. Tull responded that the Investment Team is thinking about these risks on an ongoing basis. Mr. Chujoy added that the risk team continues to provide portfolio strategies.

Mr. Greenfield, a retired member of ERS, provided public comment critical of ERS' investment strategy and performance. He suggested that ERS use commercially available funds to save on expenses and improve Trust returns.

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

14. *Review, Discussion and Consideration of Real Estate– (ACTION)

Robert Sessa, ERS Director of Real Estate, and Simon Mok, Real Estate Portfolio Manager presented the Market Update and Portfolio Overview on the Real Estate Program.

Mr. Sessa stated that the Real Estate Program is a combination of two real estate sub-groups. Private Real Estate makes up 9% of the Fund and Global Real Estate Listed Securities (REIT) make up 3% of the Fund. The overall real estate target is currently underweight at 10.7% of the total Fund.

Mr. Sessa noted that a new Investment Analyst, Sryias Pande, is now part of the Real Estate Team. He stated that many ERS staff contribute to the success of the portfolio including staff in the Office of the General Counsel, investment operations, and the administrative teams.

The REIT Portfolio was $903 million dollars as of December 31, 2020. He said that 52% of the portfolio is US based and 48% is based in developed international markets, with Asia making up 25% of international. Mr. Sessa stated that the portfolio is underweight in the US and United Kingdom.

Since inception, the REIT portfolio has outperformed its benchmark by 75 basis points annually. For the calendar year ended December 31, the REIT Portfolio outperformed its benchmark by 179 basis points. The outperformance was driven by stock selection in the US and Australia. The five year annualized outperformance is about 43 basis points, led by Australia and Japan with strong stock selection.

Mr. Sessa then shifted to Private Real Estate and highlighted a few high level statistics. He commented that the staff feels good about the overall leverage levels being just over 50%, compared to the policy limit of 65%, and that the Portfolio is in line with all other policy guidelines.

Mr. Sessa then went over the core/non-core allocation versus the target allocation as of December 31, 2020.

Mr. Sessa then discussed the geographic weights based on the Private Real Estate portfolio's' NAV (Net Asset Value) as of September 30, 2020. The portfolio is overweight with the US representing 77% of the exposure with a target rate of 70%. He went on to say that international is tilted towards Asia making up 16% of the total international exposure. He added that Asia has potential to grow as the team sees better relative value in that area.

Mr. Sessa went over the impact of the pandemic on real estate. He stated that the Hotel and Retail sectors were negatively affected, but that rental collections are increasing. Even though the economy is improving, office demand could decrease 5% to 15% due to changes in work lifestyles. He stated that the team is not sure if it will be cyclical or a longer term trend. He went on to discuss acceleration of existing trends resulting from the COVID-19 pandemic, such as e-commerce, supply chain reconfiguration, cloud computing, and the exodus from coastal cities. Mr. Sessa discussed being concerned about the effect of increasing government intervention on the real estate sector, such as mandated affordable housing, rent holidays, or impositions of rent controls. The team is monitoring global monetary and fiscal response's short and long-term impacts and the inflation it may create. Mr. Sessa commented that Real Estate has typically benefited from inflation.

Mr. Sessa went over Fiscal Year 2020 accomplishments, stating that both the REIT and Private Real Estate portfolios had outperformed their benchmarks for the 1, 3, and 5 year periods. The team continues to underwrite new deals and monitor the portfolio while working remotely. Staff has negotiated an estimated $150 million in savings and non-economic terms to improve corporate governance for the overall portfolio since inception. He ended the accomplishments by stating that the portfolio complies with all real estate guidelines.

In Fiscal Year 2021, the staff will continue to evaluate how the pandemic has affected people's behavior and analyze repositioning the private real estate portfolio. The team is targeting $350 million in commitments with a range of $300 million to $700 million and three to eight new commitments.

Mr. Sessa said that he wants to amend the Fiscal Year 2021 Tactical Plan. He stated that it serves to guide investing and is created with the asset class consultant. The original Fiscal Year 2021 Tactical Plan was completed in late March/early April 2020 at the depths of the market decline. He explained that the original plan, in hindsight, was too conservative in projections given the stock market's quick and strong rebound. The weighting of private real estate at that time was 8.9% with a target allocation of 9%. As of December 31, 2020 it was 7.8%, and with more clarity, the team is asking for more allocation to the FY 21 Tactical Plan to give more flexibility to reach the 9% target weight.

Ms. Cooley asked how the team has changed their expected risk return from the last proposal. Mr. Sessa said that the projected return has not increased, but because the value of the overall Trust has increased dramatically, the real estate weights have declined from 8.9% to 7.8%.

In response to a question from Mr. Hille, Mr. Sessa reported that unfunded commitments are approximately $1.4 billion, and typically 80-90% of that capital will be called.

Mr. Hille if the Private Equity commitment level is taken into account when the Real Estate tactical plan is adjusted. Mr. Sessa responded that Private Equity has slowed down their portfolios commitments.

Mr. Tull added that the teams are always monitoring and managing all the asset classes. He stated that the Private Equity Team has cut back on deal size and is doing more co-invests, and seeking secondary deals (selling in the secondary market).

Ms. Dotter commented that the allocation to cash does not actually sit in the Real Estate Portfolio and is an under allocated component. She suggested that the funding could come from that source.

Mr. Sessa stated that it would be a combination of money returned from existing deals and the trimming of the overweight in the Public Real Estate Portfolio. He added that it would be a moving target.

Mr. Mok presented the Proposed Fiscal Year Tactical Plan for 2022. Mr. Mok stated that the Team's commitments for FY22 is $350 million, with a range of $300 million to $700 million, but that it could be smaller or larger depending on the opportunities, and the team is targeting 50/50 in core and non-core investments, totaling $150 million.

Mr. Mok discussed that the new term strategy for the Real Estate Team is to continue to understand the post pandemic world and capitalize on new potential opportunities as they arise from market dislocations.

He went on to say that the team will focus on niche fund types to diversify the portfolio (with sectors like Life Science, Self-Storage, Manufactured Housing and Debt Funds). Mr. Mok stated the team will explore long term holds for selective investments in core investments to gain stable income and go into selective international investments with the focus being Asia and possibly the UK.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas Approve the amended proposed Real Estate Program Annual Tactical Plan for Fiscal Year 2021 and the proposed Real Estate Program Annual Tactical Plan for Fiscal Year 2022.

Motion by Ken Mindell, second by Gene Needles
Final Resolution: Motion Carries
Aye: Robert Alley, Gene Needles, Caroline Cooley, Laurie Dotter, James R. Hille, Milton Hixson, Ken Mindell

The Board of Trustees then took the following action:

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas Approve the amended proposed Real Estate Program Annual Tactical Plan for Fiscal Year 2021 and the proposed Real Estate Program Annual Tactical Plan for Fiscal Year 2022.

Motion by Catherine Melvin, second by Brian Barth
Final Resolution: Motion Carries
Aye: Craig Hester, Brian Barth, Ilesa Daniels, Jim Kee, Catherine Melvin

There were no questions or further discussion on this item.

15. *Opportunistic Credit Program - Market Update and Consideration of Proposed Opportunistic Credit Annual Tactical Plan for Fiscal Year 2022 – (ACTION)

Mr. Nicholas Maffeo, ERS Hedge Funds Portfolio Manager, Mr. Panayiotis Lambropoulos, ERS Hedge Funds Portfolio Manager, and Mr. John Claisse, Mr. Tom Cawkwell, Mr. James Kokoza, Albourne Partners, presented the Market Update and Proposed Opportunistic Credit Annual Tactical Plan for Fiscal Year 2022.

Mr. Maffeo provided an overview of the Opportunistic Credit Program noting that the purpose of the portfolio is to capture opportunities that do not fit naturally within other asset classes. The portfolio is designed to take advantage of various forms of illiquidity premium across private credit. The strategies include private lending, distressed, structured product, and real assets. The primary focus is on yield-seeking credit-oriented investments. The long-term target weight for the portfolio is 3%.

Mr. Maffeo noted that the allocation allows ERS to generate unique sources of return within the credit markets. He added that the portfolio includes a diverse spectrum of strategies, which can span across traditional asset classes such as income producing, asset backed, and distressed.

Mr. Maffeo explained the investment approach is a non-traditional portfolio construction mandate. The team will only consider compelling opportunities relative to current Trust investments. There are no minimum exposure ranges, therefore the team is not forced to allocate capital allowing ERS to invest in an opportunistic fashion. He noted that the preference is for committed capital structures where capital will be drawn over a period of time. The team believes it is a more efficient use of capital and can mitigate risks such as a drag in fees or the j-curve effect. Certain strategies may also provide consistent cash distributions throughout the life of the investment, effectively de-risking the initial investment with the manager.

Mr. Maffeo discussed the investment focus, noting that on an aggregate basis the portfolio would target returns of at least 6.5% on a net basis. He noted that the management fees will generally be paid on invested capital. To protect from downside risk the team will look at structures that are self-liquidating, senior secured strategies with consistent cash flow, and deals with both covenants and collateral.

Mr. Maffeo said that the team will incorporate a core satellite approach to portfolio construction. The team will initially focus on a multi strategy manager that will serve as a core anchor position within the portfolio with tactical flexibility to invest across different credit strategies. They will also look to niche strategies to serve as satellite smaller positions within the portfolio. These opportunities may be due to a market dislocation or to a manager’s investment focus and process. The broader portfolio will have an overweight to private lending mostly in the North American opportunities.

Dr. Kee asked what the yields for the asset class look like, compared to what it was two or three years ago, and if they are as compressed as the remainder of the fixed income universe. Mr. Maffeo responded that the yields are in the range of LIBOR+5.5% - LIBOR+6.5%.

Mr. Hester asked that if the target return for the Trust is 7%, why is the team emphasizing an asset class with an expected return of only 6.5% net. Mr. Maffeo responded that he believes the 6.5% benchmark came from a reflective benchmark for the Opportunistic Credit Program, which is the S&P Leveraged Loans Index plus an appropriate spread. This spread was determined to be +150 basis points.

Ms. Dotter asked if the 6.5% rate is what the team hopes to achieve and how long the portfolio could stay invested below the 7%. Mr. Maffeo stated that the 6.5% is more of a minimum threshold to do business with ERS. In the case of the potential multi-strategy allocation, 6.5% is set as the hurdle rate, so the potential manager needs to earn that before any performance fee is paid. He added that the team is expecting higher returns than 6.5% and that the Trust’s actuarial rate of return is a good guideline for ERS to use.

Ms. Cooley asked if the team, depending on the structure and where the team is in the spectrum of opportunistic credit managers, is leveraging their portfolios in order to turn the 6.5% return to 10%, and if the team is expecting to use leverage in the program as currently contemplated.

Mr. Maffeo responded that it can vary by strategy. In the case of the proposed multi-strategy, the team is expecting a half of turn of leverage to be used. However, other strategies could use higher amounts of leverage, although the team would be hesitant with those deals using higher leverage. He highlighted that this portfolio is opportunistic in a sense it is not forced to allocate if the team is not seeing what is expected on the return side.

Mr. Hester stated that he believes this will require a great deal of due diligence with the current environment, where credit spreads have compressed even more after the first part of 2020. He added that the monetary and fiscal programs implemented from the federal government have covered a bit of risk.

Mr. Maffeo stated that the team has been very selective and has had conversations with private equity companies to see how the current proposed multi-strategy manager operates. He added that the team is definitely trying to be diligent with the selection of managers.

Mr. Tull added that in 2019 the team was looking at rates of 6%-8%. As a result of the pandemic the expectation was lowered. He stated that he feels the team is going about it the right way to have a core base to build on as the credit side changes and that more opportunities may arise.

Mr. Alley commented that he sees the program as a credit instrument of investments and not the sole investment, but a good complement for other investments in terms of credit program and investment analysis.

Mr. Claisse, from Albourne, explained that the Albourne team has advised investors on private credit mandates for almost 20 years. He said that although there are attractive opportunities, there are associated risks and there is a vertical range of attributes across the opportunistic space. He briefly went over some of the sub strategies and explained that they offer many opportunities of flexibility and protection.

Mr. Cawkwell highlighted the outlook of the strategies and the economic cycle. He stated that credit valuations have recovered significantly from the depths of the COVID-19 pandemic, resulting from monetary and fiscal stimulus. Liquidity has improved materially, helping to alleviate price stress. With the recovery in valuations and liquidity conditions, the level of systematic risk has also moderated. He stated that interest rates are marginally rising, but central banks' rate policies and bond purchases have served to allay default risk.

Mr. Cawkwell stated that Asian markets continue to offer the most compelling opportunities across the lending and distressed categories. In contrast to Asia, European distressed credit opportunities remain muted, and marked by anemic levels of stressed debt and continue to have low default rates.

He explained that distressed is seen as a positive area for allocation today, compared to a year ago. He went on to say that the leading opportunity is in specialty finance, and that in structured products it is more in the real estate area. Lastly he commented that it is harder to provide a recommendation on real asset & esoteric credit.

Mr. Maffeo concluded that the initial target allocation expectations for the Tactical Plan for Fiscal Year 2022 will be 0-3 investments over the next 12 months equal to 1% of the Trust's allocation target ($300 million). He commented that the initial sourcing would focus on a multi asset/strategy anchor investment that could include a comingled or a "Fund of One" fund structure with the benchmark being the S&P LTSA Leveraged Loan Index + 150 basis points. He stated that the primary consultant will continue to be Albourne Partners.

Ms. Dotter asked if the team would be able to retain control of the allocation if it is a "Fund of One". She emphasized that it should be an area to invest only when there is a good opportunity. She asked if the structure with the manager would allow for that.

Mr. Maffeo responded that there is more control with these type of investments and that the hurdle rate of 6.5% will cause the proposed manager to only consider investments that exceed this return threshold.

Mr. Ally asked how the “Fund of One” will be benchmarked. Mr. Maffeo commented that the individual investments would have the benchmark of at least 6.5% net and once fully allocated it would be benchmarked against the S&P Loan Index + of 150 basis points.

The IAC then took the following action:

Motion made to move that the Investment Advisory Committee of the Employees Retirement System of Texas Approve the Opportunistic Credit Program Tactical Plan for Fiscal Year 2022.

Motion by Gene Needles, second by Ken Mindell
Final Resolution: Motion Carries
Aye: Robert G. Alley, Gene Needles, Caroline Cooley, Laurie Dotter, James Hille, Ken Mindell, Milton Hixson

The Board of Trustees then took the following action:

Motion made to move that the Board of Trustees of the Employees Retirement System of Texas Approve the Opportunistic Credit Program Tactical Plan for Fiscal Year 2022.

Motion by Brian Barth, second by Catherine Melvin
Final Resolution: Motion Carries
Aye: Craig Hester, Catherine Melvin, Brian Barth, Ilesa Daniels, James Kee

There were no questions or further discussion on this item.

16. Agency Update

Mr. Porter Wilson, ERS Executive Director, presented the Agency Update.

2021 Legislative Session – Mr. Wilson informed the Board that he has met with legislators and staff of the Senate Finance Committee and House Appropriations Committee to discuss options for returning the ERS pension plans to actuarial soundness. Staff throughout ERS are reviewing filed legislation for their impact on the programs, including any fiscal impact to the State. Staff prepared a report of bills that could have a significant impact on the agency, state employees and retirees. Staff is currently tracking and analyzing more than 150 bills. The bills list report is posted to the ERS public webpage. Anyone who is interested can sign up to receive an email update whenever ERS updates the webpage.

1836 San Jacinto Building Update – Mr. Wilson provided updates on the construction of the building. The exterior of the building is almost complete and work continues on the interior. The granite panels that were saved from the original ERS Annex building are going to be part of the feature wall in the first floor lobby of the 1836 San Jacinto building. He reported that a small ribbon-cutting event will be held outside on April 21, 2021.

2021 Get Fit Texas Challenge – The 2021 Get Fit Texas Challenge kicked off on January 11, 2021 through March 21, 2021. The challenge asks state employees to be active 30 minutes a day, five days a week for 150 minutes for 10 weeks. This year’s challenge has been extended an extra week due to the widespread snow and subsequent power disruption in February. Mr. Wilson reported that in the last three years ERS has placed first in the mid-sized agency category and intends to defend the title again this year. Results of the challenge will be presented at the May 26 Board Meeting.

Chief Investment Officer Search – Tom Tull, ERS Chief Investment Officer, has announced his plans to retire at the end of the fiscal year after nearly 12 years at ERS. ERS has enlisted the services of Korn Ferry, an international search firm to assist with the hiring process. Michael Kennedy is the senior client partner with Korn Ferry who will be working with ERS during this process. Mr. Kennedy provided the Board with information and details on the search process. The position has attracted a slate of candidates from across the US. Many candidates have expressed interest in the position based on the strong reputation of ERS and its investment program. A search committee including two Board members, two IAC members and four staff will help to narrow the field. Mr. Wilson hopes to make the final selection in early summer.

Deputy Executive Director and General Counsel Announcement – Mr. Wilson announced that Paula A. Jones, ERS Deputy Executive Director and General Counsel, announced her retirement in February after 23 years and 9 months of service at ERS. Her last day will be March 31, 2021. Mr. Wilson stated that Ms. Jones has built an exceptional team of attorneys during her time at ERS. He said that Ms. Jones has been a tremendous resource to the agency, the Board, and the Investment Advisory Committee. ERS will appoint an Interim General Counsel and conduct a search for a permanent successor. Members of the Board expressed their appreciation for Ms. Jones' wise counsel throughout her service to ERS and presented her with a resolution noting her many accomplishments on behalf of the agency, the Board, and the members and retirees. During her tenure, the legal department took on many new challenges, including staffing in order to counsel on alternative asset classes, increased federal privacy and security standards, and rigorous contracting requirements.

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

17. Reminder date for next Joint Meeting of the ERS Board of Trustees and Investment Advisory Committee, the next meeting of the Board of Trustees and the next meeting of the Audit Committee

The next meeting dates are (Wednesday) May 26, 2021, (Wednesday) August 25, 2021, and a two day workshop on (Tuesday - Wednesday) December 7 & 8, 2021.

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

18. Adjournment of the Joint Meeting of the Board of Trustees and Investment Advisory Committee

The Joint meeting of the Board of Trustees and Investment Advisory Committee adjourned at 2:52 p.m. There were no questions or discussion, and no action was required on this item.

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

19. Recess of the Board of Trustees. Following a temporary recess, the Board of Trustees will reconvene to take up the Board agenda items.

The Board of Trustees recessed until 3:05 p.m. on Wednesday, March 10, 2021.