

**AGENDA ITEM DETAILS**

**Subject:** Market Update and Program Overview

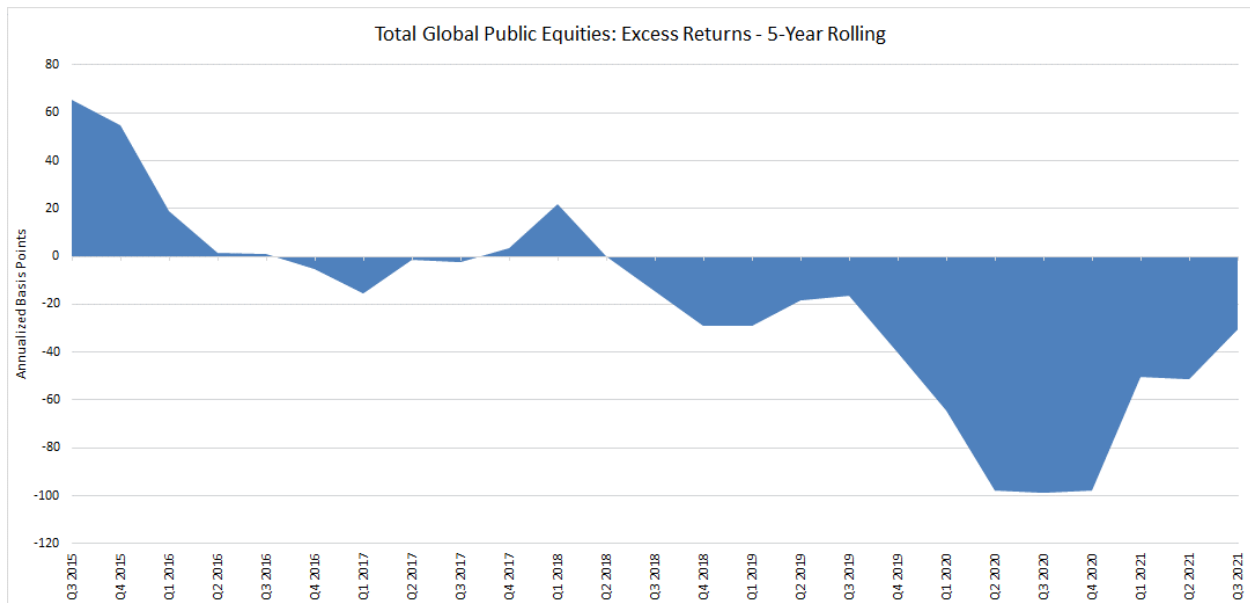
**Background:**

This agenda item will provide an annual review of the Global Public Equity Program. [There is a glossary of terms at the end of the agenda item.](#)

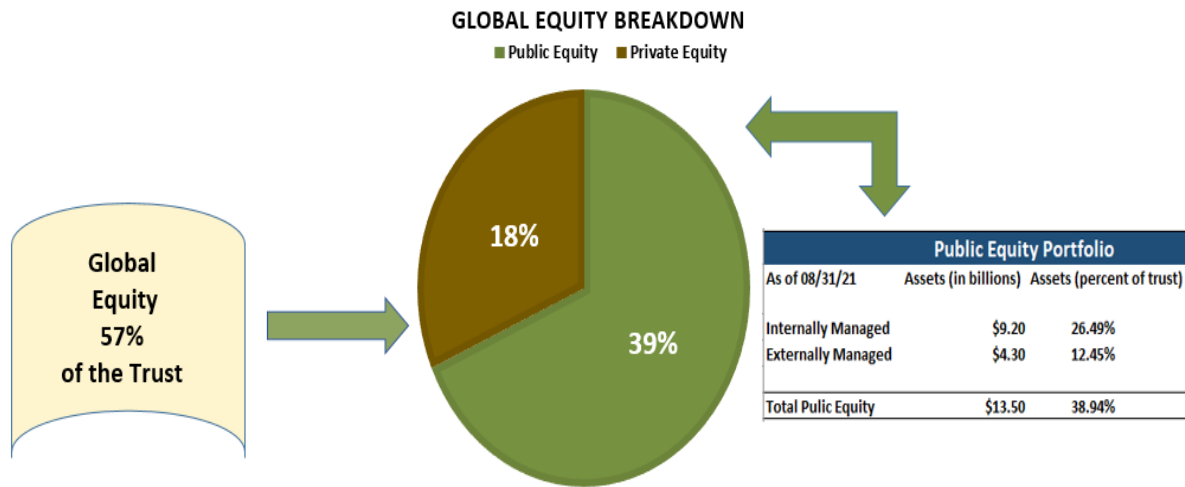
**INVESTMENT OBJECTIVE**

The investment objective for Global Public Equity is to outperform the asset class benchmark over rolling five-year periods while maintaining compliance with the active risk budget. The general investment strategy in pursuit of this objective is to combine lower risk internal portfolio strategies and higher risk external portfolio strategies to produce a stable excess return with a target tracking error of 150 basis points (bps) and an expected excess return ratio of 0.25 or better.

Over the last five years, Global Public Equity did not meet its investment objective as it trailed its asset class benchmark by 30 basis points. The chart below depicts the relative returns of the asset class over rolling five-year periods, and more details on performance will be provided in a later section.

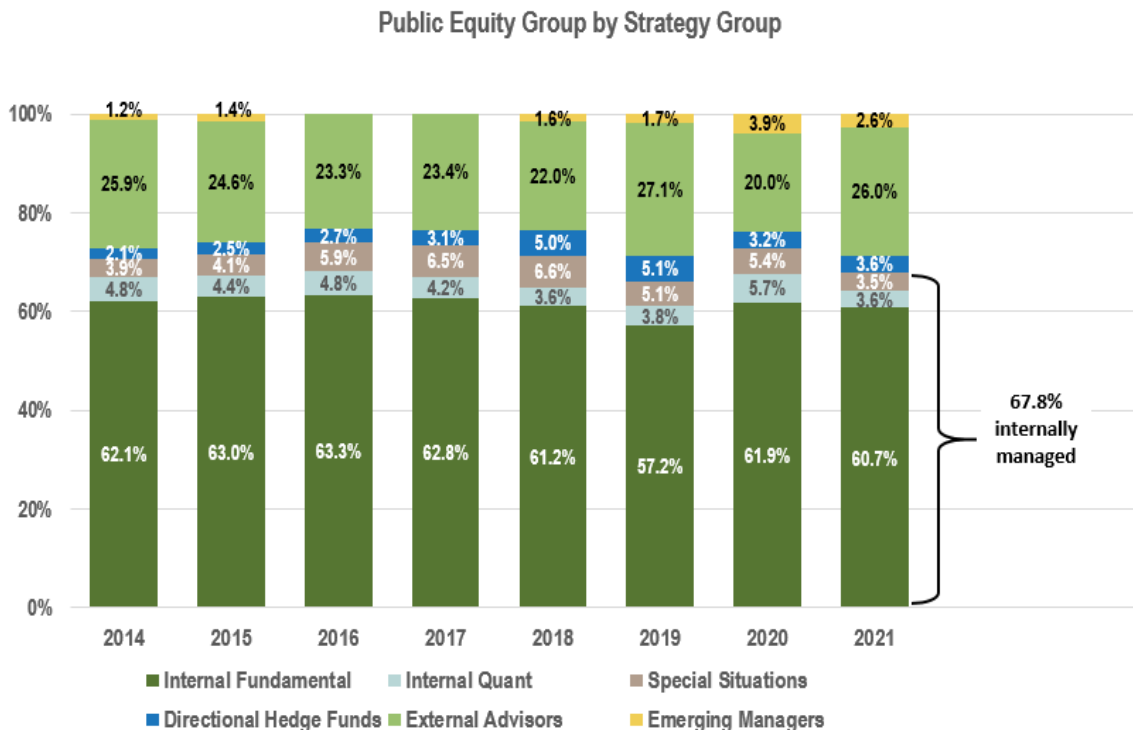


As of September 30, 2021, the Global Public Equity Composite totaled \$13.5 billion and represented 39% of the ERS Trust, as compared to a target allocation of 37%. The allocation consisted of six domestic portfolios, two international fund-of-funds portfolios, and 18 international portfolios. Global Public Equity and Private Equity together make up the Fund's allocation to Global Equity, which represents 57% of the overall Trust.



### ASSET CLASS MIX

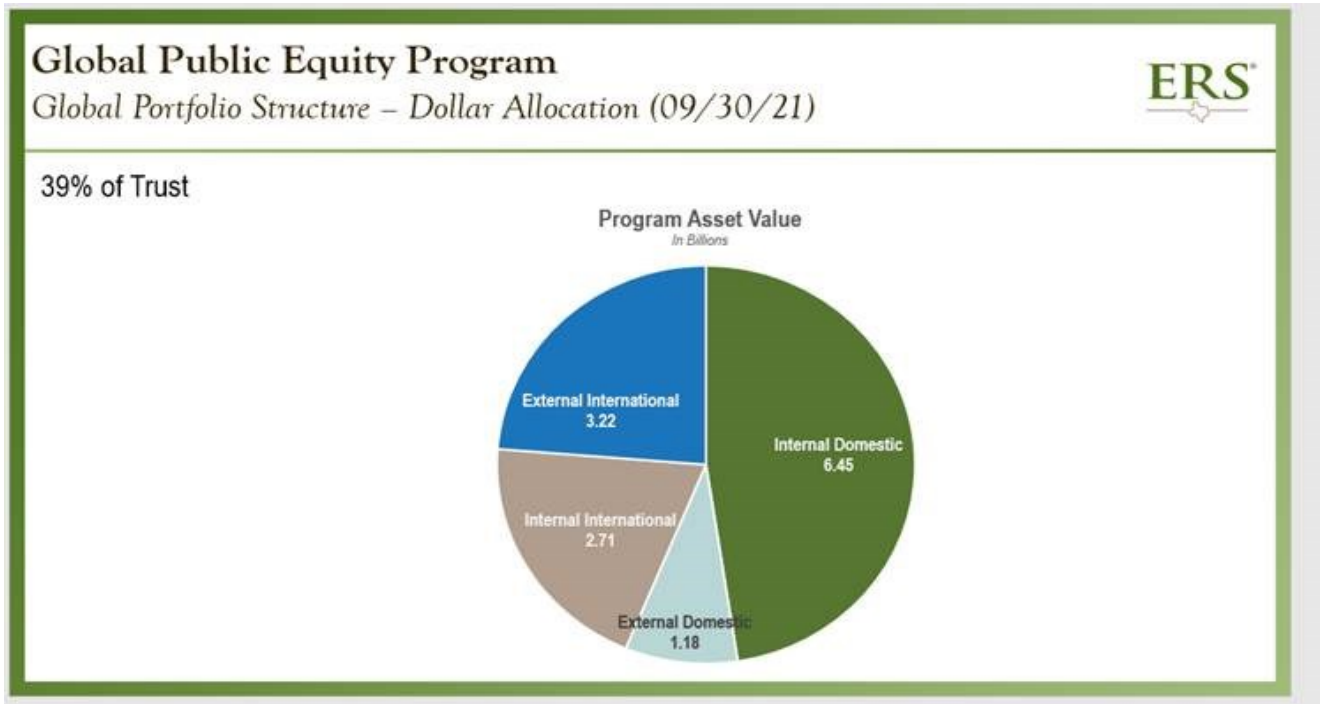
The chart below illustrates the historical breakdown between six strategy groups: (1) Internal Fundamental (2) Internal Quant (3) Internal Special Situations (4) External Advisors (5) Directional Hedge Funds and (6) Emerging Managers. The majority of the assets remain internally managed. Over the last year, the allocation to external advisors has increased as five new international advisors were added to increase the active risk of the international portion of the Asset Class.



As of September 30, 2021, \$7.63 billion of the global public equity allocation is invested in domestic public equity portfolios. This figure equates to 56.3% of the global public equity allocation, which represents an underweight to the current benchmark allocation of 58.6%.

Within domestic equities, internal portfolios comprise \$6.45 billion (85% of the domestic allocation) and external portfolios comprise \$1.18 billion (15% of the domestic allocation).

International equity portfolios comprise \$5.93 billion of the public equity allocation, which represents 43.7% of the global public equity allocation. External portfolios make up \$3.22 billion (54.3% of international equities) and internal portfolios comprise \$2.71 billion (45.7% of international equities).



## HISTORICAL PERFORMANCE

The table below displays Public Equity performance over 1-, 3-, and 5-year time periods.

Public Equity Portfolios As of 09/30/21								
	Assets (in millions)	Assets (percent of Trust)	1-Year		3-Year		5-Year	
			Return (%)	Alpha (bp)	Return (%)	Alpha (bp)	Return (%)	Alpha (bp)
<b>Domestic Equity</b>	<b>\$7,008</b>	<b>20.1</b>	<b>32.79</b>	<b>51</b>	<b>14.48</b>	<b>-179</b>	<b>16.02</b>	<b>-99</b>
Benchmark			32.23		16.79		17.02	
<b>International Equity</b>	<b>\$5,556</b>	<b>15.9</b>	<b>26.02</b>	<b>211</b>	<b>9.14</b>	<b>111</b>	<b>9.61</b>	<b>86</b>
Benchmark			23.92		8.03		8.94	
<b>Public Equity Special Situations</b>	<b>\$480</b>	<b>1.4</b>	<b>30.21</b>	<b>-47</b>	<b>10.64</b>	<b>-429</b>	<b>13.5</b>	<b>-242</b>
Benchmark			30.68		14.93		15.92	
<b>Directional Hedge Funds</b>	<b>\$521</b>	<b>1.5</b>	<b>36.39</b>	<b>775</b>	<b>15.68</b>	<b>241</b>	<b>15.71</b>	<b>277</b>
Benchmark			28.64		13.27		12.94	
<b>Total Public Equity</b>	<b>\$13,564</b>	<b>38.8</b>	<b>30.00</b>	<b>77</b>	<b>12.03</b>	<b>-68</b>	<b>13.09</b>	<b>-30</b>
Benchmark			29.23		12.71		13.39	

### 1-year performance

On a 1-year basis, the public equity asset class posted strong absolute returns and good relative performance. The asset class was up 30.00%, with relative outperformance of 77 basis points. Outperformance at the asset class level for the 1-year period was driven by:

- Strong stock selection in both domestic and international portfolios.
- A positive contribution from Directional hedge funds (Marshall Wace)

- Great performance by external advisors, which beat their composite benchmark by 438 bps.
- Good performance from Internal International Developed and U.S. Large-cap portfolios.

Headwinds to performance at the asset class level for the 1-year period came from:

- Underperformance by Internal Emerging Market and U.S. SMID cap portfolios.
- A strategic overweight to international equities and an underweight to domestic.
- A small allocation to cash in a very strong market environment.

### 3-year and 5-year performance

3-year and 5-year absolute returns were 12.03% and 13.09% respectively, which represents underperformance versus the policy benchmark of 68 basis points on a 3-year basis and by 30 basis points on a 5-year basis. Key drivers of the weak 3-year and 5-year relative performance include:

- A strategic underweight to large-cap domestic stocks, which significantly outperformed domestic SMID-cap stocks.
- Allocations to domestic value managers also negatively impacted relative performance.
- An overweight to international markets and an underweight to domestic.
- Negative stock selection within the special-situations portfolios.
- A small allocation to cash in a very strong market environment.

Positive drivers of performance included:

- Positive stock selection in international equities and directional hedge funds.
- All four internal fundamental portfolios outperforming their benchmarks.

### External and Internal Performance

The table below highlights the performance of the internal composite and external advisors on a 1-, 3-, and 5-year basis both on an absolute basis and relative to composite benchmark.

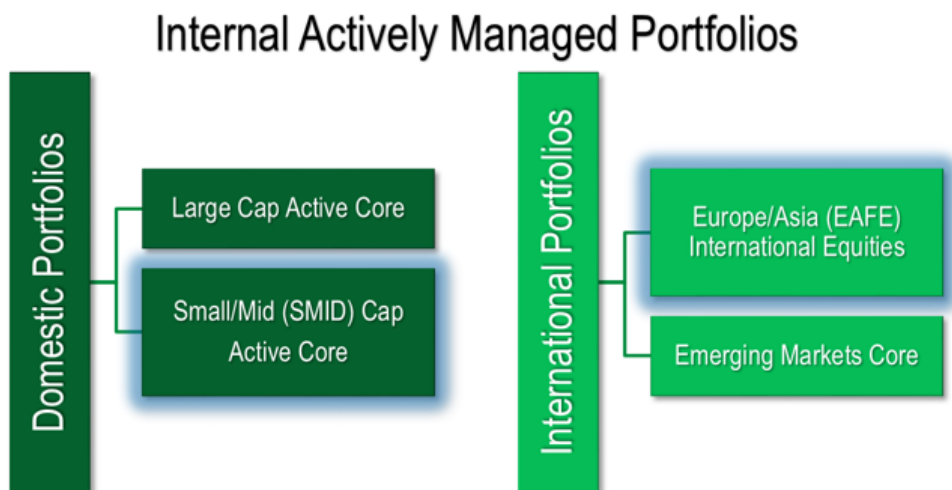
Global Public Equity									
Internal/External Returns									
	Assets	Assets	1-Year		3-year		5-Year		
	(in millions)	(percent of Trust)	Return (%)	Alpha (bp)	Return (%)	Alpha (bp)	Return (%)	Alpha (bp)	
Internal Public Equity	9155	26.2	29.45	4	12.92	0	13.93	10	
Benchmark			29.41		12.93		13.83		
External Public Equity	4409	12.6	31.92	438	10.31	50	11.31	85	
Benchmark			27.54		9.81		10.45		

The table above highlights the strong performance of our external advisors over the last year that led to positive three and five year numbers for the external advisor program. On a one-year basis, our domestic value managers as well as Blackrock and Acadian on the international side outperformed their respective benchmarks by wide margins. Over the 3- and 5-year time frames however, advisors Allianz and Templeton (both now defunded) significantly affected the performance of the external advisor program. These advisors were defunded for performance reasons and for other organizational issues.

The internal team has met or exceeded the internal composite benchmark over 1-, 3-, and 5-year periods. These internal portfolios generally carry lower risk and lower tracking error relative to our external portfolios and, as a result, the expected excess return is lower.

The substantial majority of funded portfolios (internal and external) are outperforming their individual benchmarks. As noted earlier, the primary reason for the underperformance at the asset class level on a three- and five-year basis is the underweight to U.S. Large Cap stocks and the allocation to value managers. These allocation effects were less pronounced on a one-year basis and performance was buoyed by positive stock selection, particularly among external advisors.

### Current Internal Structure

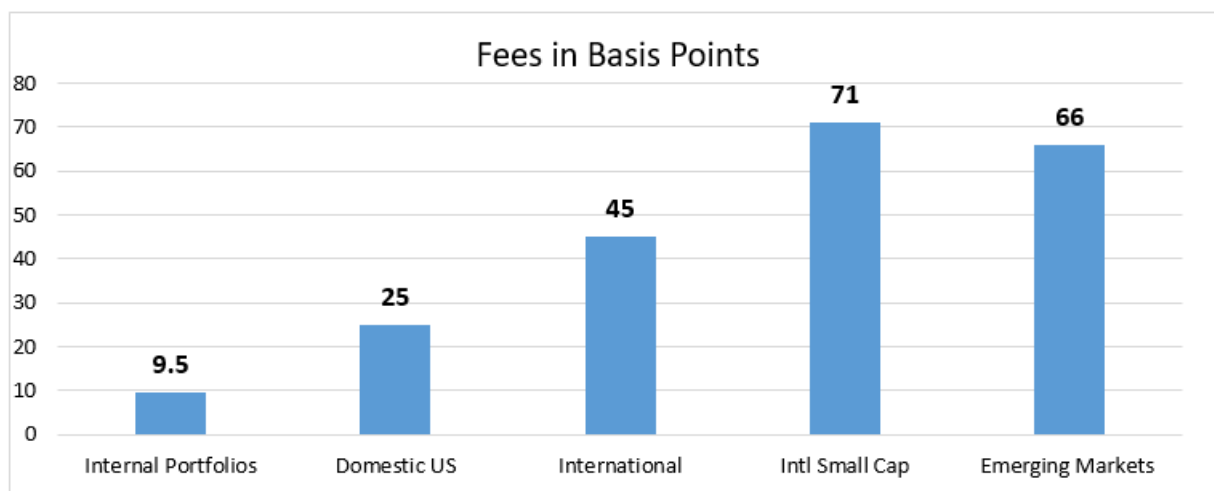


While each of the internal fundamental portfolios have a slightly different process, they all utilize quantitative tools for idea generation and risk management, but employ stock selection using a bottom-up approach, meaning that the analysts and portfolio managers perform fundamental research on individual companies and industries. The diagram below illustrates the internal Emerging Markets Portfolio process.



### MANAGEMENT FEES

The table below displays the average management fee for both the internal program and our external advisor program. Our external advisor program is separated into four portfolio types: domestic, international large cap, international small cap, and emerging markets. Unsurprisingly, our internal program is the lowest cost at 9.5 basis points. The external domestic advisor program is next lowest in terms of cost at 25 basis points. International Large Cap is 45 basis points, while International Small Cap and Emerging Markets are 71 and 66 basis points respectively.



### EXTERNAL ADVISOR PROGRAM UPDATE

The External Advisor Program seeks out external advisors that complement internal management efforts. The key consideration is whether the external advisor can add value and the goal is to work with external partners that can provide diversification benefits through increased returns and/or risk reduction. Staff looks for differentiated strategies where ERS may not have the resources and/or expertise to implement in-house. Such characteristics may include concentrated or high active share portfolio, distinctive investment philosophy/process, uniquely experienced team, and/or less efficient asset class. Appendix A contains an overview of the External Advisor Program Investment Process.

As of the end of September, the External Advisor Program was \$3.9 billion, or about 30% of Global Public Equity (see Chart in Appendix B). Allocations to individual strategies range from \$100 million to \$550 million. This allocation does not include investments that are part of the Global Public Equity Directional Growth Portfolio, which is monitored by the Hedge Fund Team. Information on this portfolio was presented during the August 2021 Joint Meeting of the Board and IAC. Currently, the External Advisor Program consists of 17 strategies that are funded (see Appendix C) and 12 strategies in the Select Pool (see Appendix D).

### External Advisor Program – Recap of Calendar Year 2021

In January 2020, ERS published a request for proposal (RFP) for International Investment Advisory Services. After investment and operational due diligence, the External Advisor Team presented twelve strategies to the Global Public Equity Asset Class Investment Committee (ACIC) in February 2021 and all were approved for the Select Pool. Staff reviewed each of the strategies within the context of the overall asset class and worked with the internal Risk Management and Applied Research (RMAR) team and NEPC to optimize allocations. The final funding decisions were made based on considerations of the manager benchmarks, manager correlations, portfolio characteristics, and overall complement to the ERS Global Public Equity portfolio.

The following five strategies were funded:

- Altrinsic Global Advisors/International Equity
- Arrowstreet Capital/International Equity – ACWI ex-US
- GQG Partners/International Equity Strategy
- J.O. Hambro Capital Management/Global Select ex-US
- Pzena Investment Management/International Value All Country (ex-US)

The team is monitoring these strategies in the Select Pool and may consider funding at a later date:

- AllianceBernstein/International Strategic Core Equity
- Arrowstreet Capital/ International Equity – ACWI ex-US Alpha Extension
- Axiom Investors/International Equity Strategy

- Neuberger Berman/International Equity
- Rondure Global Advisors/Overseas Fund
- Schroder Investment Management/International Alpha (ACWI ex-US)
- William Blair Investment Management/International Leaders

## External Advisor Program – Initiatives for Calendar Year 2022

In March 2021, ERS published an RFP for U.S. Large Cap Investment Advisory Services. The last time a search was conducted for these services was in 2010, and Staff believed it was time to refresh the Select Pool. While efficient, the sub-asset class makes up a large percentage of global public equity and adding managers to the Select Pool would allow for additional diversification and flexibility. Although other benchmarks will be accepted, the preferred benchmarks for this RFP are:

*MSCI USA Large Cap Value Index* or similar: This index includes large cap US securities exhibiting overall value style characteristics. The style characteristics for investment for index construction within value are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield.

*MSCI USA Large Cap Index* or similar: This index is designed to measure the performance of the large cap segments of the US market. With 290 constituents, the index covers approximately 70% of the free float-adjusted market capitalization in the US.

*MSCI USA Large Cap Growth Index* or similar: This index captures large cap securities exhibiting overall growth style characteristics in the US. The style characteristics for index construction within growth are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend.

Investment and operational due diligence has already begun. The External Advisor Team expects to present to the ACIC in the first quarter of 2022, with funding expected to occur thereafter.

### Funded Advisors

Firm	Strategy	Selection Date	Portfolio Inception
Acadian Assset Management	Emerging Markets	12/2/2011	11/1/2017
Altrinsic Global Advisors	International	2/10/2021	5/1/2021
Arrow street Capital	International	2/10/2021	8/1/2021
Axiom International Investors	International Small Cap Equity	12/20/2018	3/1/2019
Barrow , Hanley, Mew hinney & Strauss	Large Cap Value	12/2/2010	4/1/2011
BlackRock	International	12/2/2011	3/1/2015
Brandywine GIM	Large Cap Value	12/2/2010	4/1/2017
EAM Investors	International Small Cap	12/20/2018	3/1/2019
Global Alpha Capital Management	International Small Cap	12/20/2018	3/1/2019
GQG Partners	International	2/10/2021	6/1/2021
JO Hambro Capital Management	International	2/10/2021	7/1/2021
Kayne Anderson Rudnick	International Small Cap	12/20/2018	3/1/2019
Lazard Asset Management	International	8/23/2011	12/1/2011
Legato Capital Management	International Small Cap	5/25/2010	2/1/2017
Legato Capital Management	Emerging Markets	9/25/2019	11/1/2019
Pzena Investment Management	International	2/10/2021	5/1/2021
Quantitative Management Associates	Emerging Markets Small Cap	12/20/2018	3/1/2019

## INITIATIVES FOR 2022

The Global Public Equity Program will continue to strive toward outperforming the relative benchmark, while maintaining compliance with the ERS Investment Policy, in order to grow the Fund to the benefit of the retirees and beneficiaries of the Trust. Specific initiatives include:

**Enhance Portfolio Construction Process** – Over the last five years, portfolio allocation has detracted significantly from overall public equity performance. Staff will work closely with our external advisors, other internal groups, and the general consultant to improve the regional and factor allocation process.

**U.S. Large Cap Select Pool Buildout** – The External Advisor Team will continue to build out the select pool of external public equity advisors. The team is currently in the late stages of the solicitation process to find new advisors focused on U.S. Large Cap investments. Funding of resulting new advisory relationships is expected to occur over the next six to nine months.

**Analyze existing software tools and resources**— As fiduciaries, Staff seeks to prudently allocate our resources to software and tools that help us make informed investment decisions. Staff will be looking at our existing software and resources to determine where duplication exists and to ensure that the budget is utilized well.

**Examine Special Situations Portfolios** – These portfolios have recently delivered mixed results. Performance has been strong in the Japanese Activist portfolio while the Spinoff portfolio has underperformed its benchmark. Staff will examine ways to improve this segment of the Public Equity allocation by analyzing existing portfolios and exploring possible new ideas.

**Cultivate employee development and mentoring** – While the Public Equity team has functioned well in a work from home environment, the leadership team of the Public Equity team will encourage skill development and mentoring of new team members as we return to the office.

### **STAFF RECOMMENDATION:**

This agenda item is provided for informational and discussion purposes only. No action is required.

*\*ERS is accredited by the State Pension Review Board (PRB) as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the PRB as to the quality of our MET program. This agenda item may be considered in-house training provided by ERS to board trustees and the system administrator for purposes of fulfilling the MET program requirements. ERS is an accredited sponsor of MET for its system administrator and trustees for continuing education.*



APPENDIX

TEAM UPDATE

Four teams comprise the internal management efforts of the Global Public Equity Team. Kelley Hewell leads the U.S. Large Cap Team, Andrew Hodson leads the U.S. Small and Mid-Cap (SMID) Cap. Team. Keith Lyons leads the Developed International Team, and Tim Reynolds leads the Emerging Markets Team. The team remained stable during 2021 with no changes.

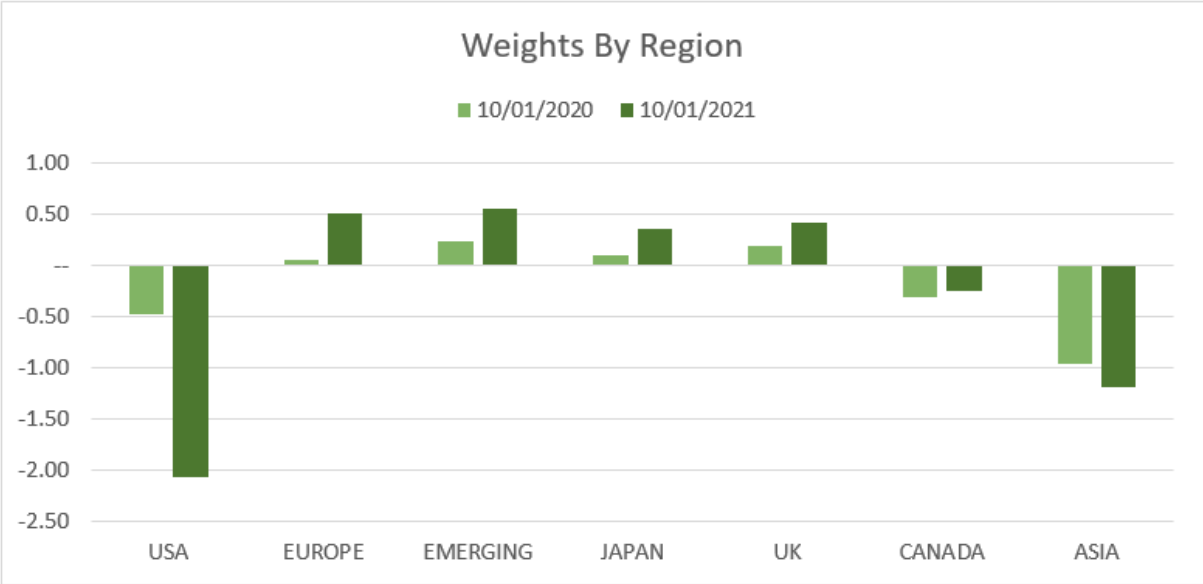
The global public equity asset class also receives assistance from the External Advisor Team. This team works to ensure that selected advisors are adding value and complementing the internal efforts of the program. Lauren Honza is the lead Portfolio Manager for the External Advisor Program.

Global Public Equity Program			ERS
Public Equity Team			
<b>Public Equity Team</b>			
Leadership: John Streun, Andrew Hodson, Tim Reynolds, Michael Clements, Lauren Honza			
<b>Domestic Portfolio Managers:</b>			
<u>Large Cap</u> Kelley Hewell, MBA, CFA (28)		<u>Small and Mid Cap</u> Andrew Hodson, MBA, CFA (19)	
<b>International Portfolio Managers:</b>			
<u>International Developed</u> Keith Lyons, MBA (17) Nancy McCarthy, MBA, CFA (13)	<u>Emerging Markets</u> Tim Reynolds, MS, CFA, CAIA (29)	<u>Canada &amp; International Value</u> Carlos Chujoy, MBA, CFA (28) John McCaffrey, MBA (6)	
<u>Quantitative</u> Carlos Chujoy, MBA, CFA (28) John McCaffrey, MBA (6)	<u>Trading</u> Michael Clements, CMT (22) Rob Newhall, CMT (20) Kyle Fenton, MBA (13)	<u>External Advisor Team</u> John Streun, MS, CFA, CPA (28) Lauren Honza, MBA, CFA (27) Michael McCrary, MBA (20) Mark Long, MBA, CFA (24) Kelley Hewell, MBA, CFA (28)	
Agenda item 16 – Joint Meeting December 9, 2020			(years of industry experience)

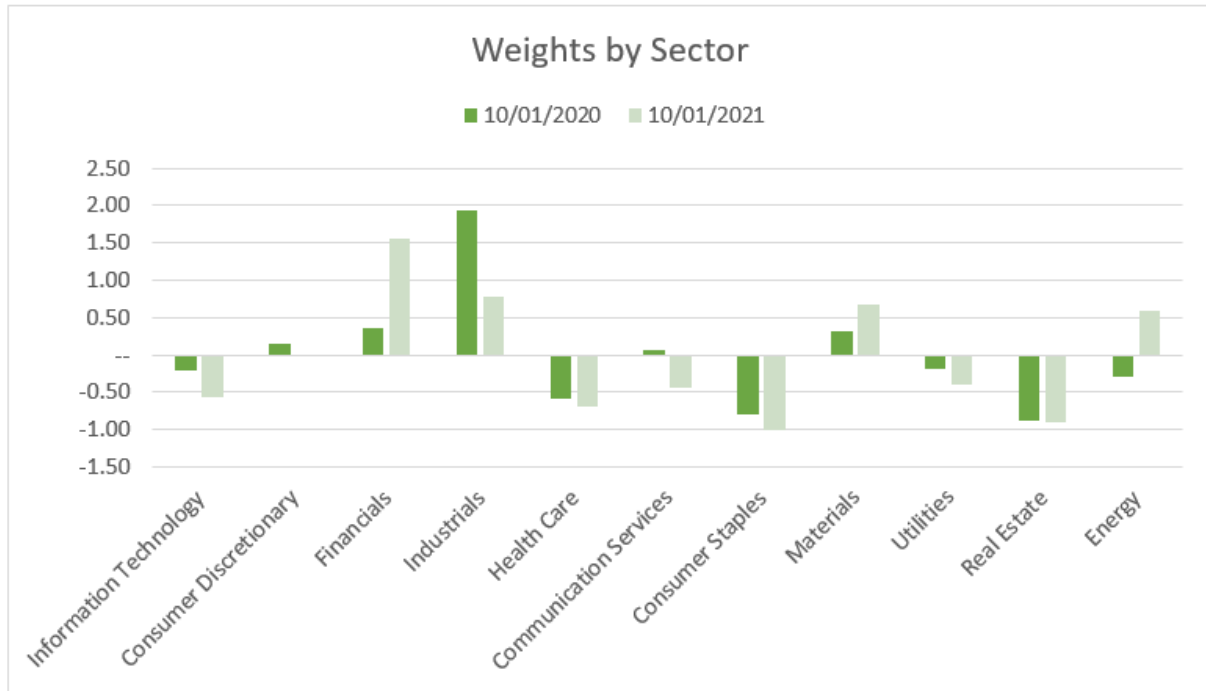
Global Public Equity Program		ERS
Public Equity Team		
<b>Public Equity Structure</b>		
<b>International</b>	<b>Domestic</b>	
<u>Emerging Markets</u> Tim Reynolds, MS, CFA, CAIA (29) John Taylor, MBA, CFA (14) June Kim (14) Ian Smith, MBA, CFA (12) Jim Gassman, MBA, CFA, (20)	<u>Large Cap</u> Kelley Hewell, MBA, CFA (28) Bob Wood, MBA, CFA (31) Michael Yuan, CFA (23) Paul Knight, CFA (19) Derek Sadowsky, CFA (22)	
<u>International Developed</u> Keith Lyons, MBA (17) Nancy McCarthy, MBA, CFA (13) Teofilo Bacungan, MBA, CFA (20) T.J. Qatato, MPA, CFA (25) Scott Schrier, CFA (10)	<u>Small and Mid Cap</u> Andrew Hodson, MBA, CFA (19) Ben Schuman, CFA (15) Jake Tisinger, CFA (12) Mark Long, MBA, CFA (24) Aris Oglesby, MBA (2)	
Agenda item 16 – Joint Meeting December 9, 2020		

ASSET CLASS EXPOSURES

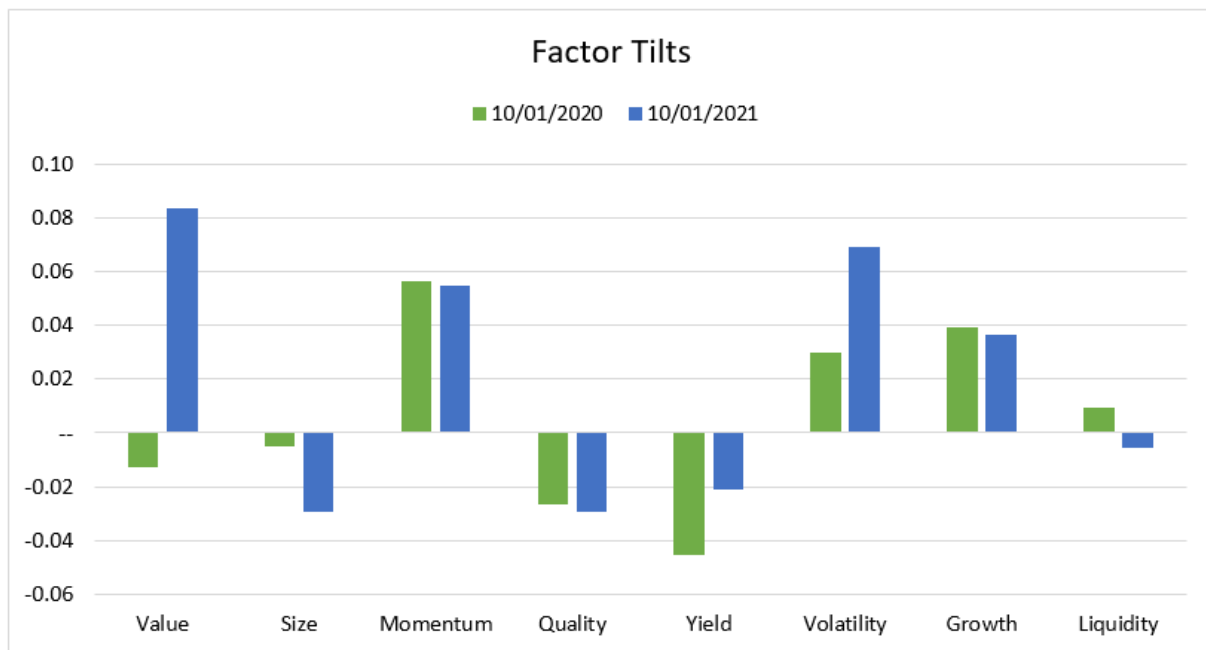
Regional Relative Weights



Relative Sector Weights



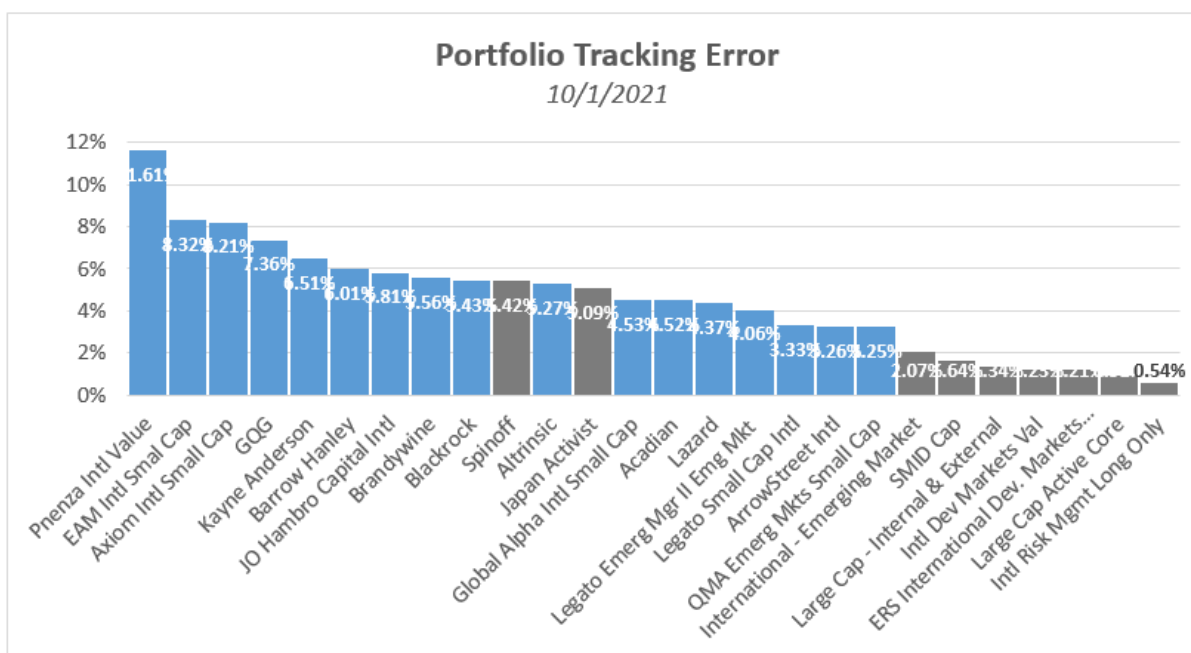
Factor Exposures



**Risk Management** – Risk management policies governing the Global Public Equity Program are detailed in the ERS Investment Policy. Risk is monitored on a daily basis through reporting to the Internal Compliance Team and at an investment level by the Risk Committee Team and the CIO. ERS uses the Barra Global Risk Model, which is considered an industry standard for forecasting risk. The model relies on extensive statistical analysis of global equity markets to forecast a range of expected outcomes relative to an underlying benchmark.

In addition to managing the relative risk of the entire Global Public Equity Program within the active risk budget outlined in Addendum I of the Investment Policy, ERS monitors the forecasted risk of various composite portfolios down to individual portfolios on a daily basis. Global public equity at an asset class level has a tracking error target of 150 basis points and a limit of 300 basis points.

The Global Equity Portfolio exhibited a forecast active risk between 66 basis points and 114 basis points, below the limit of 300.basis points.



*EXTERNAL ADVISOR SELECT POOL*

Firm	Strategy	Selection Date	Portfolio Inception
Algert Global	International Small Cap	12/20/2018	TBD
Arrow street Capital (Alpha)	International	2/10/2021	TBD
Ativo Capital Management	International Small Cap	12/20/2018	TBD
Axiom International Investors	International	2/10/2021	TBD
Fisher Investments*	International	1/24/2006	TBD
Neuberger Berman	International	2/10/2021	TBD
Rondure Global Advisors	International	2/10/2021	TBD
Schroders	International	2/10/2021	TBD
Strategic Global Advisors	International Small Cap Equity	12/20/2018	TBD
Templeton**	International	11/19/2002	TBD
TimesSquare Capital Management	International Small Cap	12/20/2018	TBD
William Blair	International	2/10/2021	TBD

*EXTERNAL ADVISOR INVESTMENT PROCESS*

The investment process for the Global Public Equity External Advisor Program is managed by the External Advisor Team in coordination with the internal Global Public Equity Team. The process requires collaboration among staff and is supported by ERS' external consultants. The multifaceted approach is comprised of five phases: research, select, implement, monitor, and rebalance.



In the research phase, ERS takes a comprehensive approach to understand how external management can best support the needs of the global public equity asset class. Members of the External Advisor Team research strategies that might complement internal portfolios. Once a strategy has been identified that could add value, staff researches managers in that particular strategy. ERS sources managers through the ERS External Advisor Website and eVestment, a third party investment manager database and recognized industry source for manager research. The general investment consultant also provides information on strategies and managers that might be of interest. In addition, the External Advisor Team

and other staff attend conferences and manager meetings to discover new investment strategies and managers.

The select phase is a four-step process that begins with a formalized search and culminates in the placement of managers into the Select Pool. This process is designed to provide transparency into the external advisor selection and is a critical aspect of the investment process. The process permits staff to be tactical with external management by allowing various external advisors' portfolios to be funded and defunded, as needed, in conjunction with staff's ongoing monitoring of the Select Pool.

The select pool was first introduced at the Joint Meeting of the Board and IAC on November 19, 2009 and has since been presented and reviewed annually at the Joint Meetings. An important milestone for the select pool process was February 26, 2013 when it was formalized by the Board and IAC in the ERS Investment Policy. The formalization of the select pool established a clear methodology regarding the selection of external advisors, and allowed for the internal selection of the select pool by an Asset Class Investment Committee (ACIC). The ACIC includes the Executive Director, the Chief Investment Officer (CIO), one IAC member, and a senior member of ERS Investments staff. By focusing manager selection at the staff level, the ERS Investment Program provides a better alignment of the Board and IAC roles relative to staff.

The steps of the select phase are as follows:

**Search** – Staff initiates a search when there is a strategy need by reviewing firms and requesting submission of Request for Proposals (RFP) and Due Diligence Questionnaires (DDQs) by firms that can address the specific strategy need.

**Due Diligence** – Staff conducts a multi-staged investment operational due diligence process during the selection phase and presents recommendations to the ACIC.

**Approval** – Based on Investments staff recommendations, the ACIC then grants approval for firms to be placed in the select pool. Once a firm has been placed in the select pool, Investment's staff work with the Office of the General Counsel to finalize contracts.

**Monitor** – The select pool is continuously monitored. Under direction of the CIO, staff revisits whether external advisors in the select pool are meeting the needs of the Trust, or if other firms need to be considered for the select pool by conducting new searches. The select pool is refreshed for unfunded external advisors on an as needed basis, targeting no less than three years from selection.

During the implementation phase, staff constructs an optimized portfolio consisting of both external and internal strategies. The funding decisions are based on staff recommendations and authorized by the CIO, in consultation with the Executive Director, pursuant to the ERS Investment Policy.

Staff then begin ongoing monitoring of funded external advisors on a daily, monthly, quarterly, semi-annual, and annual basis. This includes both investment and operational monitoring. Details on individual external advisors are included in the quarterly reports provided to the Board and IAC.

During 2020 and 2021, the team enhanced the monitoring phase. A *Manager Scorecard* was developed to rate each strategy, both those funded and in the Select Pool. The plan is to review the ratings on an annual basis, although a structural or significant change at the firm/strategy, such as a change in ownership or on the investment team, can lead to an immediate review. The team also developed two questionnaires for funded managers to complete on a quarterly basis. The *ERS Monitoring Questionnaire* is used to address changes to the firm, investment team, or investment strategy and identify operational or compliance issues. The *ERS Portfolio Review Questionnaire* is used to address portfolio performance, positioning, and outlook. This questionnaire provides staff a better idea of the thinking behind portfolio changes.

In addition, ERS recently contracted with a new firm, Analytics, to identify the investment skills of select pool participants by analyzing the individual decisions in the investment process to see what is successful and what is not. The four main areas evaluated include the research process; sizing of positions; rebalancing; and investment horizon. The Analytics service includes evaluating the performance of external advisors and preparing questions to facilitate discussions regarding investment decisions.

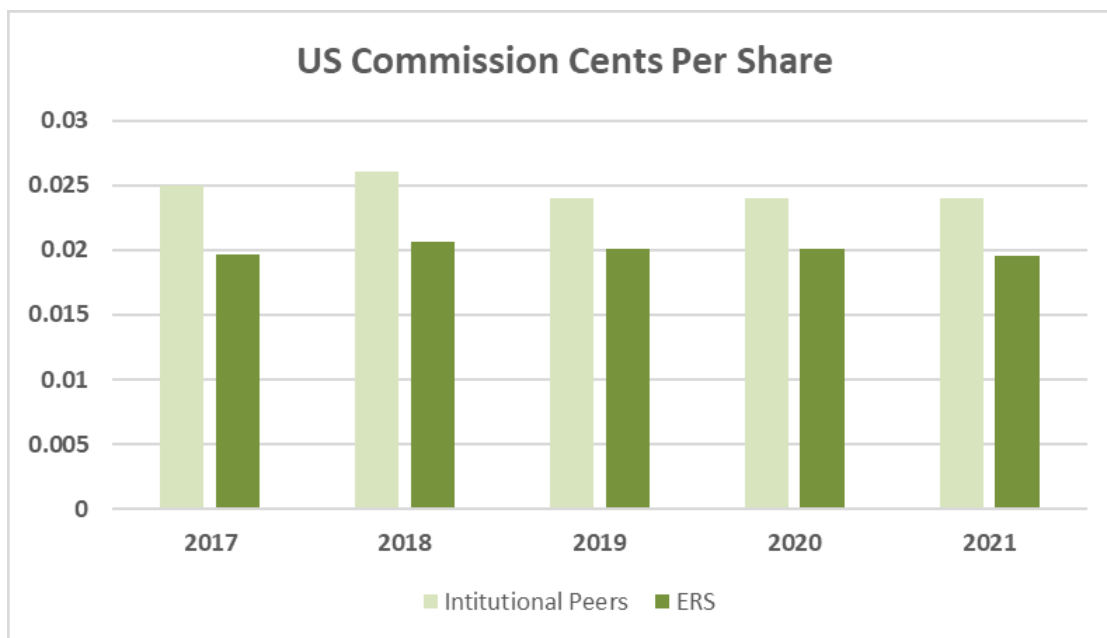
Finally, in the rebalancing phase the External Advisor Team, in consultation with the Global Public Equity Team, reviews portfolio construction and the internal/external mix and rebalances as needed to maintain progress toward overall investment goals.

*TRADING UPDATE*

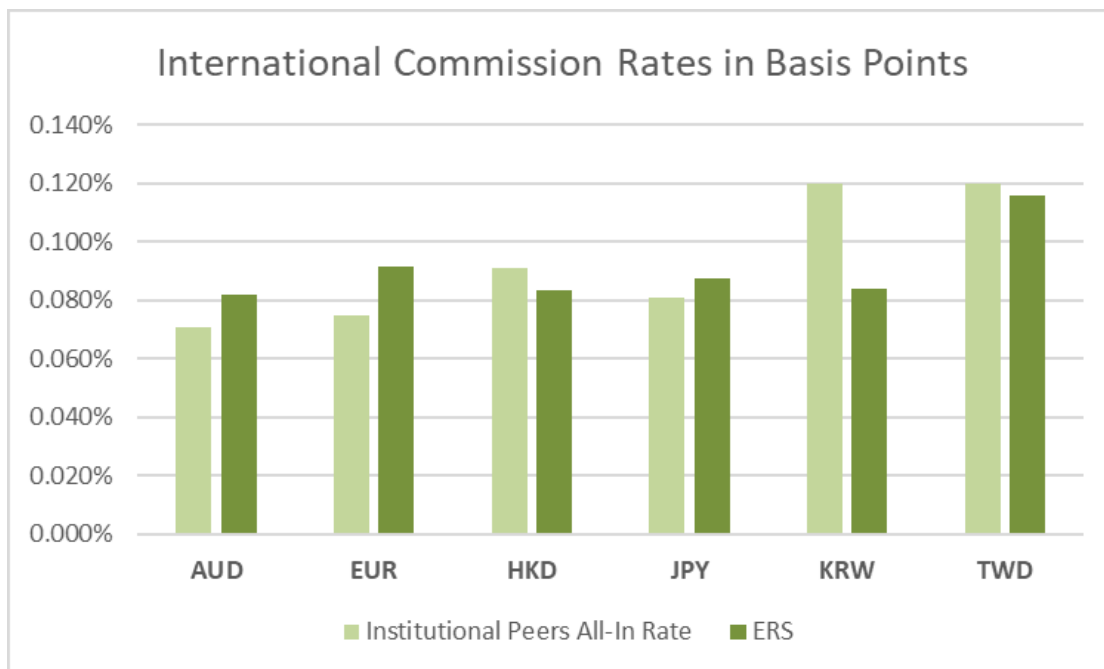
The ERS trading desk staff executed \$15.2 billion in principal value with 46% from domestic portfolios and 54% from international. The year over year commissions for 12 months ending September 30, 2021, with the prior 12 months.



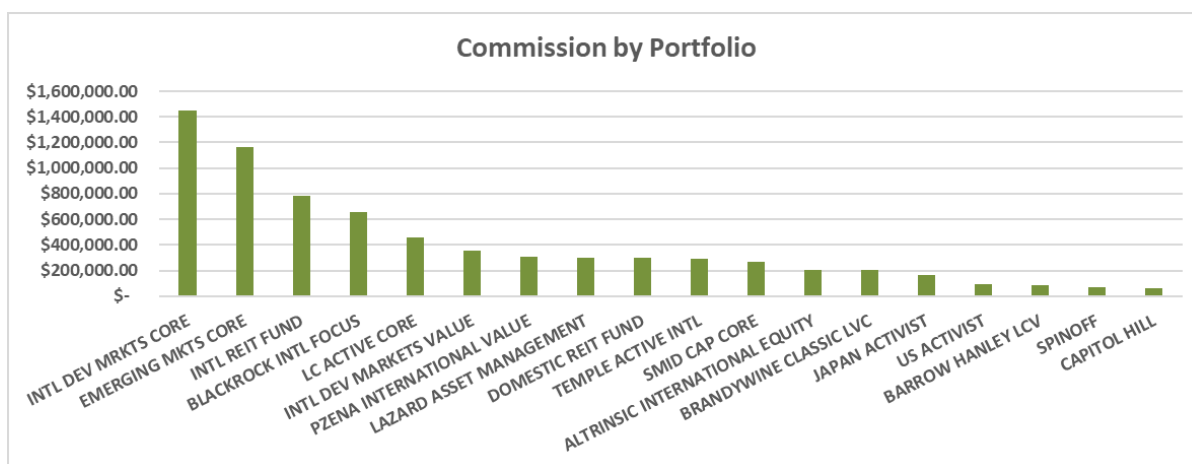
The average “all-in” blended commission rate paid by U.S. institutions to brokers on domestic shares was 2.4 cents-per-share. This average rate takes into account commissions on single-stock, program, and direct-market-access electronic trades. ERS’ average US equity commission rate was 1.96 cents-per-share. ERS’ bundled rate remains competitive against institutional peer’s all-in blended rates.



ERS' bundled rate remains competitive against institutional peer's all-in blended rates. ERS pays marginally more than the institutional peer universe in a few markets, but this is necessary to receive research from boutique research providers.



The chart below shows commissions by internally traded portfolios that had over \$50k in commission for the 12-month period ending September 30, 2021. The international portfolios continue to pay out more from the continued phenomena that US companies have not participating in stock splits as their stock increases in value. This continues to exacerbate the fact that it can be more expensive to trade in international markets that pay commission in basis points on the value of the stock versus US markets that pay commission in a fixed cents per shares regardless of the price of the stock.



### ERS Proxy Voting Policy

The Investment Policy Statement notes that the right to vote proxies for securities held has economic value, and the fiduciary act of managing ERS holdings includes the management of the voting rights appurtenant to those securities. In voting proxies, ERS shall consider only those factors that relate to the economic value of ERS' investment and cast votes in accordance with ERS' economic best interest (Please see \* in the glossary at the end of the document).



ERS Investment staff maintains and annually reviews the ERS Proxy Voting guidelines, effective February 22, 2011, which are detailed instructions based upon the ERS Proxy Voting Policy. These guidelines have been developed by Staff to vote proxies consistent with fiduciary duty.

ERS' voting policy and guidelines are organized by the following subgroups:

**1. Routine/Miscellaneous**

Routine and miscellaneous items concern company standard operating procedures including, but not limited to, the following: routine bylaw amendments; changes to the company name; changes in the date, time and location of the annual meeting; auditor ratification; adjournment of the meeting; and "other business."

Operational issues proposed by management will be supported unless ERS' review of proposals reveals attempts to limit shareholder rights, increase takeover protections or reduce shareholder value. Auditor independence from client firms is essential to achieve an objective and impartial review of financial statements. Independence of other professional service providers, such as actuaries and law firms, is also essential to companies receiving objective and impartial service and advice. Proposals to indemnify or limit the liability of auditors or other similar service providers will be opposed. Proposals to limit non-audit services will be supported.

**2. Board of Directors**

The composition and structure of the board of directors of a public company have a direct impact on its effectiveness. Votes on the composition of the board, including director nominees and slates of directors, will be evaluated on a case-by-case basis considering the following important elements of an effective board:

- A. *Board Accountability:* The board should be accountable to shareholders. Policies that promote accountability include transparency of governance practices, annual board elections, shareholder ability to remove problematic directors and shareholder vote on takeover defenses and other charter/bylaw amendments.
- B. *Board Responsiveness:* The board should be responsive to shareholders, particularly concerning shareholder proposals that receive a majority vote and to tender offers where a majority of shares are tendered.
- C. *Director Independence:* The board should be independent from management and should be, therefore, willing and able to effectively set company strategy and scrutinize performance and executive compensation. The audit, compensation and nominating/corporate governance committees should be composed entirely of independent directors.
- D. *Director Competence:* Directors should have specific skills or expertise that add value to the board and should devote sufficient time and resources to oversight of the company. Directors who are unable to attend board and committee meetings or who are overextended (i.e., serving on too many boards) raise concern on their ability to effectively serve shareholder interest. Arbitrary limits such as age or term limits may not be effective measures of director performance.

Votes on management and shareholder proposals regarding board structure will be cast to promote board accountability, responsiveness to shareholders, board independence and director competence.

**3. Shareholder Rights and Defenses**

Shareholder rights and defense items pertain to anti-takeover devices and the proxy voting process.

The majority of historical evidence regarding individual corporate anti-takeover devices indicates that companies with management teams that are more accountable to shareholders tend to outperform companies with heavily entrenched management teams. Proposals designed to instate or increase takeover protection or that eliminate, restrict or inhibit shareholder rights will be opposed.

Proposals that promote a one-share, one-vote standard and the equal treatment of all shareholders will be supported.

The integrity of the proxy voting process depends on a voting system that protects voters from potential coercion and reduction of voting power. Proposals that provide a shield against management pressure, re-solicitation and fraudulent vote tabulation will be supported.

#### **4. Capital/Restructuring**

Proposals involving capital raises, debt restructurings, spin-offs, asset sales and purchases and M&A will be evaluated on a case-by-case basis.

Financing decisions can have a significant impact on shareholder value when they involve the issuance of additional common stock, preferred stock or debt facilities. Financing proposals will be opposed that dilute investment value or include potential anti-takeover measures.

Restructuring proposals where the disadvantages of dilution of future earnings and/or change of control outweigh the prospective survival of the company will be opposed.

Proposals relating to real or potential mergers and acquisitions, asset sales and purchases, spin-offs and tender offers will be scrutinized to determine if they are detrimental to ERS. Any proposal, response by management or outside interests deemed to be detrimental to ERS will be opposed. Those management proposals where existing shareholders receive fair remuneration or shareholder value is increased will be supported.

#### **5. Compensation**

Proposals involving executive and director compensation programs will be evaluated on a case-by-case basis for adherence to the following five global principles:

- A. Maintain appropriate pay-for-performance alignment, with emphasis on long-term shareholder value. Compensation should be designed to attract, retain and appropriately motivate key employees. The link between pay and performance, the mix between fixed and variable pay, performance goals and equity-based plan costs should all be considered.
- B. Avoid arrangements that risk “pay-for-failure.” Long or indefinite contracts, excessive severance packages and guaranteed compensation should be avoided.
- C. Maintain an independent and effective compensation committee.
- D. Provide shareholders with clear, comprehensive compensation disclosures.
- E. Avoid inappropriate pay to non-executive directors. Excessive compensation could potentially compromise an outside director’s independence and ability to make appropriate judgments with respect to management pay and performance.

Management and shareholder proposals that fail to meet these guiding principles will be opposed.

#### **6. Social/Environmental Issues**

Intangible factors such as social and environmental issues are increasingly being incorporated into valuation models to better quantify the risks and opportunities of long-term investing in a company.

ERS’ voting of social and environmental proposals will be based solely on enhancing or protecting long-term value to ERS and not on establishing or endorsing social policy. As part of its fiduciary duty, ERS shall consider only those factors that relate to the economic value of ERS’ investment and shall not subordinate the interests of ERS’ participants and beneficiaries to unrelated objectives.

## **ERS 2020-21 Proxy Voting Results**

**ERS Process** – ERS uses the services of Institutional Shareholder Services (ISS) to process proxy votes. The ISS system allows them to “code” ERS’ proxy voting guidelines so that agenda items are matched to these codes and voted electronically. ERS retains the ability to override the vote posted by the ISS automated system before the actual vote is sent to the company.

In cases where ERS’ guidelines do not address the topic of the proposal to be voted or ERS’ guidelines require an internal case-by-case analysis of the proposal, ISS codes the item on the ballot as “refer” to indicate it is to be voted by ERS staff. The ERS analyst or portfolio manager responsible for that company performs the necessary research to determine what vote meets the best interests of the Plan and votes accordingly. If no vote is submitted by ERS by the end of the cut-off date, the item is voted according to ISS’ voting guidelines to help ensure that ERS’ right to vote isn’t inadvertently forfeited. For the period September 30, 2020 to September 30, 2021, 0.94% of all proposals were referred to ERS for internal case-by-case analysis.

**2020-21 Proxy Voting Results** – ERS voted 30,509 proposals in 2,082 meetings over one-year period ending September 30, 2021. Overall, ERS voted with management 92% of the time. ERS voted proxies globally in 55 countries over the period. Summary voting results are shown below:

<b>Meeting Overview</b>		
<b>Category</b>	<b>Number</b>	<b>Percentage</b>
<b>Number of votable meetings</b>	2,082	
<b>Number of meetings voted</b>	2,073	99.57%

<b>Ballot Overview</b>		
<b>Category</b>	<b>Number</b>	<b>Percentage</b>
<b>Number of votable ballots</b>	2,545	
<b>Number of ballots voted</b>	2,533	99.53%

<b>Proposal Overview</b>		
<b>Category</b>	<b>Number</b>	<b>Percentage</b>
Number of votable items	30,702	
Number of items voted	30,509	99.37%
Number of votes FOR	27,869	90.77%
Number of votes AGAINST	2,165	7.05%
Number of votes ABSTAIN	226	0.74%
Number of votes WITHHOLD	196	0.64%
Number of DNV	192	0.63%
Number of votes With Policy	30,508	99.37%
Number of votes Against Policy	1	0.01%
Number of votes With Mgmt	28,237	9%
Number of votes Against Mgmt	2,272	7.40%
Number of votes on Shareholder Proposals	795	2.61%

<b>ERS Proxy Voting Results</b> 09/30/20 – 09/30/21			
<b>Agenda Item Category</b>	<b>Total Votable Proposals 2020-21</b>	<b>% of Time Voted For Management 2020-21</b>	<b>% of Time Voted For Management 2019-20</b>
Routine/Miscellaneous	5,732	97%	97%
Board of Directors	17,667	95%	95%
Shareholder Rights and Defenses	219	92%	95%
Capitalization	2,084	90%	89%
Reorganizations, M&A	646	91%	92%
Compensation	3,230	86%	87%
SP: Social/Environmental Issues	160	81%	64%
SP: Other Shareholder Proposals	635	68%	55%
Preferred/Bondholder	20	100%	99%
<b>Total</b>	<b>30,509</b>	<b>93%</b>	<b>93%</b>

Note: SP = Shareholder Proposal.

**Glossary of Terms**

Return ratio- Expected excess return ratio is equal to excess return divided by tracking error. This is often thought of as an information ratio.

MSCI-Morgan Stanley Capital International

MSCI EAFE -Europe, Australasia and Far East

SMID- Small and Mid-Cap

ACWI ex US - All Country World Index

ERS External Advisor Website -Located at the ERS public website,  
<http://ers.texas.gov/Vendors/Investment-Service-Providers>

MifID II- MifID II is a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors. Its aim is to standardize practices across the EU and restore confidence in the industry, especially after the 2008 financial crisis.

\* In the rare case of overlapping or conflicting interests within the fund (e.g., ERS ownership of both equity and debt securities), staff will consider all holdings and seek to maximize the expected value of the combined position.

**ATTACHMENTS:**

1. Slides - Global Public Equity Market Update and Program Overview