

AGENDA ITEM DETAILS

Subject: Consideration of the TexaSaver Program Updates: TexaSaver Product Review Committee Recommendations – (Action – Board Only Vote)

Option 1: Destination fund recommended for Board approval

RECOMMENDED ACTION:

Move that the Board of Trustees remove current small cap value fund from the TexaSaver 401(k)/457 Program, with the program assets being transferred to the [_____] fund.

The Employees Retirement System of Texas (ERS) administers the TexaSaverSM 401(k) and 457 Program (TexaSaver program or program) – a voluntary tax-deferred supplemental retirement savings program. The TexaSaver program is designed to help state and eligible higher education employees save through elective payroll contributions to their chosen investment options.

The program offers 12 core funds, 9 Target Date Funds, and a self-directed brokerage account option. ERS' intent is to provide program participants with low-cost, diversified investment choices. The investment products are the same in the TexaSaver 401(k) and TexaSaver 457 plans.

The program is supported by the TexaSaver Product Review Committee (PRC). The PRC serves in a consultative capacity regarding the investment options and investment advisory services that are available to program participants. The nine-person committee includes internal ERS professionals, as well as external investment professionals. Tom Nun, CFA® with Great-West Investments (GWI) provides services to the program as a Portfolio Strategist.

During the October 20, 2021 PRC meeting, Tom Nun provided an investment update on the investment choices available to participants. Three investments were discussed in greater detail.

Target date funds: the target date funds continue to perform adequately with returns generally within +/- 1.00% of benchmark for 2Q/3Q 2021.

Mid-cap fund: The Wellington MidCap Opportunities fund was originally added to the lineup in May 2020. While it had performed reasonably well, this fund has struggled in 2021 with a shift towards core. The PRC continues to monitor this fund.

Small-cap fund: Mr. Nun led the PRC in a discussion regarding the performance of the Lord Abbett Small Cap Value I (LRSYX) Fund, the program's small cap offering. Following discussion, the PRC voted to pursue a passive domestic small cap equity replacement fund for the Lord Abbett Small Cap Value I Fund.

Lord Abbett Small Cap Value I (Lord Abbett)

Fund overview. The fund seeks long-term capital appreciation. As a small cap offering, Lord Abbett invests a majority of its assets, 80% or more, in small companies. Equity securities of small-sized companies may be more volatile than securities of large, more established companies; however, this may come with strong returns if the selected companies deliver on return projections.

Performance overview. The Lord Abbett fund experienced performance and style issues, which have been discussed with the PRC and the Board during the March 2021 fund performance update. The fund has

underperformed to its stated benchmark (Russell 2000 Value Index) over the long term. Lord Abbett is an actively managed fund with total net assets of \$688.0M as of September 30, 2021.

PRC Meeting

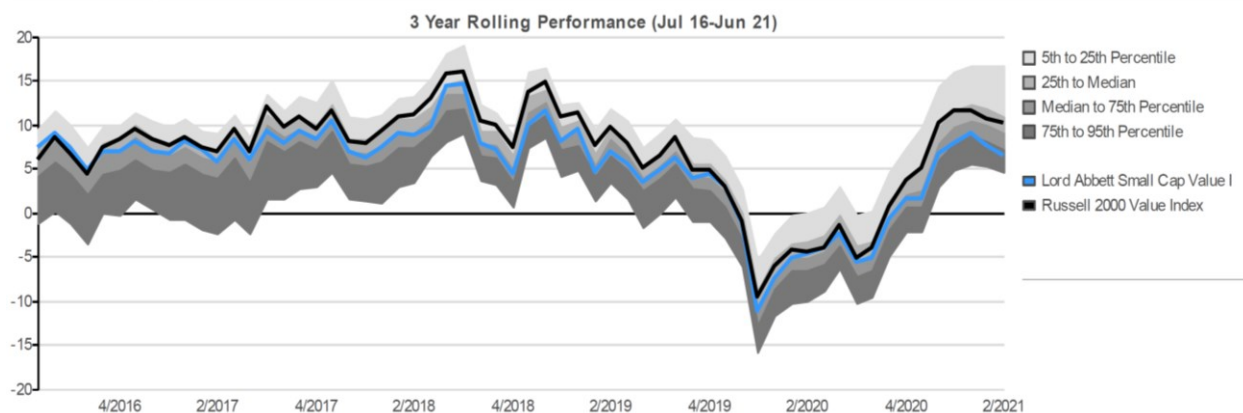
October 20, 2021

Reporting from Q2 2021 data, Tom Nun presented a Lord Abbett performance overview indicating that the fund underperformed its benchmark (Russell 2000 Index) and peers across all measured periods.

Lord Abbett Small Cap Value I (LRSYX) Fund Performance June 30, 2021

	3M	YTD	1Y	3Y	5Y	7Y	10Y	SI
Fund	2.94	21.62	56.31 / 86	6.62 / 79	9.38 / 88	7.04 / 71	8.40 / 83	10.13
Benchmark	4.56	26.69	73.28 / 39	10.27 / 37	13.62 / 25	9.26 / 25	10.85 / 30	
Peer Group Median	4.15	25.76	70.34 / 50	9.08 / 50	12.06 / 50	7.94 / 50	10.22 / 50	
Number of Funds			143	134	131	121	112	

PERFORMANCE



The fund's Sharpe ratio are in the 82nd and 85th peer percentile for the 3-year and 5-year periods. Trailing 36-month alpha is -3.3%. The up and down-capture ratios are below the fund's peer median: 97.13% up, 106.67% down; 61st and 64th, respectively.

Lord Abbett Small Cap Value I (LRSYX) June 30, 2021

RISK & PERFORMANCE STATISTICS

3 Yr	Fund	Benchmark	Peer Group Median
Alpha	-3.29	0.00	-0.92
Beta	1.03	1.00	1.01
R-Squared	96.37	100.00	96.78
Sharpe Ratio	0.33	0.45	0.41
Up Market Capture	97.13	100.00	100.69
Down Market Capture	106.67	100.00	102.89

Although diversified among its holdings, the number of holdings is down to 72, which is less than the 1,372 holdings of the stated benchmark.

Currently within the fund offerings, participants do not have alternatives within the small cap space. Asset size within this fund continues to increase in spite of the fund's performance, migration from its stated investment style, and change in portfolio management.

Following discussion of these considerations, the PRC voted to recommend the Board consider a change from an active to passive approach, removing the Lord Abbett fund from the Texa\$aver lineup and transferring assets to a passive domestic small cap equity fund, a new fund for the program.

The sub-committee was directed to immediately begin due diligence for the passive domestic small cap equity fund. The high yield bond-fund due diligence (underway), will resume in 2022 after completion of the passive domestic small cap equity fund due diligence. The appointed PRC sub-committee members made up of PRC members and ERS staff are: Brannon Andrews, Carlos Chujoy, Lauren Honza, Leighton Shantz, and Dr. Laura Starks. Gene Needles serves as an alternate.

Following many years of service on the PRC, Dr. Laura Starks resigned from the committee on November 22, 2021.

Sub-committee meetings: Preliminary Reviews October 25 & 27, 2021

The sub-committee and Tom Nun met on October 25, 2021 to discuss and consider fund search parameters for a passive domestic small cap equity fund search to include minimum fund size, fund objective, investment style and benchmark for the due diligence questionnaire (DDQ). The established initial criteria included fees less than 35 bps and AUM greater than \$2b, and both 40-Act mutual funds and collective investment trusts were included on the DDQ. The sub-committee also discussed difficulties in underwriting a securities lending program for CIT providers not already on the TPA platform. For that reason, CITs under consideration also included non-lending products.

Preliminary Review Phase. On October 27, 2021, the sub-committee reconvened with Tom Nun to review the 13 identified candidates. Ten funds have their strategy benchmarked to the Russell 2000 index and three funds benchmarked to the S&P 600 Index. Eight funds made it to the proposal review phase. The finalized questionnaire went to fund managers on October 28, 2021. Responses were received from all eight funds on November 8, 2021.

Sub-committee meetings: Proposal Review November 10, 2021

The sub-committee performed an initial evaluation of the minimum requirements, firm qualifications (management team, investment team, compliance and operations) and strategy qualifications (investment strategy and philosophy; style and process; risk management; historical returns and performance; asset flows) from all DDQ responses received. The sub-committee then conducted a substantive review of the Respondents' DDQ proposals. Based on the Proposal Review Phase of the evaluation, the sub-committee formulated its findings and recommendations to present to the PRC on November 16, 2020. The group recommended four finalists move forward to the next phase.

PRC meetings: Finalists Review Phase November 16 & 17, 2021

Tom Nun, together with the sub-committee, presented a proposal to have three fund managers present the following four funds during the finalist meetings:

- BlackRock Russell 2000 Index Strategy (Russell 2000)
- BlackRock S&P 600 Index Strategy (S&P 600)
- Fidelity Small Cap Index Fund (Russell 2000)
- Vanguard S&P Small Cap 600 Index Fund (S&P 600)

PRC members considered information from the sub-committee, finalist interviews, fund performance, management, and construction of the respective proposed benchmarks (Russell 2000 or S&P 600).

PRC Recommendation

Based on the evaluation process outlined above, PRC recommends removal of the Lord Abbett Small Cap Value I (LRSYX) Fund from the Texa\$aver 401(k)/457 Program with the program assets transferred to the passive domestic small cap equity fund.

Upon Board approval of this change and in collaboration with Empower Retirement, a communication strategy will launch to notify participants of the upcoming change.

ATTACHMENTS:

1. Exhibit A – Fund Analysis: Lord Abbett LRSYX (9/30/2021)
2. Slides – Texa\$aver Product Review Committee Recommendation