

## Public Agenda Item #23

*Consideration of the Texa\$aver Program Updates: Texa\$aver Product Review  
Committee Recommendations -  
(Action - BOT)*

December 8, 2021

Diana Kongevick, Director of Group Benefits  
Georgina Bouton, CTCM, Assistant Director of Group Benefits  
Thomas Nun, CFA®, GWI Portfolio Strategist

# Texa\$aver<sup>SM</sup> 401(k) / 457 Program



## Program Overview

### TEXA\$AVER 401(k) Program

- Established in 1985
- Available to employees of state agencies
- Uses competitive bid process for plan services
- Provides automatic enrollment for new hires since 1/1/2008
- Offers traditional and Roth contributions
- Delivers low-cost, diversified investment choices



### TEXA\$AVER 457 Program

- Defined contribution plan established in 1974
- Available to employees of eligible higher education and state agencies
- Uses competitive bid process for plan services
- Offers traditional and Roth contributions
- Delivers low-cost, diversified investment choices

# Texa\$aver Program

## Executive Summary



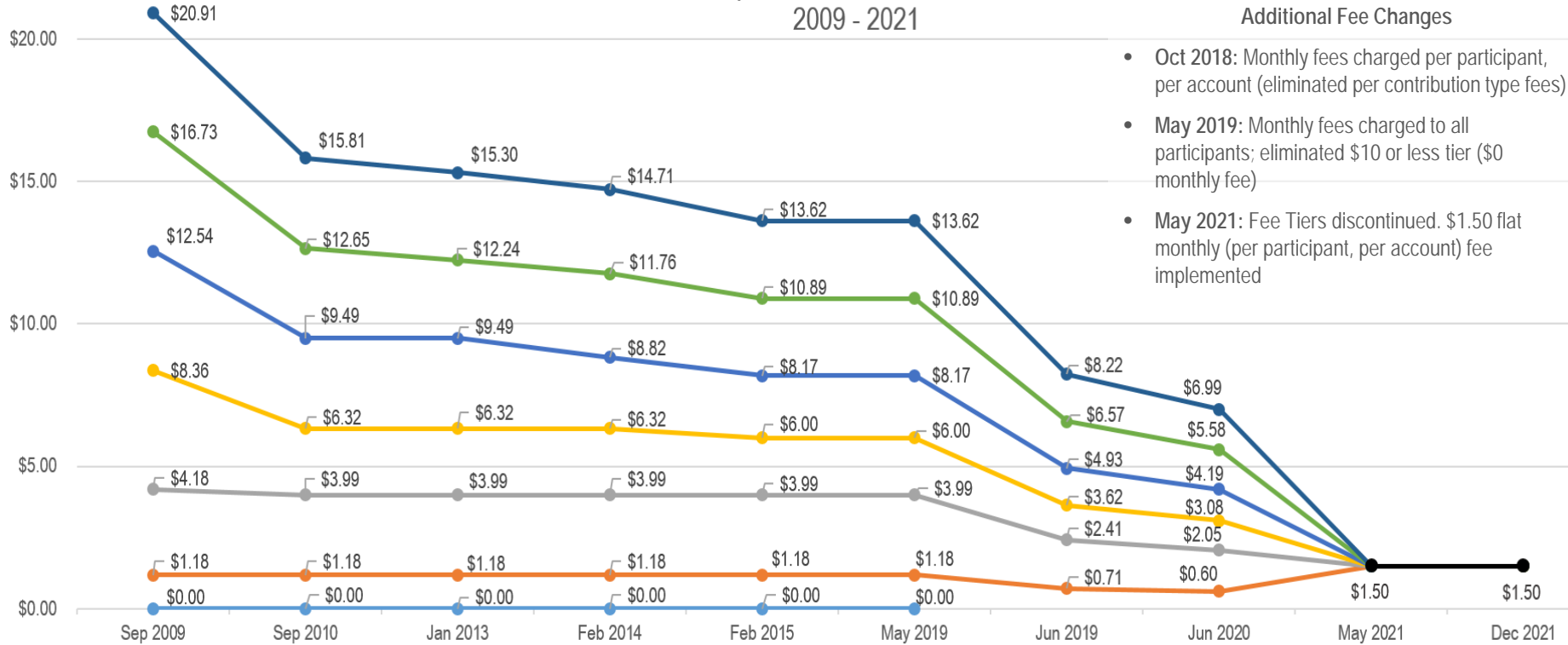
### 401(k) Plan, 09/30/21

Assets under Management (AUM)	\$3,436 million
Traditional balances	\$3,346 million
Roth balances	\$90 million
No. of Participant Accounts	221,806
Contributing	98,929
Non-contributing	112,877
Contributions, deposits, loan repayments	\$57.2 million
Change in value & Interest/Dividends	\$2.2 million
Plan withdrawals	(\$62.8) million
Fees	(\$1.3) million

### 457 Plan, 09/30/21

Assets under Management (AUM)	\$1,282 million
Traditional balances	\$1,205 million
Roth balances	\$77 million
No. of Participant Accounts	33,764
Contributing	17,668
Non-contributing	16,095
Contributions, deposits, loan repayments	\$23.6 million
Change in value & Interest/Dividends	\$ 0.3 million
Plan withdrawals	(\$16.3) million
Fees	(\$0.3) million

# Monthly Participant Fee per TexasSaver account 2009 - 2021



## Additional Fee Changes

- **Oct 2018:** Monthly fees charged per participant, per account (eliminated per contribution type fees)
- **May 2019:** Monthly fees charged to all participants; eliminated \$10 or less tier (\$0 monthly fee)
- **May 2021:** Fee Tiers discontinued. \$1.50 flat monthly (per participant, per account) fee implemented

## Participant Account Balance Tiers for Monthly Fees (Fee Tiers)

- \$10 or less
- \$10.01 - \$1,000.00
- \$1,000.01 - \$16,000.00
- \$16,000.01 - \$32,000.00
- \$32,000.01 - \$48,000.00
- \$48,000.01 - \$64,000.00
- \$64,000.01 or more

# Texa\$aver Program

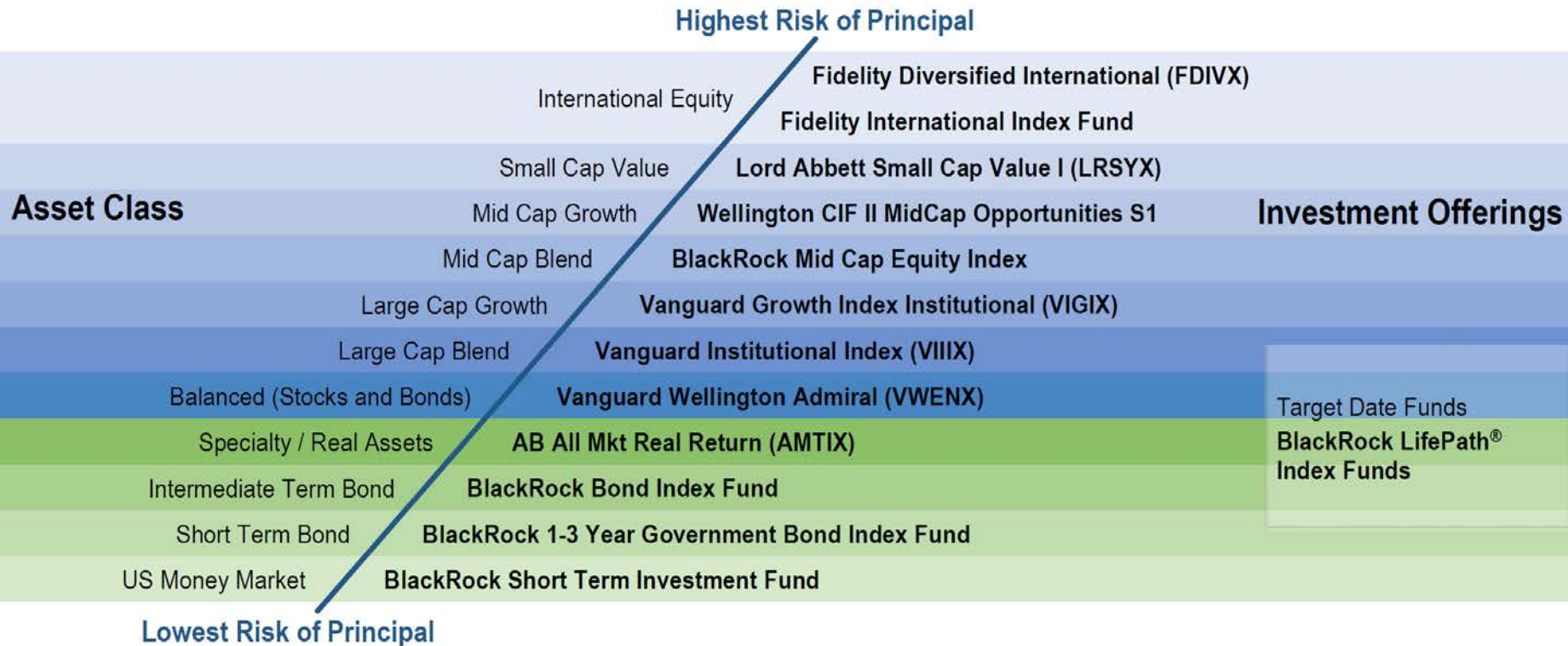
## *Investment Offerings*



- Texa\$aver 401(k)/457 Program Investment Policy
- Diversified assortment of mutual funds and collective trust funds, self-directed brokerage account, and a target date fund series
- Institutionally priced offerings between the plans are the same

# Texa\$aver Investment Offerings

September 30, 2021



# Texa\$aver Program

## Product Review Committee (PRC)



Porter Wilson	ERS Executive Director
Catherine Terrell	ERS Deputy Executive Director
David Veal	ERS Chief Investment Officer
Leighton Shantz	ERS Director of Fixed Income
Carlos Chujoy	ERS Investment Risk Officer
Diana Kongevick	ERS Director of Group Benefits
Gene L. Needles, Jr.	ERS Investment Advisory Committee (IAC) member
Laurie L. Dotter, CPA	ERS IAC member
Laura T. Starks, Ph.D.	External investment professional



# PRC

## Sub-committee



- PRC may appoint a sub-committee to perform a specific purpose (e.g., due diligence, fund evaluation, research, etc.).
- PRC sub-committee members include:

Carlos Chujoy

PRC Member

Leighton Shantz

PRC Member

Dr. Laura T. Starks

PRC Member

Lauren Honza

ERS Portfolio Manager

Brannon Andrews

ERS Assistant General Counsel

Gene Needles

PRC Member to serve as an alternate





# PRC

## *Semi-annual Meeting*



- The PRC meets at least semi-annually to conduct investment reviews and undertake any other action required for the administration of the Program
- October 20, 2021, the PRC meeting included
  - Investment performance update
  - Next steps for Lord Abbett Small Cap Value I, small cap value fund
    - Program assets, 3Q 2021: \$169.7 million
    - Number of Texa\$aver accounts, 3Q 2021: 33,042



# Lord Abbett Small Cap Value I (LRSYX)

# Lord Abbett Small Cap Value I (LRSYX)



## *Due Diligence*

- PRC closely monitored Lord Abbett Small Cap Value I fund
- Annual review with Portfolio Manager, September 21, 2021
  - Performance issues
    - Underperformed to benchmark (Russell 2000 Value Index)
    - Carries a 2-star rating from Morningstar
  - Portfolio management turnover: Eli Rabinowich (August, 2021)
  - Changes in investment process

# Lord Abbett Small Cap Value I (LRSYX)

## Small Cap Value, 3Q 2021

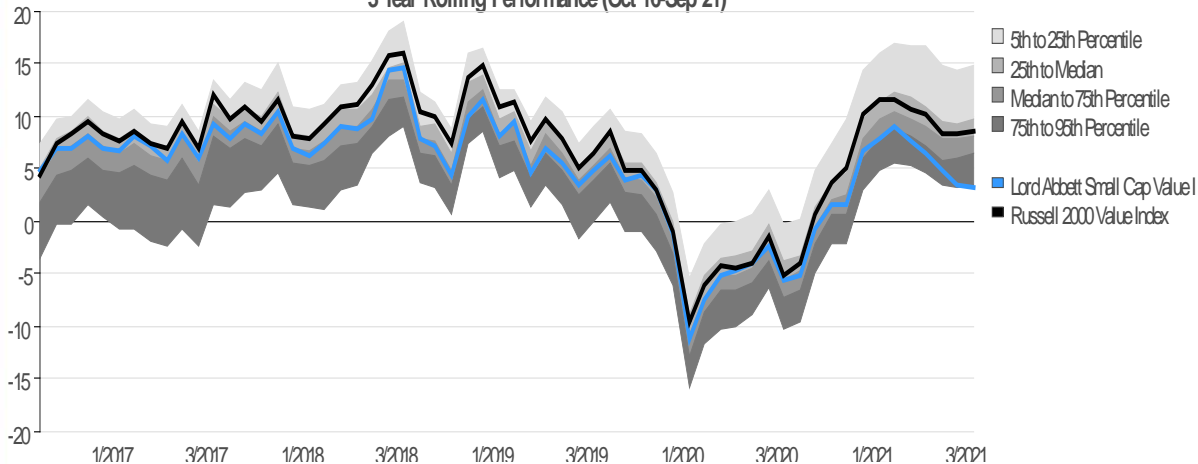


PROGRAM ASSETS: \$169.7 MILLION

NO. OF TEXA\$AVER ACCOUNTS: 33,042

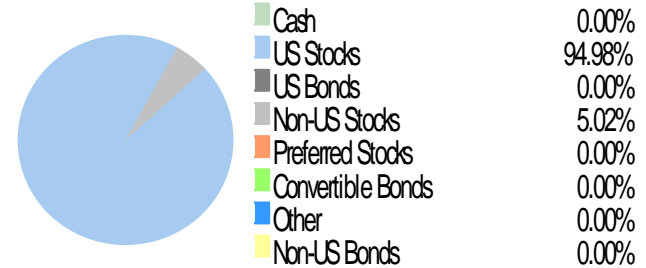
PERFORMANCE	1Y	3Y	5Y	7Y	10Y
<b>Fund</b>	<b>52.72</b>	<b>3.27</b>	<b>7.38</b>	<b>7.71</b>	<b>11.13</b>
Benchmark: Russell 2000 Value Index	63.92	8.58	11.03	10.19	13.22
Peer Group Median	62.42	8.11	10.23	8.83	12.76

3 Year Rolling Performance (Oct 16-Sep 21)



### PORTFOLIO COMPOSITION

#### Assets



Overall Morningstar Rating™



### FUND OVERVIEW

Investment type	Mutual fund
Investment strategy	Active
Fund expense ratio	0.94%
Fund reimbursement	0.10%
Net Texa\$aver expense	0.84%

# PRC Meeting

## *Lord Abbett Performance Review*



- At the October 20, 2021 PRC meeting, GWI Portfolio Strategist presented the following considerations for Lord Abbett Small Cap Value fund.
  - Texa\$aver's portion of the strategy's assets
  - Difficult risk-adjusted performance: Sharpe ratios in the 82<sup>nd</sup> and 85<sup>th</sup> peer percentiles (3- and 5-year)
  - Trailing 36-month alpha: -3.3%
  - Up- and Down-capture ratios below peer median (97.1% up, 106.7% down; 61<sup>st</sup> and 64<sup>th</sup>, respectively)

# Sub-committee Initial Screening

## *Passive Domestic Small Cap Fund*



- PRC decided to pursue a passive domestic small cap fund; appointed sub-committee for the fund search
- October 25, 2021 sub-committee met to formulate parameters for initial screening
  - \$2B minimum fund size
  - Net expense ratio  $\leq$  35 bps
  - Availability on TPA's platform
  - Fund objective and investment style

# Fund Due Diligence Questionnaire

## *Passive Domestic Small Cap Fund*



- October 27, 2021, sub-committee finalized parameters, reviewed initial list of funds, and passed 9 funds to the next phase.
- Passive Domestic Small Cap Fund Due Diligence Questionnaires (DDQ) went out on October 28, 2021
  - 7 funds use Russell 2000 benchmark
  - 2 funds use S&P 600 benchmark
- Responses were received from all funds by the required response date.

# Initial Evaluation

## *Passive Domestic Small Cap Fund*



- Sub-committee performed an initial evaluation of:
  - Minimum Requirements
  - Firm Qualifications
    - Management team; investment team
    - Compliance and operations
  - Strategy Qualifications
    - Investment strategy and philosophy; style and process; risk management; historical returns and performance; asset flows



# Finalists Recommendation

## *Passive Domestic Small Cap Fund*



- On November 16, 2021, the sub-committee recommended the following entities to the PRC as finalists based on DDQ responses and fund performance.
  - BlackRock Russell 2000 Index Fund
  - BlackRock S&P SmallCap 600<sup>®</sup> Equity Index Fund F
  - Fidelity Small Cap Index Fund
  - Vanguard S&P Small-Cap 600 Index Fund I
- PRC agreed with the sub-committee's recommendations.
- Finalist meetings were held November 16 and 17, 2021.

# Finalists Phase

## Passive Domestic Small Cap Fund



Fund Name	Fidelity Small Cap Index Fund (FSSNX)	BlackRock Russell 2000 Index Fund - L	Vanguard S&P Small-Cap 600 Index (VSM SX)	BlackRock S&P 600 Index Strategy
<b>Fund Type</b>	Mutual Fund	Collective Trust	Mutual Fund	Collective Trust
<b>Benchmark</b>	Russell 2000	Russell 2000	S&P 600	S&P 600
<b>Fee</b>	2.5 bps	1.85 bps	8.0 bps	2.45 bps
<b>AUM</b>	\$21.6 B	\$11.2 B	\$1.9 B	\$713 M
<b>Tracking Error</b>	0.08%*	0.06%*	0.05%*	0.13%*
<b>Comments</b>	<ul style="list-style-type: none"> <li>• Managed by Geode Capital Mgmt.</li> <li>• Process: Full replication</li> <li>• Consistent positive inflows (Morningstar), last 3 yrs.</li> <li>• Team turnover in 2019</li> <li>• Maximum mo. performance deviations (avg. +0.01): -18bps (1st month of operations) +8bps (11/2016)</li> <li>• Morningstar: 4 stars</li> </ul>	<ul style="list-style-type: none"> <li>• Process: Full replication or optimization</li> <li>• Sec. lending adds materially to returns</li> <li>• Team managed</li> <li>• Maximum mo. performance deviations (avg. +0.00): -40bps minimum +35bps maximum</li> <li>• Morningstar: not rated (CIT)</li> </ul>	<ul style="list-style-type: none"> <li>• Process: full replication</li> <li>• Team: Co-PMs: Coleman (2013), Butler (2015)</li> <li>• Maximum mo. performance deviations (avg. 0.00): -5.7bps minimum +5.8bps maximum</li> <li>• Morningstar: 4 stars</li> </ul>	<ul style="list-style-type: none"> <li>• Process: Full replication or optimization</li> <li>• Sec. lending adds materially to returns</li> <li>• Team managed</li> <li>• Maximum mo. performance deviations (avg. +0.00): -22bps minimum +11bps maximum</li> <li>• Morningstar: not rated (CIT)</li> </ul>

\* Tracking error figures sourced from Morningstar

# Next Steps



## *Passive Domestic Small Cap Fund*

- Passive domestic small cap fund will be offered within the program's fund lineup
  - High-quality, well-managed, competitively priced small cap fund
  - Available to participant contributions 1Q 2022
- Remove the small cap value fund from the Texa\$aver lineup, and transfer assets to the newly selected.
- TPA and ERS staff will coordinate operational process for the new funding and asset transitions, which includes a communication strategy for participants.

# Texa\$aver Program

## *PRC and Staff recommendation*



It is the recommendation of the Product Review Committee (PRC) that the Board of Trustees of the Employees Retirement System remove the Small Cap Value fund from the Texa\$aver 401(k)/457 Program with the program assets being transferred to the selected passive domestic small cap fund.

Questions?  
**Action Item -BOT**