Executive Summary

Pursuant to Section 802.109 of Texas Government Code, NEPC, LLC ("NEPC") has been engaged by the Employees Retirement System of Texas ("ERS" or "the Trust") to conduct an independent evaluation of the appropriateness, adequacy and effectiveness of ERS' investment policies and practices. In preparing this evaluation, NEPC has followed the guidance provided by the Texas Pension Review Board in composing our evaluation.

The 2024 Investment Policies and Practices Evaluation for ERS Texas covers five Evaluation Topics, broadly defined in Section 802.109 of the controlling Government Code:

- A review of the retirement system's governance processes related to investment activities;
- An analysis of any investment policy or strategic investment plan adopted by the retirement system;
- A detailed review of the retirement system's investment asset allocation;
- A review of the retirement system's investment manager selection and monitoring process; and
- A review of the appropriateness of investment fees and commissions.

Overview of Findings:
NEPC finds ERS' policies, procedures and practices to be appropriate, adequate and effective when compared to industry prevailing practice.

Overview of Recommendations:
As will be discussed in Section 6 of this evaluation, NEPC found that ERS Texas took significant steps over the last four years toward addressing the eight recommendations identified in the 2020 Investment Policies and Practices Evaluation. This 2024 IPPE report recommends eight additional actions ERS Texas should undertake which can mitigate potential impediments to efficiency and optimal investment results.

1) **ERS Texas should continue to develop innovative policies focused on recruiting, compensation, and career development to secure and retain investment talent.** The ability to hire, retain and offer competitive compensation to investment professionals is a key requirement for achieving the Trust's investment objectives with optimal efficiency.

2) **To the extent permitted under Texas Law, ERS should seek statutory procurement exemptions** similar to those applicable to other large public funds among the peer group to allow ERS additional operational flexibility when there is a need to quickly replace a struggling investment manager or take prompt advantage of an opportunistic investment.

3) **ERS may wish to consider including total public markets portfolio tracking error, including a curing period, in future revisions of the Investment Policy Statement.** This would be consistent with the IPS documents of peer institutions TRS Texas, Colorado PERA and CalPERS.

4) **ERS should periodically re-evaluate the most useful fee benchmarks and universes of manager data when reporting on manager fees.**

5) **ERS Texas should also periodically re-evaluate the current practice of bundling the cost of research with total trade costs.** NEPC acknowledges that ERS considered this same recommendation in the 2020 IPPE report and decided not to make a change because the current practice is best suited for the Trust. While permissible in the current regulatory environment, a growing number of Public Funds no longer use a soft dollar program. Instead, many have unbundled from the payment for research from trade execution. We acknowledge that ERS has an understandably larger appetite for research than most public funds given the Trust's larger percentage of assets under internal active management in comparison with peers. Paying for research directly can be a challenge in an unbundled environment.

6) **NEPC recommends regular review of asset class benchmarks.** This is particularly important for asset classes like private markets and hedge funds that, by their nature, do not have benchmarks that meet the investable and reflective characteristics of CFA Institute's SAMURAI model. For these asset classes, there is no perfect benchmark. Therefore, it is reasonable to periodically assess the appropriateness of other existing benchmark options in wide use by peer institutions and to evaluate new benchmarks that are being developed.

7) **ERS should consider establishing a more rigorous manager monitoring process.**

8) **Improvements to the SOPs for Investment Compliance and automation of the personal account monitoring function should be considered.**