

Minutes of the Board of Trustees

February 14-16, 2018

The Board of Trustees of the Teacher Retirement System of Texas met on February 14-16, 2018, in the UT Rio Grande Valley Ballroom Building in Edinburg, Texas. The following Board members were present:

Jarvis Hollingsworth, Chair
Joe Colonna
David Corpus
John Elliott
Greg Gibson
Christopher Moss
Dolores Ramirez
Nanette Sissney
James D. Nance

Others present:

Brian Guthrie, TRS
Ken Welch, TRS
Don Green, TRS
Carolina de Onís, TRS
Katrina Daniel, TRS
Janet Bray, TRS
Jerry Albright, TRS
Barbie Pearson, TRS
Amy Barrett, TRS
Rebecca Merrill, TRS
Heather Traeger, TRS
Katherine Farrell, TRS
Caasi Lamb
Chet Henry, TRS
Steve Huff, Reinhart Boerner Van Deuren
Steve Voss, Aon Hewitt
Mike McCormick, Aon Hewitt
Dan Siblik, Gabriel, Roeder, Smith & Company
Joe Newton, Gabriel, Roeder, Smith & Company
Michael Johnson, Bridgepoint

Tim Lee, TRTA
Bill Barnes, TRTA
Nancy Byler, TRTA
Ronnie Jung, TRTA
Dora Cackley, BARSEA
Gerald Albrecht, TRTA
Rosalon Reyna, TRTA
Richard Sanchetz
Patricia Macias, TRTA
Gracie Alvear, ERTA
Alrene Ready, LC
Maria Suramillo, TRS
Noemi Diaz Bald, Hgn Mid Valley RTA
Nadine Woodall, Hgn Mid Valley RTA
Tom Bald, HGN Mid Valley RTA
Fran Plemmons, TRTA
Leroy DeHaven, TRTA
Linda DeHaven, TRTA
Marcy Cann, TRTA
June Cooper, TRTA
Roland Miller, TRTA
David A. Gomez, TRTA
Margarita Gonzalez, TRTA
Janie Cantu, TRTA

Ann Fickel, TRTA
David Gonzalez, Humana
John Grey, TSTA
Beaman Floyd, TASA
Ruben Suenz, TRTA
Michael Bentrrott, Aetna
Adreana S. Garza, Caremark
Ofelia G. Esteeris, TRTA
Jose E. Lugo, ERTA
Debbie Prukop, TRTA
Patty Quinzi, AFT
Aaron Bell, TSEU

Mr. Hollingsworth called the meeting to order at 10:16 a.m. He welcomed all and thanked Trustee Ramirez for hosting the February retreat in the McAllen area. Mr. Hollingsworth thanked the University of Texas Rio Grande Valley (UTRGV) for hosting us. Ms. Trini Yunes, Director of Human Resources at UTRGV, welcomed everyone to the Rio Grande Valley.

1. Call roll of Board members.

Ms. Farrell called the roll. A quorum was present.

2. Consider the following administrative items – Jarvis V. Hollingsworth:

A. Approval of the December 14-15, 2017 proposed meeting minutes

On a motion by Mr. Nance, seconded by Mr. Moss, the Board voted to approve the proposed minutes of the December 14-15, 2017 Board meeting in accordance with the revisions provided by Mr. Hollingsworth.

B. Setting, rescheduling, or canceling future Board meetings.

On a motion by Ms. Ramirez, seconded by Mr. Nance, the Board voted to affirm the dates of the future Board meetings.

3. Provide opportunity for public comment – Jarvis V. Hollingsworth.

Ms. Dora Ferias Cackley of the Brownsville Area Retired School Employee Association, spoke against the increase in healthcare premiums, lack of cost of living increase and the possibility of changing from a defined benefit pension to a defined contribution system.

Mr. Aaron Bell of the Texas State Employee Union, spoke against a lowered rate of return. Mr. Bell presented the Board of Trustees with a petition against urging the Trustees to reject any recommendation that would negatively impact the funding ratio of the retirement plan and to wait to act until the 2020 experience study.

Mr. Beaman Floyd, representing the Texas Association of School Administrators, spoke regarding the experience study urging judicious incrementalism in the Trustees approach.

Ms. Patty Quinzi, representing American Federation of Teachers in Texas, spoke against the experience study stating it was done ahead of time and does not take into consideration major federal policy changes.

Ms. Ann Fickel, representing Texas Classroom Teachers Association, spoke against dropping the assumed rate of return all at once and recommended a gradual approach.

Mr. John Grey representing the Texas State Teachers Association, spoke against the .75 percent drop recommended and said he echoed those who spoke before him.

Mr. Bill Barnes, the Texas Retired Teachers Association's legislative coordinator and the vice-chair of the Retirees Advisory Committee at TRS, spoke regarding the rising health care costs, lack of cost-of-living raise and the questions of lowering the assumption rate.

Mr. Tim Lee, Executive Director of the Texas Retired Teachers Association, spoke to the rate-of-return assumption, stating 7 percent is too low, and how it will affect the long term solvency of the pension trust fund and plan design discussion.

4. Receive an overview of the Board meeting agenda and theme – Brian Guthrie.

Mr. Brian Guthrie stated the theme for the February retreat was "TRS: One Mission, Many Parts." Mr. Guthrie reviewed TRS' Mission Statement and the supporting strategic plan's goals and objectives. He then provided an overview for the next three days and reviewed the specifics of the agenda for the day.

5. Receive an update on the Many Parts and One Mission of TRS Customer Service – Janet Bray, Katrina Daniel, Rebecca Merrill and Barbie Pearson

Ms. Barbie Pearson discussed the customer service's history and the challenges customer services has faced. Mr. Chris Cutler discussed the technical issues experienced during the cutover from the legacy system to TRUST. Ms. Pearson described the impact on customer relations of transferring systems. In response to Ms. Sissney's inquiry, Ms. Pearson reported beginning November 16, 2017, they have outsourced certain calls to ACT. She said in the past when there is a mailing, there is an increase in call volume.

At 11:52 am Mr. Hollingsworth called a recess due to an unforeseen fire alarm.

At 12:23 pm Mr. Hollingsworth reconvened the meeting with apologies for the delay.

Ms. Pearson reviewed the history of performance measures. She said in 1995 TRS started to measure just the average speed of answer. After Compact with Texans was implemented, she said it was the first time the back office processing goals were shared with others outside TRS leadership. Ms. Pearson showed the increasing volume of calls since 2008 to today, with increasing volumes coupled with duplicate requests coming in via emails, social media request and TRS comments. Ms. Pearson discussed benefit processing and the documents associated with retirements, death claims, account maintenance and service credit.

In response to an inquiry from Mr. Hollingsworth, Ms. Pearson discussed employment after retirement. She said there is an instruction sheet provided within the retirement packet TRS distributes, information can be found on TRS' site and that work is currently underway on a video on employment after retirement. Ms. Pearson stated the new system identifies when a retiree is working more than the hours allowed within a month where in the past it would be months before the issue was identified resulting in the forfeiture of annuity for an extended period. Ms. Pearson then showed TRS' membership growth versus Benefit Services staffing growth. Ms. Pearson reviewed the Incoming Calls Management Institute (ICMI's) top five recommendations from their full analysis of all of TRS' customer service the conducted in 2017. Ms. Pearson stated to meet the performance measure 31 additional telephone counselors would be required. She said this number would free up office visit counselors who are currently working the phones and reduce the wait time of 90 days for a visit to approximately a couple of weeks. Mr. Guthrie stated these additional resources address a number of fronts. He said it would reduce the hold time members are experiencing, increase the bandwidth, capacity, and get to more member calls on a daily basis. On the counselor front, he said, additional counselors would end forced overtime, increasing moral.

Mr. Cutler reported TRS is in the process of implementing a product called inContact, a cloud-based service that will assist in tracking and add omnichannel support. He said this would allow members to text, message, email or leave a call-in and puts everyone in the same queue and is monitored from a single workforce-management platform that can provide reports and analytics form. Ms. Pearson said they are planning to implement it in June. She said this system will also allow telephone counselors to work from home.

Ms. Katrina Daniel provided the highlights on the challenges healthcare has faced. She said at the beginning of the implementation there were 270,000 retirees and nearly 90 percent of them remained in the program and were successfully transitioned. She said the majority of the retirees who terminated their coverage were eligible for Medicare. She noted this was a surprise since the more dramatic changes were expected in the non-Medicare plan.

Ms. Janet Bray addressed the turnover discussed in Benefit Counseling and the internal transfers. In an attempt to prevent this from happening a job rotation program is being implemented. Other solutions she mentioned were increasing the number of people who can remote work from home. She also reported that he Employee Assistants Program (EAP) service onsite to give tips on how to handle stress and emotionally charged calls.

Ms. Rebecca Merrill discussed the new Chair's charge to staff to take a fresh look at how TRS listens to TRS' customers which include not only active and retiree members but also reporting entity partners and school districts. She said the first option was an update to the Compact with Texans. Second, she said, was to provide the Board with regular updates from an employer advisory group. The third option is either create a new advisory committee to the Board to address customer service matters or to expand the TRS Board bylaws to include a charge to the Benefits Committee to address customer service issues. Ms. Pearson provided further details on the Employer Advisory Group's activity. She said because of the TEAM program they are meeting monthly but would like to keep the dialog going on a regular scheduled meeting and not just on an as-needed basis.

6. Consider Amendments to the Bylaws of the Board of Trustees of TRS – Rebecca Merrill, Heather Traeger, and Amy Barrett

On a motion by Mr. Moss, seconded by Mr. Corpus, Mr. Hollingsworth opened the item for discussion.

Ms. Merrill presented the proposed expanded charge of the Benefits Committee to add customer service issues to the purview of the Committee. She said there were two other staff recommended changes to the bylaws. One is reconstituting the Audit Committee to the Audit, Compliance and Ethics Committee. Ms. Merrill said the proposed Committee will consolidate compliance reporting through one committee and takes ethics and puts it with a regularly held Committee. The final staff recommendation is to repurpose the Risk Management Committee into a Strategic Planning Committee. This committee would also encompass major projects that go along with the strategic plan initiatives. After further discussion, Mr. Hollingsworth called for a vote on the outstanding motion. The Board voted to amend the bylaws of the Board of Trustees as proposed by staff with Mr. Colonna abstaining.

Without objection, Mr. Hollingsworth then called up agenda item 8.

8. Receive a presentation on Capital Market Assumptions - Steve Voss and Mike McCormick, Aon Hewitt

Mr. Steve Voss provided a broad overview of capital market assumptions. He said these assumptions are important for the funded policy and the importance of having the right return assumptions when considering funding and for the strategic asset allocation. Mr. Voss reviewed TRS' current asset allocation broken down into three broad categories: stable value, global equity and real return. He said within the Board approved allocation targets for each of the asset classes, for the 10 year the expected return is 7.14 percent, for 30 year period it is 7.34 percent. He said to look at U.S. equities under the global equity category with an expected return of 6.4 percent for ten years as the best example for why the lower return assumption. He also said the actual returns that have been earned have been so strong, more moderate expectations are reasonable on a go-forward basis.

Mr. McCormick stated inflation is a critical factor in building capital market assumptions. He said the higher inflation is, the higher the expected returns are going to be, across every asset class. He reported from Consensus Economics, the Fed reports as well as the break-even inflation number, the expected inflation over time over a ten and 30 year period is 2.3 percent.

Mr. Voss stated looking at other organizations, like J.P. Morgan, they are a bit more conservative than their assumptions are at this point in time.

9. Review and consider the TRS of Texas Experience Study Findings and Recommendations, including considering the Return Assumption – Joe Newton and Dan Siblik, Gabriel, Roeder, Smith & Co.

Mr. Joe Newton stated this is the most important decision to make as a Trustee. He said this decision is going to control or really impact your message to the outside of how you are doing, what you need, how you need to be funded over the long term.

Mr. Dan Siblik reviewed the current assumptions. He said the current investment return is 8 percent, current general inflation assumption is 2.5 percent. He said the salary increase assumption is 3.5 percent and overall payroll revenue growth assumption is at 2.5 percent. Mr. Siblik said the main driver here is the investment rate.

Mr. Newton reviewed where pension plan peers stand, the average return was around 7 ½ percent.

Mr. Newton stated the standard of practice require them to make a recommendation. He said based on the analysis they recommend for the investment assumption 7 1/4 percent. He said it is close to what the current peer systems are choosing. He said for the other assumptions they recommend decreasing the inflation to 2.3, set the payroll growth to 3 percent and decrease the salary scales to 3.05 percent.

On a motion by Ms. Sissney, seconded by Mr. Nance, the Board unanimously voted to postpone voting on the decision until the April Board meeting.

Without objection, Mr. Hollingsworth then called up agenda item 10.

10. Review the Pension Benefit Design Study and Proposed Update – Caasi Lamb.

Ms. Caasi Lamb stated in 2011 TRS was directed by the Legislature to study the actuarial and fiscal impact of potential changes to the pension plan. She said TRS at the time took the opportunity to address other issues in the study such as the different types of risk involved in pension plan design, the importance of providing adequate replacement income, identifying which plan type provides the most return for dollars contributed and the impact of pension plan design on human capital, through recruitment and retention and orderly retirement. The study released in September of 2012, highlighted the need for the state to begin addressing the unfunded liability, moving new hires to an alternative retirement plan would not eliminate existing liabilities. Additionally, Ms. Lamb said, the study found that the majority of TRS members would do significantly worse investing on their own in a plan with a defined contribution component. At the end of the legislative session, she reported a bill was passed that preserved the defined benefit plan with changes to both findings and benefits.

Ms. Lamb said going into the legislative session, it is important to have fresh and relevant information. She said updating the study also provides an opportunity to share information on the impact of increased contributions, consistent with the proposed Legislative Appropriations request. In response to Dr. Gibson's inquiry, Ms. Lamb said the results of the study would be incorporated in the value brochure and released in January of 2019.

Without objection, Mr. Hollingsworth then called up agenda item 7.

7. Receive an update on the TEAM Program, Reset for Phase 2 – Brian Guthrie and Chet Henry.

Mr. Guthrie provided an update with Phase I go live. He said today, 98 percent of the employers have completed their September payroll report. Mr. Cook stated there are 24 reporting entity partners outstanding. Mr. Guthrie reported for October, it is taking entities a lot less time to submit a report accurately and successfully to TRS. Mr. Guthrie was pleased to report there is no longer a backlog on refunds. He said on February 25th, they are about to implement 75 user friendly enhancements to the system.

Mr. Guthrie reviewed the January TEAM Transparency report. He said the grade had trended down over the past several months. He said the concern was about quality issues and the number of defects found.

Mr. Guthrie reported Phase II is not tied to a specific date to launch. He said it could be launched in a phased approach. He said there is a concern over the delay in requirements gathering. Mr. Michael Johnson of Bridgepoint stated their concerns are that key resources have been focused on stabilization of Phase I that are required to appropriately execute Phase II. Mr. Guthrie said they are only slightly behind schedule from a time perspective.

Mr. Guthrie concluded with a discussion on resources. TEAM has a total of 177 staff. He wants to keep the TEAM positions, but eliminating the contractors to make sure the resources are there to meet Agency demands. He said currently the TEAM positions do not count against TRS' FTE cap but moving forward he would like to adjust the cap to reflect the fact that they are on the payroll.

At 5:32 pm Mr. Hollingsworth recessed the meeting to resume at 8:30 am, February 15, 2018.

February 15, 2018

The Board of Trustees of the Teacher Retirement System of Texas met on February 15, 2018, in the UT Rio Grande Valley Ballroom Building in Edinburg, Texas. The following Board members were present:

Jarvis Hollingsworth, Chair
Joe Colonna
David Corpus
John Elliott
Greg Gibson
Christopher Moss
Dolores Ramirez
Nanette Sissney
James D. Nance

Others present:

Brian Guthrie, TRS	Nancy Byler, TRTA
Ken Welch, TRS	Leroy DeHaven, TRTA
Don Green, TRS	Bill Barnes, TRTA
Carolina de Onís, TRS	Ronnie Jung, TRTA
Katrina Daniel, TRS	Jon Lozano, CVS Health
Jerry Albright, TRS	Sean Donovan, CVS Health
Jase Auby, TRS	John Coombe, Rock Creek
Barbie Pearson, TRS	Cesar E. Quinton, Health Ed. Seminar
Amy Barrett, TRS	David Gonzales, Humana
Rebecca Merrill, TRS	Fran Plemmon, TRTA
Heather Traeger, TRS	Jim Cooper, TRTA
Sylvia, Bell, TRS	Terry Capistran, TREC
Katherine Farrell, TRS	Mary Cann, TRTA
Steve Huff, Reinhart Boerner Van Deuren	Patricia R. Macias, TRTA
Keith Johnson, Reinhart Boerner Van Deuren	Tiffany Caldera, Humana
Sacha Ghai, McKinsey and Company	Gary Lane, SSB
Bryce Klempner, McKinsey and Company	Sean Donovan, CVS Caremark
Matt Portner, McKinsey and Company	Joni Lozano, CVS Caremark

Dr. Keith Brown, Investment Advisor
Dr. Osama Mikhail, UT Health Science Center

Debbie Prukop, TRTA
Michael Bentrout, Aetna

Mr. Hollingsworth reconvened the meeting at 8:39 a.m.

Ms. Farrell called the roll, a quorum was present.

11. Provide opportunity for public comment – Jarvis Hollingsworth.

No public comment was received.

12. Receive an overview of the February 15, 2018 agenda – Brian Guthrie.

Mr. Guthrie provided an overview for the agenda for the day.

13. Discuss investment matters, including the following:

A. Market Update – Jase Auby

Mr. Jase Auby provided the Semi-Annual Market Update. He said looking into the first half of 2018 the market themes are similar to last reports: global synchronized growth; expected continued global monetary policy tightening in the developed markets; and the emerging markets are continuing to gain momentum over the developed markets. He noted, over the past few weeks, there has been a real resurgence of volatility in the markets.

Mr. Auby reviewed the annual Best Ideas Survey results. He said every year since 2009, TRS has sent out a survey to the entire network of external managers asking for their top three most attractive ideas and their top three least attractive ideas over a one and three year time horizon. He reported the top ideas were unanimously equities – Japanese equities is the top idea, then European equity, emerging market equity, U.S. energy and finally U.S. small cap. He said the network also stated bonds were the place not to be, the least attractive ideas were: European sovereign debt, European high-yield, U.S. high-yield, and U.S. Treasuries.

Mr. Auby discussed the macroeconomic backdrop. He said the economic cycle is divided into six stages. During the first four stages, equities are expected to do well and the final two stages are recessions, bear markets, when equities are expected to do poorly. He said six months ago it appeared we were in a mid-cycle slowdown, tipping over to weakness. However, it appears the cycle has moved back from Stage 4 to Stage 2, the economy actually strengthened from six months ago. Mr. Auby stated the concern is regarding valuation. He said he would characterize valuation as rationally exuberant.

There was discussion about fee loads. Mr. Albright noted Aon's comments that any alpha is offset by the fee so they do not model any alpha in a project because it is offset by the fee. Dr. Brown said it is a fair structure for a median partnership, to be competitive one has to keep getting into the top quartile. Mr. Auby was in agreement and stated that their goal was to be top quartile. In response to Mr. Hollingsworth's inquiry, Mr. Albright stated they did have agreements with the SPN partners but they are looking to extend that across the platform.

Mr. Auby concluded with a special topic, growth today. He said the two biggest impacts on TRS assets are inflation and growth. He stated the overall theme is GDP growth drives equity earnings and equity earnings drive stock market performance.

B. Emerging Manager Annual Update; including consideration of a finding that deliberating or conferring on investment transactions or potential investment transactions in an open meeting would have a detrimental effect on the position of the retirement system in negotiations with a third person or put the retirement system at a competitive disadvantage in the market – Sylvia Bell

On a Motion by Mr. Colonna and seconded by Ms. Ramirez, the Board voted unanimously to find that deliberating or conferring in an open meeting will have a detrimental effect on the position of the retirement system.

At 9:31 am, Mr. Hollingsworth adjourned the meeting to convene an executive session pursuant to Section 551.071 and Section 825.3011 of the Texas Government Code.

At 10:19 am, Mr. Hollingsworth reconvened the meeting in open session.

Ms. Sylvia Bell provided background on TRS' Emerging Manager Program. She reviewed the goals of the program and accomplishments. Ms. Bell stated going forward they are proposing two priorities. One is the billion-dollar EM Select Program. It is an allocation over a three to five year period where TRS would continue its investment relationship with top decile emerging managers but at \$50 to \$100 million. She said the second priority is the EM Innovation, a \$2 billion allocation over the next three to five years to essentially sustain the NAV commensurate with the growth of the Trust. She said as the Trust grows, the percent allocated to the program would also grow.

C. Industry Leadership: Building a World Class Investor – Sacha Ghai, Bryce Klempner and Matt Portner, McKinsey and Company

Mr. Bryce Klempner provided a brief background on McKinsey and Company. He noted the increasing complexities facing institutional investors in terms of achieving returns. He said both in the equities markets and in the debt markets returns are expected to be structurally lower across Europe and North America over the next 20 or so years. This lower returns across asset classes puts quite an onus on public pension funds with obligations to meet.

Mr. Matt Portner said there was real opportunity to improve the management of investment costs. He said compared to Ontario Teachers, Texas is nearly double the cost per \$1 billion of assets under management.

Mr. Sacha Ghai discussed some of the top decile peers and their archetype strategies. One archetype was a reputation for distinctive external manager selection. He described another archetype as building a highly diversified portfolio, insulating against risks and shocks as well as tilting the portfolio in order to earn excess return. The third is building internal capabilities and effectively substituting internal costs for high external manager fees and bank the spread. Mr. Ghai said from their observations, TRS may have an opportunity to unite some of the strategies and build a next-generation investor, optimizing around multiple fronts at the same time to generate world-class performance in the future. In response to Mr. Colonna's inquiry, Mr. Ghai surmised TRS is furthest along with number two due to the efforts TRS has made on risk parity and top-of-the-house asset allocation. Mr. Kempler said TRS was uniquely positioned as also being down the first archetype with the SPN program and having one of the strongest brands within the US as an asset owner.

D. Building the Fleet: Becoming a Best-in-Class Global Institutional Investor – Jerry Albright

Mr. Albright stated 10 years ago the Trust was about \$85 billion with eighty-five people in the investment division. He said today they are at \$150 billion dollars with 150 people. He said if this continues in five to seven years they will be at \$200 billion with 200 people.

Mr. Albright said we are facing a low-return environment and cost comes into play, containing cost to add dollars to the bottom of the Trust value. He said while compared to peers, TRS has added value but are third in cost, the highest cost fund within the peer set. Mr. Albright said they needed to send out “private cruisers” out to find unique transactions and “public cruisers” to find ways to manage assets better and find unique transactions as well. He said the “SPN cruiser” is launched but it can do more and he wants to explore opportunities with subsidiaries. Mr. Albright said they need to plan for scale, dedicated operations and support personnel.

Mr. Albright stated TRS is known as best in class, but wants to be a best in class global fund. He said TRS has a London office and invests around the world in 15,000 some-odd different securities in 54 countries in a myriad of currencies. Mr. Guthrie stated in his presentation he will flesh out more but he emphasized this is a first step in an iterative process. He said more will be presented in April and it will be fully fleshed out by June.

Mr. Hollingsworth stated for the record that if the Board moves forward with this proposal performance measures with respect to employee costs, fees and alpha going forward will need to be identified.

E. SPN Tactical Value Update – Jerry Albright

Mr. Albright provided a brief background on the Strategic Partnership Network (SPN) tactical value. Ms. Courtney Villalta highlighted a couple of key reasons why in January the Investment Committee approved add-on capitol. First she noted this is really a key component in the allocation plan for the absolute return portfolio. Second she said as it relates to KKR and Apollo the performance of the tactical value SPN has been very positive and these investments are very efficient due to already being in place.

14. Receive a report on Portfolio Performance Measures, Issues and Practices – Dr. Keith Brown.

Dr. Brown provided an overview on performance measures – what they should be trying to tell us and where it fits into the bigger scheme of the decisions the Board routinely makes. He said ultimately, performance measurement is a comparison of what we really did, versus what we should have done. He defined the “should have done” as taking risk and converting that risk taking into expected returns. He said there are three ways to view expected returns. One is to look at peer groups, benchmarking to other systems. Another way is to benchmark to formal indexes. The third method is producing an explicit model version of expected returns, what is called a risk factor model. Dr. Brown stated the most important way to view the expected return is as an equivalent to an opportunity cost. He provided examples of performance measures and discussed the concern of comparing against peer groups.

Dr. Brown discussed the two most widely used risk-adjusted measures in practice, the Sharpe ratio being the first. The other performance metric he discussed was the information ratio. Dr. Brown concluded by discussing attribution analysis which is to decompose alpha into how much of it comes from asset allocation decisions or from selection decisions.

15. Receive a presentation on fiduciary duties – Overview of Trustee and Employee Ethics Policies – Carolina de Onis and Heather Traeger; Steve Huff and Keith Johnson, Reinhart Boerner Van Deuren S.C.

Ms. Carolina de Onis introduced the topic of focusing on the fiduciary duties by reviewing the ethics policies that guide behavior at TRS. Ms. de Onis stated one of the best risk management tools for a Board is a culture of compliance and ethics. She then reviewed the intent behind ethics policies to assist in proceeding in various situations. Ms. de Onis discussed fiduciary duties which incorporate two fundamental concepts – duty of loyalty and duty of care.

Ms. Heather Traeger discussed the daily implementation and execution of fiduciary duties at TRS, guided within the framework of the ethics policies. Ms. Traeger then reviewed the specific components of the trustee ethics policy such as conflicts of interest. Ms. de Onis discussed using their position to obtain improper privileges, revolving door prohibitions and misuse of TRS or state resources.

Mr. Steve Huff reviewed the topic Trustee Investments. Mr. Keith Johnson covered referral of an investment provider or another service provider that relates to TRS duties. Mr. Huff discussed when a Trustee should disclose or seek guidance on TRS matters. Mr. Johnson then reviewed co-fiduciary liability.

16. Receive a report on Why is the Healthcare Market Different from other Markets? – Katrina Daniel and Dr. Osama Mikhail, University of Texas Health Science Center.

Ms. Katrina Daniel introduced Dr. Osama Mikhail. She said she invited Dr. Mikhail to talk, to bring his experience to bear, and tell why the health market is different from other markets, why the normal economic factors do not apply.

Dr. Mikhail discussed why healthcare is different from other markets. First, he said, an individual often seeks healthcare during a time of great vulnerability, motivated by fear. He said when other commodities are purchased, they are rarely motivated by fear. He said very few people challenge a physician, even when they say something wrong. He also noted there was an accounting convention that does not reflect the true underlying economics in healthcare. Dr. Mikhail said there are four bottom lines to a healthcare provider, it is not just the bottom line of profit. The provider also has to deliver quality care, improve the productivity of a community and improve the health of the community.

For the healthcare market, Dr. Mikhail described the complex distribution system, complex payment system and complex funding system. He said healthcare was a large market, one in ten people are employed by a healthcare provider of sorts. In response to Mr. Hollingsworth's inquiry, Dr. Mikhail said he did not know how costs were going to be reduced, for every dollar reduced in cost results in someone making less.

17. Consider adoption of the notice of completed rule review for the 403(b) rules in Title 34, Part 3, Chapter 53 of the Texas Administrative Code – Rebecca Merrill.

Ms. Merrill provided background regarding the closing of the 403(b) rule review.

On a motion by Dr. Gibson, seconded by Mr. Corpus, the Board voted to adopt the notice of completed rule review for 403(b) rules with Mr. Moss abstaining.

At 4:35 p.m., Mr. Hollingsworth announced the Board would recess for the rest of the day.

February 16, 2018

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Jarvis Hollingsworth, Chair
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Barbie Pearson, TRS
Amy Barrett, TRS
Heather Traeger, TRS
Katherine Farrell, TRS
Steve Huff, Reinhart Boerner Van Deuren
Keith Johnson, Reinhart Boerner Van Deuren
Dr. Keith Brown, Investment Advisor
Ron O'Hanley, State Street
Andrew Erickson, State Street
Jim Pelletier, IIA

Christine Ardis, Freelance writer
Becca Suzak, Aetna
Gracie Alvear, ERTA
Tiffany Calderon, Humana
Epi Cervantes, Physical Plant
Joni Lozano, CVS Health
Sean Donovan, CVS Health
Leonila Izaguirre, ERTA
Pat Shape, TRTA Edinburg
Marcy Cann, TRTA
June Cooper, TRTA
Pat Macias, TRTA
Dr. Irene Gulley, TRTA
Diane Almaguer, Retired Teacher
Hilda Garza DeShazo, Palm Valley
Assoc. of Retired Personnel

Mr. Hollingsworth reconvened the meeting at 8:05 a.m. Mr. Hollingsworth took a moment to acknowledge the 17 students and teachers who lost their lives in Florida at the Marjorie Stoneman High School. He said it makes us all more mindful of the environments in our academic institutions and our students and our teachers.

Ms. Farrell called the roll, a quorum was present.

18. Provide opportunity for public comment – Jarvis Hollingsworth.

Ms. Christin Ardis, freelance education writer with the Retired Teachers Association, spoke against the health care changes facing retirees.

19. Receive an overview of the February 16, 2018 agenda – Brian Guthrie.

This item was not taken up.

20. Receive a report on TRS and State Street Bank partnership – Ron O'Hanley and Andrew Erickson, State Street.

Mr. Ron O'Hanley stated it's been a privilege of serving TRS since 2002 and being part of operations. He said as TRS has grown and advanced in capabilities they too have advanced theirs. Mr. O'Hanley provided background for State Street Bank and its four business operations: State Street Global Services, State Street Global Advisors, Global Markets and State Street Global

Exchange. Mr. Andrew Erickson highlighted a couple of key aspects of the 15 year partnership of TRS and State Street. Mr. O’Hanley discussed going forward State Street via its technology agenda is building in more flexibility to provide scale advantages and scale cost advantages to TRS. He said they have worked with McKinsey to identify three vitally important areas for asset owners: talent, technology and operational risk. He said their technology investment is very much around their clients’ needs. He stated they are working to make their systems unique, proprietary but more flexible, and more cloud based. In response to Dr. Gibson’s inquiry, Mr. O’Hanley stated cybersecurity is very important, they spend 15 percent of their technology budget on cybersecurity.

21. Receive a report on Value Add of Audit – Amy Barrett and Jim Pelletier, The Institute of Internal Auditors.

Ms. Amy Barrett introduced Mr. Jim Pelletier from the Institute of Internal Auditors (IIA). She said the IIA sets the audit standards within what is called the Red Book. Ms. Barrett said in Texas Auditors are to follow both the Red Book standard and the Yellow Book standard set by the federal government. Ms. Barrett reviewed survey comparing organizations that had an audit shop with organizations that did not. The organization with an internal audit function had a median loss of \$92,000 less and the duration of fraud was less.

Mr. Pelletier stated the IIA recently surveyed their key stakeholders with the goal to find out how internal audit is fitting within organizations and how it is performing within those expectations. He said the key themes that came out of the survey were internal audit does many things well, particularly around the foundational elements of assurance work. He said that there are opportunities for internal audit to add value to the organization by spending more time focusing in risk identification and management in addition to the assurance work.

Mr. Pelletier noted that internal audit is moving away from the old fashioned audit plan to more real-time adjustment to the plan in order to address risks, to keep up to date with changes in business. He said the evaluation of the internal auditors performance is not for each auditor x dollars are saved. He said the measurements the stakeholders of the survey were focused on is the quality of the audit work and the reliability of the results – is what the internal audit tells them is true, complete, accurate and reliable. He said the focus should be the positive impact an audit recommendation had on an organization, are they moving in the right direction. Mr. Pelletier said the focus should not be just on the number of recommendations done in a given time.

Mr. Pelletier discussed how the stakeholders identified how internal audit should be part of facilitating and monitoring risk management and identifying appropriate frameworks. He said the other areas were consulting business process improvements, getting into the advisory component. Mr. Pelletier said that if you are doing an assurance engagement, there is typically an opportunity to also do some consulting, to provide additional insights beyond are you complying or not. He noted with these additional pieces comes a limitation around resources. He said it is up to the chief audit executive to communicate with their key stakeholders to prioritize those competing demands, what is audited and what is not being audited.

Without objection, Mr. Hollingsworth called up agenda item 18.

18. Provide opportunity for public comment – Jarvis Hollingsworth.

Ms. Diane Almaguer spoke against the healthcare changes that are not only unaffordable but she cannot leave to find something more affordable knowing she would not be allowed to return to TRS.

Without objection, Mr. Hollingsworth called up agenda item 22.

22. Receive an overview of the TRS audit plan for FY18 and consider amendments – Amy Barrett

Ms. Barrett provided a brief overview of the original plan. She then reviewed the proposed amendments. She said for this year, since partial refund payments were made, to scope some additional tests to make sure they were handled correctly. She also proposed scaling back the employer audits because the reporting entity partners have not finished completing all of their reports. Benefits requested a consulting project to look at the benefit disbursement area to make sure the segregation of duties are set up correctly and there is no opportunity for fraud. Ms. Barrett said they propose taking this consulting project up and delaying the capital request consulting project. On the healthcare side, she said they are adding a project to review the resources around health insurance benefits and the support functions. Mr. Colonna requested that while audit is performing their normal private equity management fee audit if they could capture if fees are getting round-tripped. Mr. Moss agreed and Ms. Barrett stated she would scope that request in. Ms. Barrett also said in investments they were going to add a TRICOT cost benefit audit.

On a motion by Mr. Corpus, seconded by Dr. Gibson, the Board approved the amendments to the fiscal year 2018 audit plan as presented by staff.

23. Receive a report on TRS Innovations: Looking Ahead – Chris Cutler

Mr. Chris Cutler provided an overview of what innovation is and why it is important to think about it. He noted that technology changes significantly about every 18 months. He said we should always want to be innovative and as we implement our new systems we want to be always changing so ten years from now we are not taking on something as large as TEAM program with all of the additional risks and oversight such a large program takes. Mr. Cutler reviewed the pillars of innovation and discussed the four types of innovation. He discussed a few examples of initiatives at TRS that really captures the innovation TRS is trying to move towards.

With no objections, Mr. Hollingsworth called up agenda item 5.

5. Receive an update on the Many Parts and One Mission of TRS Customer Service –Janet Bray, Katrina Daniel, Rebecca Merrill and Barbie Pearson

Ms. Merrill stated her portion of the presentation dealt with benchmarking TRS' pension administration services against our peers which relates directly to customer service and it also provides background on how TRS performs relative to peers in terms of expenditure. She gave an overview of CEM's survey and how TRS performed in cost, service and complexity to peers. She said TRS has traditionally trended as a low cost low service system relative to peers. She said low service does not mean poor service it just shows how TRS fits relative to its peers in terms of touches with members, etc. In comparison, TRS provides the highest amount of service for the lower cost, no one is providing better service at a lower cost than TRS. The question is should TRS move up the y axis, representing service score, to get closer to peers without moving too far on the x axis, representing costs.

Ms. Merrill said there are planned improvements in terms of service such as our peers counseled 65 percent more of their active members than TRS. She said Ms. Pearson is trying to ramp up the number of counselors to address that and to lower the wait to get in to visit. It takes 90 days to get in to visit a TRS counselor but our peers average 15 day wait. Another example Ms. Merrill gave is the ratio of presenters to attendees in group presentations. TRS' ratio is 70 attendees for everyone presenter, for peers it is about 50.

24. Receive an overview on Resource Planning: FY18 – FY23– Brian Guthrie and Don Green

Mr. Guthrie stated over the past few days you have heard about resource needs from customer service folks in benefits and health insurance, and had heard from IMD, TEAM and IT. He said this was the first presentation to the Board and he intends to come back in April with more detail and then again with a draft budget for the Board's consideration.

Mr. Guthrie approached the resource ask in terms of three buckets. First bucket is the immediate need in providing customer service to members. He said it is well documented in hold times, the complexity of calls and not meeting the service needs of members. The middle bucket he said covers next year and also the next biennium. He said this is where incremental growth and better customer service experience for our members is addressed. The third bucket is longer term look, containing the strategic transformation IMD is proposing and some of the innovations Chris Cutler discussed.

Mr. Guthrie said based upon increase of call volume, email volume and processing time these are issue needing to be addressed immediately. His proposal is to bring on 54 new member service professionals – 44 in Benefits and 10 in Health and Insurance Benefit Divisions. He reported he has authorized the posting for these positions for there is room in the current budget. He said we need to provide better front-line benefits to TRS' members and also enterprise support service for those front-line staff to make sure they have what they need.

The 54 FTEs is just the first step in trying to address the overall issue. He said membership has grown from just under a million in 2000 to 1.5 million member this year and is projected to go over 2 million in a few years, a 60 percent increase. He said our Trust Fund value has gone up by 63 percent and the k-12 enrollment has gone up 34 percent. He said during this same time period benefit staffing levels added 14 people from 2000 to 2017. Mr. Guthrie said our peers have approximately 6 ½ FTEs per 10,000 members in terms of benefit services and TRS has 2.2. He said with the immediate need and keeping pace buckets, the FTEs would go up to 2.7 per 10,000 members.

In regards to TEAM, Mr. Guthrie said there are a total of 177 FTES and contractors. He believes it is beneficial and necessary to keep 82 FTEs moving forward once TEAM is complete. He said some of those will go back to the benefits area and help keeping pace effort and some will stay in IT to work on enhancements to TEAM. Mr. Guthrie said these 82 are already being paid for it is really an administrative change to be done with the legislature because right now the 82 FTEs are not counted against the cap.

Ideally, Mr. Guthrie stated, once there is additional capacity then the focus can be on more member friendly services like extending hours during the week and offering visits and maybe even hone counseling on weekends as well.

Finally, Mr. Guthrie said transitioning IMD to become best-in-class global in-house investor is a goal. He said the proposal is to exercise what they have learned from the relationships with external managers and bring the resources in-house, lowering fees. He said this plan is to be phased in over time. He said during the first three years the proposal is to bring in 60 FTEs with the possible savings of \$500 million in fees with the overall goal of phasing in 120 FTEs. Mr. Guthrie said that with the additional investment resources additional support services like IT and legal are needed and are a part of the overall 120.

Mr. Guthrie reviewed where these proposed FTEs will be housed. He said the 1st through 3rd floor renovations will add 75 new work stations. He said another issue is parking. He said a possible solution is to rotate working from home. Mr. Guthrie also reported a real estate investment opportunity in a downtown Austin area where TRS as a limited partner has the option to exercise in 2021 to lease space in the building once it is completed. He said longer term this could allow the Red River building to be a customer service facility for members.

Mr. Green reviewed the timeline facing the Trustees regarding budget approval, legislative appropriations process and the possibility of exceeding the current FTE cap of 524.

At 12:11 p.m., without further business Mr. Hollingsworth adjourned the meeting.

APPROVED BY THE BOARD OF TRUSTEES OF THE TEACHER RETIREMENT SYSTEM
OF TEXAS ON THE 20th DAY OF APRIL 2018.

ATTESTED BY:

Katherine H Farrell

Katherine H. Farrell

Secretary to the TRS Board of Trustees

4/23/2018
Date