Meeting of the Board of Trustees

December 2, 2016

Presented for Review and Approval

February 22, 2017

TABLE OF CONTENTS

BOARD OF TRUSTEES MEETING
EMPLOYEES RETIREMENT SYSTEM OF TEXAS

December 2, 2016
ERS Board Room
ERS Building – 200 E. 18th Street
Austin, Texas 78701

TRUSTEES PRESENT
I. Craig Hester, Chair
Doug Danzeiser, Vice-Chair
Ilesa Daniels, Member
Cydney Donnell, Member
Brian Ragland, Member
Jeanie Wyatt, Member

ERS STAFF PRESENT
Porter Wilson, Executive Director
Catherine Terrell, Deputy Executive Director
Paula A. Jones, Deputy Executive Director and General Counsel
Shack Nail, Director of Governmental Relations
Tony Chavez, Director of Internal Audit
Bernie Hajovsky, Director, Enterprise Planning Office
Robin Hardaway, Director of Customer Benefits
Robert Kukla, Director of Benefit Contracts
Machelle Pharr, Chief Financial Officer
DeeDee Sterns, Director of Human Resources
Gabrielle Stokes, Director of Office of Procurement & Contract Oversight
Kathryn Tesar, Director Benefits Communications
Tom Tull, Chief Investments Officer
Keith Yawn, Director of Strategic Initiatives
Nora Alvarado, Benefit Contracts
Michelle Barron, Benefit Contracts
Georgina Bouton, Benefit Contracts
Lisa Caffarate, Office of Procurement & Contract Oversight
Amy Chamberlain, Executive Office
Kyla Cloutier, Benefit Contracts
Chloe Conner, Office of Procurement & Contract Oversight
Kelley Davenport, Executive Office
Christi Davis, Customer Benefits
D'ann DeLeon, Benefit Contracts
Brian Dowdy, Finance
Blaise Duran, Benefit Contracts
Leah Erard, Strategic Initiatives
Liz Geise, Benefits Communications
Beth Gilbert, Internal Audit
Ginger Grissom, Office of Procurement & Contract Oversight
Megan Hunter, Benefit Contracts
Jennifer Jones, Strategic Initiatives
Sharmila Kassam, Deputy Chief Investment Officer
Deborah E. Legg, Enterprise Planning Office
Nancy Lippa, Office of the General Counsel
Pamela Maas, Benefit Contracts
Roger Nooner, Benefits Communications
Davis Peacock, Investments
Jonathan Puckett, Internal Audit

Susie Ramirez, Executive Office
Lauren Russell, Benefit Contracts
Robert Sessa, Investments
Carol Stueler, Office of Procurement & Contract Oversight
Bernely Tharp, Benefit Contracts
Angelica Torres, Benefit Contracts

ALSO PRESENT
Steve Alexander, UnitedHealthcare
Patty Armstrong, Reed Group
Nick Arnold, Humana
Keith Barnes, BlueCross BlueShield of Texas
Tiffany Calderon, Humana
Melissa Campenni, UnitedHealthcare
Kevin Cassidy, BlueCross BlueShield of Texas
Andrew Clark, Speaker's Office
Chris Cook, AAG/Empower Retirement
Chris Cronn, UnitedHealthcare
Philip Dial, Rudd and Wisdom
Katy Fallon, Legislative Budget Board
Lynn Gordon, Securian
Meg Hare, Accenture Health & Public Service
Kris Hefner, Caremark
John Hryhorchuk, Office of the Governor
Peter Jansen, CBRE
Dan McCoy, BlueCross BlueShield of Texas
Kim McLeod, UnitedHealthcare
Brittany McCollum, Caremark
Tom Quirk, UnitedHealthcare
Avery Saxe, Legislative Budget Board
Jenifer Schoenke, Reed Group
Mary Stuhr, UnitedHealthcare
Bill Thornton, Empower Retirement
Brad Untiedt, Empower Retirement
Tamra Yale, Reed Group

Mr. Craig Hester, Chairman of the Board of Trustees of the Employees Retirement System of Texas (ERS), noting a quorum was present, called the meeting to order and read the following statement:

"A public notice of the Board of Trustees meeting containing all items on the proposed agenda was filed with the Office of the Secretary of State at 10:58 a.m. on Monday, November 21, 2016 as required by Chapter 551, Texas Government Code, referred to as "The Open Meetings Law."

The Board of Trustees then convened as a committee of the whole at 9:35 a.m. to consider Board of Trustee meeting agenda items.

Meeting of the ERS Board of Trustees

XIII. REVIEW AND APPROVAL OF THE MINUTES TO THE AUGUST 16, 2016 MEETING OF THE BOARD OF TRUSTEES

Board of Trustee Chair, Mr. Craig Hester opened the floor for a motion on the approval of the minutes to the Board of Trustees Meeting held on August 16, 2016.

MOTION made by Mr. Brian Ragland, seconded by Ms. Ilesa Daniels and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas to approve the minutes to the meeting held on August 16, 2016.

XIV. EXECUTIVE SESSION

Mr. Hester stated it was 9:33 a.m. on December 2, 2016. The Board of Trustees will meet in executive session in accordance with Section 551.074, Texas Government Code; the Board of Trustees will meet in executive session to evaluate the duties, performance and compensation of the Internal Auditor of the Employees Retirement System of Texas. Thereafter the Board may consider appropriate action in open session**.**

After the executive session, Mr. Hester stated it was 10:21 a.m. on December 2, 2016. The Board was in open session. No action, decision, or vote was taken by the Board while in executive session and Mr. Hester asked if there were any motions from the Board.

As a result of Mr. Chavez' annual evaluation, Mr. Ragland motioned to increase his salary on January 1, 2017 to $142,000. Mr. Ragland complemented Mr. Chavez and the Internal Audit team for their work. Mr. Hester concurred. There being no further questions or discussion, the Board took the following action:

MOTION made by Mr. Brian Ragland, seconded by Ms. Ilesa Daniels and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

XV. REVIEW, DISCUSSION AND SELECTION OF THE THIRD-PARTY ADMINISTRATOR FOR HEALTHSELECT^{SM} OF TEXAS, INCLUDING CONSUMER DIRECTED HEALTHSELECT^{SM}

HealthSelect of Texas (HealthSelect) is a statewide self-funded health benefit plan offered under the Texas Employees Group Benefits Program (GBP). It is administered by the Employees Retirement System of Texas (ERS) and a qualified third-party administrator (TPA). ERS' current contract for HealthSelect TPA services terminates on August 31, 2017. The TPA provides health-care administration services including customer service, claims processing, provider network management and medical utilization review for HealthSelect. HealthSelect includes the GBP's self-funded, managed care, point-of-service health plan and Consumer Directed HealthSelect, a self-funded high deductible health plan.

ERS entered into a four year contract with UnitedHealthcare Services, Inc. to provide TPA services for HealthSelect for a period from September 1, 2012 through August 31, 2016. ERS had the ability to extend the contract for two years after the initial four year term. ERS extended the contract with UnitedHealthcare Services, Inc. for an additional one year period that will end on August 31, 2017.

Mr. Rob Kukla, Director of Benefit Contracts, asked the Board to consider their recommendation and award the TPA contract for the HealthSelect administrator, the largest contract in Benefit Contracts. There are more than 440,000 participants and the annual plan costs approximately $3 billion including medical and prescription drugs. By the Request for Proposal submission deadline on August 11, 2016, ERS received proposals for HealthSelect TPA services (Proposals) from two entities:

- Blue Cross and Blue Shield of Texas (BCBSTX) and
- UnitedHealthcare Services, Inc. (UHC)

After a preliminary review evaluation, the ERS' Office of Procurement and Contract Oversight (OPCO) determined both proposals met minimum requirements. The evaluation team was comprised of subject matter experts throughout ERS and Rudd and Wisdom, ERS' consulting actuaries. The proposal review evaluation included operational capabilities and services – evaluation weight 40%; and projected total cost, based on financial requirements and specifications and pricing – evaluation weight 60%.

Both BCBSTX and UHC were selected as finalists. The finalist evaluation phase included site visits, face to face interviews, submission of best and final offers, reviews of past performance, contractibility, other legal requirements and regulatory compliance as well as any further clarifications. Ms. Gabrielle Stokes, Director of OPCO, described the finalist evaluation process as exhaustive. The team concluded that both respondents demonstrated full capabilities of providing the core programs and services, communication services, operational services and information systems.

Mr. Blaise Duran, Benefit Contracts, reviewed provider network contracts and projections of total cost evaluations. UHC had a larger in state network. BCBSTX developed a new network for the purpose of this RFP and is targeting 90% of their PPO network. Both have comparable out of state networks. Approximately 5,000 participants would have to find a new PCP with a switch from UHC to BCBSTX. The largest potential cost differential between the proposals was the difference in provider reimbursement. The BCBSTX proposed provider reimbursement for the newly created HealthSelect network is projected to cost about $1.05 billion less than UHC's over the six year term of the contract. In reviewing the projected total cost, Mr. Duran discussed Health Care Management incentives (HCMI) as a tool to incentivize efficient and cost effective management for in-area participants while providing for assessments in the event of adverse experience. Statistical modeling indicates the UHC HCMI proposal has an expected value to the GBP that is $7 million greater than BCBSTX's over the six year term of the contract. The BCBSTX financial proposal is projected to cost about $1.1 billion less than the UHC financial proposal based on the evaluation of the projected total cost.

Benefit Contracts leadership and Rudd and Wisdom met with ERS' Executive Office, the Office of the General Counsel and the Director of OPCO to review scoring results and discuss the recommendation.

Staff recommendation was based on the scores of subject matter experts, all clarifications, face-to face interviews, site visits, the best and final offers, past performance, contractibility and other legal requirements. Staff recommended the Board of Trustees of the Employees Retirement System of Texas award the contract to BlueCross BlueShield of Texas to act as the TPA for HealthSelect, including Consumer Directed HealthSelect, under the GBP pursuant to a contract which will cover a six year term beginning September 1, 2017 through August 31, 2023.

Mr. Hester asked if there was full compliance with all new contract guidelines and requirements. Ms. Stokes assured the board ERS attained best value and compliance with all provisions. Not only did ERS comply with all the SAO audit recommendations from the November 2014 Audit report but also Internal Audit reports and Sunset recommendations. Additionally to comply with HB 1 and a HealthSelect rider, ERS reported assurances to the Legislative Budget Board and the State Auditor's Office(SAO) with a follow up to certify evaluation and contract compliance.

Mr. Danzeiser asked Ms. Stokes to review previous audits and findings since the last procurement. Ms. Stokes and Mr. Kukla reviewed the audit history and verified the substantial implementation of all Internal Audit, Sunset, and SAO/Comptrollers recommendations as well as a contract review by the Attorney General's office. Key elements were acquisition of trained certified purchase and contract managers, suggested contract terms and the evolution of the sophisticated scoring tools. Mr. Ragland clarified that all the discussion of past audit recommendations and heightened scrutiny of this contract in no way indicates that ERS did not choose the most qualified and best value provider five years ago. Ms. Stokes stated that the SAO and internal audits specifically stated that there was no finding that best value had not been achieved.

Ms. Donnell asked about BCBSTX recruiting primary care providers to increase their network of doctors. Mr. Kukla addresses board concerns. While there are differences between the two finalists, both are quite capable with adequate networks, and support ERS initiatives and will be responsive to participants needs. Mr. Danzeiser summarized that in breaking down the financial review – the savings will allow ERS to manage premium increases while preserve plan design. Mr. Ragland stated ERS is not buying an insurance program, they are procuring an administrator – copays, and coinsurance remain the same – and asked that ERS emphasize this in the communications. Ms. Kathryn Tesar, Director of Benefits Communications, assured the Board that participants receive information that the GBP is self-insured and will outline changes. There are currently video explanations on the health plans, including one explaining what self-insured means.

Ms. Wyatt mentioned that ERS is fortunate to have two very competitive bidders and complimented staff on thoroughness of process and achieving savings in this difficult and high cost market. Ms. Daniels asked about coverage for those participants in the middle of a treatment plan when the providers switch. Mr. Kukla explained they will be transitioned and not penalized. Those issues will be dealt with individually and being self-insured allows the plan some flexibility during the transition.

Mr. Danzeiser asked about the HCMI as part of the new contract. The HCMI has changed over the years. The Texas Insurance Code has an HCMI prohibition on the commercial side – claims may go higher than expected for circumstances beyond the carrier's control. He is concerned about the amount at risk based on a percentage of their administrative fee. Penalties are based on a percentage of claims. The HCMI does not include pharmaceuticals. Both carriers plan to put a large percentage of their administrative fees at risk. There is a legislative concern that the TPA might be reluctant to side with the consumer. Risk does not kick in until claims reach 102%, based on program experience. Mr. Danzeiser suggested ERS hire a 3rd party to audit the third-party administrator, which ERS does and will continue to do.

Mr. Phil Dial, Rudd & Wisdom, explained the history and intent of HCMI. The Legislative concern historically was that TPA might not be diligent when paying claims unless they had a financial motivation, to incentivize them to efficiently and effectively manage costs, while keeping many protections in place. With a strict contract, reporting and audit provisions the potential for chance fluctuations are very small. Program is so large that the potential for large fluctuations is small – the 2% allows for an expected range. The HCMI also helps us to evaluate the proposals and lessens the uncertainty when switching TPAs. The TPA has a stringent fiduciary standard. The TPA is not rewarded for keeping costs lower than projected – no evidence of concerted effort to do this by denying healthcare within 25 years of experience at ERS.

In summary, Mr. Danzeiser expressed concern about the HCMI. Mr. Danzeiser asked to make a motion to delete the HCMI from the BCBSTX contract, and direct staff to get board approval before including it in a future RFPs.

Ms. Stokes and Mr. Dial expressed concern that the HCMI provision is an integral part of evaluation and recommendation as well as the contract provisions. The HCMI provides protection from that uncertainty when switching TPAs. Ms. Donnell suggested staff can explore reasons why the Legislature directed ERS one way and the Texas Department of Insurance commercial marketplace another way. Mr. Hester raised a concern that this is changing rules of game with this RFP bid. Sees the pros and cons but concerned about doing it wrong. Mr. Hester asked staff if historically ERS has seen claims abuse. Ms. Donnell stated there is a huge reputational hit to any company denying reasonable medical claims – must be mindful of the unintended consequences of any incentive.

MOTION made by Mr. Doug Danzeiser to strike any contract provisions from the HealthSelect TPA contract relating to Section VIII A(3) of the RFP which is the section of the RFP relating to this Health Care Management Incentive. The motion died for lack of a second from the Board.

There being no further questions or discussion the Board then took the following action:

MOTION made by Mr. Doug Danzeiser, seconded by Ms. Cydney Donnell and carried unanimously by the present members of the Board of Trustees of the Employees Retirement System of Texas.

Based on the information provided to ERS in response to the Request for Proposal, the evaluation process and results presented to the Board at this meeting, the Board has received sufficient information to determine the Third Party Administrator to provide services in the best interest of GBP participants for HealthSelect of Texas, including Consumer Directed HealthSelect.

Therefore, I move that the Board of Trustees of the Employees Retirement System of Texas award the contract to BlueCross BlueShield of Texas to act as the third-party administrator for HealthSelect of Texas, including Consumer Directed HealthSelect under the Texas Employees Group Benefits Program pursuant to a contract which will cover a six year term beginning September 1, 2017 through August 31, 2023.

I further move that the Board of Trustees of the Employees Retirement System of Texas authorized the Executive Director to negotiate and execute a contract with BlueCross BlueShield of Texas with terms that are fully acceptable to ERS, and authorize the Executive Director to thereafter administer the contract agreed to by the parties.

In the event that a contract fully satisfactory to ERS is not timely executed with BlueCross BlueShield of Texas or if it appears to the Executive Director during the term of the contract that BlueCross BlueShield of Texas will not be capable of performing the required third-party administration to ERS' satisfaction, then the Board authorizes the Executive Director to resume any necessary due diligence process and contract negotiations with BlueCross BlueShield of Texas and to negotiate and execute contract terms with BlueCross BlueShield of Texas that are fully acceptable to ERS, and to authorize the Executive Director to thereafter administer the contract agreed to by the parties.

XVI. REVIEW AND DISCUSSION OF THE DEFERRED COMPENSATION PROGRAM TEXA$AVER 401(K) AND 457 PLANS AND MONITORING STRATEGY OVERVIEW

Mr. Rob Kukla, Director of Benefit Contracts, introduced Ms. Nora Alvarado, Manager of Account Management Team in Benefit Contracts and a Certified Texas Contract Manager (CTCM) and Ms. Pamela Maas, Texa$aver Program Account Manager in Benefit Contracts and a CTCM.

Ms. Alvarado provided an overview of the Texa$aver Program, which is comprised of two plans, the 457 and the 401(k) Plan. It's a voluntary retirement program offered through ERS. The Program is designed to help state employees save for their future and is part of the three-legged stool including pension, Social Security, and personal savings such as the Texa$aver Program. All three legs are needed to provide a stable income, security, and retirement.

Higher education employees can participate only in the 457 Plan. State agency employees can participate in either or both plans. The total assets are approximately $2.6 billion as of August 31, 2016. The legislature does not appropriate funds for the administration of the Program and is 100% funded by the participants. There are flexible contributions options in either a percentage or a dollar amount with a minimum of 1% or $20. Our current third-party administrator is Empower Retirement. Since FY 15, both plans have increased in accounts and assets. Texa$aver has a total balance of approximately $28.5 million. Since January of 2008, new employees are automatically enrolled in the Plan at 1%. And approximately 55,000 participants have increased their deferral above 1%. However, 74,500 still remain at the 1% deferral - approximately about 34% of the participants in the Program.

Texa$aver is a low cost program. The administrative fees cover the cost of the record-keeping services. These fees are assessed separately to the plans. The Program has competitive administrative and investment fees. It also offers flexible and easy account management. Every year the Underwriting Data Analysis and Reporting Team staff performs a review of the fee stratification tiers and as necessary proposes adjustments based on actual enrollment figures. Administrative fees paid by the participant will not change for calendar year 2017.

Texa$aver offers investment products that are competitively priced compared to many retail mutual funds. Some funds offer attractive reimbursements to participants. The Program has been able to negotiate institutional pricing and more favorable fund reimbursements. All fund reimbursements are given back to participants who invest in those funds at the end of each quarter. And as of the third quarter of 2016, a total of $2.4 million was given back to participants. Texa$aver is one of the few that gives these reimbursements back to our participants. Mr. Danzeiser asked how well the enrollees' investments are performing when compared with the pension fund. Ms. Alvarado will provide him with that number.

Ms. Alvarado introduced Ms. Maas to review Texa$aver monthly monitoring reporting, the monthly

Account Management Review, the Operations Review, and the System and Data Management review. As illustrated by the Heat Map Summary, the Texa$aver TPA Empower did not incur any performance assessments for FY16, an improvement over FY2015.

Ms. Alvarado added that the Texa$aver Program received 25 various awards for 2016, most were MarCom and Hermes awards. ERS received an award for technology and Social media from the National Association of Governmental Defined Contribution Administrators for *Pump Up Your Savings*, the *Stay in the Family* campaign as well as the Wells Fargo Target Date Fund's video.

Mr. Hester noted the importance of the program and good value to its participants.

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

XVII. REVIEW, DISCUSSION AND CONSIDERATION OF THE TEXAS EMPLOYEES GROUP BENEFITS PROGRAM:

a. Health Insurance Financial Status Update for Fiscal Year 2016 and Outlook for Fiscal Year 2017

Mr. Kukla explained the GBP Health Plans Performance for FY16 had a $58.4 million net gain. GBP finished the plan year with $498.9 million in the contingency fund. The self-funded program saw favorable experience in the medical and prescription trends. Since 2012, the Network grew 20% and in-network participant utilization is 90.5%. From 2015, grievances and appeals increased by 264 or 69% since 2015. More than 70% of appeals were provider initiated. Mr. Danzeiser asked if this number included mediation from state mediation system through the Texas Department of Insurance (TDI). ERS participates in the state mediation system, but the grievance stats did not include the TDI system numbers. Statistics from TDI reflect 451 mediations were from ERS in 2016. That number is down from FY15. Mr. Danzeiser asked about the success of the program. Mr. Kukla said that mediation did not help contracting with out-of-network providers as most of those going to mediation did not see a large enough number of ERS patients to make contracting worthwhile. Mr. Kukla discussed how UnitedHealthCare is working to contract with anesthesiologists and emergency room physicians and there has been some success in contracting with these doctors.

Under initiatives to reduce costs, the patient-centered medical homes continue to be successful. The ongoing dependent eligibility audits saved approximately $8 million net of fees in FY16.

Mr. Duran presented the health plans FY 2017 outlook. The new high-deductible health plan began September 1, 2016 and is only available for non-Medicare GBP participants. There are currently more than 400 members enrolled, therefore it will have minimal fiscal impact. The health care trend is consistent at 8.5%. The new Pharmacy Benefit Management contract (effective January 1, 2017) is estimated to save $100 million over FY17. As a result, expected gains for the year are $94.7 million leaving a fund balance of $593.6 million. The fund has not reached 60-days of health care claims which are $677.4 million.

Mr. Kukla acknowledged the work of staff and the Board to help control health care spending and concluded the GBP health plans are on solid financial ground. Ms. Donnell recognized Benefit Contracts staff work to save the Fund money and manage health care costs. Mr. Danzeiser agreed.

This agenda item is presented for discussion and informational purposes only. No action is necessary.

Fiscal Year 2017 enrollment for all three options is more than 445,000 participants despite a 10% increase in the contribution rate.

This agenda item is presented for discussion and informational purposes only. No action is necessary.

b. GBP Medicare Plans and Monitoring Strategy Overview

Mr. Kukla introduced Ms. D'Ann DeLeon, Benefit Contracts Program Account Manager and CTCM, to review the Medicare programs, including the medical and pharmacy Medicare plans. Ms. DeLeon reviewed the two Medicare options, HealthSelect Medicare Advantage and Kelsey Care Advantage/HMO, as well as the Medicare prescription drug plan, HealthSelect Medicare Rx, plans for GBP Medicare-eligible retirees and Medicare-eligible dependents. The Medicare Advantage Preferred Provider organization is statewide. All participants are eligible for primary coverage under Medicare Part A and Part B. The contract period began January 1, 2012 and runs through December 31, 2017.

The HealthSelect Medicare Advantage Program provides a custom benefit with the most comprehensive benefits for GBP Medicare-eligible participants. This program is only available to our members. The HealthSelect Medicare Advantage Plan continues to provide the most cost-effective medical benefits to the Medicare primary GBP participants. Overall enrollment continues to grow and as of August, 2016, a total of 66,465 participants were enrolled.

The HealthSelect Medicare Advantage Plan is subject to enhanced contract monitoring. The Monthly Administrative Performance Report (MAPR) is a component of the overall contract-monitoring strategy. The MAPR captures 17 services; however, 16 of these are measured and reported monthly, quarterly, and on an annual basis. For calendar year 2015, Humana MA received a total of three assessments totaling $26,400.

Ms. DeLeon then presented the Medicare prescription drug plan, HealthSelect Medicare Rx, overview. The HealthSelect Medicare Rx is an Employer Group Waiver Plan plus Wrap which serves as a designated prescription drug plan for the HealthSelect Medicare PPO, Medicare Advantage HMO, and HealthSelect of Texas Medicare-primary participants. As previously mentioned, the SilverScripts Insurance Company is the third-party administrator of this program. Unlike the HealthSelect Medicare Advantage Program, if a participant opts out of the HealthSelect Medicare Rx Program, they lose coverage. ERS obtains subsidies, and members continue to receive comparable benefits.

This contract period began January 1, 2013 and runs through December 31 of 2016. In May the Board approved UnitedHealthCare Services, Inc., to be the administrator for this plan which will be effective January 1, 2017. The HealthSelect Medicare Rx plan continues to provide the most cost-effective prescription drug coverage for Medicare-primary GBP participants. Enrollment has increased for calendar year 2016 to 90,118 participants.

The HealthSelect Medicare Pharmacy Plan Heat Map summary and MAPR reflects the contract performance areas SilverScripts must report each month. For calendar year 2015 the MAPR captured 24 services, however 23 are specific to contract oversight. This is more than the HealthSelect MA PPO Plan because additional metrics are needed for a prescription drug plan. For calendar year 2015, SilverScripts received a total of nine assessments totaling $512,500.

This agenda item was presented for discussion and informational purposes only. No action is necessary.

c. Dental Insurance Plans and Monitoring Strategy Overview

Mr. Kukla introduced Ms. Angelica Torres, the dental insurance plans program manager, to present the overview. The first is the State of Texas Dental Choice Plan. This is a self-funded Preferred Provider Organization administered by Humana Dental Insurance Company. The second is the Humana Dental HMO which is a fully insured Dental Health Maintenance Organization (DHMO) Plan. The carrier for the DHMO Plan is Denticare, Inc., which is a wholly owned subsidiary of Humana, Inc. The third option is our State of Texas Dental Discount Plan. This is a non-insurance dental discount program administered by Careington International.

All three contracts run concurrently with the Board awarding the provider contracts for four-year terms that began on September 1, 2014 and will run through August 31, 2018. The dental programs continue to be one of the most utilized of the optional benefits, and enrollment within the dental options continues to grow at a rate of more than 3% per year.

Fiscal Year 2017 enrollment for all three options is more than 445,000 participants. Despite a 10% increase in the contribution rate, enrollment in the Dental Choice Plan increased 5% whereas the DHMO has experienced a 2.2% decrease in enrollment. ERS anticipated this decrease with the introduction of the State of Texas Dental Discount Plan.

The Monthly Administrative Performance Report is used to capture specific contractually agreed upon performance areas and includes all performance guaranteed standards.

The State of Texas Dental Choice Plan is subject to enhanced performance monitoring. Humana met all metrics throughout Plan Year 2016 except the month of August. As a result of a file–processing error, an ERS weekly maintenance file was not processed within the contractually-agreed upon timeline. ERS's total assessment for Humana Dental was $200,000 for Plan Year 2016.

The Humana Dental Health Maintenance Organization or DentiCare met all performance guarantees for Plan Year 2016.

This agenda item is presented for discussion and informational purposes only. No action is necessary.

d. Basic and Optional Term Life, Accidental Death and Dismemberment Plans Monitoring Strategy Overview

Mr. Kukla introduced Ms. Megan Hunter, Program Account Manager for the Basic and Optional Term Life, Accidental Death and Dismemberment (AD&D) plans, to present a review of performance. The Texas Employees Group Benefits Program offers these products. The employer provides funding for Basic Term Life and the other plans are optional and funded by participants. These plans are administered by Minnesota Life Insurance Company, an affiliate of Securian Financial Group, Inc. Life and AD&D Plans are popular with GBP participants. Of the 347,032 employees and retirees eligible to participate, nearly 96% are covered under Basic Life, Optional Life, or Voluntary AD&D; 32.2% of members elected Dependent Life coverage. Ms. Hunter reviewed the Monthly Administrative Performance Report for plan year 2016. Minnesota Life missed on the performance guarantee tied to approval of communications material. ERS elected to waive the assessment due to nominal impact on participants and quick response by Minnesota Life to resolve the issue. Mr. Kukla explained that the monitoring process is relatively consistent among all these programs.

This agenda item is presented for discussion and informational purposes only. No action is necessary.

e. Group Vision Care Program and Monitoring Strategy Overview

Ms. Hunter also manages State of Texas Vision, the newest self-funded group vision plan offered to all employees, retirees, and their eligible dependents. State of Texas Vision is administered by Superior Vision Services, Inc. More than 117,000 participants or 17.9% of eligible population enrolled in the plan. These numbers don't include retirees or their dependents because their effective date is January 1, 2017. Mr. Kukla added there is a total of 654,000 eligible participants. Mr. Danzeiser asked about potential for adverse selection for enrollees to opt in one year and opt out the next. Mr. Kukla stated that yes, that is possible, but typically individuals that utilize the plan stay with it. Mr. Danzeiser requested the information after the next enrollment period.

Ms. Hunter reviewed the implementation experience for the new State of Texas Vision plan; which went smoothly. ERS and Superior Vision teams worked diligently to inform members and were ready to go on September 1.

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

f. Disability Plans and Monitoring Strategy Overview

Mr. Kukla introduced Ms. Bernely Tharp, Program Account Manager for the Disability Plan also known as the Texas Income Protection Plan (TIPP). TIPP is optional insurance coverage that employees can apply for. Active employees have the choice to enroll in short-term and/or long-term disability. Short-term disability covers 66% of an employee's monthly salary and long-term disability covers 60% of an employee's monthly salary (up to $10,000). TIPP provides assistance when an employee is unable to work due to a medical condition. This plan is self-insured and funded by plan participants.

TIPP is currently administered by the Reed Group Management, LLC. Reed Group purchased Aon Hewitt Absence Management, LLC on December 31, 2015.

For FY16, 117,488 members are enrolled in the short-term disability plan and 90,529 members are enrolled in the long-term disability plan. Both plans have experienced a 1.4% decrease in enrollment for FY17, yet covered payroll is up. Enrollment in the long-term disability plan tends to be lower than the short-term disability plan. We believe this is a result of the fact that members are eligible to apply for disability retirement after 10 years of service.

The Monthly Administrative Performance Report captures all 22 criteria, 14 of which are performance guarantees (PG). The 14 PGs fall into 4 categories, Account Management, Customer Service, Operations, and Systems and Data Management.

Total assessments for PY16 were $305,000; which is higher than the $237,900 that was assessed for PY15. In PY15, there were 13 PGs missed and 8 assessments. In PY16, there were 12 PGs missed and 11 assessments. The PG waived for PY16 was for the processing of short-term disability claims within 10 days. It is reported monthly and assessments are made on a quarterly basis. The PG was missed because of the month of October, where they reported processing 85% of short-term disability claims within 10 business days. Since November showed an improvement, 96%, ERS decided to waive the missed PG.

Since July 2016, Reed Group and ERS have worked to stabilize performance and achieve stability through the Go To Green project. Areas such as customer service and operations have shown some improvement. The biggest improvement is in financial accuracy. September 2016 was first month the financial accuracy metric was met since contract awarded. Mr. Hester questioned if problems were a result of change in TPA. Ms. Tharp explained the problems have been similar to previous TPA.

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

XVIII. REVIEW AND DISCUSSION OF THE TEXAS EMPLOYEES GROUP BENEFITS PROGRAM: TEXFLEX PROGRAM AND MONITORING STRATEGY OVERVIEW

Mr. Kukla asked Ms. Angelica Torres, Program Account Manager for TexFlex, to review the program. The TexFlex Program is an optional benefit governed by the IRS and provided to active employees as a means to help budget for planned health and day care expenses using pre-tax salary contributions. The Program is comprised of four different reimbursement plans.

- A health care reimbursement plan (FSA) allows participants to be reimbursed for things like medical copays, coinsurance prescription drugs and some over-the-counter items.
- The limited reimbursement plan (LFSA) is specifically for participants who are enrolled in the Consumer Direct HealthSelect Plan (CDHS), which went into effect in Plan Year 2017. Reimbursement under this account type is limited to vision and dental expenses because participants already have access to the health savings account (HSA). The IRS stipulates you can't have access to both an FSA and an HSA.
- The dependent care reimbursement plan is used to pay for planned day care expenses for eligible dependents under the age of 13.
- The commuter reimbursement plan (CSA) went into effect January, 2016. It's comprised of both the parking and transit accounts, and allows participants to pay for transit passes and parking expenses they incur during their commute to and from work.

Pre-tax payments or premium conversion programs are automatic for state employees enrolling in TexFlex, health, dental, and life insurance coverage under the GBP. The premium conversation programs generated approximately $42 million in FICA tax savings to the State of Texas in FY16.

ADP is the program administrator for all the reimbursement plans under the TexFlex Program. However, ADP has entered into a definitive agreement to sell their spending account business to WageWorks. ADP's current contract and operations team will remain in effect until further discussions with WageWorks.

Currently there are about 50,000 participants in the healthcare reimbursement plan and 3,640 in the dependent care reimbursement plan. The enrollment in the FSA programs is about 21% of our eligible population.

With the adoption of the high deductible health plan and health savings account, ERS was tasked with implementing an LFSA to remain compliant with applicable IRS regulations. This account type is only available for participants who are enrolled in CDHS and is limited to reimbursement for dental and vision expenses. There are approximately 340 participants in CDHS. Forty chose to participate in the LFSA.

Since its inception in March of 2016, the CSA or qualified parking and qualified transit accounts available under TexFlex have seen low participation across the eligible population with only 22 participants enrolled in parking and 149 in transit. Unlike the FSA programs, the CSA is a month-to-month benefit. Participants can enroll at any time throughout the plan year. The administration fee is charged per month per participant like the FSA.

Mr. Kukla discussed the viability of continuing this benefit considering the administrative expense it takes to cover the process. There are various challenges and staff estimates that currently between $2,000 and $3,000 a month is required to administer this plan. The portion of the fee associated with this plan, returns about 10 cents per participant back to ERS to cover that cost. We need 28,000 to 30,000 participants to break even on the program administrative costs. Some higher education organizations have their own CSA programs. Some of the IRS rules regarding the use of the debit card and utilizing transit stops to purchase transit tickets are problematic. Unfortunately, Austin's Cap Metro does not meet some of those rules, so it's difficult for our members in the Austin area. Based on participation, our members aren't interested and perhaps we should discontinue the program.

With the limited participation and cost-benefit, Mr. Hester asked is the program worth it? Mr. Kukla responded that we need a year's experience. If problems and low enrollment continue, then assess continuance at that time. Mr. Ragland noted the costs significantly exceed the benefit. Mr. Porter Wilson, Executive Director, spoke to implementation costs and giving the program time to succeed. The Board discussed increased costs, traffic, working with Capitol Metro and possible discounts.

Ms. Torres reviewed The Monthly Administrative Performance Report for the ADP and the TexFlex plans. ADP was assessed a total of $206,316 in Plan Year 2016. ADP is showing improvement. The main problems are with debit card validation requests and notification timing. We expect improvement to continue.

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

XIX. REVIEW, DISCUSSION AND CONSIDERATION OF THE TEXAS EMPLOYEES GROUP BENEFITS PROGRAM: ACTUARIAL VALUATION OF RETIREE HEALTH INSURANCE BENEFITS AS OF AUGUST 31, 2016

Ms. Machelle Pharr, Chief Financial Officer, explained the actuarial valuation was conducted each year in accordance with Government Code Chapter 2264, the Governmental Accounting Standards Board, and the reporting requirements of the Texas Comptroller of Public Accounts (Comptroller). Rudd and Wisdom, Inc., ERS' consulting actuary for insurance, conducted an actuarial valuation of retiree insurance benefits, known as Other Post-Employment Benefits (OPEB), provided under the Texas Employees Group Benefits Program (GBP), for the fiscal year ending August 31, 2016.

Mr. Phil Dial, Rudd and Wisdom, stated this is the tenth valuation of GBP OPEB and will be the last valuation under the Governmental Accounting Standards Board Statement No. 43 (GASB 43). The GBP provides OPEB to retirees of state agencies, certain higher education institutions, and other employers. OPEB provided through the GBP includes health benefits and basic life insurance; it does not include retirement benefits.

The information required under GASB 43 is reported by ERS in the notes and supplementary information contained in the CAFR. ERS provides this information to the Comptroller. The Comptroller obtains similar information from TRS. The Comptroller is not required under GASB to report the information directly in the financial statements. GASB 43 requires the disclosure of the Annual Required Contribution (ARC), but the employer is not required to contribute the ARC each year.

Mr. Dial reminded the Board that Senate Bill 1459, adopted by the 83rd legislative session, amended Article 1551 of the Texas Insurance Code to provide tiered state contribution rates for retiree health insurance that varies based on length of service at retirement. The amendment applies only to employees with less than five years of service on September 1, 2014, who retire on or after September 1, 2014. Senate Bill 1459 has a small impact on the fiscal year 2016 OPEB liabilities and costs since it applies to a small segment of membership most of whom will not be eligible to retire for many years. Over time, Senate Bill 1459 will reduce the State's liability and costs for applicable employees who retire with less than 20 years of service and discourage some employees and vested terminated members with less than 20 years of service from enrolling in insurance upon retirement.

Mr. Mitchell Bilbe, of Rudd and Wisdom, explained that determination of the OPEB liability requires the use an actuarial cost method to calculate the present value of the future benefits attributable to past service. The demographic and pay-related assumptions used in the valuation are the same as those used in valuing the retirement plans. GASB 43 requires the investment return assumption for a plan funded on a pay-as-you-go (PAYGO) basis to be based on the rate of return on the employer's assets.

The demographic assumptions include mortality, disability, termination, withdrawal and retirement. The calculation for state agency employees and retirees uses the same demographic assumptions used by ERS for its retirement plan valuation for FY 2016, while the calculation for higher education employees and retirees uses the same demographic assumptions used by TRS for its retirement plan valuation for FY 2016.

The economic assumptions include: inflation, payroll growth and salary increases for merit, promotion and longevity. The economic assumptions are the same as those used for the retirement plan valuations for ERS and TRS respectively. The OPEB liability for the GBP is funded on a PAYGO basis which, under GASB 43, requires the investment return assumption to be based on the expected yield of the "assets of the employer" because there are no assets in the plan. For the State of Texas, the "assets of the employer" are the assets held in the Treasury Pool and managed by the Comptroller. The average annual real rate of return (return in excess of inflation) for the Treasury Pool has been approximately 2.0% over the last 30-years. Based on this analysis and the inflation assumption adopted by the Board for purposes of the retirement plan valuation (3.5%), an investment return assumption of 5.5% was selected for the OPEB valuation. This is the same investment return assumption used for the FY 2008 - FY 2015 valuations.

The valuation is based on projected per capita health benefit costs for fiscal year 2017 by gender and age. With the addition of the Medicare Advantage PPO Plan, HealthSelect Medicare Advantage in January 2012, it became necessary to have two sets of per capita health benefit costs, one for retirees participating in HealthSelect and another for retirees participating in HealthSelect Medicare Advantage. Another key assumption is the Health Benefit Plan Cost Trend, a select and ultimate trend assumption which begins at the levels used in projecting cost for the next biennium which is 8.5% per year. Then it is assumed to decline over the subsequent five years to a sustainable ultimate level (5.5% per year). The population used in the valuation is broken into three categories: active or current employees, deferred vested or former employees entitled to OPEB, and retirees and surviving spouses currently receiving OPEB.

The Unfunded Actuarial Accrued Liability (UAAL) is the difference between the Actuarial Accrued liability and the assets. For a PAYGO plan there are no assets so the UAAL is equal to the AAL which is **$27.091 billion** as of August 31, 2016. The UAAL was **$25.741 billion** last year. The most significant change in the assumptions used in valuing the liability is the expected savings resulting from the new PBM contract for the EGWP Program.

Beginning with FY17, GASB is replacing Statement No. 43 with Statement No. 74, which will require significant changes in the valuation for unfunded plans like the GBP. The investment return assumption will be required to be based on yields of 20-year tax exempt general obligation municipal bonds with an average rating of AA/Aa or higher. If GASB follows the market-to-market approach required for retirement plans under GASB 67 and 68, the expected investment return assumption for FY17 could be lower than the current assumption and could be less than 3% which would significantly impact liability numbers.

Mr. Hester asked Mr. Dial to estimate the impact in dollars. Due to the required changes in assumptions, Mr. Dial could not provide an estimate at this time. Mr. Hester noted that OPEB are not guaranteed benefits and the legislature can make changes each session which would affect how the liability is calculated. Ms. Pharr explained that under GASB 75, the liability may be required to be on the employer's financial statement, impacting this program and the State of Texas. Mr. Wilson mentioned there is no constitutional guarantee of the health and life insurance benefits for retirees. However, they are very important to retirees, and the legislature is committed to the benefits. The legislature makes a decision each biennium whether to continue to fund the benefits and how much to fund. Mr. Danzeiser asked about funding levels. He asked the actuaries about the necessary appropriation for the legislature to maintain the same benefits. Mr. Dial noted that the projected cost increases are included in the appropriation request.

There being no further questions or discussion, the Board took the following action:

MOTION made by Ms. Cydney Donnell, seconded by Mr. Brian Ragland and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas to.

Move that the Board of Trustees of the Employees Retirement System of Texas accept the OPEB actuarial valuation for retiree health benefits under the Texas Employees Group Benefits Program for Fiscal Year 2016 performed by Rudd and Wisdom, Inc., and presented with this agenda item as Exhibit A.

XX. REVIEW, DISCUSSION AND CONSIDERATION OF REAPPOINTMENT OF ERS INVESTMENT ADVISORY COMMITTEE MEMBER WITH TERM EXPIRING DECEMBER 31, 2016

In accordance with the Employees Retirement System of Texas (ERS) *Investment Policy,* Section 4.3, the ERS' Investment Advisory Committee (IAC) was established at the discretion of the Board of Trustees (Board) in Texas Administrative Code §63.17(b). The IAC is made up of at least five, and not more than nine, members with a current composition of seven members. IAC members serve at the pleasure of the Board for staggered three-year terms. Members are subject to compliance with the ERS Investment Policy and Texas Government Code §815.509 and §§815.5091 through 815.5092.

Mr. Tom Tull, Chief Investment Officer, outlined the requirements, statutes and duties of the Investment Advisory Committee. Staff recommends that Ms. Cooley be reappointed to her second term based on her qualifications and expertise. Mr. Hester explained that the committee could be expanded and recommended expansion be considered. Mr. Wilson mentioned a survey for the self-evaluation of the Investment Advisory Committee would be conducted following the Board meeting and should yield valuable information.

There being no further questions or discussion, the Board took the following action:

MOTION made by Mr. Craig Hester, seconded by Ms. Jeanie Wyatt and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas to reappoint Ms. Caroline Cooley to the Investment Advisory Committee for a three-year term ending December 31, 2019and the Executive Director be authorized to execute contracts in connection with the reappointment of Ms. Cooley.

XXI. EXECUTIVE DIRECTOR AGENCY UPDATE

Mr. Porter Wilson, Executive Director proceeded with the next agenda item, Executive Director Agency Update. He provided a legislative update:

- Testimony to House Pensions Committee Hearing on LECOSRF – 11/14/16 ERS presentation provided information on the funded status of the fund, explained how both the employee class and supplemental fund benefits are calculated for law enforcement and custodial officers and discussed how state employee contributions are subsidizing the higher cost of benefits for LECOSRF members. There is $378 million in liability.
- ERS submitted a required Interim Study on Type 2 Diabetes to legislators and stakeholders. Of the ERS population, 13% is diabetic and drives 31% of plan costs. ERS is implementing programs such as Real Appeal which helps manage pre-diabetics avoid becoming diabetics.
- 85th Legislative Session - 1/10/17
  Mike Ewing is leading the effort to identify and track bills for the website. The general appropriations bill will contain the fiscal provisions that provide for our pension fund and health insurance.

Mr. Wilson presented a Sunset Review update reviewing the public hearings and Sunset Commission decisions and recommendations. Since May 2016, ERS staff has been working to implement all of the Sunset recommendations that do not require statutory change to enact. To date, staff has succeeded in fully implementing five of the 15 recommendations. Another three recommendations have been partially or materially completed with identified completion dates within the current fiscal year. Seven recommendations remain under consideration by ERS staff – involving industry best practice research and operational process and organizational reviews. Six of these are related to statutory changes that will not provide final direction and authority until potential passage during the 85^{th} Regular Legislative Session.

Mr. Wilson updated the Board on PY Fall Enrollment for Medicare-eligible retirees and their families. Three webinars and 19 fairs were held across Texas. The State of Texas Vision plan is the vision insurance administered by TPA Superior Vision Services, Inc. and has over 120,000 total enrollees. The HealthSelect Prescription Drug Program will be administered by UnitedHealthcare beginning January 1, 2017 and ERS is working to communicate and assist members through the transition from CVS Caremark to UHC.

Mr. Wilson asked Ms. Robin Hardaway, Director of Customer Benefits, to explain Chapter 615 Benefits. The Texas Legislature enacted Chapter 615 of the Texas Government Code during the 60th legislative session (1967) to provide death benefits for eligible survivors of certain law enforcement officers, fire fighters, and others killed in the line of duty. The program is fully funded by the State and benefits are not paid from the retirement trust fund. The program is administered by the Employees Retirement System of Texas (ERS). Administrative duties include receiving and processing the applications, including determining whether the individual died in the line of duty. ERS also manages the payment process for the lump sum benefits.

For the February Board meeting, staff and the board are planning to transition to a new system capable of providing Board members and the IAC members meeting information. Both are provided with Board books and a secure website that is ending. ERS is procuring a web service that will allow better search capabilities, better management tools for agenda items, exhibits, meeting notes, and other information provided to Board members. It can be a paperless solution with the goal to eliminate the bulky binders with the information provided electronically. Leading into the February Board meeting, contracting may have been finalized and training will be provided for staff and the Board.

The Executive Office was reorganized to enhance teamwork and clarify duties. Governmental Relations and the Enterprise Planning Office have merged with EO. Mr. Shack Nail will reprise his role as Governmental Relations Director. Mr. Bernie Hajovsky, Director of the Enterprise Planning Office, has been guiding enterprise-wide projects to ensure efficient, timely implementations. Keith Yawn, Director of Strategic Initiatives, will be working with Governmental Relations and supporting EO to complete legislative deliverables as well as other key initiatives at ERS.

The State Employee Charitable Campaign (SECC) exceeded the ERS campaign goals, achieving a 90% employee contribution rate and a total of $56,000. Mr. Wilson shared some pictures from the SECC campaign and the successful ERS support for numerous deserving charities. Ms. Carla Lawrence chaired this year's effort and was supported by the previous chair, Ms. Beth Gilbert.

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

XXII. SET DATE FOR THE NEXT JOINT MEETING OF THE ERS BOARD OF TRUSTEES AND INVESTMENT ADVISORY COMMITTEE, THE NEXT MEETING OF THE BOARD OF TRUSTEES AND THE NEXT MEETING OF THE AUDIT COMMITTEE

Mr. Hester asked that board review the item and note that the meeting day is moving from Tuesday to Wednesday. Mr. Wilson noted that the extra time will help staff better prepare and there is a different date in August because of a conference conflict. Mr. Hester called for a motion to accept the proposed meeting dates.

The dates for the 2017 meetings of the ERS Board of Trustees and Investment Advisory Committee, the Meeting of the Board of Trustees and the Meeting of the Audit Committee are as follow:

Wednesday, February 22, 2017
Wednesday, May 17, 2017
Wednesday, August 23, 2017

2 Day Workshop:
Tuesday - Wednesday, December 12 & 13, 2017

MOTION made by Ms. Jeanie Wyatt, seconded by Mr. Doug Danzeiser and carried unanimously by the members of the Board of Trustees of the Employees Retirement System of Texas to approve the proposed meeting dates for Board of Trustees and Investment Advisory Committee, the Meeting of the Board of Trustees and the Meeting of the Audit Committee.

XXIII. EXECUTIVE SESSION

Mr. Hester stated it was 2:31 p.m. on December 2, 2016. The Board of Trustees will meet in executive session in accordance with Section 551.072, Texas Government Code; the Board of Trustees will meet in executive session to discuss the purchase, exchange, lease or value of real property and the Employees Retirement System of Texas building. Thereafter the Board may consider appropriate action in open session**.**

After the executive session, Mr. Hester stated it was 4:04 p.m. on December 2, 2016. The Board was in open session. No action, decision, or vote was taken by the Board while in executive session and Mr. Hester asked if there were any motions from the Board.

There were no questions or further discussion, and no action was taken on this item.

XIV. ADJOURNMENT OF THE BOARD OF TRUSTEES

The December 2, 2016 Meeting of the ERS Board of Trustees adjourned at 4:04 pm CT.

Porter Wilson

Certified: ______________________________

Porter Wison, Executive Director
Employees Retirement System of Texas

Elizabeth G Geise

Witnessed: ______________________________

Elizabeth Geise, Executive Office
Employees Retirement System of Texas