

Public Agenda Item #9

Consideration of Annual Review of the ERS Incentive Compensation Plan

May 11, 2022

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Incentive Compensation Plan (ICP)

Annual Review



- The Board of Trustees reviews and approves the ICP on an annual basis.
- For the May Board meeting, staff provides:
 - A review of the plan objectives and key features.
 - Information on any proposed plan changes.
 - A draft plan document for the upcoming fiscal year.
 - A summary of the ICP awards over the last five years (new this year).
- At the August Board meeting:
 - Staff presents the final proposed plan document for consideration and approval.

Incentive Compensation Plan

Objectives



- Communicate strategic performance priorities.
- Encourage sustained levels of high investment performance, without undue risk.
- Promote teamwork among employees.
- Support ERS' strategic and operational goals.
- Attract and retain key employees in a cost-effective manner.

Incentive Compensation Plan



Key Features

- Performance measures are based on 1-year, 3-year, and 5-year performance periods.
- Participants have individual and total trust performance benchmarks.
- Participants must exceed their benchmarks to receive an incentive award.
- Participants are evaluated on both quantitative (75%) and qualitative (25%) metrics.
- Payout of incentive award is done over a three-year period: 50/25/25.
- Awards can be earned, but the Trust Fund as measured by the one-year Global Composite Performance must be positive to pay awards.
- Award payments shall be deferred during non-positive years, and are forfeited after three consecutive years of non-positive returns.

Incentive Compensation Plan

Awards Summary



ICP Awards

| Plan Year | Average Realization | Minimum Realization | Maximum Realization |
|---------------------|---------------------|---------------------|---------------------|
| 2021 | 81.4% | 45.0% | 100.0% |
| 2020 | 43.0% | 15.0% | 72.5% |
| 2019 | 52.3% | 16.3% | 86.2% |
| 2018 | 66.3% | 25.8% | 100.0% |
| 2017 | 76.0% | 41.3% | 97.5% |
| 5-Yr Average | 63.8% | 28.7% | 91.2% |

Trust Fund Returns by Performance Period

1-Year

| Total Trust Return | Excess Return Over Benchmark |
|--------------------|------------------------------|
| 25.46% | 6.96% |
| 6.82% | -1.35% |
| 3.00% | -0.06% |
| 9.54% | 1.60% |
| 12.11% | 1.03% |
| 11.38% | 1.63% |

3-Year

| Total Trust Return | Excess Return Over Benchmark |
|--------------------|------------------------------|
| 11.34% | 1.62% |
| 6.42% | 0.05% |
| 8.15% | 0.08% |
| 8.94% | 0.20% |
| 5.83% | 0.19% |
| 8.14% | 0.43% |

5-Year

| Total Trust Return | Excess Return Over Benchmark |
|--------------------|------------------------------|
| 11.13% | 1.50% |
| 7.30% | -0.16% |
| 5.99% | 0.04% |
| 8.27% | 0.36% |
| 8.34% | 0.11% |
| 8.21% | 0.37% |

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Fiscal Year 2023 – Proposed Material Changes



- Revise the three and five year performance periods to be weighted more heavily.
- Increase the minimum percentage attributable to Global Composite Performance (overall Trust).
- Further simplify the Global Composite Performance calculation.
- Reduce the waiting periods for new hires.

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Longer-term Performance (section 4.8c)



Employees with five or more years of plan participation

Current Performance Period Weightings:

| 1-Year | 3-Year | 5-Year |
|--------|--------|--------|
| 33% | 33% | 34% |

Proposed:

| 1-Year | 3-Year | 5-Year |
|--------|--------|--------|
| 20% | 30% | 50% |

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Longer-term Performance (section 4.8b)



Employees with between three and five years of plan participation

Current Performance Period Weightings:

| | |
|-----------|--------|
| 1-Year | 3-Year |
| 50% | 50% |
| Proposed: | |
| 1-Year | 3-Year |
| 40% | 60% |

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Longer-term Performance



Employees with less than three years of plan participation

No Change to Performance Period Weightings:

| |
|--------|
| 1-Year |
| 100% |

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Longer-term Performance



Objective:

- Encourage an even greater emphasis on longer-term performance.

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Overall Trust Performance (section 4.7a, Appendix B)

Current Goal Weightings:

| Minimum to Overall Trust (Global Composite) | Maximum to Individual Portfolios | Maximum to Qualitative |
|---|----------------------------------|------------------------|
| 25% | 50% | 25% |

Proposed:

| Minimum to Overall Trust (Global Composite) | Maximum to Individual Portfolios | Maximum to Qualitative |
|---|----------------------------------|------------------------|
| 35% | 40% | 25% |

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Overall Trust Performance



Objective:

- Place greater emphasis on the shared goal of robust Trust performance (35%), while retaining a significant weight to strong portfolio performance (40%).

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Simplification and Consistency (section 2.16)



Proposal:

Discontinue the exclusion of **securities litigation proceeds** from the Global Composite Performance calculation (overall Trust).

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Simplification and Consistency



Background:

- In Fiscal Year 2011, ERS started calculating Global Composite Performance (GCP) net of cash performance and net of securities litigation proceeds.
- Performing the calculation in this manner results in a different return being used for ICP than is used for general reporting purposes (ACFR).
- Netting out cash performance from the GCP calculation was discontinued in Fiscal Year 2021 with Board approval.
- Now proposing discontinuing netting out securities litigation proceeds beginning in Fiscal Year 2023.

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Simplification and Consistency



Objectives/Reasoning:

- Including securities litigation proceeds in the GCP calculation would provide the same base return used for ICP that is used for general reporting purposes (ACFR).
- Staff analysis of this change concludes that it would reduce the administrative burden of excluding these figures, while having an insignificant impact on the ICP awards.
- Over the previous five years, it would have actually had no impact on ICP awards.

Incentive Compensation Plan

Recruitment (section 3.2)



New Hire Waiting Periods

| | Current | Proposed |
|---|-----------------|-----------------|
| Standard waiting period: | 6 Months | 3 Months |
| Exception to the standard waiting period (with written justification and approval by the Executive Director): | 90 Days | 0 Days |

Incentive Compensation Plan

Recruitment



Objectives:

- Help attract needed talent, in general, within a very tight labor market.
- Help attract certain experienced hires who are expected to add value from day one (i.e., with ED authority to waive the waiting period).
- Provide better alignment with peer funds, whose new hire waiting periods are generally between zero and three months.

Incentive Compensation Plan

Fiscal Year 2023 – Other Changes



In addition to the material changes, staff is proposing some other changes to the Plan document that will:

- Provide clarification.
- Better reflect current processes and practices.

These changes are reflected in the draft Plan document.

Questions?