AGENDA ITEM DETAILS

Subject: Consideration of the Incentive Compensation Plan for Plan Year 2026 - (Action)

The Board of Trustees (Board) first approved the ERS Incentive Compensation Plan (Plan or ICP) on December 13, 2006. The Board reviews and approves the Plan document for the upcoming plan year annually in a public meeting before the September 1 start of each plan year. The Board approved the Plan document for Plan Year 2025 on August 21, 2024.

PROPOSED CHANGES FOR PLAN YEAR 2026:

Staff is proposing no material changes for Plan Year 2026. Staff is proposing some minor updates to Appendix A and B of the Plan document, which are included in Exhibit A of this agenda item. The change to Appendix A includes the addition of an "Investment Analyst VI" level to reflect the new classification provided by the State Auditor's Office, effective September 1, 2025. The changes to Appendix B include an edit to one of the team headers to better align with the Investments division's current organizational chart, as well as the elimination of two trading goals that are no longer being used.

ERS INCENTIVE COMPENSATION PLAN BACKGROUND:

The ICP communicates strategic performance priorities to participating employees. It is designed to incentivize the prudent achievement of sustained levels of high investment performance without undue risk, promote teamwork among employees, support the agency's strategic and operational goals, and attract and retain key employees.

As an incentive for participating employees to work toward ERS' success, the Plan compensates qualifying employees based on ERS' overall Trust fund performance, their assigned asset class performance, and their own individual contributions to performance.

ERS measures performance based on one-, three- and five-year performance periods within risk parameters set by the Board. Both total Trust and individual portfolio performance are considered. Participating employees earn incentive compensation if performance exceeds the assigned benchmarks. Benchmarks set for the total Trust and individual asset classes are documented in the investment policy, unless otherwise stated in the Plan document.

ERS evaluates participating employees on both quantitative and qualitative metrics. Qualitative metrics include areas such as leadership, teamwork, communication, and innovation. The senior leadership of the investments team has developed a rating methodology to determine qualitative ranking scores for investment employees.

Earned incentive compensation is generally paid to employees over a three-year period. The payout is 50% in the first year and 25% for the following two years, as long as the employee remains employed in good standing for three years from the date the incentive compensation award was earned. This approach is intended to serve as an effective retention tool.

Employees can earn incentive compensation awards in plan years when the overall Trust performance is negative. However, incentive compensation awards cannot be paid during plan years when total fund performance is not positive. Incentive compensation awards are calculated based on a weighted average annual salary.

All payments are subject to claw back under certain circumstances. For example, an employee paid in error must reimburse ERS the amount of the payment, even if he or she no longer works for ERS. Similarly, if an award was incorrectly calculated and a participant was underpaid, the Executive Director may approve a supplemental payment to make up the difference between the earned amount and the previously paid amount. These two Plan provisions help ensure the goal of 100% accuracy in payment of awards.

ERS has established a robust governance process for the ICP, which includes a standing process team with clearly defined roles, as well as an annual validation of the awards and payments by an independent third-party consulting firm. In addition, the State Auditor's Office currently performs an audit of ERS's ICP on an every-other-year schedule. The most recent State Auditor's Office audit, conducted for Plan Year 2023, had no findings.

Human Resources (HR), in conjunction with executive management and other key stakeholders, annually reviews the Plan and related processes to make recommendations to the Board. ERS staff presents a draft Plan document to the Board each year at the May Board meeting for review and discussion with final Plan approval at the August Board meeting.

ATTACHMENTS:

1. Exhibit A – Proposed Plan year 2026 ICP Document
2. Slides – Consideration of the Incentive Compensation Plan Document for Plan Year 2026