



Public Agenda Item #31

Review and Discussion of the Incentive Compensation Plan for Fiscal Year 2021

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DeeDee Sterns, Director of Human Resources

Jamey Pauley, ICP Program Specialist

Incentive Compensation Plan (ICP)

ICP Document



- The Board of Trustees reviews the ICP on an annual basis.
- During the May Board meeting:
 - HR provides an overview of the plan that may or may not include any recommended plan changes, and
 - A draft plan document is submitted to the Board for the upcoming fiscal year.
- During the August Board meeting:
 - HR presents the final proposed plan document for consideration.
 - The plan must be adopted before the new fiscal year that begins September 1.

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

Overview



- Eligibility for the ICP requires compliance with ERS policies/procedures and ERS Investment Policy Statement.
 - All participants must be in good standing.
 - New hires must successfully complete their six-month probationary period.
- Performance measures are based on one-, three-, and five-year performance periods.
- Participants have individual and total trust performance benchmarks.
- Participants must exceed their benchmarks to receive an incentive award.
- Benchmarks are set in the Investment Policy Statement unless otherwise stated in the ICP document.

Incentive Compensation Plan

Overview



- Participants are evaluated on both quantitative and qualitative metrics.
 - 75% quantitative with minimum 25% total trust performance
 - 25% maximum qualitative
- Investments uses a discretionary matrix tool to evaluate participants' qualitative performance.
 - Qualitative metrics include areas above and beyond performance; leadership, teamwork, communication and innovation.
- Payout of incentive award is done over a three-year period: 50/25/25
 - The awardee must be an active and eligible ERS employee on each payment date to receive the full amount.

Incentive Compensation Plan

Overview



- Incentive compensation 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.
- Unpaid incentive awards shall be forfeited after three years of deferrals.
- Metrics and calculations are tied to the Risk Budget approved by the Board.
- ICP awards are calculated based on a weighted average salary.
- If an award is paid in error, over/under-payment provisions to correct errors and help ensure 100% accuracy.

Incentive Compensation Plan

Overview



- Administrative oversight of the plan is managed by Human Resources.
- Finance performs the award calculations.
- Independent review is performed by a third-party entity.
- Internal and external audits help ensure payments are in accordance to plan.

Incentive Compensation Plan

Fiscal Year 2021



- HR annually reviews the Plan and related processes to make recommendations to the Board.
- With executive management and other key stakeholders, HR conducted a review of the Plan document for Fiscal Year 2021.

Incentive Compensation Plan

Fiscal Year 2021 – Recommended Change



Staff recommends a material change to the definition of “Global Composite Performance” (section 2.16).

This change will include discontinuing the practice of adjusting the total trust return for ***unallocated cash***.

Incentive Compensation Plan

Fiscal Year 2021 – Recommended Change Background



Discontinuing the practice of adjusting the total trust return for ***unallocated cash***:

- Practice began in 2013 as the result of new accounting rules.
- New rules required that the short term treasuries in the Short Term Investment Fund account be marked to market daily, even though ERS usually held them to maturity.
- At the time, BNYM (Custodian) and ERS did not have a method to book the market value adjustments at the portfolio level, so the whole gain or loss was being booked to unallocated cash.
- Recently, Finance developed a method with BNYM to book these adjustments to the affected portfolios on a daily basis.
- Because the transactions are now being recorded at the portfolio level, Investments believes that ERS no longer needs to adjust the total trust return for unallocated cash effective September 1.

Incentive Compensation Plan

Fiscal Year 2021 – Non-material Changes



In addition to the material change, HR is proposing some non-material changes to the Plan document that will:

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

These changes are reflected in the draft Plan document.

Incentive Compensation Plan

Fiscal Year 2021 – Non-material Changes



Examples:

- 2.6 “CIO Goals Memo” - memo from the CIO (or the CIO’s designee) to the Executive Director which defines the Benchmarks and other quantitative metrics to be used for the upcoming Plan Year. All quantitative measures that are not expressly stated in the Investment Policy are explained in the CIO Goals Memo, and **Plan-Year** changes from the prior Plan Year to the upcoming Plan Year are highlighted.
- 4.8 (d) **Inception-to-Date for Public Market Equivalents.** The public market equivalent Performance Goals shall be excepted from the one, three, and five-year Performance Period Weightings described above. The Realization Percentages for the public market equivalent Performance Goals shall be calculated based on an internal rate of return and measured using an inception-to-date Performance Period with a 100% weighting attributed to the inception-to-date Performance Period. Such calculation and measurement is consistent with industry practice for illiquid private-market investments where performance is reliant on the timing of cash flows.

Incentive Compensation Plan

Fiscal Year 2021 – Non-material Changes



Examples:

APPENDIX A

ELIGIBLE EMPLOYEE POSITIONS WITH
MAXIMUM INCENTIVE AWARD PERCENTAGES AND PAYMENT SCHEDULES

Plan Groups	Maximum Incentive Award Percentages	Payment Schedules (Year 1/2/3, see Schedule 5.2)
Executive Director	100%	50/25/25
Chief Investment Officer	100%	50/25/25
Deputy Chief Investment Officer (Performance Goal weightings based on Public Equity under Ex.B)	100%	50/25/25
Asset Class Portfolio Managers/Directors	100%	50/25/25
Director of Investment Services (Performance Goal weightings based on Inv.Ops under Ex.B)	90%	50/25/25
Risk Management and Applied Research Portfolio Manager	80%	50/25/25
Supervising Portfolio Manager	80%	50/25/25
Portfolio Manager I, II, III, IV, V & VI	70%	50/25/25
Chief Trader I & II	70%	50/25/25
Trader I, II & III	65%	50/25/25
Investment Analyst III, IV & V	58%	50/25/25
Investment Operations Manager	50%	50/25/25
Investment Analyst I & II	35%	50/25/25
Financial Analyst I, II, III & IV (Investment Operations Specialist and Operational Due Diligence Specialist)	25%	50/50
Investment Administrative Support	5%	100
General Counsel (Performance Goal weightings based on Legal Services under Ex. B)	65%	50/25/25
Investments and Securities, Attorney (Performance Goal weightings based on Legal Services under Ex. B)	65%	50/25/25
Investments and Securities, Paralegal (Performance Goal weightings based on Legal Services under Ex. B)	35%	50/25/25

APPENDIX B

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PERFORMANCE GOAL WEIGHTINGS FOR INVESTMENT PROFESSIONALS AND LEADERSHIP EMPLOYEES

Any variations of these weightings from the preceding Plan Year for a Participant shall be justified by the CIO or other applicable ERS division director and shall be approved by the Executive Director.

Main Category Weight	Main Category	Sub Category	Exec. Director	CIO	Deputy CIO	Fixed Income	Hedge Funds	Infra-structure	Private Equity	Public Equity	Real Estate	Risk Mgt & Appl. Res.	Trading	Inv. Services	Admin.	Legal Services
25% Maximum	Discretionary		N/A	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
25% Minimum	Relative Global Composite Performance		50%	75%	25%	25%	25%	25%	25%	25%	25%	25% X	25%	25% X	25%	25%
50% Maximum	A combination of one or more of the following, as indicated below (1):															
		Overall agency leadership, management, communications, policy matters, staff development, and the implementation of agency strategic initiatives (8)	50%													
		Global Public Equity			10%					X		X			50%	
		Internal Global Public Equity								X		X				
		Portfolios					X			X		X				
		Individual Research Coverage								X						
		Internally Traded Portfolios												30%		
		Trading Performance											20%			
		Credit – Internal				X										
		Credit – External				X										
		Rates				X										
		Private Equity Public Market Equivalent (2)								10%						X
		Private Equity Peer Comparison (3)								40%						X
		Private Real Estate-Public Market Equivalent (2) (4)									X					X
		Public REITs									X					
		Private Infrastructure Cost Savings (5)						35% X								X
		Private Infrastructure Public Market Equivalent (2)						45% X								X
		Absolute Return					X									X
		Global Equity External Advisor Program			40%					25%						
		Opportunistic Credit				X	X				X					

See footnotes on the following page.

Questions?