



**Agenda**  
**Investment Advisory Council (IAC)**  
**Compensation Subcommittee Meeting**

Monday, March 18, 2013, 10:00 a.m.

Hermitage Room, First Floor  
1801 Hermitage Blvd, Tallahassee, FL 32308

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|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------|
| <b>1. Welcome/Call to Order</b>                                                                                                                                 | Chuck Newman, Chair                      |
| <b>2. Review of Requested Revisions to Mercer Presentation of Competitive Market Strategy for ED/CIO and Senior Investment Officers</b>                         | Josh Wilson, Mercer<br>Jan Olson, Mercer |
| <b>3. Review of Requested Revisions of Mercer Recommendations for Incentive Compensation Plan Design Framework including Alternative Performance Measure</b>    | Josh Wilson, Mercer<br>Jan Olson, Mercer |
| <b>4. Discussion and Decisions</b> <ul style="list-style-type: none"><li>• Decide on performance measurement</li><li>• Finalize recommendation to IAC</li></ul> | Chuck Newman, Chair                      |
| <b>5. Review of Next Steps in Project</b>                                                                                                                       | Chuck Newman, Chair                      |
| <b>6. Establish Date and Topics for Next Meeting</b>                                                                                                            | Chuck Newman, Chair                      |
| <b>7. Audience Comments/Closing Remarks/Adjourn</b>                                                                                                             | Chuck Newman, Chair                      |

# State Board of Administration of Florida (SBA) Top Executive Compensation Overview

March 18, 2013

# Introduction

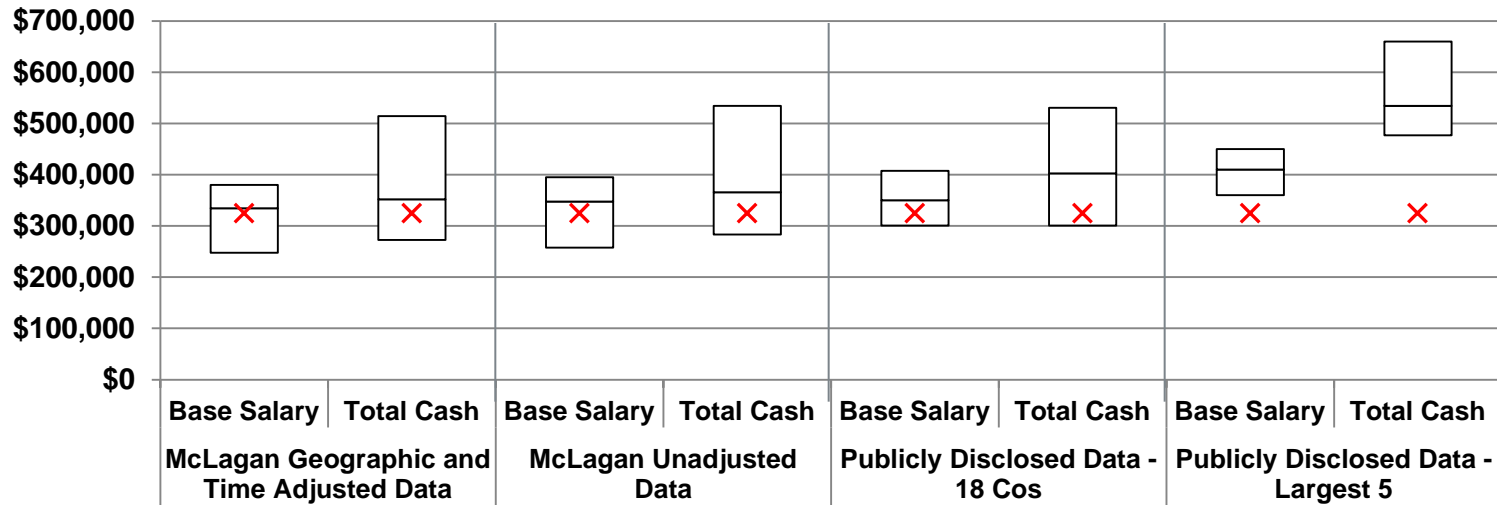
- This report compares SBA incumbent compensation with market data for select positions:
  - Executive Director and CIO
  - Senior Investment Officers
  - Remaining executives proposed for Tier 2 incentives at SBA
- The following page outlines the market references used for each role. The remaining pages provide incumbent-specific market comparisons charts
- Given SBA's size and complexity, Mercer recommends that the SBA should target the 50<sup>th</sup> percentile of the top five largest public pension fund compensation for investment and senior executive positions
  - When data for the top five funds is not available, the 75<sup>th</sup> percentile of the broader public pension fund market can be used as a proxy
  - For positions where a comparison outside of public pension funds is appropriate, we recommend targeting the median of that market data
- Not all SBA positions will have a relevant survey benchmark comparison
  - Compensation opportunities for those positions should be determined based on internal equity considerations
- Appropriate compensation for a given incumbent will consider a variety of factors, including:
  - External market value of the job
  - Perceived value of the job to the SBA
  - Incumbent performance/contribution, key skills, and perceived value to the SBA

# Market Data Survey Sources

Positions were compared to the market as referenced below

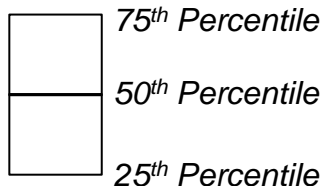
Executive	Market Reference
Executive Director & CIO	McLagan Public Pension & Custom Public Pension Research
Sr Investment Off-Fixed Income	McLagan Public Pension
Sr Investment Off-Global Equity	McLagan Public Pension
Sr Investment Off-Global Equity	McLagan Public Pension
Sr Investment Off-Real Estate	McLagan Public Pension
SIO-Strategic Inv & Pvt Equity	McLagan Public Pension
Chief Operating/Financial Officer	McLagan Public Pension / General Industry Market Composite
Deputy Executive Director	McLagan Public Pension
Chief Operating Officer, FHCF	Non-Benchmark
General Counsel	McLagan Public Pension / General Industry Market Composite
Chief Risk & Compliance Officer	McLagan Public Pension / General Industry Market Composite
Sr Investment Policy	McLagan Public Pension
Sr. DC Programs Officer	Non-Benchmark
Sr Off-Investment Prog & Governance	McLagan Public Pension

# Executive Director and Chief Investment Officer McLagan Public Pension Data and Publicly Disclosed Data



	Base Salary	Total Cash	Base Salary	Total Cash	Base Salary	Total Cash	Base Salary	Total Cash
	McLagan Geographic and Time Adjusted Data		McLagan Unadjusted Data		Publicly Disclosed Data - 18 Cos		Publicly Disclosed Data - Largest 5	
<b>75<sup>th</sup> Percentile</b>	<b>\$380,000</b>	<b>\$514,100</b>	<b>\$395,000</b>	<b>\$534,400</b>	<b>\$407,500</b>	<b>\$530,800</b>	\$450,000	\$660,000
<b>50<sup>th</sup> Percentile</b>	\$334,600	\$351,800	\$347,800	\$365,800	\$350,000	\$402,500	<b>\$410,000</b>	<b>\$534,400</b>
<b>25<sup>th</sup> Percentile</b>	\$247,900	\$272,500	\$257,700	\$283,300	\$300,900	\$300,900	\$360,000	\$476,600
<b>SBA Employee Compensation</b>	\$325,000	\$325,000	\$325,000	\$325,000	\$325,000	\$325,000	\$325,000	\$325,000

Note: 75<sup>th</sup> percentile of broader public pension fund market approximates 50<sup>th</sup> percentile of five largest funds and serves as proxy for jobs where data is not available for five largest funds



✗ SBA Employee Compensation

# Executive Director and Chief Investment Officer Public Pension Custom Research Detail

P&I Rank	Pension Fund	Name	DB AUM (Billions)	Total AUM (Billions)	Title	Year	Salary	2011 bonus	2012 bonus	Total Cash Comp
1	California Public Employees Retirement System	Joseph Dear	\$ 243.2	\$ 244.8	CIO	2012	\$ 450,000	\$ 84,375	N/A	\$ 534,375
2	CALSTRS	Christopher Ailman	\$ 155.4	\$ 155.7	CIO	2011	\$ 360,000	\$ 116,604	N/A	\$ 476,604
3	New York State Common Retirement Fund	Vicki Fuller	\$ 150.1	\$ 150.1	CIO	2012	\$ 300,000	N/A	N/A	\$ 300,000
5	New York City Retirement	Lawrence Schloss	\$ 122.1	\$ 132.1	CIO	Not a participant in McLagan Study				
6	Teachers Retirement System of Texas	T. Britton Harris	\$ 112.4	\$ 112.4	CIO	2012	\$ 480,000	\$ 396,000	N/A	\$ 876,000
7	State of Wisconsin Investment Board	David Villa	\$ 83.4	\$ 89.0	CIO	2012	\$ 410,000	N/A	\$ 250,000	\$ 660,000
8	New York State Teachers Retirement System	Thomas K. Lee	\$ 88.6	\$ 88.6	ED/CIO	2011	\$ 330,800	N/A	N/A	\$ 330,800
9	North Carolina Retirement System	Kevin SigRist	\$ 77.1	\$ 84.0	CIO	2013	\$ 350,000	N/A	N/A	\$ 350,000
10	Ohio Public Employees Retirement System	John Lane	\$ 79.0	\$ 79.6	CIO	2012	\$ 340,000	N/A	N/A	\$ 340,000
11	New Jersey	Tim Walsh	\$ 72.1	\$ 74.8	Director	Not a participant in McLagan Study				
12	Washington State Investment Board	Gary Bruebaker	\$ 58.7	\$ 70.3	CIO	2011	\$ 303,582	N/A	N/A	\$ 303,582
13	Georgia Division of Investment Services	Charles W. Cary	\$ 69.1	\$ 70.1	CIO	2011	\$ 400,000	\$ 120,000	N/A	\$ 520,000
14	State Teachers Retirement System Ohio	Michael Nehf	\$ 64.9	\$ 65.5	ED	2008	\$ 250,000	\$ -	\$ -	\$ 250,000
15	Oregon Public Employees Retirement Fund	John Skjervem	\$ 59.7	\$ 61.0	CIO	2012	\$ 350,000	\$ 80,000	\$ 105,000	\$ 455,000
16	Virginia Retirement Systems	Ron Schmitz	\$ 55.0	\$ 56.9	CIO	2012	\$ 375,000	N/A	\$ 262,500	\$ 637,500
17	Michigan State Retirement Systems	Jon M Braeutigam	\$ 50.6	\$ 55.8	CIO	2012	N/A	N/A	N/A	N/A
18	Minnesota State Board of Investments	Howard Bicker	\$ 47.5	\$ 52.9	ED	2012	\$ 245,000	N/A	N/A	\$ 245,000
19	Massachusetts Pension Reserves Investment Mgmt	Michael Trotsky	\$ 50.7	\$ 50.7	ED/CIO	2012	\$ 295,000	N/A	N/A	\$ 295,000
20	Pennsylvania Public School Employees Retirement System	Alan Van Noord	\$ 49.1	\$ 49.1	CIO	2009	\$ 251,542			\$ 251,542
25	Retirement Systems of Alabama	David Bronner	\$ 28.0	\$ 29.7	CEO	2013	\$ 576,000	N/A	N/A	\$ 576,000
31	South Carolina Retirement System	Herschel Harper	\$ 25.7	\$ 26.8	CIO	2012	\$ 485,000			\$ 485,000
<b>4</b>	<b>State Board of Administration - Florida</b>	<b>Ash Williams</b>	<b>\$ 126.9</b>	<b>\$ 155.6</b>	<b>ED/CIO</b>	<b>2013</b>	<b>\$ 325,000</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 325,000</b>

Notes: Salaries represent most current data available and was not aged to a common date

(1) Bonus represents most recent bonus or calculated bonus based on target percentage

AUM data as of 9/30/12 per Pensions and Investments (Feb 4, 2013 issue) plus est value of significant non-retirement funds managed

N/A - Not Available

## Top 5 Peers

	Total Assets (Billions)	Salary above	Total Cash Comp
75th Percentile	\$154	\$450,000	\$660,000
Median	\$141	\$410,000	\$534,375
25th Percentile	\$117	\$360,000	\$476,604

SBA salary and total cash compensation fall below the 25th percentile of the 5 largest funds although total AUM of \$155.6B is above 75th percentile

## All Funds Above

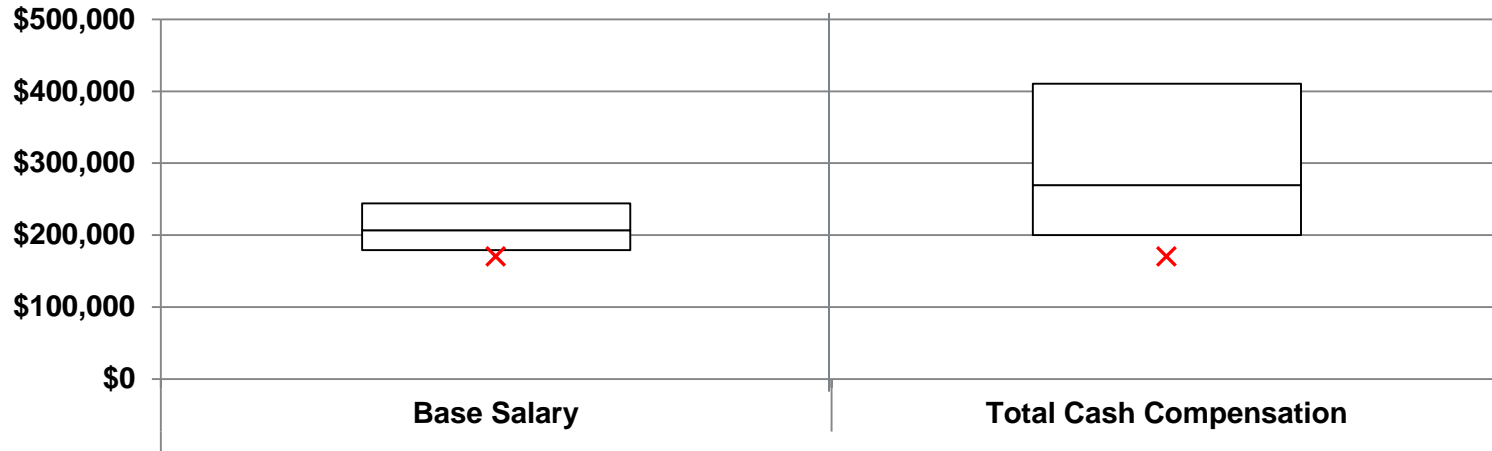
	McLagan	McLagan 2011	McLagan 2011	Mercer 2012	
90th Percentile	\$150	\$450-500,000	\$481,500	\$600-700,000	\$644,250
75th Percentile	\$89	\$395,000	\$407,500	\$534,400	\$530,781
50th Percentile	\$70	\$347,800	\$350,000	\$365,800	\$402,500
25th Percentile	\$56	\$257,700	\$300,896	\$283,300	\$300,896

SBA salary and total cash compensation fall below the median of all funds although total AUM of \$155.6B is above 90th percentile

## All Funds Above - McLagan's CIO Match

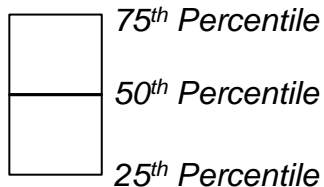
	McLagan	McLagan 2011	McLagan 2011	Mercer 2012	
90th Percentile	\$150	\$450-500,000	\$481,500	\$600-700,000	\$644,250
75th Percentile	\$89	\$415,000	\$407,500	\$555,900	\$530,781
50th Percentile	\$70	\$357,000	\$350,000	\$472,300	\$402,500
25th Percentile	\$56	\$313,200	\$300,896	\$309,000	\$300,896

# Senior Investment Officers McLagan Public Pension Data



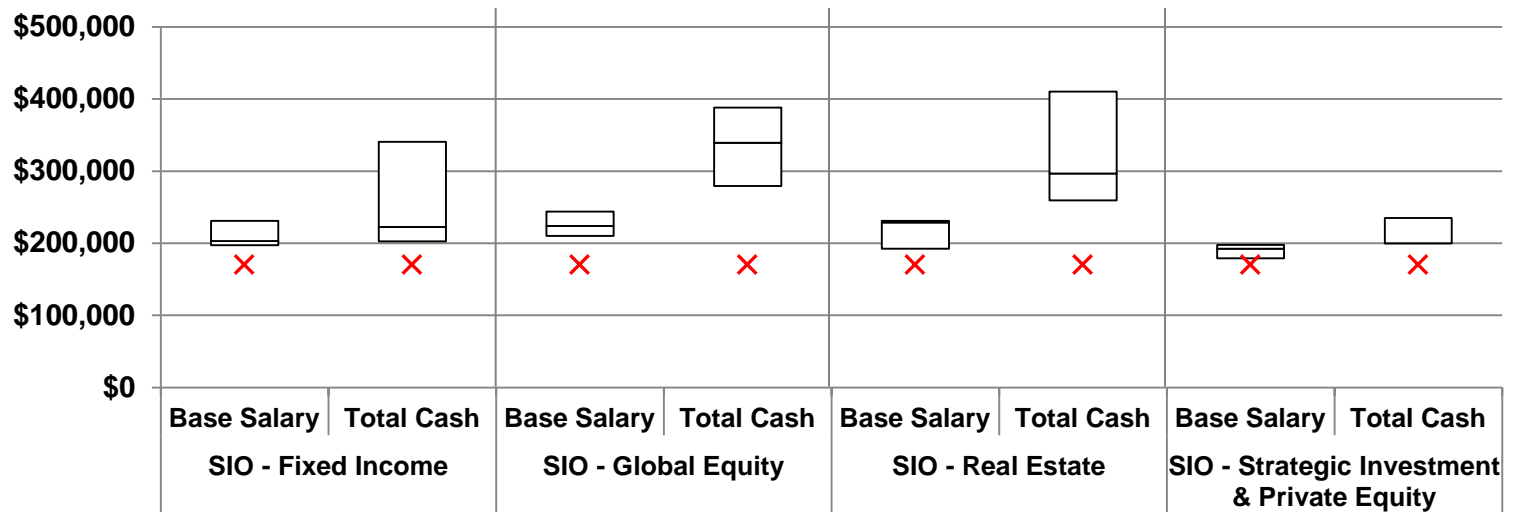
	Base Salary	Total Cash Compensation
<b>75<sup>th</sup> Percentile</b>	<b>\$244,100</b>	<b>\$410,500</b>
<b>50<sup>th</sup> Percentile</b>	\$206,650	\$269,500
<b>25<sup>th</sup> Percentile</b>	\$179,200	\$199,900
<b>SBA Employee Compensation</b>	\$170,000	\$170,000

Note: 75<sup>th</sup> percentile of broader public pension fund market approximates 50<sup>th</sup> percentile of five largest funds and serves as proxy for jobs where data is not available for five largest funds



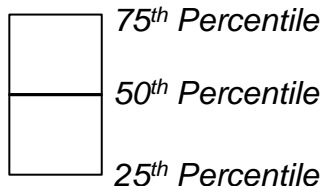
✗ SBA Employee Compensation

# Senior Investment Officers McLagan Public Pension Data



<b>75<sup>th</sup> Percentile</b>	<b>\$231,100</b>	<b>\$340,900</b>	<b>\$244,100</b>	<b>\$388,100</b>	<b>\$230,900</b>	<b>\$410,500</b>	<b>\$197,800</b>	<b>\$235,300</b>
<b>50<sup>th</sup> Percentile</b>	\$203,100	\$222,500	\$224,200	\$339,200	\$229,000	\$296,900	\$192,400	\$199,900
<b>25<sup>th</sup> Percentile</b>	\$197,400	\$202,800	\$210,200	\$279,600	\$192,400	\$259,400	\$179,200	N/A
<b>SBA Employee Compensation</b>	\$170,000	\$170,000	\$170,000	\$170,000	\$170,000	\$170,000	\$170,000	\$170,000

Note: 75<sup>th</sup> percentile of broader public pension fund market approximates 50<sup>th</sup> percentile of five largest funds and serves as proxy for jobs where data is not available for five largest funds

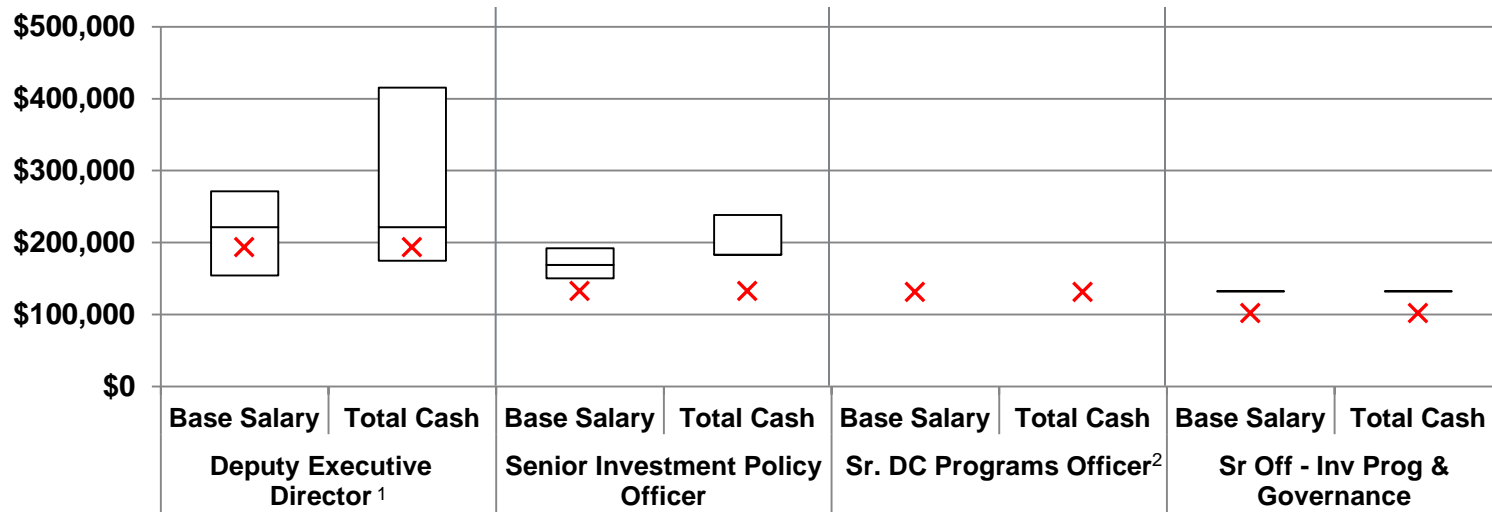


× SBA Employee Compensation



# Other Executives Proposed for Tier 2 Incentives

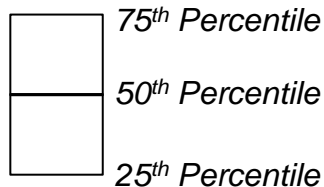
## McLagan Public Pension Data



	Base Salary	Total Cash	Base Salary	Total Cash	Base Salary	Total Cash	Base Salary	Total Cash
	Deputy Executive Director <sup>1</sup>		Senior Investment Policy Officer		Sr. DC Programs Officer <sup>2</sup>		Sr Off - Inv Prog & Governance	
<b>75<sup>th</sup> Percentile</b>	<b>\$271,300</b>	<b>\$415,500</b>	<b>\$191,900</b>	<b>\$238,200</b>	N/A	N/A	N/A	N/A
<b>50<sup>th</sup> Percentile</b>	\$221,400	\$221,400	\$168,900	\$183,300	N/A	N/A	\$131,800	\$131,800
<b>25<sup>th</sup> Percentile</b>	\$154,200	\$174,600	\$150,100	N/A	N/A	N/A	N/A	N/A
<b>SBA Employee Compensation</b>	\$193,567	\$193,567	\$132,500	\$132,500	\$131,300	\$131,300	\$102,048	\$102,048

Note: 75<sup>th</sup> percentile of broader public pension fund market approximates 50<sup>th</sup> percentile of five largest funds and serves as proxy for jobs where data is not available for five largest funds

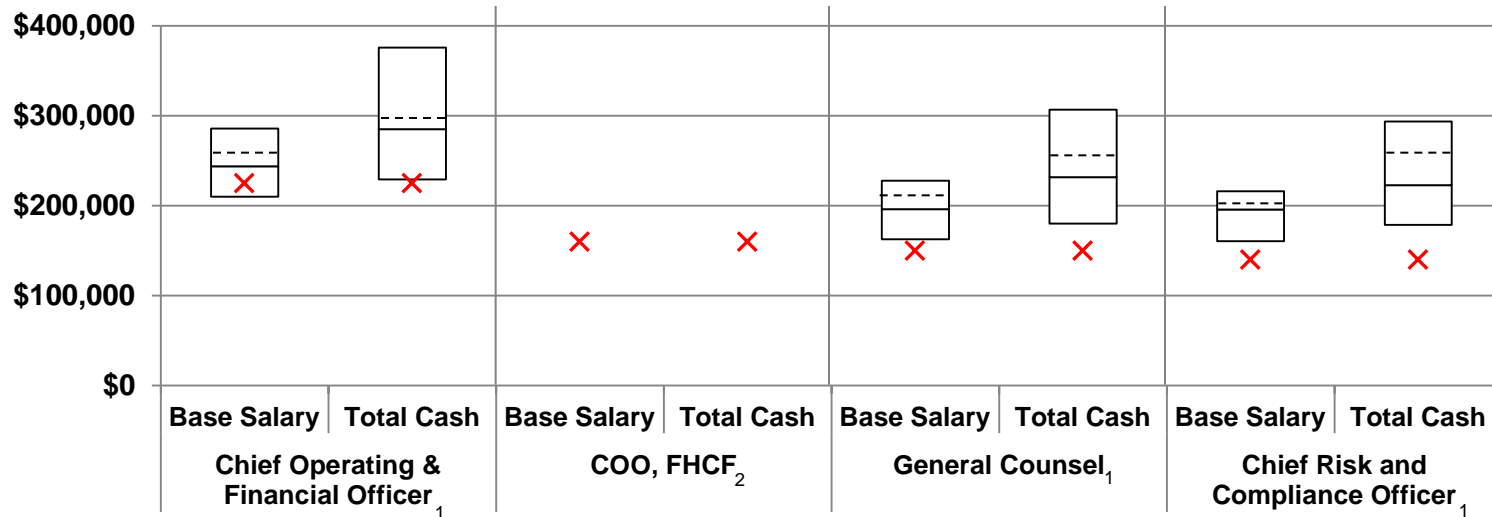
1. The Deputy Executive Director reflects the prior incumbent and role, which have changed since the benchmarking process was completed. The new incumbent is paid \$134,000; the new position responsibilities have not yet been benchmarked for pay.
2. The Sr. DC Programs Officer is a Non-Benchmark job, as no appropriate survey job could be found in the market for this position



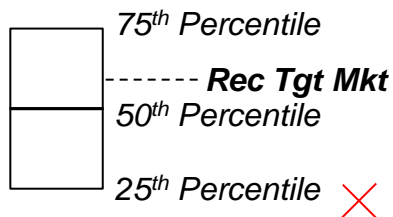
✗ SBA Employee Compensation

# Other Executives Proposed for Tier 2 Incentives

## McLagan Public Pension and General Industry Market Data



	Chief Operating & Financial Officer <sub>1</sub>		COO, FHC <sub>2</sub>		General Counsel <sub>1</sub>		Chief Risk and Compliance Officer <sub>1</sub>	
<b>75<sup>th</sup> Percentile</b>	\$280,400	\$370,600	N/A	N/A	\$245,500	\$324,800	\$211,200	\$286,400
<b>Recommended Target Market</b>	<b>\$253,700</b>	<b>\$294,700</b>	N/A	N/A	<b>\$227,100</b>	<b>\$262,600</b>	<b>\$200,000</b>	<b>\$260,100</b>
<b>50<sup>th</sup> Percentile</b>	\$239,400	\$280,400	N/A	N/A	\$200,500	\$256,800	\$191,300	\$218,100
<b>25<sup>th</sup> Percentile</b>	\$206,000	\$225,400	N/A	N/A	\$164,000	\$180,000	\$156,600	\$174,500
<b>SBA Employee Compensation</b>	\$225,000	\$225,000	\$160,000	\$160,000	\$150,000	\$150,000	\$140,000	\$140,000



1. Market compensation data represents a equal blend of McLagan public pension data and general industry data at the respective percentiles. The Target Market represents a blend of the 50<sup>th</sup> percentile of General Industry data and the 75<sup>th</sup> percentile of McLagan data (approximates 50<sup>th</sup> percentile of five largest funds).
2. The COO, FHC is a Non-Benchmark job, as no appropriate survey job could be found in the market for this position

# State Board of Administration Incentive Plan Design

March 18th, 2013

**Josh Wilson, Atlanta**  
**Jan Olson, Chicago**  
**Jon Mason, Atlanta**

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- Comparison of Additional Alternative Performance Standards
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- Impact of the Incentive Plan
- Difficulty of Goals and Historical Achievement Levels
- Incentive Recommendation: Estimated Costs
- Business Case for Additional Expense
- Deferral Mechanism
- Next Steps
- Appendix: Difficulty of Goals and Historical Achievement Levels

# Plan Objectives

Design a competitive annual incentive plan that:

- Aligns employee rewards with stakeholder goals and interests
- Rewards strong performance
- Assists in attracting & retaining top talent and increases competitive positioning against outside market
- Is defensible to all stakeholders

# Competitive Analysis – Findings

## Investment-Related Positions

- SBA salaries are generally below median market compensation levels:
  - Base salaries: generally 13-30% below PPF and 40-55% below E/F
  - Total cash: generally 17-40% below PPF and 60-70% below E/F
- While there is some variance between positions, incentives generally were reported by 60-80% of peer group funds, particularly at the more senior levels (Portfolio Managers, Head of Asset Class, etc.)
- Average bonuses paid by other public pension funds:
  - ED/CIO 50%
  - Head of Asset Class 40-50%
  - Senior Portfolio Manager I 40-45%
  - Senior Portfolio Manager II 30-35%
  - Intermediate Portfolio Manager 20-25%
  - Research Analysts 10-15%

*Note: amounts above reflect actual awards, not target percentages*

**Note:** SBA's AUM exceeds the 75th percentile for the public pension peer group (is higher than all but three of the funds). As a result, 50th percentile compensation data may understate appropriate compensation levels for SBA investment staff, particularly those in leadership roles

# Incentive Design Recommendation

	Legacy SBA Incentive Plan Design	Proposed SBA Incentive Plan Design
<b>Eligibility</b>	<ul style="list-style-type: none"> <li>• 40 Investment Professionals</li> </ul>	<ul style="list-style-type: none"> <li>• Top Senior Executives and all Investment Staff (63 people)</li> </ul>
<b>Performance Measurement</b>	<ul style="list-style-type: none"> <li>• 100% quantitative with an employee rating of “3” required for payout</li> <li>• “Value added” to Florida Retirement System Trust Fund (FRSTF)</li> </ul>	<ul style="list-style-type: none"> <li>• Fund’s financial outperformance relative to defined benchmark</li> <li>• Largely quantitative (75-90%) but with some qualitative aspects to ensure appropriate behaviors and long-term sustainability</li> <li>• “Value added” to Florida Retirement System Trust Fund (FRSTF)</li> </ul>
<b>Performance Standards</b>	<ul style="list-style-type: none"> <li>• Minimum Award at 25 value added BPS</li> <li>• Maximum Award at 51 value added BPS</li> </ul>	<ul style="list-style-type: none"> <li>• Threshold Award at 5 BPS</li> <li>• Target award at 25 BPS outperformance relative to benchmark</li> <li>• Maximum award based on 50 BPS outperformance relative to benchmark</li> <li>• <i>Note: Each basis point represents \$12.5 million of excess return for the Pension Fund</i></li> <li>• Consideration of one of the following additional provisions:               <ul style="list-style-type: none"> <li>• If final year of 3-year plan has actual negative returns, the payment will be deferred until the fund earns two quarters of actual positive returns</li> <li>• 25% of the earned award will be cancelled if, over a 3-year period, the actual return does not exceed the fund’s Long Term Nominal Target Rate of Return (currently 5% plus inflation)</li> <li>– See following page for deliberations and recommendation</li> </ul> </li> </ul>
<b>Incentive Opportunity</b>	<ul style="list-style-type: none"> <li>• 8% maximum award opportunity for all eligible positions</li> </ul>	<ul style="list-style-type: none"> <li>• Incentive targets range from 10-35% of salary, depending on organizational level and criticality to the business</li> </ul>
<b>Measurement Period/Timing of Payout</b>	<ul style="list-style-type: none"> <li>• 3 year performance period</li> <li>• No deferral</li> </ul>	<ul style="list-style-type: none"> <li>• 3 year (rolling) performance periods</li> <li>• ½ paid at end of performance cycle ½ after 1 year deferral</li> </ul>

# Comparison of Additional Alternative Performance Standards

- The table below compares the additional alternative performance standards on the basis of the overall criteria of the plan

Overall Plan Criteria	Alternative 1: Deferral of Payout Until Fund Returns are Positive	Alternative 1B: 25% Haircut if miss LT Nominal Target Return
<b>Competitive</b>	<p>Earned awards are not reduced, but rather deferred</p> <p style="text-align: center;"><b>More Competitive</b></p>	<p>Results in lower payouts in 40%+ of years with benchmark outperformance (See appendix)</p> <p style="text-align: center;">Minority practice (Ambachsteer letter of May/June 2011)</p> <p style="text-align: center;"><b>Less Competitive</b></p>
<b>Reasonable and Fair</b>	<p>Keeps participants motivated to outperform benchmark (add value) during weak market environments</p> <p>Size of award not impacted by outside factors</p> <p style="text-align: center;"><b>More Reasonable and Fair</b></p>	<p>Risks demoralizing participants during weak market environments, when they can add significant value to the fund</p> <p style="text-align: center;">Market movement is beyond control of participants</p> <p>Nominal Target Rate of Return is a very long term goal that cannot be fairly measured over a 3-year plan period</p> <p style="text-align: center;">Time lag creates incongruence between those who shape/decide asset allocation and those who would be penalized</p> <p style="text-align: center;"><b>Less Reasonable and Fair</b></p>
<b>Sustainable</b>	<p>No immediate payout following a year of negative performance, reducing headline risk</p> <p style="text-align: center;"><b>More Sustainable</b></p>	<p>Could result in a partial payout following a year of negative performance if the threshold 5 BPS of value added is reached</p> <p style="text-align: center;"><b>Less Sustainable</b></p>



## Comparison of Additional Alternative Performance Standards

Overall Plan Criteria	Alternative 1: Deferral of Payout Until Fund Returns are Positive	Alternative 1B: 25% Haircut if miss LT Nominal Target Return
<p><b>Aligns Interests of Stakeholders</b></p>	<p>Focuses participants on adding value vs. benchmark; May not focus participants sufficiently on very long term performance</p> <p>Payouts will be made only in periods with recent positive performance</p> <p>A competitive compensation program is in the interest of stakeholders</p> <p>Overwhelming majority of outperformance dollars are returned to outside stakeholders</p> <p style="text-align: center;">Well-Aligned</p>	<p>Participant focus is primarily on adding value vs. benchmark and to a lesser degree on achieving the Nominal Target Rate of Return over a 3-yr period</p> <p>Overwhelming majority of outperformance dollars are returned to outside stakeholders</p> <p style="text-align: center;">Reduction of payouts aligns with stakeholders</p> <p style="text-align: center;">Well-Aligned</p>

- On balance, weighing the pros and cons of implementing a new incentive plan based on relative and absolute metrics, Mercer feels that SBA is best served to implementing a plan with a metric that is primarily based on relative performance and a payout deferral mechanism to recognize the importance of generating positive absolute returns.

## Proposed Incentive Eligibility, Target Incentive Levels, and Financial / Non-Financial Splits

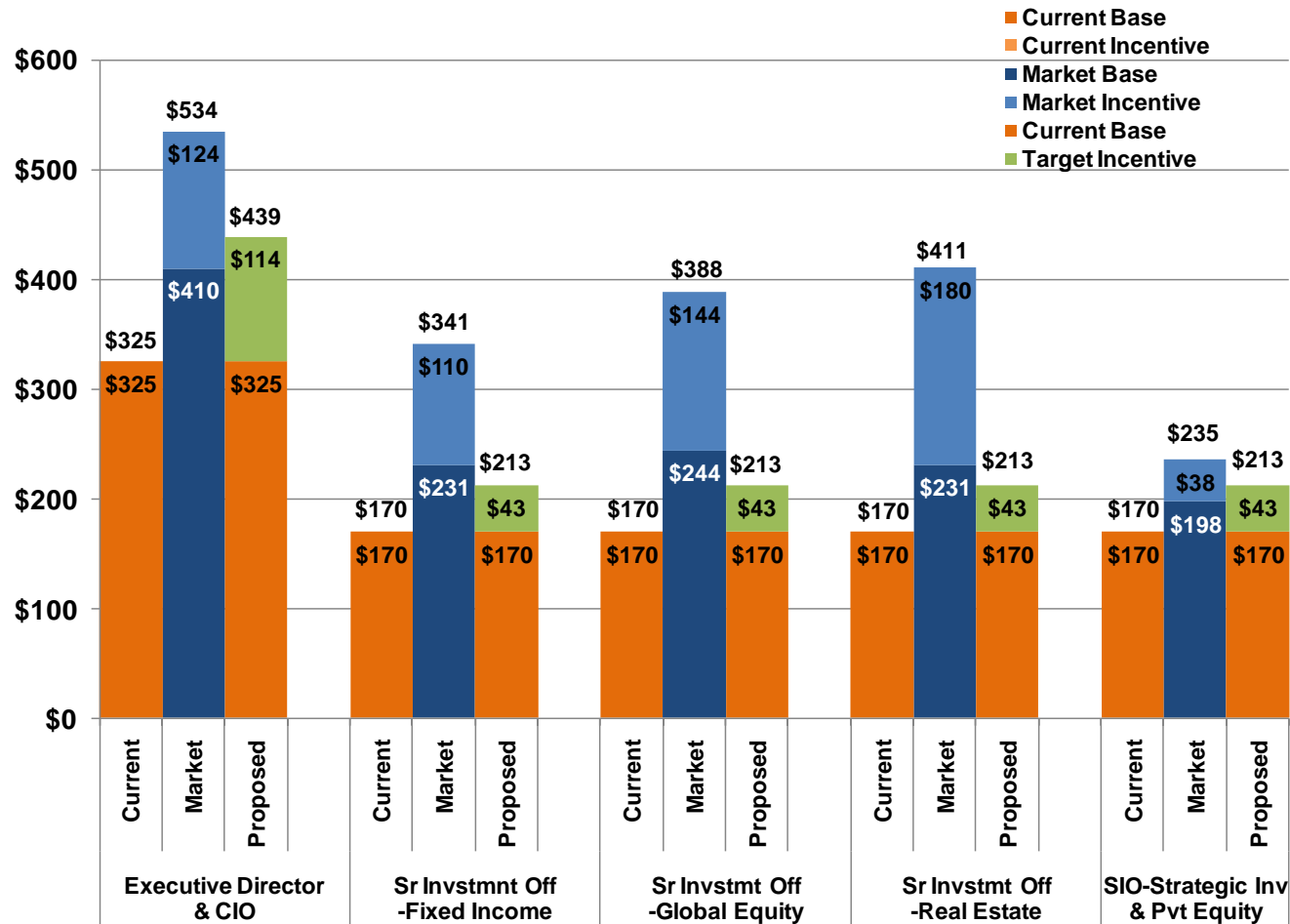
Tier	Title	# of EEs	Threshold Incentive (as a % of salary)*	Target Incentive (as a % of salary)*	Maximum Incentive (as a % of salary)*	Financial/ Non Financial
1	<ul style="list-style-type: none"> <li>Executive Director &amp; CIO</li> </ul>	1	17.5%	35%	52.5%	85% / 15%
2	<ul style="list-style-type: none"> <li>Deputy Executive Director</li> <li>Senior Investment Officers</li> <li>Chief Operating/Financial Officer</li> <li>Chief Operating Officer, FHCF</li> <li>Chief Risk and Compliance Officer</li> <li>General Counsel</li> <li>Sr. DC Programs Officer</li> </ul>	13	12.5%	25%	37.5%	80% / 20%
3	<ul style="list-style-type: none"> <li>Investment Directors</li> <li>Senior Portfolio Managers</li> <li>Portfolio Managers</li> <li>Other Investment Managers</li> </ul>	37	7.5%	15%	22.5%	90% / 10%
4	<ul style="list-style-type: none"> <li>Senior Analysts</li> <li>Analysts</li> <li>Senior Traders</li> <li>Traders</li> </ul>	12	5%	10%	15.5%	75% / 25%

# Financial vs Non-Financial Performance

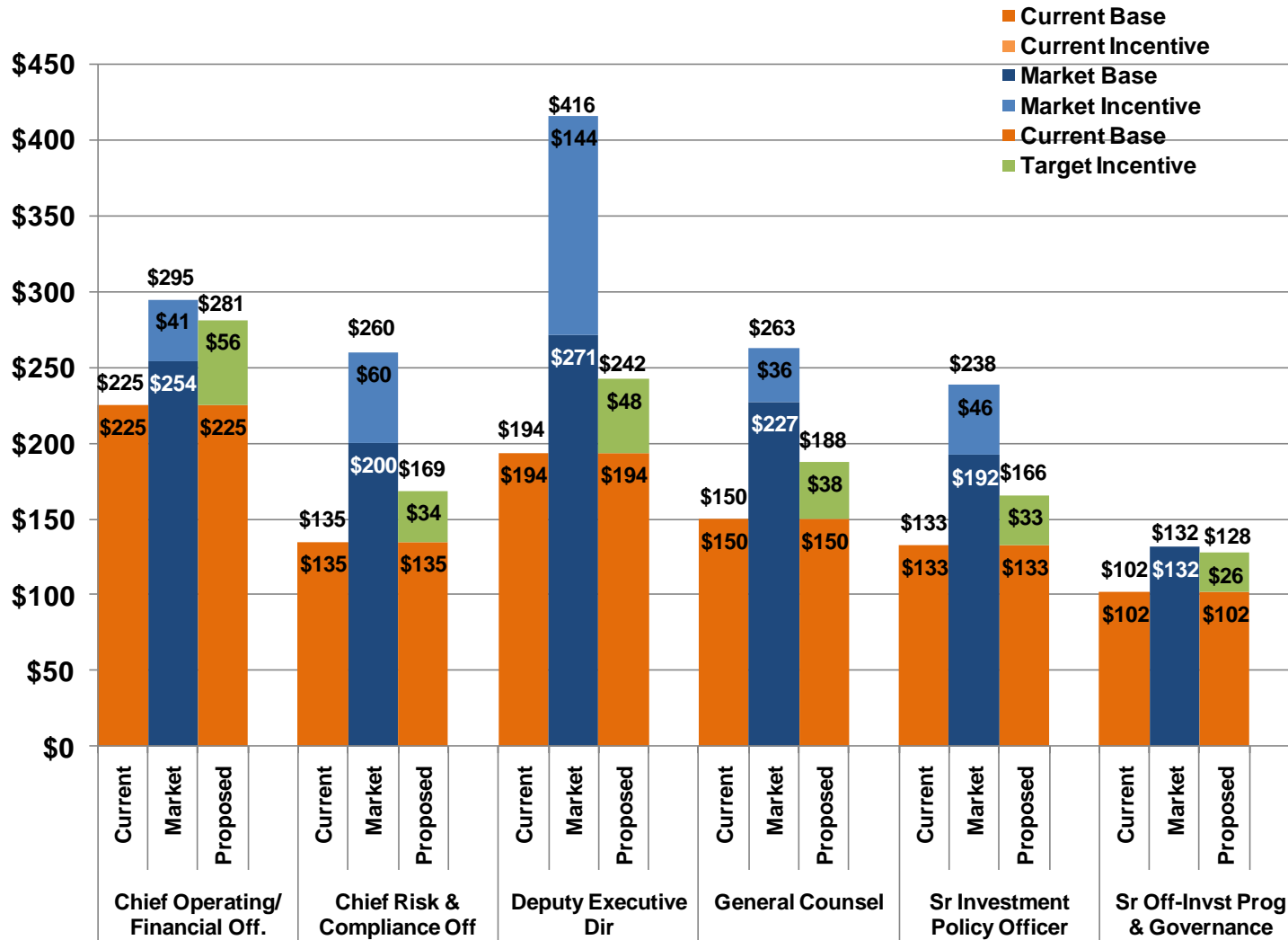
- One reason for implementing an incentive plan for pension fund management is the ability to measure performance in a concrete manner
  - Many other departments and functions of State Government are harder to assess strong performance
  - This rationale also lends credence to why the incentive plan covers investment related positions and other senior management roles rather than the whole organization
- While financial performance is critical, non-financial performance is also important to the organization. As such, Mercer recommends focusing a portion of the incentive on performance beyond the financial results. Areas for consideration include:
  - Mission (asset allocation, risk, sustainability, etc)
  - People (recruiting, retaining, training, developing, mentoring, etc)
  - Processes (new tools, methodologies, review processes, standards, etc)
  - Values (good citizen, collaborative, diversity, etc)
- For the CIO/ED, the IAC and trustees would establish the non-financial performance goals and combine the overall financial performance with performance against non-financial goals to arrive at an incentive award
- For all other SBA employees in the incentive plan, CIO/ED will be responsible for setting goals (financial and non-financial) and determining outcomes

# Impact of the Incentive Plan

- One of the goals of implementing the incentive plan one of the goals is to ensure that SBA jobs are more competitive with the market. Using the market data presented to the IAC and the incentive targets proposed earlier in this presentation, the following charts have been created which show the overall cash competitiveness of the current and proposed SBA compensation programs against the market: *(note, no salary changes are incorporated in these charts)*



# Impact of the Incentive Plan



DED chart reflects previous position and incumbent

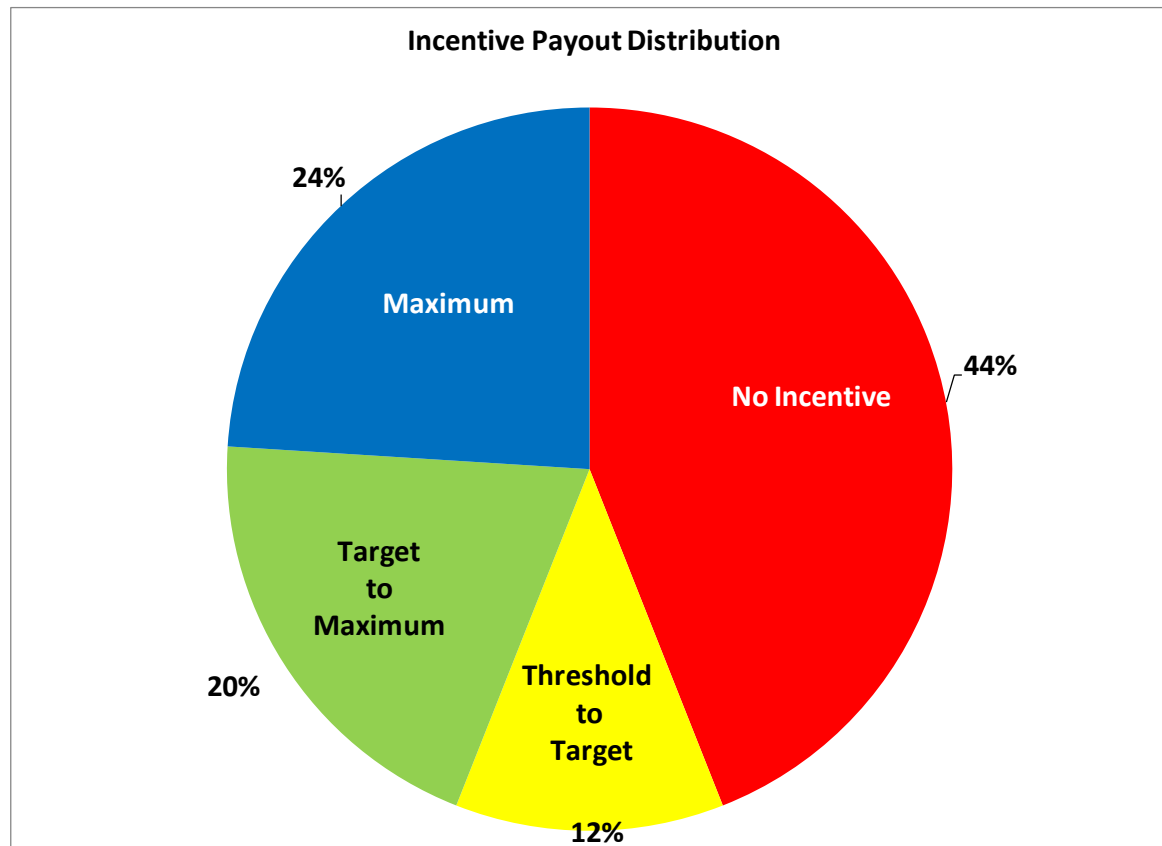
# Difficulty of Goals and Historical Achievement Levels

- In establishing the performance goals for the plan, the intent is to require levels of performance that are achievable yet challenging. Ideally, the goals would reward periods of solid performance and recognize periods where performance fails to meet expectations
- The chart below models the proposed payout levels in terms of payouts zone using the last 25 years of actual SBA total fund return information:

Date	3-yr Rolling VA	No Incentive	Threshold to Target	Target to Maximum	Maximum Incentive
6/30/2012	1.27%				
6/30/2011	0.44%				
6/30/2010	0.24%				
6/30/2009	-0.41%				
6/30/2008	0.22%				
6/30/2007	0.58%				
6/30/2006	0.54%				
6/30/2005	0.12%				
6/30/2004	-0.05%				
6/30/2003	0.43%				
6/30/2002	0.98%				
6/30/2001	1.01%				
6/30/2000	0.49%				
6/30/1999	-0.40%				
6/30/1998	-0.96%				
6/30/1997	-1.21%				
6/30/1996	-0.75%				
6/30/1995	-0.19%				
6/30/1994	0.27%				
6/30/1993	0.67%				
6/30/1992	0.25%				
6/30/1991	-0.94%				
6/30/1990	-1.55%				
6/30/1989	-3.57%				
6/30/1988	-2.56%				

## Difficulty of Goals and Historical Achievement Levels

- The variability of the excess returns over the past 25 years do not translate well into a bell shaped curve with respect to an incentive plan. Instead, there are a significant number of periods where no incentive would be earned (11 out of 25 years) and a reasonable mix of years where some or all of the incentive would be earned, as shown in the graph below



## Incentive Recommendation: Estimated Costs

- Our Initial recommendation includes a population of approximately 63 SBA employees
  - Current total SBA payroll is approximately \$14.5 million
  - At target, the incentive pool would equal 8% of SBA total salaries
  - At maximum, the incentive pools would equal 12% of SBA total salaries

Tier	# of Employees	Total Salaries	Cost at Threshold	Cost at Target	Cost at Maximum
1	1	\$325,000	\$56,785	\$113,750	\$170,625
2	13	\$2,079,415	\$243,514	\$487,029	\$730,543
3	37	\$3,362,682	\$245,189	\$490,378	\$735,567
4	12	\$600,908	\$30,045	\$60,091	\$90,136
<b>Total</b>	<b>63</b>	<b>\$6,368,005</b>	<b>\$599,048</b>	<b>\$1,198,097</b>	<b>\$1,797,145</b>

### Notes:

- Estimated costs reflect recommended incentive percentages applied to current base salary levels
- Increases to base salary levels (e.g., market adjustments) will increase projected costs



## Business Case for Additional Expense

- The table below illustrates the required outperformance at payout level and the return of funds to the stakeholders

	Threshold	Target	Maximum
Basis Pts Outperformance	5 BPS	25 BPS	50 BPS
Total Dollars above Benchmark (assumes \$125 Billion fund)	\$62.5 million	\$313 million	\$625 million
Total Incentive Cost	\$599,000	\$1,198,000	\$1,797,000
% of Outperformance Dollars Going to Employees	0.96%	0.38%	0.29%

- As the numbers indicate, the overwhelming majority of the outperformance dollars are being returned to the outside stakeholders.

# Deferral Mechanism

- The chart below highlights the award performance periods, including the introductory periods, and the associated payouts

	2014	2015	2016	2017	2018	2019	2020	2021
Cycle 1 Performance	1 year							
Cycle 1 Payout		50% Payout	50% Payout					
Cycle 2 Performance	2 Years							
Cycle 2 Payout			50% Payout	50% Payout				
Cycle 3 Performance	3 Years							
Cycle 3 Payout				50% Payout	50% Payout			
Cycle 4 Performance		3 Years						
Cycle 4 Payout					50% Payout	50% Payout		
Cycle 5 Performance			3 Years					
Cycle 5 Payout						50% Payout	50% Payout	
Cycle 6 Performance				3 Years				
Cycle 6 Payout							50% Payout	50% Payout

Incentives paid in November, following audit of fiscal-year performance data

- The plan design accomplishes the following goals
  - Measures multi-year performance
  - Increases likelihood that plans will not be hopelessly underwater for more than 1 year
  - Aides in retention by deferring the award
- Special arrangements to be made for retirement, death and disability

## Next Steps

- Gain agreement on plan design
- Introduce the plan to the full IAC
- Gain Trustee approval

# Appendix

# Difficulty of Goals and Historical Achievement Levels

- In establishing the performance goals for the plan, the intent is to require levels of performance that are achievable yet challenging. Ideally, the goals would rewards periods of solid performance and recognize periods where performance fails to meet expectations
- The chart below models the proposed payout levels in terms of payouts zone using the last 25 years of actual SBA total fund return information:

Date	3-yr Rolling VA	3-yr Rolling Return- ACTUAL	3-Yr Rolling Return-Nominal Long Term Target	Excess/ (shortfall) vs 3-Yr LT Target	No Incentive	Threshold to Target	Target to Maximum	Maximum Incentive
6/30/2012	1.27%	11.77%	7.19%	4.58%				
6/30/2011	0.44%	4.08%	6.09%	-2.02%				
6/30/2010	0.24%	-4.08%	6.59%	-10.67%				
6/30/2009	-0.41%	-2.96%	6.85%	-9.81%				
6/30/2008	0.22%	7.66%	8.54%	-0.88%				
6/30/2007	0.58%	12.88%	7.33%	5.55%				
6/30/2006	0.54%	12.42%	7.50%	4.91%				
6/30/2005	0.12%	9.74%	6.83%	2.90%				
6/30/2004	-0.05%	3.31%	6.43%	-3.11%				
6/30/2003	0.43%	-4.38%	6.52%	-10.90%				
6/30/2002	0.98%	-2.11%	7.09%	-9.20%				
6/30/2001	1.01%	5.16%	6.30%	-1.14%				
6/30/2000	0.49%	15.33%	6.86%	8.46%				
6/30/1999	-0.40%	18.99%	6.37%	12.62%				
6/30/1998	-0.96%	20.08%	7.75%	12.33%				
6/30/1997	-1.21%	18.88%	7.11%	11.77%				
6/30/1996	-0.75%	11.69%	7.18%	4.51%				
6/30/1995	-0.19%	10.99%	7.27%	3.72%				
6/30/1994	0.27%	9.70%	7.28%	2.42%				
6/30/1993	0.67%	12.73%	8.04%	4.69%				
6/30/1992	0.25%	11.26%	8.63%	2.64%				
6/30/1991	-0.94%	11.46%	9.35%	2.10%				
6/30/1990	-1.55%	8.16%	9.10%	-0.94%				
6/30/1989	-3.57%	8.04%	8.74%	-0.70%				
6/30/1988	-2.56%	11.94%	7.56%	4.39%				

Darkened colored boxes indicate where long term nominal return hurdles have not been met

# Difficulty of Goals and Historical Achievement Levels

- The variability of the excess returns over the past 25 years do not translate well into a bell shaped curve with respect to an incentive plan. Instead, there are a significant number of periods where no incentive would be earned, and a reasonable mix of years where some or all of the incentive would be earned, as shown in the graph below on the left
- The graph below on the right illustrates the impact of the long term nominal return hurdle. As it shows, 43% (6 of 14) of the incentive payouts would be negatively impacted by the long term nominal return hurdle rate:

