SBA FLORIDA
STATE BOARD OF ADMINISTRATION

Agenda
Investment Advisory Council (IAC)
Compensation Subcommittee Meeting

Monday, April 29, 2013, 9:00 - 10:00 a.m.

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

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1. Welcome/Call to Order	Chuck Newman, Chair
2. Presentation of Mercer Compensation Recommendation for ED/CIO a. Base Pay b. Discretionary Component of Incentive	Josh Wilson, Mercer
3. Discussion and Decisions regarding ED/CIO Compensation a. Base Pay Recommendation to IAC b. Discretionary Component of Incentive — Content and Process c. Finalize recommendation to IAC	Chuck Newman, Chair
4. Review of SBA Implementation Plans for Closing Competitive Compensation Gap	Ash Williams, SBA
5. Establish Date and Topics for Next Meeting	Chuck Newman, Chair
6. Audience Comments/Closing Remarks/Adjourn	Chuck Newman, Chair

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Memo

To: Chuck Newman, Chairman, Compensation Subcommittee of the Investment Advisory Council, State Board of Administration

Date: April 23, 2013

From: Josh Wilson, Partner, Mercer

Subject: Salary Recommendation for Executive Director /Chief Investment Officer (ED/CIO)

Over the last eight months, Mercer has conducted a comprehensive review of compensation for SBA employees. Mercer partnered with the SBA's Investment Advisory Council (IAC), and then its Compensation Subcommittee, to determine a compensation philosophy and establish appropriate benchmarks against which to compare current SBA pay. The results of the study are in large part complete from an aggregate standpoint. The SBA, with the concurrence of the IAC, will adopt a compensation policy (including revisions to the SBA's incentive compensation plan) that reflects market levels for the top public pension funds and will begin implementing the policy through its normal budgeting processes to close the gap between SBA salaries and competitive market salaries. This will enable the SBA to recruit, retain and motivate qualified, high-performing staff, while improving the alignment of interests between SBA employees and stakeholders and minimizing human capital risk. While SBA management, at the direction of the ED/CIO, will determine the appropriate budget requests and subsequent salary adjustments to personnel, Mercer has been asked to provide a recommendation on the salary increase for the ED/CIO.

One of the findings of the Mercer study was the base salary for the CIOs of the five largest public pension funds in the United States, ranged from $300,000 to $480,000, with a median of $410,000. This small sample included funds both larger and smaller than SBA. The tenure and prior experience of the individual incumbents varies widely among the five funds. Four of the five individuals received incentive awards, which resulted in a total compensation range for these five CIOs of $300,000 to $876,000, with a median of $534,375.

At present, the SBA ED/CIO, Mr. Ash Williams, receives a base salary of $325,000. The incumbent was recruited to the SBA in October 2008 at salary of $325,000, and his pay has not been adjusted since that time. During Mr. Williams' tenure at the SBA, through January 31, 2013, the FRS has returned 7.62% on an absolute basis, which is 70 basis points ahead of benchmark and 137 basis points ahead of the long term absolute nominal target rate of term for the fund (5% plus inflation). In addition, during that time, the SBA successfully concluded a number of other important organization-wide projects fairly attributable to his role in the organization, including building out a risk management and compliance function at the SBA, significantly reducing the number of outstanding audit recommendations, enhancing employee training and certification and overseeing adjustments and revisions to Florida PRIME

The lack of increase in Mr. Williams' salary over his five year tenure, particularly in light of the quantitative performance of funds under management and non-quantitative achievements, is inconsistent with the values of pay for performance desired by the organization. In addition, his compensation is significantly below the median for similar positions at other large public funds. Mercer believes that increasing Mr. Williams' base salary to the median of the five largest US pension funds, which is $410,000 per year as noted above, is appropriate. This increase is supported by both data and performance. In addition, Mercer recommends that, based on comparable positions in the market, Mr. Williams be eligible for participation in the revised annual incentive plan at a target level of 35% of base salary per year. Inclusion in the incentive plan will further help align, retain and motivate the ED/CIO and ensure more competitiveness against the market.

If you have any questions, please do not hesitate to contact me.

Thank you

Josh

Meeting of the Compensation Subcommittee of the IAC – April 29, 2013

Agenda Item 4. Compensation Program Implementation

(No Action Required)

Introduction

The Compensation Subcommittee and the IAC have reviewed and accepted the competitive pay study completed by its independent compensation consultants, Mercer, that shows the SBA's salary and total compensation levels, in general, are below the competitive market level. For most positions, where a comparison to financial services or general industry is appropriate, the competitive market level was defined as the 50^{th} percentile of the relevant market. For key investment and leadership roles, the competitive market level was defined generally as the 50th percentile of the five largest U.S. public pension funds. When data for the top five funds was not available, the 75^{th} percentile of the broader public pension fund market (which includes much smaller, less complex funds) was used as a proxy. Mercer found that the SBA's total compensation for investment and management positions generally was less competitive than for staff level positions.

Based on the information provided from Mercer and the input from Subcommittee members, on March 18, 2013 the Subcommittee recommended and the IAC approved the recommendation to the Trustees that to enable the SBA to recruit, retain and motivate qualified, high-performing staff, while improving the alignment of interests between SBA employees and stakeholders and minimizing human capital risk, the SBA will adopt a compensation policy (including revisions to the SBA's incentive compensation plan) that reflects the recommended market levels and will begin prudently implementing the policy through its normal budgeting process.

As the next step in the process, the Subcommittee asked the SBA to develop and share with the Subcommittee an implementation plan prior to the budget submission. It also asked Mercer to prepare a recommendation regarding an appropriate base salary for the ED/CIO, which it will consider at its next meeting on April 29, 2013.

The remainder of this document summarizes actions taken to date and outlines the implementation plan.

Actions Taken To Date

Development of Pay Structure. Since the March 18 Compensation Subcommittee meeting, Mercer has developed a grade structure for SBA base salaries, with 22 pay grades, shown below:

SBA - Grade Structure FY13-14			
Grade	**Minimum**	**Midpoint**	**Maximum**
	$	$	$
1	22,000	27,500	33,000
2	25,300	31,600	37,900
3	29,000	36,300	43,600
4	33,400	41,700	50,000
5	38,400	48,000	57,600
6	44,200	55,200	66,200
7	50,800	63,500	76,200
8	58,400	73,000	87,600
9	68,900	86,100	103,300
10	81,300	101,600	121,900
11	95,900	119,900	143,900
12	115,100	143,900	172,700
13	138,200	172,700	207,200
14	165,800	207,200	248,600
15	198,900	248,600	298,300
16	238,600	298,300	358,000
17	328,000	410,000	492,000
PM01	70,400	88,000	105,600
PM02	81,600	102,000	122,400
PM03	104,000	130,000	156,000
PM04	132,000	165,000	198,000
PM05	176,000	220,000	264,000

The middle third of a pay grade (discussed in more detail below) can be thought of as a general market/competitive level for the skills and responsibilities of a position assigned to that pay grade. For each pay grade, Mercer defined a minimum, midpoint and maximum amount. The minimum of each grade is 80% of the midpoint and the maximum of each grade is 120% of the midpoint. Within the minimum and maximum points of a pay grade, Mercer defined three "zones" as follows:

Zone 1 – Bottom Third of Range (80% to 90% of midpoint) "Learning/Development Zone"

- Generally represents the area where most new employees are hired (since most new employees are not familiar with all the complexities of the job, they may not be expected to have fully mastered all requirements of the job).

- Also for recently promoted employees who are developing the skills and experiences necessary for competent performance.
- May also include experienced or long-term employees who are having performance problems.

Zone 2 – Middle Third of Range (90% to 110% of midpoint) “Fully Proficient Zone”

- For employees who have mastered the skills and knowledge required by the job and who continuously meet the assigned accountabilities and objectives. New hires that are well-seasoned will generally fall into this zone as well.
- An employee with a salary in this zone is paid competitively with other competent and experienced employees in other peer companies.
- Most employees can expect their salaries to move into this zone as their skills and knowledge develop to meet the full requirements of the job.

Zone 3 – Top Third of Range (110% to 120% of midpoint) “Role Model Zone”

- For employees who have mastered the job and consistently and substantially exceed target performance standards, and who, because of unique skills, talents, and experience are making a significant contribution above the expected level for the job.
- Salaries in this zone are for the sustained standout or exceptional performer, and represent pay levels well above the target market position.
- Employees paid in this zone would be considered role models for others in their job to aspire to; not all employees would expect to achieve this level.

1. <u>Assignment of SBA Positions to Pay Grades.</u> Mercer initially assigned each SBA position to a pay grade based on market data for that position when market data for that position was available. For example, Mercer has market data for portfolio managers. As such, SBA portfolio managers were assigned to “the market” pay grade for portfolio managers in general. Mercer did not have market data for some specific SBA positions such as the Florida Hurricane Catastrophe Fund’s Chief Operating Officer. In these instances, Mercer and SBA personnel reviewed the specific position’s responsibilities and assigned that SBA position to a pay grade having similar position responsibilities and for which Mercer had “market” data.

   After this initial round of pay grade assignments, SBA management reviewed the positions and corresponding assigned pay grades to determine its ability to recruit qualified staff to perform the defined work responsibilities associated with each position at its assigned pay grade. This SBA management review was an iterative process, and in some cases, position responsibilities were clarified and adjustments to pay grades (to reflect the clarified position responsibilities) were made. The goal of this process was to ensure that a pay grade assigned to a particular SBA position was neither too high nor too low, given the actual responsibilities and required skills of employees in each position. As one might expect, the process resulted in some useful clarification of position responsibilities and required skill levels.

2. <u>Management's Assessment of Appropriate Placement within Pay Grades.</u> Following the assignment of each position to a pay grade, every incumbent's skills, performance, and breadth and length of experience were reviewed and used to identify an appropriate placement along the continuum of pay levels within the salary range for his/her position, i.e., in which pay grade zone for a position should the incumbent fall. The effectiveness of this assessment is critical to the success and credibility of the program, and it involves highly subjective judgments. To ensure the judgments are as fair as possible, the initial zone assessments are undergoing reviews by SBA management and human resources personnel.

3. <u>Magnitude of Compensation Gap and Estimation of Cost.</u> Once all SBA positions had been assigned to market or estimated market pay grades, and after SBA management provided feedback regarding the pay grade zone assignments for each incumbent, SBA management was able to determine a "target salary" for each employee that corresponded to the recommended salary level within the incumbent's assigned pay grade. Overall, target salaries for all SBA employees exceed the current SBA salaries, generating a "compensation gap" of approximately $2.3 million (15.6% of current salaries).

4. <u>Development of Implementation Strategy</u>. In developing a strategy to move SBA salaries to more competitive levels over time, we considered a number of factors, including the magnitude of the gap relative to our overall expense budget, our ability to fund increased compensation levels by generating additional fee revenues through growth in assets under management, and the increasing risk of losing our best staff as employment markets improve locally and in the asset management field. We also took into consideration the criticality of specific positions to the SBA and the difficulty (or ease) of replacing. Our planning horizon expanded beyond the upcoming FY13/14. Looking further down the road to FY14/15, we will need to include in that year's budget an amount equal to half of the maximum incentive awards that could be earned in FY13/14, and to include in our FY15/16 budget the maximum annual incentive award amounts. Considering all these factors, we plan to implement the overall compensation program over a three-year period. In the FY13/14 budget, we plan to request $1.6 million to cover 70-75% of the base salaries gap. The remaining $650,000 of the $2.3 million compensation gap would be requested in the following fiscal year, along with 50% of the maximum incentive award, which we estimate would be approximately $1.1 million (based on estimated future salary levels), for a total budget increment of $1.75 million, slightly larger than the request for FY13/14. In FY14/15, we would plan to budget the full potential incentive award of approximately $2.2 million.

5. <u>Entity Expense Budgets.</u> The cost of implementing the first-year program of compensation increases (and related costs for employee benefits that are based on salary levels) for employees of the Florida Hurricane Catastrophe Fund and the Office of Defined Contributions will be included in the budget submission for those respective entities. Likewise, first-year increases for the SBA

employees will be included in the SBA's FY13/14 budget submission. Based on our preliminary analysis, we expect total SBA budgeted expenses for FY13/14 to increase by 8-9% over FY12/13.

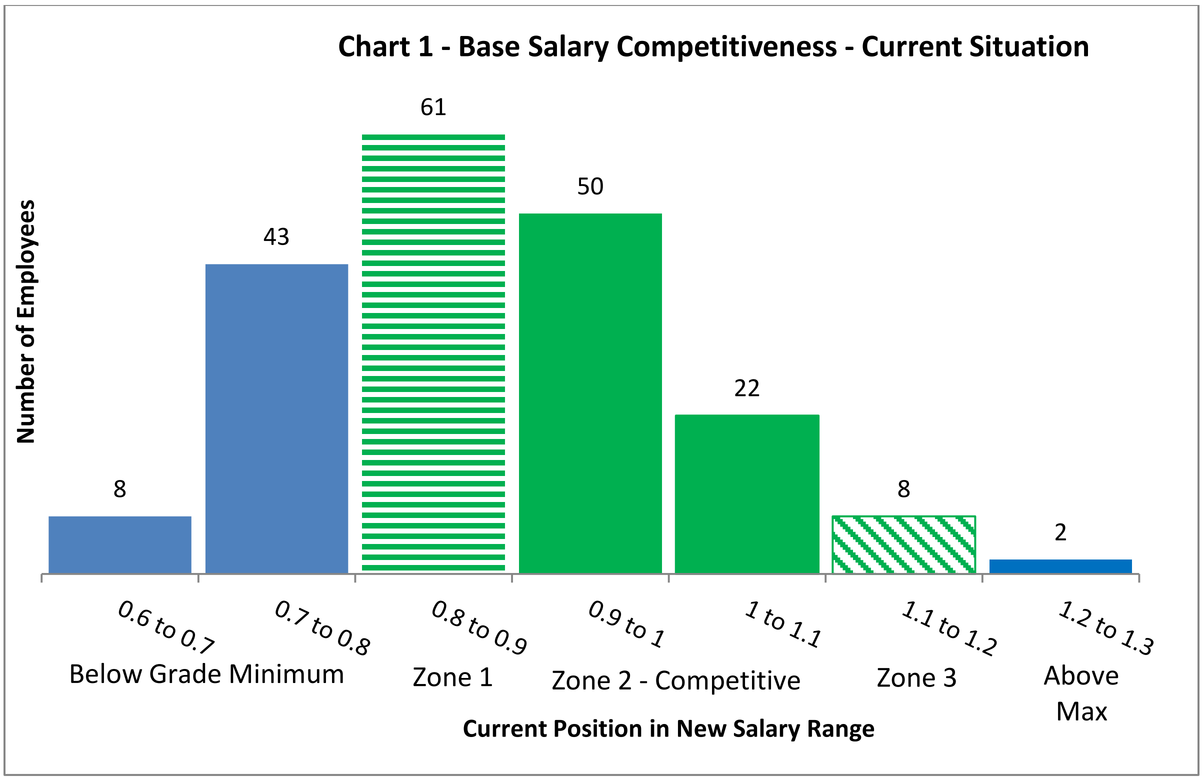
6. SBA Revenues. F.S. 215.515 provides that the operating costs of the SBA are to be paid from the funds it manages. The costs are recovered through the assessment of a monthly fee for investment, administrative and other services provided. Investment services are charged on a flat fee basis, a variable percentage charge on assets under management, or a combination of the two. Small trust funds generally pay a flat fee; the variable method is primarily utilized for larger client funds managed by the SBA and accounts for approximately 90% of the fees collected. The variable percentage charge on assets under management is 2.25 bps; for Florida PRIME, the variable percentage charge is 1.0 bps. No increase in the fee structure is proposed for FY13/14. We are planning to budget a 6% increase in fees as a result of strong investment performance experienced this fiscal year and anticipated increased contributions to the FRS Trust Fund during FY13/14. The Trust Fund AUM increased by over $7 billion between March 31, 2012 and 2013, and has grown another $1.7 billion since then (through April 26) to reach an estimated $135.4 billion. To illustrate the relationship between asset growth and SBA fee revenue, an AUM increase of $10 billion (7% of the FRS Trust Fund) translates to incremental fee revenue of $2.25 million.

7. Fund Balance. To the extent actual operating costs exceed service fees, the difference will be charged to the SBA Administrative Trust Fund, which had a balance of approximately $34 million on March 31, 2013.

8. An Appendix follows, containing tables and charts that are illustrative of the analysis we performed to develop and evaluate our planned implementation strategy. **Please note that the numbers are subject to change as we continue to review/refine the appropriate individual salary targets.**

Appendix – *Numbers Subject to Change*

Chart 1 shows the relationship of each employee's current salary to the midpoint of the new pay grade to which his/her position has been assigned. Each bar represents the number of employees whose current salary falls within the various portions of their new salary grade, in increments of 5%. The blue bars on the left side of the chart represent the number of employees whose current salaries fall below the minimum level of the new pay grades. The blue bar on the far right represents the number of employees whose current salary is above the maximum level of their new pay grade. The green bars in the middle show the number of employees whose current salaries fall within the new pay grades. The three "zones are depicted with different green patterns, with the horizontally-filled green bars showing the number of employees in Zone 1, the "Learning/Development Zone"; the solid green bars show the number of employees in Zone 2, the "Fully Proficient, or Competitive Level", and the green bars filled with a slanted pattern shows the number of employees whose current pay falls within Zone 3, the "Role Model Zone."

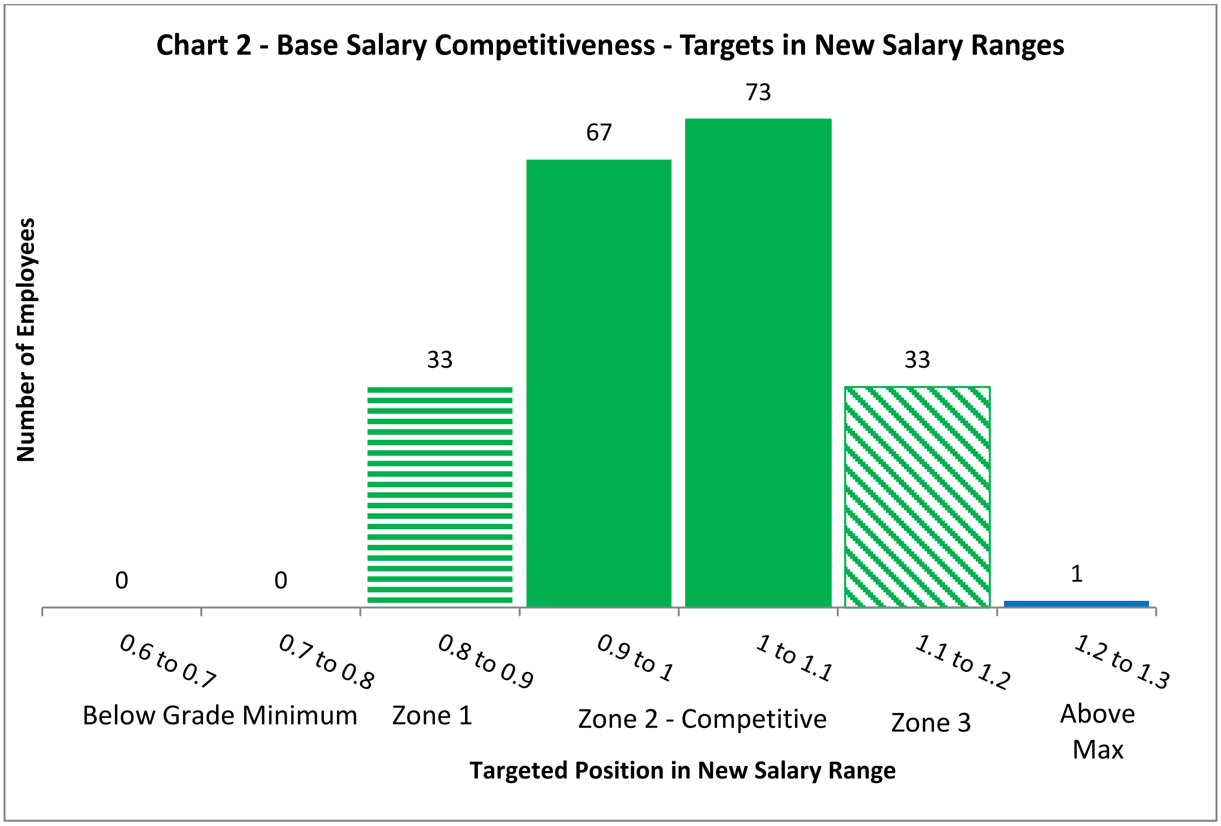


The table below summarizes the current situation, showing where in the new (competitive) salary ranges each employee's current salary would fall:

	#	%
Below Grade Minimum	51	26%
Zone 1	61	31%
Zone 2	72	37%
Zone 3	8	4%
Above Maximum	2	1%
Total	194	100%

Appendix (continued) -- *Numbers Subject to Change*

By comparison, Chart 2 below shows similar data on a pro forma basis, if we were able to pay every employee at his/her targeted salary level, taking into consideration the employee's individual performance and experience in the position.

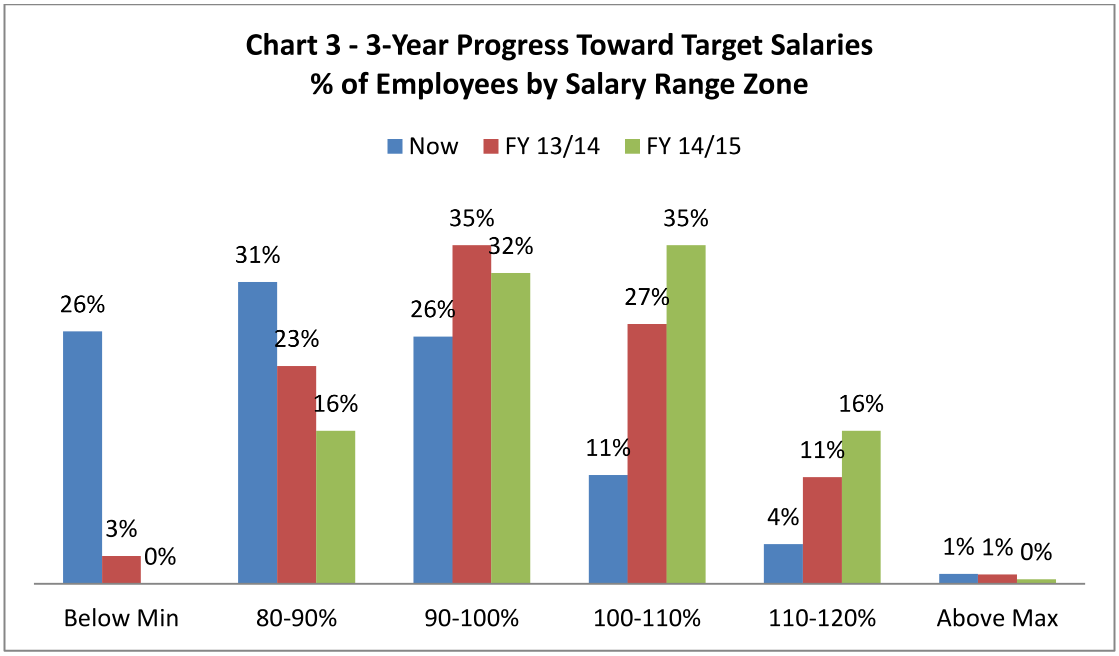


The table below summarizes the targeted placement of each employee's salary, relative to the midpoint/market value for his/her position. This summary is reassuring in that it shows that the distribution within the pay range represents an expected, normal bell curve.

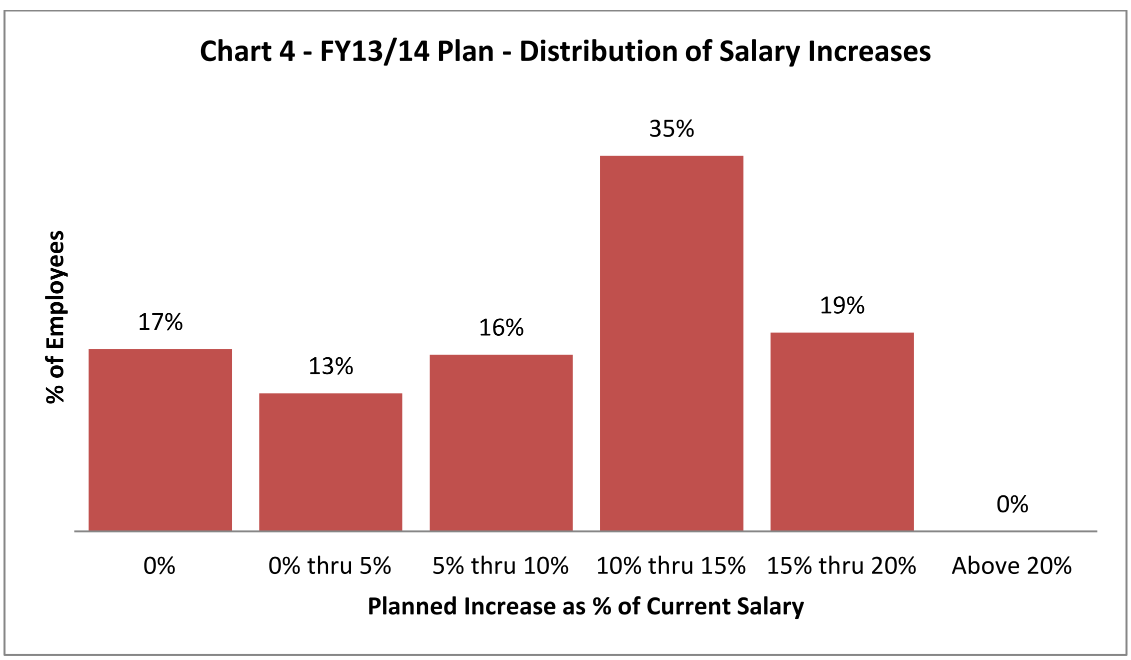
	#	%
Below Grade Minimum	0	0%
Zone 1	33	16%
Zone 2	140	68%
Zone 3	33	16%
Above Maximum	1	0%
Total	207	100%

Appendix (continued) – *Numbers Subject to Change*

Chart 3 below shows by fiscal year the percentage of employees that would fall in each zone. By FY14/15, the implementation of the plan would result in a normal distribution of pay levels.



Implementation of the first year of the plan is expected to result in salary increases that would range from zero to 20%, with an average increase of 11% in FY13/14. Chart 4 shows the planned distribution of increases, displayed in increments of 5%.



	Current (new salary grades)		FY 13/14					Ultimate Target				
Group	**# Employees > Midpt**	**Compa Ratio**	**Avg % Comp Increase (ex bonus)**	**# Employees > 11.1% Avg Inc**	**Max % Incr**	**# Employees > Midpt**	**Compa Ratio**	**Avg % Comp Increase (ex bonus)**	**# Employees > 15.6% Avg Inc**	**Max % Incr**	**# Employees > Midpt**	**Compa Ratio**
Total Current Employees	30	94	11.1%	98	20%	49	94	15.6%	65	56.5%	58	98
Non-bonus eligible	30	97	9.3%	53	20%	42	97	11.8%	33	56.5%	45	99
Bonus eligible, excl ED/CIO	0	91	13.7%	44	15%	7	91	20.7%	31	43.9%	13	96
ED/CIO	0	91	15.0%	1	15%	0	91	26.2%	1	26.2%	0	100

Total number of Employees	194
Bonus Eligible	56
Non-Bonus Eliglble	138

NOTE: The information above is preliminary and subject to change as we continue to review/refine the appropriate individual salary targets.

2013

January

S	M	T	W	T	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

April

S	M	T	W	T	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30				

July

S	M	T	W	T	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

October

S	M	T	W	T	F	S
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

February

S	M	T	W	T	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28		

May

S	M	T	W	T	F	S
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

August

S	M	T	W	T	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

November

S	M	T	W	T	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30

March

S	M	T	W	T	F	S
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

June

S	M	T	W	T	F	S
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30						

September

S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30					

December

S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

Aqua is Proposed PLGAC Meeting
Yellow is Proposed IAC Meeting
Orange is Proposed Joint IAC/PLGAC Meeting