



Performance-Based Incentive (PBI) Program

May 16, 2024

Initial Review of the Performance-Based Incentive Program for Fiscal Year 2025



- **Performance-based incentive programs:**
 - Are designed to attract, motivate and retain qualified investment professionals
 - Are standard in the investment management industry and at pension funds, including those in Ohio
 - Are the variable component of total compensation (base pay + pay for performance)
 - Align the interests of investment staff and STRS Ohio members (incentive payments increase with good performance and value added to the fund)

Initial Review of the Performance-Based Incentive Program for Fiscal Year 2025



- **STRS Ohio's internal investment management (inclusive of PBIs) saves money**
 - For 2022, CEM reported STRS Ohio's internal investment management saved ~ \$135 million annually
- **STRS Ohio's net total fund performance is in the top 15% of Meketa's plan sponsor peer group analysis over the long term:**
 - ✓ 3 yrs (top 4%) ✓ 5 yrs (top 12%) ✓ 10 yrs (top 4%) ✓ 20 yrs (top 2%)
- **Performance over the benchmark added \$2.28 billion in value during the past five years**
 - PBI Program return on investment = 57x (pay \$1 to get \$57)
- **Approximately 15% of total STRS Ohio employees are eligible for performance-based compensation; only certain eligible investment staff participate in the PBI Program**

Initial Review of the Performance-Based Incentive Program for Fiscal Year 2025



- **In fiscal year 2024:**
 - McLagan found the STRS Ohio incentive plan is aligned with competitive market practice
 - The board approved substantial PBI Program changes in August 2023, including:
 - More than 30 positions removed from the PBI Program
 - Maximum incentive percentages were reduced
 - A 10% reduction to PBI payments in any year where the board's actuary determines there is not sufficient funding to change member benefits
- **Minimal changes proposed for fiscal year 2025**

Incentive Compensation

The Maximum Eligible Incentive Compensation for Eligible Associates is outlined in Attachment A.

Incentive Compensation will be calculated on the Eligible Associate's annual base salary in effect on the final full pay period of the fiscal year.

Annual compensation (base salary plus Incentive Compensation earned) of an investment associate in any calendar year cannot exceed two times the maximum amount of pay grade 317.

Performance Measures

The following performance measures will be applied to every Eligible Associate's Incentive Plan:

- Only quantitative goals will be utilized. Subjective goals will not be used.
- If the STRS Ohio Total Fund does not earn a positive Absolute (actual) Return in the fiscal year, the Incentive Compensation for each Eligible Associate will be reduced by a factor of 4x the Total Fund Absolute Return, up to a maximum reduction of 50%. In the event a reduction of the earned incentive reaches the maximum of 50% (i.e., Total Fund Absolute Return at or below -12.5%), all incentives will be deferred for a one-year period.

See attachment D for an example of a negative Absolute Return reduction.

- Linking Incentive Compensation to the financial health of the System directly aligns the Program with member outcomes. Therefore;

If the Board's actuary determines the System does not have at least a de minimis amount available under its Sustainable Benefit Enhancement Plan (SBEP) for the fiscal year during which Incentive Compensation is scheduled for payment, the Incentive Compensation for each Eligible Associate will be reduced by 10%.

- A minimum of 20% of every Eligible Associate's Incentive Plan will be based on the Total Fund Net Relative Return allocated 50% to the 1-year period and 50% to the 5-year period. The Net Relative Return that must be met for full incentive achievement will be based on the Board's current Net Relative Return Objective as defined in the annual Statement of Investment Objectives and Policy.
- No associate will earn their Maximum Eligible Incentive Compensation unless the Total Fund Net Relative Return meets or exceeds the current Net Relative Return Objective as defined in the annual Statement of Investment Objectives and Policy. The total fund costs (difference between gross and net of fee performance goals) are reported annually by CEM Benchmarking Inc. on a calendar year basis and are reflected on the Board's Trustee Summary performance report prepared by the Investment Consultant.
- Total Fund investment performance will be based on Net Relative Returns net of all investment management costs (internal and external) including carried interest and other fund expenses. Each asset class will be based on Relative Returns net of all external management fees and costs including (as applicable) carried interest and other fund expenses as per industry convention but no costs deducted for internal management. Consistent with industry standards, private market performance is lagged one quarter due to the timing and availability of financial information.

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General Guidelines for Allocating Incentive Goals

Attachment B

The chart below is used as a general guideline for allocating the incentive goals to individual positions. This attachment is referenced on page 5 of the PBI Program document.

The allocation percentages listed below for the one year Asset Class and Total Fund performance represent minimum allocation levels. However, each Associate is generally expected to have on a combined basis, an effective weight on one year performance of at least 25%. The Portfolio/Industry group may include goals related to Individual Portfolios, industry sectors, analyst groups or other appropriate subsets within the relevant Asset Class. Private direct real estate is included in the Portfolio/Industry category for real estate positions. The "Asset Class" category for Fixed Income will include only the Core portfolio. Refer to Attachment D for an example of an incentive calculation and how these allocation percentages are used.

	Incentive Allocation Percentages		
	Assistant Director	Strategy Committee Member ⁴	All Other PBI Eligible Positions
Portfolio/Industry, if applicable³	50%	60%	70%
1 Year Relative Performance	50%	5%	40%
5 Year Relative Performance	45%	55%	60%
Asset Class	20%	20%	20%
1 Year Relative Performance	20%	2%	20%
5 Year Relative Performance ⁴	18%	18%	18%
Total Fund	30%	20%	42%
1 Year Relative Performance	15%	10%	51%
5 Year Relative Performance	15%	10%	51%
Total Incentive Allocation	100%		100%

Notes:

Currently, the Strategy Committee includes the following positions: Director, Domestic Equities; Director, Fixed Income; Director, Alternative Investments; Director, International Equities; Director, Investment Operations; Director, Real Estate. There are other positions held on the Strategy Committee that are not listed here because they are included in this footnote below. The Deputy Executive Director, Investments has a 60% allocation to Total Fund and a 40% allocation to the individual asset classes. The Sr. Economist, Director, Asset Allocation and Strategy, Investments and Chief of Staff, Investments have a 50% allocation to Total Fund and a 50% allocation to the individual asset classes.

Presented 8/17/2023



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	Incentive Allocation Percentages	
	Assistant Director	All Other PBI Eligible Positions
Portfolio/Industry, if applicable³	50%	60%
1 Year Relative Performance	0%	0%
5 Year Relative Performance	50%	60%
Asset Class	20%	20%
1 Year Relative Performance	0%	0%
5 Year Relative Performance ⁴	20%	20%
Total Fund	30%	20%
1 Year Relative Performance	15%	10%
5 Year Relative Performance	15%	10%
Total Incentive Allocation	100%	100%

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