

**OBJECTIVE CRITERIA COMMITTEE MINUTES
BOARD OF TRUSTEES
MARYLAND STATE RETIREMENT AND PENSION SYSTEM**

November 29, 2018

The Objective Criteria Committee convened at the SunTrust Building, 120 East Baltimore Street, 16th Floor, Board Room, Baltimore, Maryland, beginning at 3:00 p.m.

The Committee Members present included:

Eric Brotman, Chairman, Presiding	Mary Miller (via phone)
Susanne Brogan (Designee)	Marc Nicole (Designee – via phone)
Nancy K. Kopp (via phone)	Andrew Serafini

Other Trustees present included: Richard Norman

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary
Anne Gawthrop, Angie Jenkins, Andrew Palmer and Janet Sirkis

Assistant Attorneys General present included: Rachel Cohen

Other attendees included: Joe Rice and Hal Wallach of CBIZ Compensation Consulting and Phillip Anthony

Minutes	On a motion made by Senator Serafini and seconded by Ms. Brogan, the Committee approved the October 22, 2018 open session meeting minutes.
Ratification of the Committee' Electronic Vote regarding the Objective Criteria Committee Governance Charter	<p>At the Committee's October 22, 2018 meeting, staff presented draft language for an Objective Criteria Committee Governance Charter. Mr. Brotman requested that the Charter be revised to include separate sections that establish the distinction between Investment Division staff who hold a position with discretion over investment-related decisions and those positions that do not have discretion over investment-related decisions. The Committee approved the charter with the suggested changes.</p> <p>On October 25, 2018, Mr. Kenderdine presented, electronically to the Committee members, a revised draft OCC Governance Charter.</p> <p>Ms. Miller commented that it was her recollection that the flow of the Charter would be the CIO (salary and incentives), staff with discretion (salary and incentives), followed by staff without discretion (salary).</p> <p>Mr. Kenderdine responded that yes, that is the appropriate ordering of the sections and that modifications to the Charter would be made to reflect that order.</p> <p>Having received a motion electronically made by Ms. Brogan and electronically seconded by Mr. Brotman, the Committee electronically approved the Governance Charter of the Committee.</p> <p>On a motion made by Ms. Brogan and seconded by Senator Serafini, the Committee ratified its vote to approve the recommended changes to the OCC Governance Charter.</p> <p>Mr. Kenderdine reported that the policy requires that all Charters go through the Board's Administrative Committee for approval and recommendation to the Board of Trustees.</p>

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Compensation
Philosophy
Statement for
the System's
Investment
Division

Hal Wallach and Joe Rice from CBIZ Compensation Consulting presented the Committee with a Compensation Philosophy for the System's Investment staff, which describes the basis of attracting, retaining and motivating qualified investment staff to achieve the System's Mission.

The philosophy provides that positions are evaluated against the labor market based a comparison of the duties, responsibility and required qualifications of employees serving in similar positions. It also provides that pay structure, for investment staff, should be at the market median based on the labor market, which is based on the following characteristics:

- Industry – the labor market will be comprised of other public pension funds given the specialty nature of the investment staff positions.
- Size of Organization – the labor market will be comprised of peer funds as measured by assets under management to ensure that the organization is comparable.
- Geography – the labor market will include peer funds nationwide. National survey will be adjusted to Baltimore, Maryland based on a cost-of-labor differentials.

Ms. Brogan asked what is meant by peer funds as measured by assets under management. She asked how the peer group would be selected and as an example referred to a TUCS report presented at the last Investment Committee meeting comprised of plans greater than \$25 billion.

Mr. Rice responded that the selection of a peer group would depend on the comparison sought. Different peer groups might be appropriate for different purposes.

Mr. Wallach further responded that for this purpose CBIZ wanted to have a broad view of the investment employment marketplace for public funds. Therefore they have incorporated a number of compensation surveys from different sources to create as large a data set as possible. Unfortunately, the use of multiple data sets reduces the ability to create a specific subset of plans with particular attributes.

Treasurer Kopp noted that the TUCS survey was focused on relative investment performance and a different group could be used to evaluate compensation.

Senator Serafini opined that the size of the investment staff may be a better comparator than assets of the plan.

In addition, the philosophy also provided for the Investment Staff Compensation Policy to include the following compensation components:

- Base Salary – the annual fixed rate that an individual is paid for performing a job.
- Total cash compensation – the sum of the base salary and incentive pay. Incentive pay is the actual direct compensation paid under a short-term cash compensation plan that provides variable awards based on established criteria.

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Ms. Brogan questioned if the philosophy could say incentive pay will allow individuals to achieve market competitive total cash compensation....while providing “above market” opportunities for superior performance. Ms. Brogan commented that the philosophy should be built around the current statute, which provides for a 33% cap.

Senator Serafini asked if the language could be changed to say “above median” instead of “above market.”

Treasurer Kopp agreed with Senator Serafini.

Mr. Brotman asked that CBIZ change the language of the philosophy, as discussed and that the revised document be sent to the Committee for an electronic vote which will be ratified at the December Committee meeting for recommendation to the Board.

Analysis of
Current
Investment Staff
Compensation

The Committee was provided with a summary of the competitive market study and proposed incentive plan parameters. The report provided the following recommendations:

The objective criteria for the <u>compensation</u> of the <u>Chief Investment Officer</u>, shall include:	
Requirement	Objective Criteria
Consideration of the comparative qualifications and compensation of employees serving in similar positions and discharging similar duties at comparable public pension funds	<ul style="list-style-type: none"> • Base Salary and total cash compensation market data at the 25th, 50th, and 75th percentile • Compare to external survey descriptions based on job description • Education and certifications • CIO performance rating • Employee salary range placement
Objective benchmarks of investment performance that shall be met or exceeded for the CIO to be eligible for an increase in compensation	<ul style="list-style-type: none"> • Positive fund return • Performance rating of “satisfactory” or higher

The Committee, after discussion, agreed that the language regarding the “Positive Fund Return” should include “relative to benchmark” and that the “Performance rating of “satisfactory” or higher” should be removed from the criteria for the compensation of the CIO.

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The objective criteria for awarding <u>financial incentives</u> to the <u>Chief Investment Officer</u>, shall include:	
Requirement	Objective Criteria
Objective benchmarks of investment performance for the assets of the several systems that must be met or exceeded. Objective criteria used by comparable public pension funds awarding financial incentives to chief investment officers.	<ul style="list-style-type: none"> • Positive fund return • Performance rating of “satisfactory” or higher • Performance vs. Policy Index • Performance vs. Actuarial Assumed Rate of Return

The Committee, after discussion, agreed that both the “Positive Fund Return” and “Performance Rating of “satisfactory” or higher” should be removed from the criteria and that “Performance vs. Policy Index” should be changed to Performance vs. Policy Benchmark.”

For positions that <u>involve discretion</u> over investment-related decisions, the objective criteria for awarding <u>compensation</u> shall include:	
Requirement	Objective Criteria
Consideration of the comparative qualifications and compensation of employees serving in similar positions and discharging similar duties at comparable public pension funds	<ul style="list-style-type: none"> • Base Salary and total cash compensation market data at the 25th, 50th, and 75th percentile • Compare to external survey descriptions based on job description • Education and certifications of incumbents • CIO performance rating • Employee salary range placement
Objective benchmarks of investment performance that shall be met or exceeded by an individual to be eligible for an increase in compensation.	<ul style="list-style-type: none"> • Positive fund return • Performance rating of “satisfactory” or higher

The Committee, after discussion, agreed that the “Performance Rating of “satisfactory” or higher” should be removed from the criteria and that language should be added to the “Positive Fund Return” to include “relative to the benchmark of the System”.

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For positions that <u>involve discretion</u> over investment-related decisions, the objective criteria for awarding <u>financial incentives</u>, shall include:	
Requirement	Objective Criteria
Objective benchmarks of investment performance that shall be met or exceeded by an individual to be eligible for financial incentives, including benchmarks for the asset class in which investments are under direction of the individual.	<ul style="list-style-type: none"> • Positive fund return • Performance rating of “satisfactory” or higher • Performance vs. Policy Index • Performance vs. Actuarial Assumed Rate of Return • Performance vs. Asset Class

The Committee, after discussion, agreed that both the “Positive Fund Return” and “Performance Rating of “satisfactory” or higher” should be removed from the criteria. In addition, “Performance vs. Policy Index” should be changed to “Performance vs. Policy Benchmark.”

CBIZ also presented the Committee with the following two positions within the Investment division that they regard as “bubble” positions as it was not clear as to whether these positions exercised discretion over investment-related decisions.

Title	Investment Discretion Examples
Managing Director – Investment Administration & Accounting	Contracts investment related service providers and acts as contract officer for them.
Sr. Compliance Manager	Develops, initiates, maintains, and revises investment compliance policies, procedures and guidelines.

The Committee asked Mr. Palmer to briefly describe what each position does for the investment division.

Mr. Palmer responded that the Managing Director of Accounting and Operations position handles contracts for the division, oversees the procurement process for investment related procurements but does not provide insight or feedback regarding investment decisions. Mr. Palmer indicated that the Sr. Compliance Manager is an integral part of the manager oversight process and contributes to the operational due diligence process for potential managers. The position makes sure that all of the investment managers are in compliance with guidelines and performs background checks on potential investment management personnel.

After discussion, the Committee agreed that the Sr. Compliance Manager, should be considered a position that involves discretion over investment-related decisions; however, the Managing Director-Investment Administration & Accounting should not be considered a position that involves discretion and therefore, should be removed.

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Objective
Criteria for
Incentive
Compensation
for Qualified
Investment Staff

Messrs. Rice and Wallach next addressed the matter of objective criteria for incentive compensation for qualified investment staff. The consultants presented the process they went through to identify incentive practices offered within the competitive market, considering the System’s industry, size, as well as the duties and responsibilities of each relevant investment staff position. They reported that approximately one-half of larger public pension plans (those with more than \$10B in assets) provide incentive compensation.

The consultants’ analysis also found that performance metrics typically include a combination of comparison to a “Total Policy” index, as well as “absolute” performance, with common performance periods including one, and three-year horizons.

A table was presented showing “market average target incentive percentages, as a percent of base salary, for each of the qualified positions.

Market Average Annual Incentive (Percent of Base Salary)	
Position	Target
Chief Investment Officer	20.0%
Deputy Chief Investment Officer	25.0%
Managing Director	25.0%
Sr. Portfolio Manager V	40.0%
Sr. Portfolio Manager IV	40.0%
Sr. Portfolio Manager III / Sr. Risk Manager III	25.0%
Sr. Portfolio Manager II / Sr. Risk Manager II	20.0%
Sr. Portfolio Manager I / Sr. Risk Manager I	20.0%
Sr. Investment Analyst III	10.0%
Sr. Investment Analyst II	10.0%
Sr. Investment Analyst I	5.0%
Investment Associate	0.0%

Senator Serafini asked to have the table redone with only those plans currently providing incentives now in order to have a baseline for comparison.

Ms. Miller commented that the table suggests that Maryland’s statutory limit on incentive pay of 33% of base pay is not out of line with the market.

Mr. Brotman asked as to who the outliers are in the universe and how Maryland’s incentive structure compares.

Mr. Rice responded that this was not possible for the broad data set but the use of twenty fifth and seventy fifth percentiles should effectively exclude the outliers.

Messrs. Rice and Wallach then offered their proposed incentive plan design parameters to the Committee which include three metrics for determining incentive awards:

- Actual System performance vs. Policy Index
- Actual System performance vs. Actuarial Assumed Rate of Return
- Actual System performance vs. Asset Class

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The consultants recommended, and the Committee agreed that a three-year horizon would be used for all three of the metrics.

In addition, the consultants recommended that the plan have a single hurdle that must be met for any incentives to be awarded, specifically that the fund must have a positive return over a three-year period. The Committee rejected this recommendation. It was the view of the Committee that the preservation of the value of the System's assets may be more important to the long term health of the System than creating additional positive returns when markets are strong and should be an objective of any incentive program. For example, if the policy benchmark were down 10% and the System was down 5%, the preservation of value would be very valuable to the System in maintaining its funded status.

The consultants further recommended that earned incentive amounts be paid over a two-year period in equal installments.

Mr. Brotman asked how new hires would be accommodated under these criteria. Mr. Palmer responded saying that, in his experience, new hires were stepped into the criteria year by year. For example if a plan had a three year return target comparison, new employees would look at one year returns the first year, two year returns the second year and three year returns from that period on.

The consultants presented two additional recommended parameters:

- Performance metrics would be weighted based on position title as reflected in this chart:

Positions	Weighting		
	Policy Index	Actuarial Rate of Return	Asset Class
Chief Investment Officer	50.0%	50.0%	N/A
Deputy Chief Investment Officer	50.0%	25.0%	N/A
Managing Director	50.0%	25.0%	N/A
Sr. Risk Manager I-III	50.0%	50.0%	N/A
Sr. Portfolio Manager I-V	25.0%	25.0%	50.0%
Sr. Investment Analyst I-III	25.0%	25.0%	50.0%
Investment Associate	N/A	N/A	N/A

- All eligible employees must receive a performance rating of “meets expectations” or higher for the relevant measurement period in order to receive an incentive award. The Committee rejected this recommendation, consistent with its earlier decision pertaining to base salary compensation.

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The consultants then presented a chart that shows how the three recommended objective criteria would work when applied:

Policy Index		Actuarial Assumed Rate of Return		Asset Class	
MSRA's 3 year Trailing Average Actual Basis Points Relative to Policy Index	% of Target Annual Incentive Earned	MSRA's Trailing 3 Year Actual Basis Points Relative to Actuarial Rate of Return	% of Target Annual Incentive Earned	MSRA's 3 Year Trailing Average Actual Basis Points Relative to Asset Class Index	% of Target Annual Incentive Earned
Below	0%	Below	0%	Below	0%
0–9.99 above	50%	0–4.99 above	50%	0–9.99 above	50%
10–19.99 above	75%	5.00–9.99 above	75%	10–19.99 above	75%
20–29.99 above	100%	10.00–14.99 above	100%	20–29.99 above	100%
30–39.99 above	125%	15.00–19.99 above	125%	30–39.99 above	125%
≥ 40.00 above	150%	> 20.00 above	150%	≥ 40.00 above	150%

Ms. Miller expressed concern that the chart was too fine-grained and that without context would be difficult to understand.

Mr. Brotman asked that the data be presented not as it is in graduated steps, but rather in a linear fashion, or as a spectrum of outcomes.

Senator Serafini asked that examples be provided so that hypothetical dollar payouts could be seen and understood.

Senator Serafini raised the issue of poor performance by the fund and specific investment staff and acknowledged that criteria for all personnel action due to poor performance would be the responsibility of the Board of Trustees.

The consultants then presented a chart showing “proposed incentive opportunities by position title.”

Positions	Proposed		
	Threshold Annual Incentive	Target Annual Incentive	Maximum Annual Incentive
Chief Investment Officer	11.0%	22.0%	33.0%
Deputy Chief Investment Officer	11.0%	22.0%	33.0%
Managing Director	11.0%	22.0%	33.0%
Sr. Portfolio Manager V	11.0%	22.0%	33.0%
Sr. Portfolio Manager IV	11.0%	22.0%	33.0%
Sr. Portfolio Manager III / Sr. Risk Manager III	11.0%	22.0%	33.0%
Sr. Portfolio Manager II / Sr. Risk Manager II	11.0%	22.0%	33.0%
Sr. Portfolio Manager I / Sr. Risk Manager I	11.0%	22.0%	33.0%
Sr. Investment Analyst III	5.0%	10.0%	15.0%
Sr. Investment Analyst II	5.0%	10.0%	15.0%
Sr. Investment Analyst I	2.5%	5.0%	7.5%
Investment Associate	0.0%	0.0%	0.0%

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Mr. Brotman asked that this chart also be modified to show examples of actual dollar awards.

On a motion made by Ms. Brogan and seconded by Senator Serafini, the Committee voted to meet in a Closed Session, beginning at 5:40 p.m., at the SunTrust Building, 120 East Baltimore Street, 16th Floor, Board Room, Baltimore, Maryland for the purpose of:

- a) Reviewing the closed session Objective Criteria Committee meeting minutes, pursuant to General Provisions Art., § 3-103(a)(1)(i), the exercise of an administrative function.

CLOSED SESSION

The Committee Members present included:

Eric Brotman, Chairman, Presiding	Mary Miller (via phone)
Susanne Brogan (Designee)	Marc Nicole (Designee – via phone)
Nancy K. Kopp (via phone)	Andrew Serafini

Other Trustees present included: Richard Norman

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary Anne Gawthrop, and Andrew Palmer

Assistant Attorneys General present included: Rachel Cohen

On a motion made by Ms. Brogan and seconded by Senator Serafini, the Committee returned to open session at 5:45 p.m. at the SunTrust Building, 120 East Baltimore Street, 16th Floor, Board Room, Baltimore, Maryland.

OPEN SESSION

The Committee Members present included:

Eric Brotman, Chairman, Presiding	Mary Miller (via phone)
Susanne Brogan (Designee)	Marc Nicole (Designee – via phone)
Nancy K. Kopp (via phone)	Andrew Serafini

Other Trustees present included: Richard Norman

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary Anne Gawthrop, and Andrew Palmer

Assistant Attorneys General present included: Rachel Cohen


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During closed session, the Committee discussed and took action on the following:

- | | |
|---------------------------|---|
| Closed Session
Minutes | The Committee reviewed and approved the October 22, 2018 closed session minutes. |
| Adjournment | There being no further business before the Committee, on a motion made by Ms. Brogan and seconded by Senator Serafini, the meeting adjourned at 5:45 p.m. |

Respectfully submitted,



R. Dean Kenderdine
Secretary to the Board