Performance, Compensation & Talent Management Committee

Agenda Item 9

February 14, 2017

Item Name: 2016-17 Enterprise Operational Effectiveness Metric

Program: Administration

Item Type: Action

Recommendation
Approve proposed recommended implementation methodology and revised incentive payout ratio for the Enterprise Operational Effectiveness metric.

Executive Summary
The purpose of this agenda item is to present, for Committee review and approval, a detailed methodology for implementation of the Enterprise Operational Effectiveness metric approved by the Board in August 2016, and a proposed revision to the metric's payout ratio for inclusion in selected 2016-17 incentive plans.

Strategic Plan
This agenda item supports Goal B of the 2012-17 Strategic Plan which is to "cultivate a high-performing, risk-intelligent and innovative organization." The review directly supports this goal by identifying a compensation strategy that is aligned with organizational objectives and effectively drives desired organizational performance and behaviors.

Background
In August 2016, the Board's primary executive compensation consultant, Grant Thornton LLP presented for Board approval, performance metrics proposed for inclusion in incentive plans. Among the performance metrics approved was the Enterprise Operational Effectiveness measure, which is now included in the 2016-17 incentive plans of the Chief Executive Officer and Deputies.

As presented and approved in August, the Enterprise Operational Effectiveness metric and incentive payout ratio were illustrated using sample data. In alignment with the concept the Board approved in August, this agenda item outlines the methodology proposed for use in calculating the performance of this metric, and proposes a revision to the incentive payout ratio to ensure consistency in measuring performance of this metric on an annual basis.

Analysis
The Enterprise Operational Effectiveness metric is aligned with the 2017-2022 Strategic Plan's Total Overhead Cost measure, presented to the Finance and Administration Committee in December 2016. The Total Overhead Cost objective is to reduce overhead costs 1.5 to two

percent annually over the next five years. Correspondingly, the Enterprise Operational Effectiveness metric approved by the Board in August for use in selected 2016-17 incentive plans was established to measure organizational overhead expenses against a three-year average of Operational Overhead Costs as a percentage of Total Operational Costs.

In order to implement this metric as approved by the Board in August, the following revisions are proposed to ensure the intended performance is measured:

- **Base the 2016-17 Performance on a Two-Year Average**
  The metric as initially approved, would base performance on a three-year average of expense data. However, FY 2013-14 was a transition year in the Health Program with the introduction of the flex-funded plan options. Due to the changing nature of the Third Party Administrator Fees during this transition period, including FY 2013-14 in the three-year average would not allow for a consistent comparison to measure FY 2016-17 performance. It is, therefore, recommended that a two-year average be used for the FY 2016-17 performance calculations.

  At the close of the 2016-17 fiscal year, however, three years of data in the current reporting model will be available. The performance calculated for the Enterprise Operational Effectiveness metric in the 2017-18 plan year and beyond will be based upon a three-year average.

- **Amend the Incentive Payout Hurdles**
  The incentive payout hurdles as presented in August were based upon 2016-17 budgeted expenses rather than actual expenses, as actual data was not yet available. The revised hurdles as proposed reflect the same performance expectations as approved by the Board, but are articulated as percentages over or under the targeted performance. This will allow for the three-year average expense amount to vary on an annual basis without the incentive hurdles requiring annual revision.

  Another aspect of the hurdles proposed for revision is to move from interpolated performance ratings to a banded approach. This change is recommended to increase transparency and simplicity in the calculation of performance; and will lessen the sensitivity to slight variations in data which could impact incentive compensation.

If the recommended revisions to the Enterprise Operational Effectiveness Metric are approved, the changes will be reflected in the impacted incentive plans. The proposed revisions are outlined in Attachment 1. Grant Thornton, the Board's executive compensation consultant, has reviewed the proposed revisions and provided an opinion letter, included as Attachment 2.

Budget and Fiscal Impacts
The cost of performance awards and base pay adjustments that arise from the recommendations in this item during the year-end performance evaluation process have been addressed through the annual budget process and will be funded from existing resources.

Benefits and Risks
The review of the Compensation Policies serves to ensure the policies are designed to enhance the organization's ability to attract and retain highly skilled executive and investment professionals. Without a periodic and systematic review, there is a risk of policies becoming misaligned with the overarching goals of the organization.

Attachments
1. Proposed Revisions to Enterprise Operational Effectiveness Metric
2. Opinion letter from Grant Thornton

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