


**COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM**
Telephone: (717) 720-4749, Fax: (717) 772-5372
E-mail: jclay@state.pa.us

DATE: May 3, 2007
SUBJECT: Compensation and Classification Study for PSERS' Investment Professionals
TO: Personnel Committee
FROM: Jeffrey B. Clay, Executive Director 

In response to both the independent Compensation and Classification Study for PSERS' Investment Professionals authorized by the Board and performed by McLagan Partners (Study), and the Personnel Committee's input and discussion of the Study, Staff is making the following recommendations for the Committee's and Board's consideration:

- Select as the peer comparator group for determining both the base salary and total cash compensation for PSERS' Investment Professionals the Public Funds Select Group set forth in Exhibit A, attached hereto.
- Effective for FY 2007-2008, target the base salary and total cash compensation for PSERS' Investment Professionals to the median of the 2006 Public Funds Select Group maximum total cash amount.
- Redefine the job classifications for PSERS' Investment Professionals and re-classify the individuals involved, into the following classifications:
 - Chief Investment Officer (CIO)
 - Director
 - Portfolio Manager
 - Senior Investment Professional
 - Intermediate Investment Professional
 - Junior Investment Professional
- Delegate to Staff, subject to guidelines established by the Board, the annual promotions among all job classes below the CIO and Directors.

- Effective for FY 2007-2008, define market competitive base salary ranges for each job classification based on median salary levels in the Public Funds Select Group set forth in Exhibit A and internal equity considerations.
 - To be in the position to implement the base salary changes by July 1, 2007, adopt the base salary schedule set forth on Exhibit B.
- Beginning July 1, 2007, make salary adjustments over a two-year period, based on individual performance and contribution, toward the mid-point of the proposed base salary schedule.
- Target total cash opportunities for the Investment Professionals to the median of the Public Fund Select Group's maximum pay opportunity levels, with the understanding that maximum incentive awards would only be earned when performance is at superior levels.
- Establish a process and guidelines for annual base salary adjustments, with the Board retaining authority for adjustments to the salaries of the CIO and Directors, and Staff, subject to the Board guidelines, having responsibility for salary adjustments for all other job classifications.
- Establish guidelines to permit Staff to have the discretion to award an individual an increase of up to 2.5% of annual base salary after successfully completing each of the three levels of the Chartered Financial Analyst (CFA) exam.
- Establish guidelines to collect competitive market compensation data every two to three years, or as necessary (e.g. if a key position becomes vacant).
- Revise PSERS' existing incentive compensation guidelines to reflect the comments set forth on Exhibit C attached hereto.

Please note, these recommendations are subject to final review by the Committee and Board of the required guidelines and policies necessary to implement the recommendations.

If you have any questions concerning the above, please feel free to contact me.

Competitive Analysis

Large Public Fund Comparators

Public Fund Select Group	AUM (\$billions) 12/31/05	Internally Mgd. Assets Greater than 25%
California Public Employees' Retirement System		<input checked="" type="checkbox"/>
California State Teachers' Retirement System		<input checked="" type="checkbox"/>
Florida State Board of Administration		<input checked="" type="checkbox"/>
Division of Investment Services, State of Georgia		<input checked="" type="checkbox"/>
Michigan State Retirement Systems		<input checked="" type="checkbox"/>
New Jersey Division of Investment		<input checked="" type="checkbox"/>
New York State Common Retirement Fund		<input checked="" type="checkbox"/>
North Carolina Retirement Systems		<input checked="" type="checkbox"/>
Ohio Public Employees' Retirement System		<input checked="" type="checkbox"/>
State Teachers Retirement System of Ohio		<input checked="" type="checkbox"/>
Pennsylvania State Employees Retirement System*		<input checked="" type="checkbox"/>
Teachers Retirement System of Texas		<input checked="" type="checkbox"/>
Virginia Retirement System		<input checked="" type="checkbox"/>
Washington State Investment Board		<input checked="" type="checkbox"/>
State of Wisconsin Investment Board		<input checked="" type="checkbox"/>
Low Quartile	\$62.8	
Median	67.2	
High Quartile	105.6	
Pennsylvania Public School Employees Retirement System	\$54.8	<input checked="" type="checkbox"/>

*Included based on geographic location, not size or investment management approach.

- Of the 15 funds in the comparison group, 12 (80%) have an incentive program for investment staff.
- Three of the 12 cover top management positions only (i.e. ED, CIO or both).
- Two of the 12 implemented their incentive plan in 2006.
- Two of the 12 implemented major plan design changes in 2006.

NOTE: The peer group consists of the Pennsylvania State Employees' Retirement System plus public funds with AUM > \$40 billion who participated in the 2006 PFDE Compensation Survey. A check mark indicates that at least 25% of the fund's assets are internally managed.

Proposed Base Compensation Salary Schedule

Public School Employees' Retirement System
IP Schedule (Investment PSERS), July 2007

Pay Level ↓	Pay Group ⇔	1	2	3	4	5	6
		Hourly	20.45	32.72	44.99	57.26	71.58
1	Biweekly	1,533.75	2,454.00	3,374.25	4,294.50	5,368.50	7,668.75
	Annually	40,000	64,000	88,000	112,001	140,010	200,001
	Hourly	36.81	49.08	67.49	85.89	107.37	153.38
20	Biweekly	2,760.75	3,681.00	5,061.75	6,441.75	8,052.75	11,503.50
	Annually	72,000	96,000	132,010	168,001	210,016	300,011

Revised May 2007

Exhibit B

Incentive Plan Modifications – Key Considerations

- Incentive Opportunities: Consider increasing maximum incentive opportunities (and performance standards) in conjunction with any increase in pay opportunities.
- Performance Measurement:
 - Total Fund relative performance should be measured on a net-of-fees basis as opposed to a gross-of-fees basis to reflect the true value that is being delivered to members/retirees.
 - Currently, incentives tied to Total Fund performance are only earned when performance meets or exceeds benchmark. No additional incentives if performance far exceeds benchmark. Does staff have an incentive to perform above and beyond expectations?
 - Eliminate the portion of the Total Fund incentive award that is tied to peer comparison results. Peer universe comparison returns are not necessarily aligned with member/retiree interests.
 - External manager performance is determined based on the number of managers meeting or exceeding benchmark performance. What if poor performance of one manager results in overall underperformance of the Fund?
 - Has the Equity Substitution Program broadened in scope to cover other asset classes? If so, how should this be reflected in the incentive program and how should it be measured?

Exhibit C