

**House Bill 1348**  
**North Dakota Retirement and Investment Office (RIO)**  
**Testimony before Government and Veterans Affairs**  
**Representative Austen Schauer, Chair**

**Jodi Smith – Interim Executive Director**  
**Scott Anderson, CFA, MBA – Chief Investment Officer**

**I. STATUTORY AUTHORITY AND RESPONSIBILITIES**

The Retirement and Investment Office (hereinafter “RIO”) was created by the 1989 Legislative Assembly to capture administrative and investment cost savings in the management of the investment program of the State Investment Board (SIB) and the retirement program of the Teachers’ Fund for Retirement (TFFR). Statutory authority for the agency is found in North Dakota Century Code chapter 54-52.5 and the programs are governed by chapters 21-10 (SIB) and 15-39.1 (TFFR).

The SIB has the statutory responsibility to administer the investment program for 31 funds, including the Legacy Fund, TFFR, Public Employees Retirement System, and Workforce Safety & Insurance. It also maintains contractual relationships for the investment management of multiple political subdivisions and governmental funds. As of October 31, 2024, the combined Assets Under Management exceeds \$23 billion.

**II. INCENTIVE COMPENSATION POLICY HISTORY**

During the 68<sup>th</sup> Legislative Assembly, RIO presented testimony on an Incentive Compensation plan in appropriations hearings. The following is a summary of the presentations:

**68<sup>th</sup> Legislative Assembly**

01/06/23 Presentation outlining internal investment program inclusive of adequate classification of roles and incentive compensation plan based on programs already instituted in other states. The plan presented is to manage 15% of investments internally by RIO staff rather than with external managers enabling lower costs of managing the assets from lower fees, a lower cost of rebalancing and better cash management. Additional follow-on phases to manage more of the assets internally would be proposed at future sessions. The incentive compensation program would be based on the client plans after fee performance when compared to an opportunity cost benchmark.

01/19/23 Presentation outlining internal investment program inclusive of adequate classification of roles and incentive compensation plan including an outline of the potential bonus plan. Compared to a salary-only compensation plan, the incentive compensation plan reduces the cost of using highly skilled staff as a portion of compensation is based on and only paid when performance exceeds investment benchmarks.

*“The incentive compensation plan would assume a targeted bonus of 50% of salary and a max of 100% of salary and would only pay out when benefits exceed costs. This proposal is contingent on an incentive compensation plan approved by the legislature and administered by the State Investment Board.”*

03/09/23 Presentation outlining internal investment program inclusive of adequate classification of roles and incentive compensation plan including an outline of the potential bonus plan.

*“The incentive compensation plan would assume a targeted bonus of 50% of salary and a max of 100% of salary and would only pay out when benefits exceed costs. This proposal is contingent on an incentive compensation plan approved by the legislature and administered by the State Investment Board.”*

03/23/23 Presentation of amendment to NDCC 54-52.5:

**Incentive compensation program**

The state retirement and investment office may develop an incentive compensation program for full-time equivalent investment related positions related to the internal management of necessary for the investment of funds under the control of the state investment board. The program must promote profitability, productivity, and responsible fund management. The provisions of the program must be approved annually by the state investment board. The provisions must ensure that the payouts do not occur unless the risk-based performance of the investments that are internally managed exceed the risk-based performance of policy benchmarks. Any amounts paid under this program shall be considered compensation and not personal profit on behalf of the employee.

**State Investment Board**

This following is the timeline of RIO’s process to evaluate and implement the Incentive Compensation Plan on behalf of the SIB. This included consultant reviews, public meetings, and board approvals, culminating in a presentation to the Budget Section in June 2024 regarding the program’s structure and eligible positions.

- 6/6/23 Compensation Consultant RFP Issued through SPO Online – Procurement Officer Gabriel Hoggarth.
- 6/21/23 Amendment 1 Issued – Responses to submission of questions – no amendments to the RFP were necessary.
- 6/30/23 Response Deadline.
- 8/3/23 Finalist Presentations to the SIB Executive Review and Compensation Committee (ERCC) – Public Meeting.
- 8/7/23 Request for Best and Final Offer (BAFO) Issued.
- 8/10/23 BAFO Deadline.
- 8/24/23 SIB ERCC discussion and selection – Public Meeting  
Notice of Intent to Award Issued.
- 11/01/23 Compensation Consultant Contract Executed.
- 11/8/23 Kick Off Meeting with RIO Executive Team.
- 2/16/24 SIB ERCC received a presentation from Mercer reviewing the proposed incentive compensation plan. After discussion, the ERCC voted to recommend the incentive compensation plan to the SIB. The targeted incentive compensation ranges from 25% - 50% and the maximum ranges from 50% -100%. The payout is based on performance and in line with public plan payout averages. Public Meeting.
- 2/23/24 SIB received a presentation from Mercer reviewing the proposed incentive compensation plan. After discussion, the SIB voted to approve the incentive compensation plan as proposed. Public Meeting.
- 3/13/24 SIB ERCC received a presentation from Mercer reviewing the compensation study. After discussion, the ERCC voted to accept the compensation study and bring it to the SIB for discussion. Public Meeting.
- 3/22/24 SIB received a presentation from Mercer reviewing the compensation study. The board asked questions and discussed the compensation study results. Public Meeting.
- 4/18/24 SIB Governance and Policy Review Committee (GPR) approved the proposed changes to the SIB Governance Manual and recommended approval to the SIB, which included the addition of the incentive compensation plan. Public Meeting.

- 4/26/24 SIB approved the introduction and first reading of amendments to the SIB Governance Manual, which included the addition of the incentive compensation plan. Public Meeting.
- 5/17/24 SIB approved the second reading and final adoption of amendments to the SIB Governance Manual, which included the addition of the incentive compensation plan. Public Meeting.
- 6/19/24 Presentation to Budget Section regarding the incentive compensation program, including positions eligible for incentive compensation and the incentive amount each position is eligible to receive. Public Meeting.

### **III. INCENTIVE COMPENSATION PROGRAM POLICY**

The Governance & Policy Review (GPR) Committee is a standing committee of the SIB that is responsible for reviewing its Program Manual, ensuring that it reflects best practices and good governance. The following is an excerpt from the Program Manual of the Incentive Compensation Program Policy developed by the GPR Committee and approved by the SIB.

#### **Executive Summary**

North Dakota Century Code Chapter 54-52.5 provides that North Dakota RIO may develop an incentive compensation program for full-time equivalent investment and fiscal operations positions necessary for the management of the investment of funds under the control of the SIB.

In carrying out its responsibilities, the Board has developed and administers an incentive compensation plan that reflects careful consideration of the following:

- To achieve its long-term strategic and investment objectives, RIO must have high-quality investment management staff.
- A reasonable and competitive incentive compensation plan is critical to attracting and retaining high quality staff.
- Staff should be motivated to earn the highest possible returns for RIO at reasonable costs and controlled levels of risk.
- Given that RIO needs to provide competitive pay to attract and retain qualified staff, a significant portion of total pay opportunities should be provided through performance-based incentives, a practice that is universally accepted in the financial marketplace. Under RIO's incentive compensation plan:

- Investment-related awards should be earned only when net investment performance is above defined benchmarks (i.e., when value is created for client funds).
- The greatest share of the excess value should accrue to the client funds, not to RIO staff.

The incentive compensation plan is rigorously managed by RIO's Executive Review and Compensation Committee (ERCC) to ensure compliance with all applicable statutes and related rules and guidelines.

### **Authority**

North Dakota Century Code Chapter 54-52.5 provides that North Dakota RIO may develop an incentive compensation program for full-time equivalent investment and fiscal operations positions necessary for the management of the investment of funds under the control of the SIB. This document specifies the policies and procedures related to the administration of annual incentive compensation.

This incentive compensation plan (the Plan) provides for payment of incentive compensation awards to full-time equivalent investment and fiscal operations positions necessary for the management of the investment of funds under the control of the SIB (Participants) and supersedes all prior incentive compensation plans and/or arrangements for Participants. Participants under this Plan include all unclassified investment services related staff as may be determined by the SIB, ERCC, and Executive Director. The Effective Date of the Plan is July 1, 2024. Each plan year starts at the beginning of the fiscal year on July 1.

### **Plan Objectives**

As developed and adopted by the Board, this Plan is designed to:

1. Help attract and retain talented investment professionals.
2. Help RIO earn the highest possible investment returns at a reasonable cost and at controlled levels of risk.
3. Reward long-term investment performance.
4. Reflect the RIO client fund above-benchmark, net of all performance.
5. Motivate staff to make good decisions for RIO client funds, including implementation decisions related to asset allocation.
6. Foster a collaborative approach to investing RIO's assets under management.
7. Reward measurable and achievable performance.

8. Be clear and easily communicated in terms of the Plan's objectives, design features and associated incentive compensation opportunities.
9. Be perceived as fair by RIO's employees and potential recruits.

### **Administration and Management**

The SIB reserves the right to modify, terminate, and/or rescind any or all of the compensation schedules, provisions, policies, and procedures contained in this and all supporting documents at any time. This document describes a policy and does not provide a contract, guarantee of payment, guarantee of participation in the Plan in subsequent years, or guarantee of employment among RIO, the Board, and the Participants. Should an error in calculation or in data be discovered before or after the award distribution, RIO reserves the right to make an adjustment and recover any incentive compensation award distributed based on the erroneous data or calculation.

The Executive Director will administer the Plan with oversight by the ERCC. The Executive Director may delegate certain administrative responsibilities to other employees at RIO, including the Chief Investment Officer and the Chief Financial Officer/Chief Operating Officer.

Compensation plan participants may present questions related to the Plan to the Executive Director. The Executive Director will work with the appropriate persons to answer such questions. The Executive Director, ERCC, and SIB will have full discretion to conclusively decide all questions or matters relating to the interpretation of the provisions and administration of this Plan.

The SIB must approve any question or matter whose resolution requires a material modification to the Plan, such as a change to the performance standards or maximum award levels. Any such amendments or changes to the Plan may be proposed by the Executive Director or the ERCC but must be recommended by the ERCC and approved by the SIB.

### **Eligibility**

Positions that are eligible for incentive compensation are full-time equivalent investment and fiscal operations positions necessary for the management of the investment of funds under the control of the SIB as set forth in this plan. Any temporary employment or project positions are not eligible. Plan participation is determined based on employment status and the Executive Director's assessment of the position's impact on RIO's overall investment performance. Participants must have worked in a covered position at least three full consecutive calendar months during the year to be eligible for incentive compensation under the Plan, and incentive compensation will be paid on a pro-rata basis if not employed the entire fiscal year. The Executive Director will confirm any new positions that will be eligible under the Plan during the next fiscal year.

Employment at RIO in good standing on the day of payment is a pre-requisite for receiving any incentive compensation payment, except in the case of retirement, disability, death or otherwise as provided below. For purposes of this Plan, "employment in good standing" means (a) the Participant's performance is rated above "Developing" in the Participant's most recent performance review, (b) the Participant is not on a performance improvement plan.

#### *Eligibility upon Separation*

Generally, a Participant must be employed by RIO as of the date the incentive compensation is paid out in order to be eligible to receive the payment. In the case of disability or death occurring during the fiscal year, any Board-approved incentive compensation amount may be paid to the Participant, the amount to be determined by the Executive Director, subject to approval by the SIB, based on the time worked during the fiscal year and subject to the Participant's termination meeting the qualifications in the next paragraph, if not employed as of the date of payment. These payments will be made at the same time as any other incentive compensation award. No incentive compensation will be awarded if the Participant was employed for less than three consecutive months during the fiscal year in which the disability or death occurred.

If a Participant terminated employment prior to payment of an award, the full amount of the incentive compensation award will be paid to the Participant (or beneficiary in the case of death) only upon the following conditions:

- If the Participant's separation is due to the Participant's disability.
- If the Participant's separation is due to the Participant's death.
- If the Participant's termination is due to reasons other than the Participant's disability or death, and his/her last day of active employment is prior to the payment date then no incentive compensation award will be payable to the Participant.

#### **Plan Concepts/Mechanics**

The Plan's terms and conditions are described in this document. A summary of the Plan's overall mechanics is as follows:

- Prior to or near the beginning of each fiscal year, Participants will be assigned a maximum incentive compensation opportunity, which effective as of the Plan year will be expressed as a percentage of his or her base salary at the beginning of the fiscal year (or the Participant's start date if employed after the start of the fiscal year). Maximum incentive compensation opportunities will vary by position based on differing levels of accountability and responsibility.

- Maximum incentive compensation opportunities will be weighted or allocated to specific quantitative and discretionary Plan components. Several Plan components are based on Value Added. Value Added (VA) means the weighted average of outperformance of funds as described within the plan.
- After year-end, depending on performance, awards will be determined for each stand-alone Plan component.
- Notwithstanding any other provision in this Plan and regardless of any incentive compensation award calculations hereunder, no incentive compensation award shall be made unless and until approved by the SIB, in its sole discretion. The SIB may award, adjust (up or down), modify or deny any incentive compensation amounts calculated pursuant to the Plan. All incentive compensation awards hereunder are discretionary.

**Step 1: Set Each Participant’s Maximum Incentive Compensation Opportunity**

Prior to or near the beginning of each fiscal year, or the Participant’s start date if employed after the start of the fiscal year, Participants will be assigned a maximum incentive compensation opportunity, which will be expressed as a percentage of his or her base salary. Unless approved by the Executive Director, maximum incentive compensation opportunities will vary by the position held for most of the year (i.e., position held through June 30 for existing employees) and based on differing levels of accountability and responsibility.

Current maximum incentive compensation opportunities are set forth below.

<b>Maximum Incentive Award</b>	<b>Position Title</b>
100%	Chief Investment Officer Executive Director
90%	Deputy Chief Investment Officer
75%	Portfolio Manager Chief Risk Officer Senior Investment Officer
60%	Chief Financial Officer / Chief Operating Officer
50%	Investment Officer Risk Officer Accounting Manager
25%	Sr. Investment Accountant Investment Accountant



## Step 2: Calculate the Maximum Incentive Compensation Opportunity for the Plan

The maximum incentive compensation opportunity for the entire Plan will be calculated by aggregating the maximum incentive compensation opportunities for each Participant.

## Step 3: Allocate each Participant's Maximum Incentive Compensation Opportunity to Performance Components

Each Participant's maximum incentive compensation opportunity will be weighted or allocated among standalone quantitative and qualitative performance components.

<b>All Roles</b>		
<i>Weight</i>	<i>Performance Component</i>	<i>Allocation Method</i>
80%	Fund VA -3-year rolling	Minimum: (10%) $\geq$ 1 bp Maximum: (100%) 50 bps
20%	Individual Goals	Discretionary

Any proposed changes to incentive compensation weightings will be reviewed and approved by the Executive Director and the ERCC, and approved by the SIB, prior to the beginning of each fiscal year.

## Step 4: Calculate the Performance Components

### *VA Performance Components*

The Plan's quantitative components focus on weighted average of the Legacy Fund, PERS pension fund, TFFR fund, and the WSI fund actual, relative investment performance at Client Fund level compared with SIB-approved benchmarks. Client fund performance is measured on a net of all basis (i.e., net of all direct and indirect costs). Asset Class and Team performance is measured net of direct costs.

The SIB approves an Incentive Compensation Metric (ICM) performance verified by the SIB's independent Benchmark and Hurdle Rate consultant. The Incentive Compensation Metric represents the amount of outperformance of the applicable benchmark necessary to earn the full incentive compensation opportunity. Performance-award scales are derived from the ICM and define the linkage between RIO's actual, relative, net investment performance and a corresponding percentage of the maximum incentive compensation opportunity that is earned.

Prior to or near the beginning of each performance year, any requested changes to the ICM(s) or performance-award scales must be submitted, in writing, by the Executive Director to the ERCC and from the ERCC to the SIB for review and approval, and to the Hurdle Rate and Benchmark Consultant for review and

verification. There will be a comprehensive review of the ICM(s) up to every three to five years at the discretion of the SIB.

Under RIO Plan:

The percentage of the maximum *quantitative* incentive compensation opportunity earned:

- Equals 0% when performance is at or below benchmark.
- Equals 10% when net performance exceeds the benchmark by one full basis point.
- Increases pro rata, from 10% to 100%, for net performance that is between one full basis point above the benchmark, and the ICM.
- Equals 100% when net performance equals or exceeds the benchmark by the full ICM<sup>1</sup>

#### *Portfolio VA*

In the first three years of the Plan, the first year Fund VA will be the one year weighted average Fund VA, the second year of the plan will be the two-year compound Fund VA and the third year will be the three-year compound average of the weighted average of the Legacy Fund, the PERS pension fund, TFFR fund, and WSI fund actual, relative investment performance at Client Fund level compared with SIB-approved benchmarks. Thereafter, the weighted average Fund VA applied to all participants is a rolling three-year average of the weighted average of the Legacy Fund, the PERS pension fund, TFFR fund, and WSI fund actual, relative investment performance at Client Fund level compared with SIB-approved benchmarks.

For Participants that join RIO on or after the beginning of the fiscal year, the weighted average Fund VA applied to all participants will be used. The payout will be made pro-rata based on the percentage of plan year time employed that starts with the beginning of the fiscal year on July 1.

For Participants that joined RIO prior to the plan year starting with the beginning of the fiscal year but have been employed for fewer than three years as of the start of the fiscal year, the weighted average Fund VA applied to all participants will be used.

#### *Individual Goals Component*

The Individual Goals component is set by the manager of the Participant as part of the performance evaluation process. The final performance evaluation of each Participant is approved by the Executive Director. In addition, such Participants will be evaluated on leadership/behavioral and organizational competence factors. Some factors that may be considered include training and mentoring of staff, contribution to organizational strategic planning, and participation in projects or initiatives to update business and/or analytical processes and tools and the

associated technology applications. The Executive Director will determine the amounts awarded for Individual Goals in consultation with managers.

#### **Step 5: Allocate Discretionary Components Among Relevant Participants**

Quantitative components are allocated to Participants directly without modification.

Discretionary components for Individual Goals components, will be allocated by the Executive Director.

#### **Step 6: Present Final Award Recommendations to the Board of Trustees**

The Executive Director's award recommendations will be made to the ERCC. The ERCC will make a recommendation regarding the incentive compensation awards to the SIB for approval. For all Participants, an incentive compensation award is contingent on approval of the award by the SIB, in its sole discretion.

#### **Step 7: Payment of Awards**

Incentive compensation awards will be determined and authorized as soon as practical following the close of each fiscal year, with a target of within the first four months of each fiscal year for the previous fiscal year.

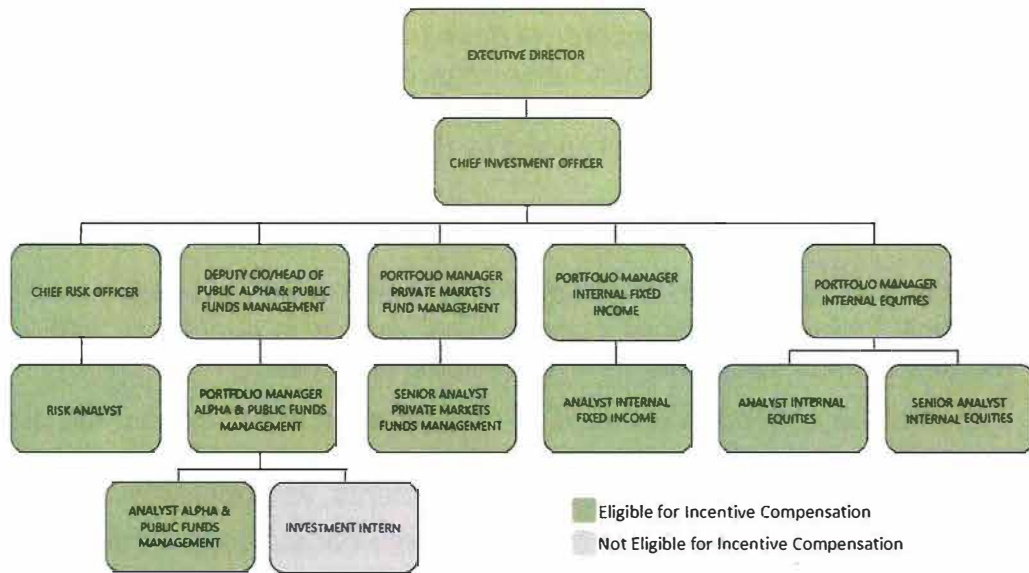
RIO shall be entitled to withhold or deduct, as applicable, from the amount of any payment under this Plan or any other compensation due to the Participant, all federal, state, city and other taxes and all other amounts, as applicable.

<sup>1</sup> ICMs are intended to reflect levels of net performance that are considered top quartile, based upon expected levels of risk and return.

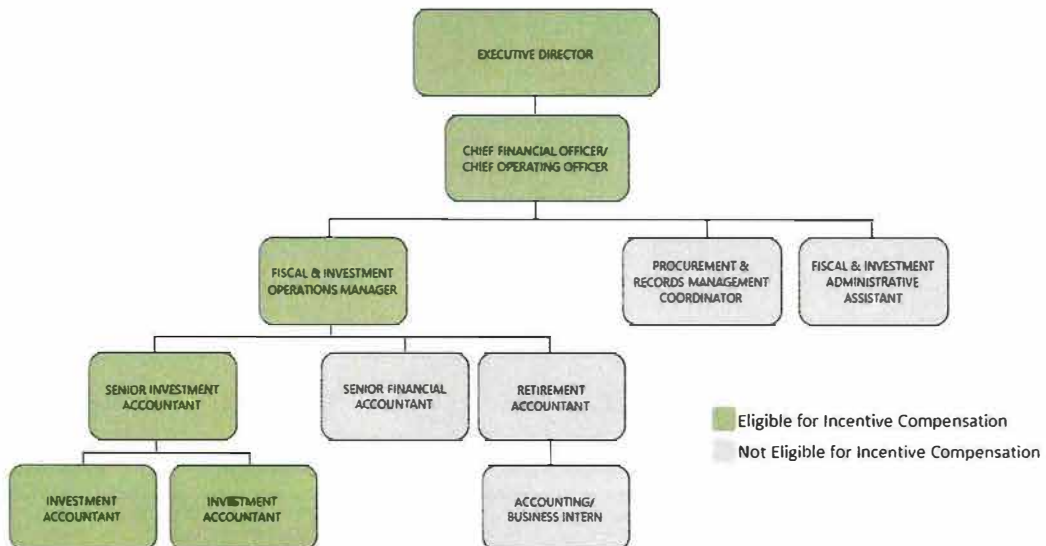
## Key Points Compensation Policy

- Only certain RIO staff are eligible for incentive compensation (19 of the 34 employees):
  - 13 Investment Division Team Members.
  - 5 Fiscal Division Team Members who perform specialized accounting that focuses on tracking and monitoring investment activity.
  - Executive Director who oversees the Investment and Fiscal Divisions.

### RETIREMENT AND INVESTMENT OFFICE - INVESTMENT DIVISION



### RETIREMENT AND INVESTMENT OFFICE - FISCAL DIVISION



- Eligible staff will not receive an incentive each year (in a ten year period it is estimated eligible staff would not receive a bonus 2-3 years and would receive the maximum bonus 2-3 years). Eligible staff incentives will be based on performance outcomes.

Under the Incentive Compensation Plan the percentage of the maximum quantitative incentive compensation opportunity earned:

- Equals 0% when performance is at or below benchmark.
- Equals 10% when net performance exceeds the benchmark by one full basis point.
- Increases pro rata, from 10% to 100%, for net performance that is between one full basis point above the benchmark, and the Incentive Compensation Metric.
- Equals 100% when net performance equals or exceeds the benchmark by the full Incentive Compensation Metric.

Title	Base Annual Salary	Min	Min Bonus (1	Mid	Mid Bonus	Max	Max Bonus
		Bonus %	bps)*	Bonus %	(25 bps)*	Bonus %	(50bps)*
Chief Investment Officer	312,000.00	10.0%	31,200.00	50%	156,000.00	100%	312,000.00
Executive Director	237,407.16	10.0%	23,740.72	50%	118,703.58	100%	237,407.16
Deputy CIO/Head of Public Alpha & Public Funds Mgmt	197,600.04	9.0%	17,784.00	45%	88,920.02	90%	177,840.04
Portfolio Manager - Internal Fixed Income	204,999.96	7.5%	15,375.00	38%	76,874.99	75%	153,749.97
Portfolio Manager - Internal Equities	186,999.96	7.5%	14,025.00	38%	70,124.99	75%	140,249.97
Portfolio Manager - Alpha & Public Funds Mgmt	181,999.92	7.5%	13,649.99	38%	68,249.97	75%	136,499.94
Chief Risk Officer	181,999.92	7.5%	13,649.99	38%	68,249.97	75%	136,499.94
Portfolio Manager - Private Markets Fund Mgmt	181,999.92	7.5%	13,649.99	38%	68,249.97	75%	136,499.94
Sr Analyst - Internal Equities	150,000.00	7.5%	11,250.00	38%	56,250.00	75%	112,500.00
Chief Financial Officer/Chief Operating Officer	162,548.88	6.0%	9,752.93	30%	48,764.66	60%	97,529.33
Risk Analyst	136,693.80	5.0%	6,834.69	25%	34,173.45	50%	68,346.90
Sr Analyst - Private Markets Funds Mgmt	123,809.52	5.0%	6,190.48	25%	30,952.38	50%	61,904.76
Fiscal & Investment Operations Manager	124,403.64	5.0%	6,220.18	25%	31,100.91	50%	62,201.82
Analyst - Internal Fixed Income	120,000.00	5.0%	6,000.00	25%	30,000.00	50%	60,000.00
Analyst - Alpha & Public Funds Mgmt	119,047.56	5.0%	5,952.38	25%	29,761.89	50%	59,523.78
Analyst - Internal Fixed Income	75,000.00	5.0%	3,750.00	25%	18,750.00	50%	37,500.00
Senior Investment Accountant	99,315.24	2.5%	2,482.88	13%	12,414.41	25%	24,828.81
Investment Accountant	85,831.20	2.5%	2,145.78	13%	10,728.90	25%	21,457.80
Investment Accountant	84,000.00	2.5%	2,100.00	13%	10,500.00	25%	21,000.00
Total Bonus			\$ 205,754.02		\$ 1,028,770.08		\$ 2,057,540.15

\* 80% of the bonus is based on performance of investment and the remaining 20% is based on individual goals and is discretionary.

As currently drafted, based on \$23 billion of assets under management, the cost benefit associated with the incentive compensation program is as follows:

<b>\$ MILLIONS</b>			
<b>PERFORMANCE<sup>1</sup></b>	<b>1 BP</b>	<b>25 BP</b>	<b>50 BP</b>
BENEFIT TO PLAN <sup>2,3</sup>	\$19,300,000	\$74,500,000	\$132,000,000
INCENTIVE	\$205,000	\$1,028,000	\$2,057,000
NET BENEFIT	\$19,095,000	\$74,472,000	\$129,943,000

#### **IV. SUMMARY**

The SIB and RIO oppose HB 1348.

The Legislature provided SIB, under NDCC 54-52.5, the authority to create an incentive compensation program. The SIB then created a policy outlining the rules and principles SIB must follow when implementing the policy.

The SIB reserves the right to modify, terminate, and/or rescind any or all the compensation schedules, provisions, policies, and procedures contained in this and all supporting documents at any time.

If HB 1348 is approved, it will dismantle the in-state investment program. Thus, the internal investment program's projected savings will not be realized and dismantling of the program will result in additional fees being charged to the SIB's client funds.

<b>Pools (Client Funds)</b>	<b>Internal Investment 15% of Assets</b>
PENSION	\$6 Million
INSURANCE	\$3 Million
LEGACY	\$8 Million
<b>Estimated Annual Savings (on \$23 Billion AUM)</b>	<b>\$17 Million</b>