

**TEACHER RETIREMENT SYSTEM OF TEXAS MEETING
BOARD OF TRUSTEES
AND
POLICY COMMITTEE**

(Mr. Barth, Chairman; Ms. Clifton; Mr. Colonna; Mr. Kelly; & Mr. McDonald, Committee Members)

AGENDA

**July 20, 2012 – 8:00 a.m.
TRS East Building – Boardroom**

1. Consider the approval of the proposed minutes of the June 7, 2012 committee meeting – Todd Barth.
2. Receive an update on and discuss proposed amendments to the Investment Policy Statement – Jase Auby.
3. Review the Performance Incentive Pay Plan and discuss possible plan amendments for adoption at a future meeting – Brian Guthrie, Janet Bray, Britt Harris, and Jerry Albright.

NOTE: The Board of Trustees (Board) of the Teacher Retirement System of Texas will not consider or act upon any item before the Policy Committee (Committee) at this meeting of the Committee. This meeting is not a regular meeting of the Board. However, because a quorum of the Board may attend the Committee meeting, the meeting of the Committee is also being posted as a meeting of the Board out of an abundance of caution.

Tab 1



Minutes of the Policy Committee

June 7, 2012

The Policy Committee of the Board of Trustees of the Teacher Retirement System of Texas met on June 7, 2012, in the boardroom on the Fifth Floor of the East Building of TRS offices located at 1000 Red River Street, Austin, Texas 78701. The following committee members were present:

Committee members present:

Todd Barth, Chair
Joe Colonna
David Kelly
Eric McDonald

Other board members present:

Chris Moss
Anita Palmer
Nanette Sissney

TRS executives and other staff present:

Brian Guthrie, Executive Director
Ken Welch, Deputy Director
Conni Brennan, General Counsel
T. Britton Harris IV, Chief Investment Officer
Dinah Arce, Senior Auditor, Internal Audit
Ashley Baum, Chief of Staff to the Chief Investment Officer
Patricia Cantú, Director – Investment Business Management
Mary Chang, Assistant General Counsel
Chris Cutler, Director of Network Infrastructure and Support
Dennis Gold, Assistant General Counsel
Brian Gomolski, Senior Investment Auditor
Tom Guerin, Manager, Benefit Counseling
Wm. Clarke Howard, Assistant General Counsel
Dan Herron, Communications Specialist
Dan Junell, Assistant General Counsel and Secretary to the Board
Lynn Lau, Program Specialist and Assistant Secretary to the Board
Denise Lopez, Assistant General Counsel
Rebecca Merrill, Special Advisor to Executive Director and Manager of Special Projects
Hugh Ohn, Director of Investment Audit and Compliance
Rhonda Price, Information Specialist
Charmaine Skillman, Assistant General Counsel
David Veal, Incoming Chief of Staff to the Chief Investment Officer
Angela Vogeli, Assistant General Counsel
Tim Wei, Assistant General Counsel

Outside counsel, consultants, contractors, representatives of associations and organizations, and members of the public present:

Dr. Keith Brown, Investment Advisor
Steven Huff, Reinhart Boerner Van Deuren, s.c., Fiduciary Counsel
Brady O'Connell, Hewitt EnnisKnupp, Investment Counsel
Steve Voss, Hewitt EnnisKnupp, Investment Counsel
Ted Melina-Raab, Texas American Federation of Teachers
Leroy DeHaven, Texas Retired Teachers Association
Bill Barnes, Texas Retired Teachers Association
Tom Rogers, Austin Retired Teachers Association
Craig teDuits, State Street
Jim Baker, Unite Here

With a quorum of the committee present, the meeting convened at 11:10 a.m.

1. Consider the approval of the proposed minutes of the April 19, 2012 committee meeting – Todd Barth.

On a motion by Mr. Kelly, seconded by Mr. McDonald, the committee approved the proposed minutes of the April 19, 2012 meeting as presented.

2. Discuss and consider recommending to the Board final adoption of proposed amendments to TRS Rule 41.4, relating to the employer health benefit surcharge under the Texas Public School Retired Employees Group Benefits Act (TRS-Care) of Title 34 of the Texas Administrative Code – Clarke Howard.

Mr. Howard presented a brief summary of the proposed amendments to rule section 41.4. Under the current rule, the retiree is required to provide information to the employer, the employer calculates the surcharge amount, and then the employer pays the surcharge amount to TRS. Under the proposed amendments, TRS would calculate the surcharge amount and provide it to the employer and the employer would pay the surcharge amount to TRS. Mr. Howard stated that the committee authorized public-comment publication of the proposed amendments at its December 2011 meeting. After the proposed amendments were published in the *Texas Register* in January 2012, he said, TRS did not receive any comments regarding them. Accordingly, he said that staff recommended that the committee recommend to the board adoption of the proposed amendments.

On a motion by Mr. McDonald, seconded by Mr. Kelly, the committee unanimously voted to recommend to the board the adoption of the proposed amendments to rule section 41.4 as presented by staff and published in the *Texas Register*.

3. Discuss and consider recommending to the Board adoption of a customized, statutorily compliant Personal Financial Statement form for use by key employees – Tim Wei

Mr. Wei briefly presented the proposed customized personal financial statement (TRS

PFS) that TRS key employees would be required to submit pursuant to state statute. He stated that the statute requires TRS key employees to file a personal financial statement, which must comply substantially with Chapter 572 of the Government Code. Mr. Wei stated that the proposed TRS PFS was substantially the same as the Texas Ethics Commission form, which TRS had historically required key employees to use. The proposed TRS PFS, he said, is more reviewer-friendly and user-friendly, and requires additional disclosures — (i) the value of the filer’s brokerage accounts at the end of the current reporting period and the prior reporting period and (ii) for key employees who are attorneys, any fees received from referrals for legal services.

Mr. Wei also reviewed the key employee determinations made by the board in April 2012. Mr. Guthrie stated that a draft of the proposed TRS PFS was provided to the staff who would be filing it and their comments were taken into account. Mr. Wei stated that personal financial statements are subject to open records requests. Mr. McDonald commented that the proposed TRS PFS seems more user-friendly than the current Ethics Commission form.

On a motion by Mr. McDonald, seconded by Mr. Colonna, the committee unanimously voted to recommend to the board the adoption of the proposed PFS.

4. Discuss and consider a fiduciary finding regarding business class travel – Don Green and Sylvia Bell.

As recommended by staff and proposed by Mr. Barth without objection, the committee passed over item 4 and proceeded to take up item 5.

5. Receive an update on the review of the Investment Policy Statement – Steve Voss and Brady O’Connell, Hewitt EnnisKnupp.

Mr. Voss reviewed the history of discussions leading up to the review of the Investment Policy Statement (IPS). He recapped Mr. Harris’ February 2012 presentation to the board regarding the investment program for the trust, the evolution of the Investment Management Division (IMD), and the board’s role in overseeing IMD and creating policies. That presentation, Mr. Voss continued, provided the board the following: historical information on the trust’s asset allocation; the development of a diversification framework and related transition plan; legislative changes to TRS’ investment authority; and board delegation of investment authority. Mr. Voss reviewed the board’s delegated investment authority and summarized the IMD approval process for external investments. He reviewed some of the restrictions on the delegated investment authority and reports that IMD makes to the board. Mr. Voss, Mr. Barth, Mr. Albright, Mr. Colonna and Mr. Lang discussed how IMD applied the manager limitations of 3 percent per investment center and the manager limitations of 6 percent of the TRS portfolio. General discussion followed regarding rebalancing in the context of delegated investment authority.

Mr. Voss then reviewed Mr. Auby’s presentation to the Policy Committee in April 2012 regarding delegation, risk controls, reporting cycles and manager concentration limits. Mr. Voss also discussed tracking error limits.

Mr. Voss reviewed the Hewitt EnnisKnupp (HEK) presentation to the Policy Committee in April 2012 regarding the board’s review of the IPS. That discussion, he recalled, provided an overview of the importance of the IPS, best practices for the policy components, key risks

associated with an investment policy, and how TRS addresses those risks. He stated that asset allocation was currently not being considered in the IPS review but benchmarks, reporting, and monitoring was. Mr. Voss and Mr. Colonna discussed the level of reporting that IMD currently provided and how it compared to the reports of other HEK clients. Mr. Voss recommended that, at board meetings, staff and investment advisors continue reporting investment results and explanations at a high level rather than reviewing individual managers. Mr. Voss added that the board does get information concerning investment managers as part of its review of different IMD investment centers.

Mr. Kelly, Mr. Voss, Mr. Barth, and Mr. Colonna discussed how an investment in a private fund is determined to be a percentage of the total fund. Mr. Voss and Mr. Lang discussed the IPS limits on private investment funds and the operational guidelines. Mr. Voss and Dr. Brown discussed limiting manager concentrations and reporting to the board, including industry practice. Dr. Brown said that he did not recall specific manager concentration limits being part of other investment policies he has reviewed. Mr. Barth requested that this issue be put on the agenda for the committee's next meeting. He also requested that Mr. Voss review best practices and provide a recommendation regarding the issue and at the next committee meeting, IMD identify each fund in which TRS' investment in it exceeds 20-25 percent of the total fund. Mr. Auby, Mr. Lang and Mr. Colonna discussed the relative significance of manager concentrations in TRS' investments in hedge, private equity, and private real estate funds.

Mr. Voss discussed the current process for reviewing the IPS. He described the roles of the board, IMD, HEK, Dr. Brown, internal audit and legal, including outside fiduciary counsel. Mr. Voss stated that HEK and Dr. Brown would review and comment on the final redline version of the proposed changes to the IPS, which would be presented to the board at its September 2012 meeting.

Mr. Voss briefly reviewed the items that had already been identified as potential changes for the IPS. He stated that IMD would present the following for consideration: changing the time period from three months to six months before a follow-on investment can be made; clarifying the use of derivatives; and reviewing operational duties and responsibilities for best practices. Mr. Voss and Mr. Guthrie also discussed including an executive summary that addresses the five key factors of the IPS. Mr. Voss stated that a draft of the proposed changes would be presented to the committee at its July 2012 meeting and the final draft would be presented to the committee and board for consideration at their September 2012 meetings. Mr. Barth, Mr. Voss, Mr. Auby and Mr. Guthrie agreed the final draft for committee and board consideration should be completed by August 15, 2012.

The meeting adjourned at 12:05 p.m.

Tab 2



Proposed Modifications to Investment Policy

Jase Auby
Chief Risk Officer
July 2012

Agenda



- ❑ The Investment Management Division (“IMD”) has reviewed the Investment Policy Statement (the “IPS”) and today is making this interim report on the annual modification process

- ❑ This presentation describes the modifications to the IPS that we anticipate presenting to the Policy Committee in September
 - Compared to recent years, this year’s amendment process has resulted in a relatively small number of recommended modifications



Proposed Modifications

- ❑ The IMD is likely to propose six modifications to the IPS
- ❑ Three of the modifications are **highlighted** and presented with further discussion herein

Modification Number	Description
1	Improve document readability <ul style="list-style-type: none">a. Add an Executive Summaryb. Standardize section labelingc. Consolidate redundant languaged. Move Placement Agents Addendum
2	Remove Real Assets Portfolio transition process
3	Clarify that the list of Public Markets Authorized Investments is for both internal and external portfolios
4	Adjust document to reflect restructuring of External Private Markets
5	Remove derivatives tenor limits
6	Increase follow-on investment waiting period from three months to six months

Modification 2

Remove Real Assets Portfolio Transition Process



Background Information

- ❑ The Real Assets funding transition process is now complete as the Real Assets portfolio is expected to be fully funded at 15% in 2013

Proposal

- ❑ This proposal removes two Real Assets transition items that are no longer required:
 1. The process that progressively raises the real assets portfolio allocation as it becomes fully funded
 - This process works by automatically lowering the TIPS, Commodities and REITs allocations as Real Assets funds up to 15%
 2. The temporary passive REITs allocation which the transition process has now lowered to a 0% allocation

Modification 5

Remove Derivatives Tenor Limits



Background Information

- ❑ The 5 year tenor limit on over-the-counter (OTC) derivatives was written into the IPS in 2008 at inception of the Trust's use of OTC derivatives
 - Tenor limits are atypical in most investment policies
 - The five year tenor limit was initially implemented to appropriately reflect that the pending implementation was in its early stages and unproven at TRS
 - At that time, neither IMD's risk management function nor the Board's Risk Management Committee were fully formed
- ❑ The IMD's risk controls and other management processes have since progressed beyond the need for a simple tenor limit
 - The usage of derivatives at TRS has now been successfully implemented at TRS for four years and the IMD has exhibited sound and prudent risk management and monitoring
 - Risk for derivatives is managed systematically as a part of the overall risk management process for the Trust
 - Use of derivatives is regularly reported to the Risk Committee of the Board
 - Trust derivatives were the subject of an internal audit in 2010 and an independent fiduciary review in 2011 and no significant weaknesses were identified

Modification 5 (continued)

Remove Derivatives Tenor Limits



Background Information (continued)

- The IMD needs the ability to access the most liquid portion of the OTC derivatives markets, which can extend beyond the current five year tenor limit

Proposal

- Remove derivatives tenor limits

Modification 6

Increase Follow-on Investment Waiting Period from Three Months to Six Months



Background Information

- ❑ The IMD is restricted to 0.5% invested in an initial investment and 1.0% for each follow-on investment

Proposal

- ❑ Increase the existing waiting period between investments from three months to six months
- ❑ Clarify the language that specifies that any investments occurring within six months after a prior investment must be considered to be part of that prior investment

Example

- ❑ If an initial investment was 0.2% and two months later a follow-on investment is 0.4%, then the initial test would need to be recalculated and the resulting 0.6% would exceed the 0.5% threshold
- ❑ The IMD would either need to obtain Board approval for the 0.4% follow-on investment or would need to make a follow-on investment of 0.3% or less



IPS Review Schedule

- ❑ The IMD (Jase Auby) and Hewitt EnnisKnupp (Steve Voss) will continue to manage the modification process and will submit the proposed modifications to the following additional parties for review:
 - Hewitt EnnisKnupp
 - Dr. Keith Brown
 - Reinhart Boerner Van Deuren
 - TRS Legal Services
 - TRS Audit

 - ❑ Hewitt EnnisKnupp and Dr. Keith Brown will prepare supporting memoranda discussing the changes

 - ❑ The final proposed list of changes, including exact language as written into the IPS, will be presented to the Policy Committee in September for consideration and proposed recommendation to the Board for approval
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Full List of Modifications

1. **Improve document readability.**
 - a. Add an Executive Summary [Article 1].
 - b. Standardize section labeling [Various].
 - c. Consolidate redundant language [Various].
 - d. Move Placement Agents Addendum [Article 12].
 2. **Remove Real Assets Portfolio transition process** [Section 1.6]. Now that the Real Assets portfolio transition is complete, the transition process language is no longer required.
 3. **Clarify that the list of Public Markets Authorized Investments is for both internal and external portfolios** [Section 2.2]. The list of Authorized Investments for the internal public markets portfolios is also used by the external public markets portfolios. This clarification relabels the list of Authorized Investments to make this clear.
 4. **Adjust document to reflect restructuring of External Private Markets** [Article 3]. The External Private Markets investment center has now become the Private Equity and Real Assets investment centers.
 5. **Remove derivatives tenor limits** [Section 8.6].
 6. **Increase follow-on investment waiting period from three months to six months** [Appendix B]. Increase the waiting period and clarify the existing language describing the calculation of the authority limits.
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Tab 3



Recruitment and Retention Investment Management Division Compensation and Performance Plan

Janet Bray, Human Resources Director

Susan Wade, Professional Development Director

Jerry Albright, Deputy CIO

Britt Harris, CIO

July 2012

Agenda



- Overview
 - Purpose and Philosophy
 - External Commentary
 - Alignment with TRS Members
 - Mechanics
 - Nine-Box Productivity Rating
 - TRS IMD Competitiveness versus Private Sector
 - Impact on Performance
 - Approval Process
 - Impact on Recruitment and Retention
 - IMD Thoughts and Observations
 - Appendix
-



Overview

- ❑ Current Investment Management Division (IMD) compensation philosophy, including performance pay, adopted by the TRS Board in October 2007
 - Based on industry analysis and recommendation of the McLagan Group
- ❑ Investment management is a unique skill
 - Compensation required typically not covered in government sector
 - Competition for talent largely with the private sector
- ❑ Management responsibilities are significant and important
 - \$110 billion global investment portfolio¹
 - 23rd largest portfolio in the world²
 - Second largest return-seeking operation in Texas
 - Risk management processes are key and complex
- ❑ Member benefits are largely funded by investment results
 - Approximately 60% of long-term funding
- ❑ TRS members are best served by an excellent, stable and dedicated Investment Division
 - 116 employees with 50 MBAs, 30 CFAs and 15 years of average experience
 - IMD repeatedly honored as being among the industry's best

Source: ¹State Street Bank

²Pensions & Investments, as of September 30, 2009

Compensation

Purpose and Philosophy



Purpose	Philosophy	Background	Results
<ul style="list-style-type: none">❑ Attract, motivate and retain highly talented investors with a unique dedication to teachers	<ul style="list-style-type: none">❑ Competition for talent is with top <u>private</u> sector funds<ul style="list-style-type: none">▪ <u>First</u> quartile <u>base pay</u> (among large <u>public</u> funds)▪ <u>Fourth</u> quartile <u>performance pay</u> (among small <u>private</u> funds)▪ Address remaining compensation gap with purpose, leadership, place and culture	<ul style="list-style-type: none">❑ Established by the TRS Board in 2007❑ Based on independent analysis from the McLagan Group<ul style="list-style-type: none">▪ Nation's leading financial industry compensation consultant	<ul style="list-style-type: none">❑ Recruitment has been exceptional❑ Retention has been high❑ Investment results have been strong❑ Risk management has been highly professional

External Commentary



- ❑ Hewitt EnnisKnupp report to TRS Compensation Committee (August 2011)
 - *“Performance Pay is **customary** in this industry and **necessary** for TRS to attract and retain top talent”*
 - *“The benchmarks articulated in the TRS IPS (and therefore the Performance Incentive Pay Plan) are, in our opinion, appropriate and satisfy the commonly accepted criteria of an effective performance benchmark”*
 - *“The use of peer universes as a measure of success in the incentive compensation plan is appropriate given the competitive nature of the investment industry and the relevance of peer ranks in rounding out the view of long-term performance success”*
- ❑ Adam Barnett, McLagan, commenting on 2010 Public Fund Compensation survey
 - *“Unlike many other public funds, TRS’ incentive opportunities approach private sector norms – which is critical given that TRS primarily competes with the private sector for talent”*
- ❑ State Auditor’s Report on Incentive Compensation 2012
 - Incentive Compensation at TRS was calculated and paid in accordance with policies and procedures – no findings on accuracy or completeness of calculation

Performance Pay

Alignment with TRS Members



- ❑ Highly aligned with TRS Members' interests
 - Performance awards are based primarily on value added above "passive benchmarks" and/or returns earned by comparable pension funds (peer groups)
 - Performance awards are based on one-year (33%) and three-year results (67%)
 - Performance awards are earned only if results are above benchmarks
 - Performance awards earned are paid over two years
 - Payouts are made only when the Trust overall has a positive return
 - Payouts are deferred if value is added but Trust returns are negative (usually due to bear market conditions in global equity)
 - Payouts are forfeited if employee leaves TRS or if an employee willfully violates an approved risk constraint
 - Partial payouts require strong results and full payouts require extraordinary results
- ❑ Performance pay has been \$12.81 per member over the past three years for an average of \$4.27 per year

Performance Pay

Alignment with TRS Members



- ❑ Example of alignment (one- and three-years ended March 31, 2012)
 - TRS total fund benchmark earned \$39.6 billion over the previous three years
 - Actual TRS IMD results produced \$45.2 billion over the same period
 - Performance pay based on value added above \$39.6 billion, or \$5.6 billion
 - Pro forma three-year TRS IMD total performance pay would have been \$6.2 million
 - Value added over one-year was not achieved, so performance pay for that period would have been zero
 - Allocated across approximately 110 eligible employees
- ❑ Example of allocation of value added (\$100 billion fund)
 - 1% value added to the overall fund equals \$1 billion
 - Related total IMD performance pool would be \$10.6 million¹
 - Split of value-added results would be 99% TRS members, 1% IMD

¹Assumes 1% value added for both one and three years versus both passive and peer benchmarks, and a 65% overall payout rate on individual productivity rankings

Performance Pay

Mechanics



Performance Period	<ul style="list-style-type: none">• Start date: October 1• One- and three-year results through the previous September 30
Key Performance Components	<ul style="list-style-type: none">• Based only on value added• 50% versus passive benchmark(s)• 30% versus TUCS Peer Group Results (Public Plans over \$10 Billion)• 20% based on individual productivity rankings of all IMD employees• Productivity payouts only made if value added is achieved• Includes 360° feedback, manager recommendation, and management committee scoring into a nine-box productivity rating
2011 Percent of Maximum	<ul style="list-style-type: none">• Passive Comparison: 36%• Peer Comparison: 72%• Productivity Ranking: 71%• Total Performance Pay: 54%
Allocation Philosophy	<ul style="list-style-type: none">• 30% or more based on overall Trust results (to assure Trust-level priority)• 50% or more, where applicable, based on contribution to value added• 20% or more to assure specific collaboration requirements• Within this construct, individual formulas are tailored based on assigned profit center
Performance Pay	<ul style="list-style-type: none">• Maximum payout ranges between 5% and 125% of base salary• Higher percentages are due to increased seniority and responsibility
2011 Average Award	<ul style="list-style-type: none">• Average payout as percent of maximum in 2011 was 54%• Range among investment professionals was 35% to 60%• All investment performance is calculated by a third party• All benchmarks are certified by an independent consultant• Performance awards are calculated by TRS Investment Accounting and certified by HR and Internal Audit

Nine-Box Productivity Rating

☐ Placement has associated award ranges (percentage of the 20% possible) for qualitative factors:

- 80% – 100% for Exceptional performance
- 20% – 60% for Satisfactory performance
- No award for those performing in the Unacceptable ranges
- Composite rating based on 360° feedback, manager ratings, and management committee review and collaboration
- Common assessment on six factors:
 1. Candor
 2. Curiosity
 3. Accountability
 4. Leadership
 5. Teamwork
 6. Contribution to constructive work environments

Productivity Rating

Profit Center:		Manager:		
		3. Exceptional 80%	2. Exceptional 90%	1. Exceptional 100%
CURRENT PERFORMANCE	+			
	0	6. Satisfactory 20%	5. Satisfactory 40%	4. Satisfactory 60%
	-	9. Unacceptable 0%	8. Unacceptable 0%	7. Unacceptable 0%
		Low	Medium	High
PERFORMANCE				

Performance Pay

TRS IMD Competitiveness versus the Private Sector



- ❑ IMD payouts are competitive with the lowest quartile of private sector performance pay
- ❑ TRS portfolio is 10 to 20 times larger, more complex, and more impactful than these peer funds

Title	Percent of Private Sector Performance Pay		
	Low	Median	High
CIO	97%	50%	21%
Sr. Managing Director, Managing Director	139%	53%	26%
Director, Sr. Investment Manager	135%	63%	31%
Investment Manager	124%	68%	44%
Sr. Associate, Analyst	45%	28%	18%
IMD Averages	108%	53%	28%

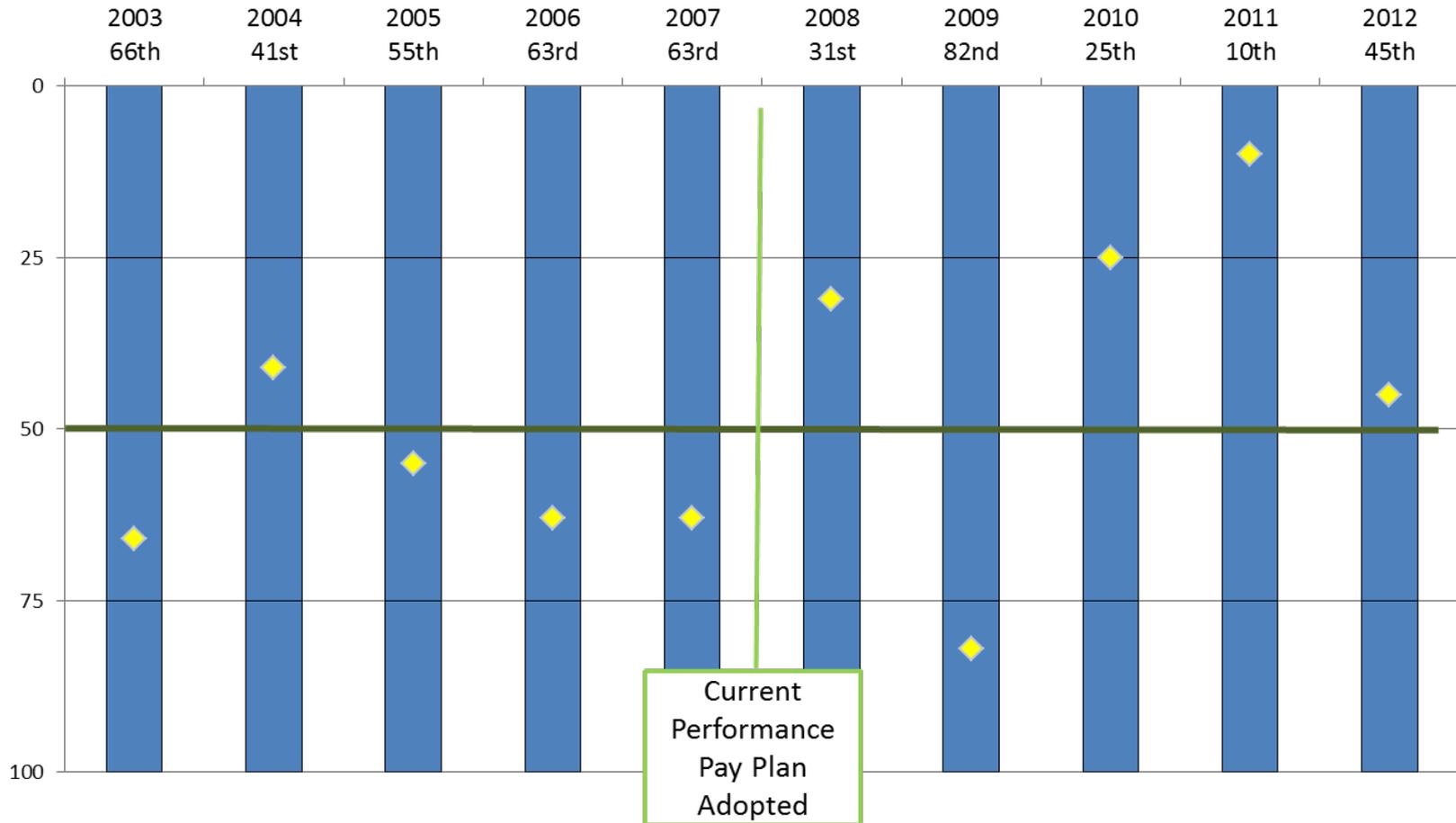
Note:
IMD figures based on average of high and low payout percentages
Source: 2010 McLagan Compensation Survey

Impact on Performance

Top 15th Percentile Over Past Three Years



Annual TRS Returns versus TUCS Public Trusts >\$10B



Source: Wilshire Trust Universe Comparison Services (TUCS)



Approval Process

July to
September

- Board approves performance pay budget for upcoming fiscal year
- IMD completes annual employee 360° reviews and ranks all employees (nine-box scale)
- CIO submits IMD productivity ranking recommendations to the Executive Director
- Executive Director certifies the CIO productivity ranking using input from Board
- Performance Incentive Plan is reviewed periodically by IMD, Executive Director and Board

October to
December

- Human Resources certifies eligible participants and salaries for next performance period
- CARE (Compensation and Review Evaluations) packages are distributed to all IMD employees, with a “subject to” note on any performance pay
- IMD senior managers meet with all IMD employees to review CARE packages
- Final performance figures are provided by State Street
- Final performance pay calculations are made by TRS Investment Accounting and certified by HR and Internal Audit
- Executive Director certifies final performance pay calculations
- Final performance pay is reported to the Board and to the Legislature

January

- Approved performance pay is processed for distribution no later than February 15, except for deferred and forfeited amounts

Impact on Recruitment and Retention

TRS IMD is now recognized as a leading investor in pension management

Attraction

- Almost 70 new investment-oriented employees attracted to TRS IMD
 - 73% from the private sector
 - 44% of experienced new employees outside Texas
 - 25% through IMD Intern Program
 - 2% from other public funds or government agencies

Retention

- IMD turnover among professionals limited to less than 8% annually on average
- Lost employees fall primarily into two categories
 - Strong employees to higher compensation, but smaller impact, funds
 - Employees ranking in bottom 20% of productivity rankings

Morale and Engagement

- IMD morale and retention are high
 - IMD received scores that are “areas of substantial strength” in 12 of 14 categories in the 2012 Survey of Employee Engagement (SEE)
 - IMD received scores that are “areas of substantial strength” in 4 of 5 categories in the Climate Analysis section of the same survey

Performance Results

- Performance results are good on both absolute and risk-adjusted basis
 - IMD in top 15th percentile against other similar pension funds
 - IMD ranks 2nd of 64 in risk-adjusted return

Review of Current IMD Leadership

Recruited Recently



Britt Harris,
CIO
Bridgewater Associates



Jase Auby,
Chief Risk Officer
Barclays Capital



Mohan Balachandran,
Managing Director
NISA Investment Advisors



Dale West,
Managing Director
T. Rowe Price



Rich Hall,
Managing Director
Bank of America



Sylvia Bell,
Director
J.P. Morgan Chase



Compensation

IMD Thoughts and Observations



- Attracting and retaining talented investors is difficult and absolutely critical to long-term success
 - Performance pay that is aligned with membership is essential and ethical
 - Current system has attracted and retained a very strong investment team to work for TRS members
 - Substantial consideration has been given to alternative proposals
 - Productivity rating
 - Performance pay triggers
 - Maximum award opportunity
 - Eligible participants
 - Current system and consistency of application is recommended
 - Also recommend biennial reviews going forward
-



Appendix

Performance Pay

Review of Maximum Payout as a Percent of Base Pay



- CIO, Deputy CIO, Senior Managing Directors, Managing Directors: 125%
- Senior Directors, Directors: 110%
- Senior Investment Managers: 90%
- Investment Managers: 85%
- Senior Associates: 65%
- Associates: 50%
- Senior Analysts: 35%
- Analysts: 25%
- Other Team Members: 5%

Note: Does not include contractors

Performance Pay

Impact on IMD Morale, Engagement and Climate

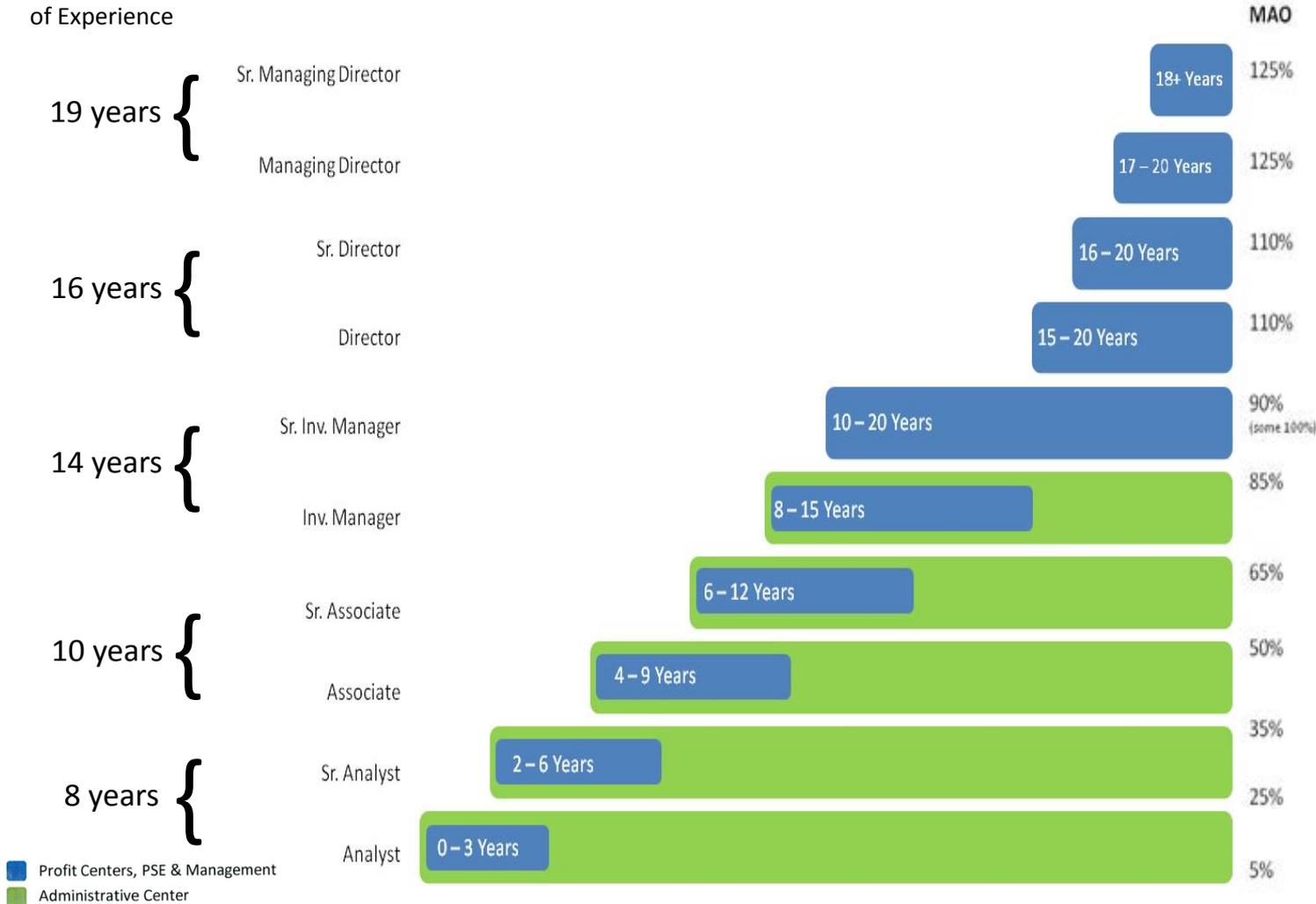


- IMD 2012 Survey of Employee Engagement results show a high degree of employee engagement and organizational effectiveness
 - Survey administered for Texas state agencies by neutral third-party experts
 - 14 areas (constructs) measured: 12 scored as “areas of substantial strength” in IMD and one scored as “viewed positively”
 - “Climate Analysis” shows 4 of 5 “areas of substantial strength” with all 5 rated positively
 - IMD results show significant positive variance from TRS-wide results in these items: Pay (+43), Employee Development (+28), Team (+23), and Climate/Feedback (+21)
- 360° reviews show high degree of cultural alignment among IMD staff
 - Division-wide average score for entire staff: 8.67 of possible 10
 - Scores ranged from low of 6.30 to high of 9.61, with only six employees receiving scores below 8.00
 - Culture components measured are strongly correlated with high-performing teams in the investment industry



IMD Career Model

Average Years of Experience



- IMD Education**
- 50 MBAs
 - 22 Masters
 - 30 CFAs
 - 5 CPAs
 - 3 PhDs
 - 3 JDs

- IMD Profile**
- 116 Professionals
 - 68 Professionals recruited since 2007
 - 98% recruited from private sector or internship



Memorandum

DATE: July 17, 2012
TO: Policy Committee; Board of Trustees
FROM: Legal Services
RE: Annual Review of Performance Incentive Pay Plan

Executive Summary of proposed changes to Performance Incentive Pay Plan for Performance Period commencing October 1, 2012

At its July 2012 meeting, the committee will review and discuss the Plan revisions proposed to be effective as of the commencement of the next Performance Period. If acceptable, the Board will consider adoption in September. This memorandum summarizes the most significant revisions marked in the draft provided with your Board materials. Outside tax counsel has also reviewed the Plan revisions. Please note the following legend when reviewing the draft:

Additions are underlined in blue.

Deletions are ~~stricken through in red~~.

Moves within the document are double-underlined in dark navy.

1. The proposed substantive changes are as follows:

- **Addendums A and B reflect IMD reorganization and revised performance comparison allocations.**

New Addendums A and B attached to the draft include the latest proposed changes that reflect changes in the “investment areas” and “peer groups within the IMD to be effective under the Plan as of October 1, 2012. In addition, the tables in those Addendums show as marked changes revisions to the allocations used to calculate Potential Awards under the Plan. These changes will affect the Potential Awards that can be earned in certain Eligible Positions.

- **Addendum C (IPS benchmarks) is deleted; IPS benchmarks, as modified from time to time, are incorporated by reference.**

In Section 4.6(a), the reference to Addendum C is deleted and replaced with language incorporating by reference the performance benchmarks adopted in the Investment Policy Statement, as amended from time to time, as the basis for calculating performance awards under the Plan. If a benchmark in the policy changes, the Plan benchmarks used for calculating performance awards are automatically changed on the same effective date (during a Performance Period). This fits the method actually used to calculate Potential Awards. This change is intended to obviate having to consider an amendment to the Plan when the Investment Policy Statement benchmarks have been amended. Addendum C is marked for deletion.

- **Employees leaving an Eligible Position within TRS can now earn an award for the final, partial Performance Period worked in the Eligible Position.**

Section 4.6(c) is marked for deletion. Section 4.6(c) currently provides that employees who leave Eligible Positions in the IMD for other positions within TRS during the Performance Period are *not eligible for an award under the Plan with respect to the partial Performance Period worked in an Eligible Position*. The proposed deletion would maintain the eligibility of an employee to receive an award in respect of the final, partial Performance Period. It is felt that the provision unfairly penalizes such employees by arbitrarily denying them a prorated award they might otherwise have earned during their final, partial Performance Period. Deleting the provision also removes any disincentive to voluntarily leave an Eligible Position during a Performance Period, even if that would be in the best interest of both of TRS and the employee. New Section 4.3(b)(v) addresses proration of awards for a partial Performance Period when a Participant accepts a TRS position outside the Plan.

- **Section 4.4(h) has been revised to provide that the qualitative performance component of the Maximum Award Opportunity will be based on a system of performance evaluation approved by the Executive Director.**

The existing language of Section 4.4(h) states that the intermediate levels of the qualitative component of the Potential Award are determined in “discrete quartiles.” This language is believed to be too narrow and that the Executive Director should have more flexibility to approve other systems of evaluation. Subsection (h) has also been reformatted for logical structure and readability.

- **The Plan has been clarified to provide that no changes will be applied retroactively, including benchmark or investment area changed, unless tax law requires it.**

Benchmark changes that occur because of changes in the Investment Policy Statement will take effect on the same date as they become effective in the Policy, but may not apply retroactively. However, if the IMD is reorganized during a Performance Period, the change will only be effective as of the commencement of the next Performance Period. The investment areas in effect at the beginning of the

Performance Period will be used for all calculations relating to that period. However, if retroactive changes are required by tax laws or regulations, those will be permitted.

- **New Section 4.6(b) addresses the addition of new profit centers in the Investment Management Division.**

Calculation of performance for any new profit centers will be based on full Performance Periods. The provision also addresses allocations between one and three year performance by full Performance Periods.

- **New language in Section 4.8(a) gives the Executive Director discretion to pay awards before December 31.**

IMD staff requested this provision to address the possibility that the Bush-era tax cuts are not extended or renewed at the end of this year. This language is still under review by outside tax counsel.

2. *Most of the marked changes are intended to clarify the Plan and improve readability.*

- Changes marked as moves are intended to improve the Plan's internal logical structure and improve readability.

- The Plan has been edited for consistent and uniform use of defined terms.

Examples: Replaced "investment division" with "IMD" throughout.

Replaced instances of "staff" with "employees" throughout.

- Undefined capitalized terms have been revised to lower case for readability.

Example: "Qualitative Performance" is now "qualitative performance."

- Long defined terms have been shortened to improve readability and reduce clutter.

Example: "Potential Performance Incentive Award" is now "Potential Award."

- Minor additions and clarifications have been added to Section 8, Definitions.

Example: Defined "investment area" and "profit center" by reference to Addendums A and B, where they are listed.

- Clarified when employment in an Eligible Position becomes effective during a Performance Period (Section 4.3(b)).

- Deleted transition language that is no longer needed (Section 4.6(c)).

- Section 7.2 further clarifies that the Plan creates no “property interest” with respect to any aspect of the Plan or an award.
- Addendums A and B have been edited to make it easier to read and understand the allocation plans in each Addendum and how they relate to the calculation of awards under the Plan.
- The investment areas in Addendums A and B have been updated to reflect pending organizational changes in the IMD.
- An automatically generated Table of Contents has been created to replace the manually prepared Table of Contents. This change will facilitate future editing if the Plan is amended in the future.

Teacher Retirement System of Texas

PERFORMANCE INCENTIVE PAY PLAN

Effective October 1, ~~2011~~2012

This version of the Plan is effective for Performance Periods beginning on or after October 1, ~~2011~~2012. Any awards for performance in prior Performance Periods, can become earned and payable subject to the terms and conditions stated in the versions of the Plan effective for those ~~P~~performance ~~P~~periods. No modification of the Plan may be given retroactive effect except as required to comply with applicable law, including federal tax laws and regulations.

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1. PERFORMANCE INCENTIVE PLAN PURPOSE AND AUTHORIZATION

To remain competitive in its efforts to attract and retain high caliber Investment Management Division (IMD) ~~staff~~employees, the Teacher Retirement System of Texas (TRS) strives to offer a competitive compensation package. ~~Awards of p~~Performance incentive pay based on specified performance criteria ~~are is~~ an industry standard practice in the private ~~sector~~ investment ~~sector arena~~ and ~~are is~~ rapidly becoming a standard practice in the public sector. By offering both a competitive base salary and performance incentive ~~award opportunity~~pay, TRS enhances its ability to fulfill ~~the its~~ mission to “prudently invest and manage the assets held in trust for members and beneficiaries in an actuarially sound system administered in accordance with applicable fiduciary principals.” Therefore, pursuant to the laws governing TRS, the TRS Board of Trustees (the “Board”) has determined that establishing and expending funds for this Performance Incentive Pay Plan (the “Plan”) is consistent with and in furtherance of the ~~required to perform the~~ fiduciary duties of the Board in administering the retirement system.

2. PLAN OBJECTIVES AND STRATEGY

2.1 Plan Objectives

The Plan serves a number of objectives:

- To attract and retain ~~Investment Division~~ IMD ~~staff~~employees who have outstanding ability;
- To create incentives for encourage ~~Investment Division~~IMD ~~staff~~employees to develop a strong commitment to the long-term investment performance of the assets for which TRS has been delegated investment responsibility; and
- To motivate investment professionals to focus on maximizing real, long-term returns for all funds managed by TRS while assuming appropriate levels of risk.

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2.2 Plan Strategy

The Plan strategy includes:

- Base salaries, targeted at competitive levels, as defined by the Executive Director and the Board with actual individual base salaries determined by an employee's experience, education, knowledge, skills and overall job performance.
- Performance incentive pay award opportunities, calculated as a percentage of an employee's base salary for performance above pre-determined standards, earned contingent upon continued employment in an Eligible Position at specified times and generally payable in two annual installments, subject to deferral as set forth in Section 4.8(b) over a two-year period.

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3. BASE SALARY ADMINISTRATION

3.1. Salary Structure

- (a) Notwithstanding any other law, the Board approves the rates of compensation of all investment division ~~IMD~~ employees. Under state law, the Board's Bylaws, and as part of the annual TRS budgeting process, ~~the~~ Board authorizes the Executive Director to determine and propose base salary ~~adopt~~ rates of compensation generally based on the salary schedules, position classifications and salary administration practices of Article IX of the General Appropriations Act, Chapter 659 of the Texas Government Code and other relevant legislation to the extent the Executive Director determines a particular provision is in the best interest of the system and not in conflict with applicable law, fiduciary duty, or TRS policy.
- (b) Under the terminology of the state compensation program, "classified" employees are those employees whose position classification titles, pay groups and ranges, and pay administration practices are based on the State Position Classification Plan and related salary administration provisions. ~~"Exempt" employees' job titles, pay groups and ranges, and pay administration practices are not based on the State Position Classification Plan and related salary administration system. For purposes of the Plan, the Chief Investment Officer and the Investment Fund Directors are considered exempt employees, while the remainder of TRS investment division employees are considered classified.~~
- (c) Upon hiring or promotion, classified employees are assigned to a classification title that is consistent with assigned responsibilities. Initial base salaries for classified employees are set between the minimum and maximum of the assigned pay group, considering the employee's experience, education, knowledge and skills, and issues of external competitiveness and internal equity.
- (d) ~~"Exempt" employees' job titles, pay groups and ranges, and pay administration practices are not based on the State Position Classification Plan and related salary administration system. For purposes of the Plan, the Chief Investment Officer and the Investment Fund Directors are considered exempt employees, while the remainder of IMD TRS investment division employees are considered classified for compensation and other purposes.~~ Exempt E employees who are exempt from the salary classification schedules do not have base salary ranges. As part of the annual TRS budgeting process, ~~the~~ Board authorizes the Executive Director to determine set base salaries for exempt positions up to a not-to-exceed rate specified in the General Provisions of the TRS Budget. Initial base salaries for exempt employees are set by the Executive Director at or below the applicable not-to-exceed rate, considering the employee's experience, education, knowledge and skills, and issues of external competitiveness and internal equity.

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3.2. Salary Adjustments

- (a) Classified employees may receive base salary increases for a number of reasons, including but not limited to career ladder promotions, and merit increases for ~~demonstrated~~ individual performance. Exempt employees may receive base salary adjustments (increase within the not-to-exceed rate or decrease) at the discretion of the Executive Director.
- (b) Notwithstanding subsection 3.2-(a), all base salary changes will be executed in accordance with TRS salary administration procedures.

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4. INCENTIVE PAY PLAN

4.1. Purpose of the Plan and Effective Date

- (a) The purpose of the Plan is to provide the opportunity for ~~Investment Division~~IMD employees to receive performance incentive pay based on specific criteria relative to TRS's investment performance and the employee's job performance.
- (b) This version of the Plan is effective for ~~Performance Periods~~ performance periods beginning on or after ~~the effective date shown on the cover page~~ October 1, 2010. ~~A Potential Award Any awards~~ for performance in prior Performance Periods can become earned and payable subject to the terms and conditions stated in the version of the Plan effective for those Performance Periods.

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4.2. Performance Period

For purposes of the Plan, the "Performance Period" begins on October 1st of each year and ends the following September 30th.

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4.3. Participation in the Plan

- (a) An ~~IMD~~ employee who is in an "Eligible Position" on October 1st of the Performance Period, is eligible to participate in the Plan (a "Participant") ~~during that Performance Period~~.
- (b) Notwithstanding ~~section~~Section 4.3-(a) above, an ~~IMD~~ employee who first begins employment in an Eligible Position (through new hire, promotion or reassignment) after the beginning of the Performance Period will become a Participant as follows:

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- (i) If ~~an the~~IMD employee begins employment in an Eligible Position ~~with an official hire date or effective date~~ after October 1st but no later than January 1st the employee will become a Participant on January 1st and ~~the Participant's award opportunity~~ ~~Potential Performance Incentive Awards~~ will be prorated to 75% of the ~~Incentive Potential Award for that Performance Period Opportunity as defined in subsection 4.4 (f)~~.
- (ii) If ~~an the~~IMD employee begins employment in an Eligible Position ~~with an official hire date or effective date~~ after January 1st but no later than April 1st the employee will become a Participant on April 1st and ~~the Participant's award opportunity~~ ~~Potential Performance Incentive Awards~~ will be prorated to 50% of the ~~Potential Award for that Performance Period Incentive Award Opportunity as defined in subsection 4.4 (f)~~.
- (iii) If ~~an the~~IMD employee begins employment in an Eligible Position ~~with an official hire date or effective date~~ after April 1st but no later than July 1st the employee will become a Participant on July 1st and ~~the Participant's award opportunity~~ ~~Potential Performance Incentive Awards~~ will be prorated to 25% of the ~~Potential Award for that Performance Period Incentive Award Opportunity as defined in subsection 4.4 (f)~~.

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(iv) If ~~an IMD the~~ employee begins employment in an Eligible Position with an official hire date or effective date after July 1st of a Performance Period the employee will not become a Participant until the beginning of the next Performance Period (assuming such employee is employed by TRS in an Eligible Position on October 1st of the Performance Period).

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~~(v) If a Participant leaves an Eligible Position during a Performance Period and begins TRS employment in a non-Eligible Position, the Participant's Potential Award for the partial Performance Period will be prorated based on the number of completed calendar quarters worked in all Eligible Positions during that Performance Period.~~

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(c) Generally, all permanent, full time employee positions assigned to the ~~Investment Division~~IMD are Eligible Positions under the Plan. ~~However, contract workers are not TRS employees and thus not eligible to participate in the Plan~~Each Eligible Position within the IMD is assigned to an investment area that determines the profit center allocations included in the Participant's Potential Award calculation under Addendums A and B. Section 4.4 (f) contains a list of Eligible Position titles.

~~(d) Secondees, contract workers, and other temporary workers are not TRS employees and are not eligible to participate in the Plan.~~

~~(de) An Eligible Position in one Performance Period is not automatically an Eligible Position in any subsequent Performance Period.~~

~~(ef) The Director of Human Resources will certify to the Executive Director in writing the name, base salary, hire date, effective date, Eligible Position title, and investment area assignment of each eligible Participant for the applicable Performance Period, including Participants employed in an Eligible Position for only a portion of the Performance Period. The Director of Human Resources will also certify the base salary, position title and Area assignment for each participant~~

~~(fg) After the beginning of a Performance Period, if a Participant moves from one Eligible Position to another Eligible Position with a different position title or area assignment, the Participant's Potential Performance Incentive Awards for that Performance Period and the measurement of the Participant's performance will be prorated between that the award calculated appropriate for the former Eligible Position old position title or investment area assignment and the award calculated that appropriate for the new Eligible Position position title or investment area assignment as follows:~~

(i) If ~~a Participant the employee~~ moves to ~~a the~~ new Eligible Position position title or investment area assignment after October 1st but no later than January 1st the Participant's employee's Potential Performance Incentive Awards and the measurement of the Participant's performance will be based on the former Eligible Position old position title or investment area assignment for the period October 1st through December 31st, and on the new Eligible Position position title or investment area assignment for the period January 1st through September 30th.

(ii) If ~~a Participant the employee~~ moves to ~~a the~~ new Eligible Position position title or investment area assignment after January 1st but ~~on or before no later than~~ April 1st the Participant's employee's Potential Performance Incentive Awards and the measurement of the Participant's performance will be based on the former Eligible Position old position title or investment area assignment for the period October 1st through March 31st, and on the new Eligible Position position title or investment area assignment for the period April 1st through September 30th.

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- (iii) If ~~a Participant the employee~~ moves to the new position title or area assignment after April 1st but no later than July 1st the ~~Participant's employee's Potential Performancee Incentive Awards~~ and the measurement of the Participant's performance will be based on the ~~former Eligible Position old position title~~ or ~~investment~~ area assignment for the period October 1st through June 30th, and on the new ~~Eligible Position position title~~ or ~~investment~~ area assignment for the period July 1st through September 30th.
- (iv) If ~~a Participant the employee~~ moves to ~~a the~~ new ~~Eligible Position position title~~ or ~~investment~~ area assignment after July 1st of a Performance Period the ~~Participant's employee's Potential Performancee Incentive Awards~~ will be based on the ~~former Eligible Position old position title~~ or ~~investment~~ area assignment for the entire Performance Period.

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(gh) An employee will cease to be a Participant in the Plan on the earliest to occur of:

- (i) ~~Except as specifically provided in Section 4.3(b)(v) with respect to continued TRS employment, (T~~the date the employee is no longer employed in an Eligible Position;
- (ii) The date of termination of the employee's employment with TRS for any reason. (For purposes of the Plan, the date of termination is the employee's last ~~physical~~ day worked and does not include any leave the employee was allowed to use to extend their employment for payroll purposes.); or
- (iii) The date of termination of the Plan.

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4.4. ~~Investment Performance Components, Qualitative Components, and Incentive-Potential Award Opportunity~~

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- (a) ~~Generally,~~Participants' ~~Potential Potential Performance Incentive AA~~awards will be based on a combination of investment ~~performance~~ and qualitative performance ~~components~~. ~~The Investment Performance Component includes a pre-defined combination of Fund and Area performance versus benchmarks and versus peer groups of other large public funds. The Qualitative Performance Component includes performance in a variety of contributions and behaviors needed for organizational success.~~
- (b) The ~~investment performance components Investment Performance Component~~ ~~comprise includes~~ two ~~p~~Performance ~~c~~Categories: – 1) ~~Benchmark P~~performance ~~measured against pre-determined benchmarks and applicable excess return targets~~, and 2) ~~performance measured against pre-determined Peer-peer Group groups. Where applicable, each Performance Category contains two Performance Sub-Categories – Fund Performance and Area Performance.~~

~~(i) The benchmark index category of the investment performance component will determine 50% of the total Potential Award.~~

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~~(ii) The peer group category of the investment performance component will determine 30% of the total Potential Award.~~

~~(i) The Fund Benchmark Performance sub-category measures the performance of the total fund relative to a predetermined benchmark.~~

~~(ii) The Fund Peer-Group Performance sub-category measures the performance of the total fund relative to the performance of a predefined universe of large public funds. The Area Benchmark Performance sub-category measures the performance of specific sub-groups ("Areas") of the total fund relative to predetermined benchmarks.~~

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~~(iii) The Area Benchmark Performance sub-category measures the performance of sub-groups ("Areas") of the total fund relative to predetermined benchmarks.~~

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(iv) ~~Where available, the Area Peer Group Performance sub-category measures the performance of investment Areas relative to the performance of similar investment Areas of a predefined universe of large public funds.~~

~~Investment Areas include:~~

- ~~• Strategic Partner Management~~
- ~~• Internal Public Markets~~
- ~~• External Public Markets~~
- ~~• Real Asset~~
- ~~• Private Equity~~
- ~~• Trade Management Group~~

(c) ~~Notwithstanding that the Performance Period is October 1st through September 30th, due to the delay in availability of final performance data for Private Equity and Real Assets, performance measurements for these two Investment Areas will experience a one quarter time lag, such that all incentive calculations involving Private Equity and Real Assets performance will use data for the twelve month period ending each June 30th.~~

~~(i) For the first year of this change in measurement period for Private Equity and Real Assets, incentive calculations will use data for the nine month period beginning October 1, 2009 and ending June 30, 2010 for one year performance.~~

~~Benchmark targets and Participant performance during the first year of this change will be prorated proportionately to the change in the measurement period.~~

~~(ii) Measurement of three year performance for the Private Equity and Real Assets investment areas during the second year of this change will use data from October 1, 2008 through June 30, 2011.~~

~~(iii) Measurement of three year performance for the Private Equity and Real Assets investment areas during the third year of this change will use data from October 1, 2009 through June 30, 2010. Measurement of three year performance for these Investment Areas during the first year of this change will use data from October 1, 2007 through June 30, 2010. Benchmark targets and participant performance during the first year of this change will be prorated proportionately to the change in the measurement period.~~

(d) Each Eligible Position will be assigned specific weightings for Total Fund and investment area performance Area Performance as shown in Addendums A and B.

(i) To encourage a focus on the “big picture” and a sense of shared mission, the investment performance component Investment Performance Component (both benchmark and peer group categories Benchmark and Peer Group Categories) for all Eligible Positions will have a Total Fund weighting of at least 20%. Weightings for investment area performance Area Performance Sub-categories will be divided among the Eligible Position’s primary investment area Area and other investment areas Areas with which the Eligible Position has regular interaction.

(ii) Where no investment area peer group Area Peer Group P performance measures are available, that investment area peer group performance Area Peer Group Performance weighting allocation is added to the Total Fund peer group performance Peer Group Performance weighting allocation.

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(e) The qualitative performance component ~~(Qualitative Performance Component)~~ will be measured as part of ~~the each~~ Participant's annual performance appraisal process and may include multi-rater feedback regarding a variety of contributions and behaviors needed for organizational success that are not directly measured in the investment performance component ~~(Investment Performance Component)~~, such as interpersonal ~~shipal~~ skills, accountability, effective teamwork, etc.

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(i) ~~(e)~~ Regardless of a Participant's performance towards the qualitative performance component ~~(Qualitative Performance Component)~~, a Potential Performance Incentive Awards will only include the portion attributed to qualitative performance ~~Qualitative Performance~~ if the Participant has attained at least the threshold level of performance in the investment performance component ~~(Investment Performance Component)~~.

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(ii) To encourage appropriate organizational behaviors, the qualitative performance component ~~Qualitative Performance Component~~ for all Eligible Positions will be weighted at 20% of the Potential Award.

~~(d) Each Eligible Position will be assigned specific weightings for Fund and Area Performance as shown in Addendums A and B.~~

~~To encourage a focus on the "big picture" and a sense of shared mission, the Investment Performance Component (both Benchmark and Peer Group Categories) for all Eligible Positions will have a Total Fund weighting of at least 20%.~~

~~Where no Area Peer Group Performance measures are available, that Area Peer Group Performance weighting allocation is added to the Fund Peer Group Performance weighting allocation.~~

~~To encourage appropriate organizational behaviors, the Qualitative Performance Component for all Eligible Positions will be weighted at 20%.~~

~~(e) Regardless of a Participant's performance towards the Qualitative Performance Component, Potential Performance Incentive Awards will only include the portion attributed to Qualitative Performance if the Participant has attained at least the threshold level of performance in the Investment Performance Component.~~

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(f) A Potential Award is the gross award amount calculated based on the actual performance achieved in the Performance Period. Depending on performance, the Potential Award in a Performance Period varies from zero to 100% of the Maximum Potential Award. The "Incentive Award Opportunity" for a Performance Period is expressed as a percentage of the "Maximum Potential Award" that can become earned and payable under the Plan is limited to Opportunity," which the percentage ranges from 5% to 125% of a Participant's Base Salary the employee's base salary, depending on in an the Eligible Position that is listed opposite each Eligible Position detailed in the table below. The Maximum Potential Award applies regardless of whether a Participant has exceeded the stated maximum performance targets or the gross amount of the Potential Award calculated under the Plan.

<u>ELIGIBLE POSITION</u>	<u>MAXIMUM POTENTIAL AWARD OPPORTUNITY</u>
Chief Investment Officer	125%
Deputy CIO	125%
Senior Managing Director	125%
Managing Director	125%

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Senior Director	110%
Director	110%
Senior Investment Manager	90%
Investment Manager	85%
Senior Associate	65%
Associate	50%
Senior Analyst	35%
Analyst	25%
Administrative Assistants	5%

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(g) Notwithstanding the Maximum Potential Award ~~listed Opportunities detailed~~ in Section 4.4-(f) above, those Participants titled “Senior Investment Manager” who remain in the Eligible Position that was titled “Lead Investment Manager” or “Lead Trader” in the Plan effective October 1, 2007, will continue to have a Maximum Potential Award Opportunity of 100% of Base Salary. If the Participant transfers to a different Eligible Position with a title other than Senior Investment Manager, the Maximum Potential Award Opportunity will change to that appropriate for the new Eligible Position and be prorated as set forth detailed in Section 4.3(g)-(f).

(h) For each investment area, the profit center weighting and excess return relative to each assigned excess return target will combine to determine the Potential Award for each Eligible Position.

(i) The ~~Incentive Award Opportunity~~ Potential Award includes a threshold, a maximum, and intermediate levels of Potential Award potential award that correspond to specific levels of investment performance.

(ii) For the ~~Investment Performance Component~~, Intermediate levels of the Potential Award for investment performance potential award are determined by linearly interpolating between the threshold and maximum.

(iii) For the ~~qualitative component~~ Qualitative Component, intermediate levels of the Potential Award potential award will be based on a system of annual performance evaluation approved by the Executive Director, determined in discrete quartiles

(i) “Potential Performance Incentive Awards” are the amounts calculated based on the actual performance achieved in the Performance Period. The Incentive Award Opportunity in a Performance Period ranges from zero to 100% of the Maximum Award Opportunity and Potential Performance Incentive Awards are capped at the Maximum Award Opportunity, regardless of whether a Participant exceeds the stated maximum performance levels.

4.5. Compliance wWith TRS Policies

(a) IMD Investment Division staff employees exercise fiduciary responsibilities delegated by the Board under applicable law. Investment professionals manage the portfolio according to the Board’s policies, advise and inform the Executive Director and the Board about investments, and recommend modifications to the Investment Policy Statement. In addition, all IMD Investment Division staff employees are responsible for complying with TRS policies, including without limitation the TRS Investment Policy Statement, Ethics Policy, and the Fraud, Waste and Abuse Policy.

(b) Excess performance by a Participant or Participants resulting from a failure to manage the assets of TRS in accordance with applicable law, the Investment Policy Statement, or TRS Ethics Policy will result in the forfeiture for that portion of the Potential Performance Incentive Awards

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for ~~those Participants that individual~~ resulting from that excess performance for the Performance Period in which the noncompliance occurred. The Executive Director will make this determination on a case-by-case basis.

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- (c) Serious violations of the TRS Investment Policy Statement, Ethics Policy, Fraud, Waste and Abuse Policy, or other TRS policy by a Participant, as determined by the Executive Director, will result in forfeiture of all Potential ~~Performance Incentive~~ Awards ~~calculated~~ for the Performance Period in which the violation(s) occurred, as well as for earlier Performance Periods that have not yet become earned (including without limitation any Potential Awards that are unearned and deferred as set forth in Section 4.8(b) below). Additionally, during the investigation of possible serious violations of law or policy, the Executive Director or the Board may suspend earning and payment of Potential ~~Performance Incentive~~ Awards until the conclusion of the investigation.

4.6. Performance Standards and Measurements

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- (a) Investment Performance (for both ~~b~~Benchmark and ~~p~~Peer ~~g~~Group ~~c~~Categories) is measured on one year and three year historical performance data, weighted at 33% for one year performance (i.e., performance during the Performance Period) and 67% for the historical three year performance that includes the Performance Period. Investment Performance is measured relative to appropriate pre-defined benchmarks as detailed in the asset allocation and benchmarks table, including applicable footnotes, in the Board's Investment Policy Statement ("IPS"), as amended from time to time-Addendum C. For the purposes of this Plan, changes to the IPS benchmarks during a Performance Period will be effective from and after the effective date of such changes in the IPS, subject to revisions to the Plan adopted by the Board of Trustees. In no event may benchmark changes be applied retroactively except as required to comply with applicable law, including federal tax laws and regulations.

- (b) Notwithstanding Section 4.6(a), the performance of any new profit center will be calculated for purposes of the Plan as follows:

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(i) The performance of any new profit center will be based 100% on 1 year performance for the first full Performance Period commencing after the profit center is created;

(ii) After the first full Performance Period of a new profit center, the performance of that profit center will be based 50% on 1 year performance and 50% on historical 2 year performance that includes the second full Performance Periods commencing after the profit center is created; and

(iii) After the second full Performance Period of a new profit center, the performance of that profit center will be based 33% on 1 year performance and 67% on historical 3 year performance by full Performance Periods.

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(iv) For the purposes of this Plan, no performance will be calculated for a Performance Period for a new profit center created during that Performance Period.

- (b) The qualitative performance ~~Qualitative Performance~~ component is measured annually as part of the Participant's current annual performance appraisal process.

- (c) During the initial implementation of the Plan, Investment Performance will be measured as follows:

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(i) For the first year of the Plan (the October 1, 2008 through September 30, 2009 Performance Period), Investment Performance will be measured on two years of historical performance data, weighted at 50% for one year performance (i.e., performance during the Performance Period) and 50% for the performance in the year prior to the

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~~Performance Period, except that Fund Performance will be based on one full year of historical performance.~~

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- ~~(ii) For the second year (the October 1, 2009 through September 30, 2010 Performance Period) and subsequent years of the Plan, Investment Performance will be based on one year and three year historical performance as detailed in section 4.6 (a) above, except that, for the second year only, Fund Performance will be based on 2 years of historical performance, weighted at 50% for one year performance (i.e., performance during the Performance Period) and 50% for the performance in the year prior to the Performance Period.~~

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4.7. Potential ~~Performance Incentive~~ Award Calculations

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- (a) Following the end of each Performance Period, the Executive Director will review the actual performance of each Participant relative to the applicable ~~performance components~~**Performance Components**.
- (b) Potential ~~Performance Incentive~~ Awards are calculated based on the Participant's level of performance achieved in the applicable ~~investment performance~~**Investment** and ~~qualitative performance components~~**Qualitative Performance Components** in each Performance Period.
- (c) Relative performance data and calculations may be reviewed by an external independent source selected by the Executive Director, but final calculations are approved by the Executive Director.

4.8. Earning Potential ~~Performance Incentive~~ Awards and Payouts

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- (a) ~~Subject to Section 4.8(b) and n~~otwithstanding ~~the~~ Executive Director's approval of Potential ~~Performance Incentive~~ Award calculations, Potential ~~Performance Incentive~~ Awards will only become earned ~~and payable~~ as stated below:
 - (i) If ~~the Participant the employee~~ is employed by TRS on ~~December~~ January-1st following the end of the Performance Period ~~during for which he or she was they were~~ a Participant, 50% of the Potential ~~Performance Incentive~~ Award will become earned. Payment of this award will be processed with that ~~December or~~ January payroll, ~~and will generally be paid typically issued~~ on or ~~before about~~ February 1st; provided, however, that in no event will payment be made later than February 15th.
 - (ii) If ~~the Participant the employee~~ is employed by TRS on ~~December~~ January-1st following the first anniversary of the end of the Performance Period ~~during for which he or she was they were~~ a Participant, the remaining 50% of the Potential ~~Performance Incentive~~ Award will become earned. Payment of this award will be processed with that ~~December or~~ January payroll, ~~and will generally be paid typically issued~~ on or ~~before about~~ February 1st; provided, however, that in no event will payment be made later than February 15th.
 - (iii) For the Performance Periods ending on or before September 30, 2012, if the Participant is employed by TRS on December 1, 2012, 50% of a Potential Award will become earned and will generally be payable between December 1, 2012 and February 1, 2013 provided, however that in no event will payment be made later than February 15, 2013.
 - (iv) For the Performance Periods ending on or before September 30, 2012, if the Participant is employed by TRS on December 1, 2013, the remaining 50% of a Potential Award will become earned and will generally be payable between December 1, 2013 and February 1, 2014; provided, however, that in no event will payment be made later than February 15, 2014.

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(v) ~~Subject to the provisions of this subsection (a) and Section 4.8(b), the Executive Director has sole discretion to determine the timing of payments of earned awards under this Section 4.8.~~

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(b) Notwithstanding subsection 4.8-(a), no Potential ~~Performance Incentive~~-Awards will become earned or payable following a Performance Period in which the Fund experiences a total return of zero or less. ~~If this occurs, in this situation,~~ Potential ~~Performance Incentive~~-Awards ~~for that Performance Period~~ that ~~otherwise would might~~ have become earned on ~~the~~ January 1st ~~next~~ following the end of that Performance Period will not become earned until January 1st following ~~the next a~~ Performance Period in which the ~~Total~~ Fund ~~experiences has~~ a return greater than zero ~~during a Performance Period, subject to the requirement that assuming~~ the employee ~~be employed is employed by~~-TRS on that January 1st. Payment of this award will be processed with the January payroll, typically issued on or about February 1st; provided however that in no event will payment be made later than February 15th.

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~~(c) If an employee ceases to be a Participant before the end of a Performance Period due to no longer being employed in an Eligible Position (but is still employed by TRS), Potential Performance Incentive Awards for that Performance Period will not become earned and will not be paid. Potential Performance Incentive Awards from earlier Performance Periods that have not yet become earned (as set forth in section 4.8 above), can become earned and be paid according to the terms in section 4.8 above, unless such payments are prohibited by applicable law or conflict with the Board's fiduciary duties.~~

(~~c~~) If an employee ceases to be a Participant before the end of a Performance Period due to termination of employment with TRS for any reason other than involuntary termination of employment due to a ~~Reduction in Force~~ ~~reduction in force~~, death, or disability within the meaning of Section 409A of the Internal Revenue Code, ~~a~~ Potential ~~Performance Incentive~~ Awards for that Performance Period will not become earned and will not be paid. Potential ~~Performance Incentive~~-Awards from earlier Performance Periods that have not yet become earned (as set forth in ~~S~~section 4.8(~~b~~) above) will not become earned and will not be paid.

(~~e~~) If an employee ceases to be a Participant before the end of a Performance Period due to involuntary termination of employment with TRS because of a ~~Reduction in Force~~ ~~reduction in force~~, death, or disability within the meaning of Section 409A of the Internal Revenue Code, ~~a~~ Potential ~~Performance Incentive~~ Awards for that Performance Period will not become earned and will not be paid. Notwithstanding subsections 4.8(a) – (b), Potential ~~Performance Incentive~~ Awards from earlier Performance Periods will immediately become earned and payable. Payments under this subsection will be made to the terminated employee, or to the estate of the deceased employee, or to the disabled employee, or as otherwise provided by law. These payments will be made as soon as administratively practicable, but no later than 2-1/2 months after the end of the calendar year in which the ~~Reduction in Force~~ ~~reduction in force~~, death or disability occurred.

(~~e~~) If an employee ceases to be a Participant before the end of a Performance Period due to termination of the Plan (as provided for in Section 5.1), ~~a~~ Potential ~~Performance Incentive~~ Awards for that Performance Period will not become earned and will not be paid. Potential ~~Performance Incentive~~-Awards from earlier Performance Periods that have not yet become earned (as set forth in ~~section~~Section 4.8 above), can become earned and be paid according to the terms in ~~section~~Section 4.8 above, if the Board determines that such payments continue to be ~~consistent with and in furtherance of required to perform~~ the fiduciary duties of the Board in administering the retirement system, and if such payments are not prohibited by applicable law.

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5. PLAN AUTHORITY AND RESPONSIBILITY

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5.1 Plan Modification, Suspension and Termination

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The Board shall have the right in its sole discretion to modify the Plan or any portion thereof at any time. The Board shall have the right in its sole discretion to suspend or terminate the Plan entirely or any portion thereof at any time. For avoidance of doubt and notwithstanding any other provision of this Plan or any modification, amendment, suspension, or reinstatement of this Plan, no modification or action of the Board may be given retroactive effect in the administration of this Plan except as required to comply with applicable law, including federal tax laws and regulations.

5.2 Plan Administration

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Consistent with the provisions of the Plan, the Executive Director has the sole discretion to administer and interpret the Plan. The Executive Director may adopt such procedures and practices as deemed advisable to carry out the Plan.

5.3 Record Keeping and Reporting

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All employee performance, salary and incentive pay records for the Plan shall be maintained by the Director of Human Resources.

5.4 Compliance ~~w~~With State and Federal Law

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If the Executive Director or a court with appropriate jurisdiction determines that any provision portion(s) of the Plan violates applicable state or federal law, that provision portion(s) shall not be given in effect at any time. The remaining provisions portions of the Plan shall remain in full force and effect to the maximum extent possible, and any amendments or modifications that are necessary to give effect to the remaining provisions will be deemed to have been made to allow proper administration of the Plan.

6. AT-WILL EMPLOYMENT

Nothing in the adoption of this Plan or the awarding of performance incentive pay alters the at-will nature of TRS employment ~~that TRS has with its employees~~, creates a contract between TRS and any TRS employee, confers on any TRS employee the right to continued employment with TRS, or affects in any way the right of TRS to terminate the employment of ~~its~~ employees at any time.

7. OTHER PLAN PROVISIONS

7.1 Non-assignment and Non-transferability of Awards

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Except as authorized in applicable law, Potential ~~Performance Incentive~~ Awards or the actual awards under the Plan are non-assignable and non-transferable and are not subject to anticipation, adjustment, alienation, encumbrance, garnishment, attachment or levy of any kind.

7.2 Plan Does Not Create a Property Interest, Trust, or Entitlement

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(a) Neither the establishment of the Plan, the calculation of Potential ~~Performance Incentive~~ Awards or the actual awards shall be deemed to create a property interest, trust or entitlement. The Plan is an unfunded, unsecured liability of TRS to make payments in accordance with the provisions of the Plan. Any amounts budgeted by TRS for ~~Potential Performance Incentive A~~ awards earned under the Plan shall be the TRS assets of the TRS pension fund, and no employee or third party shall have any property, security, or other interest in any assets of TRS by reason of the Plan.

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(b) Nothing ~~contained~~ in the Plan shall be deemed to ~~create or confer give~~ any ~~right~~, interest, or title to any specific property of TRS to any ~~Participant-employee~~, or to any personal representative or beneficiary ~~of a Participant~~.

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7.3 Tax and Other Deductions

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All payments under the Plan shall be subject to any deductions (1) for tax and withholding required by federal, state, or local law at the time of payment and (2) for any and all amounts owed by the employee to TRS at the time of payment. TRS is not obligated to advise an employee of the existence of ~~any the~~ tax or the amounts that TRS will be required to withhold.

7.4 Payments Not Eligible for Retirement Purposes

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~~There is no intention for payments made pursuant to the Plan to be eligible compensation for TRS pension plan purposes, and, as currently written, a~~Any payments made pursuant to the Plan are fringe benefits and ~~are~~ not eligible compensation for TRS pension plan purposes.

7.5 Grievances

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All grievances related to the Plan will be addressed according to the TRS Grievance and Appeals Policy ~~or any successor policy, as amended from time to time~~.

8. DEFINITIONS

Base Salary for use in the Plan is the Participant's annualized monthly salary as of October 1st of the ~~applicable~~ Performance Period (not including longevity or benefit replacement pay), or the annualized monthly salary of new Participants as of the date they first become a Participant, as certified by the Director of Human Resources.

Eligible Position is defined in Section 4.4(f). Eligible Positions refers to the positions ~~themselves~~, not the actual Participants in the positions, and includes all positions assigned to the Investment Division ~~and listed as designated in Section 4.4(f) the Plan~~.

Incentive Award Opportunity is expressed as a percentage of the Maximum Award Opportunity for a Performance Period.

Investment areas are listed in the first column of Addendums A and B.

Maximum Potential Award Award Opportunity is defined in Section 4.4(f) and is the maximum ~~Potential Award Incentive Award Opportunity that can become earned and payable with respect available to an Eligible Position during a Performance Period. Depending on the Eligible Position, the Maximum Award Opportunity ranges from 5% to 125% of the Participant's base salary.~~

Participant is an employee in an Eligible Position on October 1st of the Performance Period, or who first is employed in an Eligible Position after the beginning of the Performance Period based on the schedule detailed in the Plan, as certified by the Director of Human Resources.

Performance Period is the period beginning on October 1st of each year and ending on September 30th of the following year.

Potential Performance Incentive Awards is defined in Section 4.4(f) and is ~~are~~ the amounts calculated based on the Participant's ~~level of~~ performance achieved in the applicable ~~investment performance and Qualitative Performance Component~~ qualitative performance components. A Potential ~~Performance Incentive Awards is are~~ capped at the Maximum ~~Potential Award Award Opportunity~~, regardless of whether ~~the a~~ Participant exceeds the stated maximum ~~P~~ performance. ~~The phrase "award opportunity" is synonymous with Potential Award.~~

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Draft July 17, 2012

Profit centers are listed in the first row of Addendum A, except that Trade Management is also listed as a profit center in the first row of Addendum B only for peer allocation purposes.

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Reduction in Force for use in the Plan refers to termination of an employee due to elimination of the employee's position caused by a required reduction in the number of TRS Full-Time Equivalents (FTEs) or by a required reduction in expenses within the TRS operating budget. The Executive Director has sole discretion in determining whether an employee's termination is due to a Reduction in Force ~~reduction in force~~.

SAA means the Strategic Asset Allocation investment area.

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SPN means a Strategic Partner Network investment area. TRS has both private markets and public markets SPNs.

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TAA means the Tactical Asset Allocation investment area.

Total Fund means the TRS total or overall investment portfolio and includes all pension assets held in trust by TRS and invested by the IMD to provide retirement, death, and disability benefits administered by the system, including cash and cash equivalents. For avoidance of doubt, for the purposes of the Plan the Total Fund does not include the assets of health plans administered by TRS and held in trust by the Board of Trustees.

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Administrative Policy

Reviewer: Executive Director, Chief Investment Officer, Human Resources & Legal Services

Review Cycle: Annually

Authorized by: TRS Board of Trustees

Approved: Brian Guthrie
Executive Director

*This version of the Plan is effective for performance periods beginning on or after October 1, ~~2012-2014~~. Any awards for performance in prior Performance Periods can become earned and payable subject to the terms and conditions stated in the versions of the Plan effective for those Performance Periods.

Current Effective Date:
October 1, 201~~2~~⁴*

First Issued: October 1, 2007

Last Reviewed/Revised:
September ~~15~~, 201~~2~~⁴

Next Review Due:
August, 201~~3~~²

Date: September ~~15~~, 201~~2~~⁴

Date: October ~~13~~, 201~~2~~⁴

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Addendum A

Performance Payout Allocation and Maximum Payout Targets vs. Passive Benchmark
(50% of Potential Award)

Fund Level	Total Fund	Internal Public	External Public	Private Equity	Risk ¹	Stable Value /SAA	Real Assets	TAA	Public and Private SPN and Opportunistic ^{2,4}	Natural Resources ³	Emerging Managers	Total
Index	Total Fund Policy Composite Index	Global Equity Portfolio vs. MSCI ACWI Free (net)	Daily Weighted Excess Return Based on Actual Portfolio Weights	State Street Private Equity Index	Daily Weighted Excess Return Based on Actual Portfolio Weights	Daily Weighted Excess Return Based on Actual Portfolio Weights	NCREIF	Total Profit & Loss for Incentive Period/Total Trust Average Daily Balance	Daily Weighted Excess Return Based on Actual Portfolio Weights	TRS Real Return Benchmark	Daily Weighted Excess Return Based on Actual Portfolio Weights	
Excess Return Target	100 bps	50 bps	100 bps	300 bps	75 bps	35 bps	250 bps	25 bps	200 bps	175 bps	100 bps	
CIO/Deputy CIO	75.00%					5.00%	5.00%		5.00%	5.00%	5.00%	100.00%
Risk	50.00%	5.00%	5.00%	5.00%	20.00%	5.00%	5.00%	5.00%				100.00%
Internal Public Markets	30.00%	60.00%	5.00%	5.00%								100.00%
External Public Markets	30.00%	5.00%	60.00%	5.00%								100.00%
Private Equity	30.00%	5.00%	5.00%	60.00%								100.00%
Stable Value/_SAA	50.00%					50.00%						100.00%
Real Assets	30.00%						60.00%			10.00%		100.00%
Tactical Asset Allocation (TAA)	30.00%							60.00%	10.00%			100.00%
Public and Private SPN/ Opportunistic	30.00%							10.00%	60.00%			100.00%
Natural Resources	30.00%						10.00%			60.00%		100.00%
Emerging Managers	30.00%		10.00%	10.00%			10.00%				40.00%	100.00%
Trade Management Group	30.00%	20.00%	10.00%			20.00%		20.00%				100.00%
Investment Operations	50.00%	10.00%	10.00%	5.00%		10.00%	5.00%	10.00%				100.00%

Notes:

- ¹ Risk group allocation excludes Trust hedging activities
- ² Benchmark for Opportunistic portfolio is Total Fund Benchmark; Benchmark for Public SPN is the SPN Composite Index
- ³ Final benchmark and excess return targets will be presented for Board approval once program is fully established
- ⁴ Daily weightings across Opportunistic portfolio, total Public SPN, total Private Equity SPN and total Real Asset SPN

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Addendum B
Performance Payout Allocation and Maximum Payout Targets vs. Peer Group Comparison
(30% of Potential Award)

Fund Level	Total Fund	Trade Management Group	Private Equity	Real Assets	Total
Index	TUCS Public Funds > \$10 Billion Universe	ITG / Plexus	TUCS Private Equity > \$1 billion Universe	Real Estate vs TUCS Real Estate > \$1 billion Universe	
Excess Return Target	100 bps	8 bps	300 bps	250 bps	
CIO/Deputy CIO	90.00%	0.00%	5.00%	5.00%	100.00%
Risk	90.00%	0.00%	5.00%	5.00%	100.00%
Internal Public Markets	95.00%	0.00%	5.00%	0.00%	100.00%
External Public Markets	95.00%	0.00%	5.00%	0.00%	100.00%
Private Equity	40.00%	0.00%	60.00%	0.00%	100.00%
Stable Value /_SAA	70.00%	30.00%	0.00%	0.00%	100.00%
Real Assets	40.00%	0.00%	0.00%	60.00%	100.00%
Tactical Asset Allocation (TAA)	100.00%	0.00%	0.00%	0.00%	100.00%
Public and Private SPN /_Opportunistic	90.00%	10.00%	0.00%	0.00%	100.00%
Natural Resources	90.00%	0.00%	0.00%	10.00%	100.00%
Emerging Managers	80.00%	0.00%	10.00%	10.00%	100.00%
Trade Management Group	50.00%	50.00%	0.00%	0.00%	100.00%
Investment Operations	50.00%	40.00%	5.00%	5.00%	100.00%

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ADDENDUM C Benchmark Plan for Performance Period Commencing On October 1, 2011

(Note: The benchmarks in Addendum C shall be revised, if necessary, at the beginning of each performance period (October 1) to conform to the benchmarks in the TRS Investment Policy Statement in effect on that date, subject to other action of the Board to modify the Plan.)

Asset Class	Benchmark¹	Bloomberg Ticker	Target
Global Equity:			
US Large-Cap	MSCI USA Standard	GDDUUS	18%
US Small-Cap	MSCI USA Small Cap	GCUDUS	2%
Non-US Developed	MSCI EAFE and Canada	NDDUEC	15%
Emerging Markets	MSCI EM	NDUEEGF	10%
Directional Hedge Funds	HFRI Fund of Funds Composite	HFRIFOF	5%
<i>Total Public Equity</i>	<i>Target weighted Blend</i>		<i>50%</i>
Private Equity	State Street Private Equity Index—lagged one quarter ²		12%
Total Global Equity	Target weighted Blend		62%
Stable Value:			
US Treasuries	Barclays Capital (BarCap) Long Treasury Index	LUTLTRUU	13%
Absolute Return (Including Credit Sensitive Investments)	3-Month LIBOR + 2%	USCOTR03 (plus 2%)	0%
Stable Value Hedge Funds	HFRI Fund of Funds Conservative	HFRIFOFC	4%
Cash	Citigroup 90-day US Treasury	SBMMTB3	1%
Total Stable Value	Target weighted Blend		18%
Real Return:			
Global Inflation Linked Bonds	BarCap US Treasury TIPS index	LBUTTRUU	5% ³
Real Assets	NCREIF ODCE—lagged one quarter ²		15% ³
Commodities	Goldman Sachs Commodity Index	SPGCCIR	0% ³
REITS	MSCI US REIT	RMSG	0% ³
Total Real Return	Target weighted Blend		20%
TOTAL PLAN	Target weighted Blend		100%

¹ The table in Addendum A will reference the MSCI ACWI Free (net) index for the columns titled “External Public Markets” (with respect to those external managers benchmarked to the MSCI ACWI) and “Total Internal Public Markets”.

² Due to the delay in availability of final performance data for Private Equity and Real Assets, performance measurements for these two Investment Areas will experience a one-quarter time lag, such that all incentive calculations involving Private Equity and Real Assets performance will use data for the 12-month period ending each June 30th.

³ On October 1 of each year, the Target for Real Assets for the following twelve months will be reset by the CIO to the averaged funded level of Real Assets for such succeeding twelve months as projected by the Real Assets investment management team (rounded to the nearest whole percentage); provided, the Target for Real Assets may not be more than 15%. Any decrease to the Target for Real Assets below 15% will result in an equivalent amount of increase allocated to the Targets for first, REITS (until REITS is 2%), second, Commodities (until Commodities is 2%) and, third, Global Inflation Linked Bonds.

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Teacher Retirement System of Texas
PERFORMANCE INCENTIVE PAY PLAN

Effective October 1, 2012

This version of the Plan is effective for Performance Periods beginning on or after October 1, 2012. Any awards for performance in prior Performance Periods can become earned and payable subject to the terms and conditions stated in the versions of the Plan effective for those Performance Periods. No modification of the Plan may be given retroactive effect except as required to comply with applicable law, including federal tax laws and regulations.

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1. PERFORMANCE INCENTIVE PLAN PURPOSE AND AUTHORIZATION

To remain competitive in its efforts to attract and retain high caliber Investment Management Division (IMD) employees, the Teacher Retirement System of Texas (TRS) strives to offer a competitive compensation package. Awards of performance incentive pay based on specified performance criteria are an industry standard practice in the private investment sector and are rapidly becoming a standard practice in the public sector. By offering both a competitive base salary and performance incentive award opportunity, TRS enhances its ability to fulfill its mission to “prudently invest and manage the assets held in trust for members and beneficiaries in an actuarially sound system administered in accordance with applicable fiduciary principals.” Therefore, pursuant to the laws governing TRS, the TRS Board of Trustees (the “Board”) has determined that establishing and expending funds for this Performance Incentive Pay Plan (the “Plan”) is consistent with and in furtherance of the fiduciary duties of the Board in administering the retirement system.

2. PLAN OBJECTIVES AND STRATEGY

2.1 *Plan Objectives*

The Plan serves a number of objectives:

- To attract and retain IMD employees who have outstanding ability;
- To create incentives for IMD employees to develop a strong commitment to the long-term investment performance of the assets for which TRS has been delegated investment responsibility; and
- To motivate investment professionals to focus on maximizing real, long-term returns for all funds managed by TRS while assuming appropriate levels of risk.

2.2 *Plan Strategy*

The Plan strategy includes:

- Base salaries, targeted at competitive levels, as defined by the Executive Director and the Board with actual individual base salaries determined by an employee’s experience, education, knowledge, skills and overall job performance.
- Performance incentive pay award opportunities, calculated as a percentage of an employee’s base salary for performance above pre-determined standards, earned contingent upon continued employment in an Eligible Position at specified times and generally payable in two annual installments, subject to deferral as set forth in Section 4.8(b).

3. BASE SALARY ADMINISTRATION

3.1 *Salary Structure*

- (a) Notwithstanding any other law, the Board approves the rates of compensation of all IMD employees. Under state law, the Board’s Bylaws, and as part of the annual TRS budgeting process, the Board authorizes the Executive Director to determine and propose base salary rates of compensation generally based on the salary schedules, position classifications and salary administration practices of Article IX of the General Appropriations Act, Chapter 659 of the Texas Government Code and other relevant legislation to the extent the Executive Director determines a particular provision is in the best interest of the system and not in conflict with applicable law, fiduciary duty, or TRS policy.

- (b) Under the terminology of the state compensation program, “classified” employees are those employees whose position classification titles, pay groups and ranges, and pay administration practices are based on the State Position Classification Plan and related salary administration provisions.
- (c) Upon hiring or promotion, classified employees are assigned to a classification title that is consistent with assigned responsibilities. Initial base salaries for classified employees are set between the minimum and maximum of the assigned pay group, considering the employee’s experience, education, knowledge and skills, and issues of external competitiveness and internal equity.
- (d) “Exempt” employees’ job titles, pay groups and ranges, and pay administration practices are not based on the State Position Classification Plan and related salary administration system. For purposes of the Plan, the Chief Investment Officer and the Investment Fund Directors are considered exempt employees, while the remainder of IMD employees are considered classified for compensation and other purposes. Employees who are exempt from the salary classification schedules do not have base salary ranges. As part of the annual TRS budgeting process, the Board authorizes the Executive Director to determine base salaries for exempt positions up to a not-to-exceed rate specified in the General Provisions of the TRS Budget. Initial base salaries for exempt employees are set by the Executive Director at or below the applicable not-to-exceed rate, considering the employee’s experience, education, knowledge and skills, and issues of external competitiveness and internal equity.

3.2. *Salary Adjustments*

- (a) Classified employees may receive base salary increases for a number of reasons, including but not limited to career ladder promotions, and merit increases for individual performance. Exempt employees may receive base salary adjustments (increase within the not-to-exceed rate or decrease) at the discretion of the Executive Director.
- (b) Notwithstanding subsection 3.2(a), all base salary changes will be executed in accordance with TRS salary administration procedures.

4. INCENTIVE PAY PLAN

4.1. *Purpose of the Plan and Effective Date*

- (a) The purpose of the Plan is to provide the opportunity for IMD employees to receive performance incentive pay based on specific criteria relative to TRS’s investment performance and the employee’s job performance.
- (b) This version of the Plan is effective for Performance Periods beginning on or after the effective date shown on the cover page. A Potential Award for performance in prior Performance Periods can become earned and payable subject to the terms and conditions stated in the version of the Plan effective for those Performance Periods.

4.2. *Performance Period*

For purposes of the Plan, the “Performance Period” begins on October 1st of each year and ends the following September 30th.

4.3. *Participation in the Plan*

- (a) An IMD employee who is in an “Eligible Position” on October 1st of the Performance Period, is eligible to participate in the Plan (a “Participant”) during that Performance Period.

- (b) Notwithstanding Section 4.3(a) above, an IMD employee who first begins employment in an Eligible Position (through new hire, promotion or reassignment) after the beginning of the Performance Period will become a Participant as follows:
 - (i) If an IMD employee begins employment in an Eligible Position with an official hire date or effective date after October 1st but no later than January 1st the employee will become a Participant on January 1st and the Participant's award opportunity will be prorated to 75% of the Potential Award for that Performance Period.
 - (ii) If an IMD employee begins employment in an Eligible Position with an official hire date or effective date after January 1st but no later than April 1st the employee will become a Participant on April 1st and the Participant's award opportunity will be prorated to 50% of the Potential Award for that Performance Period.
 - (iii) If an IMD employee begins employment in an Eligible Position with an official hire date or effective date after April 1st but no later than July 1st the employee will become a Participant on July 1st and the Participant's award opportunity will be prorated to 25% of the Potential Award for that Performance Period.
 - (iv) If an IMD employee begins employment in an Eligible Position with an official hire date or effective date after July 1st of a Performance Period the employee will not become a Participant until the beginning of the next Performance Period (assuming such employee is employed by TRS in an Eligible Position on October 1st of the Performance Period).
 - (v) If a Participant leaves an Eligible Position during a Performance Period and begins TRS employment in a non-Eligible Position, the Participant's Potential Award for the partial Performance Period will be prorated based on the number of completed calendar quarters worked in all Eligible Positions during that Performance Period.
- (c) Generally, all permanent, full time employee positions assigned to the IMD are Eligible Positions under the Plan. Each Eligible Position within the IMD is assigned to an investment area that determines the profit center allocations included in the Participant's Potential Award calculation under Addendums A and B.
- (d) Secondees, contract workers, and other temporary workers are not TRS employees and are not eligible to participate in the Plan.
- (e) An Eligible Position in one Performance Period is not automatically an Eligible Position in any subsequent Performance Period.
- (f) The Director of Human Resources will certify to the Executive Director in writing the name, base salary, hire date, effective date, Eligible Position title, and investment area assignment of each eligible Participant for the applicable Performance Period, including Participants employed in an Eligible Position for only a portion of the Performance Period.
- (g) After the beginning of a Performance Period, if a Participant moves from one Eligible Position to another Eligible Position with a different position title or area assignment, the Participant's Potential Award for that Performance Period and the measurement of the Participant's performance will be prorated between the award calculated for the former Eligible Position title or investment area assignment and the award calculated for the new Eligible Position or investment area assignment as follows:
 - (i) If a Participant moves to a new Eligible Position or investment area assignment after October 1st but no later than January 1st the Participant's Potential Award and the measurement of the Participant's performance will be based on the former Eligible Position or investment area assignment for the period October 1st through December 31st,

and on the new Eligible Position or investment area assignment for the period January 1st through September 30th.

- (ii) If a Participant moves to a new Eligible Position or investment area assignment after January 1st but on or before April 1st the Participant's Potential Award and the measurement of the Participant's performance will be based on the former Eligible Position or investment area assignment for the period October 1st through March 31st, and on the new Eligible Position or investment area assignment for the period April 1st through September 30th.
 - (iii) If a Participant moves to the new position title or area assignment after April 1st but no later than July 1st the Participant's Potential Award and the measurement of the Participant's performance will be based on the former Eligible Position or investment area assignment for the period October 1st through June 30th, and on the new Eligible Position or investment area assignment for the period July 1st through September 30th.
 - (iv) If a Participant moves to a new Eligible Position or investment area assignment after July 1st of a Performance Period the Participant's Potential Award will be based on the former Eligible Position or investment area assignment for the entire Performance Period.
- (h) An employee will cease to be a Participant in the Plan on the earliest to occur of:
- (i) Except as specifically provided in Section 4.3(b)(v) with respect to continued TRS employment, the date the employee is no longer employed in an Eligible Position;
 - (ii) The date of termination of the employee's employment with TRS for any reason. (For purposes of the Plan, the date of termination is the employee's last day worked and does not include any leave the employee was allowed to use to extend their employment for payroll purposes.); or
 - (iii) The date of termination of the Plan.

4.4. *Investment Performance Components, Qualitative Components, and Potential Award*

- (a) Participants' Potential Awards will be based on a combination of investment performance and qualitative performance components.
- (b) The investment performance components comprise two performance categories: 1) performance measured against pre-determined benchmarks and applicable excess return targets, and 2) performance measured against pre-determined peer groups.
 - (i) The benchmark index category of the investment performance component will determine 50% of the total Potential Award.
 - (ii) The peer group category of the investment performance component will determine 30% of the total Potential Award.
- (c) Notwithstanding that the Performance Period is October 1st through September 30th, due to the delay in availability of final performance data for Private Equity and Real Assets, performance measurements for these two investment areas will experience a one quarter time lag, such that all incentive calculations involving Private Equity and Real Assets performance will use data for the twelve month period ending each June 30th.
 - (i) For the first year of this change in measurement period for Private Equity and Real Assets, incentive calculations will use data for the nine month period beginning October 1, 2009 and ending June 30, 2010 for one year performance. Benchmark targets and Participant

performance during the first year of this change will be prorated proportionately to the change in the measurement period.

- (ii) Measurement of three year performance for the Private Equity and Real Assets investment areas during the second year of this change will use data from October 1, 2008 through June 30, 2011.
- (iii) Measurement of three year performance for the Private Equity and Real Assets investment areas during the third year of this change will use data from October 1, 2009 through June 30, 2010.
- (d) Each Eligible Position will be assigned specific weightings for Total Fund and investment area performance as shown in Addendums A and B.
 - (i) To encourage a focus on the “big picture” and a sense of shared mission, the investment performance component (both benchmark and peer group categories) for all Eligible Positions will have a Total Fund weighting of at least 20%. Weightings for investment area performance categories will be divided among the Eligible Position’s primary investment area and other investment areas with which the Eligible Position has regular interaction.
 - (ii) Where no investment area peer group performance measures are available, that investment area peer group performance weighting allocation is added to the Total Fund peer group performance weighting allocation.
- (e) The qualitative performance component will be measured as part of each Participant’s annual performance appraisal process and may include multi-rater feedback regarding a variety of contributions and behaviors needed for organizational success that are not directly measured in the investment performance component, such as interpersonal relationship skills, accountability, effective teamwork, etc.
 - (i) Regardless of a Participant’s performance towards the qualitative performance component, a Potential Award will only include the portion attributed to qualitative performance if the Participant has attained at least the threshold level of performance in the investment performance component.
 - (ii) To encourage appropriate organizational behaviors, the qualitative performance component for all Eligible Positions will be weighted at 20% of the Potential Award.
- (f) A Potential Award is the gross award amount calculated based on the actual performance achieved in the Performance Period. Depending on performance, the Potential Award in a Performance Period varies from zero to 100% of the Maximum Potential Award. The Maximum Potential Award that can become earned and payable under the Plan is limited to the percentage of a Participant’s Base Salary in an Eligible Position that is listed opposite each Eligible Position in the table below. The Maximum Potential Award applies regardless of whether a Participant has exceeded the stated maximum performance targets or the gross amount of the Potential Award calculated under the Plan.

ELIGIBLE POSITION	MAXIMUM POTENTIAL AWARD
Chief Investment Officer	125%
Deputy CIO	125%
Senior Managing Director	125%
Managing Director	125%

Senior Director	110%
Director	110%
Senior Investment Manager	90%
Investment Manager	85%
Senior Associate	65%
Associate	50%
Senior Analyst	35%
Analyst	25%
Administrative Assistants	5%

- (g) Notwithstanding the Maximum Potential Award listed in Section 4.4(f) above, those Participants titled “Senior Investment Manager” who remain in the Eligible Position that was titled “Lead Investment Manager” or “Lead Trader” in the Plan effective October 1, 2007, will continue to have a Maximum Potential Award of 100% of Base Salary. If the Participant transfers to a different Eligible Position with a title other than Senior Investment Manager, the Maximum Potential Award will change to that appropriate for the new Eligible Position and be prorated as set forth in Section 4.3(g).
- (h) For each investment area, the profit center weighting and excess return relative to each assigned excess return target will combine to determine the Potential Award for each Eligible Position.
 - (i) The Potential Award includes a threshold, a maximum, and intermediate levels of Potential Award that correspond to specific levels of investment performance.
 - (ii) Intermediate levels of the Potential Award for investment performance are determined by linearly interpolating between the threshold and maximum.
 - (iii) For the qualitative component, intermediate levels of the Potential Award will be based on a system of annual performance evaluation approved by the Executive Director.

4.5. Compliance with TRS Policies

- (a) IMD employees exercise fiduciary responsibilities delegated by the Board under applicable law. Investment professionals manage the portfolio according to the Board’s policies, advise and inform the Executive Director and the Board about investments, and recommend modifications to the Investment Policy Statement. In addition, all IMD employees are responsible for complying with TRS policies, including without limitation the Investment Policy Statement, Ethics Policy, and the Fraud, Waste and Abuse Policy.
- (b) Excess performance by a Participant or Participants resulting from a failure to manage the assets of TRS in accordance with applicable law, the Investment Policy Statement, or TRS Ethics Policy will result in the forfeiture for that portion of the Potential Award for those Participants resulting from that excess performance for the Performance Period in which the noncompliance occurred. The Executive Director will make this determination on a case-by-case basis.
- (c) Serious violations of the TRS Investment Policy Statement, Ethics Policy, Fraud, Waste and Abuse Policy, or other TRS policy by a Participant, as determined by the Executive Director, will result in forfeiture of all Potential Awards for the Performance Period in which the violation(s) occurred, as well as for earlier Performance Periods that have not yet become earned (including without limitation any Potential Awards that are unearned and deferred as set forth in Section 4.8(b) below). Additionally, during the investigation of possible serious violations of law

or policy, the Executive Director or the Board may suspend earning and payment of Potential Awards until the conclusion of the investigation.

4.6. *Performance Standards and Measurements*

- (a) Investment Performance (for both benchmark and peer group categories) is measured on one year and three year historical performance data, weighted at 33% for one year performance (i.e., performance during the Performance Period) and 67% for the historical three year performance that includes the Performance Period. Investment Performance is measured relative to appropriate pre-defined benchmarks as detailed in the asset allocation and benchmarks table, including applicable footnotes, in the Board's Investment Policy Statement ("IPS"), as amended from time to time. For the purposes of this Plan, changes to the IPS benchmarks during a Performance Period will be effective from and after the effective date of such changes in the IPS, subject to revisions to the Plan adopted by the Board of Trustees. In no event may benchmark changes be applied retroactively except as required to comply with applicable law, including federal tax laws and regulations.
- (b) Notwithstanding Section 4.6(a), the performance of any new profit center will be calculated for purposes of the Plan as follows:
 - (i) The performance of any new profit center will be based 100% on 1 year performance for the first full Performance Period commencing after the profit center is created;
 - (ii) After the first full Performance Period of a new profit center, the performance of that profit center will be based 50% on 1 year performance and 50% on historical 2 year performance that includes the second full Performance Periods commencing after the profit center is created; and
 - (iii) After the second full Performance Period of a new profit center, the performance of that profit center will be based 33% on 1 year performance and 67% on historical 3 year performance by full Performance Periods.
 - (iv) For the purposes of this Plan, no performance will be calculated for a Performance Period for a new profit center created during that Performance Period.
- (b) The qualitative performance component is measured annually as part of the Participant's current annual performance appraisal process.

4.7. *Potential Award Calculations*

- (a) Following the end of each Performance Period, the Executive Director will review the actual performance of each Participant relative to the applicable performance components.
- (b) Potential Awards are calculated based on the Participant's level of performance achieved in the applicable investment performance and qualitative performance components in each Performance Period.
- (c) Relative performance data and calculations may be reviewed by an external independent source selected by the Executive Director, but final calculations are approved by the Executive Director.

4.8. *Earning Potential Awards and Payouts*

- (a) Subject to Section 4.8(b) and notwithstanding the Executive Director's approval of Potential Award calculations, Potential Awards will only become earned and payable as stated below:
 - (i) If the Participant is employed by TRS on December 1st following the end of the Performance Period during which he or she was a Participant, 50% of the Potential Award will become earned. Payment of this award will be processed with that December

or January payroll, and will generally be paid on or before February 1st; provided, however, that in no event will payment be made later than February 15th.

- (ii) If the Participant is employed by TRS on December 1st following the first anniversary of the end of the Performance Period during which he or she was a Participant, the remaining 50% of the Potential Award will become earned. Payment of this award will be processed with that December or January payroll, and will generally be paid on or before February 1st; provided, however, that in no event will payment be made later than February 15th.
 - (iii) For the Performance Periods ending on or before September 30, 2012, if the Participant is employed by TRS on December 1, 2012, 50% of a Potential Award will become earned and will generally be payable between December 1, 2012 and February 1, 2013 provided, however that in no event will payment be made later than February 15, 2013.
 - (iv) For the Performance Periods ending on or before September 30, 2012, if the Participant is employed by TRS on December 1, 2013, the remaining 50% of a Potential Award will become earned and will generally be payable between December 1, 2013 and February 1, 2014; provided, however, that in no event will payment be made later than February 15, 2014.
 - (v) Subject to the provisions of this subsection (a) and Section 4.8(b), the Executive Director has sole discretion to determine the timing of payments of earned awards under this Section 4.8.
- (b) Notwithstanding subsection 4.8(a), no Potential Awards will become earned or payable following a Performance Period in which the Fund experiences a total return of zero or less. If this occurs, Potential Awards for that Performance Period that otherwise would have become earned on the January 1st next following the end of that Performance Period will not become earned until January 1st following the next Performance Period in which the Total Fund has a return greater than zero during a Performance Period, subject to the requirement that the employee be employed TRS on that January 1st. Payment of this award will be processed with the January payroll, typically issued on or about February 1st; provided however that in no event will payment be made later than February 15th.
- (c) If an employee ceases to be a Participant before the end of a Performance Period due to termination of employment with TRS for any reason other than involuntary termination of employment due to a Reduction in Force, death, or disability within the meaning of Section 409A of the Internal Revenue Code, a Potential Award for that Performance Period will not become earned and will not be paid. Potential Awards from earlier Performance Periods that have not yet become earned (as set forth in Section 4.8(b) above) will not become earned and will not be paid.
- (d) If an employee ceases to be a Participant before the end of a Performance Period due to involuntary termination of employment with TRS because of a Reduction in Force, death, or disability within the meaning of Section 409A of the Internal Revenue Code, a Potential Award for that Performance Period will not become earned and will not be paid. Notwithstanding subsections 4.8(a) – (b), Potential Awards from earlier Performance Periods will immediately become earned and payable. Payments under this subsection will be made to the terminated employee, or to the estate of the deceased employee, or to the disabled employee, or as otherwise provided by law. These payments will be made as soon as administratively practicable, but no later than 2½ months after the end of the calendar year in which the Reduction in Force, death or disability occurred.

- (e) If an employee ceases to be a Participant before the end of a Performance Period due to termination of the Plan (as provided for in Section 5.1), a Potential Award for that Performance Period will not become earned and will not be paid. Potential Awards from earlier Performance Periods that have not yet become earned (as set forth in Section 4.8 above), can become earned and be paid according to the terms in Section 4.8 above, if the Board determines that such payments continue to be consistent with and in furtherance of the fiduciary duties of the Board in administering the retirement system, and if such payments are not prohibited by applicable law.

5. PLAN AUTHORITY AND RESPONSIBILITY

5.1 Plan Modification, Suspension and Termination

The Board shall have the right in its sole discretion to modify the Plan or any portion thereof at any time. The Board shall have the right in its sole discretion to suspend or terminate the Plan entirely or any portion thereof at any time. For avoidance of doubt and notwithstanding any other provision of this Plan or any modification, amendment, suspension, or reinstatement of this Plan, no modification or action of the Board may be given retroactive effect in the administration of this Plan except as required to comply with applicable law, including federal tax laws and regulations.

5.2 Plan Administration

Consistent with the provisions of the Plan, the Executive Director has the sole discretion to administer and interpret the Plan. The Executive Director may adopt such procedures and practices as deemed advisable to carry out the Plan.

5.3 Record Keeping and Reporting

All employee performance, salary and incentive pay records for the Plan shall be maintained by the Director of Human Resources.

5.4 Compliance with State and Federal Law

If the Executive Director or a court with appropriate jurisdiction determines that any provision of the Plan violates applicable state or federal law, that provision shall not be given effect. The remaining provisions of the Plan shall remain in full force and effect to the maximum extent possible, and any amendments or modifications that are necessary to give effect to the remaining provisions will be deemed to have been made to allow proper administration of the Plan.

6. AT-WILL EMPLOYMENT

Nothing in the adoption of this Plan or the awarding of performance incentive pay alters the at-will nature of TRS employment, creates a contract between TRS and any TRS employee, confers on any TRS employee the right to continued employment with TRS, or affects in any way the right of TRS to terminate the employment of employees at any time.

7. OTHER PLAN PROVISIONS

7.1 Non-assignment and Non-transferability of Awards

Except as authorized in applicable law, Potential Awards or the actual awards under the Plan are non-assignable and non-transferable and are not subject to anticipation, adjustment, alienation, encumbrance, garnishment, attachment or levy of any kind.

7.2 Plan Does Not Create a Property Interest, Trust, or Entitlement

- (a) Neither the establishment of the Plan, the calculation of Potential Awards or the actual awards shall be deemed to create a property interest, trust or entitlement. The Plan is an unfunded,

unsecured liability of TRS to make payments in accordance with the provisions of the Plan. Any amounts budgeted by TRS for awards earned under the Plan are TRS assets, and no employee or third party shall have any property, security, or other interest in any assets of TRS by reason of the Plan.

- (b) Nothing in the Plan shall be deemed to create or confer any right, interest, or title to any specific property of TRS to any Participant, or to any personal representative or beneficiary of a Participant.

7.3 Tax and Other Deductions

All payments under the Plan shall be subject to any deductions (1) for tax and withholding required by federal, state, or local law at the time of payment and (2) for any and all amounts owed by the employee to TRS at the time of payment. TRS is not obligated to advise an employee of the existence of any tax or the amounts that TRS will be required to withhold.

7.4 Payments Not Eligible for Retirement Purposes

Any payments made pursuant to the Plan are fringe benefits and are not eligible compensation for TRS pension plan purposes.

7.5 Grievances

All grievances related to the Plan will be addressed according to the TRS Grievance and Appeals Policy or any successor policy, as amended from time to time.

8. DEFINITIONS

Base Salary for use in the Plan is the Participant's annualized monthly salary as of October 1st of the applicable Performance Period (not including longevity or benefit replacement pay), or the annualized monthly salary of new Participants as of the date they first become a Participant, as certified by the Director of Human Resources.

Eligible Position is defined in Section 4.4(f). Eligible Position refers to the position, not the actual Participant in the position, and includes all positions assigned to the Investment Division and listed in Section 4.4(f).

Investment areas are listed in the first column of Addendums A and B.

Maximum Potential Award is defined in Section 4.4(f) and is the maximum Potential Award that can become earned and payable with respect to an Eligible Position during a Performance Period.

Participant is an employee in an Eligible Position on October 1st of the Performance Period, or who first is employed in an Eligible Position after the beginning of the Performance Period based on the schedule detailed in the Plan, as certified by the Director of Human Resources.

Performance Period is the period beginning on October 1st of each year and ending on September 30th of the following year.

Potential Award is defined in Section 4.4(f) and is the amount calculated based on the Participant's performance achieved in the applicable investment performance and qualitative performance components. A Potential Award is capped at the Maximum Potential Award, regardless of whether the Participant exceeds the stated maximum performance. The phrase "award opportunity" is synonymous with Potential Award.

Profit centers are listed in the first row of Addendum A, except that Trade Management is also listed as a profit center in the first row of Addendum B only for peer allocation purposes.

Reduction in Force for use in the Plan refers to termination of an employee due to elimination of the employee's position caused by a required reduction in the number of TRS Full-Time Equivalents (FTEs) or by a required reduction in expenses within the TRS operating budget. The Executive Director has sole discretion in determining whether an employee's termination is due to a Reduction in Force.

SAA means the Strategic Asset Allocation investment area.

SPN means a Strategic Partner Network investment area. TRS has both private markets and public markets SPNs.

TAA means the Tactical Asset Allocation investment area.

Total Fund means the TRS total or overall investment portfolio and includes all pension assets held in trust by TRS and invested by the IMD to provide retirement, death, and disability benefits administered by the system, including cash and cash equivalents. For avoidance of doubt, for the purposes of the Plan the Total Fund does not include the assets of health plans administered by TRS and held in trust by the Board of Trustees.

Administrative Policy

Reviewer: Executive Director, Chief Investment Officer, Human Resources & Legal Services

Review Cycle: Annually

Authorized by: TRS Board of Trustees

Approved: Brian Guthrie

Executive Director

*This version of the Plan is effective for performance periods beginning on or after October 1, 2012. Any awards for performance in prior Performance Periods can become earned and payable subject to the terms and conditions stated in the versions of the Plan effective for those Performance Periods.

Current Effective Date:
October 1, 2012*

First Issued: October 1,
2007

Last Reviewed/Revised:
September __, 2012

Next Review Due:
August, 2013

Date: September ____,
2012

Date: October ____, 2012

Addendum A

Performance Payout Allocation and Maximum Payout Targets vs. Passive Benchmark
(50% of Potential Award)

Fund Level	Total Fund	Internal Public	External Public	Private Equity	Risk ¹	Stable Value / SAA	Real Assets	TAA	Public and Private SPN and Opportunistic ^{2,4}	Natural Resources ³	Emerging Managers	Total
Index	Total Fund Policy Composite Index	Global Equity Portfolio vs. MSCI ACWI Free (net)	Daily Weighted Excess Return Based on Actual Portfolio Weights	State Street Private Equity Index	Daily Weighted Excess Return Based on Actual Portfolio Weights	Daily Weighted Excess Return Based on Actual Portfolio Weights	NCREIF	Total Profit & Loss for Incentive Period/Total Trust Average Daily Balance	Daily Weighted Excess Return Based on Actual Portfolio Weights	TRS Real Return Benchmark	Daily Weighted Excess Return Based on Actual Portfolio Weights	
Excess Return Target	100 bps	50 bps	100 bps	300 bps	75 bps	35 bps	250 bps	25 bps	200 bps	175 bps	100 bps	
CIO/Deputy CIO	75.00%					5.00%	5.00%		5.00%	5.00%	5.00%	100.00%
Risk	50.00%	5.00%	5.00%	5.00%	20.00%	5.00%	5.00%	5.00%				100.00%
Internal Public Markets	30.00%	60.00%	5.00%	5.00%								100.00%
External Public Markets	30.00%	5.00%	60.00%	5.00%								100.00%
Private Equity	30.00%	5.00%	5.00%	60.00%								100.00%
Stable Value / SAA	50.00%					50.00%						100.00%
Real Assets	30.00%						60.00%			10.00%		100.00%
Tactical Asset Allocation (TAA)	30.00%							60.00%	10.00%			100.00%
Public and Private SPN / Opportunistic	30.00%							10.00%	60.00%			100.00%
Natural Resources	30.00%						10.00%			60.00%		100.00%
Emerging Managers	30.00%		10.00%	10.00%			10.00%				40.00%	100.00%
Trade Management Group	30.00%	20.00%	10.00%			20.00%		20.00%				100.00%
Investment Operations	50.00%	10.00%	10.00%	5.00%		10.00%	5.00%	10.00%				100.00%

Notes:

- ¹ Risk group allocation excludes Trust hedging activities
- ² Benchmark for Opportunistic portfolio is Total Fund Benchmark; Benchmark for Public SPN is the SPN Composite Index
- ³ Final benchmark and excess return targets will be presented for Board approval once program is fully established
- ⁴ Daily weightings across Opportunistic portfolio, total Public SPN, total Private Equity SPN and total Real Asset SPN

Addendum B
Performance Payout Allocation and Maximum Payout Targets vs. Peer Group Comparison
(30% of Potential Award)

Fund Level	Total Fund	Trade Management Group	Private Equity	Real Assets	Total
Index	TUCS Public Funds > \$10 Billion Universe	ITG / Plexus	TUCS Private Equity > \$1 billion Universe	Real Estate vs TUCS Real Estate > \$1 billion Universe	
Excess Return Target	100 bps	8 bps	300 bps	250 bps	
CIO/Deputy CIO	90.00%	0.00%	5.00%	5.00%	100.00%
Risk	90.00%	0.00%	5.00%	5.00%	100.00%
Internal Public Markets	95.00%	0.00%	5.00%	0.00%	100.00%
External Public Markets	95.00%	0.00%	5.00%	0.00%	100.00%
Private Equity	40.00%	0.00%	60.00%	0.00%	100.00%
Stable Value / SAA	70.00%	30.00%	0.00%	0.00%	100.00%
Real Assets	40.00%	0.00%	0.00%	60.00%	100.00%
Tactical Asset Allocation (TAA)	100.00%	0.00%	0.00%	0.00%	100.00%
Public and Private SPN / Opportunistic	90.00%	10.00%	0.00%	0.00%	100.00%
Natural Resources	90.00%	0.00%	0.00%	10.00%	100.00%
Emerging Managers	80.00%	0.00%	10.00%	10.00%	100.00%
Trade Management Group	50.00%	50.00%	0.00%	0.00%	100.00%
Investment Operations	50.00%	40.00%	5.00%	5.00%	100.00%