

June 4, 2021

Rob Feckner
 Performance, Compensation & Talent Management Committee Chair
 California Public Employees’ Retirement System
 400 Q Street
 Sacramento, California 95811

Dear Rob,

Re: CEO Incentive Plan Measures and Weights for Fiscal Year 2021-22

This memo is in response to your request for Global Governance Advisors (“GGA”), in its role as CalPERS’ Board compensation consultant, to review and propose the CEO incentive plan measures and weights for the upcoming fiscal year.

Overall Framework:

As presented at the April 19th PCTM Committee meeting, GGA noted that the core performance areas and plan weightings have generally worked for CalPERS since the establishment of its new plan for fiscal year 2016-17. GGA also assessed the general competitive balance between Quantitative and Qualitative measures for the CEO position and found that the Quantitative and Qualitative weightings are within GGA’s observed market norms.

As a result, GGA recommends that CalPERS adhere to its historic measures and weightings for the upcoming 2021-22 fiscal year, with consideration of updated performance expectations for the Customer Service and Stakeholder Engagement metrics included within the CEO Incentive Plan.

Proposed Incentive Plan Measures and Weights:

NO CHANGE

GGA proposes that CalPERS adhere to the same Measures and Weightings used in previous years:

Plan Weight	Measure	Assessment Type
25%	Organizational Leadership Priorities	Qualitative Assessment
15%	Total Fund Performance	
20%	Enterprise Operational Effectiveness	Quantitative Assessment
10%	Investment Office CEM	
15%	Customer Service	
15%	Stakeholder Engagement	

Organizational Leadership Priorities (25% Weighting)

CHANGE PROPOSED

Established from Board expectations and insight, the CEO is to provide organizational leadership in support of the following priorities from July 1, 2021 to June 30, 2022:

- Board Support
- Open and Transparent Communication / Building Relationships
- Efficient and Effective Organization
- Supportive and Engaged Leadership
- Customer Satisfaction Driven Organization
- Team Member Engagement
- **(NEW)** Establishment of a new 5-year Strategic Plan (For consideration in Fiscal Year 2021-2022)

Scoring Information: A single rating will be given for the above Organizational Leadership Priorities measure, based on the following table. Payout ratio for intermediate results will be determined by interpolation.

Score	Payout Ratio
Far Exceeds High Expectations	1.50 (150%)
Meets High Expectations	1.0 (100%)
Does Not Meet High Expectations	0 (0%)

Please Note: The introduction of the strategic plan priority is meant to highlight the importance of this task and to ensure that adequate attention is placed on getting a useful plan in place that provides direction and focus for both the Board and Staff members over the next year.

As well, prior to the September PCTM Committee meeting, GGA will work with the committee to establish clear and concise rating definitions/descriptions for each of the priorities outlined above. With this work, it is our intention to provide greater clarity throughout the rating process for trustees who are tasked with providing a fair and accurate assessment as well as for the CEO who will be expected to apply the results and feedback.

Total Fund Performance (15% Weighting)

NO CHANGE

This metric is based on fund performance against the policy benchmark for the five-year period of July 1, 2017, through June 30, 2022. Payout ratio for intermediate results will be determined by interpolation.

Variance from Benchmark (bps)	Payout Ratio
+35	1.50 (150%)
+30	1.41 (141.7%)
+20	1.25 (125%)
+5	1.00 (100%)
0	0.76 (76.3%)
-15	0.05 (5%)
<-15	0.00 (0%)

Please Note: While GGA is satisfied through its discussions with Wilshire Investments LLC (CalPERS' investment consultant) that the current variance from benchmark levels are reasonable for the upcoming fiscal year, GGA recommends that it work collaboratively with Wilshire Investments LLC to perform a detailed review of the appropriateness of the Total Fund and Asset Class benchmark indices and variance from benchmark hurdle rates during Fiscal Year 2021-2022 for potential adjustment for Fiscal Year 2022-2023. This detailed review would include market analysis of the benchmark indices used by other peers, variance from benchmark hurdle rates used by peers as well as an objective historic assessment of the performance variance levels and associated payout ratios over the last 5 to 10 years internally at CalPERS. Given that it has been several years since a detailed review has been performed and that a permanent CIO should be named in the coming months, the purpose of this work is to provide the Board with a greater insight into the reasonableness and market competitiveness of the benchmark indices and performance levels used under the plan to ensure continued confidence in performance expectations moving forward. It will also allow for better alignment with the vision and strategy of the new permanent CIO.

Enterprise Operational Effectiveness (20% Weighting)

NO CHANGE

This metric for 2021-22 is defined as Overhead Operating Costs as a percentage of Total Operating Costs ("OOC").

- Total Overhead Operating Costs ("OOC") identify all administrative costs not mapped directly to Product and Service Delivery Operating Costs ("PSDOC"); excludes Board and Third-Party Administrator Costs
 - $OOC = OOC / (OOC + PSDOC)$

Score	Payout Ratio
< -1.1%	1.50 (150%)
-1.1% to < -0.6%	1.25 (125%)
-0.6% to 0.0%	1.00 (100%)
> 0.0% to 1.0%	0.75 (75%)
> 1.0% to 1.5%	0.50 (50%)
> 1.5%	0.00 (0%)

Investment Office CEM (10% Weighting)

NO CHANGE

This metric for 2021-22 is determined by CalPERS annual participation in the CEM benchmarking survey and shows how CalPERS’ investment costs and return performance compares to a customized peer group over a five-year period.

Score	Payout Ratio
Outperforms US Benchmark on Net Value Added (Returns) and Cost by 0.2% and 5 bps, respectively	1.50 (150%)
Outperforms US Benchmark on Returns and Cost by .001% and 1 bps, respectively	1.00 (100%)
Outperforms US Benchmark on Cost or Outperforms US Benchmark on Returns	0.50 (50%)
Underperforms US Benchmark on Returns and Cost	0.00 (0%)

Customer Service (15% Weighting)

CHANGE PROPOSED

This metric for 2021-22 is based on two Service Dimensions:

- Benefit Payment Timeliness: Percentage of benefit payments issued to our customers within established service levels
- Customer Satisfaction: Customer service with CalPERS services as measured by surveys and other methods

In the interest of improving Customer Service performance throughout the CalPERS System and the maintenance of a fair and defensible structure, GGA recommends the following changes to the 2021-22 Customer Service performance levels and related payout ratios:

Past 2020-21 Metrics

Score	Payout Ratio
≥ 95%	1.50 (150%)
94% to < 95%	1.25 (125%)
92% to < 94%	1.00 (100%)
90% to < 92%	0.75 (75%)
88% to < 90%	0.50 (50%)
< 88%	0.00 (0%)



Proposed 2021-22 Metrics

Score	Payout Ratio
≥ 96%	1.50 (150%)
95% to < 96%	1.25 (125%)
94% to < 95%	1.00 (100%)
93% to < 94%	0.75 (75%)
92% to < 93%	0.50 (50%)
< 92%	0.0 0%)

Additional details on how GGA arrived at the proposed 2021-2022 performance expectations for Customer Service is provided in a separate memo titled, *Annual Incentive Plan Metrics and Additional Considerations* and also dated May 28, 2021.

Stakeholder Engagement (15% Weighting)

CHANGE PROPOSED

This metric for 2021-22 is based on results of the following three Stakeholder Engagement Survey questions:

- Is CalPERS sensitive to the needs of Stakeholders?
- Does CalPERS do a good job of keeping its stakeholders informed?
 - On a scale of one to ten, how would you rate CalPERS being effective in engaging and communicating with stakeholders?

In the interest of improving Stakeholder Engagement performance throughout the CalPERS System and the maintenance of a fair and defensible structure, GGA recommends the following changes to the 2021-22 Stakeholder Engagement performance levels and related payout ratios:

Past 2020-21 Metrics

Score	Payout Ratio
> 83%	1.50 (150%)
> 81% to 83%	1.25 (125%)
> 79% to 81%	1.00 (100%)
> 77% to 79%	0.75 (75%)
> 75% to 77%	0.50 (50%)
≤ 75%	0.00 (0%)



Proposed 2021-22 Metrics

Score	Payout Ratio
≥ 82%	1.50 (150%)
81% to < 82%	1.25 (125%)
80% to < 81%	1.00 (100%)
79% to < 80%	0.75 (75%)
78% to < 79%	0.50 (50%)
< 78%	0.00 (0%)

Potential Alternative Scoring & Payout Ratio for 2021-22

Score	Payout Ratio
≥ 83%	1.50 (150%)
81% to < 83%	1.25 (125%)
80% to < 81%	1.00 (100%)
79% to < 80%	0.75 (75%)
78% to < 79%	0.50 (50%)
< 78%	0.00 (0%)

The “Proposed” Score and Payout Ratio would align impacted staff (including the CEO) closer to Ideal attainment levels (80/60/20 rule) for Threshold, Target and Maximum performance and provide for a more symmetrical payout curve, if selected.

The “Potential Alternative” would only increase the Minimum performance expectation, but keep the Maximum performance expectation the same as currently. While this would lead to a less symmetrical payout curve and be less aligned to Ideal attainment levels, it would continue to signal to stakeholders that high satisfaction levels are always a goal of CalPERS staff.

Additional details on how GGA arrived at the proposed 2021-2022 performance expectations for Stakeholder Engagement is provided in a separate memo titled, *Annual Incentive Plan Metrics and Additional Considerations* and also dated June 4, 2021.

Rob, we trust that this letter addresses your concerns on this matter. If you have any questions on the contents within this letter or our recommended changes, please let us know.

Sincerely,

Global Governance Advisors



Peter Landers
Senior Partner



Brad Kelly
Partner

cc: Karen Van Amerongen, CalPERS

cc: Luis Navas, Global Governance Advisors