Compensation Policy for Executive and Investment Management Positions

Legend for Board Members
RED TEXT: items for consideration & approval
GREEN TEXT: administrative items for information

Contents

General Program Overview

Purpose

The compensation policy has been developed over years of public review, discussion, and debate. It represents the strategic decision that pay must be high enough to encourage highly qualified individuals to accept and remain in positions, but not so high as to attract candidates solely for the compensation. Moreover, compensation systems must be carefully structured to both recognize labor market forces and reinforce maximum performance through placing a substantial portion of total compensation at risk. This pay-at-risk approach places a premium on achieving objectives that are directly connected to the CalPERS Board of Administration's strategic and business plans. As a result, the recruitment and retention of highly skilled executives and investment management professionals serve as the foundation for the organization's overall success.

Program Principles **(TO BE ADDED)**

(**NOTE:** There is no outline of the Compensation Program Principles included up-front. GGA will work with the PCTMC members and the HR team to further refine the purpose and program principles and develop specific language as GGA feels this is something we would require feedback from Board members, HR, and management (where possible) to determine what those principles should be for CalPERS.)

Rationale

The rationale for establishing a compensation policy for executive and investment management positions covered by this policy is based on consideration of the labor market conditions affecting the recruitment and retention of professionals in the fields of institutional investing, actuarial valuation, and pension administration, most of whom are recruited from the private sector. Especially in the case of investment management professionals, the civil service salary structure differs substantially from that of the for-profit sector, the primary recruitment source. Not only are these positions more highly compensated in the for-profit sector than traditional civil service pay scales can accommodate, but total cash compensation in the for-profit sector is tied to pay-for-performance and incentive bonuses in a manner that makes fixed civil service salary ranges and steps impractical for recruiting and compensating such professionals.

Authority

SB 269, enacted in 2003, amended Government Code Section 20098 to provide that the Board of Administration shall fix the compensation of the Chief Executive Officer, Chief Actuary, Chief Investment Officer and other investment officers and portfolio managers whose positions are designated managerial. The Government Code was further amended in 2007 and 2011 to include the General Counsel and Chief Financial Officer, respectively; and again in 2019 to include the Chief Operating Officer and Chief Health Director.

All covered positions, except the exempt Chief Executive Officer, shall be filled through general civil service appointments and are subject to most of the civil service provisions of existing law, including the tenure provisions governing managerial employees. The positions are not eligible to receive Merit Salary Adjustments (MSA) as provided in Government Code Section 19832. This policy describes the program components of base pay, performance (incentive) awards, and other special pay provisions comprising the compensation system for covered positions.

Compensation Administration and Management

The CalPERS Board of Administration (Board) reserves the right to rescind or modify this policy and the compensation schedules derived from them at any time.

Covered Positions

Executive Management Positions:

- Chief Executive Officer
- Chief Actuary
- Chief Financial Officer
- Chief Health Director
- Chief Investment Officer[1]
- Chief Operating Officer
- General Counsel

Investment Management Positions:

- Chief Operating Investment Officer
- Deputy Chief Investment Officer
- Managing Investment Director
- Investment Director
- Investment Manager
- Associate Investment Manager

The covered positions listed above may change based on any future amendments to Government Code Section 20098.

Program Elements

There are three components to the CalPERS Executive Compensation Program:

- Base Pay / Salary

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[1] Considered an Investment Management Position for purposes of determining base pay ranges (see page 6).

- Pay-for-Performance / Incentive Pay
- Special Pay

Base Pay Overview

- Each covered position classification has a discrete salary range (or base pay range)
- Base pay ranges are based on relevant public and private sector market data gathered, at a minimum, every two years, or as the Board deems necessary
- Movement within defined base pay ranges is driven by the annual employee performance appraisal process or other compelling circumstances such as equity or retention

Incentive Award Overview

Incentive awards are intended to further the mission of CalPERS by providing “at-risk” pay for a portion of pay consistent with the CalPERS total compensation philosophy. The intent of this “at-risk” program is to promote an integrated focus on achievement or progress towards organization-wide, long-term strategies.

- Covered positions may be eligible for annual and/or long-term incentive awards; incentive award potential varies by position
- An incentive award is a form of pay-for-performance which is intended to ensure CalPERS is meeting critical organizational objectives
- Annual incentive awards are contingent cash awards reflecting an individual and/or organizational achievement of measurable performance on objectives or measures documented in an Annual Incentive Plan, among other conditions
- Long-term incentive awards balance performance with the long-term goals of the fund, reflecting the fund’s performance, with annual payouts occurring at the end of five-year rolling performance periods if certain conditions are satisfied

Standard Performance Levels and Definitions

Performance will be assessed and scored using the following standard rating scale:

Performance Rating Scale and Definitions
Maximum – <u>Exceptional</u> (Distinguished Performance) Performance far exceeds expectations due to exceptionally high quality of work performed, resulting in superior quality outcomes. Responsible for exceptional or unique contributions which have significant impact on the organization. Completion of objectives far exceed expectations for timeline and/or budget allocation.
Slightly Above Target – <u>Consistently Exceeds Expectations</u> (Superior Performance) Performance consistently exceeds expectations, and the quality of work overall is excellent. Goals are exceeded or met under challenges which were at times out of their control and required sustained extraordinary effort.

Performance Rating Scale and Definitions
Target – Fully Meets Expectations (Fully Successful Performance) Performance consistently meets expectations, at times possibly exceeding expectations, and the quality and timeliness of work overall is very good. Work products achieve desired results, and employee demonstrates responsiveness to priorities. Completion of objectives was always on time and on budget.
Slightly Below Target – Occasionally Meets Expectations (Inconsistent Performance) Performance occasionally meets expectations but is inconsistent, and/or one or more critical goals were not met. Achieved results are at significantly lower than expected levels. Completion of objectives may have sometimes been on time and on budget, but improvement is needed in one or more areas.
Threshold – Does Not Meet Expectations (Unsatisfactory Performance) Performance is consistently below expectations and/or reasonable progress toward critical goals was not made. Responsiveness to changes in priorities is slow; work products are incomplete. Significant improvement is needed in many important areas.

Special Pay Overview

Special pay provisions are designed to address specific or extenuating circumstances:

- Special within-range salary movement may be granted to address retention, internal equity, or extraordinary performance, subject to appropriate approvals
- Additional compensation may be granted in conjunction with interim assignment of additional responsibilities until a position is filled
- A recruitment differential, or one-time payment upon appointment to a position, may be provided to eligible appointees based on an individual's specific circumstances

Tax Section

The provisions of this Policy will be administered and interpreted in a manner intended to comply with sections 409A and 457(f) of the Internal Revenue Code ("Code") and the regulations and guidance issued thereunder. It is intended that payments under this Policy satisfy, to the greatest extent possible, the exemption from the application of Code sections 409A and 457(f), and any state law of similar effect, provided under Treasury Regulation section 1.409A-1(b)(4) and proposed Treasury Regulation section 1.457-12(d)(2), namely as "short-term deferrals."

Base Pay

Base Pay Ranges

Base pay ranges, rather than single rates of pay, will be established for positions covered under Government Code Section 20098(a).

Determination of base pay ranges will be based upon one or more of the following:

- Consideration of internal equity factors
- Relevant marketplace salary survey data gathered every two years, or as determined by the Performance, Compensation and Talent Management Committee (PCTMC)
- A review of relevant data when a position becomes vacant
- Consideration of industry standards and best practices relative to executive and investment compensation

Determining Base Pay Ranges

At the discretion of the PCTMC, the target quartile for covered positions may be determined based on market salary data for the comparator groups below at the time each salary survey is conducted.

Base pay ranges are established by using a blend of private and public-sector data as follows:

Executive Management Positions:

- Leading US public funds, leading Canadian public funds, select California-based agencies (including large local agencies), banks and insurance companies.

Investment Management Positions:

- Large and complex institutional investors, including: US public funds, Canadian public funds, and US corporate plan sponsors.
- Private sector asset management organizations of comparable size (approximately ½ to 2 times CalPERS AUM) that are key competitors for CalPERS team members, including: investment management/advisory firms, university endowment funds, insurance companies and banks.

Current Base Pay Ranges

The following base pay ranges and associated quartiles are effective July 1, 2020, unless otherwise noted: (TO BE UPDATED BASED ON ANY BOARD DECISIONS MADE IN RELATION TO GGA'S COMPENSATION REVIEW AND RECOMMENDATION IN AGENDA ITEM 5B)

Position	Base Pay Range	Max of 1st Quartile	Max of 2nd Quartile	Max of 3rd Quartile	Max of 4th Quartile
Chief Executive Officer	\$377,250 - \$628,750	\$440,125	\$503,000	\$565,875	\$628,750
Chief Actuary	\$206,000 - \$310,000	\$232,000	\$258,000	\$284,000	\$310,000
Chief Financial Officer	\$217,500 - \$362,500	\$253,750	\$290,000	\$326,250	\$362,500
Chief Health Director	\$204,750 - \$341,250	\$238,875	\$273,000	\$307,125	\$341,250

Position	Base Pay Range	Max of 1st Quartile	Max of 2nd Quartile	Max of 3rd Quartile	Max of 4th Quartile
Chief Operating Officer	$187,500 - $312,500	$218,750	$250,000	$281,250	$312,500
General Counsel	$225,000 - $375,000	$262,500	$300,000	$337,500	$375,000
Chief Investment Officer	$424,500 - $707,500	$495,250	$566,000	$636,750	$707,500
Deputy Chief Investment Officer	$339,900 - $566,500	$396,550	$453,200	$509,850	$566,500
Chief Operating Investment Officer	$246,000 - $410,000	$287,000	$328,000	$369,000	$410,000
Managing Investment Director	$309,000 - $515,000	$360,500	$412,000	$463,500	$515,000
Investment Director	$240,750 - $401,250	$280,875	$321,000	$361,125	$401,250
Investment Manager	$183,000 - $305,000	$213,500	$244,000	$274,500	$305,000
Associate Investment Manager	$109,500 - $182,500	$127,750	$146,000	$164,250	$182,500

Salary Surveys

To ensure base pay ranges are appropriate and relatively competitive with the defined market comparator group, a comprehensive salary survey of all comparable executive and investment management positions is conducted at a minimum of every two years, or as the Board deems necessary. Special surveys may also be done to validate the existing range or establish a new recruiting range when a position becomes vacant, or a new position is established. In the intervening years, base pay ranges may be adjusted by an amount reflective of general annual private sector salary movement as substantiated by current market data. The implementation date of any revised or newly established pay range will be determined by the Board at the time the range is approved.

Base Pay Upon Appointment

Individual base pay is determined at the time of hire based on a well-defined and objectively scored competency and situational framework related to factors such as internal equity, value of skills and/or expertise, length of similar experience, and other relevant factors.

For the Chief Executive Officer, base pay is determined by the Board, based on the recommendation of the PCTMC. An individual's base pay upon appointment may not exceed the maximum for the established pay range of the position, and requires the following approvals:

Position	Approver(s)
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)
Deputy Chief Investment Officer Chief Operating Investment Officer Managing Investment Director Investment Director Investment Manager Associate Investment Manager	Chief Executive Officer Chief Investment Officer (by delegation from Chief Executive Officer)

Base Pay Increase and Merit Matrix

Individual base pay increases are considered annually in conjunction with the performance appraisal process. While an annual base pay increase is not guaranteed, an individual may be granted an increase based on the Overall Performance Rating on their annual performance appraisal and as guided by the merit matrix below:

Merit Matrix: (FINAL SCALE WILL BE PROPOSED IN JUNE UPON CONSULTATION WITH CALPERS HR)

Overall Performance Rating	Percentage Increase
Exceptional	6%
Consistently Exceeds Expectations	4.5%
Fully Meets Expectations	3.0%
Occasionally Meets Expectations	1.5%
Does Not Meet Expectations	0%

Annual base pay increases will be based upon the written performance appraisal, unless otherwise recommended by the PCTMC to address existing retention or pay equity considerations. Any appraisal rating above "Fully Meets Expectations" will require a clear justification from the supervisor, in addition to the documentation already required as part of the annual performance appraisal process, and any base pay increase may be withheld if there is a violation of CalPERS' policies and/or unsatisfactory demonstration of CalPERS Leadership Competencies or Core Values.

If the annual increase, as defined by the merit matrix, places the individual's base pay above the maximum for the base pay range, the individual will be placed at the maximum for the range. Under no circumstance can the base pay exceed the range maximum.

Annual Incentive Plan

Elements of Annual Incentive Plan

The basis for payment of the annual incentive award is the Annual Incentive Plan, which will tie annual incentive awards to the following distinct segments of the plan:

- Organizational Performance Outcomes (e.g., Incentive Metrics, investment returns)
- Individual Key Business Objectives (e.g., business goals, leadership)

All participants will have Organizational Performance Outcomes as part of their Annual Incentive Plan. Specific Organizational Performance Outcomes may vary from participant to participant. Participants may or may not have Individual Key Business Objectives.

Organizational Performance Outcomes will be quantifiable metrics that reward for PCTMC pre-approved performance criteria in categories such as the following:

- Operational Effectiveness: Measures organizational efficiency
- Stakeholder Engagement: Measures member and/or employer perceptions
- Customer Satisfaction: Measures member and/or employer and/or employee perspectives on service received
- Investment Returns: Measures total fund and/or asset class and/or portfolio returns

Covered positions responsible for investment compliance oversight or investment financial independent check functions will not have Investment Returns as an Organizational Performance Outcome.

Through CalPERS' best efforts and whenever possible, Individual Key Business Objective performance measurements will be objectively based on specific, measurable, attainable, timebound, ethical, and risk weighted focal points for the participant relative to the Organizational Performance Outcome categories discussed above.

Organizational Performance Outcomes and Individual Key Business Objectives will each be assigned a weight, with total weighting per Annual Incentive Plan not to exceed 100%. Weights, like the applicability of each metric, may vary from participant to participant. Performance will be rated as outlined in *Standard Performance Levels and Definitions* (page 5).

The Discretionary Modifier is an upward or downward adjustment that can be applied to all participants on an individual basis, as detailed in *Discretionary Performance Adjustments* (page 17).

Annual Incentive Plan Cycle

The Annual Incentive Plan cycle consists of the following activities:

- Annual Incentive Plan Development

- Semiannual Performance Reporting
- Performance Evaluation based upon achievement of Annual Incentive Plan measures
- Board approval, which generally occurs in or around September of each year

Development of an Annual Incentive Plan

Prior to the beginning of the fiscal year (or as soon as practical for new hires), each participant develops an Annual Incentive Plan comprised of organizational performance outcomes and individual key business objectives incentive plan measures for approval as follows:

Position	Approver(s)
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)
Deputy Chief Investment Officer Chief Operating Investment Officer Managing Investment Director Investment Director Investment Manager Associate Investment Manager	Chief Executive Officer Chief Investment Officer (by delegation from Chief Executive Officer)

Organizational Performance Outcomes and Individual Key Business Objectives will be measured against approved performance criteria (e.g., benchmarks, enterprise performance targets). To ensure consistency with CalPERS long-term strategies, all measures require the review of appropriate supervisors and the Board's investment consultant as follows:

Position	Supervisor	DCIO	CIO	Investment Consultant[2]	CEO	Board
Chief Executive Officer				✓		✓
Chief Investment Officer				✓	✓	
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer General Counsel					✓	
Deputy Chief Investment Officer			✓	✓	✓	
Chief Operating Investment Officer		✓	✓	✓	✓	
Managing Investment Director		✓	✓	✓	✓	

[2] Investment Consultant review is required for all Investment Return performance outcomes.

Position	Supervisor	DCIO	CIO	Investment Consultant[2]	CEO	Board
Investment Director Investment Manager Associate Investment Manager	✓	✓	✓	✓	✓	

Status Reports and Plan Changes

Each participant must prepare status reports on their Individual Key Business Objectives at mid-year (covering July 1 through December 31) and year-end (covering January 1 through June 30). Performance data on Organizational Performance Outcomes is reported at year-end.

Mid-year status reports require performance check-in meetings with each participant's immediate supervisor, and year-end status reports require a final year-end performance review discussion. The CEO will provide mid-year and year-end reports to the board and participate in related performance discussions.

Under extenuating circumstances, changes to incentive plan measures may be accepted and require the following approvals:

Position	Approver(s)
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)
Deputy Chief Investment Officer Chief Operating Investment Officer Managing Investment Director Investment Director Investment Manager Associate Investment Manager	Chief Executive Officer Chief Investment Officer (by delegation from Chief Executive Officer)

Investment Return performance measure changes also require review by the Board's investment consultant, who serves as an independent check to ensure consistency with established performance objectives, investment policies, and compliance procedures prior to approval and integration into the plan.

Incentive Awards

Annual and Long-Term Incentive Awards

An incentive award is part of an individual's total compensation: a payment opportunity based on achieving specific objectives or measures as defined in an Annual Incentive Plan or Long-Term Incentive Plan, subject to other conditions described herein.

Annual Incentive Award Ranges

The Board, upon recommendation of the PCTMC, sets the incentive award ranges for all covered positions. The incentive award range represents the percentage of base pay available to be earned based on the level of achievement (threshold, target, or maximum) on the Annual Incentive Plan measures. The "target award" for any given annual incentive award range is set to two-thirds of the incentive award range maximum.

Current annual incentive award ranges are displayed in the table below. Annual incentive award ranges will be periodically reviewed by the PCTMC, and any change to established incentive award ranges must be approved by the Board. Maximum annual incentive opportunities may never exceed the ranges outlined below, but ranges may vary by position based on differing roles and responsibilities within the organization, as determined by the CEO and to ensure alignment between peer positions. (TO BE UPDATED UPON DISCUSSION AND BOARD APPROVAL OF GGA'S RECOMMENDED ADJUSTMENTS IN AGENDA ITEM 5B)

Position	Annual Incentive Award Range	Annual Target Award
Chief Executive Officer	0 - 40%	27%
Chief Actuary	0 - 40%	27%
Chief Financial Officer	0 - 40%	27%
Chief Health Director	0 - 40%	27%
Chief Operating Officer	0 - 40%	27%
General Counsel	0 - 40%	27%
Chief Investment Officer	0 - 150%	100%
Deputy Chief Investment Officer	0 – 120%	80%
Chief Operating Investment Officer	0 - 75%	50%
Managing Investment Director	0 - 105%	70%
Investment Director	0 - 75%	50%
Investment Manager	0 – 60%	40%
Associate Investment Manager	0 – 40%	27%

Annual Incentive Award Computation

Annual incentive awards are computed using the following formula:

Performance Measure Weight	**X**	**Level of Achievement (Multiplier)**	**X**	**Target Award**	**=**	**Incentive Award**

Annual Incentive Plan Performance Periods

Quantitative performance measures tied to investment returns will generally be based on five-year, multi-year performance against relevant benchmarks, utilizing an award schedule approved by the Board. The purpose of the schedule is to align the investment award schedules for individuals with the long-term sustainability objectives of the organization.

Quantitative performance measures other than total fund or specified asset class performance (if applicable) will generally be based on annual performance, whether internal performance improvement objectives or relevant benchmarks.

Individual Key Business Objectives will generally be based on annual performance.

The performance measurement periods and the provisions of the instructions for calculation are effective July 1, 2016 and will remain in effect until the issuance of a replacement schedule by the Board.

Annual Incentive Award Calculation (Investment Returns and Metrics)

The annual incentive award for any investment return metric will be calculated based on five-year performance, relative to benchmark, based on the fiscal year a participant began employment in a covered position. The incentive award for all other Organizational Performance Outcomes will be calculated based on annual performance. Below are sample award calculations for Organizational Performance Outcomes.

Sample 5-Year Investment Return Payout Table (payout ratio for intermediate results will be determined by interpolation): (MULTIPLIER AND SAMPLE TO BE UPDATED UPON DISCUSSION AND BOARD APPROVAL OF GGA'S RECOMMENDED ADJUSTMENTS IN AGENGA ITEM 5C)

Variance (bps) from Benchmark	Payout Ratio (Multiplier)
+35	1.50
+30	1.41
+20	1.25
+5	1.00
0	0.76
-15	0.05
< -15	0.00

Sample Incentive Metric Payout Table:

Sample Scores	Performance Level	Payout Ratio (Multiplier)
> 70%	Maximum	1.50
> 65% to 70%	One Up from Goal	1.25

Sample Scores	Performance Level	Payout Ratio (Multiplier)
> 60% to 65%	Goal	1.00
> 55% to 60%	One down from Goal	0.75
> 50% to 55%	Threshold	0.50
≤ 50%	Below Threshold	0.00

Rating Scale for Key Business Objectives Measures on Annual Incentive Plans

The following scale describes an individual's level of achievement on Individual Key Business Objectives and the corresponding multiplier used when computing the annual incentive award:

Rating Scale for Key Business Measures	Rating/Multiplier *(Intermediate points are interpolated)*
Exceptional	1.5
Consistently Exceeds Expectations	1.25
Fully Meets Expectations	1.0
Occasionally Meets Expectations	0.5
Does Not Meet Expectations	0

Definitions for the Performance Ratings above are as outlined in *Standard Performance Levels and Definitions* (page 5).

Long-Term Incentive Award Opportunity

Initial long-term incentive (LTI) award values are based on the lower of: (i) a participant's actual annual incentive attributable to the first year of the five-year performance period, or (ii) a participant's annual incentive range target in the first year of the performance period.

Current long-term incentive award ranges are displayed in the table below. Long-term incentive award ranges will be periodically reviewed by the PCTMC, and any change to established incentive award ranges must be approved by the Board. Maximum long-term incentive opportunities may never exceed the ranges outlined below, but ranges may vary by position based on differing roles and responsibilities within the organization, as determined by the CEO and to ensure alignment between peer positions. The opportunity levels outlined below are based on an incumbent's base salary at the start of the Long-Term Incentive performance period and not the incumbent's base salary at the end of the Long-Term Incentive performance period. (COULD BE FURTHER UPDATED BASED ON BOARD DIRECTION AND APPROVAL OF GGA's RECOMMENDED UPDATES TO INCENTIVE OPPORTUNITY LEVELS AS PART OF AGENDA ITEM 5B)

Position[3]	Long-Term Incentive Award Range	Target Long-Term Incentive Award
Chief Executive Officer	0 - 40%	27%
Chief Investment Officer	0 - 150%	100%
Deputy Chief Investment Officer	0 – 120%	80%
Chief Operating Investment Officer	0 - 75%	50%
Managing Investment Director	0 - 105%	70%
Investment Director	0 - 75%	50%
Investment Manager	0 – 60%	40%
Associate Investment Manager	0 – 40%	27%

Long-Term Incentive Award Performance Measurement

LTI awards are measured on a five-year performance period based on absolute Total Fund returns calculated using the compound annual growth rate ("CAGR") or annual returns throughout the performance period.

Payouts occur at the end of the performance period, with payouts occurring annually for each overlapping performance period thereafter, if certain conditions are satisfied.

Long-Term Incentive Award Determination

Target/goal performance levels for the entire performance period are based on the Board-approved expected rate of return (actuarial assumed rate of return) in the first year of the performance period. These board-approved performance levels must be achieved for payout to occur.

Threshold and target Total Fund return levels are set at the same value, meaning there will be a 0.0 payout multiplier for all returns below target/goal, and a 1.0 multiplier if the target return is achieved. Maximum performance levels are set 120% above the target/goal performance level, unless otherwise determined by the Board.

Payouts at the end of the performance period can range from 0% to 150% of the initial LTI award value based on Total Fund performance and Board-approved performance levels. Payouts for Total Fund performance between target/goal and maximum levels will be linearly interpolated.

[3] Long-Term Incentive eligibility applies to the CEO and investment management positions within the Investment Office.

Sample Long-Term Incentive Payout Table:

Performance Level	5-Year Total Fund Return Level	Payout Ratio (Multiplier)
Maximum	8.4%	1.5
Target/Goal	7.0%	1.0
Below Target/Goal	Less than 7.0%	0.0

Discretionary Performance Adjustments

Discretion can be exercised to adjust an individual's incentive award in the following situations:

- An annual incentive award can be adjusted upward to any percentage (not to exceed the maximum of the individual's associated incentive range) based on extraordinary qualitative individual contributions.
- An annual incentive award can be adjusted downward to any percentage, or eliminated altogether, based on unsatisfactory individual performance, violation of CalPERS' policies, and/or unsatisfactory demonstration of CalPERS Leadership Competencies or Core Values. (For example, in situations of non-adherence to CalPERS' risk management principles, policies, processes, or procedures, an annual and/or long-term incentive award can be reduced by either 50% or eliminated entirely, based on the severity of non-adherence).

These adjustments will be made based on the annual performance evaluation process and will take into account qualitative factors such as performance relative to CalPERS' culture and values; leadership; extraordinary contributions, efforts, or results; development and successful implementation of business or stakeholder imperatives; or strategic workforce activities involving succession planning, retention and flight risk, or talent supply or development.

Discretionary Modifier adjustments will be administered as follows:

Position	Approval Authority
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)
Deputy Chief Investment Officer Chief Operating Investment Officer Managing Investment Director Investment Director Investment Manager	Chief Executive Officer (based upon recommendation of the Chief Investment Officer)

Associate Investment Manager	

Discretion exercised by the Chief Executive Officer must be disclosed to the PCTMC as part of the annual incentive award determination process.

Pro-Rata Awards

Annual and long-term incentive awards may be prorated based on months of service for participants who are appointed on or before December 31 of the fiscal year and meet the continued employment conditions (page 22). The recommendation for a pro-rata incentive award will be based on the nature of the performance measures, the level of progress in their achievement, as well as overall performance.

An individual appointed on or after January 1 of the fiscal year will not be eligible to receive prorated annual and long-term incentive awards for that fiscal year and will not become eligible to receive annual and long-term incentive awards until after completion of the following full fiscal year, providing continued employment conditions are met (page 22).

An individual who vacates a covered position within six months of appointment shall not receive an annual or long-term incentive award for that fiscal year.

REMOVE ~~At the discretion of, and upon the recommendation of the Chief Executive Officer and the PCTMC, the Board may grant a partial year pro-rata annual incentive award to an individual who has served fewer than six months in a covered position, if the award is based entirely on performance measures designed to cover the period of time between the appointment and the end of the fiscal year. An individual who vacates a covered position within six months of appointment shall not receive an annual or long-term incentive award.~~

An individual who is promoted from the CalPERS Investment Officer classification series to a covered position during the fiscal year would be eligible to receive incentive awards based on the incentive plans and annual base salaries of both positions (as pro-rated to reflect the mid-year appointment), subject to the applicable policy provisions and calculation processes outlined in the respective Investment Officer and Executive and Investment Management Positions policies. Partial year awards shall not be granted to an individual who has served fewer than a combined six months in both positions during the fiscal year.

Authority to Defer, Reduce, or Eliminate Incentive Awards[4]

Payment of incentive awards shall be subject to and conditioned upon all of the following (among other conditions described herein):

Qualifying Triggers

If certain events ("Qualifying Trigger") occur during the plan year, then the Board has discretion to pay zero, reduce the amount of the incentive award, or defer all or part of a Participant's incentive award for that plan year. Qualifying Trigger means any one of the following events:

Investment Performance Triggers

At Total Fund Level:

- The Total Fund one-year absolute return, net-of-fees, for a plan year for which the incentive award is calculated is less than zero percent (i.e., -0.01 percent, or worse).
- The one-year underperformance of the relative return of the Total Fund by 100 percent or more. For example: If the level of performance necessary to attain the Maximum incentive opportunity assigned to the Total Fund is 10 basis points above the benchmark, net of fees, then the trigger would occur when the one-year relative investment performance is 10 basis points or more below the benchmark (negative 10 basis points).

At Asset Class Level: (NOTE: THIS PROVISION WILL ONLY APPLY IN THE EVENT CALPERS APPROVES THE INCLUSION OF A WEIGHTING ON ASSET CLASS PERFORMANCE WITHIN THE ANNUAL INCENTIVE PLAN FOR AFFECTED STAFF MEMBERS)

- The Asset Class one-year absolute return, net-of-fees, for a plan year for which the incentive award is calculated is less than zero percent (i.e., -0.01 percent, or worse).
- The one-year underperformance of the relative return of an Asset Class by 100 percent or more. For example: If the level of performance necessary to attain the Maximum incentive opportunity assigned to the Asset Class is 10 basis points above the benchmark, net of fees, then the trigger would occur when the one-year relative investment performance is 10 basis points or more below the benchmark (negative 10 basis points).

Policy Violation Triggers

Policy Violation Triggers include but are not limited to the following:

- Discovery of significant misconduct, unlawful conduct, misrepresentation, or fraud by an employee under this policy.
- Discovery of significant non-compliance with any applicable investment policy by an employee covered under this policy.

[4] The terms "disabled," "disability," "retired," "retires" and "retirement" throughout the policy are used as defined in California Public Employees' Retirement Law sections 20026, 20027 and 20060.

- Significant non-compliance with regulations from the Securities and Exchange Commission, Internal Revenue Service, Fair Political Practices Commission, or other applicable regulators by an employee covered under this policy.

Reputational Risks Triggers

A Reputational Risk Trigger includes an event or action that significantly discredits the reputation of CalPERS in such a way as to cause a significant decline in member trust or satisfaction; the reduction of State's credit rating; or call into question the fiduciary performance of the trustees. Examples of events that could cause reputational risks would be:

- Receiving a qualified opinion on the external audit of the System's Year End Financial Statements.
- Imprudent use of fund assets.

Action Upon Qualifying Trigger Occurrence

For clarity, the occurrence of a Qualifying Trigger does not mean that the Board must defer, eliminate or reduce the Incentive awards in a given year. While the Board maintains incentive payment discretion in the event of a Qualifying Trigger, the application of that discretion will take into account the extent to which the employee's, group of employees' or team's action or performance are considered to have contributed to the occurrence of the Qualifying Trigger.

In the event a Qualifying Trigger occurs and the Board elects to defer payment of an award to a future date (a "Deferred Payment Date"), the deferred incentive award shall remain subject to forfeiture until the Deferred Payment Date and shall be conditioned upon the employee continuing to perform services for CalPERS up to the Deferred Payment Date, as described below. Where the Board elects to defer payment due to the occurrence of one or more Investment Performance Triggers (page 19), payment of the award may be deferred up to 120 days beyond the end of the first subsequent fiscal year. The Board shall not be obligated to treat all employees eligible to an incentive award alike in determining whether to defer, reduce or eliminate an incentive award, how large a portion to defer or reduce, and when to pay the deferred or reduced incentive award. If warranted, the Board will take into consideration the differentiation between individual and organizational performance when making its final determination.

The following provisions will guide the Board's action upon the occurrence of a Qualifying Trigger:

a) An employee will be eligible to receive an incentive award for any period only if the employee has complied with all CalPERS policies applicable to the employee, and regulatory requirements throughout the period, as determined by the Board in good faith. A policy or regulatory violation in a prior period shall be treated as a continuing violation in each subsequent period through the date as of which the Board determines that the violation was adequately remedied. All references to the Board in this subsection and the following subsections also refer to the Board's delegate or CalPERS staffing on behalf of the Board, and all references to "employees" in these subsections refer both to current employees and former employees.

b) If the Board believes a Policy Violation or Reputational Risk Trigger occurred (pages 19-20) and that an employee is not entitled to an incentive award, it will notify the employee in writing by certified mail or personal service on the employee. If the employee disputes that finding, the employee must so notify the Board in writing within 15 days of receiving the Board's notice. If the employee does not timely notify the Board, the employee will be deemed to have admitted the violation. If the employee admits or is deemed to have admitted the violation, the employee will forfeit the incentive award in question. If the employee timely denies the violation, the Board will conduct such further investigations as it deems appropriate ("Investigation"). The Investigation must be completed within 90 days of the date the incentive award would otherwise have been paid but for the violation. Within 60 days after the Investigation has been completed, the Board shall determine whether the violation occurred. Its good faith determination shall be final and binding. The incentive award shall remain subject to forfeiture if and until the Board makes a final determination that it should be paid, and no amount shall be paid pending that determination. If the Board determines that there was no violation, the employee will receive the incentive award plus interest at the annual rate of 6% interest for the period of late payment in excess of 60 days between the date the Board makes its final determination following the Investigation and the date the incentive award would otherwise have been paid. This payment will be made by the earlier of (1) 30 days after the Board's determination following the Investigation, or (2) December 31 following the Board's determination.

c) If an incentive award is paid to an employee but, within three years after the payment, the Board determines that the employee was not entitled to the payment because of a Qualifying Trigger occurrence, it will notify the employee in writing by certified mail or personal service on the employee. If the employee disputes that finding, the employee must so notify the Board in writing within 15 days of receiving the Board's notice. If the employee does not timely notify the Board, the employee will be deemed to have admitted the violation. If the employee timely denies the violation, the Board will investigate. When the Investigation has been completed, the Board shall determine whether the violation occurred. Its good faith determination shall be final and binding. If the Board determines that there was a violation, or if the employee admits the violation or is deemed to have admitted it, the employee must repay the incentive award, plus interest at the annual rate of 6% interest for the period from payment to repayment, within 365 days after the Board's determination following the Investigation.

d) If at any time the Board determines the criteria used to determine an employee's incentive award were, with hindsight, improperly designed or otherwise mistaken, the Board may correct those criteria in any way, even if correction reduces or eliminates the incentive award the employee would otherwise receive.
e) Notwithstanding anything else, an employee shall not be entitled to an incentive award to the extent the Board determines that payment of the incentive award would violate applicable law.

Action Upon Unsatisfactory Performance

Individuals must achieve a minimum Overall Performance Rating (see *Year-End Performance Appraisal Process*, page 25) of "Occasionally Meets Expectations" and not have contributed to any Policy Violation or Reputational Risk Triggers (page 19-20) to be eligible for incentive award payout.

Individuals who receive an Overall Performance Rating of "Does Not Meet Expectations" in their annual performance appraisal will be ineligible to receive any portion of the annual incentive award at any time for the year in which the unacceptable rating was received.

Individuals who receive an Overall Performance Rating of "Does Not Meet Expectations" in their annual performance appraisal will be ineligible to receive any portion of the long-term incentive award for the five-year performance period that ended the year they received the unacceptable rating.

In addition, individuals who receive an unacceptable rating and participate in the long-term incentive program will be subject to an initial long-term incentive award value of zero for the performance period that begins the year the unacceptable rating was received.

Continued Employment Requirement; Board Discretion Under Special Circumstances

Subject to the exceptions described below, an employee shall have no right to an incentive award for a fiscal year if his or her employment with CalPERS terminates for any reason prior to the date on which incentive awards for such year are presented to and/or approved by the Board (generally in September following the performance period), whether or not such employee's individual incentive award is actually presented to or approved by the Board (the "Approval Date"), or, in the case of a deferred incentive award, prior to the Deferred Payment Date. For purposes of this Policy, an employee will be deemed to have terminated employment with CalPERS if he or she has had a separation from service within the meaning of Treasury Regulation section 1.409A-1(h).

Notwithstanding the foregoing, a former employee whose employment terminated on or after January 1 of the fiscal year to which the award relates on account of death, disability, retirement, or involuntary termination without cause, will be eligible to receive prorated annual and long-term incentive awards, in all cases subject to approval of the Board; provided, however, an employee will not be eligible for a prorated award if the employee substantially relinquishes their primary duties prior to January 1 (without regard to whether leave credits are being used and/or exhausted). In addition, where there are compelling circumstances, the Board may approve prorated annual and long-term incentive awards for a former employee whose employment terminated on or before December 31 of a fiscal year on account of death, disability, retirement, or involuntary termination without cause. If the Board does approve any incentive award to (or in the event of death, with respect to) such a former employee, then the term “Approval Date” shall refer to the date on which the Board approves the incentive award(s) to the former employee. In determining a former employee’s prorated award, no credit will be given for any period after the date on which the individual substantially relinquishes their primary duties. For clarity, the Board shall be under no obligation to approve incentive awards for former employees and any such approval shall be within the discretion of the Board.

In all cases, if an employee’s employment terminates voluntarily (other than retirement) or for cause prior to the Approval Date, or if applicable, Deferred Payment Date, the inventive award will be forfeited.

Time of Payment

Incentive Award payments shall be paid as soon as practicable following the Approval Date (or, if applicable, Deferred Payment Date), but in no event later than the 15th day of the third month following the end of the calendar year in which the Approval Date or Deferred Payment Date occurs or, if later, the 15th day of the third month following the end of the CalPERS fiscal year in which the applicable Approval Date or Deferred Payment Date occurs.

Special Pay

Special Within-Range Base Pay Adjustment – Investment Management Positions

The Chief Investment Officer may, at any time during the year, recommend granting a special within-range base pay adjustment of up to 15% of annual base pay to an investment management team member covered by this policy, to address retention or internal equity issues. In extenuating circumstances, the within-range adjustment may exceed 15% of annual base pay. All adjustments (up to and exceeding 15%) must be approved by the Chief Executive Officer by delegation from the Board and will be reported to the PCTMC.

Criteria considered in support of a Special Within-Range Base Pay Adjustment include the following:

- **Performance**: Individual performance that significantly and consistently exceeds expectations
- **Equity**: Demonstrated value of incumbent and/or inequity with relevant peers, both internally and externally
- **Retention**: To retain competent investment professionals at risk of leaving to accept offers from other money managers or employers

Special Within-Range Base Pay Adjustment – Executive Positions

There may be extraordinary circumstances that warrant a covered executive's base pay rate be increased, in conjunction with or outside of the annual performance appraisal process, to address unique retention or pay equity considerations. When a Special Within-Range Base Pay Adjustment is deemed necessary for an executive, the following approvals are required:

Position	Approver
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)

Interim Appointment

Interim appointments to covered positions may be made in instances where it is necessary to temporarily assign a team member the full range of responsibilities in a position until a new permanent appointment is completed. Such assignments shall typically be at least 60 days in duration. Interim incumbents may be eligible for additional pay while performing the interim higher-level duties. Additional pay may be based on factors such as level of duties and the base pay range of the vacant position.

Interim appointments and temporary additional compensation require the following approvals:

Position	Approver
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)

Position	Approver
Deputy Chief Investment Officer Chief Operating Investment Officer Managing Investment Director Investment Director Investment Manager Associate Investment Manager	Chief Executive Officer (based upon recommendation of the Chief Investment Officer)

The Chief Executive Officer will report interim appointments and additional temporary compensation to the PCTMC and the Board.

Recruitment Differential

In order to attract and retain highly skilled executives and investment management professionals, a recruitment differential may be provided when hiring individuals from outside State service and objectively supported through the competency and situational framework. It is a one-time, front-end payment upon appointment and is designated as an incentive to accept a position. The amount of the differential is specific to each eligible individual's personal circumstances. In no case shall a recruitment differential exceed 60% of a new hire's annual base pay. The following approvals are required:

Position	Approver
Chief Executive Officer	Board (upon recommendation of PCTMC)
Chief Actuary Chief Health Director Chief Financial Officer Chief Operating Officer Chief Investment Officer General Counsel	Chief Executive Officer (by delegation from the Board)
Deputy Chief Investment Officer Chief Operating Investment Officer Managing Investment Director Investment Director Investment Manager Associate Investment Manager	Chief Executive Officer (based upon recommendation of the Chief Investment Officer)

The following payback provisions apply to all employees awarded a recruitment differential:

- 100% payback is required if employed less than 12 full months from appointment date
- 50% payback is required if employed between 12 and 24 months from appointment date

Any exception to the repayment schedule requires approval of the Chief Executive Officer and/or other approving authority as listed above.

Year-End Performance Appraisal Process (Incentive Awards and Base Pay Increase)

Performance Appraisal Process Overview

The year-end performance appraisal process is the basis of the payment of the annual incentive award and the individual base pay increase. The performance appraisal document is completed at the end of the plan/fiscal year and covers both individual achievement on the Annual Incentive Plan and general managerial performance as described below.

The Chief Executive Officer, with partial re-delegation to the Chief Investment Officer for the investment management positions, will approve performance appraisal outcomes and base pay increases within the established ranges for covered positions. The PCTMC completes the performance appraisal for the Chief Executive Officer.

Annual Incentive Award Determination Process

As part of the performance appraisal process, each participant must submit a year-end (2nd semiannual) status report to his/her immediate supervisor reflecting the final status of all Annual Incentive Plan measures. This comprehensive report is the basis for the annual incentive award.

For purposes of determining the annual incentive award amount, the following occurs:

- The primary evaluator assigns performance ratings for individual key business objectives and comments, soliciting additional input if appropriate.
- Performance ratings on quantitative investment measures are determined by calculations performed by the Board’s Investment Consultant, based upon investment performance data provided by the bank engaged to provide custodial services to CalPERS, as well as other relevant sources.
- Using calculations received from the Board’s Investment Consultant, Human Resources aggregates the quantitative factor multipliers (ratings), adds in the impact of individual key business objective ratings, and calculates the dollar value of the annual incentive award.
- CalPERS’ external auditor or other select independent advisor will review and assess the accuracy of data and processes used to calculate the results of all Organizational Performance Outcome performance achievement prior to any award being paid.

Final approval of incentive awards is defined as shown in the *Performance Appraisal Approval Process* section of the policy on page 27.

Base Pay Increase and Overall Performance Rating Scale

The general assessment of managerial performance and the Overall Performance Rating is the basis for consideration of a participant's base pay increase. Base Pay Increases are administered separately and apart from the Annual Incentive Plan. At the end of the plan/fiscal year (June 30), all participants prepare a year-end Summary of Accomplishments highlighting their most noteworthy achievements not covered in the incentive plan. The primary evaluator completes the assessment of the individual's general managerial performance and assigns an Overall Performance Rating. Employees that have received promotions within the last 6 months of the fiscal year end will not be eligible to receive Base Pay increases until the completion of the following fiscal year.

The Overall Performance Rating, as indicated in the *Standard Performance Levels and Definitions* (page 5), is the basis for consideration of a base pay increase as defined in the Merit Matrix on page 9.

Performance Appraisal Approval Process

The following depicts the primary evaluator and final approver for all performance appraisal outcomes:

Position	Primary Evaluator	Provides Input	Approver(s)
Chief Executive Officer	PCTMC	Board members not on PCTMC	Board (upon recommendation of PCTMC)
Chief Actuary Chief Financial Officer Chief Health Director Chief Investment Officer Chief Operating Officer General Counsel	Chief Executive Officer	PCTMC and other Board members (optional)	Chief Executive Officer (by delegation from the Board)
Deputy Chief Investment Officer	Chief Investment Officer	Chief Executive Officer	Chief Executive Officer (by delegation from the Board; based on recommendation of Chief Investment Officer)
Chief Operating Investment Officer	Deputy Chief Investment Officer	Chief Investment Officer	Chief Executive Officer (by delegation from the Board; based on recommendation of Chief Investment Officer)
Managing Investment Director	Deputy Chief Investment Officer	Chief Investment Officer	Chief Executive Officer (by delegation from the Board; based on recommendation of Chief Investment Officer)
Investment Director	Managing Investment Director	Chief Investment Officer Chief Operating Investment Officer	Chief Executive Officer (by delegation from the Board;

Position	Primary Evaluator	Provides Input	Approver(s)
			based on recommendation of Chief Investment Officer)
Investment Manager	Investment Director	Managing Investment Director Chief Operating Investment Officer	Chief Executive Officer (by delegation from the Board; based on recommendation of Chief Investment Officer)
Associate Investment Manager	Investment Manager	Managing Investment Director Chief Operating Investment Officer	Chief Executive Officer (by delegation from the Board; based on recommendation of Chief Investment Officer)

Revision History

This policy has been approved as follows:

Effective Date	Approved by	Description of Changes (if needed)
7/1/2019	Board of Administration	• Addition of Chief Health Director and Chief Operating Officer positions • Updated base pay and incentive ranges (effective 7/1/2019) • Other revisions related to policy administration (e.g., base pay merit matrix, tax section, award calculation based on employee's start date in covered position)
7/1/2019	Board of Administration	• Updated base pay range for General Counsel position • Addition of Long-Term Incentive Program
9/18/2019	Board of Administration	• Addition of Deputy Chief Investment Officer position
7/1/2020	Board of Administration	• Updated base pay range for Chief Executive Officer position
TBD	Board of Administration	(TO BE FINALIZED UPON BOARD APPROVAL) • Added a minimum standard for compensation survey assessments • Harmonized performance scales and definitions • Removed references to "qualitative" performance elements • Adjusted sample payout tables to align with the harmonized performance scale • Updated upper range of asset size of private sector peers • Defined trigger violations use to justify deferral, reduction, or elimination of awards. • Refined how prorate awards will be treated • Added details to continuation of employment and subdivided the treatment of voluntary and for cause terminations vs. special situations.