



Agenda Item 5

May 20, 2014

ITEM NAME: Proposed Compensation Policy Revisions

PROGRAM: Administration

ITEM TYPE: Action

RECOMMENDATION

Approve the proposed changes to the Compensation Policies and Procedures for Executive and Investment Management Positions.

EXECUTIVE SUMMARY

The purpose of this agenda item is to present for approval the revised Compensation Policies and Procedures for Executive and Investment Management Positions (Policy) that will modify the existing Rating Scale for Qualitative Performance Measures, which is utilized in the course of the annual appraisal process.

STRATEGIC PLAN

The Executive Compensation Program supports Goal B of the 2012-17 Strategic Plan in cultivating a high-performing, risk-intelligent and innovative organization. The program provides a means for recruiting and retaining highly-skilled executives to the benefit of the CalPERS organization as a whole.

BACKGROUND

Periodic reviews of the Board's Compensation Policies and Procedures are conducted to incorporate improvements and transparency, and to ensure policy provisions remain aligned with CalPERS strategic goals and Board priorities. Staff will soon be engaging in a long-term project, in collaboration with a compensation consultant, to conduct a comprehensive Compensation Program Review of all CalPERS compensation policies and programs to ensure alignment with CalPERS goals and strategies. In the short term, staff has reviewed the following three current policy provisions for potential policy revisions that could be adopted for implementation in the upcoming 2014-15 fiscal year: Base Pay, Special Pay, and the Rating Scale for Qualitative Measures.

Based upon staff's analysis, it has been determined that no policy revision recommendations will be brought to the Committee for the Base Pay or Special Pay provisions at this time. These sections will be better served when analyzed thoroughly as part of the long-term Compensation Program Review project. This will ensure that possible unintended consequences will be taken into account and mitigated prior to recommending policy changes. However, staff is recommending alternatives for the Rating Scale for Qualitative Measures for the Committee's consideration.

ANALYSIS

The current Rating Scale for Qualitative Measures, which has been in place since the inception of the compensation program policy, is used to measure performance of individual qualitative goals. These individual goals are developed to support CalPERS strategic objectives, and are established within the Annual Performance Plan of each covered employee at the beginning of the fiscal year. The performance ratings given at year-end directly impact the performance award received.

Presently, the Rating Scale for Qualitative Measures allows for achievement of target performance (a rating of 1.0) to be obtained for meeting standards. Staff has conducted research in an effort to identify options for revising the rating scale in such a manner as to incentivize and reward staff by defining target performance as the meeting of high expectations, rather than standards.

The compensation programs of five other public pension plans were reviewed: Ohio State Teachers Retirement System (STRS), Texas Teachers Retirement System (TRS), State of Wisconsin Insurance Board (SWIB), Virginia Retirement System (VRS) and California State Teachers Retirement System (CalSTRS). Research revealed that Ohio STRS incents only quantitative measures, and the programs of Texas TRS and SWIB tie qualitative performance to base pay, rather than to a performance award.

The qualitative rating structure most similar to CalPERS was that of the Virginia Retirement System (VRS). VRS uses a similar scale for rating qualitative performance with slight variations, and defines target performance as the meeting of high expectations (see Attachment 1).

Qualitative Rating Scale Alternatives

The following alternatives are presented for the Committee’s consideration:

Alternative 1:

Do nothing at this time and continue using the existing Rating Scale for Qualitative Measures, as shown below. Consider updating the Rating Scale and the rating definitions as part of the upcoming Compensation Program Review.

Target Performance: ⇒

Alternative 1: Current Performance Rating Scale for Qualitative Measures	
Rating	Rating (Multiplier)
Significantly Exceeds Standards	1.5
Exceeds Standards	1.25
Meets Standards	1.0
Meets Some, Not All Standards	.5
Does Not Meet Standards	0

Benefit:

- Making no changes to the Qualitative Rating Scale reduces the potential impacts to the plan for employees in the upcoming plan year.

Risk:

- Making no changes to the Qualitative Rating Scale does not address the concerns regarding target performance (a rating of 1.0) being obtained by meeting standards.
- This model does not allow for flexibility for interpolation between rating categories.

Alternative 2:

Replace the current Rating Scale for Qualitative Performance Measures with a scale modeled after the Virginia Retirement System Qualitative Performance-Award Scale (see Attachment 1), using CalPERS current 0 to 1.5 rating system, as shown below:

Alternative 2: Proposed Performance Rating Scale for Qualitative Measures	
Rating	Rating (Multiplier)
Far Exceeds High Expectations	1.5
⋮	⋮
Meets High Expectations	1.0
⋮	⋮
Does Not Meet Expectations	0
<i>Intermediate points are interpolated</i>	

Target Performance: ⇒

Benefits:

- This simplified rating scale would be comprised of three rating categories: Far Exceeds High Expectations, Meets High Expectations, and Does Not Meet Expectations. Desired performance would be targeted at “Meets High Expectations.”
- This model contains flexibility for interpolated performance ratings to be assigned, which fall between each of the three rating categories.
- There would be no substantial impact to participants with the implementation of this rating scale, as the range of possible ratings would remain 0 to 1.5. These rating categories clarify the terms which define desired performance.

Risks:

- In contrast to the current Rating Scale which allows for employees to achieve target performance by meeting standards, employees would not be able to obtain a target performance rating of 1.0 for achieving most but not all of their performance plan goals under this model.
- There is potential for this to have an adverse impact on staff motivation due to a perceived increase in performance required to attain a target performance rating of 1.0.

Alternative 3:

Revise the terminology used in the existing Rating Scale to reflect desired target performance of “Meets High Expectations” rather than “Meets Standards.” Staff who meet and exceed high expectations would receive a rating of 1.0 or greater; those who meet expectations would receive a rating of .5; and staff who do not meet expectations would receive a rating of 0.

Alternative 3: Proposed Performance Rating Scale for Qualitative Measures	
Rating	Rating (Multiplier)
Far Exceeds High Expectations	1.5
Exceeds High Expectations	1.25
Meets High Expectations	1.0
Meets Expectations	.5
Does Not Meet Expectations	0

Target Performance: ⇒

Benefits:

- This modification to the language within the existing Rating Scale would clarify that the desired target performance is “Meets High Expectations,” and could encourage a higher standard of achievement for staff desiring to obtain a performance rating of 1.0 or higher.
- This model maintains the current structure of 5 rating categories.

Risks:

- Similar to Alternative 2, there is potential for this model to have an adverse impact on staff motivation due to a perceived increase in performance required to attain a target performance rating of 1.0.
- This model does not allow for the flexibility to interpolate between rating categories.

Recommendation

Staff recommends that the Committee approve Alternative 2, which would implement a rating scale modeled after that of the Virginia Retirement System. The terminology in this model is focused on targeting ratings that Meet High Expectations rather than Meet Standards; it utilizes a simplified rating scale; and allows for the interpolation of numeric ratings to be given, in-between each of the three rating categories. Approving this policy revision is in alignment with the purpose of the periodic policy review, in that it streamlines the qualitative rating scale, and better aligns targeted performance with high expectations.

BENEFITS/RISKS

The current policy provision outlining the current Rating Scale for Qualitative Measures allows for achievement of target performance (with rating of 1.0) to be

obtained for meeting standards. The concept of pay-for-performance should reward employees for meeting or exceeding high expectations rather than standards. Not adopting a policy revision for the Rating Scale for Qualitative Measures would result in the continuation of awarding staff for the meeting of standards rather than encouraging and awarding staff for the achievement of meeting or exceeding high expectations.

ATTACHMENT

Virginia Retirement System's Qualitative Performance-Award Scale

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