

**Michael C. Schlachter, CFA**  
**Managing Director & Principal**

June 9, 2014

Mr. Michael Bilbrey  
Chair, Performance Compensation and Talent Management Committee  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: 2014-2015 Incentive Compensation Plans for CEO and Interim CIO

Dear Mr. Bilbrey,

You requested our comments regarding the quantitative portions of the proposed plans for incentive compensation for the CEO and Interim CIO for the 2014-2015 fiscal year.

The quantitative portion of the proposed plan for the CEO is consistent with past practice over the last several years. In addition, the details of the calculation, including composite and benchmark identifiers, bonus factor schedule, and other details have been verified via comparison with the plans for other members of Staff and appear to be correct.

The quantitative portion of the proposed plan for the Interim CIO is also correct in its details. This plan, however, differs from the practice over the last several years of excluding specific asset classes from the CIO's plan. Given that the current CIO is an interim CIO and was promoted from the Real Assets asset class, we agree that an exception should be made in this case and we support the inclusion of this factor.

As there is currently a search underway for a new CIO and that permanent CIO is likely to be in place before fiscal year end 2015, we recommend having this plan return to the committee at the conclusion of the CIO search. If the Interim CIO becomes the permanent CIO, this plan should be changed to reflect past practice and all individual asset class references should be removed. If another individual is selected as CIO, then some blend of this plan and a more typical asset class-heavy SIO plan should replace this plan for Mr. Eliopoulos, with the weights to the old and new plans reflecting the fraction of the year in which he served as Interim CIO.

In the event that you have any questions regarding these recommendations or wish for us to provide more detail or analysis, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read 'Michael Schlachter'.