



CalPERS

Compensation Policies Review For 20098, CEA and IO3 Positions Board Workshop

For November 18, 2014

Workshop Agenda

1. Project Plan and Framework
2. FutureSense Discovery
 - a. Organization Strategy
 - b. People Strategy
 - c. Total Reward Strategy
3. Compensation Concepts



COMPENSATION POLICIES REVIEW: PROJECT PLAN AND FRAMEWORK

High Level Project Plan for Review of: Compensation Policies/Practices for 20098, CEA & IO3 Positions

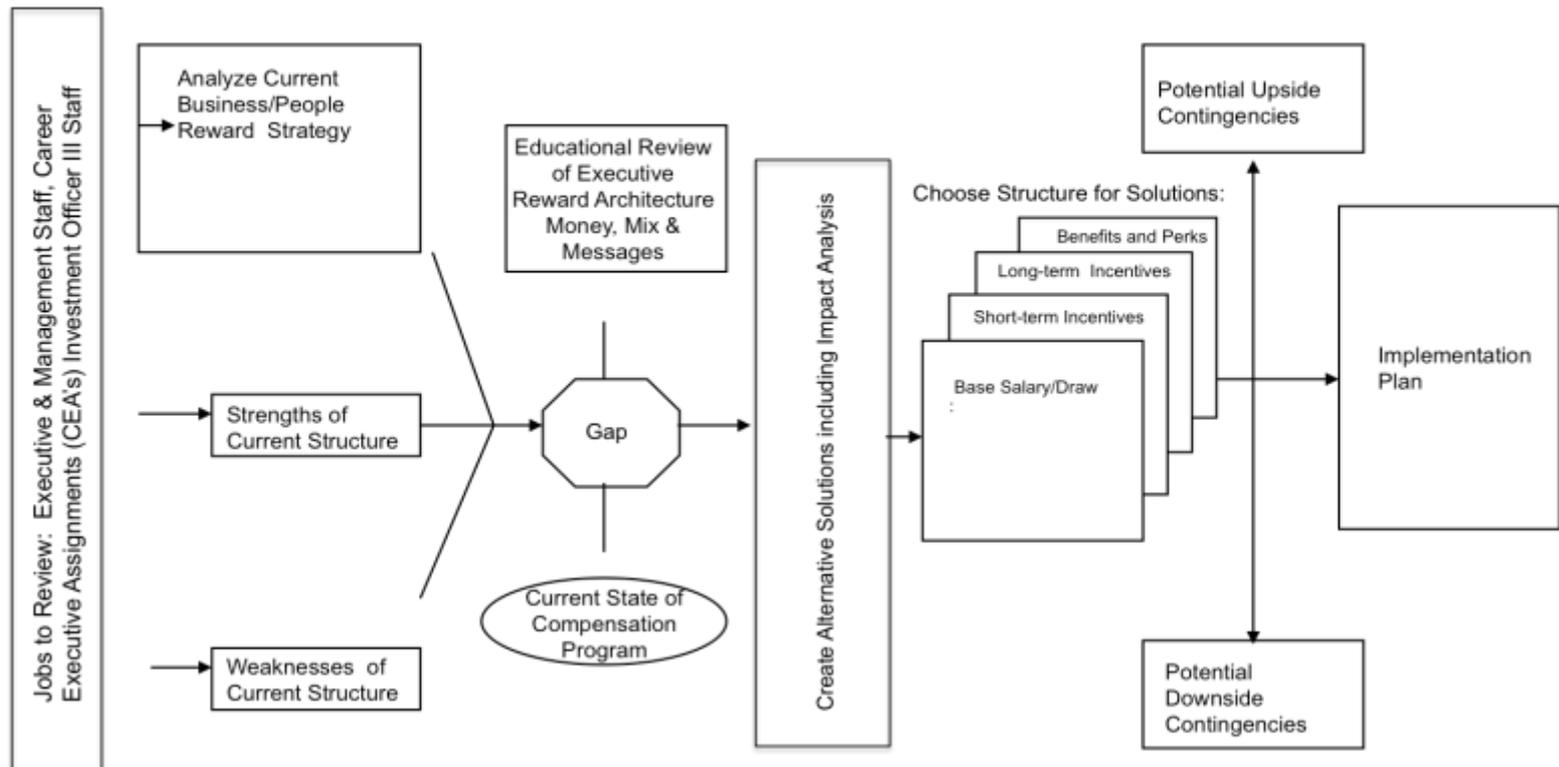
Timeline: May July **Nov 2014** Jan Mar May July 2015

**Phase 1
Program
Review**

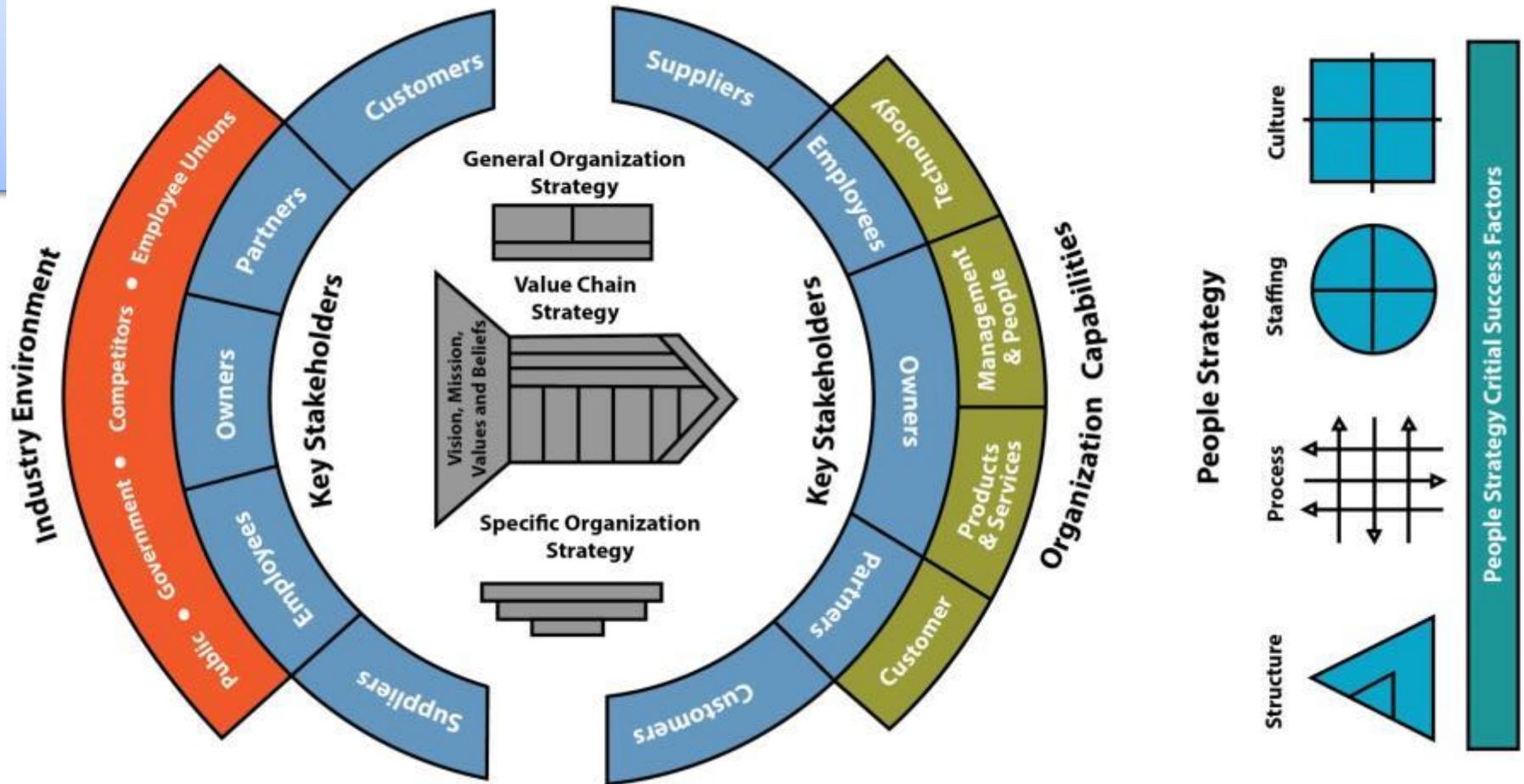
**Phase 2
Educational
Review**

**Phase 3
Recommendations
& Solutions**

**Phase 4
Compensation Plan Final
Design & Implementation**



Before Reward Strategy Comes Organization and People Strategies



Total Reward Program: M1- M4

Market Attachment (money) – M1

- The amount or level of rewards

Mix – M2

- The composition of various elements within the given level

Messages – M3

- The communication of desired behaviors through reward program elements

Management – M4

- Setting, monitoring and changing the appropriate programs



DISCOVERY: ORGANIZATION STRATEGY

Key Organization Drivers

- Challenging and Changing Industry and Local Environment
 - Political
 - Economic and Financial
 - Population
 - Public
 - Geography
- Diverse Stakeholders with Different and Changing Needs
 - Board of Administrators
 - Members & Beneficiaries
 - Executive Leadership
 - Employees
 - State Government
 - Media
 - Legislature
 - Tax Payers

Key Organization Drivers (Cont.)

- Strategic Goals have Implications on People and Reward Strategy
 - Improve long-term pension and health benefit **sustainability**
 - Cultivate a **high-performing, risk-intelligent and innovative** organization
 - Engage in state and national policy development to enhance the long-term **sustainability and effectiveness** of our programs

Key Organizational Capabilities Critical for Success

- Direct investment skills
- Asset allocation and portfolio construction
- Investment risk management and operations
- Selecting and monitoring investment strategies and managers
- Customer service (external and internal)
- Risk management
- Actuarial services
- Information technology
- Transaction processing
- Operational efficiency
- Influencing stakeholders
- People management
- Healthcare
- Finance
- Compliance



DISCOVERY: PEOPLE STRATEGY

Structure

- CalPERS is a mix of a hierarchical organization in some areas and a flatter organization in other areas.
- CalPERS is a complex, multi-responsibility organization, where many diverse skills are required.

Processes

- **Knowledge Management** – High knowledge organization.
- **Decision Making** – A dichotomy between daily (for transactions) and longer-term (to ensure engagement of all key stakeholders).
- **Planning, Allocating and Monitoring** – short-term to long-term horizons.
- **Supervision** – given multiple people strategies (up from within, come contribute and leave, churn and turn, etc.) the type of supervision required is going to need to be situational and therefore difficult to pattern.
- **Communications and Contacts** – Complex and multidimensional with a significant range of stakeholders and issues, alternative communications channels, and timeframes
- **Innovation** – Limited in some areas (where the majority of day to day issues are well known and solutions are available from various internal and external sources) but is required in other areas due to complexity of tasks and challenges.
- **Management of Change** – Perhaps not well understood, but the organization is quite likely going to struggle with the changing needs of its key stakeholders – both internal and external

Staffing

Multiple Paradigms

1. **Up from within** (the “career employer”)
2. **Come, contribute and stay** (the “destination employer”)
3. **Come, contribute and leave** (the “resume value employer”)
4. **Churn and turn** (the “production employer”)

Observations

- Volume of staffing is #1 for core transaction processing functions
- Intellectual capital and engagement functions are a combination of #2 and #3 for career employees from other California agencies
- INVO seems to be a combination of all four
- Many people have stayed a long time, however, there are some employees getting their tickets “punched” (i.e. coming to add great resume value) and then leaving or staying

Culture

- Vision, Mission and Values Drive the CalPERS Culture(s)
 - Vision
 - A trusted leader respected by our members and stakeholders for our integrity, innovation and service
 - Mission
 - Provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries
 - Core Values
 - Quality, respect, accountability, integrity, openness, balance

Culture

- Pension and Investment Beliefs Also Drive the CalPERS Culture(s) – a sample
 - Long time investment horizon
 - Reflecting wider stakeholder views
 - Effective management of capital: financial, physical and human
 - Ensure clear accountability for well articulated investment goals and performance measures
 - Will take risk where there is a belief that CalPERS will be rewarded for it
 - Costs matter and need to be effectively managed
 - Strong processes and teamwork and deep resources are needed
 - Innovative and flexible financial education
 - Plan design should ensure that lifetime benefits reflect service, age and earnings and are adequate for full-career employees
 - Funding policies should be applied in a fair, consistent manner, accommodate return fluctuations and support rate stability
 - Highest ethical standards
 - Retirement system must meet needs of members and employers

Culture (cont.)

- Multiple cultures within CalPERS
 - Mostly functional and process oriented.
 - Also substantial elements of a networking culture within the “engagement” and high knowledge portions of the organization.
 - Perceived skill differences and talent required to do jobs might create a “we and them” culture of exclusivity and might need to be managed.

People Strategy: Critical Success Factors

- CalPERS needs to be a **multifaceted high performing organization across dramatically different organization capabilities** to perform consistent with its future requirements.
 - An analogy would be a consulting organization (high knowledge requirement) attached to a major credit card or bank operation (high transaction requirement)
- CalPERS needs to be **driven by its long-term mission** of providing sustainable retirement and health benefits to plan participants within the complex envelope of contrasting stakeholders interests.
- CalPERS needs to **acquire the talent and develop an organization that can fulfill the long-term mission** while imposing discipline (i.e. efficiency and effectiveness) on its various operations.
- CalPERS needs to define and identify **strategic advantage positions**
 - These are positions which are critical to the overall success of the enterprise.
 - This might be a challenge for CalPERS since the people strategies may not be well understood nor fully integrated with the business strategy.



**DISCOVERY:
TOTAL REWARD PROGRAMS
FOR 20098, CEA AND IO3 POSITIONS**

Discovery:

Total Reward Strategy – M1 (Money)

- Incentives seem to have been initially provided to position total compensation more competitively in the talent markets
 - Original intent of plan may have been to recruit and retain key staff
 - There is a sense that this may have changed over time – now, for some, it seems to be a recruitment tool only; retention occurs for other reasons (other reward and motivation programs)
- CalPERS is a destination employer in certain areas – people seek to get a foot in the door and move around within the organization; this impacts M1 strategy
- Political pressure and civil service environment impacts and/or constrains M1 strategy
- Holistic integrated organization or two (or more) “separate” entities impacts M1 strategy
- Risk averse environment impacts M1 strategy

Total Reward Program Alternatives: Competitive Market Attachment – (M1)

- A **consistent homogeneous market attachment** (i.e. at market)
- A surgical market strategy based upon **position level** (e.g. senior positions above market, middle management at market)
- A surgical market strategy based upon **competitive advantage positions** (i.e. found throughout the organization)

Discovery:

Total Reward Strategy – M2 (Mix)

- Incentive plans are the “norm” in the private investment community; they are also the norm in other industries which may feed talent to CalPERS (e.g., legal, financial, actuarial and health, among others)
- Employees have a perceived level of power and influence working for largest state pension fund. This impacts M2 strategy.
- There is a need for employees that are leaders and think across the enterprise. This impacts M2 strategy
- There is a need for employees across the enterprise that are not just looking for civil service status, but for those that want to give back and are committed to the mission. This impacts M2 strategy.

Total Reward Program Alternatives:

Mix - (M2)

- Surgically mirror the market mix of reward components which would be found in the public sector for some groups and the private sector for other groups.
- Emphasize a team-based, performance oriented, longer-term incentive for all groups and create individual rewards through career paths and development based on individual performance.

Discovery:

Total Reward Strategy – M3 (Messages)

- Mixed opinion from interviews (and from best practice research) on whether incentives motivate behavior
- Pension and job security seem to be important factors in total reward strategy for some; but not for all, e.g. some strategic advantage positions
- Qualitative performance objectives are unclear and very subjective
 - Concern that if there are no incentives or no qualitative component to incentives, there is a fear of a “free-rider” effect
- Is this about me? My performance? Or “our” performance? Current incentives seem to drive “what’s in it for me” behavior?
- Are people driven by “making” their incentive rather than “doing the right thing?” For example, incentives only seem to measure performance but doesn’t measure risk that may be taken on to gain performance (for INVO)
- Are incentives used appropriately, i.e. people make money when the fund does well, don’t “lose” money when it doesn’t?

Total Reward Program Alternatives:

Messages – (M3)

- Focus on the **longer-term** (5 – 10 year+). Short term rolling encourages focus on individual portfolios and unnecessarily creates complexity
- Focus on **organizational performance** (we allocate a pot of money based upon the accomplishment of long-term objectives); what are the key measures of success?
- **No individual goals** (message is we're all in it together); can this be handled in regular performance management system?
- Does the reward program need to be a **meritocracy**? Is the driving goal of the rewards strategy to create career paths and promotion? If so, incentives become less a portion of the reward program; emphasize pay and reward for performance and potential (leading to promotion).
- In a process driven culture, very **limited need for qualitative measures** (very score card driven)
- When skillset is available, should CalPERS be **hiring from within**? When skillset is not available, should CalPERS be **developing from within**?

Discovery:

Total Reward Strategy – M4 (Management)

- Enterprise wants one CalPERS; new reporting relationship of INVO finalized by the Board in September 2014
- Current State
 - Salary/benefits/promotion/performance review – centrally designed
 - Incentive measures/performance plans design – decentralized
- Need to have alignment of the measures of success across the enterprise
- Challenge with quantification of measures of success because the *performance is truly only known long-term* and the *people move around the organization short-term*.
- Incentive calculations are complicated and nontransparent
- Ongoing changes to performance plans during the year create complexity

Total Reward Program Alternatives

Program Management - (M4)

- Fix incentive plan to build trust and transparency
- Dramatically simplify the incentive plan
- If incentives:
 - Provide longer-term component to align with strategic plan intent.
 - Either emphasize total team and/or provide executives/managers more authority and flexibility to reward based on individual and team results and/or episodically, as appropriate.
- If no incentives:
 - Structure appropriate “buy-out” of the incentive opportunity to ensure that the current participants are treated fairly and are retained
 - Set salary levels to ensure that CalPERS can still attract, retain, motivate and develop key employees



COMPENSATION CONCEPTS

Total Rewards: A Mix of Compensation and Climate

Compensation

- Salaries
- Incentives
- Performance Management
- Health and Welfare Benefits
- Retirement Benefits
- Recognition
- Paid Time Off

Climate

- Environment
- Location
- Culture
- Development
 - Competencies
 - Learning Organization
 - Career Experience
 - Career Paths

Compensation and People Strategy

- Multiple people strategies will guide compensation design; can be all of the following, or some of the following:
 - One CalPERS
 - The dominant people strategies would be “*promotion from within*” and “*come for a career of public service*” and “*we are all in this together.*”
 - Superior leadership
 - The dominant people strategy would be “*great leadership trumps all else.*”
 - Strategic advantage positions
 - The dominant people strategy would be “*promotion from within*”; but there would be a “*come, contribute and leave*” for those special (but in some cases temporary) individuals with unique skills.

Compensation Design

- Longer-term focus both in design and in payouts
- Broader, measurable organization goals which are transparent and easy to understand, e.g., investment returns, risk management, customer service and cost effectiveness of the enterprise
- Use of qualitative assessments in incentive plans can either be minimized (eliminated) or leveraged (used multiplicatively)

Compensation Design (Cont.)

- Continue to use incentives for the leadership group and strategic advantage positions.
 - Possibly expand eligibility to include other key managers, or reduce to include only key leaders and identified strategic advantage positions
 - Possibly balance incentive mix (M2) to be similar across the enterprise (comparable “at risk” percentages of total compensation)
- Enhance the performance management system to evaluate organization, group, team and individual performance against goals and competencies
- Recognize that career paths, development and promotion (based on performance) are essential reward strategies.

Next Steps

- Design of Specific Recommendations
- Implementation Issues Overall
- Implementation Issues by Recommendation