



# CalPERS

Compensation Policies Conceptual Recommendations  
For 20098, CEA and IO-III Positions  
Board Workshop

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*January 21, 2015*

# Purpose of Workshop

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- Review of Compensation Policies and Practices for 20098, CEA & IO-III Positions only to ensure that the Board's compensation policies, philosophy and rationale remain appropriate and relevant.
- Present conceptual recommendations for discussion

# Project Plan for Review of Compensation Policies and Practices for 20098, CEA & IO-III Positions

Phase	Timeline	Status
1. Program Review / Analysis of People and Reward Strategy	May 2014 – July 2014	Completed Workshop 7/14/14
2. Educational Review / Findings and Conclusions	July 2014 – November 2014	Completed Workshop 11/18/14
3. Conceptual Recommendations	November 2014 – January 2015	In process Workshop 1/21/15
4. Final Recommendations and Discussion of Options	January 2015 – March 2015	TBD 3/2015
5. Policy drafting and Approval of Board	March 2015 – June 2015	TBD 6/2015
6. Implementation work to be done	Fiscal 2015/2016	TBD
7. New policies implemented	Fiscal 2016/2017	TBD

# Overview: Contextual Framework and Recommendation Summary

## Framework

- One CalPERS = One Plan
- Use of incentives in talent marketplace
- Desire for simplification
- Need for transparency

## Recommendation Summary

- Continued use of an incentive plan for a key group of strategic advantage and key leadership positions at CalPERS
- Continued evaluation of performance on an annual basis (even though some goals may have a longer-term horizon)
- Use of deferred incentive payments to create longer term alignment with mission.
- Ensuring that the plan is based on pre-determined, quantifiable goals, including the use of leadership objectives, as appropriate.

# Overview: Total Reward Program

## M1- M4

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### 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

# M1 – Competitive Position in the Talent Marketplace

## Comments and Recommendations

- Comparator organizations are appropriate.
- Total Direct Pay (“TDP”) (base salary, annual incentives, long-term incentives) better defines the motivational drivers and compensation components in the talent marketplace.
- Job security is not what this candidate pool is worried about

## Current Policy

- **Executive Management Positions.** Data is weighted 50% on the median of large financial services (banking and insurance) private sector and 50% on the 75<sup>th</sup> percentile of large global (U.S. and non-U.S. public sector (greater than \$75 billion in assets)).
- **Investment Management Positions.** Data is a blend of large and complex public institutional investors and private sector asset management organizations of comparable size (\$150B to \$350B AUM). The quartile for comparison is determined each time a salary survey is conducted.
- This comparable data is for the establishment of base salary ranges only.

# M1 – Competitive Position in the Talent Marketplace

## Comments and Recommendations

- The quartile for comparison should be the same across the enterprise for all key leaders and strategic advantage positions.
- Salary, Total Cash and TDP Compensation philosophy should be defined relative to market
  - At market – salary
  - At X% of market – total cash
  - At Y% of market – TDP
- Defined benefit plan and health benefits do not “make up” for long-term incentives (*see McLagan study from 2013*) for positions under review.
  - They are not a driver in the decision to work for CalPERS
- Recommend TDP survey every two years at a minimum.

## Current Policy

- Data may be reviewed every two years or as deemed necessary by the Board.
- Most recent salary surveys by Board directive:
  - Investment Management Positions survey (2013). McLagan Partners
  - Establishment of CFO Position and Salary Range (2011). McLagan Partners
  - Compensation Program Review (2010). High level survey by Mercer for Investment Management positions.
  - Salary survey (2008). Executive and Investment Management positions. Watson Wyatt.

# M2 – Use of Incentives

## Because

- Industries specific to services provided by CalPERS (e.g. investment management, benefits administration, actuarial and health services, customer service, etc. provide incentives, and
- CalPERS does and will continue to recruit from these industries, and
- “One CalPERS” requires knowledge-based, client-driven and operational skills from these industries, and

## Therefore

- We recommend the (continued) use of an incentive plan for a key group of strategic advantage and key leadership positions at CalPERS, and
- We recommend that the plan provide a more open, simplified and transparent framework with ease of administration, that we will contrast from the “current plan” by referring to it as an “open architecture plan.”

# M2 - Eligibility for Incentives

## Comments and Recommendations

- Include all strategic advantage positions and key leadership positions that will ensure success in key business areas

## Current Policy

- Executive Staff
  - CEO
  - CIO
  - DEO
  - CFO
  - Chief Actuary
  - General Counsel
- Senior Management
  - COIO
  - SIO
  - CEAs
- Other Investment Managers
  - SPM
  - PM
- Represented
  - IO-III

# M2 – Incentive Levels

## Comments and Recommendations

- Align incentive opportunities, as % of pay, to be comparable across different levels of organization.
- Use variable pay to attract, retain and motivate all key leaders and strategic advantage positions.
- Drive “pay-for-performance” culture through the incentive plan with increased targets and maximums where appropriate.
- Eliminate some “other pay practices” such as special increases, etc. (only applicable to 20098s)

## Current Policy

Position (Sample)	Target (% salary)	Max (% salary)
CEO	27%	40%
CIO	50%	75%
CFO	27%	40%
SIO	50%	75%
SPM	40%	60%
All CEAs	N/A	15%
All IO-IIIs	10%	15%

# M2 - Recommended Incentive Levels

Incentive Plan Level (“IPL”)	Min-Target-Max Incentive As a % of Salary
IPL 1	0% - 50% - 75%
IPL 2	0% - 40% - 60%
IPL 3	0% - 30% - 45%
IPL 4	0% - 20% - 30%

- Eligibility for each IPL level is TBD through the implementation phase of the project
  - Determine strategic advantage and leadership positions across the enterprise that would have comparable value
- Determine desired total cash position (M1) in the marketplace (salary plus incentive)
  - With these recommended incentive levels, then determine mix of actual salary and targeted incentive payments

# M3 – Incentive Plan Design and Messages

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- One CalPERS, one plan
- Simplify goals and measurements
- Make transparent and understandable
- Evaluate performance on an annual basis (even though some goals may have a longer-term horizon)
  - Add retention/long-term performance plan through the use of deferred compensation payments from annual incentive plan.
- Ensure that the plan is based on pre-determined, quantifiable goals, including the use of leadership objectives, as appropriate.

# M3 – Deferred Compensation

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- Deferral of payment – retention plan and long-term performance plan.
- **Example** of plan design is shown below:
  - X% of earned award (percentage TBD)
  - Credited with the actual return rate for the fund as a whole
  - Vesting 100% after X years
  - Rolling vesting (by X year cycle)
  - Vests immediately if retirement, death, disability, involuntary separation without cause, etc.
  - Unvested amount is “lost” if voluntary separation or involuntary separation with cause.
- Implementation of plan could be transitioned with current incumbents grandfathered without deferral program.

# M3 – Incentive Plan Design and Messages

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- Define clear measures of success. Mix will vary by person
  - Enterprise vs. Division vs. Team vs. Leadership Qualities
  - How deep? Push upwards from individual accomplishment to team based
    - For enterprise (fund, health, risk, policy, strategy, operations, programs, initiatives, etc.)
    - For division (budget management, people management, investment returns, etc.)
    - For team (budget management, people management investment returns, etc.)
    - For leadership qualities/objectives (aligned with Executive Leadership Competencies)
- Goals may be a blend of absolute (specific expected results) versus relative performance (percentiles or results over benchmarks)

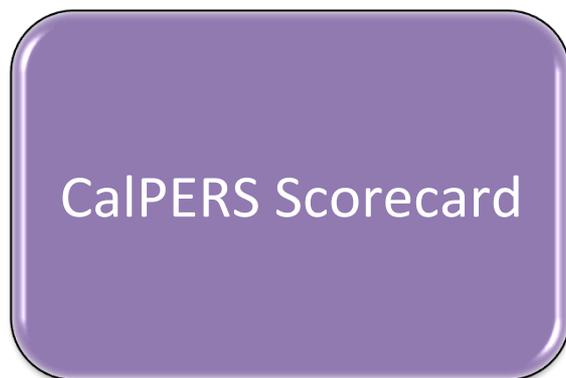
# M4 - Management

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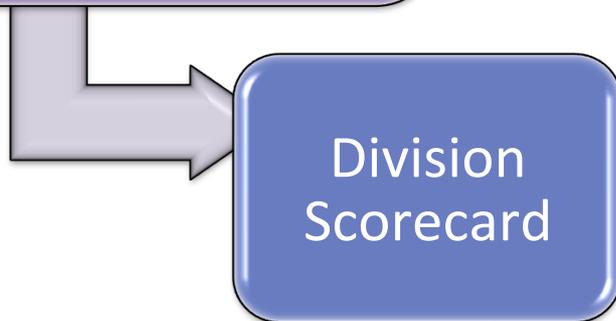
- We are recommending an “open architecture plan” – One CalPERS, One Plan - which consists of the following elements/components:
  - A **Scorecard** system of goals.
  - An **Organizational Unit Weighting** factor.
  - A **Target Incentive**.
  - A **Modification Factor** for actual verses target performance.
  - Simple, clear and effective **Management/Administrative Policies** – who sets the goals, reviews accomplishments, administers exceptions and audits results.

# M4 – Incentive Plan Design and Management

## First Component – Scorecards



- Identify the goals to be accomplished by the entity.
- Determine the range around those goals that communicates success, extreme success, threshold success and failure to achieve.
- Identify the relative importance (weight) of those goals.



- Do the same for each division and then each sector/unit/team.
- Goals can “cascade down” or build up from the bottom or be independent of each other



# M4 – Incentive Plan Design and Management

## First Component – Scorecards

Sample Goals Inventory	Entity	Target	Level of Performance and Modification Factor**					
			0	1	2	3	4	5
Total Fund Performance	Enterprise	"X"%	<80%	80%	90%	100%	110%	120%
Employee Engagement	Enterprise	"Nth" percentile	<95%	95%	98%	100%	102%	105%
Technology Savings	IT Division	\$"X" millions	<90%	90%	95%	100%	105%	110%
Global Fixed Income	INVO/Team	"X" BP above benchmark	<50%	50%	75%	100%	125%	150%
Global Equity Fund	INVO/Team	"X" BP above benchmark	<80%	80%	90%	100%	110%	120%

\*\*Level of Performance and Multiplier Factor  
(which varies by goal)

- 0 – Unacceptable – 0%
- 1 - Well below Target – 50%
- 2 – Below Target - 75%
- 3 – Target – 100%
- 4 – Above Target – 125%
- 5 – Substantially Above Target – 150%

## M4 – Incentive Plan Design and Management

### Second Component – Organizational Weighting Scheme

- The second component is the development of an organizational weighting scheme which communicates the relative balance of organizational performance
- The following is an **example** of an organizational weighting scheme:

Position Category	Enterprise	Division	Team/Unit	Leadership Objectives
A	100%	0%	0%	0%
B	75%	25%	0%	0%
C	50%	25%	0%	25%
D	25%	25%	25%	25%
E	0%	25%	50%	25%

# M4 – Incentive Plan Design and Management

## Third Component – Target Incentive Table

- The third component is the development of appropriate target incentive levels when goals are accomplished:

Incentive Plan Level (“IPL”)	Min-Target-Max Incentive As a % of Salary
IPL 1	0% - 50% - 75%
IPL 2	0% - 40% - 60%
IPL 3	0% - 30% - 45%
IPL 4	0% - 20% - 30%

# M4 – Incentive Plan Design

## Example Calculation of Incentive

- Below is an **example** of the high level concepts inherent in an open-architected, scorecard based plan. Example is for an individual with a \$100,000 salary, in IPL 3 (30% target and 45% maximum bonus) and with a \$30,000 target bonus. Each individual's combined performance factor is calculated (much like a GPA) which determines the target bonus multiplier.
- A portion of the calculated bonus would be deferred (design TBD).

	Organization Weighting And Performance on Scorecards				GPA and Multiplier	Calculated Bonus
	Enterprise	Division	Team	Leadership		
						Target * Multiplier = Earned Bonus
Weight	25%	25%	25%	25%	<b>GPA = 3.25</b>	
Performance	4	2	2	5	<b>Multiplier = 106.25%</b>	<b>\$30,000 * 1.0625% = \$31,875</b>

\*\*Level of Performance and Multiplier Factor  
(which varies by goal)

- 0 – Unacceptable – 0%
- 1 - Well below Target – 50%
- 2 – Below Target - 75%
- 3 – Target – 100%
- 4 – Above Target – 125%
- 5 – Substantially Above Target – 150%

## M4 – Incentive Plan Design and Management

### Fourth Component – Administrative/Management Policies

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- The fourth component is the development of consistent administration/management policies and processes for:
  - Goal setting (tracked in a single data base)
  - Organizational scorecard weighting (determined prior to the beginning of a measurement cycle)
  - Calculation of incentives (calculated in a single data base with electronic forms)

# Organization Impact Analysis

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- Goal setting will improve
- Goals will become more integrated
- The incentive plan will become a tool for alignment
- The plan's credibility with all stakeholders should increase
- The auditability of the plan should also increase

# Next Steps

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- Final Recommendations and Discussion of Options (March 2015)
- Policy drafting and Approval of Board (June 2015)
- Implementation work to be done (Fiscal 2015/2016)
- New policies implemented (Fiscal 2016/2017)