MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

PERFORMANCE, COMPENSATION &

TALENT MANAGEMENT COMMITTEE

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, MARCH 15, 2016

12:31 P.M.

JAMES F. PETERS, CSR
CERTIFIED SHORTHAND REPORTER
LICENSE NUMBER 10063

A P P E A R A N C E S

COMMITTEE MEMBERS:

Mr. Michael Bilbrey, Chairperson

Ms. Priya Mathur, Vice Chairperson

Mr. John Chiang, represented by Mr. Grant Boyken

Mr. Richard Costigan

Mr. Richard Gillihan, represented by Mr. Ralph Cobb

Mr. Ron Lind

Ms. Theresa Taylor

BOARD MEMBERS:

Mr. Rob Feckner, President

Mr. Henry Jones, Vice President

Ms. Dana Hollinger

Ms. Betty Yee, represented by Ms. Lynn Paquin

STAFF:

Ms. Anne Stausboll, Chief Executive Officer

Mr. Doug Hoffner, Deputy Executive Officer

Mr. Matthew Jacobs, General Counsel

Ms. Tina Campbell, Chief, Human Resources Division

Ms. Carol Takehara, Committee Secretary

ALSO PRESENT:

Mr. Bill Gentry, Grant Thornton, LLP

Mr. Eric Gonzaga, Grant Thornton, LLP

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P R O C E E D I N G S

CHAIRPERSON BILBREY: Call this meeting of the Performance, Compensation & Talent Management Committee meeting to order.

First order, call the roll please.

COMMITTEE SECRETARY TAKEHARA: Michael Bilbrey?

CHAIRPERSON BILBREY: Here.

COMMITTEE SECRETARY TAKEHARA: Grant Boyken for John Chiang?

ACTING COMMITTEE MEMBER BOYKEN: Here.

COMMITTEE SECRETARY TAKEHARA: Richard Costigan?

COMMITTEE MEMBER COSTIGAN: Here.

COMMITTEE SECRETARY TAKEHARA: Ralph Cobb for Richard Gillihan?

ACTING COMMITTEE MEMBER COBB: Here.

COMMITTEE SECRETARY TAKEHARA: Ron Lind?

COMMITTEE MEMBER LIND: Here.

COMMITTEE SECRETARY TAKEHARA: Priya Mathur?

VICE CHAIRPERSON MATHUR: Here.

COMMITTEE SECRETARY TAKEHARA: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

COMMITTEE SECRETARY TAKEHARA: Thank you.

CHAIRPERSON BILBREY: Thank you.

Next item is election of Performance, Compensation & Talent Management Chair and Vice Chair.

For that I turn the gavel over to the Vice Chair, Ms. Mathur.

VICE CHAIRPERSON MATHUR: Thank you.

I will now entertain nominations for the position of Chair of the Performance, Compensation & Talent Management Committee.

And I'll call on Mr. Lind.

COMMITTEE MEMBER LIND: Thank you.

I'd like to nominate Michael Bilbrey for committee chair.

VICE CHAIRPERSON MATHUR: A nomination's been put in for Michael Bilbrey to be chair of the Performance, Compensation & Talent Management Committee.

Are there any further nominations?

Any further nominations?

Any further nominations?

Seeing none.

I'll entertain a motion to elect Michael Bilbrey as chair by acclamation.

ACTING COMMITTEE MEMBER BOYKEN: So moved.

ACTING COMMITTEE MEMBER COBB: Second.

VICE CHAIRPERSON MATHUR: Moved by Boyken, seconded by Cobb.

Any discussion on the motion?

Seeing none.

All those in favor say aye.

(Ayes.)

VICE CHAIRPERSON MATHUR: Motion passes.

Congratulations.

(Applause.)

CHAIRPERSON BILBREY: Thank you.

So now open up the floor for nominations for Vice Chair.

For that I'll call on Ms. Taylor.

COMMITTEE MEMBER TAYLOR: I'd like to make a nomination for Priya Mathur for vice chair of the Performance, Compensation & Talent Management Committee.

CHAIRPERSON BILBREY: Thank you.

There's been a nomination for Priya Mathur for vice chair.

Any other nominations?

Any other nominations?

Any other nominations?

Seeing none.

I'd like to entertain a motion to vote -- an acclamation to affirm Priya Mathur as vice chair.

COMMITTEE MEMBER COSTIGAN: I'll move.

CHAIRPERSON BILBREY: Moved by Costigan.

COMMITTEE MEMBER TAYLOR: Second.

CHAIRPERSON BILBREY: Seconded by Taylor.

Any discussion on the motion?

Seeing none.

All those in favor say aye.

(Ayes.)

CHAIRPERSON BILBREY: Opposed?

Motion carries.

Congratulations, Madam Vice Chair.

(Applause.)

CHAIRPERSON BILBREY: So now Executive Report.

Mr. Hoffner.

DEPUTY EXECUTIVE OFFICER HOFFNER: Good afternoon, Mr. Chair and members of the Committee.

First, congratulations both to you and Priya for your election to the chair and vice chair of the Performance, Compensation & Talent Management Committee.

Today we've just got a few items; and I'm looking forward to walking through with Tina Campbell and myself.

We've got an item related to a slight modification to the delegations of the Committee we'd like to discuss with you.

And we have our first opportunity to have an information item with the Board's incentive compensation consultants today. So it's going to be our first opportunity since the January off-site to hear some of their feedback and input based upon interviews with you-all, since January, and that discussion.

And then we'll move into a closed session to discuss the mid-year reports of both the CEO and CIO.

With that, Mr. Chair, that concludes my executive report. Happy to answer any questions.

CHAIRPERSON BILBREY: No question.

So next the item, consent items.

Action consent.

Approval of the minutes from December.

Do I have a motion?

COMMITTEE MEMBER TAYLOR: I'll make a motion.

CHAIRPERSON BILBREY: Motion by Taylor.

VICE CHAIRPERSON MATHUR: Second.

CHAIRPERSON BILBREY: Seconded by Mathur.

Any discussion on the motion?

Seeing none.

All those in favor say aye.

(Ayes.)

CHAIRPERSON BILBREY: Opposed?

The motion carries.

Next item, consent item.

Information items. I've had no requests to remove any items off of the consent items.

So we'll move to Item 7, Compensation Review Project Update.

Begin with Ms. Campbell.

DEPUTY EXECUTIVE OFFICER HOFFNER: Review of the delegation of the Committee.

CHAIRPERSON BILBREY: Oh, sorry. I was jumping ahead.

So Item 6, Review of the Performance, Compensation & Talent Management Committee delegation.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Also, congratulations --

CHAIRPERSON BILBREY: Thank you.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: -- to both of your for your appointments.

Tina Campbell, CalPERS staff. Agenda Item 6 is an action item.

Staff has reviewed the delegation resolution for the Performance, Compensation & Talent Management Committee and recommends revisions to provide clarification around activities conducted by the Committee. Page two of the delegation resolution, Item 5, has been modified to be specific to the setting of the annual performance plan goals of the CEO and CIO.

Approval of performance plans for all other covered positions is delegated to the CEO.

Item 6 is modified to better align with Item 3, which speaks to the Committee's share responsibility with the CEO to hire, evaluate, and terminate the CIO.

And the edits in Item 7 and 8 clarify that the Committee approves base salary ranges and incentive ranges as well as oversees the compensation paid to all covered positions.

Any additional revisions of the delegation resolution that the Committee wishes to make will be incorporated and brought back to the Board for consideration and approval in April.

This concludes my report. I'm happy to answer any question you may have.

CHAIRPERSON BILBREY: Thank you.

Seeing no questions.

This is an action item.

VICE CHAIRPERSON MATHUR: I'll move it.

COMMITTEE MEMBER COSTIGAN: Second.

CHAIRPERSON BILBREY: Moved by Mathur, seconded by Costigan.

Any discussion on the motion?

Seeing none.

All those in favor say aye.

(Ayes.)

CHAIRPERSON BILBREY: Opposed?

Motion carries.

Thank you.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Thank you.

CHAIRPERSON BILBREY: Now next, Item 7, Compensation Review Project Update.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Okay. Item 7 is an information item.

(Thereupon an overhead presentation was Presented as follows.)

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: The purpose of this agenda item is to present an update on the progress of the Compensation Review Project. The project provides a comprehensive approach for conducting a review of compensation policy for all executives, senior managers, and investment staff covered under CalPERS compensation policies.

The overarching goal of this initiative is to conduct a comprehensive review of the programs to ensure alignment with CalPERS' goals and strategies as well as best practice in the implementation. The project is anticipated to take about 18 months.

Today's Compensation Review Project update will be presented by Bill Gentry and Eric Gonzaga of Grant Thornton LLP.

And with that, I will turn it over to Eric. I believe you're going to kick it off.

MR. GONZAGA: Well, thank you for, you know, the opportunity to be here. We've had -- you know, I've done quite a bit of work here in terms of, you know, gathering, you know, feedback from all of the various committee and board members.

And, you know, with that in mind, you know, let's just go into the agenda.

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MR. GONZAGA: What we're planning on covering today is, you know, four items.

One is simply a, you know, high-level summary of, you know, what we want really for you to take away both in terms of initial analysis, as well as kind of the key considerations that we really want you to think about just based on this initial review.

Secondarily, you know, we did do some peer group analysis in terms of, you know, pay design and market levels for a sampling of positions; just cover that quickly.

The third item's probably the most important, you know, which is really to, you know, help you all figure out what the appropriate pay philosophy is for CalPERS, recognizing there's a lot of complexities to it. And, you know, we have some recommendations. And what we'd really like to do is get some collaboration and feedback, you know, as you'll see midway through the deck, going through point by point the various elements of what we perceive as a good solid pay philosophy for your organization.

And, finally, just a discussion of governance and next steps from our perspective.

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MR. GONZAGA: Now, you know, before we even get into the summary of findings and considerations, I think the one thing just to point out is that, you know, whenever we entertain, you know, these reviews, you know, for just about any organization, what we're really trying to do is -- you know, pay is in some respects -- you know, some would argue it's just a number. But from our perspective it's moving beyond the numbers.

And what we're really focused in on, you know, is - all of our interviews and all of our analysis, even the peer-group analysis - what we're trying to do is, you know, deal with a few issues.

First and foremost, do you have a good pay plan that assists in accomplishment of the mission of your organization?

The second component is really certainly recruitment and retention of the appropriate level of talent.

And the third and final component is just making sure that any sort of incentive compensation plan or pay plan in general, you know, really balances the appropriate considerations relative to risk management, you know, which would -- you know, obviously is something on everybody's mind considering, you know, the assets that are under consideration here.

So with all of this,

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MR. GONZAGA: So with all of that, you know, just a quick summary of what we found. And these are kind of the themes that will go throughout. There's a lot of more detail as we go through the presentation.

But I think, you know, first and foremost, let's just talk about our peer group analysis. These are the primary takeaways that we'll talk to in a little bit more detail as we go through this.

You know, when we take a look at the sampling of positions that we reviewed from a market competitive standpoint, I think -- first and foremost, I think that your peer group is great that you've looked at historically. You know, namely, those larger funds, those public funds of comparable size to your organization.

What we found is pretty consistent with what historically was found before, and that's pay all in, you know, in terms of direct salary plus incentive compensation matches at approximately the 25th percentile for the sampling of positions.

And, you know -- and that's primarily due not because of salaries; it's because of lower use of annual incentives as well as prevalence in the marketplace of the peers that use a significant amount of long-term incentive.

Now, the other component to that though, and it's something that you've considered before, is when we take a look at all the intangibles of the organization, that indirect remuneration, we certainly believe based on all the interviews and a look at the program sitting out there that CalPERS without question is a market leader for that indirect remuneration. What we mean then by that, if we're talking about prestige as an organization, if we're talking about the culture of the organization, as well as, you know, the various components that come in in terms of the defined benefit or, you know, the health and welfare benefits associated with this organization, there's no question that relative to other organizations, whether it's for-profit or other government organizations, CalPERS is certainly a leader in that indirect remuneration. So the challenge here is kind of balancing those two.

Now, what we'll go through later on is a specific pay philosophy that we're recommending. And what you'll see is that it really doesn't require a lot of additive dollars in terms of where you sit from a competitive pay perspective. Our thoughts are simply that, where existing pay is, where it ranks right now at least for the sampling positions that we took a look at, there's no need to kind of modify or significantly increase; and that wouldn't be our recommendation in terms of pay philosophy, the existing pay amounts.

However, when we think again -- think about accomplishment of mission, think about recruitment retention, think about the risk management associated with any good compensation plan for an organization like yours, the philosophy that we're recommending may require a few tweaks, and not the least of which is we want you to consider maybe a little bit of increase in salaries to the extent that we're talking about a modest reduction in annual incentives.

And the whole perspective on that is that to ease off the incentive in terms of annual incentive only, you know, more, you know, kind of security in terms of salary, certainly not additive, but, you know, maybe what we're talking about is a reallocation of dollars.

Likewise, probably our primary recommendation and one that we feel strongly about is implementation, certainly for those responsible for long-term strategy, is implementation of a specific long-term plan. And that would include certainly the Investment Office where we're talking about what we're really -- what's the mission of the organization. It is to make sure that we have a hundred-year mission, we sustain that mission, and we're measuring our performance in the long term.

And so what we're recommending is a couple different components to the long-term incentive plan. One is the implementation of a plan that measures performance over a five-year period. In addition, mandatory deferral of certain bonus dollars, you know, subject to overall performance of the specific fund as well as more emphasis on overall team and long -- team performance for the fund itself.

So movement away from just annual incentives and movement towards something that's longer term, in addition to measuring overall success of the fund in general to coordinate and encourage teamwork.

And then the final component for the 20098 position, specifically what we're talking about there would be the CEO and the direct reports to that, such as the CFO, Chief Actuary, General Counsel, certainly in emphasis and movement away from the existing long-term incentive plan and coming up with more concrete outcomes related to that balanced core of performance.

What see right now is something that's more akin to something that's quite qualitative, and we think there's better ways that this committee and the Board can work with management to reward, recognize, focusing in on, you know, outcomes. As opposed to just focusing in on the outcomes for the Investment Office, what are the outcomes for the organization as a whole? And then for certain individuals maybe select participation in the long-term incentive plan.

So those are the primary themes of our findings and in terms of what you want to focus in on. Again, all of this analysis and our more concrete recommendations as we go through, it's balancing again. How do we make sure that you've got a good pay plan in to focus in on the mission of this very important organization?

Second, again, do we have enough compensation in the mix and is it structured appropriately to optimize recruitment and retention. And we don't think there's a lot of dollars that need to be added there.

And third, and finally, you know, focused in on making sure that we have the appropriate risk management techniques implemented into the plan.

So with that, that's kind of the summary of our findings, and I'll hand it over to Bill to go into -- to start going into a little bit more detail.

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MR. GENTRY: Hi, everybody.

CHAIRPERSON BILBREY: I want to remind the -- that there is the updated on the iPad. It should be on the bottom of your agenda part. Updated when that was given to us.

MR. GENTRY: Thank you. I just want to sort of lay the groundwork. I think really the most meaningful aspect of our discussion today is towards the back end of the report.

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MR. GENTRY: I just want to take this slide to sort of set expectations in terms of where we left off from the January meeting. And that's basically, the ask for us or our deliverable for today is to validate the peer group and the pay data that the Committee reviewed last year, take an additional look just to see if there's any meaningful insights we could glean primarily in the area of pay practices as opposed to pay values.

And the other things are essentially to put forth a straw-dog pay philosophy, and we'll then be in a position to collect the Committee's feedback, refine, retool, and then come back in April with a more concrete design.

So that's really what our objective is for today.

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MR. GENTRY: In terms of timing -- let me see if I go this way.

Timing and in-scope roles. You can see the March, April focus is more towards the top of the house and both on the corporate side as well as the Investment Office. And then as we work through those levels, in June we'll focus on deeper into the organization primarily in the sort of the middle management ranks. But that's what we're working towards.

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MR. GENTRY: I just want to spend A couple of minutes talking about peer group. I know you all have spent a lot of time on this topic anyway, so I don't want to belabor the point. But, you know, again we started with looking at the peer group. Use the traditional methodologies to come up with the same set of companies that you've reviewed in the past. And again we look at both, not only data, but also pay practices, because I think that provides some nuances that are important as we take a broader view of what the philosophy should be. You know, it's not a big surprise - and I'm certainly not a rocket scientist - but we have a wide range of pay practices given the different types of organizations and the different size in the peer group. So, you know, I learned at business school, the bigger the range, the greater the chances I'm going to be right.

The downside to that is it's really -- there's a high margin of error if we peg solely to market. I think for an organization like CalPERS, it's just as important to think about internal considerations as external considerations. So if we sort of look at the pay analysis, you know, you're 25th percentile positioning for this handful of jobs we looked at for this go-round, it's not a surprise, you've heard it before we're at the 25th percentile. From our perspective, the ultimate arbitrator of "are we paying appropriately" is are we able to attract and retain the right types of talent? And at least at the top of the house this appears to be the case in terms of your ability to pull in the people that you need.

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MR. GENTRY: Sort of the standard look in terms of size and complexity of the pension managers. And, again, you know, in terms of size and complexity, you're on the high end of the range. If we look at performance, it's a different story. Really big takeaway I think for us in terms of the performance piece of it, if you look at the 1-, 3-, 5- and 10-year periods, it really begs the question, "What's the appropriate period to assess performance?" And just given the investment cycle and all the things that can happen, you know, our inclination would be more sort of a 5- to 10-year measurement period makes more sense than a 1- to 3-year period, just given everything that's happening, because the reality is it's difficult to sort of bridge between today and your 100-year mission. That's just something that's difficult to do. But at least if we extend the horizon a little bit, we think there's's an opportunity to come up with a more -- more clarity around how you're performing vis-à-vis what the goals of the organization are.

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MR. GENTRY: This slide's a more granular look at the public pension funds. And you can see CalPERS is on the far left both in terms of assets under management and members. And then it declines from there as you move from left to right across the page.

What's interesting to us is, you know, as we think about pay and talent, what we really are looking for are what are the skills required to manage an organization? And what's the complexity of the organization, because that suggests a higher skill level. So, you know, it's an interesting nuance. I think if we look at what we've referred to as the big four, it's the three big Canadian pension funds as well as CalSTRS, not so much in terms of pay value, but how are they approaching pay philosophy? What have they done in terms of their design of their programs that might be different that's worth consideration by the committee?

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MR. GENTRY: Again, this is just an easy illustration. It's not a surprise. You know, you're at the 25th percentile. The reality is that feels about right to us for most of the jobs. Again, you're able to attract and retain people. And I think ultimately that determines whether or not you're in the ballpark of where you need to be.

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MR. GENTRY: The next slide is just a different perspective, because we've talked a little bit about sort of external benchmarks in terms of how should we pay. By looking at sort of pay for the CEO's direct reports as a ratio of CEO pay, it helps us understand from a structural perspective, which is really an internal perspective, what should pay look like? Or at least in terms of -- for those other companies out there that are like us, in terms of complexity - and again these are the four largest funds other than CalPERS - what do they do that might be like us or might be different from what they're doing? And clearly that one of the things that they do do differently is they don't have such discrepancy in terms of how their

CEOs are paid relative to the top investment office jobs.

And I think again, we're always cognizant of there's best practice and there's best fit. What makes sense for CalPERS?

Our initial reaction really is, you know, we probably want to have a closer semblance to a more structural approach to allow those internal considerations to impact the pay decisioning process. So what does that really mean? You know, I think at least in terms of what we're recommending in the back of the report, we'd see closer alignment in terms of the pay levels between the CEO and these top Investment Office jobs.

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MR. GENTRY: The next slide is simply a pie chart. Again -- well, the big takeaway here, it's not so much the mix -- or actually it is the mix. I think what we find interesting is how the peers or our big four, these structural twins, have structured pay which is much more of a balance between each pay component; but also, most importantly, I think it's a balance between how they define success for pay purposes both in the short term, meaning one year, and the long term. As they define it, it's typically a 3- to 4-year performance period, you know. And as I've already said, our inclination would be, you know, at least five years probably makes sense for a performance period in a long-term incentive plan. So we're deviating from market, but the fact that they're balancing short-term and long-term performance considerations I think is one of those topics we want to elevate with the committee to get your feedback on in terms of does it make sense.

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MR. GENTRY: Next page. This is more of an academic exercise. We're not suggesting this is where you want to land. Again, the data is driven primarily by the Canadian pension funds. As you can see, they have significant payouts in relation to salary both on an annual and long-term basis. That's not what we're suggesting. But again I think the interesting thing is if you look at sort of a balanced approach - and by that I mean the three-year average of the annual pay versus the three-year average of the long pay - you know, there's some variations, they don't true up exactly, but again it's a balanced approach. And anytime you talk about risk and how it drives pay, one of the first things that come up in terms of a design -- of good practice in terms of design is you want a balance, not only in terms of the metrics, but also the measurement periods.

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MR. GENTRY: The next page, it's like, okay, so we know that the peers, especially the big four, provide a blend of annual and long-term incentives. For the Canadian pension funds those opportunities are significant, what are they paying for? And these are the types of things, both in terms of the short term and long term, that, you know, these are the drivers is our compensation programs. And you can tell in the short term it tends to be more individual-based outcomes; longer term, total fund. And, you know, there's a theme that you see appearing in terms of what can the executives influence on a day-to-day basis. And then finally, how do we ultimate -- what's the ultimate definition of success, which tends to be around total fund.

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MR. GENTRY: At this point I'll turn the clicker back over to Eric.

MR. GONZAGA: Any questions on the analysis at all?

Okay. Okay.

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MR. GONZAGA: Well, you know, will we -- you know, in just going back to those components that we discussed earlier. You know, we took a look at -- we reviewed obviously your pay plans; and, you know, there's a lot of good there, and it's a good foundation for what we're proposing. And, you know, I think that as background, just kind of a summary of how we got here. A lot of it is a consolidation of the questions we asked coming into this, as well as from the input that we received from all of the various committee and Board members. You know, the questions that we were asking ourselves is just take a look at size. You know, to what extent should -- and we discussed the size annual performance considerations, long-term performance considerations. You know, we're really just asking ourselves, okay, what is the right peer group? How much should size impact the recommended pay levels, you know, at your organization? On the annual performance side it was really, are we measuring the right things that would represent strategic emission success for CalPERS?

And the whole issue around long-term incentives is really that we recognize - this is an organization that's probably best measured in the long term - is there a right place for use of long-term incentives in your organization?

And so, you know, in terms of driving our recommendations, what did we specifically consider? Well, I think first and foremost, you know, there's no question in our mind that CalPERS is unique from a lot of different perspectives. You know, part of it is certainly the size of the organization and your global influence. But the other component is really, you know, the emphasis on recruitment retention considerations are a little bit unique in that, you know, from the top of the house versus where you're recruiting your middle Investment Office professionals, you know, it would require balanced thought process because of the uniqueness of where you're getting the talent from the distinct groups of employees, you know, there's some customization that needs to take place.

And you think about that with respect to, so where are you getting the 20098 specifically? And historically they've either come from other public agencies or they've come from private industry with folks at the -- towards the end of their careers.

You know, secondarily, if you take a look at the Investment Office role specifically - and, you know, I'd call these the managers and below - where are you getting them from? Well, you know, there you're more likely to recruit from both industry as well as the public agencies. Hence, the competitive market in many respects is going to be a little bit different in terms of where you're recruiting from, what you're retaining against. Again, a need to customize based on level.

And, you know, the other component is really that when you think about -- you know, we're thinking through any sort of pay design within the context that you have a hundred-year mission. Let's have a plan that coordinates specifically with that hundred-year mission.

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MR. GONZAGA: Now, as we go through, you know, the process, I mean, again some of the things that we're thinking about is, you know, the pay certainly has evolved significantly at CalPERS over the years. You've added incentives, added a little bit more leverage. And now it begs the question in terms of, do we have the right metrics? And we think that incentives make a lot of sense, whether we're talking about the 20098 specifically, not on the investment side versus the investment side. You've made that choice, and we think that -- to certain degrees we think incentives are appropriate for both sides.

The issue is, are we paying incentives for the right reasons in terms of talent or business strategies related to the folks in those specific categories?

Now, the other thing that we think -- I mean, that being said, I mean, when we just start thinking about the incentive metrics, so let's go outside of the Investment Office specifically and talk about the 20098s and more of the administrative executive positions. We think there's a great opportunity to improve upon what you have from an incentive plan perspective, more from the standpoint of coming up with true measurables as opposed to, you know, these qualitative assessments in terms of what the job really is. We think that's better for the performance review, not so good for the incentive plan. Because, again, the whole purpose of the incentive plan is to communicate what do you want executives to accomplish for the year or that 3- or 5-year period. We think that you can come up with better metrics.

Now, the final component to all of this is just thinking through the long-term incentive plan and from an incentive compensation perspective. Your return, whether it's what you budget, whether it's what your expectations are, or just why you exist, it's that long-term funding vehicle for the organization. And thus we do think that things are a little bit out of balance in terms of your current annual bonus structure without a long-term incentive plan. Our preference again would be to come up with a better balance between the two to measure progress in terms of making sure -- rewarding for asset management, making sure that the gap is gradually closed over time in terms of the funding deficit.

And, you know, finally, we just want to make sure that whatever plan we put in place again, it balances appropriately the risk management that's incumbent upon this organization; recognizing that if there's significant drawdowns, significant reductions in value, that could be quite costly to the State itself.

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MR. GONZAGA: Now, again, right before we get to pay philosophy, you know, you start thinking about -- of course we're jumping ahead to think about what kind of metrics could we put into the plan. Again, thinking through what we want to do is make sure the plan is more outcome oriented on the administrative side of the house for the 20098 metricals, in addition to what are better refinements to the Investment Office annual or long-term incentive plan. And so we broke it down in terms of -- both in terms of review, discussions with you all, what do we think are the appropriate metrics in terms of creation of that value chain and hence appropriately measured as part of any incentive plan.

On the Investment Office side, you know, one of the things that we thought about was cross-asset class -- cross-asset class and fund performance, focusing more on teamwork both within asset class, cross-asset class, and to encourage more collaboration across the fund. You have a little bit of that, there's an opportunity to do more of that.

You know, the other thing is just overall fund performance over the long term, recognizing you're expecting that 7-1/2 percent return per annum. You know, how do we best manage towards that? You know, risk management, i.e., avoidance of drawdowns.

And the other thing that we think is very important is talent management succession planning at your organization. In many respects, as you see as those folks that sit at the more senior levels of your organization, there are typically folks that have worked their way up through the ranks, after having been employed in the public sector. You know, that can be an appropriate metric in terms of integration and certainly concept as you think through incentive planning and performance planning.

On the overall organizational side, we made the comment that we think a lot of the metrics that you're using in terms of incentives are much more qualitative. We think that you can put numbers to many of these things, whether it is governmental in board relations; effective cost management for the organization managing two budgets, making sure that the organization is appropriately managing the funds from a fiduciary standpoint meeting budget, et cetera.

Member satisfaction and service. That's what this organization's all about. Can you measure member satisfaction and service? Certainly common themes in terms of the balance score card. What is used in other organizations that implement annual incentive plans? Much more outcome oriented.

Talent and culture are quite important. Here, so again, we're talking about employee engagement. Or limiting turnover in your organization, a lot of that is driven by culture.

And then of course the insurance side of the house. What are you doing from that standpoint, whether it's cost containment, your various health and welfare initiatives, et cetera? There's a lot of measurables that you can do above and beyond simply, you know, statements as part of the job itself, in terms of being incentive worthy.

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MR. GONZAGA: Any questions, you know, thus far? Because, you know, I'd like to dig into the pay philosophy and, you know, what we're recommending. And from this perspective what I'd like to do is just go down number by number to solicit feedback. You know, primary perspective would be we get feedback from you and build as much consensus as possible. Come in April, we can assist you with development and finalization of conceptual design for the pay plans.

So any questions at this point?

CHAIRPERSON BILBREY: None at this point.

VICE CHAIRPERSON MATHUR: I don't really have a question but just an observation.

I think your plan is a very well -- or your process is really well considered and the insights that you have drawn and conclusions that you've come to, to me, really resonate with me and reflect sort of how I've been -- how my thinking has evolved over -- with respect to the plans. I feel very much like you're on the right track and I look forward to sort of the digging in a little bit more on the compensation philosophy, the sample philosophy that you've outlined.

MR. GONZAGA: Thank you.

CHAIRPERSON BILBREY: Mr. Lind.

COMMITTEE MEMBER LIND: Thank you.

I echo what Priya said. I think we're definitely moving in the right direction and I appreciate this approach.

I did have a question - and I think I may have raised this when we had our individual, you know, discussion - with respect to long-term incentives, which I think is a great idea. It fits within our Investment employees who have a long termism. And I really want to especially focus on in the Investment Office.

Well, there's a lot of reasons why long-term incentives are important. There are some possible concerns. And one would be that, you know, somebody in year 4 of a year 5 incentive program has an "uh-oh" moment and there's, you know, possible risk in we've got to catch up in year 5 or we have to take some sort of different approach or, you know, whatever.

So could you talk about how you deal with that sort of situation?

MR. GONZAGA: No, that's a good point. I mean, a lot of it really goes down to, you know, measurement. You know, one, it's how you measure that five-year period, right. And we have to be reasonable in terms of how we set our goals and what the expected returns are. So that's one component to it.

You know, the second aspect would be really what types of structure in terms of the number of cycles. You know, from our perspective it's always good to have multiple long-term plan cycles moving at any given moment in time. Because the whole issue is that if you have two cycles going: Okay, one, we're in year 4 of a 5-year cycle; but let's say you have another plan starting in year 3 and that goes out to year 8. Maybe, you know -- that again helps to mitigate risk in terms of what thoughts and behaviors are in year 4, because if things get messed up, that certainly will impact that later potential for opportunity on down the road. So...

You know, there's a lot of structural techniques to it, and there's nothing perfect, but you have to put some layers over it to make sure that risk can be mitigated as well as possible.

And the other component to this that I should say, Ron - and I think it's an important one - is that long-term incentive plan that we're talking about, by and large, our thinking right now is that you will get the individual emphasis from an annual bonus plan standpoint; but when we talk about the long-term performance plan, we're talking about the overall fund performance, because again we just think there's a lot of opportunities.

And I think that -- you know, the Investment Office, I know that, you know, they have a lot of, you know, kind of collaboration in terms of capital allocation with respect to assets or with respect to risk management. All of these policies are being adopted by the organization of course with the Board and the Committee. But there's a collegiality of team work there that I think that the long-term performance plan if it's focused more on that long-term team fund performance, it will go a long ways towards making sure that we have that right balance.

COMMITTEE MEMBER LIND: Thank you.

CHAIRPERSON BILBREY: Thank you.

Ms. Hollinger.

BOARD MEMBER HOLLINGER: Yeah, thank you.

I think I asked you at the retreat. And given the difficulty of measuring performance and no investable alternative for many of our private asset classes like Real Estate and Private Equity even with your three- or five-year plan, would you suggest that -- maybe with those asset classes, do you think a top quartile salary and benefits and no incentive can be effective for us? Because, you know, that's not a market that -- like I said, there's no investable alternative.

MR. GONZAGA: And, Dana, what I'd say is that, you know, we echo your thoughts from the standpoint that, you know, in terms of the lack of, you know, metrics to measure against, we certainly do believe that it's consistent with what we're thinking in terms of salary. Maybe -- and I don't know if I'd say that no incentive, but some sort of lower, you know, emphasis in terms of annual incentive. But there may be a way to structure a long-term incentive plan again pretty consistent with that as part of the overall team performance. So...

MR. GENTRY: It's a great point, Dana. I think --

CHAIRPERSON BILBREY: Don't forget to turn your microphone on.

MR. GENTRY: You know, I think -- and you'll see in the philosophy that Eric's going to walk us through, is really a hybrid approach that address just those sort of issues: Higher base salary, with some incentive pay, but not so much that we're hanging our hats on an outcome that we're all hoping for. That's just not good enough. So, again, sort of a hybrid model.

If you think back to the pie chart I showed for the peer group, which was heavy on incentives, equal balance between long term and short-term, well, what we're suggesting is we draw the pie chart to have those three components but salary would probably be the biggest component of it, with a portion tied to annual incentive and then a portion tied to long term.

But I -- you're absolutely -- that's a great question and -- because one of the trade-offs I think in any sort of equation is, at least for the Canadian pension funds - and I'm not saying those who we need to compare ourselves to - we don't - but they have highly leveraged pay plans. Well, one of the ways you respond to that - and high leveraged means it's a risk, you know, that's not guaranteed pay - one of the ways you can put yourselves more closer to market would be higher fixed pay and not so much risk. So your -- I think your thinking's spot on to what we're thinking too.

CHAIRPERSON BILBREY: Very good.

Ms. Stausboll.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Thank you, Mr. Chair.

I wanted to follow up to Mr. Lind's point around some concern about excessive risk taking, just on a related point. So -- and I don't think this is something getting decided today. I just want to put it on the table.

But there's this concept in here about the total fund long-term performance versus 7.5; it showed up in a couple of places. And so while when the Board went through the ALM process, the discount rate is 7-1/2 over a 60-year time period, but for the first ten years that we're in now it was lower. And then your investment consultants have indicated the expectation may not even be that. So just setting the goal at 7.5, or the target there, might also lead to excessive risk taking. So it's something to take into account as you move forward.

CHAIRPERSON BILBREY: Thank you.

I do want to make comment. Thus far the work that has been done, I want to thank both of you. It's been very comprehensive.

I want to ask the Committee now as we move through this sample compensation philosophy to please give input so we get some direction as we move forward. As Ms. Stausboll has stated, we're not doing this all today, but we need some direction and we do need comments. So I hope you'll definitely take advantage of that.

I do also want to for the record note Mr. Jones, Ms. Hollinger, and Mr. Feckner joining the Committee, and Ms. Paquin for Controller Yee.

All right. We'll continue.

MR. GONZAGA: All right. You know, what I'd like to do is -- you know, we have about eight points to go through. Some of them won't take much time. But, you know, we'll just pause for a second; and, you know, if there's any feedback that you want to provide, that would be great. But we'll just go one by one if that's okay. Okay?

Because, you know, the reason philosophy's important is simply that, you know, you hold yourself out there, you know, it creates appropriate expectations and it creates the architecture with which any of these conversations at the beginning of the year -- end of the year, we're all going to harken back to this philosophy, because it's good governance.

Now, you know, the first point - and I think it is -- there's a little bit of a nuance here - it's:

CalPERS business needs demand that we identify, attract, develop, and retain the right talent to meet our objectives, manage our business, and actively support our values. And the emphasis on the "right."

You know, I know that we've had a lot of conversations about, you know, potential for losing certain individuals, as well as a conversation around, you know, the dollars. But I think that the emphasis on "right" is really our perspective in terms of, you know, recruitment of individuals to come to this organization, typically early on or mid-career, and getting our fair share of those right employees that are committed to the mission of the organization.

Any questions on that at all?

CHAIRPERSON BILBREY: Any comments?

I think we agree with that one.

MR. GONZAGA: Okay. Number two, the combination of direct and indirect forms help us to compete for talent. So it is an acknowledgement of the fact that our direct and indirect compensation forms are both important. You know, and I think that -- I think it's clear. I'm confident you can hold yourselves out as saying that, that your indirect talent in terms of indirect remuneration - prestige, culture, benefits - top of the market.

So I don't think we disagree there.

The question becomes for us number 2 and number 3, stated market percentiles.

You know, for the most senior positions - and that would include all the 20098s, those jobs reporting directly up to the CEO, and that would include CEO, CFO, Chief Actuary, General Counsel, CIO - targeted market positioning of the 25th to 35th percentile of the peer group that we discussed earlier. And it's pretty consistent, wherein there's maybe an outlier or two. But at the end of the day that's where you're at right now, is at that 25th to 35th percentile. And all we're saying is from an outstanding performance here, you have the ability to pay up to the 50th percentile relative to your current peer group.

CHAIRPERSON BILBREY: Ms. Taylor.

COMMITTEE MEMBER TAYLOR: I just wanted to say that I really like what you're taking into consideration under number 2, and being so responsive to what we were talk -- what all of us I think were probably talking about when you did your interviews. Because I think this covers such a wide range of what we were taking into consideration and taking some of that risk out and paying more in terms of what we're looking at in the long term. And I think that was so important, was looking at long term. And I really appreciate that that's what -- all of this, the whole report -- and I really am impressed, and thank you very much.

MR. GONZAGA: Thank you.

CHAIRPERSON BILBREY: Anyone else?

Mr. Cobb.

ACTING COMMITTEE MEMBER COBB: Just wanted to get a little clarity on how you took collective bargaining into consideration in setting the targeted levels.

MR. GONZAGA: Could you give me a little bit -- I'm sorry, I didn't -- I may be missing --

ACTING COMMITTEE MEMBER COBB: Specifically to the third bullet, under item 2.

MR. GONZAGA: Oh, I'm sorry. You know, so that would include -- I mean, really what we're talking about there is the Investment Office managers specifically. And, you know --

ACTING COMMITTEE MEMBER COBB: Oh, okay. I understand. Not the IO IIIs.

MR. GONZAGA: Right.

ACTING COMMITTEE MEMBER COBB: This is the -- got it. Thank you.

MR. GONZAGA: Right.

You know, there is a nuance there, because we are talking about the 25th to 35th percentile for senior-most executives or officers at this organization. Our recommendation for - and I don't want to be misleading in any respect - would be the 50th percentile for the managers specifically at that level. And the reason for that is that, you know, this is an organization that brings folks in.

Now, there's a difference between once you're at that senior executive pay level, what are you willing to leave for, how much will it get you to come in, versus at that Investment Office manager or associate manager level. What we're talking about there is, that's the new blood that you want to bring into the organization in the hopes that, recognizing turnovers - a legitimate issue - that you want to be more competitive relative to market at that manager level than you necessarily need to at the top level; because of course, at the top level folks are doing this for more than just the money. It's the mission of the organization.

Now that being said, if you're making less money at that manager level, et cetera, you want to be able to bring in as good a talent as you possibly can find, you know, to come in the doors. So...

CHAIRPERSON BILBREY: All right. Continue.

MR. GONZAGA: Okay. Are we all comfortable with that?

CHAIRPERSON BILBREY: Yes, I believe so.

MR. GONZAGA: Okay. Now, you know, the final component is that all of the pay plans -- that point number 3 is just to say that what's going to be incumbent in any of our pay plans is that it's always going to reflect the mission and the values of the organization. In other words, you know, the 100-year mission, let's close the gap in terms of funding. We're here to service the members of CalPERS. Those will always find their way into the compensation plan, which also requires adherence to risk management principles.

CHAIRPERSON BILBREY: Any thoughts from the Committee?

Seeing none.

I think they're comfortable.

MR. GONZAGA: Great.

And then, you know, number 4 and number 5 are pretty consistent with that. I don't want to belabor the point, other than on number 5 specifically, you know, performance assessments, whether it's evaluations or the metrics themselves, will always have integrated specific risk management principles as part of the plan.

CHAIRPERSON BILBREY: All right.

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MR. GONZAGA: Okay. Now, to Dana's point, which is a very important one from our perspective, and it actually coordinates well with Ron's point as well. The risk management component.

When you think about that, whether it's because there's limited measurables, et cetera, you just want to deleverage the relevant risk taking, you know, base salaries will be higher relative to market than the overall total direct compensation. And from that perspective, I mean, we think that, you know, moving between the 50th to the 75th in terms of salary but lower leverage on the incentives is the appropriate vehicle to go.

CHAIRPERSON BILBREY: Mr. Lind.

COMMITTEE MEMBER LIND: Thank you.

You know, I've -- as we've had these kind of discussions, I've been one that has often advocated for a lessening of the incentive piece. More so, not Investment Office -- the Investment Office. But I like the direction that we're going here, which is -- we can't just eliminate incentives obviously. That's not the way these sorts of organizations work. But changing the ratio, changing the mix, putting more emphasis on base salary I think is the right way to go. And then we just have to figure out the other pieces of it. So I certainly support that approach.

CHAIRPERSON BILBREY: Anyone else?

All right. Good.

Wait. Mr. Jones.

VICE PRESIDENT JONES: Yeah, thank you, Mr. Chair.

Do you have any data that describes the performance levels based on which option organizations take in terms of higher base salary, lower incentive versus high incentive, low base salary?

MR. GONZAGA: Well, I mean I think that -- we -- we didn't do that analysis specifically, just to prove the point. But I think that what you'd find, having done that in other instances, is that it's kind of all over the place.

You know, the -- in good times, you know, at the end of the day, I mean, the high leverage is going to demonstrate or at least insinuate that performance is better.

You know, our whole concept of incentives isn't so much that -- you know, there's appropriate, you know, kind of risk/reward associated with it. And our recommendations are driven more by what we see the portfolio and the way this organization is run and the mission of this organization.

But we can certainly come back at another time with a little bit deeper dive into the relative performance with respect to leverage versus salary.

VICE PRESIDENT JONES: Thank you.

CHAIRPERSON BILBREY: All right. Continue. Go ahead.

MR. GONZAGA: Okay. Now, you know, the other components -- this really is just one of the general concepts: How is this plan going to look?

Incentive opportunities should strike the right balance between risk and reward. I don't think there's going to be any disagreement there.

Only those roles that are accountable for the overall organizational success should participate in the incentive plan.

Shared accountability. Again, we've talked about that before. That's one of our big themes that we've talked about, and one of our big takeaways as part of the process.

Short-term incentives is nothing more than a step to long-term performance, recognizing that final bullet point that it's all about long-term performance; and, hence, more emphasis on long-term incentives. And we really do think that it's best measured over a five-year period as opposed to something shorter than what you're doing right now.

CHAIRPERSON BILBREY: Ms. Mathur.

VICE CHAIRPERSON MATHUR: Yeah. I just want to say that I think these -- this Item 7 and the sub-bullets below it really get to the heart of sort of the alignment of the incentives and the performance of the individuals covered by this philosophy with the organizational goals and values and mission. So I wholehearted endorse this. I think it's encapsulated very clearly and succinctly but really captures what we are trying to get at.

Thanks.

CHAIRPERSON BILBREY: Thank you.

Any other members of the Committee?

Seeing none.

MR. GONZAGA: All right.

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MR. GONZAGA: Well, you know, insofar as, you know, we have general agreement on the principles laid out there, and there's always this pragmatic component to it, well, how does it look, and, you know, our -- we show a recommendation in terms of overall philosophy and pay mix for the CEO on a go-forward basis.

And, you know, I'll just walk through all three components that we're talking about there, because I'm sure there will be -- it will spur on some discussion.

First things first, you know in terms of salary recommendation. You know, our recommendation is just simply that we've got two very key positions; and it's to, you know, set salary consistent with market, consistent with the rest of the world does and match salary relative to that of the CIO.

Second is -- we talked about that before -- modest bonus participation. But what's it going to be linked to? It's going to be linked to those outcomes that we were talking about before. Not the activities of the job but things like member constituency satisfaction; managing to budget; Board and government relations, what are the appropriate outcomes there? So true outcome-oriented balanced score card assessment of performance, in addition to, you know, fund performance.

The third component so that of course is the addition of a five-year long-term plan. And the way we're recommending structuring this is, again, it's consistent with this being an organization that you want very talented people to come in the door; be consistent and be motivated by the long-term mission of the organization; and establish a five-year plan, a total fund performance.

And it would -- the performance period would end at the end of five years; 50 percent of that would be paid out immediately; and the remaining 50 percent would be deferred, you know, techni -- in our perspective, would be into retirement or close to retirement, and it would be subject to, you know, modifications up or down based on overall fund performance. So at the end of the five years you would get half. Everything else would be measured and paid out at separation from service, i.e., retirement, at the end of it all.

So it's a way to -- and it's a way to kind of incorporate that long-term component, measure for the long term, as well as, you know, allowing some, you know, retention mechanisms for any long-term performance plan.

CHAIRPERSON BILBREY: Could you explain a little more when you put in here about termination date and about how you were thinking around that. I don't necessarily know you wanted to use the term "termination."

MR. GONZAGA: Yeah.

CHAIRPERSON BILBREY: Should that be separation?

MR. GONZAGA: Separation from service.

CHAIRPERSON BILBREY: Yeah.

MR. GONZAGA: That's right.

And there would be vesting criteria, you know; and what it requires is that you have to be there for the full five-year period. If an individual leaves before then, no payout. If they're there at the end of that five-year period, you know, there's an appropriate payout for half of the award. The remainder would get deferred out for a period of years subject to the ebbs and flows of the fund performance. So it's somewhat duplicative in terms of making sure that, yes, we have that five-year performance period, but there's always going to be that alignment and line of sight relative to long-term fund performance.

CHAIRPERSON BILBREY: Thank you.

Ms. Mathur.

VICE CHAIRPERSON MATHUR: I also have a question about this deferred 50 percent of the long-term incentive.

Could you articulate some of the potential advantages and disadvantages of having it be deferred until following separation. And one concern I might have - I'll just voice it and maybe you can reflect on it - is, you know, our investment returns are volatile, depending -- they depend largely on the market, on sort of ex -- they depend largely on exogenous forces and somewhat on internal management of the fund. But you could anticipate that if we had a particularly strong year and might be looking out at more challenging years, that that might prompt a separation earlier than you might want from a CEO. For example, if there -- they'd be worried that this 50 percent that's been -- that's earning and losing alongside the fund might drop in value over the upcoming year.

So, anyway, I just raise that as a concern, how can -- is it -- maybe it's possible to address that in some way.

MR. GONZAGA: Yeah, there is. And part of it is just what the right opportunities are, you know, making sure that there's an appropriate payout at the end of that five-year period. And they should be meaningful numbers.

Now, the other issue that you address in terms of -- and we would never design a plan to encourage one to voluntarily separate. You know, however, what we would do is kind of, you know, come up with -- and actually -- I mean, it's a good point, because there are a lot of plans that are accidentally structured as such. But what we would do here is just require an additional vesting period for that additional 50 percent gain. So it's almost as if, you know, it's sitting out there for an additional amount of time.

VICE CHAIRPERSON MATHUR: I see. Because you do list first and second anniversary. Do you think -- you think that's the right amount or you think it should be even further out?

MR. GONZAGA: We'll give it -- a little bit more thought to that. But I think that the whole thought of structuring it where it gets paid out a year after retirement essentially - and we'd want a longer vesting term something like retirement - the reason you would want that extra year or two added on is just to make sure the right decisions are made in the couple years leading up to it. So to extend it out any longer, then all of a sudden you're thinking to yourself, "Oh, gosh, are we" -- you know, there's a matter of fairness to the departing executive as well.

VICE CHAIRPERSON MATHUR: Okay. Thank you.

MR. GENTRY: The only thing I have to add.

The CEO makes decisions that have a long tail. They're going to impact the organization for a long time. So what can we do to provide rough justice in terms of let's not think short term, let's think longer term? If they were to leave prematurely, any of the un-vested long-term incentive opportunities would be forfeit. So there is some additional holding power in terms of the program. But we absolutely hear your concerns.

VICE CHAIRPERSON MATHUR: Thanks.

CHAIRPERSON BILBREY: Any more on the Committee who's left?

All right. Anne.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Sorry. And just for the record, all this applies to another person, not to me, but --

(Laughter.)

CHIEF EXECUTIVE OFFICER STAUSBOLL: I just -- you've used separation and retirement a little bit interchangeably. So -- and maybe you haven't decided yet what you think it should be. But those could be very different things.

MR. GONZAGA: Yeah. And so we'll have to take a look at -- I mean part of it is just, you know, the appropriate retention period. But our thinking is retirement plus separation from service. I mean, we're -- you meeting retirement date and subsequent -- and separation from service. So there is a required retirement date, you know, that should be consistent with your existing retirement plans.

CHAIRPERSON BILBREY: And if I understand correctly, we -- again we'll be bringing back and refining this further over the next month or two.

MR. GONZAGA: That's correct.

CHIEF EXECUTIVE OFFICER STAUSBOLL: But we don't have a required retirement date, just --

MR. GONZAGA: I'm sorry. Normal retirement age is probably the best way to think of it.

CHAIRPERSON BILBREY: And I think it's important that -- I think we've heard throughout this talking about risk and not -- people not necessarily doing premature risk based upon worrying about meeting certain goals. We don't want them to take risks that shouldn't be taken for the fund just because of certain incentives that are in place. We want them to do it for the good of fund obviously.

So I think I've heard that a few times mentioned and I want to make sure we highlight that.

MR. GONZAGA: Absolutely. And that is the -- ultimately that's what we're trying to get to, which is a better balance kind of incentive portfolio.

CHAIRPERSON BILBREY: Okay. We can continue.

MR. GONZAGA: All right. Well, just a few more slides to cover on the philosophy because it does -- you know, just to kind of hit home the points in terms of what we're talking about.

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MR. GONZAGA: You know, modest increases to salary, a little reduction in annual bonuses, and implementation of a long-term incentive plan. And we'll have to find a little bit more balance certainly when we start talking about, you know, private equity, for example, or real estate when there's less liquidity. Maybe we emphasize salary a little bit more in one area than we do in the other.

And so all of that is, you know, what are the pros and cons, what are we trying to do? Better alignment with risk considerations in terms of a strategy we're talking about. Certainly some customization depending on asset-class type of job, you know, et cetera.

And really all of this comes down to mission strategy - mission strategy - and reward for that. And I think that's what we're trying to strike the balance with and, you know, I think that this kind of lays that fundamental framework for that.

And, you know, we just talk about potential numbers. This is kind of what we're thinking in a nutshell right now in terms of straw numbers. You know, in terms of the mix between fixed annual incentive and then long-term pay, those numbers can be determined. But I mean really what we're trying to do is strike the balance between - you know, kind of being a hybrid organization - what's the right appropriateness in terms of incentives, if any, as well as annual versus long-term incentive.

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MR. GONZAGA: And, you know, finally, once you start thinking about this, you know, here's what we're talking about in terms of potential incentive strategies.

I mean, you know, the 20098 CEA bonus, we're talking about moving the metrics that we discussed earlier.

The Investment Office bonus, part of it linked to the individually-managed fund; 10 percent linked to overall fund performance maybe five percent cross-asset class performance.

And then the other component for the Investment Office bonus that we talk about is really just mandatory deferral for bonuses that exceed target, again subject to the ebbs and flows of overall long-term performance. So you earn your bonus. Anything above target would get deferred for, say, a three-year period subject to increases based on total fund performance.

And the LTI is what we specifically discussed.

All of this is about finding the right balance for your organization.

Couple Tweaks. And really what we're talking about is taking the architecture that you already have in place and just making it a little bit more balanced in terms of customized to the 20098s on the executive administrative side, customized to the Investment Office side in terms of implementation of that long-term performance plan, and balancing what should be paid out immediately versus what should be paid out over a three-year period.

CHAIRPERSON BILBREY: All right. Mr. Jones.

VICE PRESIDENT JONES: Yeah, thank you, Mr. Chair.

On the deferred amounts, when the time comes to pay that out, how is that treated? As interest added to it or is it current dollars? Or how does that work?

MR. GONZAGA: It would be taxed -- if it's created appropriately, it would be taxed at the value at the date of payout.

Now, the issue that you raised is, okay, the deferral amounts, what will be the increase if there's any? And, you know, a perspective would be those deferral amounts would be subject to the ebbs and flows of total fund performance is certainly one alternative.

So any of those amounts deferred would have the potential to increase or decreased based on overall fund performance.

VICE PRESIDENT JONES: Okay. But that's the face value but not any adjustments for interest, earnings or any adjustments for those kinds of changes -- inflation, for example?

MR. GONZAGA: The hope is, you know, simply that whatever gets deferred -- you know, CalPERS is managing to -- the way we're proposing does not include any specific interest or make whole based on, you know, annual applicable federal rate, for that matter. It's based on fund performance.

MR. GENTRY: Our think --

VICE CHAIRPERSON MATHUR: Microphone.

MR. GENTRY: Thank you.

Our thinking is the total fund rate of return would exceed the time value of money essentially. So if we outperform, you're in a surplus situation, so to speak; if you underperform, there's a penalty, there's consequences to that, and it will reflected in the deferred amounts.

VICE PRESIDENT JONES: Yeah, but that would be on the new dollars, not the old dollars.

MR. GENTRY: Well, it would -- yeah, in terms of -- there's a timing. There's a sequence to the timing. There's amounts deferred. They would be tied up during the deferral period and subject to plus or minus adjustments based on total fund return. New dollars coming in would happen over the course of someone's career. So every year, if you're overdelivering or if it's the long-term incentive, it's an annual grant, it essentially sort of resets in terms of we're not going to penalize you and we're not going to give you a benefit in terms of a high interest rate environment or a low interest rate environment.

Does that make sense?

VICE PRESIDENT JONES: Well, yeah. I mean, you answered the question, it's going to always be current dollars. It's not going to be adjusted for any inflation or interest earnings or anything.

MR. GONZAGA: That's right.

CHAIRPERSON BILBREY: Mr. Lind.

COMMITTEE MEMBER LIND: Thank you.

I guess this is more of a process question as we move forward. And it sounds like there's consensus in moving forward on the direction that you are outlining here. But -- and I'm not advocating that we do this today. But we've heard a little bit of input from Anne. I wouldn't mind hearing more. I'd certainly like to get some input from our CIO about how he thinks this could work, what sort of an impact it would have on the Investment Office.

CHAIRPERSON BILBREY: Sorry. I was making a --

COMMITTEE MEMBER LIND: That's a question for you --

CHAIRPERSON BILBREY: I was making a note under -- at the direction for the next meeting.

COMMITTEE MEMBER LIND: Thank you.

CHAIRPERSON BILBREY: Unless you wanted to do any direction --

CHIEF EXECUTIVE OFFICER STAUSBOLL: Well, maybe I would just mention an area that I'd like to understand better and maybe give you some input on. It's in addition to hearing definitely from Ted and from the --

CHAIRPERSON BILBREY: Go ahead.

CHIEF EXECUTIVE OFFICER STAUSBOLL: And we understand the role is consultative.

But with regard to the General Counsel and the Chief Actuary and Chief -- CFO, I'm not exactly sure, you know, what's being recommended around that and how the salaries would relate to what they are now. And we don't have to delve into now. Maybe it's more conceptual. But those are really tough recruitments. And, you know, we brought in -- after a difficult General Counsel recruitment you know, we were really fortunate to get the person we got, but we brought him in right near the top. There's nowhere to go.

So I just think it's important we have a chance to talk about those.

CHAIRPERSON BILBREY: Mr. Eliopoulos.

CHIEF EXECUTIVE OFFICER STAUSBOLL: I don't know if now's the time. We haven't really engaged on it.

CHAIRPERSON BILBREY: Yeah, I don't -- I'll let you say a few comments. But I think because we weren't to have the meeting next month but we are now based upon some of the recommendations from our consultant, so I think we should wrap that all into both -- some more discussion and you both coming back at that time.

If you wish to make a few comments now to get sort of the ball rolling at least for what we might be thinking, that's -- go ahead.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I'll keep it very brief. Ted Eliopoulos, Chief Investment Officer.

At the top level, in agreement with many -- with the comments made by the Committee regarding the design, the philosophy, the structure, the -- the pieces to be put together are well thought out and I think it would be very congruent with the goals and objectives of the Investment Office. Some of the details I think we'd like to understand more. I think the point that Ms. Stausboll made with respect to a 7-1/2 target is something to look at pretty explicitly.

CHAIRPERSON BILBREY: All right. Very good.

As several Committee members have questions, I'll continue with the Committee.

Ms. Taylor.

COMMITTEE MEMBER TAYLOR: Yeah, I just had one question. I know we were talking about the five-year total fund for the CEO: If they're here for five years, they complete their plan and then they get their 50 percent up front and 50 percent deferred. And I'm imagining this isn't something we've run into for a very long time, but what if they decide to stay longer? Do we start a five-year period over again?

MR. GONZAGA: Yeah, the recommendation, you know, from our end would be to have multiple five-year performance cycles going on at any given moment in time.

COMMITTEE MEMBER TAYLOR: Okay.

MR. GONZAGA: So, you know, whether it's every year or every other year, our recommendation would be one of those two.

COMMITTEE MEMBER TAYLOR: And then how does that work -- so say, for example, our CEO ended their five-year plan -- right? - and they're staying on, how does that -- how does work out for the payout? Do they still get a 50 percent up front and then the rest is deferred for a couple of years even though it's -- because it's only if they retire or --

MR. GONZAGA: So what would be the recommendation, at the end of every five-year period 50 percent would be paid out and then 50 percent would be deferred up until that retirement date.

COMMITTEE MEMBER TAYLOR: Actually retired --

MR. GONZAGA: Correct.

COMMITTEE MEMBER TAYLOR: -- or left?

Okay. Great. Thank you.

CHAIRPERSON BILBREY: All right. Mr. Cobb.

ACTING COMMITTEE MEMBER COBB: Thank you, Mr. Chair. I just -- the thought occurred to me, something we need to make sure and look at with respect to, you know, a deferred compensation arrangement is to make sure that the IRS rules around having deferred compensation for highly compensated employees doesn't have some kind of adverse impact on the Savings-Plus Program like subjecting it to nondiscrimination testing and those kind of things that it currently is not.

MR. GONZAGA: Very good point, and we'll make sure that's addressed.

CHAIRPERSON BILBREY: Ms. Paquin.

ACTING BOARD MEMBER PAQUIN: Yes, thank you.

I was curious. If we do go to a different comp model, how long will it take to phase this in over time?

MR. GONZAGA: Well, I mean, I think that you can implement it, you know, certainly, I mean -- to fully phase it in, I mean, because there will be a phase-in, because whenever you start talking about reallocation from annual to long term, you know, what you will have to do is just make sure that you don't draw down any sort of annual incentive too quickly because the long-term incentive plan isn't still taking effect. What we'd like to do as a minimum, keep it neutral, you know, for those first two or three years as the plan's in place. So probably will be a two-, three-year phase-in.

ACTING BOARD MEMBER PAQUIN: Thank you.

CHAIRPERSON BILBREY: Mr. Boyken.

ACTING COMMITTEE MEMBER BOYKEN: Thanks.

I was just going to echo Mr. Lind's concerns about -- his comments about wanting to get input from staff and their feelings. I know you interviewed the Board. And I wondered, did you interview staff as well?

MR. GONZAGA: Yes.

ACTING COMMITTEE MEMBER BOYKEN: At some point through the process it would be interesting I think to see a roll-up of both Board and staff comments in general.

But I'm sure a lot of them are reflected in the PowerPoint presentation we saw today.

MR. GONZAGA: Yeah, absolutely. And I think that, you know, one of the things is that, you know, management certainly needs to be engaged with respect to selecting performance metrics and just making sure we understand the full array of, you know, kind of human capital concerns and considerations as part of the process. And it's an absolutely critical step.

ACTING COMMITTEE MEMBER BOYKEN: Thank you.

CHAIRPERSON BILBREY: Thank you.

And Ms. Hollinger.

BOARD MEMBER HOLLINGER: Yes, thank you.

Also, I thought it might be beneficial on figuring out some of these compensation nuances, are you getting input from our consultants, PCA and Wilshire? Because I know they work intimately with staff and really understand the metrics by which our fund on the investment side is compensated as well as their other pension funds. So I think there is a lot of history there and a lot of metrics of other users that would really be beneficial insight and adding meaningful contribution.

MR. GONZAGA: We'd welcome the opportunity.

CHAIRPERSON BILBREY: All right. Seeing no other.

Did you want to discuss next steps on your slide deck or --

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MR. GENTRY: I'll just spend a minute or two on this slide.

You know, we're sort of at the front end of evaluating where there might be some efficiencies in the process.

I think there's going to be a number of potential opportunities that reside within whatever the final disposition of the incentive strategies looks like because I know that creates a lot of complexity. So that's where we're starting with. But we'll also be mindful of any other low-hanging fruit we see along the way.

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MR. GENTRY: In terms of next steps, we very much appreciate your feedback today. What we intend to do is to create a straw-dog design with much more of a tactical look in terms of what we're suggesting before we went down that path. We just wanted to make sure the Committee was comfortable with the overall direction.

And when we come back to you again, we'll have a much more robust discussion around design, mechanics, cost analysis in terms of pay movements and other things. And then, again, we'll -- you know, to the extent it's just pulling the materials together as we did before and getting them to the Committee well in advance of the meeting so you'll have time to review.

So that's really what we're looking at.

--o0o--

MR. GONZAGA: And I think that that's been raised before. I mean, I think what we really would like to do is, you know, have some discussions with management in terms of, you know, definition of metrics, you know, and get their reactions to the ideas out there now that we're at this point.

CHAIRPERSON BILBREY: Great.

Well, thank you for your initial project update. We are looking forward to continuing the work and the work that will come forward. We thank you for your time today for being here.

All right. Next item is the summary of Committee direction.

So we were -- the draft agenda, et cetera, all state about May, but we'll be having a meeting in April rather than May. And I think it's been clear that there will be some dialogue and input between the CEO, CIO, and the consultants, and will come back at the next meeting to talk about that further with the Committee as they have requested.

And did I miss anything, Mr. Hoffner?

DEPUTY EXECUTIVE OFFICER HOFFNER: I just had a few other questions that were identified by the Committee members, and some sort of data elements which I think we've captured here. So I would incorporate that into work that the consultants would be doing and bring back to you next month as part of that overall review and the deeper dive.

CHAIRPERSON BILBREY: Very good. All right.

Very good.

Thank you all for your participation, especially the Committee.

And with that, I have no public comment.

Anyone wishing to speak?

Seeing none.

This meeting is adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Performance, Compensation, & Talent Management Committee meeting adjourned at 1:52 p.m.)

C E R T I F I C A T E   O F   R E P O R T E R

I, JAMES F. PETERS, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing California Public Employees' Retirement System, Board of Administration, Performance, Compensation & Talent Management Committee meeting was reported in shorthand by me, James F. Peters, a Certified Shorthand Reporter of the State of California;

That the said proceedings was taken before me, in shorthand writing, and was thereafter transcribed, under my direction, by computer-assisted transcription.

I further certify that I am not of counsel or attorney for any of the parties to said meeting nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 22nd day of March, 2016.

James F. Peters

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Certified Shorthand Reporter
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