Compensation Study Progress Update

PCTM Committee Briefing

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Grant Thornton | An instinct for growth™

Report Summary

Today's Objectives

1) Provide progress update on compensation study
2) Gather PCTM feedback, refine approach, etc.

Existing State

Phase I Scope (Today)

- *CEO, 20098 executives*
- *Investment Office ("IO")*
- *CEAs/CEA executives (incentive metrics only)*

Phase II (after Phase I)

- *Other key roles*
- *Associate Investment Managers*
- *FINO jobs with IO classifications, etc.*
- *Pay practices that create inequities*

Cost Neutral Strategies (~93% of changes)[1]

A. All: Reallocation of fixed and variable pay levels (no "haircuts" on potential earnings opportunities)[2]

B. All: New incentive metrics to better reflect value creating results, enterprise-wide priorities, and risk considerations[2]

C. IO: Abandon Merit Matrix and replace with discretionary/performance-based salary increase budget, reducing importance/impact of In Range adjustments when combined with additive cost strategies

Additive Cost Strategies (~7% of changes)[1]

A. CEO & 20098s: Structural adjustments

B. All: Expand ability of CEO and CIO to "right size" pay by making discretionary (+/-) adjustments to formulaic bonus awards (with controls) [2]

C. All: Expand flexibility of CEO and CIO to retain top talent via discretionary retention bonuses (with controls) [2]

D. All: Implement long-term incentive program for top performers with annual grant frequency and five-year performance horizon (with controls) [2]

Future State

Expected Collateral Benefits

- *Customization*
- *Alignment of interests*
- *Planning flexibility*
- *Pay-for-performance*
- *Pay differentiation*
- *Simplification and transparency*
- *Financial discipline*

Notes

1. Preliminary values subject to change, as measured by payroll cost impact
2. "All" specifically excludes CEAs/CEA Executives

Key Topics

Per the PCTM's instructions, Grant Thornton met with the leadership teams of PERS and the Investment Office on April 4-6. Suggested actions reflect their feedback.

- **Outcomes from the PCTM Meeting (March 15, 2016)**
- **Suggested Philosophy**
- **Objectives & Guiding Principles**
- **SWOT Analysis**
- **Preliminary Transformation Roadmap**
- **Preliminary Cost Analysis**
- **Current State**
- **Total Direct Compensation ("TDC") Cost Neutral Strategies**
- **TDC Additive Pay Strategies**
- **Wrap-up (PCTM Committee Design Feedback Checklist & Next Steps)**

Outcomes from PCTM Meeting (March 15, 2016)

1. **Improve alignment of business and talent needs with pay philosophies**

2. **GT's suggested strategies to improve alignment (March 2016)**

Additional strategies discussed herein

Strategies	Execution
Pay reallocation to better align with business and talent needs, create greater commonality of pay structures and pay outcomes, eliminate any misperceptions of inappropriate risk taking	Increase base salaries and decrease target short-term incentive opportunities to differentiate CalPERS in its chose talent markets, increase transparency, better reflect risk considerations, and recognize the value and potential disruption costs of those with the skills to successfully manage the complexities and challenges of a highly visible public agency with diverse business, talent and constituent (employers and members) needs
Enhance messaging and impact of **incentive opportunities**	Revise incentive structures (weights and measures) to better reflect how the business is managed and value is created, enhancing the alignment between pay and value creating results
Extend **pay horizon** to better reflect risk considerations, align interests of leadership team, and enhance holding power (retention) for key talent	Introduce a long-term incentive/deferred ("LTI") compensation vehicle to extend the pay-and-performance horizon, elevate importance of commonality and risk considerations in pay outcomes, and enhance holding power (retention) – same approach applied to corporate and IO leaders

3. **Marching orders – gather management's input and with its assistance develop actionable strategies and implementation plans**

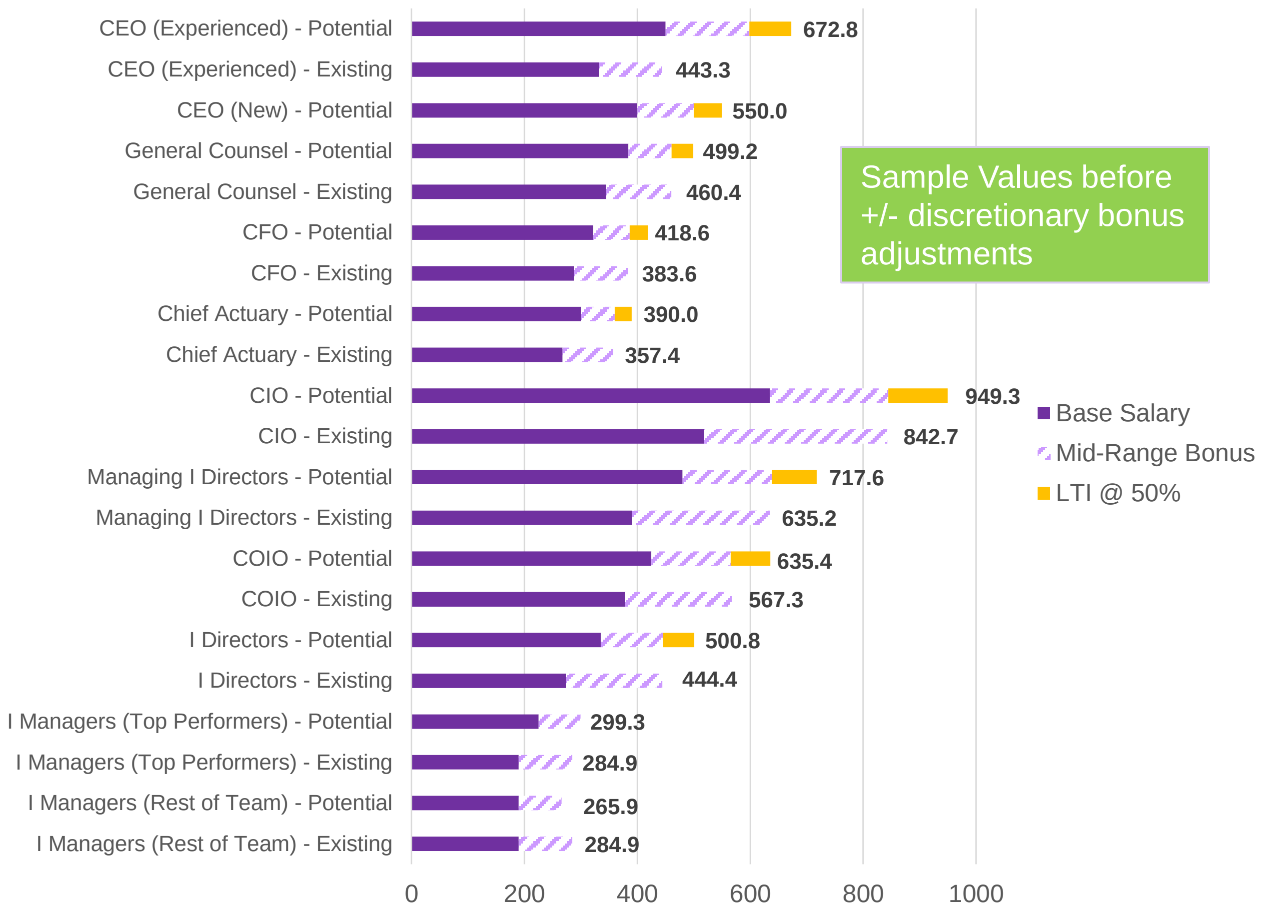
Suggested Philosophy

Migration to a hybrid pay structure that blends "best practice" and "best fit"

Employee Segment	Base Salary 1	Annual Formula Bonus	New Formula Bonus Metrics 2	Discretionary Bonus Modifier (max at 50%) 3	Additive Long-term Incentive 4	Total Direct Compensation 5
CEO & 20098 Execs.	↑	↓	+	+	+	↑
CEAs/CEA Executives	---	---	+	---	---	---
IO Leadership	↑	↓	+	+	+	↑
IO Middle Management (excluding FINO)	↑	↓	+	+	+	↑

1) Cost shifting and pay differentiation helps control incremental implementation expense
2) Corporate metrics change to reflect value creating results; IO metrics change to reflect "big picture" considerations, facilitating teamwork and shared accountabilities
3) PCTM has ability to right size bonuses for certain executives. CIO needs flexibility to apply discretion to the IO since top performers generate disproportionate value in relation to others, etc. Maximum bonus including discretion is capped at 150% of target
4) Additive LTI increases implementation costs but increases holding power, extends pay horizon to better align with risk horizon, and increases the buyout costs of CalPERS's top talent. IO leadership determines IO eligibility.
5) Combination of structural and competitive adjustments will increase total direct compensation for those most accountable for success.

Side-by-side Structural Assessment ($000)



Comments

- Potential Salary and Mid-Range (formulaic) Bonus values reflect FY17 estimated base salaries aged at 3% and normalized bonus awards (midpoint between target and maximum values under existing award schedules); no reduction in "take home" pay
- New philosophy, targeted structural adjustments and additive programs increase pay opportunities for top performers
- Discretionary bonus adjustments enhance pay-differentiation, pay for performance, and risk sensitivity, while helping with cost containment of pay programs

Side-by-side Alternative (granular) View ($000)

Identifier for opportunities for initial structural or competitive adjustments

Table I: CEO and 20098 Executives (excl. CIO)

		Experienced in Role		*New in Role*								
		Chief Executive Officer		Chief Executive Officer		General Counsel		Chief Financial Officer		Chief Actuary		Cumulative
Ref	Pay Element/Component	Existing	Potential	Existing	Potential	Existing	Potential	Existing	Potential	Existing	Potential	$ CHG
1	Representative Base Salary	332.1	450.0	332.1	400.0	344.8	384.0	287.4	322.0	267.7	300.0	224.0
2	Mid-Range Formulaic Bonus $	111.2	148.5	111.2	100.0	115.5	76.8	96.3	64.4	89.7	60.0	(63.0)
3	Representative Mid-Range Formulaic Bonus %	34%	33%	34%	25%	34%	20%	34%	20%	34%	20%	
4	Mid-range Total Annual Comp (4 = 1 + 2)	443.3	598.5	443.3	500.0	460.4	460.8	383.6	386.4	357.4	360.0	161.0
5	Discretionary Bonus Adj. (Cumulative Bonus <= 150%)	---	*TBD*	---	*TBD*	---	*TBD*	---	*TBD*	---	*TBD*	
6	Annual LTI @ 50% Mid-Range Bonus	---	74	---	50	---	38	---	32	---	*30*	174.9
7	Mid-Range Total Direct Compensation (7 = 4 + +5 + 6)	443.3	672.8	443.3	550.0	460.4	499.2	383.6	418.6	357.4	390.0	335.9

Table II: Investment Office, including CIO (no Cumulative $ Change provided due to multiple incumbents)

		CIO		COIO		MID		ID		IM (Top Performers)		IM (Rest of Team)	
Ref	Pay Element/Component	Existing	Potential	Existing	Potential	Existing	Potential	Existing	Potential	Existing	Potential	Existing	Potential
1	Representative Base Salary	518.6	635.0	378.2	425.0	390.9	480.0	273.5	335.0	189.9	225.0	189.9	189.9
2	Mid-Range Formulaic Bonus $	324.1	209.6	189.1	140.3	244.3	158.4	170.9	110.6	95.0	74.3	95.0	76.0
3	Representative Mid-Range Formulaic Bonus %	63%	33%	63%	33%	63%	33%	63%	33%	50%	33%	50%	40%
4	Mid-range Total Annual Comp (4 = 1 + 2)	842.7	844.6	567.3	565.3	635.2	638.4	444.4	445.6	284.9	299.3	284.9	265.9
5	Discretionary Bonus Adj. (Cumulative Bonus <= 150%)	---	*TBD*	---	*TBD*	---	*TBD*	---	*TBD*	---	*TBD*	---	*TBD*
6	Annual LTI @ 50% Mid-Range Bonus	---	105	---	70	---	79	---	55	---	*TBD*	---	---
7	Mid-Range Total Direct Compensation (7 = 4 + +5 + 6)	842.7	949.3	567.3	635.4	635.2	717.6	444.4	500.8	284.9	299.3	284.9	265.9

Comments

1) Existing base salary reflects 3% annual increase factor
2) Existing Mid-Range Formula Bonus ($ and %) reflects normalized bonus equal to midpoint of target and maximum award opportunity
3) Potential discretionary performance bonus TBD (final design, including eligibility and controls)
4) Potential annual Long-term Incentive award value reflects [50]% of bonus (final design, including eligibility and controls)
5) Please refer to Slide 5 for preliminary cost impact of pay transformation for "in-scope" Staff and IO roles

Preliminary Cost Impact of Pay Transformation ($000)

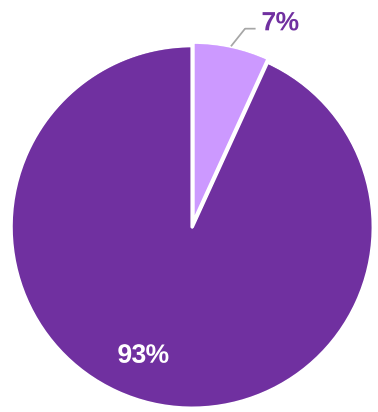
↑ $2.2 mm
(subject to change)

Please note that values are subject to change.

	Base Salary	Formula Bonus	Discretionary Adjustment	Long-term Incentive	Total Direct Comp.
CEO and 20098 Executives	*(a)*	*(b)*	*(c)*	*(d = b x 50%)*	*(e = a+b+c+d)*
Preliminary Strategy	1,456.0	349.7	0.0	174.9	1,980.6
Existing Strategy	1,232.0	412.7	0.0	0.0	1,644.7
Cost Differential (Staff)	224.0	(63.0)	0.0	174.9	335.9
Investment Office, incl. CIO					
Preliminary Strategy*	20,007.3	7,134.2	0.0	1,676.4	28,817.9
Existing Strategy	17,817.1	9,901.4	0.0	0.0	27,718.5
Cost Differential (IO)	2,190.1	(2,767.2)	0.0	1,676.4	1,099.4
Combined					
Preliminary Strategy	21,463.3	7,483.9	0.0	1,851.3	30,798.4
Existing Strategy	19,049.1	10,314.1	0.0	0.0	29,363.2
Cost Differential (Combined)	2,414.2	(2,830.2)	0.0	1,851.3	1,435.2
Margin of Error @ 50%	1,207.1	1,415.1	0.0	925.6	717.6
Preliminary Cost Impact	3,621.2	(1,415.1)	0.0	2,776.9	2,152.9
Incremental Cost Impact for Today's Discussion (subject to change)					**2,152.9**

** LTI eligibility TBD; analysis assumes 100% participation from CIO to Investment Directors and 0% for Investment Managers (TBD)*

Changes of New Philosophy as measured by Cost Impact



Per Incumbent Average LTI Funding (Target Award)	CEO & 20098s	Investment Office
@ 50% of Bonus (shown)	$43.7	$62.1
Holding Power of 5 Concurrent Award Cycles	$218.5 *($44 x 5)*	$310.4 *($62.1 x 5)*

"Stretch" assumption could be that negative and positive adjustments are offsetting – controls can ensure that this outcome is attained across the combined leadership team or for the IO office

SWOT Analysis

Strengths	Opportunities
• Minimizes incremental costs by "self funding" a portion of strategies via reallocation of existing pay • Realigns incentives and messaging with mission, common objectives, and risk considerations • Extends performance horizon and its impact on pay, which is a better reflection of the investment cycle • Increases buy-out costs for those leaving for new jobs • Mitigates perceptions that incentives motivate participants to take excessive risks by reducing large incentive payouts without reducing "take home" pay • Enhances clarity of pay and performance objectives • Builds on existing processes, aligns with business objectives	• Develops new target pay ranges that incorporate market intelligence and nuances of CalPERS; refocus market competitiveness on base salary rather than total pay • Provides common focus and definitions of success across enterprise leadership team (corporate + IO) • Increase pay differentiation and pay-for-performance within a risk appropriate framework • Simplifies incentive administration, review and oversight; creating bandwidth for other activities/priorities
Weaknesses	**Threats**
• Reallocation of variable to fixed pay could increase pension benefits • Shift from traditional IO pay strategies to more fixed/less short-term variable deviates from industry norms, which could increase flight risk • Constraints on revising CEA pay program for CEO's direct reports exacerbates misalignment with combined leadership team	• Flight risk • Optics (internal and external) • Additive program costs • New administrative requirements and PCTM oversight processes

Please note that Phase II scope involves an assessment of and expected remediation of internal equity issues ("in range adjustments" and disparity in bonus practices for IO staff who ultimately can land in finance or investment organizations)

Suggested Transformation Roadmap

Cost Neutral Strategies – CEO & 20098s	Additive Pay Strategies – CEO & 20098s
1) Reallocate short-term variable pay to fixed pay, maintaining "take home" pay 2) Modify incentive metrics to reflect value adding results (Cost Effective Management of CEM, stakeholder satisfaction, and for leaders other than the CEAs an individual goal (which might include health care focus for certain jobs) 3) Include board relations on CEO's "scorecard" 4) Add bonus modifier for IO Total Fund performance, aligning interests with IO (quid quo pro is adding modifier to IO bonuses for CEM and Stakeholder Satisfaction)	8) Structural base salary and bonus adjustments for all roles (n = 4, excluding CIO), recognizing the size and complexities of CalPERS and the skills it requires to manage the organization's four primary segments (staff, customer service, insurance and pension) at satisfactory levels 9) Each year authorize CEO to approve discretionary bonus adjustments (assume cost neutral, as positive adjustments funded by negative adjustments) and retention bonuses to right size pay and to increase ability to respond to business and talent needs without adding to fixed costs – enhance and enforce discipline and attainment of objectives with controls and periodic reporting to PCTM Committee 10) Add long-term incentive program - initial and settlement (payout) values are functions of actual bonus and of multi-year Total Fund results, respectively
Cost Neutral Strategies – Investment Office ("IO")	**Additive Pay Strategies - IO**
5) Reallocate short-term variable pay to fixed pay, maintaining "take home" pay 6) Move from formulaic base salary adjustment methodology based on Merit Matrix to an annual salary adjustment budget of [2.5-3]% of salaries that the CIO uses to make discretionary adjustments to base salaries to enhance pay differentiation among the IO office 7) Modify definition of investment performance for incentive purposes to provider greater balance (total fund, cross fund, individual fund), reflecting how business is managed and to reduce any perceptions of excessive risk taking – and include modifier for CEM and stakeholder satisfaction	11) Annually authorize CIO to make discretionary bonus adjustments and retention bonus payments subject to CEO approval – enhance and enforce discipline and attainment of objectives with controls and periodic reporting to PCTM Committee 12) Add long-term incentive program – same as for CEO & 20098s

Current State

Profile

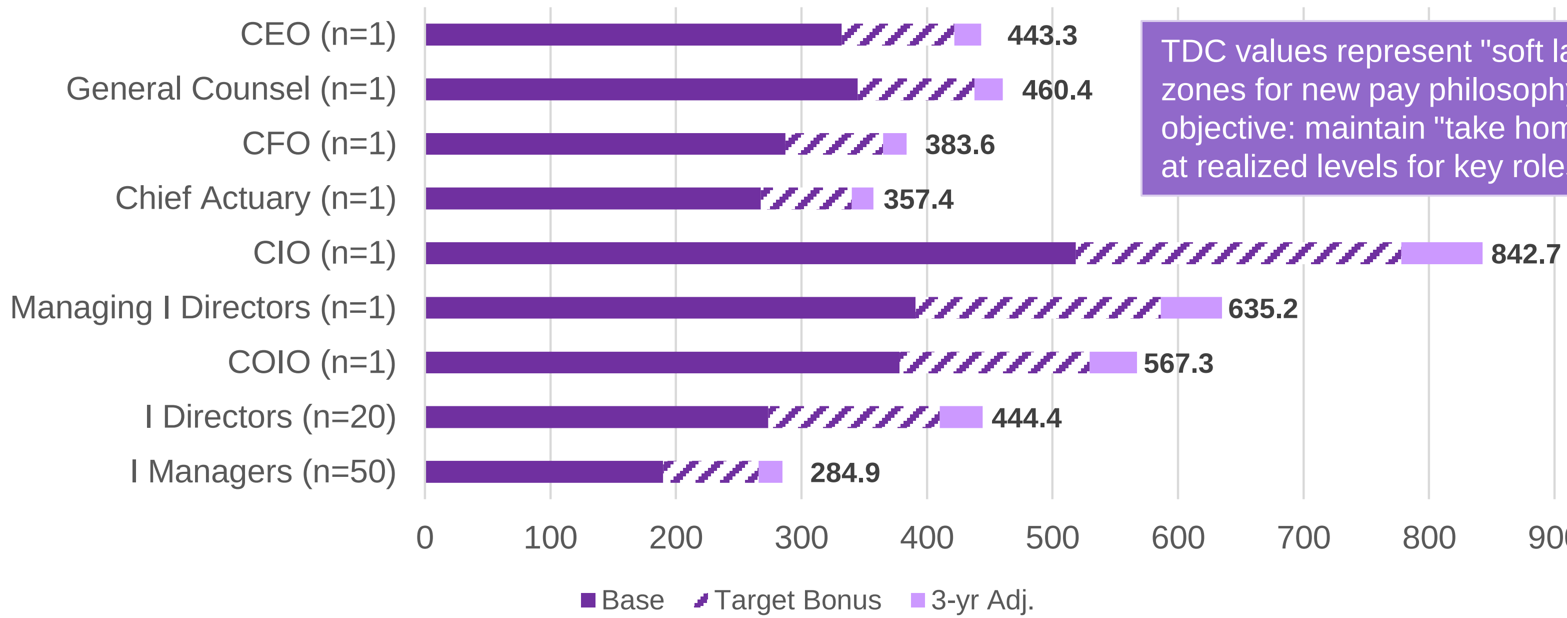
Grant Thornton Points of View

- Competitive adjustments are needed for staff leadership roles
- Reallocation of a portion of IO labor budget of $27.7 mm for in-scope roles creates opportunities to reward top performers via enhanced pay differentiation without increasing costs. Additive pay strategies will help differentiate pay programs in your chosen talent markets

Executive Population	Direct Compensation Strategies (excludes benefits, etc.)	Total Direct Cost of Management (FY17e)*
CEO & 20098 Executives ("Staff")	• Defined base salary pay ranges • Base salary and annual base salary adjustments • Annual incentive (bonus) opportunity target = 27%, max = 150% of target) • Promotions	*$1.6 mm*
Investment Office (CIO thru Investment Managers) ("IO")	• Defined base salary pay ranges • Base salary and annual base salary adjustments tied to merit matrix • Discretionary "In Range" adjustments of up to 15% • Annual incentive (bonus) opportunity (targets = 30-60%, max = 150% of target) • Discretionary award schedule adjustment to as high as 0-75% (with CEO approval) • Promotions	*$27.7 mm*
CEAs	• Base salaries and annual adjustments • Annual Incentive (bonus) opportunities (target = 10%, max = 15%)	*Defined by CalHR and previously established bonus policy*
Other	• Finance organization roles with investment office job classifications (Phase II) • Associate Investment Managers (Phase II)	

*"FY17e" means estimate based on average base salary adjustment of 3% and existing incentive bonus award schedules. Pre-adjustment total cost of IO management is $26.9 mm.

FY17(e)Target Total Direct Compensation ($000)



TDC values represent "soft landing" zones for new pay philosophy – objective: maintain "take home" pay at realized levels for key roles

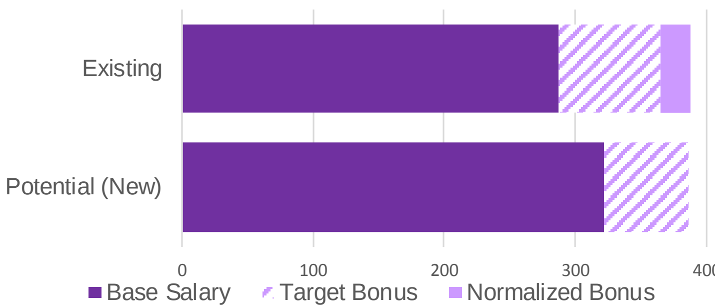
Target Total Direct Compensation represents the sum of annual base salary following an assumed increase of 3%, the associated target bonus using the existing incentive bonus award schedule (% of base), and an adjustment for trailing three-year average bonus, which has exceeded target.

TDC Cost Neutral Strategies

Pay Reallocation Strategy

No "haircuts" vs. existing pay opportunities

Example: Staff Executive earning TDC of $387,000

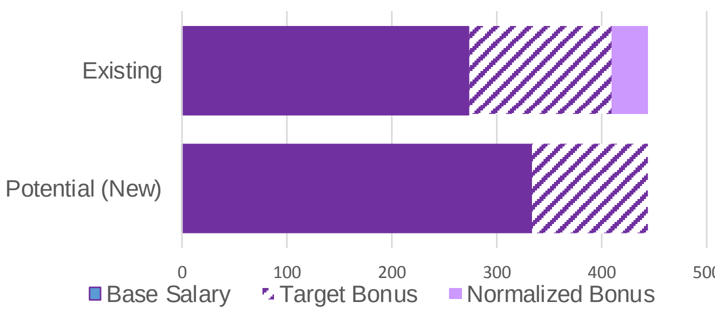


	Realized		
Base	**Bonus**	**Bonus %**	**TDC**
287	100	35%	387

	Target		
Base	**Bonus**	**Bonus %**	**TDC**
322	64	20%	386

YOY Change at Target			
12%	***-36%***	***-43%***	***0%***

Example: IO Executive earning TDC of $444,000



	Realized		
Base	**Bonus**	**Bonus %**	**TDC**
273	171	63%	444

	Target		
Base	**Bonus**	**Bonus %**	**TDC**
334	111	33%	445

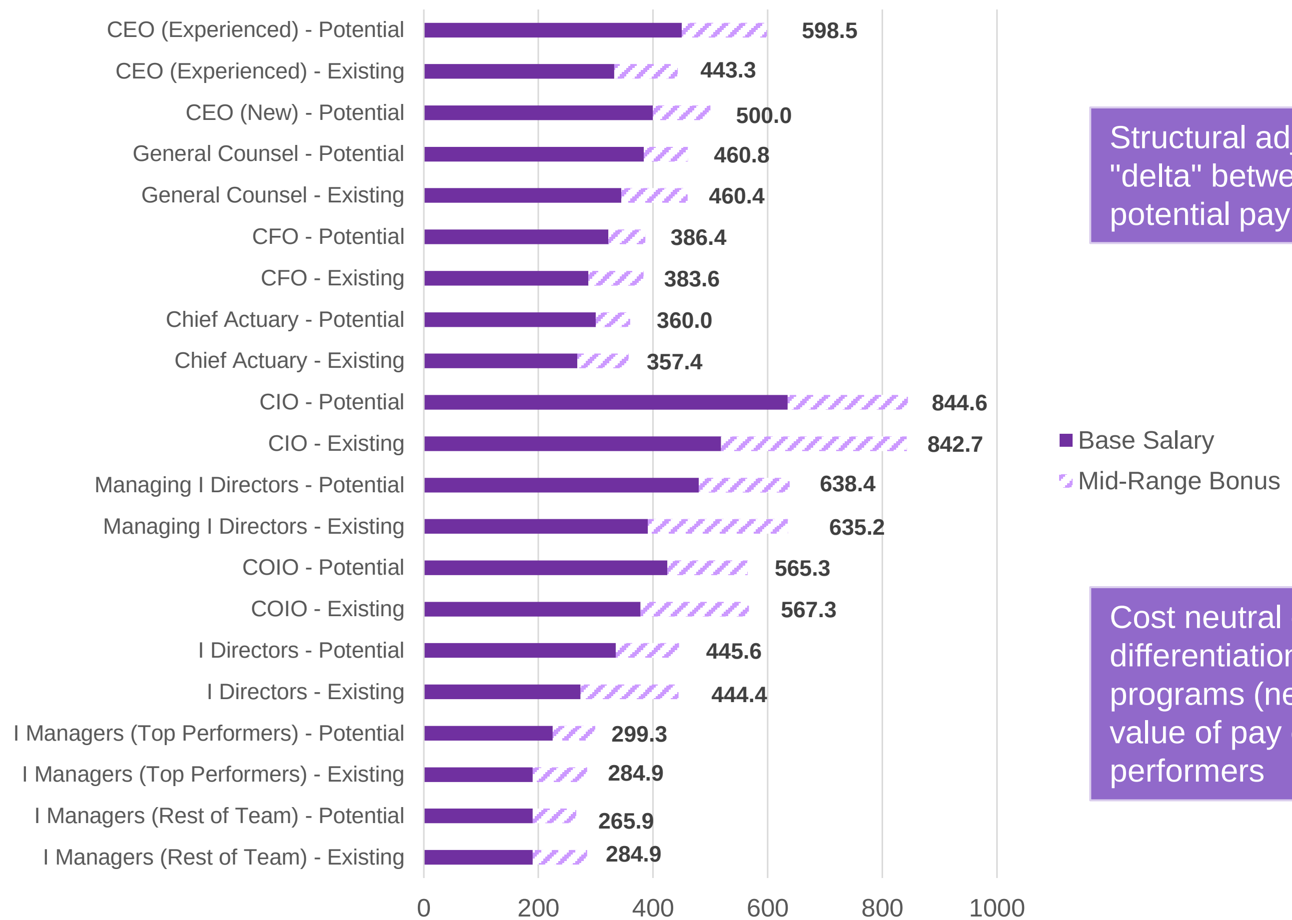
YOY Change at Target			
22%	***-35%***	***-47%***	***0%***

Methodology normalizes bonus at the midpoint between target and maximum to approximate actual ("realized") earnings over the past few years. Normalized bonus value plus FY17 base salary estimate becomes part of Target Total Compensation under the new pay philosophy, ensuring change does not create financial hardships for participants.

Phase II analysis will rely on three-year average bonus values on an individual incumbent/line item basis, adding precision for "fine tuning" after we receive PCTM guidance on approach, etc.

Pay Reallocation Strategy ($000)

"Pay leveling" to arrive at sample target pay values (before discretionary bonus adjustments and "LTI")



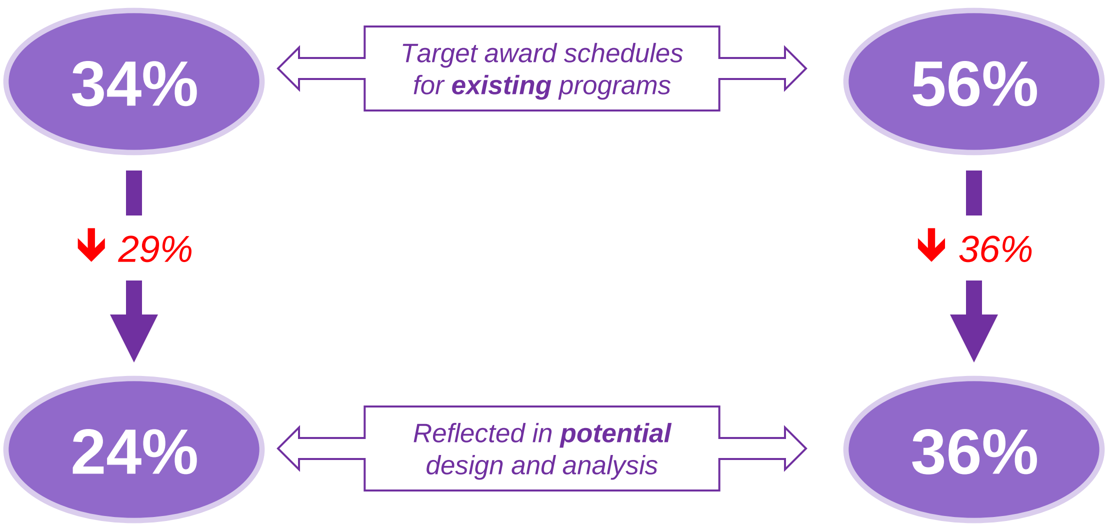
Structural adjustments explain the "delta" between existing and potential pay strategies

Cost neutral objective – pay differentiation and additive programs (next section) improve value of pay opportunity for top performers

Do reallocation "outcomes" on incentive bonus compensation align with your design preferences?

CEO & 20098 Executives (excl. CIO) Normalized Target Bonus %

IO (CIO through Investment Manager) Normalized Target Bonus %



A. CEO (Experienced) Target - Max: 33-43% (130%)
B. CEO (New): 25-33% (130%)
C. 20098s: 20-26% (130%)
D. CEAs: 10-15% (150%)

A. CIO to I Director Target-Max: 33-43% (130%)
B. I Manager: 40-50% (125%)

Total bonus including new discretionary adjustments capped at 150% of target (same as existing). Long-term incentive award also will increase incentive compensation that can be earned in any year.

Base Salary Administration

Discretionary Performance-based Salary Adjustments

Context

- Base salary and the associated adjustments are a key compensation tool, providing predictable increases and the associated "lift" in bonus opportunities, and rewarding long service – should it?
- In the IO office, the existing base salary administration process reflects a rigid process with predefined adjustment levels defined by a Merit Matrix (table)
  - Management considered abandoning the Merit Matrix two years ago for a discretionary approach
  - Existing approach caps pay adjustment at less than 10% once salary exceeds first quartile, limiting the Merit Matrix's flexibility to reward top talent (workaround is "In range adjustments")

Quartile	#	10%	8%	6%	4%	2%	0%
1st	16	4	10	1	0	0	1
2nd	10	***cap*** ⌦	3	5	2	0	0
3rd	27	***cap*** ⌦	***cap*** ⌦	5	15	6	1
4th	27	***cap*** ⌦	***cap*** ⌦	***cap*** ⌦	8	15	4
Total	80	4	13	11	25	21	6

- Average IO increase for FY16 was 4.4% (approx. $750K in total increases)
- "In range adjustments" for high value employees accelerates salary range compression issues for those CalPERS most wants to retain
- Compression issues likely necessitates the need for in range adjustments, exacerbating internal equity issues with non-IO jobs

Discretionary Performance-based Salary Adjustments

Potential action

- Abandon Merit Matrix for discretionary performance-based annual salary increase budget
- IO leadership given flexibility to allocate budget across the team based on performance considerations
  - Pay differentiation on the fringes (top performers receive disproportionately greater increases, poor performers receive disproportionately less increases; reallocates budget across team based on performance considerations)
  - Elevates importance of performance assessment process and manager effectiveness in having "tough" conversations with poor performers
  - CEO review and approval required for individual adjustments exceeding [5]%
- Control feature: salary increase budget is fixed, maximum individual adjustments capped at [10]%
- Transition strategy: FY17 Implementation roadmap reflects 3% adjustment (next step is developing individual adjustments based on new philosophy); salary increase budget strategy applies to FY18

Incentive Design

Sample Performance Scorecards

Chief Executive Officer (Target = 33%)

1) Cost Effective Mgmt. (CEM) 2) Stakeholder Satisfaction 3) Total Fund 4) Board Relations 5) Board Discretion

20098 Executives (Target = 20%)
1) Enterprise CEM vs Improvement
2) Stakeholder Satisfaction
3) Individual or Health care Goal
4) CEO Discretion +/-50%
+/- 20% Modifier for Total Fund Perf.

CEAs (Target = 10%)
1) Enterprise CEM [5]%
2) Stakeholder Satisfaction [5]%

CIO (Target = 33%)
1) Total Fund Performance
2) Enterprise CEM
3) Stakeholder Satisfaction
4) CEO discretion +/-50%

COIO (Target = 33%)
1) Maintain existing goals
2) Enterprise CEM
3) Stakeholder Satisfaction
4) CIO discretion +/-50%

Managing I Directors (33%)
1) Total Fund
2) Cross-fund/Asset Class
3) CIO discretion +/-50%
+/-20% Modifier (CEM & S. Satisfaction)

Public Asset I Directors (33%)
1) Total Fund
2) Cross-fund/Asset Class
3) Individual Fund
4) CIO discretion +/-50
+/-20% Modifier (CEM & S. Satisfaction)

Private Asset I Directors (33%)
1) Total Fund
2) Cross-fund/Asset Class
3) CIO discretion +/-50%
+/-20% Modifier (CEM & S. Satisfaction)

Notes

- Stakeholder Satisfaction includes employers, members, employees (and government)
- Final approval of IO positive discretionary bonus adjustments resides with CEO
- Design and target bonus %'s subject to change (no changes to CEA target bonus %)
- Formula bonus, Modifier and positive discretionary adjustments capped at 150% of target
- **Investment Manager** structure follows Investment Directors; target bonuses set at [40]%

TDC Additive Pay Strategies

Incentive Design

Discretionary Bonus Adjustments & Retention Payments

Context

- CEO and CIO lack ability to make meaningful adjustments based on their views of quantitative and qualitative considerations not captured by rigid incentive bonus formulae
- Effective use of discretion is key to balancing formulaic incentive award decisions – and a key risk remediation strategy in the financial services sector
- Absence of discretion in pay programs limits flexibility to respond to business and talent needs (albeit it reducing transparency into the process if not documented)

Potential Action

- Allow CEO and CIO to make **discretionary adjustments** to formula-based incentives by as much as +/-50% not to exceed total bonus cap (150% of target, which is consistent with existing program)
  - Control: positive adjustments cannot exceed cumulative value of negative adjustments
- Allow CEO and CIO to authorize **retention bonuses** for key employees viewed as flight risks
  - Provides enhanced value without increasing fixed costs (controlling salary growth)
  - Reduces need for "in range adjustments" when combined with discretionary salary increase budget
  - Control: Not to exceed [x]% of base salary without PCTM approval; time/frequency limit (TBD)

Incentive Design

Long-Term Incentive Framework

Mechanics

1) Each year [50]% of actual bonus earned is credited to a participant's LTI account
2) Funding value is deferred for five years and adjusted annually for total fund performance (performance standard TBD)
3) Adjusted value is paid at the end of five years if participant is employed by CalPERS and received a satisfactory or better rating in in the [year of and immediately preceding] the year payment occurs]
4) Award payment subject to CEO approval, who informs the PCTM of cumulative payment value (with line item detail)
5) Adverse risk outcome of [X] that result in a significant draw down or material loss in the 12 months preceding payment results in cancellation of the award prior to settlement
6) Accompanying illustration provides an example of annual awards over a multi-year period
7) Cumulative value of overlapping 5-year award cycles increases holding power for and buy-out costs of those who flight risk creates the greatest potential disruptions to CalPERS
8) Consider capping funding and settlement (payment) value (example: 50% of actual bonus not to exceed $[50,000]) as examples of controls

Inputs/Assumptions ($000)	
Year 0 Base Salary	360
Base salary annual adj.	3%
Bonus % (constant)	25%
LTI Match (% of Bonus)	50%
Annual Total Fund Performance	5%

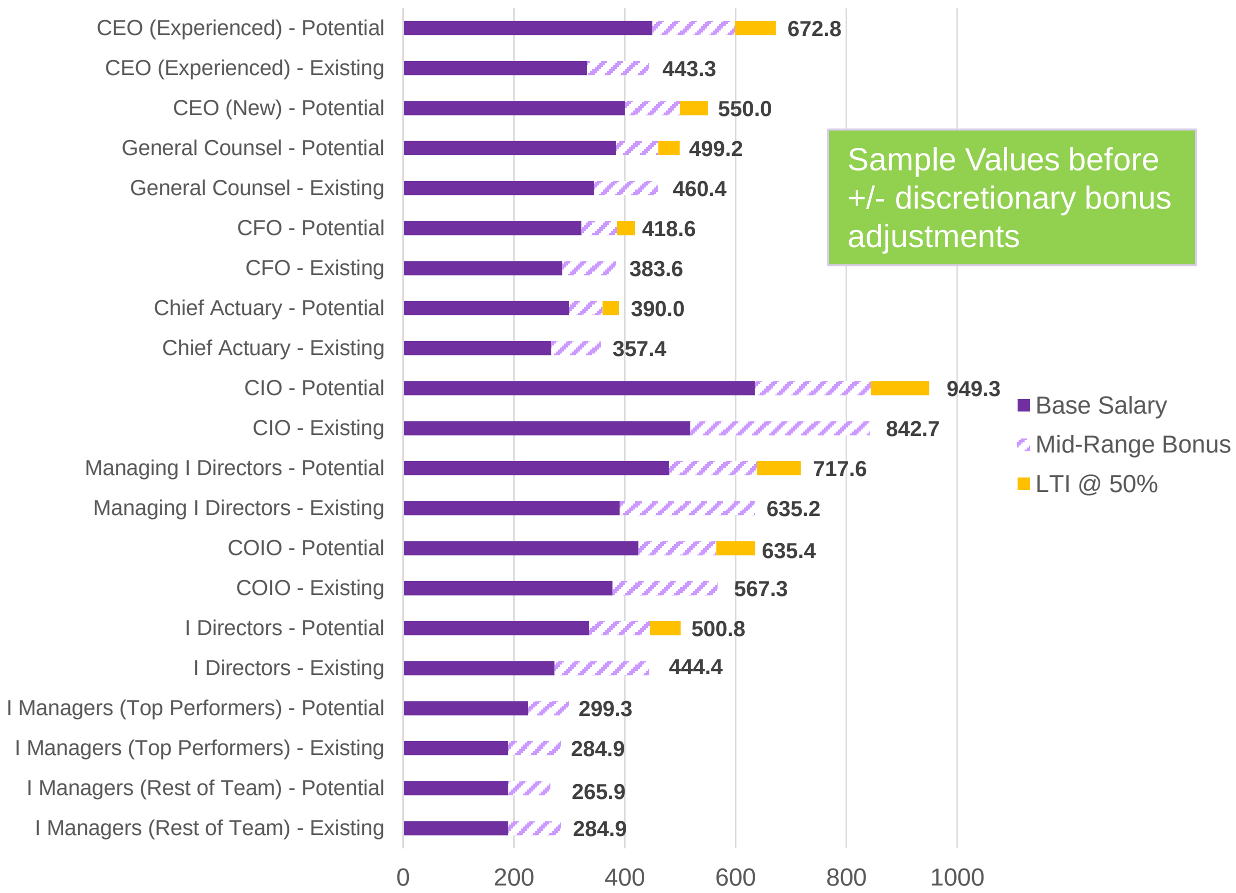
Year 0 identifies Cycle 1 LTI target award value, Cycle 2 reflects next annual target award value, etc.

						Payout of Cycle 1 LTI Award							
LTI Award Cycle	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**	**Year 11**	**Year 12**
Cycle 1 / Cycle 6 / Cycle 11	45	47	50	52	55	***57***	55	58	60	63	67	65	69
Cycle 2 / Cycle 7 / Cycle 12		46	49	51	54	56	***59***	55	58	61	64	67	67
Cycle 3 / Cycle 8 / Cycle 13			48	50	53	55	58	***61***	60	63	66	69	73
Cycle 4 / Cycle 9 / Cycle 14				49	52	54	57	60	***63***	62	65	68	71
Cycle 5 / Cycle 10					51	53	56	59	62	***65***	60	64	67
Unvested LTI Value (Holding Power)	45	94	146	202	263	276	285	292	303	314	322	333	347
Senstivity to Total Fund Performance (End of Year 5)													
If annualized Total Fund Return = +10%						319							
If annualized Total Fund Return = (10%)						177							

Year 5 identifies Cycle 1 LTI payment value

Recap of Financial Impact ($000)

Same content as presented on Slide 4



Comments

- Additive pay strategies increase earnings upside for top performers
- CEO can make discretionary adjustments of up to +/-50% to "right size" pay" (IO discretionary bonuses require CEO approval); consider use of individual and total dollar caps as controls
- CIO can make same discretionary adjustments for IO team to "right size" pay and provide "fail safe" for risk considerations; consider use of individual and total dollar caps
- Discretionary bonus opportunity expands at or below maximum given gap between target and maximum total bonus opportunity of 150% of target bonus
- Analysis assumes LTI is funded at 50% of formula bonus up to a maximum of $[50]K and investment managers do not participate

Wrap-up

PCTM Committee Design Feedback Checklist

Requested Rating:

Same content as presented on Slide 8

Cost Neutral Strategies – CEO & 20098s	Additive Pay Strategies – CEO & 20098s
1) Reallocate short-term variable pay to fixed pay, maintaining "take home" pay 2) Modify incentive metrics to reflect value adding results (Cost Effective Management of CEM, stakeholder satisfaction, and for leaders other than the CEAs an individual goal (which might include health care focus for certain jobs) 3) Include board relations on CEO's "scorecard" 4) Add bonus modifier for IO Total Fund performance, aligning interests with IO (quid quo pro is adding modifier to IO bonuses for CEM and Stakeholder Satisfaction)	8) Structural base salary and bonus adjustments for all roles (n = 4, excluding CIO), recognizing the size and complexities of CalPERS and the skills it requires to manage the organization's four primary segments (staff, customer service, insurance and pension) at satisfactory levels 9) Each year authorize CEO to approve discretionary bonus adjustments (assume cost neutral, as positive adjustments funded by negative adjustments) and retention bonuses to right size pay and to increase ability to respond to business and talent needs without adding to fixed costs – enhance and enforce discipline and attainment of objectives with controls and periodic reporting to PCTM Committee 10) Add long-term incentive program - initial and settlement (payout) values are functions of actual bonus and of multi-year Total Fund results, respectively
Cost Neutral Strategies – Investment Office ("IO")	**Additive Pay Strategies - IO**
5) Reallocate short-term variable pay to fixed pay, maintaining "take home" pay 6) Move from formulaic base salary adjustment methodology based on Merit Matrix to an annual salary adjustment budget of [2.5-3]% of salaries that the CIO uses to make discretionary adjustments to base salaries to enhance pay differentiation among the IO office 7) Modify definition of investment performance for incentive purposes to provider greater balance (total fund, cross fund, individual fund), reflecting how business is managed and to reduce any perceptions of excessive risk taking – and include modifier for CEM and stakeholder satisfaction	11) Annually authorize CIO to make discretionary bonus adjustments and retention bonus payments subject to CEO approval – enhance and enforce discipline and attainment of objectives with controls and periodic reporting to PCTM Committee 12) Add long-term incentive program – same as for CEO & 20098s

Next Steps

- **Revise approach based on PCTM Preferences (May/June delivery)**
  - Pay adjustments (base salary and bonus at a line item/incumbent level)
  - Final annual incentive philosophy and design
  - Design and controls for discretionary programs (salary increase budget, performance-based bonus adjustments, retention bonuses)
  - Final LTI design (eligibility, funding, crediting rate, termination and retirement provisions)
- **Update analytics and cost projections (May/June delivery)**
- **Develop final report (asking for approval in May/June)**
- **Parallel work streams (concurrent to identified activities)**
  - Phase I Implementation planning
  - Phase II analytics (pay benchmarking) and design (cascading Phase I final program framework, expected cost impact)
  - Phase II implementation planning