MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

PERFORMANCE, COMPENSATION &

TALENT MANAGEMENT COMMITTEE

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

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SACRAMENTO, CALIFORNIA

TUESDAY, JUNE 14, 2016

11:11 A.M.

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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 Ms. Katie Hagen

Mr. Ron Lind

BOARD MEMBERS:

Mr. Rob Feckner, President

Mr. Henry Jones, Vice President

Ms. Dana Hollinger

Mr. Bill Slaton

Ms. Betty Yee, represented by Mr. Alan Lofaso

STAFF:

Ms. Anne Stausboll, Chief Executive Officer

Ms. Cheryl Eason, Chief Financial Officer

Mr. Ted Eliopoulos, Chief Investment Officer

Mr. Doug Hoffner, Deputy Executive Officer

Mr. Matthew Jacobs, General Counsel

Ms. Donna Lum, Deputy Executive Officer

Mr. Brad Pacheco, Deputy Executive Officer

A P P E A R A N C E S   C O N T I N U E D

STAFF:

Ms. Tina Campbell, Chief, Human Resources Division

Ms. Carol Takehara, Committee Secretary

ALSO PRESENT:

Mr. Allan Emkin, Pension Consulting Alliance

Mr. Steve Foresti, Wilshire Consulting

Mr. Bill Gentry, Grant Thornton, LLP

Mr. Eric Gonzaga, Grant Thornton, LLP

I N D E X

P R O C E E D I N G S

CHAIRPERSON BILBREY: I call the meeting of the --

(Laughter.)

CHAIRPERSON BILBREY: I've got to get the right microphone on here.

I call this meeting of the Performance, Compensation and Talent Management Committee to order. Please call the roll.

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: Katie Hagen for Richard Gillihan?

ACTING COMMITTEE MEMBER HAGEN: Here.

COMMITTEE SECRETARY TAKEHARA: Ron Lind?

COMMITTEE MEMBER LIND: Here.

COMMITTEE SECRETARY TAKEHARA: Priya Mathur?

VICE CHAIRPERSON MATHUR: Here.

COMMITTEE SECRETARY TAKEHARA: Theresa Taylor?

CHAIRPERSON BILBREY: Excused.

All right. With that, we'll move to the Executive Report. Mr. Hoffner.

DEPUTY EXECUTIVE OFFICER HOFFNER: Good morning. Doug Hoffner, CalPERS staff.

Only one thing to highlight today which would be Agenda item 5, which we'll be getting into a minute. I just want to kind of set the context. Since we last met a month ago, I think there's been an extraordinary amount of effort and work put together by staff throughout CalPERS at many levels, as well as the Board's consultant, Grant Thornton, at looking at performance metrics for the coming year.

And I just want to highlight there's been extensive involvement and engagement in that last 30-day period of time. I don't want to belabor this, other than to say I'm looking forward to the presentation and your input and engagement on this item. And at this point, I'd like to turn it over to the consultants as you go through your consent items.

CHAIRPERSON BILBREY: First, we need to do the consent item.

VICE CHAIRPERSON MATHUR: Move approval.

COMMITTEE MEMBER COSTIGAN: Second.

CHAIRPERSON BILBREY: Moved and seconded to approve the consent item of the minutes.

Any discussion on the motion?

Seeing none.

All those in favor say aye?

(Ayes.)

CHAIRPERSON BILBREY: Opposed?

Motion carries.

Item 4, no one has asked to remove any of those information consent items. So now, we'll move to item 5 Grant Thornton and Ms. Campbell are you beginning this?

The Fiscal 16-17 compensation review performance metrics.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Good morning, Committee members. Tina Campbell, CalPERS staff.

Last month, Grant Thornton provided an update on the Compensation Review Project, including a phased in implementation strategy and a timeline of activities to occur during the remainder of the project. The Committee gave direction to move forward and bring back draft performance metrics for implementation of fiscal year 2016-17 for review this month.

Today's presentation will be presented by Bill Gentry an Eric Gonzaga of Grant Thornton. Unless you have questions for me, I'll turn it over to Grant Thornton. And then just a reminder that Agenda 5 is an action item for today.

(Thereupon an overhead presentation was Presented as follows.)

CHAIRPERSON BILBREY: All right.

MR. GONZAGA: Great. Well, thank you for the opportunity to present today. I'm technologically challenged, so I apologize for that.

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MR. GONZAGA: Thank you.

Well, as Doug and Tina had mentioned, you know, we've done quite a bit of, you know, background research and discussion, you know, in preparation for today's meeting. And, you know, just to summarize the materials and what you have in place there are, you know, first of all, what we're aiming to do here is establish performance metrics that will drive the incentive plan for 2016-2017.

And, you know, so what this report really demonstrates is, you know, our thought process, rationale, you know, for selection and proposal of really a streamlined incentive plan focused in on what we believe are, you know, not just the most important performance measure categories, but ways to measure performance from an outcomes standpoint pretty consistent with, you know, common practice.

So a lot of detail, but walking through our thought process, and our recommended goals for 2016-2017 in terms of incentive metrics that will drive incentive awards relative to outcomes. We've also provided a framework on how these incentive metrics would be used for the incentive award for both the CEO and the CIO.

And, of course, finalized in terms of suggested actions steps, what our recommendations are, because obviously, you know, we'd like to get feedback and perspective. Hopefully get, you know, some action on these items.

So, you know, with all of that you just -- what was our primary thought process? When you look through kind of the big picture, what were really trying to do is two things. One, any sort of incentive plan, we want two things. One is strategic alignment with your organization with your organizational strategy, and the second component as a significant financial services asset manager, make sure we have the appropriate risk enhancements, risk focus as part of the incentive plan.

So just taking that thought process through, because it is the foundation for everything that we're recommending, is when you take a look at the metrics, what we're focused in on are what are the strategic performance measure categories for your organization?

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MR. GONZAGA: And we're proposing essentially three categories: The mission of the organization, how do we measure that; operating efficiency; cost matters, that's something that every organization pays attention to; and, of course, the stakeholder -- you know, customer and stakeholder engagement perspectives as well.

And we're taking an enterprise-wide perspective. And the whole purpose of that is just to make sure that we're getting the full executive team on the same page in terms of team work, driving organizational strategies from an outcomes standpoint.

From a risk perspective, when you think about the metrics, we're using multiple metrics. There are no perfect metrics. But use of multiple metrics assists in, you know, potentially, you know, the risk management, as well as mitigates the potential for gaming performance metrics.

And we're also blending qualitative and quantitative concepts, you know, just to make sure that we have the appropriate -- not everything can be perfectly measured quantitatively. So qualitative discretion, qualitative perspectives are certainly appropriate as part of the incentive plan.

Weights in terms of what should drive the incentive award. We're recommending customized weights depending on the position, depending on the alignment with the organization, despite the fact that we're talking about shared metrics.

Performance standards. You know, there are a few things to cull out, and I think they speak to both, you know, best practice from a strategic performance standpoint, as well as risk standpoint. Balanced incentive metrics, taking a look at both the internal and external performance standards.

Potentially extending the investment performance period. This is a long-term organization, long-term objectives relative to not just investments, but just the general mission of the organization.

Objective perspectives. That's where the outcome orientation comes into play. What we're talking about is, you know, really metrics that are demonstrative and objectively reviewable from a performance standpoint.

And, you know, all of that relates back to, you know, both whether we're talking about risk management or we're talking about strategic priorities. One of the things that we should also point out is when we start taking a look at performance standards and goals, again the emphasis on the risk, and the potential behavioral aspects of, you know, both existing incentive criteria, as well as how do we modify that on a go-forward basis, something we considered very strongly, you know, as we worked through it.

Finally, discretion. We highly recommend a significant emphasis based on specific criteria related to use of discretion, both at the CEO and CIO level as well as at the Board level for the CEO. And we'll walk through that, whether it is from a risk-based adjustment, where if you violate certain risk principles of the organization, you have the authority to reduce awards down fully.

Also, address the whole issue around what do we do in the instance of negative returns?

So, you know, when we go through all of these, Bill and I will be switching off on the metrics, but recognizing that we are talking about a significant meaningful, we think, best practice change. It will require some policy adjustments. And so with that, we can get into the performance metrics.

Bill.

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MR. GENTRY: Hi, everybody. My name is Bill Gentry.

VICE CHAIRPERSON MATHUR: Microphone.

MR. GENTRY: Good morning.

CHAIRPERSON BILBREY: You're going to have to turn your mic on. We have to turn on your mic.

There you go.

MR. GENTRY: Good morning, and thank you.

My name is Bill Gentry. I'll be spending probably the next 20, 25 minutes walking the Committee through the metrics we're recommending before passing the baton back to Eric, who will talk about the proposed incentive frameworks for the Chief Executive Officer, as well as the Chief Investment Officer, and a straw-man design for other sort of key contributors in the organization, which will build on the work or the suggestions for those groups.

He'll walk you through some policy amendments and, at least from where we're sitting right now, what we think the next steps are.

So as Eric talked about, we're really focused on -- our first focus is always to do no harm. We want to do what's right for the organization, recognizing the interest and impact on all stakeholder and constituents. Eric has already talked about the three categories or the three types of metrics we've focused on, which is mission, operational effectiveness, and stakeholders. And those are really quantitative, because I think one of the things, as we talked to the Committee in the February and March time frame, that came out was a desire for transparency and simplicity. Those two things are attainable when you incorporate sort of quantification of performance against stated goals.

At the same time, I think it's important that the Committee reserves the right to exercise discretion, because formulas can generate outcomes that while they're accurate, they don't necessarily reflect reality. So we very much view the ability to make discretionary adjustments on the back end is key to making sure pay and performance are appropriately aligned.

We recognize that the organization has a number of initiatives that are currently in progress. One of this is the development of the strategic plan, which will be finalized towards the end of the year. You know, ideally, you like to be able to put the comp program after the strategic plan just to make sure we get the alignment that we're looking for. But in this instance, since the workstreams are concurrent, we think you can still make progress without necessarily having the final answer for what the strategic plan looks like over the next five years. And that's the reason for we're going to focus on mission, we're going to focus on operational effectiveness, and we're going to focus on the impact on stakeholders and what that means.

So we viewed 16-17 as really a transitional year. There's a number of substantive steps that the Committee can take that you can work towards sort of culmination of all of the strategies and implementation in the 17-18 time frame. So when I talk about transition, it's really this year recognizing that there's some additional work to be done. And hopefully this time next year we'll be at the finish line so to speak.

For the 16-17 time frame, under our three different categories, what we have focused on are those metrics that we think can be implemented without too much complexity, something -- or things that already align very closely with what staff is focused on, and again, provide the transparency and the simplicity that I think the Committee is looking for.

Under the mission category, investment performance would definitely be in for 16-17. We know there's a role for health care. But as we've talked to not only our colleagues who supported CalPERS in terms of strategy work, but also members of staff, and even the Board's investment advisors, you know, health care is -- you know, it's just a fact that CalPERS has more members that are receiving health care benefits than does just about any other pension management firm.

So there's a significant number of people. It's extremely important, but are we ready to include it as a metric for this year? We don't think so. We'd wait till next year, so we have more clarity in terms of not only what it means and how it will be measured, but also to allow staff to develop action strategies so they can influence results to the Committee's satisfaction.

The two metrics we're focusing on and suggesting under operational effectiveness are we're going to look at sort of the cost structure and the spend in terms of what's going on. We think it's consistent with what you're already doing, both in terms of how you evaluate performance, it's existing in terms of part of the strategic plan, but also over the last few months, we've learned a lot in terms of what we believe go-forward priorities will be, and there's a constant message around cost effective measurement and management. So CEM we'll talk about as well, but we want to align with that.

The other piece of it is the CEM calculation for the Investment Office. Now, the Investment Office has already engaged an outside consultant. They've got the methodology in place. They've looked at results. I think it's going to be -- it will have a lot of gravity in terms of how they view the success of their performance. And INVO CEM relates sort of the two key components of their business, which is investment results as well as costs on a relative basis.

And it's relative, both in terms of U.S. peers, but also global leaders. And those are the 14 largest sovereign wealth funds. And I think by looking at both of those dimensions of relative performance, you're reflecting the reality of CalPERS, both in terms of size, as defined as assets under management, as well as different cost structures, because they do vary considerably.

In terms of stakeholders, we're looking at customer service. There's -- over the course of the year, there's probably millions of customer interactions that Donna Lum and her team are leading, in terms of whether it's regarding retirement, or medical benefits, or the other services CalPERS provides, but also in terms of your members or employers. So that's how we've sort of viewed the world in terms of we want to look at things that are meaningful, are relevant, and again under management's control.

CHAIRPERSON BILBREY: We have a question. Ms. Hagen.

ACTING COMMITTEE MEMBER HAGEN: Thank you.

I was just wondering as we walk through the PowerPoint, if you could help me understand if you're looking at these for CEO and CIO, or if you'd have some for one and not for the other. As I read through it, I had a hard time telling the difference.

MR. GENTRY: Right, right. Absolutely be glad to. I'm glad you brought that up, because I think one of the things that's different about the framework we're suggesting is more of an enterprise focus than what we viewed under the existing programs. And on -- back in the reference section, it's page 44, you can see what sort of representative metrics are.

And this is not only for the CEO and CIO, but you get a sense for they're very branch specific, very activity focused. And I think at the highest levels of the organization it makes sense to have alignment between what's happening on a global basis. And by global, I mean enterprise, so we'll walk through. But all of the metrics we're talking about today will cover both.

ACTING COMMITTEE MEMBER HAGEN: Okay. Thank you.

MR. GENTRY: And there are some nuances. For example, for stakeholders and customer service, we just recommend we just focus on customer service for the investment office, and we'll tell you why. But generally, commonality of metrics where you're going to see variation is really in what the weights are, in terms of accountability. So we tried to be thoughtful about the approach.

Next slide please, Eric.

Oh, I got it.

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MR. GENTRY: Okay. Great. Well, I'm going to talk about in more detail those metrics that I've just mentioned across mission, operational effectiveness, and stakeholders. The first thing we really want to focus on, and I think this is probably the biggest departure in terms of what the existing metrics have been, have really -- really holding staff accountable for efficiency. I think it's part of the strategic plan. They're asking the Board from time to time for funds to make investments.

Inefficiency. Well, what's the best way to measure that? You know, ideally, we'd be ready to go with CEM. I don't think that's the case today. CEM is still in early-stage development. It's going -- the methodology is going to require customization to include not only pension management activities, which is now the case, but we also need to expand it in terms of health care. CalPERS is a very complex organization with high service levels. We want to make sure the metric fits, as just opposed to using it as a blind instrument, and just overlaying it on the organization.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Yes. I'm sorry to interrupt. I think it just might be helpful for the Committee to -- when you're talking about CEM to clarify as between on the investment side and on the pension administration side.

MR. GENTRY: Absolutely. Thank you, Anne.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Great. Thank you.

MR. GENTRY: So enterprise CEM. That's what I'm referring to, as opposed to investment CEM. So I think it's -- we recognize it's coming. Are we ready to implement for the coming year? We don't think so. We think there's more work to be done, both at the Board level and by staff on enterprise CEM. So our counsel is let's not implement it this year, but let's have an eye towards implementing in 17-18.

On the contrary, the Investment Office CEM, again they're farther down the path. They're ready to go. We've had conversations with both the Chief Investment Officer and the Chief Operating Investment Officer. It's consistent with how they manage the business, and something they're going to be looking at. So I don't think we have to slow the train down on this type of metric to make sure everybody is lock-step. Investment Office is ready to go and we're supportive of that.

So as we -- if we can't use CEM, what really should we focus on?

And we always come back to sort of the cost side of the equation. It's either operating costs or overhead operating costs. And the next couple of pages we'll make the distinction between the two. But again, we want to focus on something that's under management's control. They have an ability to make an impact in terms of efficiency, while at the same time not negatively impacting service levels.

CHAIRPERSON BILBREY: We have a question before you move on.

MR. GENTRY: Yes, sir.

CHAIRPERSON BILBREY: Mr. Boyken.

ACTING COMMITTEE MEMBER BOYKEN: Just a quick question. So within the CEM universe, is there significant, you know, peers in terms of the health side?

MR. GENTRY: Well, I think that -- and I -- CEM is provided by a different firm than Grant Thornton. I was invited to, and participated in, an initial briefing with the CEM consultant. And I think it's great analytics, great research, but CalPERS is unique in terms of this health care component. So I think it's possible, but at least, like I said, it will probably require some additional customization, because I think a lot of the complexity comes not from only the service levels that you provide, but also the types of services. So you're just not in the pension business.

CHAIRPERSON BILBREY: And that's why we're not until 17-18, because there's so much work to do.

Ms. Stausboll.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Yeah. So the Committee is all familiar with the CEM work on the investment side. And it's the Canadian company Cost Effectiveness Measurement. They do similar work, parallel work on the pension administration side. It doesn't take health -- the administration of health care into account at all right now.

The presentation for the Board on CEM and the pension administration side isn't scheduled till later in the fall. But I think we'll talking about it a little bit this afternoon in the strategic planning workshop. But for now, it's pension administration, not health.

ACTING COMMITTEE MEMBER BOYKEN: Thanks.

CHAIRPERSON BILBREY: Thank you. Continue.

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MR. GENTRY: So this slide provides more detail. When you hear us talking about operating costs and overhead operating costs, what exactly do they mean? You know, I think there's different -- and in my mind, the definition really turns on whether or not you're talking about how they're defined by budget, or how they're defined in terms of how the finance group manages the business.

And overhead operating costs you can see it's shaded -- slightly shaded. That's the one we're actually recommending, but we want to demonstrate to the Committee how we sort of arrived at the conclusion. And you'll see a number of slides that have sort of a side-by-side comparison, in terms of common.

Total operating expenditures, it's a pretty basic calculation. It starts with your total operating costs, which is one of your five budgeted cost categories. The other four being enterprise, HQ building, third-party administrator fees, as well as the investment and external management fees, so all of those costs.

On the overhead operating costs, and this is what we like about it so much, overhead are those costs that aren't mapped to a particular product or service delivery. So it's the back-office operations. And what we like about it is it does a couple of things. One, it makes it easy to identify how management is managing the business. At the same time, it gives the Committee insights into the effectiveness of past investments that are designed to drive efficiency. So it gives you a more granular look, in terms of I think how the business is being operated.

In terms of performance focus, you can both look at them in terms of absolute and relative terms. I think for the coming year, it makes sense to really look absolute, meaning looking at just CalPERS at this point, because you can establish a goal or an expectation and then task the staff with delivering on it.

The potential incentive metrics. Any time you measure something, you have to have a yardstick to measure it by. It can be budget, which we already know, just given the budgeting process, is not a good indication of success at CalPERS. The other number would be a plan or expectation number, which you can develop looking at prior results, statistical analysis, or other things. And then the ones that we prefer and we think the most sense is looking at costs in relation to other things.

On the left side of the page, the other things are the sum of those other -- all of your cost categories. So you'll come up with a percentage. On the right side of the sheet, it looks at -- and remember overhead operating costs are the costs that don't map to product and service delivery.

Well, the other piece of the equation are what are the costs that do map to product and service delivery? So those are the two components that we're looking at and will relate to. And then the next couple of slides will give you a more granular look in terms of what they actually mean.

All right.

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MR. GENTRY: Page nine is again just sort of pie charts. Again on the left side shows you the total operating expenditures. It includes both the investment operating costs, as well as administrative operating costs. There's a lot of things baked in the numbers. It's probably going to be in the neighborhood of 470 to 480 million. So it's a big number. If you want more details on the costs, back in the reference section, on page 50, it gives you the break out.

Now, on the right side, it shows you the overhead operating costs, or OOC. And you can see what the various components are. And we've called this out in a box. You know, INVO is a separate carve-out, so it's not reflected in there. And I think that's important for a couple of reasons. Probably the biggest one is any time you look at the Investment Office, sort of there's payments that are directly attributable to success, meaning as assets go up, you're going to be -- you're going to be paying more in terms of incentives, fees, and profit sharing. When assets come down, you're going to be paying less. So that creates noise, which doesn't really allow the Committee to see how effectively is staff managing the business. That's what we're trying to provide.

But you can see what the different cost categories are. Details are on page 52. And what we're recommending is you look at overhead operating costs as the numerator. And in the denominator, it's the sum of these costs, as well as the product and service delivery operating costs, which include -- there's four categories. It's actuarial services, customer service, audit, and third-party administration.

So we've taken the Investment Office out of the cost structure, so to speak. And what -- again, it allows you to focus on efficiency in managing the business. But one of those things that staff is doing to make the Investment Office successful? It's by recruiting people. It's by making sure they're progressing in their careers. It's all those other things that we think of as overhead.

So are there any questions on sort of the component parts of each one of our pie charts?

And again, there's more details on the back.

CHAIRPERSON BILBREY: Seeing none. Go ahead.

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MR. GENTRY: Next page, slide 10, I think really gets to the heart of the matter in terms of trend analysis. And again, our total operating costs are really defined by the budgeting process. And if you look at the trend, and this is on the left side of the page, since the 11-12 time frame to date, you get a very interesting set of charts.

And I think this -- you know, it's baked in the data. You'll see what's happening, but we basically had a reset in 13-14, and then things are fairly stable, again, as we look at costs as defined by the budgeting process.

If you look on the right-hand side of the page, this gives you a different sense in terms of what's happening to the overhead operating costs, which again are those costs that aren't mapped directly to product and service delivery. And you can see our overhead costs have been increasing, the product and service delivery costs, which is the bottom curve, has declined in the last year, and the total is somewhere in between. We think this is a much clearer recognition -- or much clearer picture of reality. So when we talk about transparency, we think this is probably exhibit A and why we think overhead operating costs makes sense.

CHAIRPERSON BILBREY: We have a question here.

Ms. Hollinger.

BOARD MEMBER HOLLINGER: Yeah. Isn't the over -- or is the overhead operating cost the reason it's increasing because we're managing more internally? And actually then, it's causing our ex -- actually to net more on our investment returns?

MR. GENTRY: That's true on the left side of the page, because it does pick up Investment Office. On the right side, what's happened -- and if we can flip to -- well, on page 12, the lower right corner, you can actually see the data --

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MR. GENTRY: -- in terms of what's happening. And for the 16-17 budgeted numbers, the overhead operating costs are going up by 10 million, but the product and service delivery costs have come down.

BOARD MEMBER HOLLINGER: Right.

MR. GENTRY: So the denominator -- you get both of those actions that are increasing to, at least in terms of the percentage performance, what's above. But those other things that are happening directly attributable to back office, not Investment Office, that are impacting the cost curve back on 10. Did I answer your question, Dana?

BOARD MEMBER HOLLINGER: Not really, because I don't understand your -- I didn't --

CHAIRPERSON BILBREY: Let me have Cheryl.

BOARD MEMBER HOLLINGER: Yeah, Cheryl.

CHAIRPERSON BILBREY: Cheryl, would you chime in?

CHIEF FINANCIAL OFFICER EASON: Cheryl Eason, CalPERS staff.

So maybe if I can just take a kind of conceptual approach to this. When we talk about the investment costs, they're really driven by a different driver. So the investment costs are driven typically more around assets under management and the administration of those assets under management.

BOARD MEMBER HOLLINGER: Right.

CHIEF FINANCIAL OFFICER EASON: So that's why we've said let's carve that out and let's look at it strictly from what are the drivers associated with Pension and Health administration. And so that's the concept of the overhead operating cost. And I think what's really important for the Committee to think about as we look at this concept is that there is a -- there is a correlation between the direct, which is those service costs, and the overhead costs or those indirect costs.

And what we're trying to determine here is that the overhead costs, if the total cost to deliver service goes down, so should your overhead cost. But if the total cost to deliver those services go up, the correlation -- the positive correlation is that your operating costs would go up as well, but the percentage would stay constant.

And so that's that concept of, you know, we have 30 percent -- 30, 35 percent to deliver that service, 35 percent goes towards the operating costs. The -- sorry, the overhead operating costs. That percentage would stay constant. If the cost to deliver that service goes up, the 35 percent could stay the same, but the dollar value would go up, because your bottom underlying basis goes up. So the whole idea would be we wouldn't be compromising any service in this particular measure, which is really important, but it does -- there is a positive correlation between total cost of delivering service and the cost -- the overhead carve-out cost of that.

BOARD MEMBER HOLLINGER: So then just if I'm understanding you correctly, what we've carved out of that equation is -- we're just looking at the cost to administer the services, and nothing else.

CHIEF FINANCIAL OFFICER EASON: That's right.

BOARD MEMBER HOLLINGER: Got it. Okay. Thank you.

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MR. GENTRY: On 11, it tees up. So we're transitioning from, as we think about costs, which one makes sense in terms of the incentive program, which one aligns with how staff manages the business and should be focused on to talking about how should we assess how we're doing in terms of performance.

Now, this gives you four alternative examples and it's versus budget, it's versus year-over-year change, it's versus goal. And really the two categories I want to focus you on are the number 3 and number 4, because we believe those are the most viable candidates to measure operational effectiveness for incentive purposes. And you can see with shading, we're focused again on the OOCP, which is overhead operating costs as a percentage of those total administrative costs.

And again, it's -- we talk about messaging. Cheryl has already sort of given you the advantages of the OOC metric. Again, it provides a lot of transparency in terms of how staff is managing the business, but at the same time, what we like about it is, as investments have been made to drive efficiency, that's where you're going to start to see the benefits show up. They're not going to be clouded or distorted by anything else.

And you can just -- as you work down the list, total operating expenditures as defined by budget, similar in concept, but again, we're picking up a lot of different things, and it just doesn't provide you with the level of granularity that number 4 provides.

And then, you know, the advantages and disadvantages. I think balance is key to all things, including incentive design. So you've heard about the advantages. The disadvantages are we need to set some goals. This is going to be a new process, I think, for the Committee as well as staff. We understand where we are, about $0.35 of the dollar in terms of delivering products and services ties back to overhead, but what's sort of the right metrics in terms of we want to drive continuous improvement.

I think while these are concepts that the Finance Office looks at, it's going to be new for other members of staff, because it's an enterprise-wide focus, there's a number of moving parts you need to focus on. But sort of the collateral benefit or the primary objective of this is we really want to start to cultivate new behaviors, and we think an enterprise-wide focus focused on -- that focuses on efficiency is the right place to be.

Any time you sort of have to think about costs, one of the things we need to consider are adjustments. We try to account for those things we know are going to happen that fall outside the norm. We've got a list of several adjustments in the back for the Committee to consider, there's three.

One of those is tied to the FLSA requirements that will have to be implemented before the end of the year. That's going to have an impact on salaries. Another one is, you know, ad hoc expenses that happen we just don't foresee. And then our third one is -- it isn't all that innovative, but it basically says the Committee is going to have the authority to make adjustments they see fit, based on stuff we just can't anticipate.

So again, how can we control for it?

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MR. GENTRY: Page 12 are our recommendations for what a payout schedule would look like. For an OOCP metric, as the definition of operational effectiveness, the table in the upper left shows you various performance levels and how they would map to incentive award opportunities. It's worth noting that lower percentages reflect improving efficiency, and that means it's just you're delivering your back-office requirements or the costs are coming down relative to the total costs.

On the right side is the trend analysis. And you can see there's some things that have happened over the years. We show you, sort of, year by year what it looks like, the three-year average, what the budget is for 16-17. And again, the 16-17 numbers, if you look -- without understanding what's going on with the data, it's like, boy, we've really come up. Why is that the case?

Well, OOC has gone up. Your overhead costs are going up. But at the same time, those product and service delivery operating costs are coming down. So there's almost an artificial lift. We're doing better on one piece of it, but it's distorting the puzzle, but -- and we'll walk you through how we came up with the schedule.

The first thing is starting at target, which is the middle row on our chart, is 36.4 percent. And the first thing we did is we sort of looked at what's budgeted for this year. I think there's been a number of changes in terms of the cost impact of items over the last few years. So it's hard to look at the five years as representative of what's going to happen going forward.

So 36.9 percent is a starting point with budget. We then said, well, if we can make a 50 basis point improvement, that's going to have a positive impact to the organization. And then from there, we built a structure, both on the low end and the high end, based on a couple of things. The first thing was you'll notice at target our one-up performance level has been the three-year average, so -- which is 34.9 percent. And then we set the maximum at 250 basis points below target, which is 33.9 percent. It hasn't been attained in the last five years.

But at the same time, in 11-12 and 12-13, there's been two occurrences when we were very, very close. So we think that's a reasonable maximum. Going the other direction, we just calibrated down. So if budget is attained, 36.9 percent, that would have an incentive payout of 75 percent of the opportunity. So if we just do like we think we're going to do, we're not going to get a full payout.

And then finally on the low end, if we take it down 150 basis points, 37.9 percent, that would be a payout of 50 percent of target. And anything below that means there would be no payout for this particular component.

So we looked at the past. We put in some expectations in terms of continuous improvement, and then just developed the range we thought would be reasonable and fair for management in terms of marching orders.

CHAIRPERSON BILBREY: We have a couple of questions.

Ms. Hagen.

ACTING COMMITTEE MEMBER HAGEN: I'll probably have a question in a minute about the incentive award payout percentage, but can we -- I'm sorry, can I ask a question on one of the prior slides?

MR. GENTRY: Absolutely.

ACTING COMMITTEE MEMBER HAGEN: I'm a little slow. So that I understand correctly, if -- you're suggesting option 4, the OOCP, but that does not -- for both the CEO and CIO, but that does not include investment operations in that calculation, correct?

MR. GENTRY: That's correct. The Investment Office is stripped out from that. And you don't have to look at it, but back on -- it's one of the pages in the references. You can look at both the overhead operating costs that don't -- that are the back-office costs that don't map to product or service delivery. And then the four categories that do map the product service delivery, Investment Office is not included in it. And the four were Actuarial, Customer Service, third-party administrator fees, as well as Audit.

ACTING COMMITTEE MEMBER HAGEN: So just sort of walking through implementation in my head, this would be an example of a category that you might weight lower for the CIO comparative to the CEO?

MR. GENTRY: Correct.

CHAIRPERSON BILBREY: Ms. Stausboll would like to --

CHIEF EXECUTIVE OFFICER STAUSBOLL: Yeah. Just knowing the Committee, I think it would be really helpful -- and sorry to throw a wrench in your presentation plan. But if the Committee could look I think at page 44 -- I'm not sure what page that is on your presentation. It's 44 on the Diligent -- that gives you really the big picture overview for the CEO and the CIO weightings. And it might help the rest of -- it might help for context as you go through the presentation. It's 32.

CHAIRPERSON BILBREY: That's 32 on the screen.

MR. GENTRY: Yeah, it's slide 32. And this is actually each one of the categories and the weightings we're suggesting for the CEO and CIO. Moving across the page from left to right, you can see for the CEO there's four metrics, for the CIO there's five metrics. The light blue box shows what the weightings are, zero below threshold, 50 percent at threshold, 100 percent at target or goal, and 150 percent maximum, and then the relative weightings between the two roles for each of the metrics that we're recommending.

So, Katie, to your point -- you anticipated our presentation -- that we're weighting the OOCP metrics for the CEO at 25 percent of total, and for the CIO at 10 percent of total. And again, we want to promote an enterprise-wide focus by staff. And staff, as Eric and I have learned, is not just non-investment investment. It's everybody.

So to the extent that the leaders are focused on efficiency in running the business and especially the stakeholder customer service components, there's going to be a benefit, because you have your best minds focused on the same sort of hope for outcomes, and it's all reinforced with pay design.

CHAIRPERSON BILBREY: Is that okay?

ACTING COMMITTEE MEMBER HAGEN: Yeah.

CHAIRPERSON BILBREY: Mr. Jones.

VICE PRESIDENT JONES: Yeah. Thank you, Mr. Chair. I'm trying to get a handle on -- it's an earlier chart, but you use the term expenditures in some cases and you use the term budget in some cases. And I'm trying to understand when are you using budget and when are you using expenditures? Because in that chart that showed the average three years, was that the average three years of expenditures or the average three years of the prior budgets?

MR. GENTRY: Right. And I apologize. Expenditures are how they're reported in the budget. You look at budget and then what the actual expenditures are. So I'm using those terms interchangeably. So I'm the cause of confusion. I apologize.

In terms of the three-year average, which I believe is this chart on 12 --

CHAIRPERSON BILBREY: Or 24 of the iPad.

MR. GENTRY: -- those are the actual costs.

VICE PRESIDENT JONES: Actual expenditures.

MR. GENTRY: Yes, sir.

VICE PRESIDENT JONES: So -- but then when you moved to 16-17, that's a budget number, because that hasn't occurred yet.

MR. GENTRY: 16-17.

VICE PRESIDENT JONES: Back to the chart.

MR. GENTRY: Oh, I see. I see. That's correct. That's 16-17's budget, and that's why we've got the --

VICE PRESIDENT JONES: Okay. And so therefore your 16-17 goal is based on budget also.

MR. GENTRY: Correct. We're --

VICE PRESIDENT JONES: So it appears to me that there would be an inappropriate comparison, because you're looking at the average of the prior three years are expenditures. So you're looking at a budget number that you know is going to come down, because you -- traditionally, you never spend 100 percent of your budget.

MR. GENTRY: Right.

VICE PRESIDENT JONES: So there's some margin that needs to be factored in if you're going to use a budget number going forward. See what I'm saying?

MR. GENTRY: Right. Yeah, Henry, that's a great point. And that's why we have a spike in 16-17, as you can see on the chart. And then I was trying to understand, all right, what's behind the numbers?

And that's why you see the data numbers below it. Well, what we're forecasting on the PSDOC, which is product and service delivery operating costs, is actually coming down from 412 to 398 out there on the far right.

At the same time, the growth in OOC it's a fairly linear progression going year over year there's an increase, so it's up 10 million, which on a 220 in 16 -- 15-16, it's probably margin of error. So as we thought about, okay, we understand what's going on with the budget, how are we going to -- how are we going to account for this in the goal? And that's why you see goal was 50 basis points less. It's 36.4 percent as opposed to 36.9.

VICE PRESIDENT JONES: And I would suggest though, if you were trying to see what that relationship of budget to expenditures, what percent differences in the prior years, when you look at the budget and expenditure levels, because it's not 100 percent.

MR. GENTRY: Right.

VICE PRESIDENT JONES: But you're starting at 100 percent on your goals out here in 16-17 and reducing those. That's all I'm trying to suggest.

MR. GENTRY: I understand. Cheryl, do you have any color to add?

CHIEF FINANCIAL OFFICER EASON: No, I think that's a very fair comment, Mr. Jones. And I think that's -- we'd need to look at that, because as you correctly point out, typically our budget numbers tend to come in. They're higher than what the actually comes in. And so having a three-year average on actual seems like a bit of an apples-to-orange comparison.

VICE PRESIDENT JONES: Exactly. Thank you.

CHIEF FINANCIAL OFFICER EASON: So we agree. Thank you.

MR. GENTRY: So are there any questions on 12 before we move to 13?

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MR. GENTRY: Thirteen are the types of adjustments that I've identified. Again, any time you look at costs or think about costs, there's things that happen that we can't plan for during the year. The three I've already talked about. It's non-budgeted payments required by the new FLSA requirements. The other would be non-budgeted costs that occur during the year. And finally, three is our catch-all in terms of if things happen, the Committee will have the authority to exercise its discretion or whether or not they're included. So that's the operational effectiveness slide -- slides.

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MR. GENTRY: The next metric I'd like to talk about Investment Office CEM starting on page 14. It's calculated using a five-year comparison of costs and NetValue added. Both of these are compared in relation to two sets of benchmarks, one is the U.S. pension managers, the other is the global leaders, which are the 14 sovereign funds. It gives you different dimensions and you really need to look at performance through both of those lenses when you're considering the Investment Office on a relative basis, because it picks up the size consideration, both in terms of assets under management.

It also picks up large numbers of members, which the global leaders give you those perspectives, but at the same time their cost structures are very different. So we look at those in relation to the U.S. pension managers. And I think it provides you with an accurate representation how performance has been over a five-year period for the Investment Office.

In terms of the mechanics of the program, it's really a matrix as you'll see on the next page. And depending on where you plot on the matrix, that's going to generate a payout based on performance. And there's a threshold target and maximum levels. Our suggested weightings for the CEO and CIO are 15 and 20 percent respectively. And if you think back to Katie's question where we overweighted on the CEO relative to the CIO on the operational effectiveness metric, since this is the Investment Office, it's the same thinking. They each should have accountability for the results, but there's going to be a heavier weighting for the CIO than the Chief Executive Officer.

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MR. GENTRY: Now, this page illustrates output --

I'm sorry?

CHAIRPERSON BILBREY: Okay. Sorry. Ms. Mathur.

VICE CHAIRPERSON MATHUR: Hi there. And maybe you're going to get this, so forgive me if I'm anticipating. But back on page 14, the page we were just on, the incentive award opportunity ranges from 0 to 150 of target award. The first bullet under that is about the maximum attainable for outperformance of U.S. and global benchmarks. And I guess my question is around how do you -- how do we manage -- and I know you're going to get to this, but I'll jut ask it anyway. How do we ensure that we're not incentivizing too much risk taking with that benchmark -- with that incentive award range?

MR. GENTRY: Right. And I think that's a question that's on point with everything we've incorporated into the design. There's sort of multiple levels of defense in terms of we don't want to motivate people to take excessive risk.

And it's sort of a what's going on this year, as well as changes that I think we're thinking about for next year. The one piece is, if you look at the overall weightings, they're relatively small. Nobody is going to have a windfall base solely on any one individual metric. That's a different way of saying we have multiple metrics, in terms of what the incentives are tied for. They're paid for different things.

The other thing is the Committee again has the discretion, if we think we're taking risks that are inappropriate, you have to ability to reduce or eliminate awards.

There's other pay strategies that we've talked about, for example, rebalancing base salary and the incentive cash award opportunity. So the incentive cash award opportunity is actually coming down, which again makes the value that's tied to this particular outcome less than it has been typically.

And then finally, if we were to implement a long-term incentive program, which is one of the things we talked about potentially for next year, that's going to have skin in the game in terms if you have an adverse risk outcome, it's not only going to eliminate all of the annual incentive, but it's also going to negatively impact or eliminate the long-term incentive award as well.

So there's multiple strategies. Some of it's quantitative. Others is, you know what, we -- our last line of defense is discretion. If we think we're doing things we shouldn't do, we have the ability to eliminate the incentives.

VICE CHAIRPERSON MATHUR: Okay. Thank you.

CHAIRPERSON BILBREY: Ms. Hollinger.

BOARD MEMBER HOLLINGER: Yeah. My other thing in comparing us and like on the sovereign wealth funds, a lot of times they're just looking to park capital. And also on the investment side, you know, because of our -- we manage to a 7½ percent bogey, I mean, they may have to end up passing on deals because, you know, once they do the calculus on them -- I'm just -- I'm just not sure that you can look at things under the same optics as -- and consider that a benchmark.

MR. GENTRY: Right. No, I think -- I agree. It's difficult to assess performance at any point in time. And to the extent we can bring as many different lenses, that's going to give us the best chances of having the outcome. But you're right, investment strategies are different. What they're --

BOARD MEMBER HOLLINGER: We've got a lot of --

VICE CHAIRPERSON MATHUR: Your mic is not on.

CHAIRPERSON BILBREY: It is now.

BOARD MEMBER HOLLINGER: We have a lot of illiquid asset classes that may not have liquidity for, you know, 5 -- I mean 5, 10 years.

MR. GENTRY: I think Ted sitting beside me is not a coincidence.

(Laughter.)

CHIEF INVESTMENT OFFICER ELIOPOULOS: Terrific.

I thought -- Ted Eliopoulos, Chief Investment Officer.

I think on this page you can see that the graduation of target payouts takes into account some of the concerns that you just raised. In other words, only at the very highest outperformance, the 150 percent takes into account the global peers versus the U.S. peers. And part of that is some of the distinguishing factors that you raised, as well as in addition to that, it's not just the global sovereign wealth funds that are in that global peer group, it's also the Canadian plans. And both of the sovereign wealth funds and the Canadian plans, and some of the European peers they have some significant, you know, business model advantages versus the U.S. public plans.

So I think to outperform on a cost-adjusted as well as a value enhancement basis, that's the methodology for CEM, competing against those global benchmarks is a stretch goal in many respects, and also there's distinguishing factors that make it not appropriate to measure for the entire waterfall that you see up there.

The second piece though is the value-adjust -- the value-added takes into account some of the differences in benchmarks between the plans. So we think it's a pretty good benchmark.

BOARD MEMBER HOLLINGER: Thanks.

CHAIRPERSON BILBREY: Yes, please say.

MR. GENTRY: I asked that Ted stay, because the section will continue to sort of build on some concepts in terms of other changes we're suggesting, and I think having him available is valuable, I think, to the Committee's decisioning process.

So, you know, CEM again this is -- the Investment Office CEM, not enterprise CEM, is something they're already doing in terms of how they manage the business, how they think about performance, both not only for Ted and Wylie, but also for the other leaders in the Investment Office. Again, it's a different perspective.

Is there a perfect metric? There's not. The ones I'd point to, you know, we've got a balance of sort of the enterprise metrics. We've got metrics that are specific to the Investment Office. One of the things I could want to point out about the CEM metric, it's independently developed, but there is a one year lag. In meaning the results it just takes time for this company to get the results of the other pension managers in place, get everything captured. So that's probably a flaw in one of the metrics.

But at the same time, just because it lags by a year doesn't mean its not an effective look, because as we know, performance measurement is a snapshot in time. I take comfort in the fact it's not -- again, it's not the only metric. And when we would be measuring the Investment Office CEM as well as investment results, which we'll get to, which would be of the current time period, which everyone would expect.

But as you can see, it's a matrix payout. There's not interpolation, depending on how we perform. And the grid lines on the right side really shows the point of demarcation. The horizontal grid line and the vertical grid line determine whether or not an incentive is paid and how much is paid. And at least on the horizontal grid line, as you move to the left on the chart, that means your cost per unit is falling, which is the outcome that you want. It means you're more efficient. At the same time, as you're moving north on the chart, so to speak, that means your variance from the benchmarks in terms of investment returns, you're outperforming.

So ultimately where you want to land is the upper left quadrant. And we've tied incentive opportunities in three levels. It's 100 percent if CalPERS outperforms the U.S. benchmark on both cost and returns. It's 125 percent payout if it outperforms the U.S. benchmark on both cost by at least five basis points, and net value added, which is 20 basis points. And then finally, there's 150 percent if you beat both the U.S. as well as the global leaders on both of those dimensions.

So that's the grid. And as you can see, there's a 50/50 on the lower left and the upper right. And then if we're in the bottom right means we're underperforming on both cost and return. There's no payout.

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MR. GENTRY: In connection, I think, with total fund performance, which is what we're going to talk about over the next two slides, there's a couple of changes that we are suggesting for the Committee's consideration. One is the investment period for total fund performance. We know it's currently three -- three years. And there's been decisions that have been made in the past that we don't fully understand. I don't mean that to sound negatively. We just don't know the history or the thought process.

But part of our role we think is to bring a fresh perspective on some topics that are probably time tested. So, you know, I hope you'll indulge me over the next couple of minutes. But of the three metrics that we're suggesting for consideration as they relate to the total fund performance, the first one is the investment horizon. You know, currently it's three years. We're suggesting extending that horizon to five years. And we're suggesting it for a couple of reasons.

The first one is and I think this is reflected in the Board's investment advisor's letters, it really does reflect the investment cycle and the long-term nature of your investment strategies. At the same time, from a risk perspective, the longer the measurement period, the better the chances are that adverse risk outcomes will present themselves.

So I think that's a -- that's something that -- and it's not just us saying that. If you look at all of the literature in the marketplace about what can financial services organizations do to make -- pay more sensitive to risk, extending the measurement period is always right at the top of the list.

And then finally, I think as we think about it, again five years is consistent with the Investment Office CEM methodology. So for simplicity and transparency is moving to a common measurement basis. So that's the first suggestion.

The second suggestion is I -- you know, rather than sort of the normal compound annualized growth rate measurement period, which takes into account sort of the starting and ending period, an alternative measurement basis might be simply taking a simple five-year average over the measurement period, so you're capturing all the periods. But at the same time, it doesn't raise any motivation or temptation to try to do things, and maybe the final period or any one specific period, to have a better outcome than might you want prudently to deliver to.

And then the third suggestion is -- and again, we know there's a history for the discussion, but we think it's probably the right time for the Committee to look at the incentive curve for the Chief Investment Officer. And by that it's the performance range over which the incentive opportunity can be earned for investment results.

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MR. GENTRY: And this is illustrated on page 18. Now, page 18, there's two lines on the chart. You'll see one that's got a couple of kinks, which is the upper line. Then you've got the straight line on the lower half of the chart. The lower half -- the straight line is what CalPERS incentive curve is today. No incentive is earned until you're one basis point above the benchmark. And the maximum incentive is earned at 30 basis points above the benchmark.

That's a slope of five percent. And what it means is is that for every one basis point improvement in performance, the incentive award goes up five percent. That's a steep curve, because you can materially change the outcome of what your incentive opportunity is by doing a little bit more.

And so there's a couple of things from a risk perspective, as we look at it, we want to call to the Committee's attention. One is you've got a high, steep entry point, meaning you have to perform -- you have to beat the benchmark to get any incentive. And to get an expected incentive, which we would say would be about 100 percent of target, you have to beat the benchmark by 20 basis points.

Now, Eric and I have been working with clients in the asset management and financial services organization for a long time. Virtually every head of their investment management organization we talk to tells us the same thing, they don't want to be best in class, because if they are, that means they're taking risks that others are unwilling to take.

And so I think as we really think about it from the risk perspective, you've got a high entry point, then a steep slope that maxes out at 30 basis points above, is that consistent with the long-term view of the Investment Office and your investment strategies?

As an example, we've dropped in an incentive curve for a for-profit organization. They have an asset and liability management incentive program. So it's the same mentally, balancing risk and reward. And what have they done? They've expanded the incentive zone, so that it kicks in much sooner than CalPERS situation is. It sets a target performance level of minus 25 basis points to zero. So it's not an individual point on the curve where you can earn the incentive, but it's like if we're within a reasonable distance of the benchmark, that's target payout, and then it's got a slow ramp up in terms of additional pay, again as a way to make sure we're not motivating people to take excessive risks.

So CalPERS is a not-for-profit company. The model we show is for the PNC Financial Services Group. This information is disclosed in their proxy statement, which is a public filing with the SEC. But we were just struck by the shape of CalPERS curve based on other risk mitigation strategies I think the Board and the Investment Office have been working on just in terms of is this necessarily driving the right types of behavior?

So that's sort of context for the point that I want to make.

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MR. GENTRY: On the very next slide, what if we redrew CalPERS incentive curve to look more like -- or to provide more balance? We've expanded the curve. It's got a similar shape, to the for-profit curve on the prior page. But you see we haven't increased the award opportunity. We've actually kept it the same. But as rough justice for dropping the performance level at which the target incentive can be earned, you would now have to achieve five basis points in additional return to receive the maximum award. So that's again, as we were thinking about the program, we thought it would be a good opportunity to surface the issue to see what the Committee is thinking is in terms of is the incentive curve doing what we want it to do from an incentive perspective as well as a risk perspective?

CHAIRPERSON BILBREY: Ms. Mathur has a question.

VICE CHAIRPERSON MATHUR: Thank you. Yes, I think this is a very important point. We really want this incentive curve to match -- to be aligned with our organizational goals, our incentive -- our investment goals, our asset liability work, which has all been focus -- which has largely been focusing on reducing risk in the portfolio, and particularly in certain asset classes.

And I think while it is in some ways hard to explain perhaps why you would give an incentive payout for below benchmark performance, it -- I do think -- I do think it is important for limiting our preventing excessive risk taking, because we do want to be within sort of a range around the benchmark. We know we're not going to hit the benchmark every time. You never do really, and so I think this is a very appropriate suggestion and one we should consider seriously.

Thank you.

CHAIRPERSON BILBREY: Mr. Boyken.

ACTING COMMITTEE MEMBER BOYKEN: Thanks. I just have a couple questions about it. I do get the logic of trying to a void excessive risk. Two questions. One is does it make more sense in the private sector where much more of the total compensation is bonus to have payouts for under-benchmark performance?

And then I guess the other thing is I think it's hard enough for us, as a public agency, to give payouts, you know, on relative performance, which I think bonuses should be based on relative performance. But in years where the market performs poorly, it's harder to explain to the public why the bonus is based on relative rather than absolute performance.

So I'm just trying to think about, you know, how we deal with the difficulty of saying here's the benchmark we set, but you get an extra reward for performing under the benchmark.

MR. GENTRY: Well, I think on the first point, the -- sort of the range around -- or how we think about target rather than trying to -- you know, I'm not a golfer and people have heard me make this analogy before. But, you know, asking the team to hit a hole-in-one every hole, it does sound risky, right? We have to beat the benchmark. So by expanding the target, even slightly below what the benchmark is, we want the steep ramp up to get them into a reasonable range. And if then the risks are appropriate, there might be an opportunity to move above the benchmark, right? Because I think we understand what our risk tolerances are. We want to be able to drive the team to land in the right spot in terms of balancing risk and reward, not only in terms of investment returns, but also in terms of what their incentive opportunities look like.

And I know there's never any easy question, but paying for negative performance -- and we've got some commentary in a couple of slides on that as well in terms of how it should be handled -- I think it's -- you know, there's precedent for doing it, whether it's public sector or private sector. Again, I think the real benefit is in terms of a risk mitigation -- risk mitigating strategy, which we've got a number of on the next page.

So if we look at sort of the continuum of what strategies you can do to make sure everything is buttoned up, it's just one of those things we'd like to call out.

On the second piece, paying incentives when results are down, I don't believe is necessarily a bad outcome for a couple of reasons.

One is, the investment cycle as we know it's highly fluid, highly dynamic. The other thing is by design the portfolio strategy and the assets will be negative for time to time just for defensive reasons. So I think it's do we value incenting the team to play defense as well as they do offense?

And that's a question I can't answer for you. I think it's for the Committee's consideration. But capital preservation, avoiding significant drawdowns, I do believe has value.

CHAIRPERSON BILBREY: Ms. Hollinger.

BOARD MEMBER HOLLINGER: Yeah. Thank you.

I agree with you. And being as probably looking forward where there is volatility -- a lot of volatility in the market, and I know I'm from the particular bent that going forward I'm looking more toward a principal protection strategy. So I think that for people to be compensated for being prudent is valuable. So thank you.

CHAIRPERSON BILBREY: Mr. Slaton.

BOARD MEMBER SLATON: Thank you, Mr. Chair.

I just want to echo what Ms. Hollinger said. You know, the ability to play defense and be compensated for it is really important. And I think it's incumbent upon this Committee and this Board to be able to explain when needed, and to have the public understand that it's part of an overall strategy. You know, this is not a five-year fund. It's not a 10-year fund. This is a long-term fund. And therefore, you have to play defense as well as offense.

So, to me, it just logically makes sense that you want to have the incentive match the actions that you want people to take. So, to me, that is, you know, just a common sense fit.

Thank you.

CHAIRPERSON BILBREY: All right. We can continue.

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MR. GENTRY: The next slide on 20 is really intended to say, you know, we've suggested some strategies and we've talked a lot about risk, but I think it's important just to pause for a minute and look at the strategies in the context of a comprehensive risk-avoidant strategy as they relate to incentives.

And you can see on row one, we've got a carve-out for the CIO and CFO. For their teams, it's -- we're not incenting people under the same set of metrics. That's something you currently have in place. Then the middle blocks that are shaded would be -- we would think would be enhancements that would be -- would result from the approval of the '16 and '17 strategies that we're recommending. And then seven and eight, you can see are for future consideration. But again, as we think about where are the holes, how can we button those up, we think by implementing the one that you have in place, the five that we're suggesting for this year and then the two for next year, you will have achieved the objective of making sure that risk is -- compensation is sensitive to risk. And you've done everything you can to button things up.

So that's just a recap of sort of where we've been. And hopefully the risk perspective, we know it's been a strong one, and it's driven a lot of our thinking, but we hope it's a fresh perspective for the Committee.

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MR. GENTRY: Page 21 comments on negative absolute returns. This sets forth what our suggestion is. You know, the fact that you have a policy in place we think is a very good place to be. It's going to generate discussions. And I think anytime you have a negative absolute return, that's what we should have a discussion on, why did this happen? Is it a matter of the investment cycle, is it intentional because our asset allocation strategy given market conditions is going to put us in that position, or did it result from non-adherence to our risk management policies and principles, which is a bad outcome?

So we very much like the policy statement in place. You know, I think anytime there is a negative absolute return what does cause it mean, why did it happen, who was involved, and then what should the potential response strategy should be?

The things we would say, and we'd advise the Committee on, you really need to think of it in terms of individual participants on a case-by-case basis. Just because returns are negative, doesn't necessarily mean that's a bad outcome, as some of the Committee members themselves have recognized.

But I think in terms of when action might be taken to either reduce or eliminate rewards, I think it really starts with instances where we see double negatives. And by that, I mean, it's negative absolute return, and negative variance from the benchmark. And that's really, okay, we should probably have a discussion why this happened, and then on -- in instances when there has been non-adherence to your risk management policies, principles, processes, and procedures, we do think it does make sense to take corrective action in terms of eliminating or reducing awards. I wouldn't use it as a blunt instrument. I think it's -- again, it really should be considered on a case-by-case basis.

CHAIRPERSON BILBREY: Ms. Hagen.

ACTING COMMITTEE MEMBER HAGEN: Thank you.

So I think your last comment may have clarified it for me. But, you know, early on in the presentation, you indicated that you really undertook an effort to make this a more objective process, but this seems to include a lot of discretion. But you mentioned non-adherence to risk-reduction strategies. So I'm assuming that those would be outlined in a policy or going forward?

MR. GENTRY: That's correct. In August, we'll be coming back with a red-lined version of the policy changes that we're recommending. But it's important, and I've sent emails to HR as well as in the Investment Office, to really influence behaviors. People need to understand the consequences. So it's not only a policy document, but it's things like training on an ongoing basis. It's getting the participants to acknowledge that they've received the training and they understand the consequences.

So there's things we can do in terms of talent management that's outside of sort of the compensation program to reinforce everything that's happening. And, Ted, would you like to talk about your training policy currently?

CHIEF INVESTMENT OFFICER ELIOPOULOS: Yeah, I think you -- so there's a whole range of compliance training that I think Ms. Hagen is familiar with, as is the Committee, that both the investment officers complete as well as other members in the enterprise as well. But he's really referring to that to make sure we have a culture of compliance, that all of the training that is required is completed and is meaningful.

MR. GENTRY: Thank you.

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MR. GENTRY: The very next slide, Katie, I think provides more teeth to what I'm saying in terms of the impact. And you can sort of see current state on the left, what the employee impact is in the middle and future State. And as we look at, you know, if it's codified in the policy, I think that's going to help. It's reinforced by training, and it comes back to which policy, because we did a -- just a scan of the word "risk" in the current compensation policy, and risk came up four times, but it's more in connection with pay-for-performance, at-risk pay. There weren't any direct references to -- or it wasn't explicit that if there's an adverse risk outcome, or if the participant fails to adhere to our risk management policies, these consequences, one through eight, could potentially happen.

And we think again to the extent we're going to influence behaviors it's got to be documented. And it's not just in the policy document. It's going to spill over into the training as well.

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MR. GENTRY: If there are not any questions, I'll put the clicker in Eric's hands. Thank you.

MR. GONZAGA: Thank, Bill. You know, Bill touched on, you know, obviously the two first -- the first two metrics that we have for consideration, efficiency and the mission-related objectives.

Now, the final metric that we have for consideration is really -- it really is tied directly to mission. And it's one of success with stakeholders, whether that be members, employers, employees in coming up with outcomes, like many organizations do, you know, as a mission and service-driven organization tying an element of the incentive award and getting the executive team on the same page relative to stakeholder success.

And, you know, so our thought process as we go threw this and when we're thinking about what the right metrics are for 2016-2017, it's a couple things. One, what do you have in place right now in terms of what you're measuring?

The second thing is just thinking about going into the next year. You know, it's been a challenging economic environment. You're going through organizational changes, and you've had some success from a stakeholder perspective in recent years. It's maintaining that progress despite -- kind of leadership change, despite the environment, measuring outcomes relative to that.

And so, you know, we took a look at a couple different components. One is customer satisfaction, and employee satisfaction and stakeholder engagement specifically. Currently, right now, you use the OHI survey from an employee engagement standpoint. And it's a great survey, and there's been a lot of progress. We had the opportunity to sit through the engagement, but recognizing that right now OHI is something that's done once every few years, as well as the fact that employee engagement is quite strong.

Our focus was going into 2016-2017, let's look at two components. You know, one is tying incentive awards to customer satisfaction. Those specific service levels that the Board is used to reviewing.

Secondarily, stakeholder engagement capitalizing on the various surveys that you use.

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MR. GONZAGA: And so, you know, just to give you a little bit of color in terms of how we ended up, where we ended up. For customer service specifically, we keyed in on, you know, two of the most critical areas in terms of the quarterly and annual surveys that you as an organize, you as a Board look at.

It is two questions, percentage of benefit payments issued to our customers within established service levels, and that includes retirement service, disability retirement and refund service. The second would be overall customer satisfaction, benefit payments, service delivery, employer interaction, and member self-service, you know, something that is used by the customer service department with significant frequency.

And you take a look at it. Most recent year performance in the two questions was 91 to 95 percent, exceeding the thresholds at 85 and 90 percent in terms of what the committees and the Board approved as the appropriate expectations, and a long-term target for both of these questions to getting to 95 to 98 percent.

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MR. GONZAGA: So our suggestion was taking a look at -- and essentially averaging those two questions, you would receive 100 percent of target award for meeting what has been significant performance improvement, you know, from last year. So that would be right at 92 to 94 percents. Threshold payout between 88 and 90 percent, which would exceed, you know, the lowest percentage of recent performance, and payout at maximum levels to the extent that you achieve 95 percent or greater, which would be comparable to those long-term targets, which you're establishing. So tied directly to the survey questions and questions that are used with significant frequency.

Any questions on that?

CHAIRPERSON BILBREY: Hold on. Mr. Slaton. One moment.

BOARD MEMBER SLATON: Thank you.

So I understand this -- that we've done a lot of work in customer satisfaction, so we're kind of using that metric, because we have experience with it. But I've been involved with other organizations where they're moving to customer experience, rather than just customer satisfaction. So is that something we -- that we could get to in the future, because we don't have any past data to look at, because we haven't been, you know, looking at it through that lens?

But do you have -- have you had other experience where we're starting to move to that customer experience measurement rather than customer satisfaction?

MR. GONZAGA: Yeah, that's a good point. And what I would say is that the customer experience category is -- you know, it's significantly -- in totality it's -- there's overall questions and folks just keying in to the most important strategic questions for the year.

And I actually would say that with the next question coming up here, it does kind of -- although it's not the specific customer experience one vendor, et cetera, it does speak to that holistic perspective, once you start thinking about stakeholder engagement, and that is the second question.

But I do agree with you that for a customer experience standpoint, the best way to measure it is from a holistic perspective as opposed to just service levels.

BOARD MEMBER SLATON: And one other question, can you -- again -- oh, I see. I was misreading the chart for a second. So you have to get to above -- you have to get 88 or above --

MR. GONZAGA: Right.

BOARD MEMBER SLATON: -- to be able to be compensated. But isn't 88 below our expectations on the prior chart, or did I misread it?

MR. GONZAGA: No. This is an average of the two questions. And so it's actually in excess by 0.5. The 80 --

BOARD MEMBER SLATON: Oh, I see, because you've got 85 to 95.

MR. GONZAGA: Right.

BOARD MEMBER SLATON: Okay. Thank you.

CHAIRPERSON BILBREY: All right. Ms. Hagen.

ACTING COMMITTEE MEMBER HAGEN: Thank you.

Similar to a couple of my previous questions, I guess I'm just trying to determine how this would reflect the performance of the CIO in this measurement, because the questions appear to be service related, benefits administration, and that kind of thing.

MR. GONZAGA: That's right. And this would not be a question for the CIO.

CHAIRPERSON BILBREY: I also wanted to note on page 44 in the back, it said customer service, but it should have said, I believe, stakeholder engagement is what --

VICE CHAIRPERSON MATHUR: For the CIO.

CHAIRPERSON BILBREY: For the CIO.

MR. GONZAGA: That's right. That's a typo on our end. It should be stakeholder engagement, which is the next question we're going to talk about. Customer service should -- we're not recommending that that be for the CIO.

ACTING COMMITTEE MEMBER HAGEN: Right, but just looking at the stakeholder questions too, I'm not sure -- I just don't know if that -- that's a -- I guess it's my opinion. I don't know if that's reflective of the

CIO's performance more along the lines of those that have direct customer service, you know, with CalPERS. But I was just interested in your feedback on that.

MR. GONZAGA: You know, there's no question. That's a debate to be had, you know, Katie. I mean, in terms of when you think about it from the standpoint that we're talking about an executive incentive plan, and we're really talking about the CEO, CIO, and the senior most folks in the organization, there's a level of collaboration, you know, that goes into all sorts of executive meetings and making sure that all activities, you know, are going down the same path.

And so the rationale would be that, you know, the Investment Office should share some burden in terms of stakeholder engagement, stakeholder communication, and that's the rationale for it. Now, is it one-on-one as big a part of their job as total fund performance versus stakeholder engagement? The answer is no, but it's intended to be an enterprise-wide incentive.

CHAIRPERSON BILBREY: Ms. Stausboll.

CHIEF EXECUTIVE OFFICER STAUSBOLL: So maybe -- we've had a lot of conversation about this. This is a very tricky measure. And I think the question that Ms. Hagen asks applies really not only to investments, but to the Actuarial Office or all of the organization really.

Because what we find in these surveys is in a year when the returns are down, or the employer contribution rates go up, or something else happens that's controversial, the surveys go down. And so what we really want to emphasize is education of the stakeholders and engagement with them, because -- and that's important in all environments. And I do strongly believe that that is a role of all the executives to make sure that we're engaging, outreaching, and educating our stakeholders about all of these issues.

So in these conversations, we talked about how far down this would cascade into the organization. And particularly on the investment side, we don't participate -- anticipate it going very far down. I think Ted's level, the CIO level, and maybe one level --

DEPUTY EXECUTIVE OFFICER HOFFNER: And Wylie.

CHIEF EXECUTIVE OFFICER STAUSBOLL: -- below.

Fair enough?

MR. GONZAGA: That's right.

CHAIRPERSON BILBREY: Are you all right, Ms. Hagen?

ACTING COMMITTEE MEMBER HAGEN: (Nods head.)

CHAIRPERSON BILBREY: Ms. Mathur.

VICE CHAIRPERSON MATHUR: Yeah. I just think it's also important to clarify the difference between customers and stakeholders. Stakeholders is a much broader group that includes the legislature, it includes labor organizations, it includes employer organizations. I mean customers also include the employers and the members directly themselves. But I think that distinction is also very relevant in determining what should be allocated to the investment side of the office versus what should be allocated to the rest of the enterprise.

That's it.

CHAIRPERSON BILBREY: That was it. Okay.

MR. GONZAGA: All right.

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MR. GONZAGA: Okay. So, you know, the next element just in the final broad metric that we're talking about is really stakeholder engagement, again going into the next year. The importance of stakeholder engagement, it's always important, but again certainly important this year.

So you have a process keying into, you know, pretty darn good long-term trend questions in terms of engagement with both employers and members. Keying into again stakeholder engagement, the questions that we keyed in on are is CalPERS sensitive to the needs of its stakeholders, does CalPERS do a good job of keeping stakeholders informed, and on a scale of 1 to 10, how would you rate CalPERS on being an effective and engaging in communicating?

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MR. GONZAGA: And so, you know, the next slide shows you, you know, average performance in all three of those questions, whether it's for employers or members since 2014. And, you know, it essentially equates to on average, when you average the three questions, 71 percent.

And what I'd also say is that there's been significant improvement, you know, since 2014 in these numbers where the positive trends are significantly upward.

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MR. GONZAGA: And so our recommendation, you know, in terms of metrics is again similar methodology to what we use for the customer satisfaction scores, which is just simply to take the average three-year performance period, because it has been trending upward, and you are in a period of change, let's set target -- target award between 70 to 72 percent, which is that three-year average score, and upward or downward based off meaningful progress below historical performance. But again, awards would not be paid below 66 percent average performance which is still above, you know, average performance over the last few years.

Any questions on that?

CHAIRPERSON BILBREY: All right. Yeah. Ms. Mathur.

VICE CHAIRPERSON MATHUR: I'm sorry, I had a question back a couple pages that I forgot in my -- when I made my last comment. And that is, I guess in reference a little bit to what Mr. Slaton was raising about customer experience versus customer satisfaction, can you explain what the difference is between those two and does not the benefit payment service levels sort of capture the experience piece or --

MR. GONZAGA: It is a combination of just simply -- and you're right, the benefit service levels meeting certain threshold, and that is a good point. You know, the benefit service question is are we being timely in terms of the turnaround for the service levels? That is a customer experience question.

Now, in terms of what customer experience means is, is it -- you know, part of it is just the satisfaction with the service levels, part of it is believing in, you know, the state of the organization and really kind of buying into the organization with, you know, some broader questions. The final thing is just finite service levels.

So that's where my perspective comes around to saying although it's not just one survey, I think overall we're getting close to the customer experience topic.

It's just they're different surveys that we're using.

VICE CHAIRPERSON MATHUR: Okay. I just want to make sure it's not just semantics. I just want to understand what it is.

CHIEF EXECUTIVE OFFICER STAUSBOLL: No, it's not, but our surveys are -- our customer surveys do ask questions that get to the customer experience. And, in fact, we wondered if we should rename the surveys, but -- and Donna could elaborate a little bit.

DEPUTY EXECUTIVE OFFICER LUM: Yeah. It certainly is, Mr. Stausboll was mentioning -- Donna Lum, CalPERS staff -- is that the current questions that we ask on the survey are a combination of satisfaction and experience. So not only are we asking did you receive your benefit timely, we also have touchpoint questions, so that we can assess, along the way, from the point in which the member has interacted with us, all the way to the point in which they actually received the service, what was their experience throughout that journey?

And so what we'll be seeking to do is to further refine our surveys, because we really do want to better quantify the experience versus the satisfaction. And we've gotten a lot of data around that, more so now than we've had in previous years. And so we do feel that we can begin to isolate and separate.

And then the other thing that we need to continue to do, because we, through this Committee and others, we interchange the use of experience and satisfaction. And I think our goal is to continue to evolve towards the experience so that we get the holistic view of the member and to be able to continue to speak in those terms consistently.

So we do have the opportunity, with what we have, to begin to separate them and measure them a little different. But it took a long time to get to the strategic measures that we have right now, so I think we would be looking at another cycle of that.

VICE CHAIRPERSON MATHUR: Okay. So you don't think it's timely to change it to customer -- to change the terminology to customer experience at this time, but that that will be something for consideration perhaps next year or the year after?

DEPUTY EXECUTIVE OFFICER LUM: Correct.

VICE CHAIRPERSON MATHUR: Okay. Thank you. That's helpful.

CHAIRPERSON BILBREY: Mr. Slaton.

BOARD MEMBER SLATON: Yeah, I would -- just on that particular subject, and there's -- actually, if you go to businessinsider.com you can get a -- the fact that customer experience is not the same thing as customer satisfaction. Customer satisfaction is meeting a need. Customer experience is are you happy? Are you happy with being involved with CalPERS, for example. And so there's a lot of written material that's available to talk about the differences between the two.

I want to come back to though, the -- if you go forward in the charts to the stakeholder engagement. It just concerns me that although these are the numbers that we have for the past three years, but the incentives seem to be tied to -- you know, to me it's a C grade. You know, 71 in school terms, I always viewed it as a C. That was not what my parents wanted me to do.

So I wonder if we're just settling based on where we are today versus where we need to be? You know, I think that grade should be a lot higher than 68 percent to 70 something percent. So if you can go to the next chart, I guess, that had the percentage numbers. One more on the incentive.

CHAIRPERSON BILBREY: Page 40 of the iPad.

BOARD MEMBER SLATON: Well, page 28, 29 -- yeah, there we go. That's the one that I'm looking at

CHAIRPERSON BILBREY: Yeah, page 40 of the iPad.

BOARD MEMBER SLATON: So the scoring is you're at 150 percent greater than 73 percent. And that's in the ballpark of where we are today. So I just raise the concern to the Committee that what are we really trying to get to. And if -- an incentive plan is supposed to try to get you to a better future that you'd like to see, if you're going to pay for high performance. So I just find I'm not comfortable with those numbers, but I'm not a Committee member, but I thought I'd toss that out to the group.

CHAIRPERSON BILBREY: Mr. Jones.

VICE PRESIDENT JONES: Yeah. Thank you, Mr. Chair. Yeah, I'm going back to Ms. Hagen's comments about the CIO or the Investment Office's relationship with the stakeholder community and environment. Because when you look at the numbers that are presented, this is reflecting our engagement with our stakeholders that's driven by people that's their job and not the Investment Office going out and engaging stakeholders. So I'm concerned about taking -- developing a number that's based -- the criteria was used to develop a number and now using it for something totally different. That's one point.

The second point is that the -- you know, whether it's health benefits, whether it's pension benefits, or all those issues we have dedicated teams to engage our stakeholders to have that relationship and that dialogue. So, to me, that's a concern of taking data that was compiled using a group, if you will, now taking that data and using it to set performance standards in another group. So that's seems to me to be a disconnect.

For example, you know, investments -- stakeholders, you know, is corporate America in many cases. And we're -- we have engagement with corporations about their board structure, and we have engagement with our investment partners, et cetera. So I'm trying to reach to see how this connects to the CIO function. And I just haven't. Maybe that's something I'm missing here though.

CHAIRPERSON BILBREY: Ms. Mathur.

VICE CHAIRPERSON MATHUR: Well, I just -- I would like to hear a little bit about sort of what is industry standard, because my -- I'm not sure that -- 71 percent might look low on a 0 to 100 scale, but my guess is that's -- you know, customer satisfaction, stakeholder engagement levels, those are fairly high compared to what others experience. So I think that would be useful data points here.

DEPUTY EXECUTIVE OFFICER PACHECO: Michael. Brad Pacheco, CalPERS staff. Maybe I could just briefly address what Henry brought up.

I think, as Anne mentioned, we, as staff, have discussed this quite a bit. And I think the goal that Grant Thornton has laid out is that we're trying to develop measures that cover broadly the executive leadership, and that we all have some type of skin in that game.

So I guess what I would point out for Henry is that the last year that we did the stakeholder engagement survey, it reflects scores, for example, of the engagement that we did on the asset liability management risk mitigation policy. And while that is the responsibility of my team to engage that staff on that policy, the Investment Office, the Financial Office, and the Actuarial Office were integral in that process. And so to the extent that there is some measure related to the CIO, and maybe later the CFO or the Chief Actuary, I would just point that out, that I think that's where there is a connection to stakeholder engagement.

VICE PRESIDENT JONES: Yeah. And I'm not suggesting there's no connection with the CIO or the Investment office, but it's very limited is my point, because every month you have stakeholder engagement meetings with the variety of our stakeholders, whether it's a retiree organization, et cetera. So I am aware that, you know, periodically the Investment Office is part of that -- those meetings.

DEPUTY EXECUTIVE OFFICER PACHECO: Yeah, I think that's a good point. We have institutionalized that. I think the thinking is, is that as a team and as an executive team, that it's not just the Communications and Stakeholder Relations office complete responsibility, it's all of our responsibilities to keep stakeholders informed.

VICE PRESIDENT JONES: Right.

CHAIRPERSON BILBREY: And I think when you look also Henry on page 44, the percentage we've assigned to it, it shows, you know, where we emphasize and where the percentage would be a little less in this area, because of not as much engagement as other areas of the organization might be, but still it is an important part of all the -- the whole organization as a whole working together.

DEPUTY EXECUTIVE OFFICER PACHECO: And, Mr. Chairman, if I can, lastly, and I've mentioned this to Grant Thornton, those eight trend questions were not just asked in the last three years. We have data beyond the last three years. I think at least an additional six years of data on previous surveys before we actually established the Stakeholder Relations Project. I don't have those numbers here, but if it's, you know, important to the Committee and to this project, we can certainly provide that data.

CHAIRPERSON BILBREY: Very good.

Mr. Slaton.

BOARD MEMBER SLATON: So based on Ms. Mathur's comment, I just want to, you know, add some clarity to my earlier comments. So on the customer satisfaction side, you know, you bump up against the really of how far you can go. And clearly, we're in that range, and you could spend twice as much money and hardly move the needle.

And so I guess my question that I'm raising is, on the stakeholder relations, is the universe such that this is the -- this is expected as the best we can do? Is this -- are we confident that, in fact, we're bumping up against a practical limit or are we just being satisfied with where we are, and there actually is room to move? So that if we're paying out 150 percent, maybe we should be at 80 percent or 85 percent. So I don't know where the ceiling is on the stakeholder relations. So that's -- I'm operating a little bit in the blind.

MR. GONZAGA: I think, you know, three comments. I mean, I think, first and foremost, we came up with the recommendations based on historical trends, recognizing that there has been, you know, pretty significant movement, depending on the question, up by three or five points over the last three years.

Now, taking that into account, we're also thinking through the fact that, you know, as with any organization, when you go through leadership change or, you know, things -- when you start talking about investment returns, when everything is not rosy, maintaining, you know, historical improved levels over a one-year period is very good. And that requires a lot of communication, a lot of engagement with folks. So that's kind of the genesis in terms of where the levels were recommended.

Now, the final thing is in terms of satisfaction, I mean, going back and forth between different industries, I mean, I've seen anywhere from 70 up to 90 percent, depending on the survey questionnaire. Our basis was the historical trend line and the improvement over it. But the other issue is that I don't think there's any question that long term, you're going to want to push the envelope in terms of moving ahead of where those scores are right now.

But when we developed and analyzed the numbers, our perspective from a Grant Thornton perspective, there's a lot of change. It would take a lot, when -- even just thinking about something as leadership succession, continuity of plans, it requires a lot consistency to maintain what's been in place historically.

BOARD MEMBER SLATON: Well, and I don't mean to imply that there's not a great deal of work and successful effort in stakeholder outreach. I think we've just made incredible strides in that area. I'm not sure they're reflected -- maybe they're not really reflected in the numbers. And, you know, depending on the situation -- the political situation that's happening, and, you know, sometimes we have to deliver bad news and maybe bad news gets incorporated in survey results, much differently than good news does.

But when I look at 100 percent performance allocation for reaching where we are today, that tells me that we're not really incenting to move forward. And I think the answer to that is we're then saying this is the best we can really expect, because we're not incenting anything above. We're incenting up to 70 -- if you get to the 73, then that's the top of the -- top of the chart. So I just again raise that concern to the Committee.

Thank you.

CHAIRPERSON BILBREY: Ms. Mathur.

VICE CHAIRPERSON MATHUR: Sorry. Just one more thought on this point. And I think -- I can't remember if it was Ms. Stausboll or Mr. Eliopoulos who raised this, but I think we know from historical data that poor investment return years have a significant impact on it. So it's not all about how well we're doing the job of communicating and engaging, it does incorporate, as you've so well pointed out, other factors. And so trying to set a reasonable threshold that doesn't penalize -- double penalize our staff in years when the performance is also suffering and it's -- we're communicating about that or when rates are going up.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Yeah, I mean, that's very true, but I also think that we should try to find a way and keep on trying to find a way to communicate with stakeholders, so that they understand more and better, you know, when those things are happening in the environment.

And, you know, we made a huge push over the last few years on the employers in our communication there, and the scores did go up. But, you know, we're bringing this back -- or these folks are bringing it back in August --

(Laughter.)

CHIEF EXECUTIVE OFFICER STAUSBOLL: -- you know, so why don't we take Mr. Slaton's comments into account, look at the scores and see if we should tweak it a little.

CHAIRPERSON BILBREY: Very good. So we are at a point where I would not like people to start dropping like flies on this podium, as well as the poor court reporter who I'm sure is ready to have something to eat, since he's been here all day, we are going to take a lunch break until 1:45.

(Off record: 1:01 p.m.)

(Thereupon a lunch break was taken.)

A F T E R N O O N   S E S S I O N

(On record: 1:45 p.m.)

CHAIRPERSON BILBREY: I'll call the meeting to order for the Performance, Compensation and Talent Management Committee. We'll continue on, Mr. Gonzaga.

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MR. GONZAGA: Good. Good.

Well, there's really essentially three primary slides we want to go through. One is to talk about key business objectives, which can be a part of the incentive plan. Second is to talk about that discretionary component to the awards that we were discussing before. And then the third is how all of these proposed metrics align in terms of our proposal for CEO, CIO, incentive awards.

Now, you know, key business objectives, you know, this slide, you know, page 29, all we're referencing here is simply that consistent with historical preferences, the Board, for the CEO, and the CEO for his or her direct reports, and the same for the CIO will have the discretion to go above and beyond just these enterprise, these organizational metrics to drive the incentive award.

And you can structure it, you know, consistent as you have done before, rating it as a 0.5, 1.0, or 1.5, or it can be a modifier where it will drive the incentive award for that specified individual down to 0 or up all the way up to 150 percent of the maximum. So that is the primary slide. And that is the primary role for key business objectives. Okay.

Any questions on the key business objective component?

CHAIRPERSON BILBREY: No.

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MR. GONZAGA: Okay. Now, the use of discretion. You know, I know that this is, you know, something that we've discussed historically. But, you know, our whole perspective here is that the Committee and the CEO and the CIO should have discretion for their direct reports, in terms of driving the incentive award up or down. And the rationale for that being, again, we don't want, because we are moving to a more kind of organizational and enterprise-wide dynamic, one, we want to make sure there's discretion to bring awards down for, you know, poor risk behaviors. And the second thing is to evaluate folks, you know, from a broader perspective, so there is an ability to use discretion up or down based on individual performance for the year.

So our perspective is that again negative adjustment or elimination of incentive wards, if an individual is involved with non-compliant risk expectations.

The second thing is positive or negative discretion based on culture and values of the organization. And what we're talking about there is leadership, extraordinary contribution or efforts, or results, development of specific strategic initiatives that the CEO or CIO have delegated to that individual.

In that -- those are the primary characteristics with which we would expect to drive that kind of discretion up or down off of the calculated incentive award.

And, you know, our thought with that is just simply again to allow discretion, you know, up to 150 percent of target all the way down to zero based on those general broader criteria to allow capture of individual performance, you know, throughout the year.

And I think that we know that we want to make sure that the documentation is tight, and the rationale is very fair. We think that that discretion should be exercised and documented within the context of your typical performance review process just to make sure it's being vetted out fully. So that is our proposal in terms of discretion.

So both the key business objectives and the discretionary component are the final aspects of our proposal and recommendation for 16-17.

Any questions on that?

CHAIRPERSON BILBREY: None. Nope.

MR. GONZAGA: Okay.

--o0o--

MR. GONZAGA: Well, I think that this is the slide that everything is leading up to. And hopefully, it will help bring things together. But this is our proposal. We have the recommended metrics in front of you. And what are we talking about, it's strategic alignment as well as risk management. And, you know, using the metrics that we discussed, this is our proposal for the CEO and the CIO heading into 2016-2017, based on those defined characteristics.

And when you look at the CEO, it's very balanced. And it's 25 percent on operational effectiveness, 15 percent related to INVO CEM, 40 percent linked to stakeholder engagement and customer service, 20 percent each, and 20 percent linked to investment returns. So it's a very balanced portfolio of incentives, so to speak.

And then we would also recommend, recognizing it's going to be a new CEO, just think about using specified key business objectives as -- you know, that discretionary adjustment to go up or down, recognizing with a new CEO, you may have some specific tactical objectives for the CEO.

For the CIO, there is a typo up there. Operational effectiveness enterprise-wide 10 percent, INVO CEM 20 percent, and stakeholder engagement, not customer service, 20 percent, and finally investment returns over the five-year period measured at 40 percent, and a 10 percent allocation for key business objectives.

So I think that what this says is a balanced incentive portfolio customized weights, and to an extent metrics, based on position, differentiating between the CEO and the CIO. And that's essentially ore proposal.

CHAIRPERSON MATHUR: Okay. At this time, I'd like to invite forward PCA and Wilshire.

Go ahead an identify yourselves.

MR. FORESTI: Steve Foresti from Wilshire.

Just to -- we provided a request -- an opinion letter from the materials that were provided in the PowerPoint. So those views were somewhat limited obviously to what was in the deck, and some previous conversations we had, but didn't include some of the final conversations that went into the deck.

And I think at a very high level we're in full agreement that the idea of bringing discretion into the process is important. I think the value of a metric-based, rules-based process is very important in terms of transparency and understanding. That obviously leads to credibility and an incentive program.

But at the same time without the discretionary part of the framework, really can't encourage some of those intangibles, the values that the folks that go above and beyond what their responsibilities may be. You really have no way to incentivize them. And by contrast, you don't have a way to discourage this so-called kind of free-rider type of behavior. So I think that's -- from our view, that's a critical component of it.

We're also in agreement with the cost -- the curve -- the incentive curve being flattened out. I think it's completely consistent with trade-offs, in terms of the type of risk taking that you want to encourage.

As you discussed, or in that section of the presentation, I think there's lots of options you have in terms of, you know, where those break points are, what the slope is, but we would -- we would certainly encourage that sort of a flatter incentive structure, again because of the risk-taking elements that it would encourage and discourage.

There were some other more detailed things that we'd touched on in the letter. One that I'll just talk about is this idea of, in terms of the performance measures, doing an equal weighting of years. And if it's on a five year basis, I think that makes perfect sense, in terms of not putting too much weight on a particular year, and again encouraging excessive risk taking over the short term.

The one thing we would note there is a simple averaging approach is not directly connected to the wealth or the value of a portfolio. So a compounding -- and I'll use an extreme example just to highlight that. But if you have an up 50, down 50, the simple arithmetic average would tell you that's flat at zero on average, but on a compounding, the portfolio value would be down 25 percent in that situation.

So we'd kind of call your attention to some of those nuanced type of issues. But again, fully supportive of the general high level direction that many of these proposals have taken.

CHAIRPERSON BILBREY: Very good.

Mr. Emkin.

MR. EMKIN: Very rare I get the opportunity to agree with Wilshire, so I'm happy to do that.

(Laughter.)

MR. EMKIN: And we've given this a lot of thought in a limited amount of time, and we really do like the direction, but I think there's a whole array of details that would really benefit from the investment people, the

Investment staff and Grant Thornton siting in a room together and coming back to you with the specific numbers after having debated some of the concepts, for example, how negative can you be and still get a bonus, and how do you really look and measure risk in this context?

And I think those are complex. But conceptually, we are very supportive. We think they really spent a lot of time to address issues of your concern to better align behavior. But sometimes the devil really is in the details. And I would urge you to sort of forestall final judgment until some of those details are well defined.

Thank you.

CHAIRPERSON BILBREY: Thank you.

I do want to remind the Committee today, we are going to be looking at conceptual and trying to move direction on the conceptual ideas of the metrics, so that staff can begin putting together plans for especially the CIO, but also CEO starting in July. But our second reading will be again in August when we work to fine-tune many of these issues, which during that process, Grant Thornton and both of you could have some conversations, if you'd like to further. I would recommend that.

With that, I'm going to go to Mr. Costigan.

COMMITTEE MEMBER COSTIGAN: So I'll ask in reverse order, Mr. Bilbrey. So today is just a vote on conceptual items. There's no direct action as a result of today's vote? Is there just conceptual for a first reading or is there going to be some...

CHAIRPERSON BILBREY: For the CIO, we need to do some -- Ms. Stausboll.

COMMITTEE MEMBER COSTIGAN: I'm just trying to make sure it's not a conceptual vote. There's actually -- there's an action item voting on moving some concepts forward, but there is a direct act as a result of the vote, potentially?

CHIEF EXECUTIVE OFFICER STAUSBOLL: I think so. So just because concepts could mean different things to different people. You know, the plan -- we run these plans on a fiscal year, July 1 to June 30, basis. So people -- the people here are embarking their work very soon. So I think it's important that the staff here knows what the metrics -- not the exact numbers necessarily or the thresholds, but what they're going to be.

So are you embracing the concept of the operational effectiveness, the INVO CEM, and so forth? If you can -- if you commit to those, we can -- the team will come back in August with more detail around that, but I think it's important that there's a commitment to moving forward with that as the performance measures.

CHAIRPERSON BILBREY: I'm sorry, I wasn't clear.

I was -- that's -- I meant by the --

CHIEF EXECUTIVE OFFICER STAUSBOLL: I know. I know you and I have talked.

CHAIRPERSON BILBREY: -- overarching --

CHIEF EXECUTIVE OFFICER STAUSBOLL: I just want to make sure everyone understands the importance of clarity at this point in the game.

COMMITTEE MEMBER COSTIGAN: So it's really we are -- I just want to make sure I understand, because actually I have a second question on something unrelated, but in the report. We are making a policy change. This is not -- at a first reading, because we are, in fact, going to take a vote that will result in a policy change?

CHAIRPERSON BILBREY: Regarding the plan, yes, but we also are going to be taking a policy in September -- August, September, is that right, first readings?

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: August.

CHAIRPERSON BILBREY: August.

CHIEF EXECUTIVE OFFICER STAUSBOLL: I would say that your -- the direction or vote is that you -- that the Committee embraces these metrics.

CHAIRPERSON BILBREY: If you look on page 49 of the iPad, maybe would that help or no?

CHIEF EXECUTIVE OFFICER STAUSBOLL: Right, that the Committee is embracing going forward with these metrics and the framework with the understanding that it will come back -- there will be more work. It will come back in August for final approval.

COMMITTEE MEMBER COSTIGAN: So I mean, that's what I was just getting at. So, I mean, we are taking an action item in the vote today that will make a policy change as set forth on page 49, items 1.1 through 1.4, and then 2.2 and 2.3, because that's approval of the incentive framework, but it's actually a policy change. I'm just --

CHAIRPERSON BILBREY: Which is also on 3.1 through 3.4 as well.

COMMITTEE MEMBER COSTIGAN: Yeah.

CHIEF EXECUTIVE OFFICER STAUSBOLL: But it's a first reading, so subject to final approval in August.

COMMITTEE MEMBER COSTIGAN: Correct. So there won't be any -- and I know I'm nuancing it here. There is not -- until there's a vote taken a second time, there will be no policy change? So there is no economic impact until there is a second vote, is that correct?

CHIEF EXECUTIVE OFFICER STAUSBOLL: Correct.

COMMITTEE MEMBER COSTIGAN: Okay. Which then leads to in the write-up, Mr. Hoffner, it says that all the funds have been exhausted for this study, and that it has been submitted in the normal course of budgets.

So when will Finance and Admin either be seeing taking up additional requests, what is the additional cost for the program to continue moving forward? And budget, the total project, five-year consultant to the Board is 600,000 funds for this -- for the work in the current fiscal year 2015-16 were encumbered based on budget have been exhausted with the work completed to-date. Additional funding has been requested through the formal process.

CHAIRPERSON BILBREY: What slide are your referring to?

COMMITTEE MEMBER COSTIGAN: I'm on page 11 of 74. It's in the staff write-up under budget and fiscal impact.

CHAIRPERSON BILBREY: Thank you.

DEPUTY EXECUTIVE OFFICER HOFFNER: It's the 15-16 funds that were encumbered that are exhausted. And it's not specified in this, I think, completely.

COMMITTEE MEMBER COSTIGAN: So again, as moving forward, so just asking, because I -- it will come to Finance and Admin, and I don't think we're slated to meet till August, so is there a budget request coming forward? Is this something that staff can encumber? How much of the continuation of the first 600,000 have been spent?

DEPUTY EXECUTIVE OFFICER HOFFNER: So let me clarify. So it's already included in the budget that the

Committee and Board approved back in April --

CHIEF EXECUTIVE OFFICER STAUSBOLL: For 16-17.

DEPUTY EXECUTIVE OFFICER HOFFNER: -- for 16-17. So the statement referenced here is for the 15-16 year, not the 16-17 or the outyears. You have a multi-year contract with Grant Thornton related to incentive compensation. It's a five-year contract.

COMMITTEE MEMBER COSTIGAN: How much is the total contract?

DEPUTY EXECUTIVE OFFICER HOFFNER: Six hundred thousand.

COMMITTEE MEMBER COSTIGAN: Okay. I'm sorry. I'm now confused just a little. It says in the sentence, I'm just reading it, is that -- so 600,000 for the entire project, and of the X that was appropriated in 15-16 of the 600 has already been spent or was it 600,000 in 15-16 and we're encumbering additional dollars?

DEPUTY EXECUTIVE OFFICER HOFFNER: No, it's just the portion in the 15-16 year of the 600,000 has been encumbered and spent is what they're referring to, not 600,000 plus additional funds.

COMMITTEE MEMBER COSTIGAN: Okay. It just reads a little weird on that.

DEPUTY EXECUTIVE OFFICER HOFFNER: Gotcha. We'll clarify it for in the future items.

COMMITTEE MEMBER COSTIGAN: So the total project is only 600,000?

DEPUTY EXECUTIVE OFFICER HOFFNER: Correct.

COMMITTEE MEMBER COSTIGAN: Okay. And only funding is needed -- you're going to appropriate funds over the course of five years or over the course of two budget cycles, four years?

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Four years. Four more years.

COMMITTEE MEMBER COSTIGAN: Okay. All right. Thank you, Mr. Bilbrey. I appreciate it.

CHAIRPERSON BILBREY: Thank you. We have a long list of people.

Mr. Feckner.

PRESIDENT FECKNER: Yeah. Thank you, Mr. Chair.

I know I'm not part of the Committee, but I have been, as President, involved with the Chair and Vice Chair in meeting with the consultants since the beginning of this project, and having input in helping the framework, et cetera. And I know there's still lots of moving parts and questions out there, but I strongly urge the Committee to approve the first reading and move this forward to allow us to continue working forward and making sure that we have things going in the right direction. We can still make changes come in August. We know that we always have changes during the first and second reading, but it gives us the opportunity to move things forward and let staff know that we're taking it seriously and that we're moving them forward. So I strongly urge the Committee to approve it and move it forward.

CHAIRPERSON BILBREY: Thank you.

Mr. Lind.

COMMITTEE MEMBER LIND: Thank you. I certainly -- well, first of all, this is quite an impressive body of work that Grant Thornton came up with for us, almost borderline too impressive.

(Laughter.)

COMMITTEE MEMBER LIND: It's pretty detailed. And initially, when I first saw it, I was pretty overwhelmed. But as you did the presentation and we got down to some of the slides to really pull it together, it was very helpful.

I certainly support the concepts of the metrics and the key business objectives. And I think discretion is an important piece. I agree there are a lot of details that need to be worked out. For one, I'm not ready to get me arms around incentivizing negative relative performance for investments. But that sounds like that's one of the things that we can work out as we move through this.

So I will make the motion that we -- that the

Committee support the concepts moving forward that have been laid out. I think that Ms. Stausboll kind of laid out for us -- I'm not sure I'd use the word "embrace". I'd use the word "support".

(Laughter.)

COMMITTEE MEMBER LIND: And that's my motion.

VICE CHAIRPERSON MATHUR: Second.

CHAIRPERSON BILBREY: All right. One second. I want to get -- so people are clear, we're talking -- looking -- if we're looking at page 49, is that what you were referring to?

COMMITTEE MEMBER LIND: Yes.

CHAIRPERSON BILBREY: The incentive metrics of operating efficiency, INVO Cost Effective Measurement, total fund investment return, stakeholder engagement, customer service, and then the incentive framework also that's been laid out for the CEO and CIO.

COMMITTEE MEMBER LIND: That was my motion.

CHAIRPERSON BILBREY: Okay. I just want to make sure we were all clear.

COMMITTEE MEMBER LIND: Said much more clearly than I did.

CHAIRPERSON BILBREY: So -- but there's still some people that wish to speak.

Mr. Boyken.

ACTING COMMITTEE MEMBER BOYKEN: On the motion.

So we heard from Mr. Emkin about the importance of having Grant Thornton work with staff when it comes to determining the details. And I guess I wanted to know up to this point, has Investment staff, has the CEO, how much involvement have they had, and do they feel, at least with the conceptual framework that this is, you know, workable for them, that -- you know, I don't think we've heard a lot about that along the process from staff.

CHAIRPERSON BILBREY: I think we're going to hear from Mr. Eliopoulos and Ms. Stausboll.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Okay. Well, I'll begin and then Ted can speak for himself.

So, you know, over the last few weeks, there's been a lot of iterative process between Grant Thornton and the executive team as well as with Ted and the senior Investment staff.

I'd say the overall consensus is that we're very positive and also support the approach, which we think is very thoughtful, and that the metrics for 16-17 are a really good starting point.

Change is always really tough. And this is a really big cultural change for the organization. And I think that it's really important to take that first step. So while it may not be perfect, we probably know that it isn't, and that it will continue to evolve over time. That the consensus among the staff involved is that it's reasonable and fair, and that we are supportive of -- very supportive of moving forward.

CHAIRPERSON BILBREY: Okay.

CHIEF INVESTMENT OFFICER ELIOPOULOS: I can completely echo those comments for myself and Wylie and our participation with -- as part of the executive team. And the only thing I would add to that is in talking with our Managing Investment Directors, formally known as SIOs, they also believe that it's very important to move forward, that from -- you know, all the investment professional's standpoint. Change is new and difficult for sure, but very much felt that it's better to move forward with this change now than to delay.

ACTING COMMITTEE MEMBER BOYKEN: Thank you.

CHAIRPERSON BILBREY: Ms. Hagen.

ACTING COMMITTEE MEMBER HAGEN: So I think I understand that you're looking for feedback. So I have some, if it would be appropriate to share at this juncture. So -- and before I do that, I also know firsthand how difficult this is. And so I want to applaud all of you, Grant Thornton, but also CalPERS staff for doing a great job.

So there's several things that I wholeheartedly agree with, and there's some that I disagree. And so I thought I would share that just for -- as we move forward. I agree with extending the performance measurement period from three to five years. I think that's been a long struggle that we've had and I totally agree with that. I also like the inter-period weights. Also something we've struggled with in years past. I'm open to the concept of the incentive curve, though I would have liked a little bit more time and a little bit more discussion and detail around the -- what that could look like. So what maybe a scenario using this year's performance indicators, like what would that look like compared to what Ted's incentive comp looked like this year. You know, I just don't have a baseline.

So -- and then I like the focus on the operational efficiency, but concerned -- with the operational budget efficiency, but I'm concerned with the removal have INVO operating costs and having this as a measure for the CIO and anyone in the Investment Office.

I think it's really important that we measure the CIO and the senior leaders in Investments on what they're doing relative to operating costs. And if I get any of these facts wrong, please let me know, because this is a lot to take in.

And then the -- on the investment return measures, I really do think it's -- it seems much simpler than in prior years, so I'm excited about that, but I'm uncomfortable with the shift to awarding the target. Maybe I'm not saying it right, but I always looked at incentive pay as you're working towards a stretch goal. And I don't -- I didn't get that from these changes in the -- around the investment returns measures.

I like the carve-out for negative returns, but again, I've expressed my concern about discretion. I would want to see policy details around that in the second reading.

Overall, discretion can be problematic in an incentive pay program, and we've seen that here at CalPERS. I've seen the Board's discomfort with discretion at times. So again, I would need to see details around that.

And then I love the customer service focus, but I just don't think we're quite there yet in terms of capturing the right stakeholder feedback. And I think I heard a couple other Board members echo that concern in their comments.

And then my final point is I don't think we talked about it, but I read somewhere in the materials that the COIO and the CFO would not be included under the same incentive performance measures as the programs they supervise. And I think that also is a positive change. That's something we've debated in years past. So I'm supportive of that as well.

And that's my comments.

CHAIRPERSON BILBREY: Thank you, Ms. Hagen.

Ms. Mathur.

VICE CHAIRPERSON MATHUR: Thank you, Mr. Chair.

I think the idea of an example of how the curve works is a really good idea. It can help to make it more concrete for the Committee, so I would definitely endorse that idea.

Are you looking for direction or -- around sort of -- particularly around the operating efficiency for the enterprise, or for the pension side, are you looking for -- you know, you've listed four different options and recommended one. Are you looking for direction on that today?

MR. GONZAGA: If you're prepared to give us feedback on it, absolutely.

VICE CHAIRPERSON MATHUR: Okay. I mean, I guess, I would -- and maybe this is a friendly amendment to the motion. I do think the overhead operating costs approach is the best approach that we've come up with at this point. And there's probably still some refinement as to exactly how it will work in practice, but I -- I would --

I guess I'm suggesting as a friendly amendment that the motion include an endorsement of that specific approach for the -- I'm sorry, I'm on page 20 of 74.

CHAIRPERSON BILBREY: iPad page 20.

VICE CHAIRPERSON MATHUR: -- that particular approach. That's my recommended friendly amendment, if it's amenable to the maker of the motion.

CHAIRPERSON BILBREY: So on the shaded part, the overhead, operating cost.

VICE CHAIRPERSON MATHUR: The overhead operating costs approach.

COMMITTEE MEMBER LIND: As long as you're offering it as a concept to look at.

VICE CHAIRPERSON MATHUR: Still is a concept that will require some more detail work, I'm sure, between now and August.

COMMITTEE MEMBER LIND: I can see that as a friendly amendment.

VICE CHAIRPERSON MATHUR: Thank you.

CHAIRPERSON BILBREY: All right.

VICE CHAIRPERSON MATHUR: Sorry, if I -- so I -- what was I going to say now? I've lost my train of thought. Maybe I'll come back to it then, thanks.

CHAIRPERSON BILBREY: Okay. Mr. Costigan.

COMMITTEE MEMBER COSTIGAN: So, Mr. Hoffner, this will be a fairly nuanced question. I know this focuses on incentive compensation and we're talking about three years, five years. I wear my other hat. Did we look at any impact on disciplinary, performance evaluation? I mean, I know we're focusing over here on one element, but I can't lose site at the end of the day that there's a -- sort of a civil service system. So -- and I just -- it's nowhere in any of these reports, so do we know of any impact?

I mean, because what we're basically doing is we're treating -- it's a performance evaluation now that we're changing. And so by even pushing it out five years, we're tinkering with a few other things. So I just -- one of my other little hats, because it -- I mean, if the answer is, no, it has no impact, that's great, because then I'll look back to this record, should we ever get anything and say that.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: It's not covered in the presentation, but it does exist in current policy about performance issues, disciplinary --

COMMITTEE MEMBER COSTIGAN: So we are going to be change -- so this is why, sort of the question I asked, Mr. Bilbrey. It's kind of the unintended consequence. All right. So from a civil serve standpoint, so we're talking about compensation. How does it affect performance, discipline, termination, progressive discipline, probationary periods, all of that, all this other equation here, and where is that in this report or is that something we're going to see at a later date or...

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: That's not covered in this slide deck or this report. It's covered in the current policy. And the policy will come back with what revisions that we're going to make through.

COMMITTEE MEMBER COSTIGAN: So there may be some impacts inside of the civil service system?

DEPUTY EXECUTIVE OFFICER HOFFNER: Yeah. So I think there's -- probationary period doesn't change. That's not something that's in the policy. We have a three-year -- policy language about the three-year duration. The proposal is to make it five. So I think to your question, Mr. Costigan, it's not going to change those underlying programmatic, disciplinary activities. Those will still be played out as they --

COMMITTEE MEMBER COSTIGAN: But do these metrics -- I'm just asking, because we hear cases on this. These metrics now become part of a record. And then should you discipline -- and there's still Investment Officers, that's what the class is, whether they're called Managing Directors or not. Does this come -- I'm just -- again, I'm trying to establish a record for something else. You're going to make a policy change here that has an impact on another State agency.

DEPUTY EXECUTIVE OFFICER HOFFNER: So I think I would play this out this way. Should there be a disciplinary issue, I don't see that they would be paid out. I mean, based on the discretionary comments today, and should the issues be adopted in terms of a risk mitigation strategy, that you'd be then paying out on a performance side, if there's some disciplinary activity that's occurring within that same time frame. I see this as sort of two separate things.

COMMITTEE MEMBER COSTIGAN: Okay. And I just want -- I just want a clear record on that, because you're talking about new matrices actually tied to performance and pay. Well, performance is always an underlying issue. That's what -- I just want to make sure we're just clear on that? Ms. Stausboll, did you have something or no?

CHIEF EXECUTIVE OFFICER STAUSBOLL: Well, I was -- there's probably a lot of nuance to this. I think that we're fine, but I think the best thing would be just we talk off you off -- talk with you offline, making sure we understand exactly what you're asking from State Personnel Board civil service perspective, and we'll make sure we answer it clearly in August.

COMMITTEE MEMBER COSTIGAN: Okay.

CHIEF EXECUTIVE OFFICER STAUSBOLL: But this is for the --

COMMITTEE MEMBER COSTIGAN: I just want to know how the matrix are going to come into play, because you're setting up a whole -- you're looking at employees differently with a set of matrix on pay, but we'll talk.

CHIEF EXECUTIVE OFFICER STAUSBOLL: For the incentive portion?

COMMITTEE MEMBER COSTIGAN: Correct. But we can't lose sight there's another part of the system as well.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Agreed.

CHAIRPERSON BILBREY: Ms. Mathur.

VICE CHAIRPERSON MATHUR: Thank you.

So with respect to the operational effectiveness metric being applicable to the investment side of the house, or at least the top -- the top executives on the Investment side of the house, I think it is clear that the Investment side of the house has impact on the rest of the enterprise. It's not a stand-alone organization. It is part of the entire enterprise, and I think it is entirely appropriate that some component of that measure be in the Chief Investment Officer's incentive plan.

With respect to customer experience and stakeholder engagement, I would agree that there is work to be done there. I would hate for the perfect to be the enemy of the good in this case. I think we have a place to start that is reasonable and fair and measurable, and that we can -- I fully expect that we will continue to refine and improve that metric in future years, but I actually think we have a reasonable place to start, and so I would encourage support of the motion that's on the table.

CHAIRPERSON BILBREY: All right. Seeing no one else wishing to speak. The motion is on the floor.

All those in favor say aye?

(Ayes.)

CHAIRPERSON BILBREY: Opposed?

(No.)

CHAIRPERSON BILBREY: Motion carries.

I want to just echo what Ms. Hagen said to staff, Grant Thornton, to the Investment consultants, everybody involved, including this Committee, and especially the help of my Vice Chair and the Board President that we've been working through this, you know, over the last several months. I thank you all for the work and time you put into it. It is a first step. It's a good step. And as everybody has said, it is not perfect. We will come back again.

And then when we go to work on 17-18, we will also, I believe, make some more working revisions and all. But I think this is a start to get us through and see how this first year goes. And I look forward to August to get the refinements. I do encourage Grant Thornton and PCA and Wilshire to have some discussion.

Hopefully, you can get together and figure out a time that you can talk together about any concerns and additional questions you may have as well.

With that, we move to Summary of Committee Direction.

CHIEF EXECUTIVE OFFICER STAUSBOLL: Good luck.

(Laughter.)

DEPUTY EXECUTIVE OFFICER HOFFNER: I had asked Anne to take these notes, and apparently she had not.

(Laughter.)

DEPUTY EXECUTIVE OFFICER HOFFNER: So I'm going to do my best.

CHAIRPERSON BILBREY: I know you did take -- and I do want to point out, many of -- you know, I was trying to write them down as well, and Ms. Hagen may help us with what she was -- we're trying to write -- I saw everybody trying to write feverishly to help us with some of your concerns that we can hopefully work on.

DEPUTY EXECUTIVE OFFICER HOFFNER: I actually think I caught Ms. Hagen's comments there. And I echoed them with what Ms. Mathur said as well. So follow up to Mr. Costigan's question as well. I think we've -- I think we've captured the feedback where more detail was requested. I know Mr. Slaton, not a member of the Committee, but did ask some questions related to the thresholds in the performance metrics, and where does that fall. So we'll -- I'll work with Brad and others on that as well.

So I think we've captured that between the group behind me here. So we'll capture that in the summary, and then return back to the Committee at the next available meeting to provide that feedback.

CHAIRPERSON BILBREY: Fantastic.

I see no public comment.

This meeting is adjourned.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Performance, Compensation, & Talent Management Committee meeting adjourned at 2:19 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 20th day of June, 2016.

JAMES F. PETERS, CSR
Certified Shorthand Reporter
License No. 10063