



Review of Incentive Plan Performance Metrics

by Grant Thornton

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Metrics Overview

Total Fund Performance

- Aligns the organization with its mission to provide for pension benefits
- Measures over a five-year rolling period to align with long-term investment strategy
- Balances risk management
- Worked as intended; no recommendations

Metrics Overview

INVO CEM

- Intent: balance cost effectiveness and risk appropriate returns to align with CalPERS' strategy and compare against custom and US peers
- Industry recognized measure; information gathered by a third neutral party
- Worked as intended; no recommendations

The 2017-18 annual participation in the CEM benchmarking (CEM) survey analyzes CalPERS' investment costs and return performance over a five-year period against a customized peer group.

Score	Rating*
Outperforms US Benchmark on Net Value Added (Returns) and Cost by 0.2% and 5 bps, respectively	1.50
Outperforms US Benchmark on Returns and Cost by .001% and 1 bps, respectively	1.00
Outperforms US Benchmark on Cost or Outperforms US Benchmark on Returns	0.50
Underperforms US Benchmark on Returns and Cost	0.00

* *Intermediate points are interpolated*

Metrics Overview

Stakeholder Engagement

- Intent: incentivize fulfillment of duty to effectively communicate and engage with stakeholders and exhibit sensitivity to their needs
- Potential future consideration may include re-setting scores if higher targets are deemed appropriate

The Stakeholder Engagement Metric for 2017-18 is based on results of the following three Stakeholder Engagement Survey questions:

- Is CalPERS sensitive to the needs of Stakeholders?
- Does CalPERS do a good job of keeping its stakeholders informed?
- On a scale of one to ten, how would you rate CalPERS being effective in engaging and communicating with stakeholders?

Score	Rating
75%	1.50
73% to < 75%	1.25
71% to < 73%	1.00
69% to < 71%	0.75
67% to < 69%	0.50
< 67%	0.00

Metrics Overview

Customer Service

- Intent: align leadership to a common goal of fulfilling service levels as identified by the Board
- Utilizes two key measures to focus both on perceived service and actual timeliness
- No metric change recommended, but targeted scores are at historical highs

The Customer Service Metric for 2017-18 is based on the following two Service Dimensions:

- Percentage of benefit payments issued to our customers within established service levels
- Customer service with CalPERS services as measured by surveys and other methods

Score	Rating
= or >95%	1.50
94% to < 95%	1.25
92% to < 94%	1.00
90% to < 92%	0.75
88% to < 90%	0.50
<88%	0.00

- **RECOMMENDATION:** Study the opportunity to reduce scoring slope to ensure alignment with goal challenge (i.e., realistic goals)

Metrics Overview

Enterprise Operational Effectiveness

- Intent: incentivize balance between cost efficiency and product and service delivery from a perspective of shared accountability

The Enterprise Operational Effectiveness Metric for 2017-18 is defined as Overhead Operating Costs as a percentage of Total Operating Costs ("OOC").

- Total Overhead Operating Costs ("OOC") identify all administrative costs not mapped directly to Product and Service Delivery Operating Costs ("PSDOC")
- $OOC = OOC / (OOC + PSDOC)$

Score*	Rating
<-1.1%	1.50
-1.1% to < -0.6%	1.25
-0.6% to = 0.0%	1.00
> 0.0% to = 1.0%	0.75
> 1.0% to = 1.5%	0.50
>1.5%	0.00

* As measured against the average of prior three years.

- **RECOMMENDATION:** direct staff to conduct further analysis and work with Grant Thornton to develop options for a more effective metric

Enterprise Operational Effectiveness

Total Operating Costs – *included*:

- Administrative Operating Costs for all Overhead divisions
- Administrative Operating Costs for all Product/Service Delivery divisions
- Third Party Administrator Expenses

Total Operating Costs – *excluded*:

- Investment Office Administrative Operating Costs
- Investment Operating Costs
- Investment Management Fees
- Enterprise Projects
- Headquarters Building Costs
- Pro Rata
- Incentive Compensation

Enterprise Operational Effectiveness

Overhead – *branches included*:

- Health Policy and Benefits (less Health Account Management Division)
- Customer Services and Support (Branch Support Services section)
- Communication and Stakeholder Relations
- Executive Office (includes Board costs)
- Financial Office (less Pension Contract Mgmt. and Prefunding Programs)
- General Counsel's Office (less Office of Audit Services)
- Operations and Technology (less IT Capital Budget)

Overhead – *costs included*:

- Administrative operating costs for all overhead divisions
 - Personal Services* (all positions: permanent, temporary, limited-term, seasonal, etc.)
 - **Excludes** *incentive compensation payments*
- Operating Expenses and Equipment (all; equipment, software, hardware, consultants, travel, etc.)

* Personal Services costs include negotiated raises, merit salary adjustments, and increases in retirement contributions

Enterprise Operational Effectiveness

Product and Service Delivery – *branches included:*

- Actuarial Office
- Health Policy and Benefits (Health Account Management Division)
- Customer Services and Support (less Branch Support Services section)
- Financial Office (Pension Contract Mgmt. and Prefunding Programs)
- General Counsel's Office (Office of Audit Services)
- Third Party Administrators (Heath, LTC, CERBT, SIP)

Product and Service Delivery – *costs included:*

- Administrative operating costs for all product and service delivery divisions
 - Personal Services* (all positions: permanent, temporary, limited-term, seasonal, etc.)
 - **Excludes** *incentive compensation payments*
- Operating Expenses and Equipment (all; equipment, software, hardware, consultants, travel, etc.)
- Third Party Administrator Expenses (Heath, LTC, CERBT, SIP)

* Personal Services costs include negotiated raises, merit salary adjustments, and increases in retirement contributions

Discretionary Modifier

- Intent: provide ability for the Board, the CEO, and/or the CIO (with proper approvals) to eliminate, decrease, or increase award for substantially negative or positive behavior or contributions
- Policy revision for Fiscal Year 2016-17 included ability to eliminate or decrease by 50%; or increase by 25%, 50%, or 100%
 - Note – final award may not exceed maximum potential award
- Use of the modifier in Fiscal Year 2016-17 uncovered a need to broaden flexibility of application
 - This may include a sliding scale of decrease or increase options which are based on quantitative criteria
- **RECOMMENDATION:** direct staff to conduct further analysis and work with Grant Thornton to develop options for a broader and more quantitatively applicable modifier. With this direction, consider any changes to be applied to this fiscal year.

2016 Recommendations Not Yet Addressed

- Long-term incentive plan linked to Absolute Total Fund Performance (rather than relative performance) to assist with alignment of pay for performance, and to enhance tie between long-term performance and pay
- Increasing fixed compensation (salary) while reducing variable compensation (incentive) to assist with risk mitigation, recruitment/retention, and internal equity