



Performance, Compensation &
Talent Management Committee
Agenda Item 9

February 13, 2018

Item Name: Executive Compensation Policy: Discretionary Modifier

Program: Administration

Item Type: Action

Recommendations

Approve one of the Board Executive Compensation Consultant's proposed Discretionary Modifier policy amendment options.

Executive Summary

The purpose of this agenda item is to present options for modifying the Discretionary Performance Adjustments section of the Executive Compensation Policy (Policy) for Committee review and approval. Proposed amendments are based on Committee feedback and are recommended for implementation during the Fiscal Year 2017-18 year-end process.

Strategic Plan

The Executive Compensation Program supports the 2017-22 Strategic Plan's goal to promote a high-performing and diverse workforce, by recruiting and empowering a broad range of talents to meet organization priorities. The compensation program provides a means for recruiting and retaining highly-skilled executives for the overall benefit of the CalPERS organization.

Background

In August 2016, as part of the Compensation Review Project, the Board of Administration (Board) approved several policy changes recommended by the Board's Executive Compensation Consultant, Grant Thornton LLP (Consultant), including the addition of the Discretionary Performance Adjustments policy provision. The authority to implement upward or downward discretionary adjustments serves as an important pay strategy for the Board (and Chief Executive Officer) to ensure incentive pay appropriately reflects a balanced and thoughtful view of individual performance by rewarding extraordinary performance and addressing unsatisfactory performance.

Through the course of the Fiscal Year 2016-17 year-end process, the Committee identified a need for more flexibility in the application of discretionary adjustments to incentive awards. In December 2017, the Board directed staff and the Board's Consultant to bring back recommendations for a policy amendment.

Analysis

The current Policy provision reflects the Board Consultant's original recommendation which allows for upward or downward adjustment of an incentive award "by 25%, 50%, or 100% (not to exceed 150% of target incentive opportunity) based on qualitative individual contributions or performance."

In follow-up to the Committee's direction in December 2017, staff worked with the Board's Consultant to identify options for revising the Discretionary Modifier language in the policy. Options proposed for the Committee's consideration are as follows:

Option A: Increases flexibility by allowing discretion to be exercised upward or downward on an award in 20 percent increments.

Option B: Allows maximum flexibility in applying discretion upward or downward on an award in any percentage.

All adjustments would continue to be based on the overall performance evaluation process and qualitative factors such as performance relative to CalPERS' culture and values, leadership, and extraordinary or unsatisfactory contributions. Discretionary adjustments may never exceed the maximum incentive opportunity for any given position; in the event an adjustment would exceed the maximum incentive opportunity, the incentive award will be limited to the maximum incentive opportunity defined in the policy.

No changes are being recommended for the current parameters around discretion in situations of non-adherence to CalPERS' risk management principles, policies, processes, or procedures (the current provision allows an award to be cut in half or eliminated entirely based on the severity of any non-adherence).

Attachment 1 presents a clean version of the proposed options, with substantive revisions in bold; Attachment 2 presents a redline version. Attachment 3 is an opinion letter from the Board's Consultant which outlines considerations on the proposed discretionary modifier options and a recommendation.

Future items pertaining to the Board's Executive Compensation Policy will address layout and formatting changes to improve the flow of information, such as moving approval details currently displayed in narrative form into a table, consistent with other areas of the Policy. Other policy amendments to increase clarity on current policy provisions and improve readability will also be presented.

Budget and Fiscal Impacts

The cost of incentive awards and base pay adjustments that arise from the recommendations in this item during the year-end performance evaluation process have been addressed through the annual budget process and will be funded from existing resources.

Benefits and Risks

The review of the Compensation Policies serves to ensure the policies are designed to enhance the organization's ability to attract and retain highly skilled executive and investment professionals. Without a periodic and systematic review, there is a risk of policies becoming misaligned with the overarching goals of the organization.



Attachments

Attachment 1 – Proposed Policy Changes to Discretionary Modifier Adjustments (Clean)

Attachment 2 – Proposed Policy Changes to Discretionary Modifier Adjustments (Redline)

Attachment 3 – Opinion Letter from Grant Thornton LLP

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