MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

PERFORMANCE, COMPENSATION &

TALENT MANAGEMENT COMMITTEE

ROBERT F. CARLSON AUDITORIUM

LINCOLN PLAZA NORTH

400 P STREET

SACRAMENTO, CALIFORNIA

TUESDAY, JUNE 18, 2019

2:50 P.M.

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

## A P P E A R A N C E S

COMMITTEE MEMBERS:

Ms. Theresa Taylor, Chairperson

Mr. Rob Feckner

Ms. Fiona Ma, represented by Mr. Frank Ruffino

Ms. Lisa Middleton

Ms. Eraina Ortega, represented by Mr. Ralph Cobb

Ms. Mona Pasquil Rogers

BOARD MEMBERS:

Mr. Henry Jones, President

Mr. David Miller

Mr. Jason Perez

Ms. Betty Yee, represented by Ms. Lynn Paquin

STAFF:

Ms. Marcie Frost, Chief Executive Officer

Mr. Doug Hoffner, Deputy Executive Officer

Mr. Matthew Jacobs, General Counsel

Mr. Scott Terando, Chief Actuary

Ms. Tina Campbell, Chief, Human Resources Division

Ms. Jerrolyn Queral, Committee Secretary

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

ALSO PRESENT:

Mr. Al Darby, Retired Public Employees Association

Mr. Eric Gonzaga, Grant Thornton

Mr. Andrew Junkin, Wilshire Consulting

Mr. Eric Myszka, Grant Thornton

INDEX

P R O C E E D I N G S

CHAIRPERSON TAYLOR: I call the Performance, Compensation and Talent Management Committee -- thank you -- to order. I think I talk loud enough, don't I?

Not for you.

So first on the agenda is roll call.

COMMITTEE SECRETARY QUERAL: Theresa Taylor?

CHAIRPERSON TAYLOR: Here.

COMMITTEE SECRETARY QUERAL: Dana Hollinger?

CHAIRPERSON TAYLOR: Excused.

COMMITTEE SECRETARY QUERAL: Rob Feckner?

COMMITTEE MEMBER FECKNER: Good afternoon.

COMMITTEE SECRETARY QUERAL: Frank Ruffino for Fiona Ma?

ACTING COMMITTEE MEMBER RUFFINO: Present.

COMMITTEE SECRETARY QUERAL: Lisa Middleton?

COMMITTEE MEMBER MIDDLETON: Present.

COMMITTEE SECRETARY QUERAL: Ralph Cobb for Eraina Ortega?

ACTING COMMITTEE MEMBER COBB: Here.

COMMITTEE SECRETARY QUERAL: Mona Pasquil Rogers?

COMMITTEE MEMBER PASQUIL ROGERS: Here.

CHAIRPERSON TAYLOR: All right. Thank you.

Okay. So now we're going to move on to the election of the Performance, Compensation and Talent

Management Committee Vice Chair.

First of all, I want to say that Dana Hollinger has put in her resignation. It is good as of or through June 30th. So this election will be for July 1st, the person will take place -- or take the position.

And I would like to now put in and ask for a nomination for Vice President of Perf, Compensation and Talent Management Committee.

COMMITTEE MEMBER FECKNER: Vice Chair.

CHAIRPERSON TAYLOR: I'm sorry, Vice Chair. Did I say Vice President?

Vice Chair. And I need you. Go ahead.

I think.

CHIEF EXECUTIVE OFFICER FROST: Ms. Taylor, you can run elections for Vice Chair.

CHAIRPERSON TAYLOR: I can run elections?

CHIEF EXECUTIVE OFFICER TAYLOR: For Vice Chair, yes.

Okay. Are you -- who are you -- so I'm very confused here, guys, because I have different names running through my head. I'm asking for a nomination for Vice Chair of the Perf and Comp Committee. And does -- do I have a nomination for the Vice Chair?

COMMITTEE MEMBER FECKNER: Oh, that's why we couldn't figure it out. She's not here.

CHAIRPERSON TAYLOR: Yeah.
(Laughter.)
CHAIRPERSON TAYLOR: You're not on. Okay. Hold on. I thought I clicked you.
COMMITTEE MEMBER FECKNER: Thank you, Madam Chair. I would like to place the nomination of Eraina Ortega for Vice Chair of the Perf and Comp Committee.
CHAIRPERSON TAYLOR: Okay. I've received a nomination for Eraina Ortega for Vice Chair of the Perf and Comp Committee.
ACTING COMMITTEE MEMBER RUFFINO: Second
CHAIRPERSON TAYLOR: I've got a second.
I've received -- any other nominations?
Any other nominations?
Any other nominations?
All right. Nominations are closed.
I need a motion -- go ahead. I need a motion for the election of Eraina for Perf and Comp.
Come on. There you go.
COMMITTEE MEMBER FECKNER: I move that we elect Eraina Ortega by acclamation.
COMMITTEE MEMBER PASQUIL ROGERS: Second.
CHAIRPERSON TAYLOR: It's been moved by Mr. Feckner, seconded by Ms. Pasquil Rogers. And it's by acclamation, so motion is carried.

Thank you.

CHAIRPERSON TAYLOR: Sorry about that confusion guys.

COMMITTEE MEMBER FECKNER: Are you going to tell her Ralph?

(Laughter.)

CHAIRPERSON TAYLOR: Yeah, please let her know.

CHIEF EXECUTIVE OFFICER FROST: Ms. Taylor, you still need to take a vote even by acclamation.

CHAIRPERSON TAYLOR: Oh. All those in favor of Ms. Ortega for the Vice Chair?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

All right. Motion carries.

BOARD MEMBER PEREZ: Can I proxy for her.

CHAIRPERSON TAYLOR: Can you proxy for her?

BOARD MEMBER PEREZ: Poor girl.

CHAIRPERSON TAYLOR: She is here though. Ralph is here.

BOARD MEMBER PEREZ: Oh, but Ralph is leaving in a little bit.

(Laughter.)

CHAIRPERSON TAYLOR: All right. I think we're done there.

So let's move on to Agenda Item 3, approval of the June 18th, 2019 Performance, Compensation and Talent Management Committee timed agenda. What's the Committee's --

COMMITTEE MEMBER FECKNER: Move approval.

CHAIRPERSON TAYLOR: Thank you.

COMMITTEE MEMBER PASQUIL ROGERS: Second.

CHAIRPERSON TAYLOR: It's been moved by Mr. Feckner, seconded by Ms. Pasquil Rogers.

All those in favor of moving approval say aye?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Motion carries.

And we are finally here. Executive report. Thank you, Mr. Hoffner.

DEPUTY EXECUTIVE OFFICER HOFFNER: Thank you, Madam Chair and members of the Committee. We have three things before you today, two information items and one action item relating to incentive metrics. The 2019-2020 CEO performance plan for approval, as well as Grant Thornton, the Board's independent consultant, will be talking about long-term incentives based on information that was requested from several months ago. This item is a first reading.

I would make one recommendation because two of the items relate to incentive metrics. One is information. One is action. I would suggest we take Item 8a out of order, so we can hear the metric items themselves, some of which are contained in the CEO's performance plan. And if there are any modifications based on that feedback, then we'll incorporate it into that action item, if that's okay with you. And then we -- I think we can move back to the long-term incentive as the final item for the day. That would be my recommendation.

CHAIRPERSON TAYLOR: Okay. Then we will do so.

DEPUTY EXECUTIVE OFFICER HOFFNER: With that, that concludes my report.

CHAIRPERSON TAYLOR: All right. Great. So we have our action consent item. So I will -- instead of 7, we're going to go to 8 after I do this. But I just wanted to make it clear we're -- action consent items, I need to move approval for the Performance, Compensation March 19th meeting minutes.

COMMITTEE MEMBER FECKNER: Move approval.

CHAIRPERSON TAYLOR: Moved by Mr. Feckner.

ACTING COMMITTEE MEMBER COBB: Second.

CHAIRPERSON TAYLOR: Seconded by Mr. Cobb.

All those in favor say aye?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Motion carries.

Information consent items. I didn't have any request to take anything off the information consent item calendar, so we're going to move on. And this is where you want me to move to 8, right?

DEPUTY EXECUTIVE OFFICER HOFFNER: Yeah, I think Item 8a would be the first one, then we'd go to 7a, and then 8b to close out the -- today's session.

CHAIRPERSON TAYLOR: Got it. All right. Let's move on to 8a and that is Grant Thornton, I think, right?

(Thereupon an overhead presentation was presented as follows.)

MR. GONZAGA: Great. Eric Gonzaga. And glad to be here to discuss the Annual Incentive Plan metrics again. You know, first and foremost, what you have in front of you is just the same consistent performance metrics that we've -- that have been in place and recommended since we started the work back in 2016.

And the whole intention of, you know, these metrics was to come up with a balanced score card with which to evaluate CalPERS performance. And when I say balanced score card, it was -- it was intended to cover all organizational metrics, you know, to the extent that what we're really focusing in on is global performance for the organization.

And those metric categories specifically are:

One, total fund performance, so management of the funds to ensure there's appropriate benefit; enterprise operational effectiveness, which that's intended to ensure that the organization is operating efficiently, whether it's as an organization overall or relative to the Investment Office; and customer service and stakeholder engagement. So those are the metrics that you have in front of you.

Now, you know, going back a few years, because it very much sets the baseline for the recommended categories and the recommended performance levels that are included in this document, you know, what we did when these were put in place is just study two-, three-, four-year performance levels of the organization and tried to come up with metrics that would pay out at threshold for good performance, target for very good performance, and maximum levels for outstanding performance levels. And a lot of this was based on, you know, historical performance, including -- and trying to stretch the organization accordingly.

And I think these are, you know, in some respects, considered best practice performance metrics. So when you take a look at the proposed performance metric for total fund performance, you know, it ranges and it's based on relative performance. You pay out at target for beating the benchmark by, you know, five basis points, maximum for beating the benchmark by 35 basis points. And you have to be comparable to the benchmark before there's any payout accordingly. So that's metric number one.

Metric number two in terms of overhead enterprise operational effectiveness. There's two metrics. One is for the overall organization, which measures, you know, performance in terms of overhead operating cost as a percent of overall expenses, overall budget. And again, these metrics are based on historical performance ranging from, you know, you have to -- they'll pay out a maximum if we reduce the ratio by 1.1 percent to paying out at target, only to the extent the we're somewhere between 1 to 1.5 percent of prior year.

Investment Office CEM, that's another way of demonstrating operational effectiveness. And that's the Investment Office taking a look at both costs and returns, paying out, in cascading impact to the extent that you're both beating and exceeding both cost and returns. So it's the efficiency of the returns that you're generating. The same metric as used historically.

The next metric that's used -- and again, it's customer service. So how are we reacting to the needs of the members and how are we delivering service. We have a combination metric related specifically to the survey scores with one element linked to benefit payment timeliness, so an indicator of the service that we're providing in customer satisfaction.

And again, these levels haven't changed over last year. They -- we considered them to be stretch performance last year. We considered them to be good goals this year.

And then the final metric is stakeholder engagement, which is, okay, we're a mission driven organization. How engaged are we with our members? And it's based on, you know, survey scores related to the needs. Is CalPERS designated? There's a survey filled out. Are we responsive and sensitive to the needs of stakeholders? Do we do a good job of keeping our members informed? And how good are we at engaging in communicating?

And what we've done this year -- so there is a bit of a change, because we know this is an organization that wants to continue to stretch its performance, its deemed performance, and continuous performance improvement. The scores have went up by, you know, a percentage point to continue that evolution in terms of stretching performance, in terms of how we're meeting and engaging with the needs of stakeholders.

So that is -- those are the performance metrics in a nutshell. We believe that they're very solid metrics, you know, symbolic of the overall missions of the organization. Returns are important. It's a portion of it. But in addition, we're talking about measuring the performance of the overall organization. And the executive team has line of sight where there's shared accountability relative to these organizational metrics.

So that is it in a nutshell.

CHAIRPERSON TAYLOR: Thank you.

Ms. Campbell.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Tina Campbell, CalPERS team. Just one point of clarification. This is a first reading item, but it is at the discretion of the Committee. If you either don't have questions or changes, you can approve this as is today, if you choose to do so.

CHAIRPERSON TAYLOR: Okay. I appreciate that. I'm not sure what we're -- I did have a couple of questions. The -- I know we've been working on this for a long time, Eric. So I don't want to say, oh, my God. I just saw this. But I'm looking at the customer service score. So are we saying the customer service score is if we answer and/or pay benefits at equal to or above 95 percent of our -- then that's where we get to 150. And to get to 100 percent of your bonus, it's 92 to 94 percent?

I thought that was -- that seems new, but maybe I'm just --

MR. GONZAGA: No, that's correct. That's correct. It's within those established performance levels. And a lot of it was driven by the fact that, you know, I think there's been a new survey methodology adopted over the last few years. But it was starting from the standpoint of taking a look at historical performance. And I don't know if you've ever -- you haven't ever achieved, you know, 95 percent. And it started with setting the baseline for exceeding historical performance levels, so...

CHAIRPERSON TAYLOR: Okay. And the historical performance levels our -- are our historical performance levels and we're not comparing it to any other phone service area, are we, Ms. Campbell? I'm not sure.

DEPUTY EXECUTIVE OFFICER HOFFNER: In this case -- this is Doug Hoffner, CalPERS team member. In this case, we're not. This is basically looking back at our historical performance. We also report this out in the enterprise performance reporting on a quarterly basis to the board, so you can actually see then quarter by quarter where we're trending. Are we above that threshold or not?

So this is really trying to connect the incentive as it relates to actually our performance. And so you can see that on a quarterly basis. I don't have the most current one in front of me. But we'll report that out after the current fiscal year is over. But you would then see how we've trended historically over time, over years, and to where we going to be looking, what is the impact at this point to this metric --

CHAIRPERSON TAYLOR: Okay.

DEPUTY EXECUTIVE OFFICER HOFFNER: -- which is consistent with what we had the last two years.

CHAIRPERSON TAYLOR: Okay. And that's what I was -- I was just trying to figure out if -- I can't -- I couldn't remember if we had compared it to anything other than our own history. Okay.

DEPUTY EXECUTIVE OFFICER HOFFNER: (Shakes head.)

CHAIRPERSON TAYLOR: I see no other questions. I would like to move back to 7a then.

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Good afternoon, Madam Chair, members of the Committee. Tina Campbell, CalPERS team member.

Agenda Item 7a is an action item, which seeks approval for an incentive plan for the Chief Executive Officer for fiscal year 2019-20.

The Board's Compensation Policy for executive and investment management positions requires the annual approval of an incentive plan for the CEO. The proposed plan maintains the priorities and metrics from the CEO's fiscal career 2018-19 incentive plan. Any changes made to the incentive metrics that we just spoke of will be incorporated into the incentive plan for the CEO.

The committee may approve the plan as presented or if you have questions, I'm happy to take them.

CHAIRPERSON TAYLOR: So, Ms. Campbell and Mr. Hoffner, I was wondering if we could possibly, since we -- this is a first reading, and I'm not sure that we're ready to move on the first reading of the actual long-term incentive plan from 8a -- or the metrics -- I think these are tied together. Are we -- Mr. Hoffner, did you want to address that?

DEPUTY EXECUTIVE OFFICER HOFFNER: So actually, they're not. These two are tied -- so this item related to the CEO's joint 19 -- 2019-2020 performance plan is tied to the metrics that Mr. Gonzaga just spoke of, which are the same metrics we've had in place the last two years. This would be the third year of that plan.

This item includes additional leadership metrics based upon the conversations on these five categories up front that you discussed with the CEO two years go when she started.

CHAIRPERSON TAYLOR: Right.

DEPUTY EXECUTIVE OFFICER HOFFNER: The long-term piece is not included in these two portions of these two items.

CHAIRPERSON TAYLOR: Oh, they just --

DEPUTY EXECUTIVE OFFICER HOFFNER: The long-term incentive is actually not --

CHAIRPERSON TAYLOR: Part of it now.

DEPUTY EXECUTIVE OFFICER HOFFNER: -- as designed today to be included in the CEO's performance plan as presented in the next item later on today. So they are separate. We wanted to identify that the information item that you just spoke of is embedded -- half of it's embedded here in the CEO's plan as well, in addition to the leadership metrics that are additive to the overall plan. And that's what we're trying to convey.

So if you approve one or you don't approve -- you modify the 7a item, you'd want to make a corresponding change to this item. But this is not talk to the long-term incentive at all.

CHAIRPERSON TAYLOR: Okay. So if we adopt -- because I believe Ms. Campbell said earlier that if we want to move to adopt 8a rather than just an information item, we can do so, which would then also allow us to adopt 7a, is that correct?

DEPUTY EXECUTIVE OFFICER HOFFNER: That is correct.

CHAIRPERSON TAYLOR: Okay. Do I have any appetite for doing that?

Does anybody want to speak on that?

I'm going to go ahead and give direction from the Committee Chair then to go ahead and vote on -- hold on -- vote on 8a as an action item. I need a -- to move a motion to have 8a as an action item to be approved.

COMMITTEE MEMBER MIDDLETON: So moved.

CHAIRPERSON TAYLOR: I need a second.

COMMITTEE MEMBER PASQUIL ROGERS: Second.

CHAIRPERSON TAYLOR: Moved by Ms. Middleton and seconded by Ms. Pasquil Rogers to have 8a as a -- an action item. All those in favor of the annual review 2019-20 incentive metrics being passed as an action item say aye?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Motion carries.

All right. And we were on 7a. And did we want to continue -- go ahead -- on the CEO's -- I don't know if you'd finish or not?

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Yeah. So it was basically any discussion that you had. And I heard a little bit of discussion. And it would -- you all -- this is an action item. So if you are okay with the way that it is written, then you can approve that as well, the action item.

CHAIRPERSON TAYLOR: Do I have any comment or anything on this item?

All right. Seeing none. I --

COMMITTEE MEMBER FECKNER: I'll move the item.

CHAIRPERSON TAYLOR: I need a motion.

Thank you. Mr. Feckner has moved the item.

I need a second.

COMMITTEE MEMBER MIDDLETON: Second.

CHAIRPERSON TAYLOR: Ms. Middleton has seconded Agenda Item 7a, the 19-20 incentive plan of the Chief Executive Officer.

All those in favor say aye?

(Ayes.)

CHAIRPERSON TAYLOR: All those opposed?

Motion carries, 7a. Thanks.

CHAIRPERSON TAYLOR: And sorry. Mr. Darby, come up here to our right. I thought you were further down.

MR. DARBY: Madam Chair, Committee members, Al Darby, President, Retired Public Employees Association.

The specific part of this plan that I'm speaking to is the Investment Office. And since this is all part of the same motion, I believe, is it not?

CHAIRPERSON TAYLOR: This is 7a that we're talking on, yeah.

DEPUTY EXECUTIVE OFFICER HOFFNER: Would -- I guess what's the specific question? So the total fund provisions or which?

MR. DARBY: Well, okay, may -- are you going to shut off my time, because --

CHAIRPERSON TAYLOR: Can we start it over, guys.

MR. DARBY: 7a includes not only the CEO plan, but also the Investment Office enterprise operational effectiveness. And so --

DEPUTY EXECUTIVE OFFICER HOFFNER: Correct.

CHAIRPERSON TAYLOR: Right.

MR. DARBY: All right.

CHAIRPERSON TAYLOR: That's all the CEO's.

MR. DARBY: All right. Specific to the investment incentive plan, RPEA believes that the investment performance bonus plan as presented here is not aligned with the interests of members and beneficiaries. It appears to lack risk-adjusted safeguards, and thereby serves the interests of the investment officers eligible for the performance bonus.

A plan that encourages and/or permits adding risk to the portfolio without a appropriate risk adjustment safeguards is not in the best interests of members.

In addition, a system such as this that allows bonus payments for underperformance is also a disservice to members. Bonuses should be paid upon achieving the benchmark for risk-adjusted return on investment. This should only -- this should be the only incentive pay criterion.

RPEA recommends you amend this motion to reflect the conditions that we've mentioned here. Thank you.

CHAIRPERSON TAYLOR: Thank you, Mr. Darby.

All right. Mr. Hoffner, can we move on to 8b. I think that might help Mr. Darby. Long-term incentive program design. And that's Ms. Campbell. I lied.

(Thereupon an overhead presentation was presented as follows.)

HUMAN RESOURCES DIVISION CHIEF CAMPBELL: Tina Campbell, CalPERS team member.

Agenda Item 8b is an information item and first reading for Long-Term Incentive Program, LTIP, design. The Board's primary executive compensation consultant, Eric Gonzaga and Eric Myszka from Grant Thornton are here to present the recommendations for your review.

This item is being presented as a follow-up to the February 2019 Performance, Compensation and Talent Management Committee meeting when the Board approved a revised compensation structure for investment management positions.

The approved structure included revised base salary and incentive ranges, as well as long-term incentive component. When the structure was approved, the Committee requested the consultant return with design details regarding the long-term incentive component, which they will do today. We'll return for a second reading in August 2019, along with applicable changes to the Board's Compensation Policy for executive and investment management positions.

Unless the Committee has any questions at this time, I will now turn it over to Mr. Gonzaga and Mr. Myszka.

CHAIRPERSON TAYLOR: All right. Mr. Gonzaga, go ahead.

MR. GONZAGA: Great. Thank you. So -- and certainly, I think that this will blend in nicely with the -- you know, the public comment that was just recently raised.

--o0o--

MR. GONZAGA: You know what we're talking about here today is -- so what we're talking about here today, ultimately when we were engaged -- and this goes back a good three years now when we were engaged to take a look at the incentive strategy. And part of it is certainly reflective of the need to recruit/retain the right types of professionals.

Secondarily, you know, the issue is, okay, let's come up with a pay plan that, you know, reflects the mission of the organization. And certainly a big portion of that is sufficiency of funding in investment funding related to the pension obligations.

Initially, we started out, you know, modifying the Annual Incentive Plan, so it looks like where we're at right now, certainly taking into account, you know, performance -- relative investment performance, which, you know, addresses risk to a certain extent.

The second component that we talked about right from the get-go was, okay, if what we're trying to do is, you know, balance the incentives of the organization focused on both the long-term nature of the mission of the organization, doesn't it make sense to also have a long-term incentive plan, such that there's this balance between, you know, annual performance, in addition to sustained long-term performance. And ultimately, that's how we ended up at this long-term incentive design structure.

And so in this instance, what we'll walk through -- I'm just going to walk through the basics and then I'll hand it over to Eric to walk through the technical details. But the things to remember, first, are just some definitional items as we go through this.

--o0o--

MR. GONZAGA: One is that the metric revolves around CAGR, so that's compounded annual growth rate. That's intended to make sure that -- there's a lot of blips that go on from one year to the next, but it's intended to measure sustained performance for that five year period. How good are actual returns as opposed to just simple average returns?

And the whole point is to have performance tied to sustained five-year performance, which complements the nature of the Annual Incentive Plan, which is short-term and periodic in nature.

Second is, you know, at least to start out, we recognize at this point that, you know, the expected return is approximately 7 percent. That's what you use for all the actuarial funding. And so right now, we modeled this out assuming target should be that 7 percent, because that's what the organization is expecting. That's the expected rate of return.

The initial Long-Term Incentive Plan values. There's a relationship here between the Annual Incentive Plan and the Long-Term Incentive Plan, which is to say that the initial Long-Term Incentive Plan, it's going to be funded from the standpoint of it's going to be the lower of the target values under the Annual Incentive Plan or the most recent historic payout under the Annual Incentive Plan. That's what's going to go into -- that equivalent amount is what's going to go into the long-term incentive plan.

So what that says is, okay, if you achieve certain relative performance criteria, that's the amount that is going to go into the Long-Term Incentive Plan. And aside from -- so we measure relative performance through the Annual Incentive Plan and then consistent in -- with alignment of the pension holders, it's simply that that amount will go up or down based on the absolute return to the organization. In other words, unless you meet certain criteria and the funding isn't improved, there aren't appropriate returns, the Long-Term Incentive Plan payout goes all -- away altogether.

Additionally, we're capping the amount at 150 percent of whatever goes into the Long-Term Incentive Plan, so we're not encouraging too much risk taking. But the intention is to come up with a balanced scorecard, again measuring relative through the Annual Incentive Plan absolute on the Long-Term Incentive Plan side of the house and coming up with certain threshold and maximum criteria, such that we're not encouraging too much risk by either paying out too much or paying out too little, you know, for the most part.

And, you know, the performance period is going to be for a five-year performance period. We're recommending that some -- that -- it's actually longer than what you find in many industry organizations, where it tends to be measured over a three-year performance period. The point there is, again, we recognize that we do want returns, but we're also recognizing that it needs to be sustained over a long-term period, hence the longer performance period than normal.

And, you know, finally, this all going to be based on total fund returns. We're talking about managing performance, how much are we -- is -- are we returning from an appreciation standpoint with the overall fund itself.

So with that, that's the baseline. I will hand it over to Eric to walk us through the technical detail.

--o0o--

MR. MYSZKA: All right. Thanks. Good afternoon, everybody. Just to recap real briefly. I know Ms. Campbell mentioned this prior. But in the February meeting, the Committee then, you know, agreed to increase salary midpoints to 50th and 75th percentile; adjusted and consolidated the annual incentive ranges for the

Investment Office, and also introduced the Long-Term Incentive Program concept.

--o0o--

MR. MYSZKA: Kind of overview recommendations, measure total fund return over five years. And we'll go through each of these items in a little bit more detail on what this means. Target goal performance for the entire period, with the goal being the expected rate of return in the first year.

The initial LTIP award going to be the lesser of actual performance -- actual bonus pay out, as well as the target award for that year. And then that amount will adjust, 0 to 150 percent, depending on performance.

--o0o--

MR. MYSZKA: So when you talk about performance levels, you know, the target performance being that expected, you know, rate of return in year one based upon the actuarial assumptions at 7 percent. You know, having a guideline of, you know, performance that's kind of a threshold performance up to a maximum performance of about 80 to 120 percent of target is what we recommend.

This gives us a little bit of room for -- maybe performance that wasn't quite up to target, but still provides a payout and also mitigates any potential excessive risk taking to get to, you know, a target payout of 100 percent. Which 80 percent of 7 percent would be 5.6 percent would be that threshold performance over that five-year period on a compound -- compounded annual growth rate. Maximum Performance being up to 100 -- or sorry, 8.4 percent, which reflects 120 percent of 7.

Again, anything that kind of falls in between that would be interpolated. So if there was a performance that fell between 5.6 and 7 percent, the payout would be adjusted accordingly.

I'll get into how these relate to payouts in a second. But if there's any questions on the total fund return performance metric?

CHAIRPERSON TAYLOR: I have no -- oh, wait. I do have a question. I have two questions.

Ms. Pasquil Rogers.

COMMITTEE MEMBER PASQUIL ROGERS: Thank you for the report. I just have a -- I'm not sure if this is a ridiculous question, but -- so I get the five years. But you mentioned the industry usually does about three years. So do we -- you know, does that negatively impact us in terms of getting good people by saying, you know, everybody else, or on average, does it three years, but we're going to go five years? I just don't.

MR. GONZAGA: No, that's a great question. And, you know, my thought would be that we made -- and that is the one perspective is that when we did the analysis going back a few months back, this -- there's a total pie that we're talking about here. And so long as, you know, salaries and annual incentives are competitive, the fact that, you know, you're extending performance over five years as opposed to three years, it should not make a difference if the rest of the compensation program is fair.

Now, what I will say is that, you know, the market -- you know, I mean, there's this whole concept of long-term incentives. And long-term performance plans, they just kind of, you know, fell on it being three years as the market practice. And there's no reason other than it seems a little bit easier to manage instead of five or seven years, recognizing that three years isn't necessarily a perfect long-term performance period.

I think with the mission of the organization, it's good, because a couple things. We're talking about grants that are going to overlap. You'll get a grant every year. And so at some point after that five-year period, you'll have an opportunity for a payout every year. It's just those intervening first couple of years where there may be some issues.

But I don't think it should reduce the ability to recruit and retain. And the other thing is that if anybody should have a longer term performance horizon, it's an organization like CalPERS, which really does have a hundred year mission, and sustained liabilities that are going to go on for a number of years. It's not a short-term play like you find with, you know, for-profit asset managers, so...

COMMITTEE MEMBER PASQUIL ROGERS: Thank you.

MR. MYSZKA: And the one thing too, we are seeing some of the larger financial institutions considering or moving towards a five-year -- at least a five-year element to their plan. Just because three year might be the average now, that might change in the future.

CHAIRPERSON TAYLOR: So I'll say, Ms. Pasquil Rogers, when we did this a couple years ago, we were thinking long term, because we are such a long-term investor. And I think that's why we picked the five years for the same reasons, so...

And then, Mr. Cobb.

ACTING COMMITTEE MEMBER COBB: Thank you, Madam Chair. We remain concerned because of the lack of analysis and the magnitude of the pay increases that this facilitates. You know, CalHR was just criticized in the media for giving a three percent rate increase to public safety workers that put their lives on the line. And this -- you know, the long-term incentive just adds to the -- you know, to the order -- another order of magnitude to the pay to some of the high -- most highly compensated State employees of all.

But with that, looking at the threshold performance, the 5.6 percent total fund return, that's the minimum threshold for triggering a payout under the proposed plan, what is the magnitude of a 5 percent -- 5.6 percent rate of return over five years. What does that look like in terms of funding level for the fund?

And I think that needs to be presented, so that we can see -- you know, is that something that we're comfortable paying an incentive bonus for?

CHAIRPERSON TAYLOR: That's a perfect question, Mr. Cobb, because that brought Mr. Junkin right up. And I was going to ask him -- number one, I wanted to sort of address Mr. Darby's, our CAGR calculations that we use also includes risk adjustment. So when we do that, it is risk adjusted.

But also -- could you address what Mr. Cobb was talking about what that would mean, because I also had a question on that. Who wants to go first?

DEPUTY EXECUTIVE OFFICER HOFFNER: I think we should let Mr. Terando from the Actuarial Office.

CHAIRPERSON TAYLOR: Oh, well, there you go.

DEPUTY EXECUTIVE OFFICER HOFFNER: He's done some analysis, so I think -- and then --

CHAIRPERSON TAYLOR: That would be great.

DEPUTY EXECUTIVE OFFICER HOFFNER: -- if Mr. Junking wants to weigh in on that as well.

CHAIRPERSON TAYLOR: That would be great. What would happen if we got a 5.6 percent return for five years?

CHIEF ACTUARY TERANDO: Good afternoon. Scott Terando, Chief Actuary.

We looked at what would happen if we got a 5.6 return for five years starting with the 366 -- approximately $366 billion fund we have today. And then we looked at this in terms of loss and additional contributions this would generate.

Over the five years, we estimate approximately $29 billion loss. And then additional contributions approaching 59 billion in additional contributions for the entire fund. It would also probably result in about a 5 percent decrease in the funded status.

CHAIRPERSON TAYLOR: Wow. So basically this minimum threshold -- what you're telling me is this minimum threshold shouldn't be getting even 50 percent of a payout, based on the fact that we would be --

CHIEF ACTUARY TERANDO: Well, I'm not -- it's not for me --

CHAIRPERSON TAYLOR: I mean that's why my assumption is

CHIEF ACTUARY TERANDO: It's not for me to comment. I just --

CHAIRPERSON TAYLOR: You're not telling me anything, I get it, Scott.

CHIEF EXECUTIVE OFFICER FROST: Ms. Taylor, I would ask either Grant Thornton or Mr. Junkin to talk about industry and why the recommendation is coming from your independent consultants on these numbers. I would ask to go into a little bit more background and analysis of where these numbers are coming from.

CHAIRPERSON TAYLOR: So if you want to -- yeah, if you want to address that.

MR. GONZAGA: Yeah, I'll just start out with. You know, the whole purpose for, you know, recommending -- you know, where we started out was that it was with the total fund returns at 7 percent paying out at target, because that's, you know, what's stated.

The 5.6 and the 8.4 is nothing more than an industry standard in terms of, you know, plans tend to pay out based on good performance at threshold, outstanding performance at maximum. And so this was just really -- and it tends to be in that 80 to 120 percent, you know, performance dichotomy.

Now -- and I recognize, you know, certainly the loss of -- although returns are positive, it's just because you're planning on a 7 percent return, that that would result in, you know, some deficits because of, you know, how the plan -- how the pension is funded.

Our recommendation isn't -- and that 5.6 percent we can always work around that. But, you know, the issue is just making sure there's an appropriate spread between threshold to target, to maximum.

And the whole point is we recognize that performance in any given year isn't an exact science. And what we're trying to do is create an array of, you know, performance criteria that payout at variable levels. It also, you know, encourages -- it helps to ensure, you know, excessive risk taking as opposed to just picking one specific number.

If it's just 7 percent and we're at, you know, 6.4 percent, don't we want to continue to encourage continued performance improvement trying to get to that 7 percent, as opposed to, you know, putting an absolute minimum performance threshold at 7 percent, which in some years, given the change in circumstances, may actually be great performance, better than good target performance.

CHAIRPERSON TAYLOR: So I will say for me -- and I know we've looked at this before, but I -- I think that the numbers we're looking at, I think the threshold -- based on being underfunded, okay, we're 70 percent funded. We can't afford to be paying bonuses when somebody hits 5.6 -- or when we hit a total overall fund of 5.6 percent.

I'm wondering if we want to make the 7 percent the threshold performance. And I'm going to talk -- ask Mr. Junkin to comment on what he thinks about just, in general, what Grant Thornton has come up with, and then create a middle between that target and the 8.4 percent maybe. But in any event, Mr. Junkin, could you comment?

MR. JUNKIN: Gladly. So Andrew Junkin with Wilshire Consulting.

I just want to touch back on the compound annual growth rate, that that's how all returns are ever presented to you when you're wearing your Investment Committee hats. That's the standard across the investment industry. It does not have a -- an explicit risk adjustment in the same way that a Sharpe ratio might, but it's -- as Mr. Jones pointed out yesterday, compound returns do account for large drawdowns, in that if you lose 50 percent, and then you gain 50 percent, you're not even, right? You're still down 25 percent.

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: So that's till reflected in the way compound returns are calculated. But we would never show you a return that wasn't a compound return.

CHAIRPERSON TAYLOR: Got it.

MR. JUNKIN: So that's just industry standard. And Scott got to the shortcut that I was going to come up, which is if you're a percent and a half behind your actuarial rate for five years, it's not perfect, because you have to account for the size of the liabilities and the size of the assets, but you can pretty quickly do the math on you're not making actuarial progress. You're losing ground.

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: One of the concerns that I -- I actually take notes in my iPad, and I still have my notes from when we talked about this in February. And one of the things that I talked about was having a long-term incentive plan payout based on absolute return is really something that is -- that staff is going to have zero control over, right?

So it will get funded by excess return. And so if they do a good job of beating the benchmark over five years, even if the benchmark is down, there would be an allocation to the long-term incentive plan. But if you have a year in the subsequent five years like 2008 --

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: -- you're never going to get to 7 percent with years that follow with a -- you know, four good years are probably still not going to get you to plus 7 percent.

CHAIRPERSON TAYLOR: Right, 7 percent.

MR. JUNKIN: So quite honestly, I struggled with that and I struggled with it for the same reason that you did. And one of the points of view that I sort came around to, in the corporate world -- in some ways, this is analogous to me to a stock option plan. And so if you're a participant in the plan, you're granted options on the corporate stock that have a strike price. And if the stock goes up, you can exercise and profit from that. If the stock goes down, you make zero --

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: -- if it's below the strike price.

And so really what you're incentivizing people on is generally corporate health and welfare and that the stock goes up. Now, you could still have a 2008 that would push an individual stock down, and there would be no payout in that stock option plan there as well.

Where you set the numbers gets a little bit challenging. As you'll recall, the 7 percent actuarial return is basically your forever return, right? It's the return that I think Scott assumes you're going to make from now until the last benefit payment is made for the current population.

But you don't really want to have a long-term incentive plan that's that long term.

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: Probably too much for any individual employee. The expected return -- but that is the expected return with some, I think, margin for adverse deviation. The expected return over the next 10 years is actually below 7 percent. And you if you think back to the CEPPT presentation that we did yesterday --

CHAIRPERSON TAYLOR: Earlier, yeah.

MR. JUNKIN: -- you saw some of those numbers.

But I think the expected return on the PERF over the next 10 years is something like six and a quarter. And Scott is welcome to correct me on that. And that would be great. And then we expect the next 40 years following that, so years 11 through 50 basically, to be higher than 7 percent by a large enough margin that it drags up the overall return to 7 percent.

So all of that is to say I don't know if 7 percent is the right number, or 5.6, or 6 and a quarter. But I think if you think about this as the overall health of the organization, I mean, there's really -- the Investment Committee -- I'm used to addressing the Investment Committee, so I have to change my thinking.

CHAIRPERSON TAYLOR: That's fine.
MR. JUNKIN: The Investment Committee sets the strategic policy and that drives the expected returns. And if there's a great market in equities or a really poor market in equities, staff doesn't have enough levers to be able to move out of the way or into the way of that, as the case may be, to really -- let's say the policy returns of the -- you know, call it 50 percent growth and 30 percent income, and however the -- I don't have the numbers quite in my head programmed at the moment. But, you know, if that -- if that turns out to be 5 percent, they can't make the returns of the portfolio be 8.
CHAIRPERSON TAYLOR: Right.
MR. JUNKIN: They just don't have enough tools in their toolbox. So this is one of my concerns about using total fund returns. The only way I can make it make sense in my head is thinking about it as the overall health of the organization, like that stock option plan that I talked about. So --
CHAIRPERSON TAYLOR: What would you suggest for that then, overall health of the organization?
MR. JUNKIN: Well, I think -- I think actuarial progress is the right way to go, so I think you've asked the right question.
CHAIRPERSON TAYLOR: See, I think if we were

fully funded, we could do this, right? We could do the 5.6 and not have to worry about it or the 6. -- I mean, I'm aware that we're targeting 6.1 or 6.25 for the next 10 years. And that's where we might be, and that means that nobody gets a payout, but we are underfunded. If we had 95 percent funding, I'd have no problem with this. But I don't disagree with Mr. Cobb on the fact that we can't afford -- I mean, we -- maybe we -- I don't know. What about making the target -- the 10-year target as part of it?

MR. JUNKIN: As the threshold?

CHAIRPERSON TAYLOR: Yeah.

MR. JUNKIN: I think you'd still lose ground actuarially, looking down at Scott --

CHAIRPERSON TAYLOR: Right. Scott.

MR. JUNKIN: -- for confirmation, if you made 6 and a quarter --

CHAIRPERSON TAYLOR: We would still lose ground, right, if we went for the 10-year target? Yeah. I'm seeing nods. And then we'd have to reset.

CHIEF ACTUARY TERANDO: The challenge -- there's a couple challenges. I mean right now we're -- the valuations are based on the flat 7 percent. So if we don't get 7 percent, it's going to fall behind.

CHAIRPERSON TAYLOR: Right.

CHIEF ACTUARY TERANDO: And basically the result will be -- we will increase contributions to make up for that loss. That's just how kind of -- how it works actuarially. If there's a gain, you know, excess returns, we will -- we factor that in. And that's -- that the excess is used to reduce contributions.

CHAIRPERSON TAYLOR: Right.

CHIEF ACTUARY TERANDO: So there's kind of like a --

CHAIRPERSON TAYLOR: So it's a back and forth.

CHIEF ACTUARY TERANDO: So there's a back and forth. The one -- the one challenge I see with using a 10-year return is, remember, we have a 10-year return. Next year, we're going to have a new 10-year return.

CHAIRPERSON TAYLOR: Right.

CHIEF ACTUARY TERANDO: We have 10-year return, so it's --

CHAIRPERSON TAYLOR: Well, yeah, because 2008 fell off, didn't it?

CHIEF ACTUARY TERANDO: So it's going to be constantly moving. So at what point do -- where do you put your endpoint?

CHAIRPERSON TAYLOR: Right.

CHIEF ACTUARY TERANDO: Because, you know, right now, the return for the 10-year is like 6.1, 6.2. Five years from now, you're going to have a different 10-year return.

CHAIRPERSON TAYLOR: Right.

CHIEF ACTUARY TERANDO: And so how do you -- how do you -- you have a moving target, if you use the 10-year return. That would be just another challenge that you're going to have to deal with, if you -- if you look at it from that point of view.

CHAIRPERSON TAYLOR: Okay. I'm going to let everybody else wrap their brain around this. And I'm going to start with Lynn.

ACTING BOARD MEMBER PAQUIN: Thank you.

CHAIRPERSON TAYLOR: Oops, wait. I didn't get you. There you go.

ACTING BOARD MEMBER PAQUIN: Thank you.

Mr. Gonzaga, can you remind me what portion of the total compensation would the Long-Term Incentive Program be?

MR. GONZAGA: It is -- it's a -- it would depend on position, but it would essentially be equal to -- the intention is for it to be of equal value to the annual incentive plan, which would require -- you know, because I -- as we went through the process -- I mean, you could take a look at that right there, where it's intended to match up to be equivalent to what the annual incentive opportunities are. And the whole thinking behind that is just always to have this push/pull in terms of motivating annual performance versus the long term.

ACTING BOARD MEMBER PAQUIN: And plus the retention component of staff.

MR. GONZAGA: Absolutely. Absolutely.

ACTING BOARD MEMBER PAQUIN: Okay. And for that reason, I think five years probably makes more sense than 10 for the retention. But I agree with you, Theresa, I think it would be very difficult to be in a situation where the fund is raising contribution rates again, and lowering the discount rate, and the funding status is going down, and then be paying out five-year incentive bonuses.

CHAIRPERSON TAYLOR: Incentive bonuses.

ACTING BOARD MEMBER PAQUIN: AndI know that the first year -- even if it was approved now, the first incentive payment wouldn't be paid out potentially until five years from now. But couldn't you be in a situation where you have double digit returns for the first two years of the five-year period, and then you've got negative returns, and you still owe the five-year bonus payment? I think that would be hard to do.

CHAIRPERSON TAYLOR: No, that's -- it make sense. And I will say the -- one thing before I -- somebody got off. Okay. One of the things that I think we, as average folks, when the Wall Street crash happened and people were still getting paid their huge bonuses, you know, crash may have not been through the fault of the CEO of Google, but -- but, you know, their returns went down too. So their shareholders were taking a loss.

So I think it's important that we look at, you know, these are our -- these are our, you know, members. And if our employers have to put in more money and -- I just -- I see a problem where 5.6 percent is just too low.

I've got one more person. Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: Okay. Thank you, Madam Chair. I have some competing opinions. But I was struck by Mr. Cobb's comments. And I know if we are in a situation where we've lost value and we're going to municipalities and counties and telling them that the discount rate is not going to be 7 percent anymore, it's going to be something less than that, they're not going to be looking to reward anyone. What they will be looking for is heads to -- to do something with that's not really very nice.

That said though, we had yesterday a very good conversation with our Chief Investment Officer, almost all of it devoted to conversation around how to manage the potential for a drawdown. And if we are in a situation where the market has turned substantially to the adverse, what I want to be rewarding is an Investment Officer and leadership that weathers that storm, and does so more successfully than the competition that they are in, that truly demonstrates leadership at a time.

So I don't want to create incentive programs that leave us in a position where we have folks instead of preparing for the worst are trying to maximize their benefits at a time that they potentially can.

So one fallback it seems to me we have is we can come back each year and make adjustments to these plans as we need to make adjustments based on what's happening in the real world. And if we wake up 12 months from now and we are in a substantial economic downturn, we may well be finding that something less than 7 percent is viable. I pray we are not there.

CHAIRPERSON TAYLOR: I agree.

MR. GONZAGA: Yeah. And I would just -- you know, that's a great point, Ms. Middleton. And what I would say is that there's this discussion around, you know, picking the 7 percent versus the 6.25 percent. And what I will say is that this plan, like all performance plans, is intended to be flexible.

And what we would say is that let's say the target is 7 percent for that first five-year cycle, second year comes around, there's going to be another five-year cycle there. And you may well say, okay, well, the market is moving at 8 percent or we should be at - it slowed down a little bit - 6.25 percent is the right number.

There is a lot of flexibility around that for the Committee and the executive team to debate what's realistic. And so these performance metrics, you know, could potentially be modified, not -- maybe not every year, but every other year. You know, there's a discussion about what the long-term projections are. So it forces a discussion around what the right expected returns are.

CHAIRPERSON TAYLOR: So and I will say before I call you, Mr. Junkin, that don't forget everybody that we are doing an annual incentive as well. So let's bear that in mind. This is a long-term incentive that we're discussing at this point.

Mr. Junkin.

MR. JUNKIN: I just -- just wanted to hit on the point that Ms. Middleton made. Having been here during 2008, and it being an entirely different incentive plan at the time, certain asset classes earned their incentives in a down market. And there was a significant amount of public pressure on the Board about paying those bonuses. I would argue there's a lot of economic value added in outperforming in a down market. I mean, as much as there is --

CHAIRPERSON TAYLOR: Absolutely.

MR. JUNKIN: -- in outperforming in an up market. Mathematically, it might be more in a down market. But a percent of outperformance in a down market to me is still worthy of a bonus. But I watched this body struggle with the pressure from the Sac Bee and others during that period of time, and it was intense.

CHAIRPERSON TAYLOR: And I will say that we weren't -- I mean people were not just looking at CalPERS, they were looking at Wall Street, the fact that bonuses were still being paid. And I get what Ms. Middleton is saying that if we're outperforming and doing what Mr. Meng is saying, that we should be doing which is, you know, really looking for those opportunities to make great investments. And being successful at it, I think that's a really good thing and may -- yes, that probably does deserve a bonus, but maybe that can be something we look at down the road. I would certainly -- I was not here. I know that Mr. Feckner was here. But I would certainly not want to be sitting up here with that conversation right now.

MR. GONZAGA: And then --

DEPUTY EXECUTIVE OFFICER HOFFNER: Just follow up real quick.

CHAIRPERSON TAYLOR: Mr. Hoffner.

DEPUTY EXECUTIVE OFFICER HOFFNER: So Mr. Meng wasn't able to be here for this session, but he has an opportunity at the July offsite to talk about the workforce plan that he's going to be bringing and presenting to you in terms of additional feedback.

So between a first and second reading, you'll have that other meeting. I think a little more information available to all of you and the full Board in terms of, sort of, that future planning that I think Ms. Middleton is talking about, so...

CHAIRPERSON TAYLOR: Great. Great. And I don't have any other questions on that -- oh, yes, I do. Boy, you guys are quick, man.

MR. GONZAGA: Ms. Taylor, could I make one comment?

CHAIRPERSON TAYLOR: Sure.

MR. GONZAGA: It really goes back to, you know, the whole purpose of, you know, why we recommended the structure that we had. Relative returns are ultimately the funding vehicle for what goes into the Long-Term Incentive Plan. So unless you're beating the benchmark, there won't be anything that goes into the Long-Term Incentive Plan. And that was by intent, you know, just to specifically, you know, always have a decent incentive out there for -- whether it's beating in a down market or making sure you're beat -- you know, if everybody is going by 15, 20 percent up, you still have to beat the benchmark. So there is nothing that goes into the annual incentive plan -- the Long-Term Incentive Plan without good relative performance.

The other thing is that absolute returns why that becomes important is specifically to address that whole issue. I know that there's a lot of public sensitivity out here. And it's to say that, you know what, if we're not growing by X amount, there won't be any bonus paid. If returns are negative under this absolute component, there would not be any part paid out under the Lont-Term Incentive Plan. There may be as part of the Annual Incentive Plan, but not as part of the Long-Term Incentive Plan. Okay?

CHAIRPERSON TAYLOR: Great.

Mr. Miller, go ahead.

BOARD MEMBER MILLER: Yeah. Those of you who have spoken with me about this whole subject know that I'm something of a contrarian on this, in particular in that I kind of view this -- I think the linkage causality of performance and incentive pay is very tenuous. But I view it as critical to being able to attract the kind of talent we need to attract.

And to do that, we have to have -- to attract and retain people through good times and bad. Even if you're having a losing season you still need a dynamite starting pitcher. You still need to keep your talent. And so when I look at this, I think of it often more in terms of the symbolism, the alignment of our communication, our priorities, the ability for our CEO and the rest of the executive team to send a message about what's important to us, what's important to our stakeholders. It's symbolism. It's messaging. It's all that.

To me, that's a much more convincing reason to do this stuff, because of what is -- something being a standard practice in the industry, I don't always agree it's necessarily because that truly drives a person's ability to perform or make a decision. The fact that it reinforces our priorities and expectations on behavior, that's the importance of it to me.

And to some extent it's message, it's pageantry, it's ritual. But the fact that it has value in people's minds, especially the kind of people we want to recruit and retain, and the value it provides the organization, I have some of the same arguments about some of the fallacies of some of the root assumptions we make with strategic planning as well. But no matter what we do, we're going to get the market -- if there's a, you know, drawdown, we're going to get beat up, we're going to get beat up by the Bee, we're going to get beat up by the right, we're going to get beat up by the left, if just -- for just even paying people at all if they're not, you know -- so, I think we need to really focus on what do we need to do to support the organization, what do we need to do to support our executive team and their ability to get and keep the talent that they need, as Ben works on his plan going forward and the workforce elements of it.

And so that's what I would suggest we try to keep forefront of our mind versus really looking at assuming that these differences are going to actually drive someone's performance, make them any smarter, make them change any given decision that they're going to make on any given day, because whether you pay this much or this much, that's not what changes it. It's the message it sends about our priorities and how we manage the organization, not I'm going to be that much better at making a portfolio decision if I'm paid X amount more.

CHAIRPERSON TAYLOR: Thank you, Mr. Miller.

MR. GONZAGA: Yeah, I think that Mr. Miller makes a lot of good points. And in my perspective as a compensation professional it's just simply that, look, you're going to have to pay what you have to pay to recruit and retain the type of people that you want in.

Incentives, they do not make okay performers great performers. What you're talking about here is your ability to hire the right people. And we've taken a look at the numbers. This is all built around paying as competitive as you can. And it certainly isn't going to be competitive with industry. There's still going to be a significant discount coming to CalPERS, but it's paying competitive enough to optimize your recruitment and retention for certain people.

Now, if we can agree that you have to pay whatever you have to pay to get people in the door, the second issue comes down to, well, what's the value of the pay plan in general? And it is -- compensation is about nothing more if we assume that you have to pay what it takes to get talent in the door. Incentives are about communication, and they're about alignment, and it's about culture. They are not -- they will not make a good performer a great performer, but they will help rally. Because it doesn't matter if it's a for-profit organization, or if it's CalPERS, or a tax exempt, the reason incentives are used is to get the Board and executive team on the same page in terms of communication about what's most important for that given year or that specific performance period, so...

CHAIRPERSON TAYLOR: So, Mr. Cobb.

ACTING COMMITTEE MEMBER COBB: Thank you, Madam Chair.

Something that you were touching on earlier about that these can be changeable. How does -- how is this going to work if we're two years into a cycle and there is a need to change the discount rate, and all of a sudden, you know, 7 percent isn't 7 percent anymore, it's some other number, higher or lower?

MR. MYSZKA: Yeah. So for the first year, we'll say -- let's use 7 percent as the example. That would be the target, depending on growth for that five-year period moving forward. And then the next year, let's say you have a discount, and maybe now the target is 6.5 percent, that would set the target for that next five-year period.

So it wouldn't -- we wouldn't retroactively adjust the current period that's, you know, midway through, but it will just be prospective moving forward for that performance period.

ACTING COMMITTEE MEMBER COBB: Because we don't necessary -- we need -- you know, we don't change the discount rate all that often.

MR. MYSZKA: Sure.

ACTING COMMITTEE MEMBER COBB: But when we need to change it, we need to change it, regardless of whether it fits into some artificial five-year cycle. So you'll need to build something into the policy that -- you know, that accommodates that. Because when there is a need to change the discount rate, that need is compelling and can't be driven by extraneous factors.

And then I just wanted to validate my understanding -- there's a lot of material here. And I didn't see anything in there where there was some kind of discretionary element to award compensation when a target wasn't met. I think there is in like the base pay area. I just wanted to validate there's no discretion in here where the CIO or CEO could award a long-term incentive when a target wasn't met?

MR. GONZAGA: And the answer is yes. I mean, there certainly is discretion to take away awards if an individual doesn't receive meets performance evaluation during the performance period.

ACTING COMMITTEE MEMBER COBB: Okay. I saw that.

MR. GONZAGA: But the reason is this. And, you know, because it comes down to this plan would be governed by the regulations governing deferred comp 457(f). And there's a worry that if you provide too much discretion, you know, it may result in a violation of what they call substantial risk of forfeiture and the amounts would have to be paid up front. So that is the reason why it's not in there.

ACTING COMMITTEE MEMBER COBB: Okay. No, I'm not in favor of the discretion. So I just wanted to validate that there wasn't any there.

MR. GONZAGA: That's right. And we wanted to make this as simple as possible, because we know that despite its complexities, you know, we don't need anything too complic -- CalPERS is a very, you know, complicated organization with a lot of moving parts. We wanted to make this as simple as possible, specifically from -- for Mr. Miller's concept, which is rallying the troops around overall group performance, so...

ACTING COMMITTEE MEMBER COBB: Okay. Thank you.

CHAIRPERSON TAYLOR: And Mr. Jones.

PRESIDENT JONES: Yeah. Thank you, Madam Chair. Identifying all of the issues surrounding the threshold being at 6.5 that have been raised by my colleagues, would all those -- most of those concerns go away if the tar -- threshold is 7 percent, which our discount rate?

MR. GONZAGA: They do go away, except to the extent if that 7 percent is unrealistic. Folks would argue that by not paying out --

PRESIDENT JONES: You say unrealistic to what? That is our discount rate.

MR. GONZAGA: Right. Is -- if it comes down to, you know, the sustainability -- if 7 percent is a stretch then, you know, is that truly outstanding performance or is it, you know, good performance.

There's an issue there. I will say that generally the issues go away. It's just a matter of 7 percent is an appropriate target or even a threshold if it is a realistic --

PRESIDENT JONES: Well, I guess I would have a problem with that comment. Because if we're -- the whole sustainability of our fund is based on this 7 percent achievement goal. And if we're saying that now it's not good enough for an incentive award, then that doesn't work for me in terms of that comment about it's not realistic or is --

MR. GONZAGA: No, my point was that if it is realistic, I think it's a -- it's a great target or even a great threshold. It just has to be relative.

PRESIDENT JONES: And so -- and then I think someone also mentioned that the discount rate could change in the future.

MR. GONZAGA: Um-hmm.

PRESIDENT JONES: Your threshold would change, with the discount rate change going forward, right?

MR. GONZAGA: Absolutely. Absolutely.

PRESIDENT JONES: And so all these other pieces would kind of go away, because I -- as Mr. Junkin indicated the strike point in private enterprise where you don't get that until you get the returns that are designated to be a profitable company, and then you start participating in it. And so our discount rate is what we need to be sustainable. So you should be rewarded if you go -- hit that or go above it, not below it, I don't believe.

MR. GONZAGA: Yeah. No question. And again, it just comes down to achievability. And if we can settle on the fact that the 7 percent is a very realistic expectation, then absolutely, I'd agree with you 100 percent.

CHAIRPERSON TAYLOR: And I will say that I think that Mr. Miller's conversation about culture, if we're -- if we're going to meet a 7 percent rate, right, and that's part of the incentive, I think that's part of our culture then. And that's how that gets communicated, et cetera.

But, Mr. Perez, you're next.

Oops. Wait. Do it again. My bad.

I need you to click your --

BOARD MEMBER PEREZ: Oh.

CHAIRPERSON TAYLOR: There. Thank you.

BOARD MEMBER PEREZ: I haven't been tracking all this. Am I understanding correctly where it's a total fund not just a certain area?

MR. GONZAGA: That's correct.

BOARD MEMBER PEREZ: In my pea-brain, it makes more sense to have, you know, the real estate guy tied to the real estate performance, the widget guy tied to the widget performance.

CHAIRPERSON TAYLOR: We have widgets?

BOARD MEMBER PEREZ: Yeah.

(Laughter.)

BOARD MEMBER PEREZ: But I'm sure you have a reason why that's a bad idea.

MR. GONZAGA: Yeah. It -- and it's -- it certainly isn't unheard of to incentivize folks with, you know, their specific asset class, et cetera. But, you know, the point here is to encourage a level of overall group performance, you know, kind of that group-think mentality.

And a Long-Term Incentive Plan in just about any industry does tend to be driven more by overall organizational performance. Because again, what does it do? You have the Annual Incentive Plan that has certainly some organizational components, some individual components versus the Long-Term Incentive Plan, which is intended to encourage all the senior players to come together in terms of making sure that you satisfy your fiduciary duty.

So it encourages an overall perspective on performance to balance with the inherent individual nature of things like salary increases or some annual incentive components.

BOARD MEMBER PEREZ: Well, I under the -- I'm thinking under the assumption that we were hiring the professionals that we're always going to do that. They're always going to put fund the first. But the widget guy shouldn't be held back by the doohickey guy.

(Laughter.)

CHIEF EXECUTIVE OFFICER FROST: So maybe I can take this one. So the former -- or the current incentive plans prior to July 1 really were incenting at the asset class level, so the real estate guy versus the global equity person, right, et cetera, private equity, all separately incented based on their asset class.

What Ben is trying to do within the Investment Office in creating this culture to the total fund is to incent people to the total fund for any additional payout beyond their base pay.

So part of the July offsite session with Ben, he will be walking through his 180-day plan, his workforce plan, and why incenting to the total fund is what he's trying to creat within the culture of the Investment Office. So we're moving out of what you described as the doohickey and what --

(Laughter.)

CHAIRPERSON TAYLOR: The widget.

CHIEF EXECUTIVE OFFICER FROST: -- the widget maker into we want everyone working to the total fund. Because the way that the entire portfolio can be successful is if you have all of the investors working together to make sure that that 7 percent return target can be hit.

Otherwise, what we've found is that there is too much siloed thinking and not across asset class thinking. And so we had potentially investment decisions canceling out investment decisions and other asset classes, because there wasn't that total fund thinking. So this is something Ben is bringing in. I know the team had been working on this prior to Ben coming in, but Ben is really reinforcing it and getting it moving through pretty quickly, and then tying it to the incentive plans, including the annual plan.

BOARD MEMBER PEREZ: So we tried it and it didn't work.

CHIEF EXECUTIVE OFFICER FROST: It doesn't work to the culture that we're trying to create over there.

BOARD MEMBER PEREZ: So what's the gaps or then if we're trying to make it -- excuse me. If we're trying to make it more attractive and to bring people in, and then retain the good folks that we have, what's the gap between, you know, top step widget guy and industry standard widget guy?

Basically, why don't we just give them a raise, instead of incentives, so we don't have to tie it to this, and that, and the other thing?

CHAIRPERSON TAYLOR: I think they get that too.

BOARD MEMBER PEREZ: Why don't we -- I mean, you get what you pay for.

CHAIRPERSON TAYLOR: So they get that too.

MR. GONZAGA: Yeah, they do. As part of the salary increase component, there's an ability to, you know, make -- because your salaries if -- you're never going to pay absolutely competitive with what goes on in industry. And so the salaries are a key component. And so, you know, those have been benchmarked and they're set at market levels from a salary perspective. And, you know, one's individual performance will be contemplated as part of that.

The other thing is that when you think about both the Annual and the Long-Term Incentive Plan, there's always an incentive to focus in on your own individual responsibilities. Because if they're not up to par, if they're not up to snuff, you do not get to participate in either the Annual or the Long-Term Incentive Plan, so...

CHAIRPERSON TAYLOR: Does that make sense?

DEPUTY EXECUTIVE OFFICER HOFFNER: And maybe I can follow up on that. Doug Hoffner, CalPERS team.

So in February, the Committee and the Board ratified the elongation of the salary ranges that exist based upon the data that was provided. So that's going to give a longer runway for individuals to move through those salary ranges. So that's not like a guaranteed, you know, pay increase by any means. But based on performance and how they -- how they perform over time to meeting to Ben's plan of the total fund, we've given them a longer runway, or you have.

And then this is an additive piece to that as well from an incentive perspective that we haven't had historically. So they're sort of all additive pieces. And then what does it look like when they're put together over time and what does that performance look like, because that's really what we're striving for. If we're not performing, we shouldn't get paid. That's sort of the mentality we're talking about.

BOARD MEMBER PEREZ: Notwithstanding optics or external pressures, I really believe you get what you pay for.

CHAIRPERSON TAYLOR: All right. Thank you.

I want to remind everybody that this is a information item. We will be discussing more of this as we move into the July offsite, because Ben has his presentation. And with that, I'm going to call on Mr. Miller.

BOARD MEMBER MILLER: Okay. I'll keep it really short. I think to some extent --

CHAIRPERSON TAYLOR: And it's 4:06.

BOARD MEMBER MILLER: -- the challenge is it's a little bit of semantics. When we say long-term incentive, we're not talking a 30-year long term, but we seem to be applying that really tough lift that Ben is talking about that is way beyond kind of even the expectation of cycles of longevity and tenure in these kind of positions here or elsewhere. And so the idea of maybe using something other than that 30-year target for the long-term incentives on kind of a moving along basis and those five-year resets would make more sense to me.

CHAIRPERSON TAYLOR: Okay. Having -- I have no more questions.

MR. JUNKIN: Ms. Taylor, I just --

CHAIRPERSON TAYLOR: Oh. Thank you, Mr. Junkin.

MR. JUNKIN: Sorry.

CHAIRPERSON TAYLOR: That's okay.

MR. JUNKIN: I just wanted to tie together a couple of things that I think were sort thematic in Mr. Jones' comments, and Mr. Perez's comments, and Mr. Miller's comments. Having -- Wilshire has had a large role in incentive compensation since incentive compensation began at CalPERS, including the calculation of the factors that are used to pay out people, based on performance relative to benchmarks and things like that.

And I think the changes over time within the organization and within the compensation structure have been aligned. And so to the point that Ms. Frost made, there's been a 10-year effort within this organization to remove silos, to breakdown the silos, so that there's knowledge sharing across all of the asset classes, which -- I'll just honest and say 15 years ago -- well, I started 14 years ago -- 14 years ago, it didn't really exist.

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: You know, fixed income thought about fixed income, because that drove 100 percent of their incentive compensation plan. And that's not to pick on them. The same would be try of any asset class.

So adding a total fund component came about a few years back. It's been increasing in weight. There's been some discussions for a number of years about moving to 100 percent total fund, and that's really the direction that you're headed here.

So having gone through my own compensation issues at Wilshire, being very sensitive to culture, I really feel like you all are headed down the right path in continuing to break down the walls. Because you think about 2008, which is something we all want to protect against, right, there was damage in real estate, there was damage in fixed income, there was obvious damage in equity, but there were also ways to work together to protect the fund that crossed all of those asset classes.

I also want to kind of go back to the 7 percent, because I'm not sure I gave a great answer, because I sort of was --

CHAIRPERSON TAYLOR: No, you didn't.

MR. JUNKIN: -- thinking through it as we went along. And some of your own -- your comments clarified my own thoughts.

You know, this brand is new, right? You haven't had a long-term incentive plan, so you are setting the precedent here. And so I think setting the precedent and saying, we're aligning the long-term plan with the long-term goals of CalPERS would argue for that 7 percent goal.

And even if the 10-year number -- the 10-year expected return is a little bit different than that, it's not 25 percent -- you're not setting the payout at 25 percent, which is so unrealistic that it would demotivate people, if that's a word.

So -- and I think, you know, from a precedent setting standpoint, you're just saying we're all in this together, right? Your goals and our goals are tied together.

So I just felt like sort of -- I think the fact that what you do this time around will echo for a number of years was an important point.

CHAIRPERSON TAYLOR: Thank you, Mr. Junkin.

I will -- I did have a question for you. When you are doing Wilshire's performance compensation, is it typical in this -- in the industry to be siloed or is that a State issue?

MR. JUNKIN: No. I can comment very specifically about Wilshire. Wilshire has four different business units. There is some siloing that goes on. And we are working to tear that down, just like you are here, because we recognize, as an organization, there's a lot of intellectual capital within the firm that we want everyone to benefit from.

CHAIRPERSON TAYLOR: Right.

MR. JUNKIN: And so that's -- I think industry-wide that is exactly --

CHAIRPERSON TAYLOR: It's an Industry-wide --

MR. JUNKIN: -- what you're seeing --

CHAIRPERSON TAYLOR: Okay.

MR. JUNKIN: -- that it's not -- it's not an eat-what-you-kill industry as it -- as much as it used to be.

CHAIRPERSON TAYLOR: I see.

MR. JUNKIN: And I think -- I think that's a technical --

CHAIRPERSON TAYLOR: Is that a technical term?

MR. JUNKIN: -- performance term.

(Laughter.)

MR. GONZAGA: I would just follow up with to say, I mean, that was one of the outcomes. You know, we've all read the reports. And, you know, both Eric and myself, we consult a number of financial services companies.

And there has been a strong movement towards, you know, specifically organizationally-based long-term incentives. You know, in -- you know, the whole issue is to causation, right? I mean, but what came out of one of the reports was simply that below that senior executive level, the folks that were managing the money on a day-to-day basis, they had so much incentive based on their own individual performance, that they were placing risk bets, because they were going for that bet to, you know, the collateralized debt obligations, et cetera, just to bring in the deals by the of the year.

And it was so short-term focused, but they had a lot of money on the line. But because it was individually focused and because it was so short-term focused, there was an argument that that helped to contribute to the claps.

Now, it's not everything --

CHAIRPERSON TAYLOR: Right.

MR. GONZAGA: -- but it certainly is a factor that folks are trying to avoid, so...

CHAIRPERSON TAYLOR: All right. I appreciate it. Anybody else?

So we are now on 8c, which is summary of Committee direction.

Did we have something, Mr. Hoffner?

DEPUTY EXECUTIVE OFFICER HOFFNER: I didn't hear any specifics, other than I think we would take back through Grant Thornton's work to look at those threshold, and targets, and those things to come back with a different set of parameters based upon the feedback. While it wasn't Committee direction, I got a very strong sense of what I think the group is looking for from the next round.

CHAIRPERSON TAYLOR: Yeah.

DEPUTY EXECUTIVE OFFICER HOFFNER: I think the only question I have, is there any other data, analysis, information, or feedback that you would like to have the consultants Incorporate so when they're back before you in August -- so if there's anything that comes to mind, I think that would be an opportunity to give them some -- anything else that we haven't heard already today.

CHAIRPERSON TAYLOR: So wouldn't our CIO's workforce plan have some impact on that?

DEPUTY EXECUTIVE OFFICER HOFFNER: Yes. I just thought from the Committee's perspective, we're not going -- you won't hear that for another month --

CHAIRPERSON TAYLOR: Yeah, we don't hear that for another month.

DEPUTY EXECUTIVE OFFICER HOFFNER: -- so with just an intervening time period, but --

CHAIRPERSON TAYLOR: I can't think of anything.

DEPUTY EXECUTIVE OFFICER HOFFNER: Okay.

CHAIRPERSON TAYLOR: Does anybody have anything to add?

I think we -- I think we're at this 7 percent is our bottom and we're trying to create a culture. So I think that's it.

MR. GONZAGA: You know, and we would be comfortable. I mean the 7 percent -- and there's always things to work through. But, you know, we're well -- I mean what we wanted to do was demonstrate how this could potentially work. If the 7 percent is where you end up, I mean, that certainly is -- it sounds reasonable.

CHAIRPERSON TAYLOR: Okay. Great.

All right. And then 8d is public comment.

Did -- I don't have anything else.

Did I miss anything?

CHAIRPERSON TAYLOR: All right. So if that's the case, then the Performance, Talent, Compen -- Compensation and Talent Management Committee meeting is adjourned at 4:14.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Performance, Compensation, & Talent Management Committee meeting adjourned at 4:14 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 24th day of June, 2019.

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