

Overview of the Board's Compensation Decisions

Human Resources Division

Purpose of Compensation

The Board's Compensation Policy for Executive and Investment Management Positions says:

“It represents the strategic decision that pay must be high enough to encourage highly qualified individuals to accept and remain in positions; but not so high as to attract candidates solely for the compensation. Moreover, compensation systems must be carefully structured to both recognize labor market forces and reinforce maximum performance through placing a substantial portion of total annual compensation at risk.”

The intent: recruit and retain highly skilled professionals who are the foundation for CalPERS' overall success.

Pay Philosophy

The foundation for compensation decisions, defined by the Board's Compensation Policy for Executive and Investment Management Positions

- Pay should be set to attract and retain highly qualified individuals
- Pay-at-risk, or incentive compensation, connects achievement to strategy, driving performance

Purpose matters



- Compensation ranges are established using a blend of private and public-sector data, with slight differentiation for executive vs. investment management positions

Comparator group matters



- Total compensation aiming for 50th to 75th percentile of market, including:
 - Base pay
 - Annual incentive
 - Long-term incentive

Market alignment matters



Timeline of Key Compensation Decisions

2018

- Board confirmed **pay philosophy, purpose, and peer comparator groups** for compensation benchmarking
- Approved base salary and/or incentive ranges for Chief Investment Officer, Chief Financial Officer, and Chief Operating Officer positions

2019

- Approved base salary and/or incentive ranges for Chief Executive Officer and investment management positions, including the addition of a **long-term incentive plan**
- Approved base salary and/or incentive ranges for General Counsel, Chief Health Director, and Deputy Chief Investment Officer positions based on comparator group compensation data

2020

- **TODAY**: Review the consultant's recommendation to align the Chief Investment Officer position's compensation package with all other investment management positions in the Investment Office by reducing the annual incentive opportunity and adding the long-term incentive plan

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Market-Aligned Decisions

Applied the pay philosophy to set a competitive total compensation package

Base Pay

Target 50th to 75th Percentile

- Reviewed comparator group base pay data
- Used the 50th to 75th percentile to set our base pay range *midpoint*
- Established a 67% spread (distance from range minimum to maximum)

Total Compensation

Target 50th to 75th Percentile

- Reviewed comparator group total cash data
- Set incentives so that base pay and incentives combined fall somewhere at or near the 50th to 75th percentile

Long-Term Incentive

New for CIO Position

- Board adopted previously for all investment management positions within the investment office
- Combined with base pay and annual incentive, brought total compensation at or near 50th to 75th percentile (see above)

Long-Term Incentive

Long-Term Incentive (LTI) Overview

- LTI awards are intended to balance performance with the long-term goals of the fund. Under the LTI plan, participants may earn an additional award if board-approved performance levels are achieved for the corresponding 5-year performance period.
- An “initial LTI award value” is determined based on a participant’s annual award earned in the first year of the 5-year performance cycle (capped at target). At the end of the fifth year, payout on the “initial LTI award value” may occur as follows:

5-Year Total Fund Return	LTI Payout
Less than 7%	NO Payout
7.0%	100% of initial LTI award value
Between 7.0% and 8.4%	Between 100% and 150% of initial LTI award value
8.4% or higher	150% of initial LTI award value

Example LTI Award Calculation – CIO Position

- The tables below illustrate an example where a hypothetical CIO earns an annual incentive award of \$500,000 in the first year of a 5-year LTI cycle. Since the CIO's annual incentive award exceeds the target award of \$452,800 (80% of base salary), the *initial LTI award value* is capped at target, or \$452,800. At the end of the 5-year LTI cycle, a payout up to 150% of the *initial LTI award value* may occur only if the 5-year total fund return is at least 7%.

Initial LTI Award Value Determination (in <i>first</i> year)			
Base Salary	Annual Target Award	Actual Annual Award Earned	Initial LTI Award Value
\$566,000	\$452,800	\$500,000	\$452,800



LTI Award Calculation Scenarios (in <i>fifth</i> year)					
5-Year Return	LTI Payout %		Initial LTI Award Value		LTI Payout
6.0%	0%	x	\$452,800	=	\$0
7.0%	100%	x	\$452,800	=	\$452,800
8.4%	150%	x	\$452,800	=	\$679,200

Example of Overlapping LTI Performance Periods and Historical Payout Scenarios

- If the current LTI plan model was applied to historical fund performance, outcomes are displayed below:

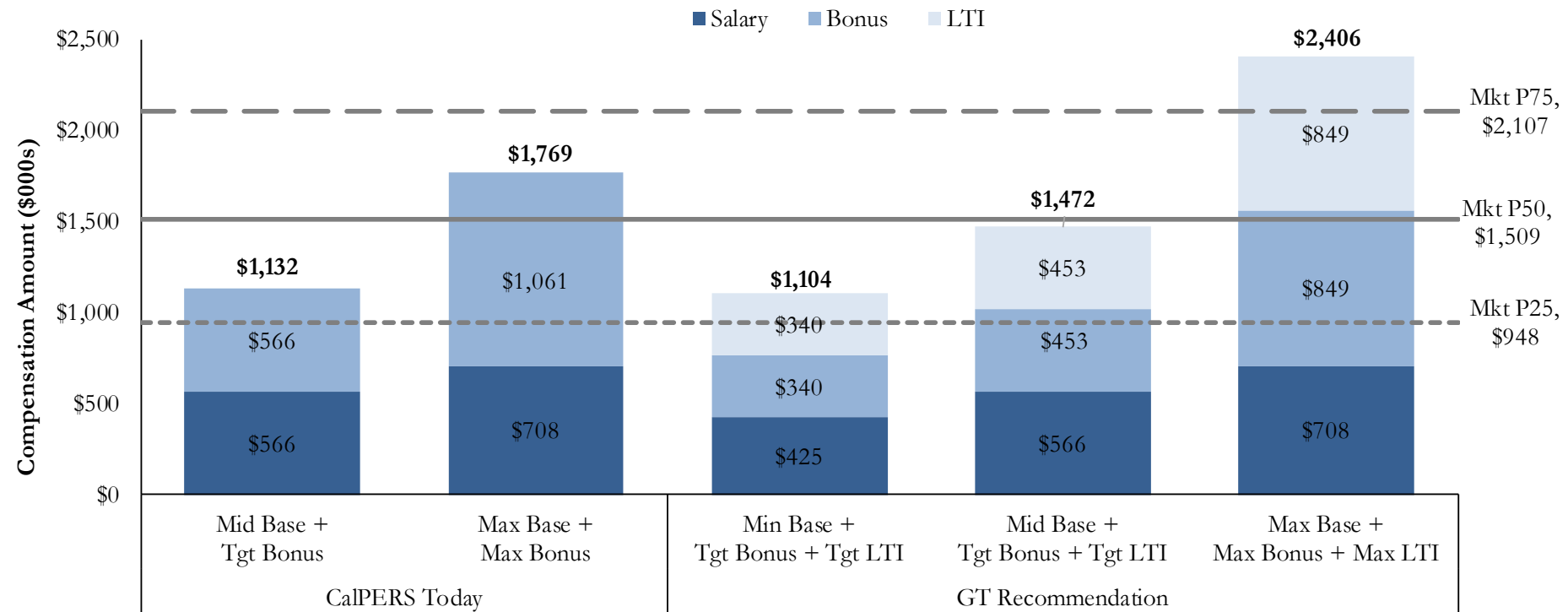
Example #	Historical Total Fund Returns						LTI Payout Result		
	'13 – '14	'14 – '15	'15 – '16	'16 – '17	'17 – '18	'18 – '19	'19 – '20	5-Year Return ¹	LTI Payout
#1	18.40%	2.40%	0.60%	11.20%	8.60%			8.05%	1.375 Payout
#2		2.40%	0.60%	11.20%	8.60%	6.70%		5.83%	NO Payout
#3			0.60%	11.20%	8.60%	6.70%	4.70%	6.30%	NO Payout

¹ Measured over the five-year performance period using the Compound Annual Growth Rate formula

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Total CIO Compensation Levels

- The graph below, provided by Grant Thornton LLP, illustrates the consultant's proposed compensation package for the CIO position, including **base salary**, **annual incentive**, and the inclusion of a **long-term incentive**. This proposal provides alignment with the current pay structure of the CEO and other investment management positions.



Next Steps – Where do we go from here?

Today's Objective

- Review the consultant's CIO compensation recommendation to redistribute incentive pay between annual and long-term incentives
- Establish a CIO pay package aligned with the investment management positions in the investment office and the Chief Executive Officer position

Desired Outcome

- Accomplishes a consistent, competitive pay package for all investment management positions in the investment office
- Provides differentiation between total compensation earning potential between the CIO and DCIO positions

Appendix

Policy-Defined Comparator Groups

Ensuring the appropriate data blend

Executive Management Comparator Group	Investment Management Comparator Group
<p><i>“Leading US public funds, leading Canadian public funds, select California-based agencies (including large local agencies), banks, and insurance companies.”</i></p>	<p><i>“Private sector asset management organizations of comparable size (\$150B to \$350B AUM) that are key competitors for CalPERS team members, including: investment management/advisory firms, university endowment funds, insurance companies and banks.”</i></p>

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Comparator Group Organizations

Organizations included for the most recent review of *investment management* positions

Organization Type	Included Organizations	
US Pension Funds	California State Teachers' Retirement System Teachers' Retirement System of Texas State of Wisconsin Investment Board	Georgia Employees' Retirement System State Teachers' Retirement System of Ohio Virginia Retirement Systems
Canadian Pension Funds	Canada Pension Plan Investment Board Caisse de depot et placement du Quebec Ontario Teachers' Pension Plan Board	Ontario Municipal Employees' Retirement System Healthcare of Ontario Pension Plan
US Corporation Plan Sponsors	GE Asset Management Incorporated General Motors Asset Management	Lockheed Martin Investment Management Co. DuPont Capital Management
Investment Management/Advisory Firms, Banks and Insurance Companies	Company names protected by confidentiality agreements between the companies and McLagan, the organization who conducted the salary survey.	