



GLOBAL  
GOVERNANCE  
ADVISORS

# Board Education

## Total Portfolio Approach & Compensation



# FOUNDATIONAL ELEMENTS



# CalPERS Compensation Philosophy

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- **Compensation is designed to attract and retain highly qualified individuals by offering competitive pay and incentivizing performance.**
- **A significant portion of total compensation is "at-risk," emphasizing the achievement of organizational, strategic, and business plan objectives.**
- **Incentive awards are tied to organizational performance outcomes (e.g., incentive metrics, investment returns) and individual key business objectives.**
- **For investment return metrics, annual incentive awards are calculated based on five-year performance relative to a benchmark for the particular asset class that an individual or team manages.**

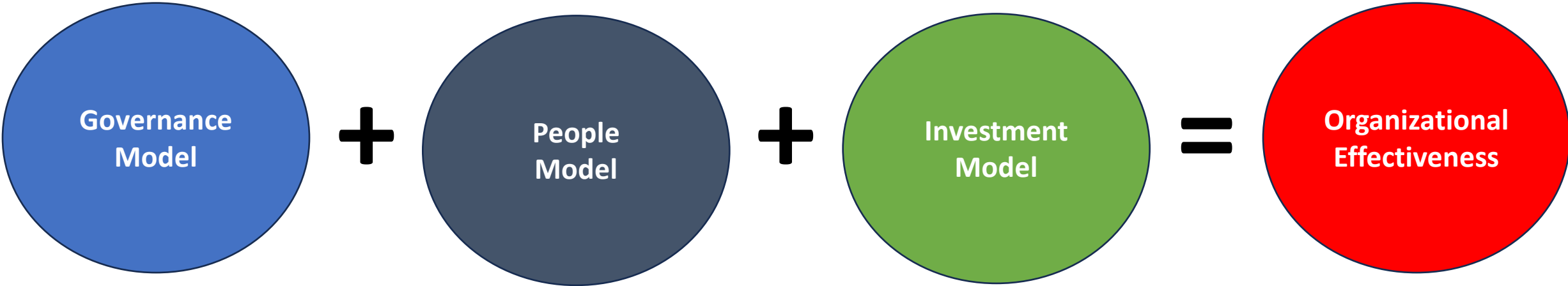
***Moving to a Total Portfolio Approach will likely require changes both in CalPERS' culture and incentive compensation.***

# Impact on Governance



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- The impact of governance is seen in the inherent stickiness of the principle that “the board owns the SAA” – this makes it difficult to move away from a SAA-based approach and adopt a TPA.



Source: Thinking Ahead Institute: Total Portfolio Approach

**Board Buy-In Is Essential**

# TPA Adoption



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- **New Zealand Superannuation Fund:** Known for its implementation of TPA and is considered a pioneer in adopting this strategy.
- **Australian Future Fund:** Practices a “joined-up-whole-portfolio approach.” where its CIO office has no asset allocation targets.
- **CPPIB (Canada Pension Plan Investment Board):** Endorse a “factor lens” approach when categorizing asset classes and when understanding the drivers and risk and return of a diversified portfolio.
- **OPTrust (Ontario Public Service Employees Union Pension Plan):** Developed a unique Member-Driven Investing strategy, a form of TPA, to maintain its fully funded status. This approach focuses on aligning investment decisions with the fund's obligations to its members.
- **Singapore Sovereign Wealth Fund:** Adopted a “joined-up investment framework” that enables it to focus on fundamental value, rather than short-term changes in price.

**TPA is gaining traction among public pension funds globally as it emphasizes holistic portfolio management over traditional asset allocation methods, potentially leading to improved risk-adjusted returns.**

***Successful adoption of a TPA necessitates a strong organizational culture characterized by ownership, trust, and empowered decision-making.***

***In a TPA framework, CalPERS will need to shift its focus from rigid asset allocations to a more holistic view of portfolio construction, emphasizing alpha generation, and overall risk exposure.***

***Moving to a TPA may necessitate changes to overall organizational structures which could be disruptive.***



# INCENTIVE DESIGN CONSIDERATIONS



# 10 Key Considerations

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- Alignment with Investment Objectives:

- Ensure incentives align with the overall reference portfolio strategy, including risk-adjusted returns and long-term growth.

**Example:** Should CalPERS compare to a Simple Reference Portfolio? Is Relative or Absolute performance most important?

- Risk-Adjusted Performance Metrics:

- Encourage a balance between return generation and risk management.

**Example:** Should CalPERS consider other metrics like Sharpe Ratio, Sortino Ratio, or risk-adjusted return on capital (RAROC)?

# 10 Key Considerations

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- Long-Term Time Horizon & Strength of Fund Going Forward:

- Structure incentives over a long-term horizon to promote longer-term thinking in making investment decisions.

**Example:** Is 5-year performance still the right timeframe to measure performance?

- Diversification & Asset Allocation Considerations:

- Reward decisions that enhance portfolio diversification and optimize asset allocation and avoid over-concentration in high return, high risk assets.

**Example:** Should CalPERS consider less quantifiable metrics around asset allocation as part of the incentive program?

# 10 Key Considerations



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- Benchmarking & Performance Measurement:

- Establish a relevant reference portfolio that reflect CalPERS' total fund objectives and are simple to understand.

**Example:** Should CalPERS look to compare performance against a Simple Reference Portfolio or custom indices?

- Liquidity & Capital Constraints:

- Ensure incentives encourage alignment with the capital needs of the organization.

**Example:** Should capital preservation and liquidity requirements be considered in the incentive program?

# 10 Key Considerations

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- Alignment with Stakeholder Interests:

- Design incentives that ensure alignment with the best interests of the fund.

**Example:** Should CalPERS incorporate enhanced due diligence considerations in the incentive program?

- Cost Efficiency & Fee Structures:

- Ensure incentives do not lead to excessive costs or fees that reduce net portfolio returns.

**Example:** Should consideration of operating or investment costs be included in the incentive program?

# 10 Key Considerations

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- Behavioral Considerations & Unintended Consequences:

- Avoid incentives that promote excessive risk-taking or moral hazard through establishing appropriate safeguards.

**Example:** Does CalPERS require additional administrative policies and/or procedures that govern the incentive program?

- Regulatory & Compliance Considerations:

- Continue to adhere to industry regulations, fiduciary responsibilities, and ethical guidelines and appropriate disclosure.

**Example:** Does CalPERS require further enhancements in the transparency of its current incentive program?

# POTENTIAL COMPENSATION POLICY ADJUSTMENTS

***CalPERS' long-term incentive is already focused on five-year absolute total fund performance.***



***CalPERS' annual incentive plan currently does not include asset class benchmarks but will likely need to be updated to better reflect the principles of TPA and promote a unified approach to managing the entire portfolio.***

# Potential Adjustments



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- Refocusing Incentive Metrics:

- **CalPERS could consider incorporating incentive metrics that directly align with the achievement of total portfolio goals, risk factor management, and collaborative success.**

- Rewarding Collaboration:

- **The compensation policy could be revised to include stronger incentives for teamwork and collaboration, potentially reducing the emphasis on individual performance metrics.**

# Potential Adjustments



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- **Enhancing Agility Incentives:**

- **CalPERS may explore ways to incentivize employees for dynamic decision-making and timely adjustments to the portfolio based on market conditions.**

- **Strengthening Long-Term Alignment:**

- **While long-term incentives are already in place, CalPERS could further align compensation with the long-term success of the fund under a TPA framework though additional performance measurement over different time periods.**

# Potential Adjustments



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- **Balancing Qualitative and Quantitative Measures:**

- **With the increased focus on factors like collaboration and dynamism, CalPERS may need to adjust the balance between Qualitative and Quantitative performance measures in the current incentive plan.**

- **Measuring Total Fund Performance:**

- **CalPERS may consider the merits of measuring Total Fund investment performance relative to a Simple Reference Portfolio.**

# Other Individual Performance Management Considerations

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## Investment professionals should always pursue favorable outcomes.

- Additional performance management program elements that might be considered as part of an individual's annual performance

- **Peer Reviews:** Gathering feedback from other team members on a manager's collaboration, communication, and willingness to share information.
- **Information Sharing and Communication:** Evaluating an individual's proactive sharing of market insights, research, and potential risks with other team members within cross-asset meetings.
- **Flexibility, Adaptability, and Speed:** Evaluating an individual's willingness to adjust their strategies based on feedback from other team members & changes in the portfolio's objectives.

# Potential Next Steps Moving Forward



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Potential Next Step	Meeting
CalPERS Board to continue to evaluate the merits of TPA and decide on a path forward	November 2025 Board Meeting
Depending on decision of CalPERS Board, Board’s Consultant to work with the PCTM and CalPERS team members to analyze potential changes to incentive program	November 2025 or February 2026 PCTM Meeting
Potential updates to performance metrics and weightings within the CalPERS incentive program brought forward	April 2026 PCTM Meeting
Feedback from April 2026 PCTM to be addressed with finalized updates to the CalPERS incentive program brought forward for approval	June 2026 PCTM Meeting



GLOBAL  
GOVERNANCE  
ADVISORS



**Peter Landers, Senior Partner**

[peter.landiers@ggainc.com](mailto:peter.landiers@ggainc.com)  
+1.416.799.6640

**Brad Kelly, Partner**

[brad.kelly@ggainc.com](mailto:brad.kelly@ggainc.com)  
+1.416.707.4614