



GLOBAL
GOVERNANCE
ADVISORS

Board Education

Aligning Incentives Through a Total Portfolio Approach



CalPERS

Foundational Elements

CalPERS Compensation Philosophy

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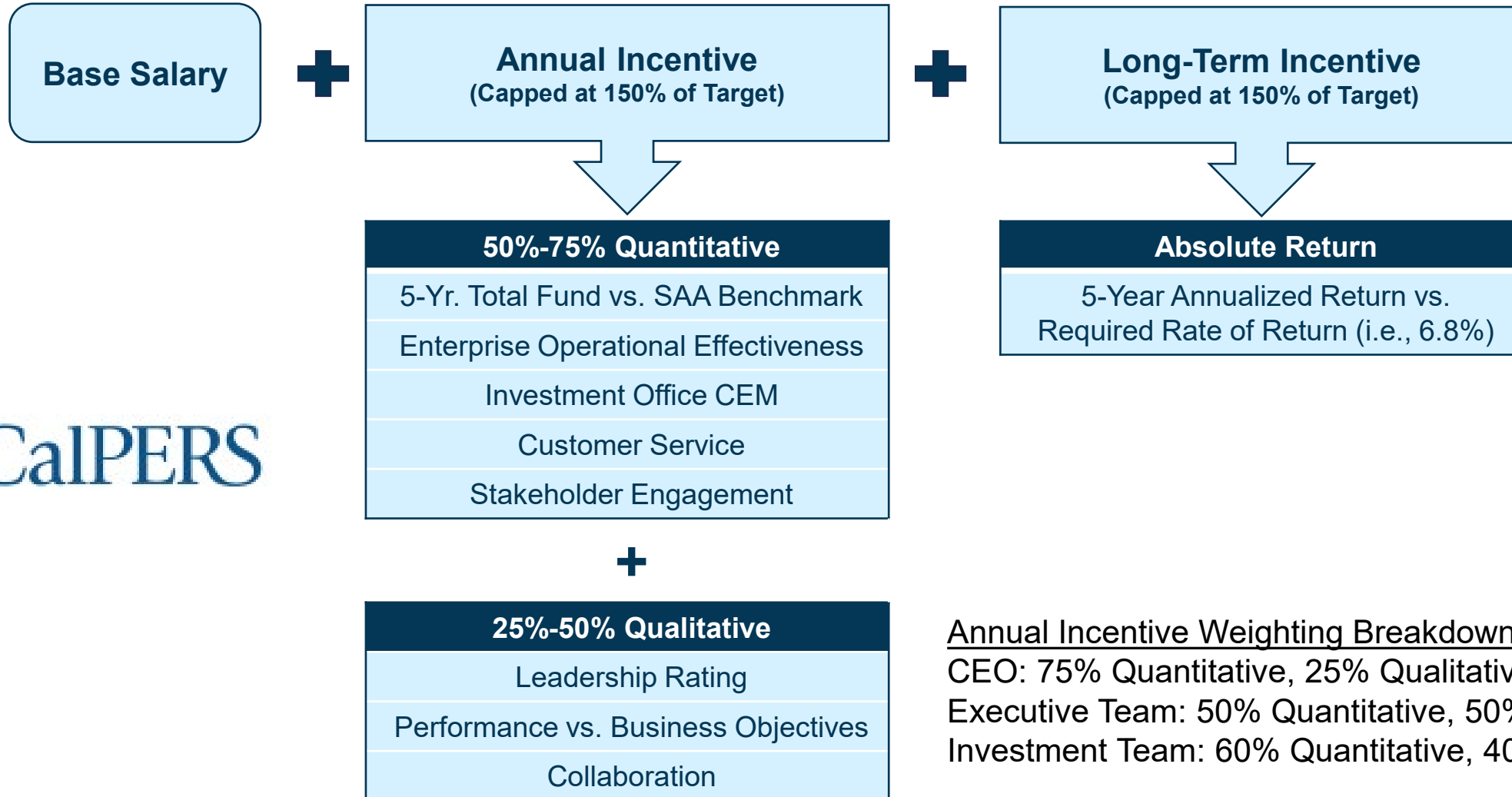


- **Compensation is designed to attract and retain highly qualified individuals by offering competitive pay and incentivizing performance.**
- **A significant portion of total compensation is "at-risk," emphasizing the achievement of organizational, strategic, and business plan objectives.**
- **Incentive 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 Total Fund.**

CalPERS Current Incentive Design



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Annual Incentive Weighting Breakdown:
 CEO: 75% Quantitative, 25% Qualitative
 Executive Team: 50% Quantitative, 50% Qualitative
 Investment Team: 60% Quantitative, 40% Qualitative

Moving to a Total Portfolio Approach will require changes in CalPERS' culture and incentive design

Incentive Designs At TPA-Aligned Funds

TPA Adoption



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To better understand the potential changes required to CalPERS incentive design, three of the world's leaders in TPA adoption have been analyzed to uncover their approach to incentives and how that is used to incent the right behaviors and culture.

These are:

- Australian Future Fund
- New Zealand Superannuation Fund
- CPP Investments

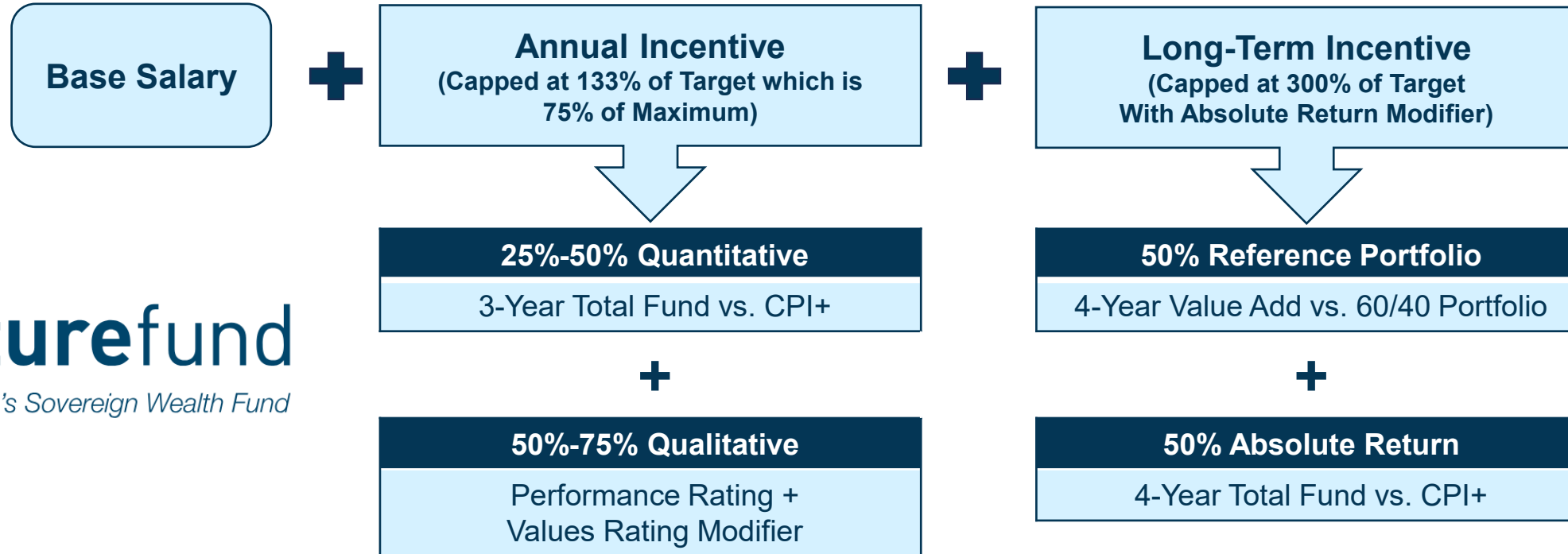


Australian Future Fund



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futurefund
Australia's Sovereign Wealth Fund



Key Highlights:

- Investment Professionals have higher weighting on Total Fund performance than others.
- Values Rating includes assessment of Collaboration and Role Modelling.
- LTIP provided only to Senior Leaders and other important roles.
- Reference Portfolio only used for LTIP and not for Annual Incentive.

Australian Future Fund



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How Total Fund Performance is Measured:

Value Add vs. CPI:

Threshold Performance:

Some tolerance below Investment Mandate

Maximum Performance:

Match Investment Mandate

Value Add vs. Reference Portfolio:

Threshold Performance:

Above Benchmark by Specific %

Maximum Performance:

Above Benchmark by Higher %

How Individual Performance is Measured:

Performance Rating modified by Values Rating

Consider values, risk and conduct expectations

Developed a Celebrating Collaboration Survey:

- Provide 5 names of people that collaborated strongest with during the year
- Tried this past year with plans to continue

Built descriptions of what collaboration and role modelling at different levels looks like

Different expectations around collaboration as senior leaders expected to collaborate more than junior staff

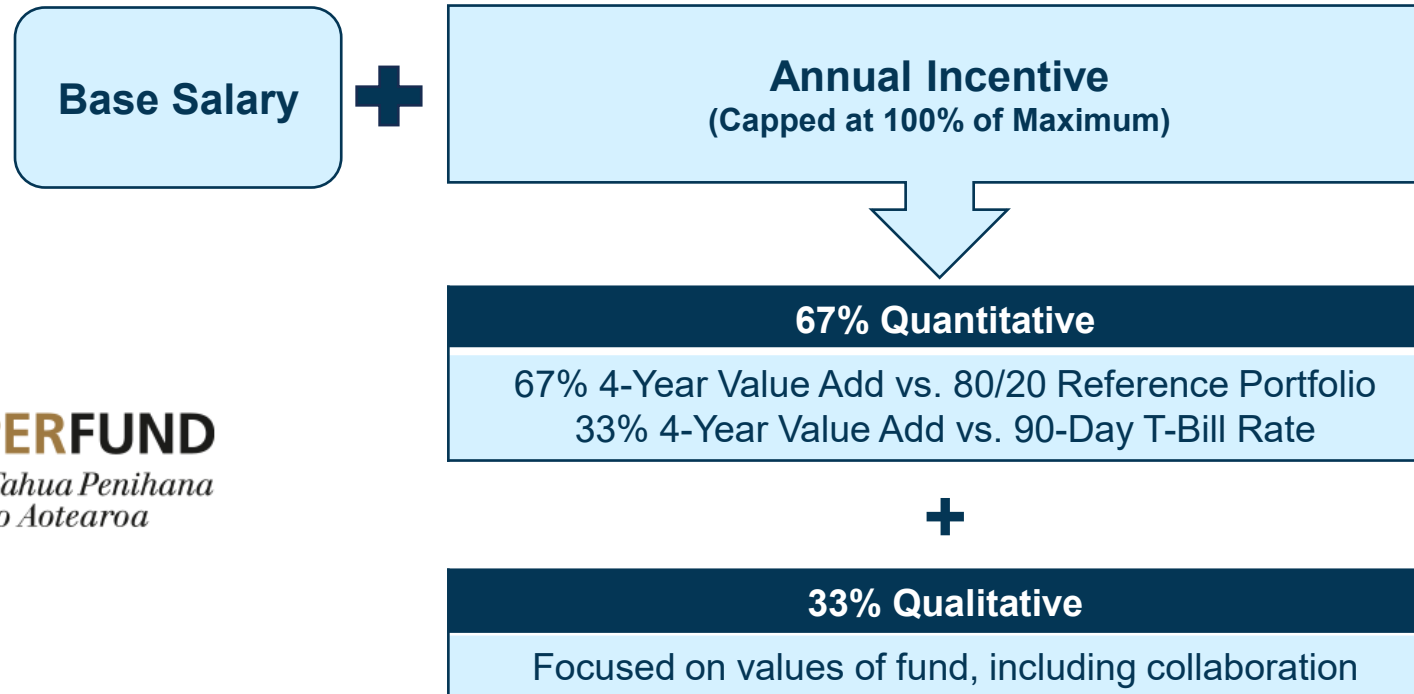
Measured on more of a Qualitative basis, but trying to identify Quantitative measures

futurefund

Australia's Sovereign Wealth Fund

New Zealand Superannuation Fund

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Key Highlights:

- Same weighting on Total Fund and Individual performance for all Investment and Executive staff.
- Comparison to Reference Portfolio and a low-risk absolute return w/ emphasis on Reference Portfolio.
- No LTIP provided, only Annual Incentive.

New Zealand Superannuation Fund

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How Total Fund Performance is Measured:

Value Add vs. 90-Day T-Bill Rate:

Threshold Performance:

0%

Maximum Performance:

+4%

Value Add vs. Reference Portfolio:

Threshold Performance:

+0 bps

Maximum Performance:

+75 bps

How Individual Performance is Measured:

Performance Rating based on
“How You Do the Work”

Really focus on the values of the fund and how they are exemplified

Look to identify outliers across and within teams to find anomalies

Look to catch performance issues early and try to have those conversations earlier than the end of the year

Collaboration is measured qualitatively as part of the Performance Rating

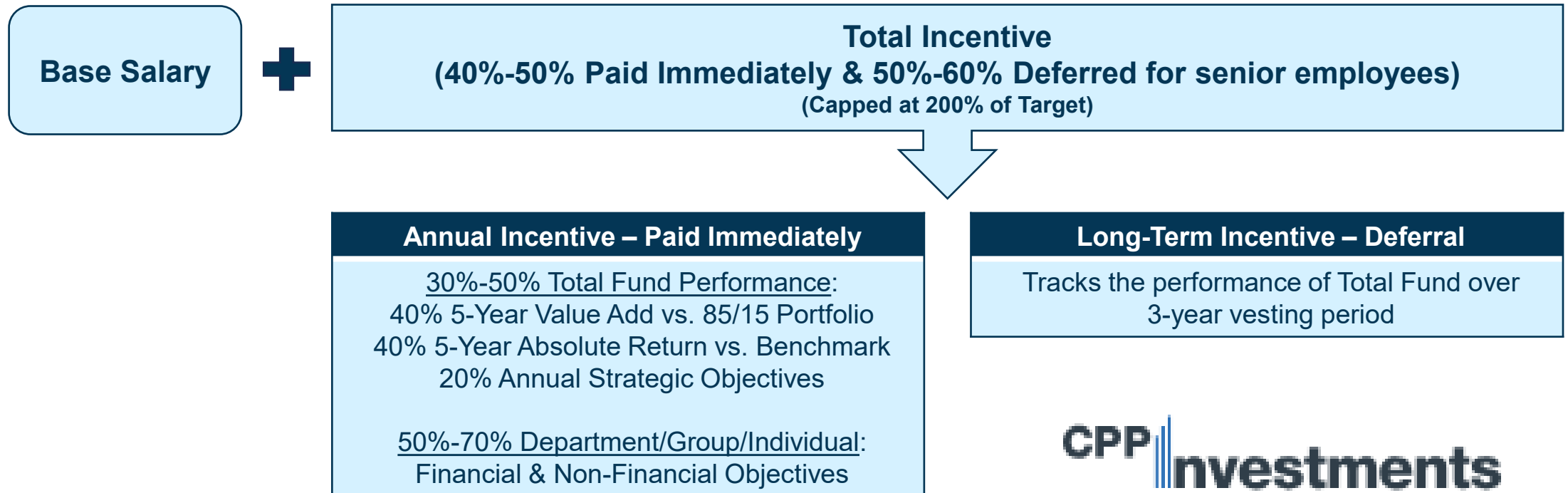
Measured on more of a Qualitative basis



CPP Investments



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Key Highlights:

- Weighting between Total Fund and Department, Group & Individual performance varies between roles with Senior Management at 50/50 and others at 30/70 weightings.
- Equal weighting on Reference Portfolio and Absolute Return objectives tied to required rate of return.
- LTIP is provided in terms of a Deferral of Total Incentive (60% for CEO and 50% for Others).

CPP Investments



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How Total Fund Performance is Measured:

Absolute Return Benchmark (estimate):

Threshold Performance: 0%

Target Performance: 6.24%

Maximum Performance: 12.48%

Reference Portfolio (estimate):

Threshold Performance: -100 bps

Target Performance: +39 bps

Maximum Performance: +178 bps

Strategic Objectives (Fiscal 2026):

Knowledge Capability: Leverage info & AI

Relative Value: Optimize resource flow to take advantage of opportunities across portfolio

Productivity: Process streamlining & automation of org. design & decision-making

How Department, Group & Individual Performance is Measured:

Department & Group Performance:

Value Add Returns of different asset classes
Other strategic objectives

Individual Performance:

Individual objectives with tie in to Integrated Risk Framework, Integrated Career Framework and CPP's guiding principles of integrity, partnership and high performance, measured on a 5-point rating scale

Measured on both a Quantitative and Qualitative basis



Comparison of Approaches



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Similarities

- Use of a Reference Portfolio for Total Fund performance
- Use of Absolute & Relative Total Fund return measures
- Use of Individual performance ratings in incentives
- Both Investment and Executive staff have Total Fund investment performance included as part of incentive design
- Including Collaboration/Partnership considerations in determining Annual Incentive awards

Differences

- Outperformance hurdles vs. Reference Portfolio vary greatly
- Use different Absolute Return benchmarks (CPI, T-Bills, etc.)
- Investment performance periods differ between 3, 4 or 5 years
- Long-Term Incentive not offered at all funds reviewed
- Performance multipliers differ between funds
- Different mix between Total Fund & Investment performance
- Individual performance measured on a Qualitative basis in Australia and New Zealand, but mixed with Quantitative & Qualitative Group & Department goals at CPP

While there are many differences in approaches between these funds, CalPERS can leverage the similarities when developing its approach to Incentives under TPA.

TPA Impact on Incentive Design at CalPERS

Items Already in Place at CalPERS

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Fortunately, CalPERS already has several design features already embedded within its current Incentive Design to align with TPA. These are:

- **Only Total Fund investment performance is measured**
- **Relative & Absolute investment performance are considered under the Annual and Long-Term Incentive Plans respectively**
- **60/40 split between Total Fund and Individual performance in determining Annual Incentives for most roles**
- **Collaboration is already considered as part of Individual performance evaluations for investment team members**



Potential Updates to Consider

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- **Reference Portfolio Performance Hurdles**

- Value Add performance hurdles will need to be updated to reflect the new Reference Portfolio and the desire to incent more alpha.
- A certain level of under-performance to Reference Portfolio may still need to generate a small Incentive payout given greater volatility in results.

- **Grandfathering of TPA Results into Multi-Year Calculation**

- Given TPA is first being adopted for FY2026-2027, the measurement of 5-year Total Fund results for the Annual Incentive likely should not be based solely on TPA results vs. Reference Portfolio but a mix of TPA and SAA results.

Potential Updates to Consider

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- **Consideration of Collaboration outside of Sr. Investment Roles**

- **Given need for greater collaboration between different asset classes, should Collaboration be split out as part of the Individual performance ratings for Senior Investment roles to include CEO & other investment team members?**

- **Identify Quantitative Way to Measure Collaboration Results**

- **While measuring Collaboration is difficult as it will always involve some level of Qualitative assessment, identifying Quantitative ways to measure performance in this area would help justify performance outcomes.**

Potential Updates to Consider

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- **Include Total Fund Results for Executive Team below CEO**

- **Aligning Executive Team Members below the CEO to a similar weighting on Total Fund investment performance as the CEO under the Annual Incentive would align with the approach followed by other funds using TPA.**

- **Include Executive Team below CEO in Long-Term Incentive**

- **Aligning Executive Team Members below the CEO to the CEO through eligibility to receive Long-Term Incentive would align them with both Relative and Absolute Total Fund investment performance and the approach followed by most other funds using TPA. A decision on this can be made as part of the next labor benchmark study planned for early 2027.**

Other Individual Performance Management Updates to Consider

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

- **Peer Reviews:** Gathering feedback from other team members on a team members collaboration, communication, and willingness to share information
- **Measuring Information Sharing & Communication:** Evaluating an individual's proactive sharing of market insights, research, and potential risks with other team members within cross-asset meetings and through surveys should gain better insight in these areas
- **Flexibility, Adaptability, and Speed in Relation to Investment Decision-Making:** Evaluating an individual's willingness to adjust their strategies based on feedback from team members & changes in CalPERS' objectives. This includes noting where a team member advocates for investing outside their own asset class



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