



GLOBAL  
GOVERNANCE  
ADVISORS

# Opinion Letter

May 28, 2026

## Annual Incentive Plan Metrics & Additional Considerations

Prepared for:

Performance, Compensation & Talent  
Management Committee

400 Q Street  
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CalPERS

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This memo is in response to your request for Global Governance Advisors (“GGA”), in its role as CalPERS’ Board compensation consultant, to provide a review of the proposed annual incentive plan metrics for Fiscal Year 2026-2027.

## Background

The current metrics used within the Annual Incentive program were first introduced as part of a new annual incentive plan for the 2016-2017 fiscal year with shared organizational metrics that aligned awards for all positions to the following performance areas:

- Fund Performance
- Enterprise Operational Effectiveness (“EOE”)
- Investment Office CEM (“INVO CEM”)
- Customer Service
- Stakeholder Engagement

CalPERS continues to use these metrics but, in recent years, has proactively reviewed and updated the performance expectations for all metrics to ensure performance levels remain challenging, yet fair to both incentive participants and CalPERS members. The performance metrics used within the incentive plan have generally worked for CalPERS, and GGA has not had any concern with their placement and use within the annual incentive program.

Given the decision to move to a Total Portfolio Approach (“TPA”) investment model starting in Fiscal Year 2026-2027, GGA recognizes that updated Total Fund value add performance expectations have to be set, given the adoption of a new Reference Portfolio to replace the historical Strategic Asset Allocation-based benchmark, starting in the 2026-2027 Fiscal Year. Administratively, there have been questions around the integration of TPA performance into the annual incentive program, which GGA has also addressed within this letter.

One other area addressed in this letter is the potential reduction in weighting for the EOE metric within the annual incentive program.

## Summary of GGA’s Assessment

GGA reviewed the proposed annual incentive metrics for Fiscal Year 2026-2027 and believes that the metric performance areas still meet the needs of CalPERS at this time. They align to CalPERS mission and strategic plan while continuing to encourage teamwork by tying CalPERS management to a consistent set of metrics. That said, there are a few areas that should be addressed moving forward.

With the adoption of a TPA investment model at CalPERS, GGA recommends that performance relative to the Reference Portfolio be phased-in over a 5-year period in the Total Fund Performance calculation as follows, with a corresponding decrease in the current Strategic Asset Allocation (“SAA”)-based performance calculation:

- Year 1: 1 year of TPA performance, 4 years of SAA performance
- Year 2: 2 years of TPA performance, 3 years of SAA performance
- Year 3: 3 years of TPA performance, 2 years of SAA performance
- Year 4: 4 years of TPA performance, 1 year of SAA performance
- Year 5: 5 years of TPA performance
- Year 6 & Beyond: 5 years of TPA performance

In setting updated performance expectations relative to the Reference Portfolio under TPA, GGA considered performance expectations through three (3) lenses:

- Historical Total Fund Return results at CalPERS relative to the Reference Portfolio
- Performance expectations set by other leading public pension funds who have adopted a TPA approach and measure performance relative to a Reference Portfolio
- Forward-looking performance expectations communicated by CalPERS for the Total Fund portfolio under a TPA model.

GGA also recognizes that relative performance results under TPA will tend to be more volatile when compared to the historical customized SAA benchmark results and that CalPERS is looking to motivate the team to generate more alpha over the long run.

Through this comprehensive approach, GGA recommends adjusted performance expectations at a Threshold, Target and Maximum level of performance for CalPERS' Total Fund return relative to the new Reference Portfolio. In GGA's research, some funds such as CPP Investments allow for a certain level of under-performance (-100 bps) relative to the Reference Portfolio, while others require over-performance to earn any incentive. The philosophy behind setting Threshold performance levels below the Reference Portfolio benchmark is to take into account the higher level of volatility in investment results relative to a Reference Portfolio when compared to a more customized SAA Total Fund benchmark, which can lead to larger negative (and positive) swings in relative performance. This being said, GGA's recommendations retain a Threshold performance expectation of meeting the Reference Portfolio return (i.e., 0 bps) in order for any incentive to start being earned on TPA performance to reward solely for over-performance. Given the expected higher volatility and historical results at CalPERS relative to the Reference Portfolio, GGA recommends Target and Maximum performance levels at challenging, but attainable levels to still act as a motivator and driver for higher alpha generation at CalPERS. While GGA has recommended specific performance levels for Fiscal Year 2026-2027, we recommend annual assessment and potential refinement of these performance expectations to reflect the evolving nature of the TPA within CalPERS. Over time, we would anticipate performance expectations relative to the Reference Portfolio trending towards the stated expectations CalPERS has for performance under TPA.



Lastly, with the movement to TPA and the evolving strategy at CalPERS, there is a question as to whether a 20% weighting should continue to be placed on the EOE metric for the CEO, CFO, COO, General Counsel and Chief Actuary positions within the annual incentive program. In GGA's view, the weighting on performance metrics within an annual incentive program should align with the strategic priorities of a fund. Strategies evolve over time and the relative importance of metrics will also evolve over that same period. With the shift to TPA, one key tenet is that all team members generally have a Total Fund investment performance weighting within their plan design. CEOs also tend to have a slightly higher weighting on Total Fund performance than what is currently observed at CalPERS. Given this market practice, GGA can support a reduction in the weighting on EOE performance down to 15% within the annual incentive program to better reflect CalPERS' strategic priorities and adjustments at this time. In the case of the CEO, GGA recommends increasing the weighting on Fund performance to 20% with the CEO using their delegated authority to determine appropriate adjustments to the weightings for the CFO, COO, General Counsel and Chief Actuary positions.

Provided below are details surrounding GGA's exact recommendations for the proposed annual incentive metrics for Fiscal Year 2026-2027.

## CalPERS' Performance Metric Review Details:

### Metric #1: Total Fund Performance

#### PROPOSED CHANGES FOR FISCAL YEAR 2026-2027

This metric is based on fund performance against the policy benchmark for the five-year period of July 1, 2022 through June 30, 2027. Payout ratio for intermediate results will be determined by interpolation. Performance for the period of July 1, 2022 to June 30, 2026 will be measured against the current SAA-based Total Fund benchmark with performance for the period of July 1, 2026 to June 30, 2027 based on the new Reference Portfolio.

#### 2026-2027 Metric Relative to New Reference Portfolio (for 1 Year of Performance from July 1, 2026 to June 30, 2027)

Performance (bps)	Payout Ratio
+80	1.50 (150%)
+40	1.00 (100%)
0	0.00 (0%)

#### 2026-2027 Metric Relative to Current Total Fund Benchmark (for 4 Years of Performance from July 1, 2022 to June 30, 2026)

Performance (bps)	Payout Ratio
+20	1.50 (150%)
+10	1.00 (100%)
0	0.00 (0%)

The historical internal analysis and market analysis utilized by GGA to recommend the new performance expectations for Total Fund performance relative to the new Reference Portfolio highlighted above is outlined in **Appendix A**. The performance expectations are set to incentivize more alpha generation from the CalPERS portfolio, while simultaneously considering the greater level of volatility in results under a TPA model when measured against a simpler Reference Portfolio.

Ultimately, relative performance expectations against the Reference Portfolio should be reviewed on an annual basis in earlier years of TPA adoption and evolve over time based on the maturity of the TPA approach within CalPERS.

**Metric #2: Enterprise Operational Effectiveness (“EOE”)**

**NO CHANGE FOR FISCAL YEAR 2026-2027**

This metric for 2026-27 is defined as Overhead Operating Costs as a percentage of Total Operating Costs (“OOC”) and is measured based on year-over-year improvement.

- Total Overhead Operating Costs ("OOC") identify all administrative costs not mapped directly to Product and Service Delivery Operating Costs ("PSDOC"); and excludes Board and Third-Party Administrator Costs
  - $OOC = OOC / (OOC + PSDOC)$

Score	Payout Ratio
< -0.80%	1.50 (150%)
-0.80% to < -0.40%	1.25 (125%)
-0.40% to 0.0%	1.00 (100%)
> 0.0% to 0.40%	0.75 (75%)
> 0.40% to 0.80%	0.50 (50%)
> 0.80%	0.00 (0%)

GGA notes that while the performance metric and performance expectations are not to be changed this year, a reduction in the weighting of EOE within the annual incentive program for Executive Team members (excluding CIO) from the current 20% is recommended.

Furthermore, a more detailed review of the EOE metric and underlying calculation in this area is expected in advance of Fiscal Year 2027-2028, which may lead to changes in the calculation and associated performance expectations in future years.

**Metric #3: Investment Office CEM**

**NO CHANGE FOR FISCAL YEAR 2026-2027**

This metric for Fiscal Year 2026-2027 is determined by CalPERS annual participation in the CEM benchmarking survey and shows how CalPERS' investment costs and return performance compares to a customized peer group over a five-year period.

Score	Payout Ratio
Outperforms US Benchmark on Net Value Added (Returns) <b>and</b> Cost by 0.1% and 8 bps, respectively	1.50 (150%)
Outperforms US Benchmark on Returns <b>and</b> Cost by .05% and 4 bps, respectively	1.00 (100%)
Outperforms US Benchmark on Cost <b>or</b> Outperforms US Benchmark on Returns	0.50 (50%)
Underperforms US Benchmark on Returns <b>and</b> Cost	0.00 (0%)



**Metric #4: Customer Service**

**NO CHANGE FOR FISCAL YEAR 2026-2027**

This metric for Fiscal Year 2026-2027 is based on two Service Dimensions:

- Benefit Payment Timeliness: Percentage of benefit payments issued to our customers within established service levels
- Customer Satisfaction: Customer service with CalPERS services as measured by surveys and other methods

Score	Payout Ratio
≥ 97%	1.50 (150%)
96% to < 97%	1.25 (125%)
95.5% to < 96%	1.00 (100%)
95% to < 95.5%	0.75 (75%)
94% to < 95%	0.50 (50%)
< 94%	0.0 0.00 (0%)

**Metric #5: Stakeholder Engagement**

**NO CHANGE FOR FISCAL YEAR 2026-2027**

This metric for Fiscal Year 2026-2027 is based on results of the following three Stakeholder Engagement Survey questions:

- Is CalPERS sensitive to the needs of its members?
- Is CalPERS doing a good job of keeping in touch with its members and keeping them informed?
- CalPERS is effective in communicating and engaging with stakeholders (rate on scale from one to ten).

Score	Payout Ratio
≥ 80.5%	1.50 (150%)
80% to < 80.5%	1.25 (125%)
79.75% to < 80%	1.00 (100%)
79.5% to < 79.75%	0.75 (75%)
79% to < 79.5%	0.50 (50%)
< 79%	0.00 (0%)

GGA re-iterates that a minimum 5% response rate be required in order for this metric to be included within the annual incentive program calculation.

We trust that this letter addresses your concerns on this matter and look forward to discussing it in more detail at the June PCTM meeting. If you have any questions on the contents of this letter, please let us know.

Sincerely,

**Global Governance Advisors**



Peter Landers  
Senior Partner



Brad Kelly  
Partner

cc: Brittany Emmons, CalPERS

## Appendix A:

# Historic Probability Assessment and Metric Adjustment Recommendation for TPA-Based Investment Performance

### Background:

As part of our ongoing compensation advisory work, GGA conducted a historical probability assessment for the Total Fund Value Add performance metric which will measure CalPERS' Total Fund performance relative to the new Reference Portfolio. Given the phasing-in of performance results, GGA examined historical performance over both 1 and rolling 5-year performance cycles.

In addition to the historical analysis, GGA also highlighted below additional considerations such as the value-add expectations set by other pension funds that have adopted a TPA-based Reference Portfolio as well as CalPERS' own expectations on performance relative to the Reference Portfolio.

In GGA's view, it will be important to review TPA-based performance expectations on an annual basis in earlier years of TPA adoption to ensure they align with the evolving maturity of the TPA approach within CalPERS.

### Related Historic Data:

The tables that follow shows the related historic data from Fiscal Year 2015-2016 to Fiscal Year 2024-2025 provided to GGA by CalPERS. Data is shown on both a 1 and 5-year rolling basis (where possible).

Fiscal Year	1-Year				Rolling 5-Year			
	CalPERS Total Fund (%)	Reference Portfolio (%)	Return vs. Reference Portfolio (%)	Return vs. Reference Portfolio (bps)	CalPERS Total Fund (%)	Reference Portfolio (%)	Return vs. Reference Portfolio (%)	Return vs. Reference Portfolio (bps)
2015-2016	0.61	-0.94	1.55	155	*	*	*	*
2016-2017	11.19	12.52	-1.33	-133	8.83	8.60	0.23	23
2017-2018	8.58	7.45	1.13	113	8.06	7.54	0.52	52
2018-2019	6.68	6.58	0.1	10	5.82	5.34	0.48	48
2019-2020	4.70	5.45	-0.75	-75	6.29	6.12	0.17	17
2020-2021	21.33	24.81	-3.48	-348	10.35	11.14	-0.79	-79
2021-2022	-6.12	-13.48	7.36	736	6.67	5.45	1.22	122
2022-2023	5.80	10.86	-5.06	-506	6.12	6.11	0.01	1
2023-2024	9.28	14.11	-4.83	-483	6.63	7.57	-0.94	-94
2024-2025	11.64	13.34	-1.7	-170	8.01	9.14	-1.13	-113

## Rolling 5-Year Total Fund Value Add Performance – Historical Analysis against Proposed Performance Hurdles

Using the same historic data and assuming the following performance expectations relative to the Reference Portfolio illustrates the following results against rolling 5-year returns at CalPERS.

Year	Return vs. Reference (bps)	Modeled Incentive Performance Hurdles		
		Threshold	Target	Maximum
2017	23	0.00	40.00	80.00
2018	52	0.00	40.00	80.00
2019	48	0.00	40.00	80.00
2020	17	0.00	40.00	80.00
2021	-79	0.00	40.00	80.00
2022	122	0.00	40.00	80.00
2023	1	0.00	40.00	80.00
2024	-94	0.00	40.00	80.00
2025	-113	0.00	40.00	80.00

## Total Fund Value Add Performance – Effect of Proposed Levels

The following table outlines how GGA’s proposed expectations align with historical performance levels.

	Attainment Probability		
	Threshold	Target	Maximum
<b>Ideal</b>	<b>80%</b>	<b>60%</b>	<b>20%</b>
<b>Proposed</b>	<b>67%</b>	<b>33%</b>	<b>11%</b>

Both Threshold and Maximum performance levels align fairly closely with the Ideal probabilities of attainment. Target performance shows the largest spread to the Ideal probability of attainment.

## 1-Year Total Fund Value Add Performance – Historical Analysis against Proposed Performance Hurdles

Using the same historic data and assuming the following performance expectations relative to the Reference Portfolio illustrates the following results against 1-year returns at CalPERS.

Year	Return vs. Reference (bps)	Modeled Incentive Performance Hurdles		
		Threshold	Target	Maximum
2016	155	0.00	40.00	80.00
2017	-133	0.00	40.00	80.00
2018	113	0.00	40.00	80.00
2019	10	0.00	40.00	80.00
2020	-75	0.00	40.00	80.00
2021	-348	0.00	40.00	80.00
2022	736	0.00	40.00	80.00
2023	-506	0.00	40.00	80.00
2024	-483	0.00	40.00	80.00
2025	-170	0.00	40.00	80.00

## Total Fund Value Add Performance – Effect of Proposed Levels

The following table outlines how GGA’s proposed expectations align with historical performance levels.

	Attainment Probability		
	Threshold	Target	Maximum
<b>Ideal</b>	<b>80%</b>	<b>60%</b>	<b>20%</b>
<b>Proposed</b>	<b>40%</b>	<b>30%</b>	<b>30%</b>

Given the higher level of volatility in annual performance relative to the Reference Portfolio and greater tendency for results to end up at the Top and Bottom end of the performance range, performance expectations are generally less aligned with the Ideal probabilities of attainment. That said, the range is deemed to be fair to participants as the higher probability of not achieving Threshold performance is offset by a higher probability of achieving Maximum performance.



## Publicly Disclosed Performance Expectations Relative to Reference Portfolio at TPA-Aligned Funds

Provided below is a summary of the publicly disclosed performance expectations for Total Fund performance relative to the Reference Portfolio at TPA-Aligned Funds.

Fund	Level of Performance		
	Threshold	Target	Maximum
CPP Investments	-100 bps	+39 bps	+178 bps
NZ Super Fund	0 bps	+37.5 bps	+75 bps

Future Fund in Australia does not disclose its performance expectations publicly, but GGA is aware that a certain level of outperformance is required relative to the Reference Portfolio and that performance below benchmark leads to no payout for that portion of the incentive.

## Publicly Disclosed Performance Expectations Relative to Reference Portfolio at CalPERS

Provided below is the publicly disclosed performance expectations for the TPA approach at CalPERS over the long run relative to a Reference Portfolio.

In an article written by Angela White at Top1000funds.com, it was mentioned in an interview with Stephen Gilmore, CIO at CalPERS that:

*A WTW Thinking Ahead Institute peer group study of 26 asset owners, quoted by CalPERS in its press release announcing TPA, showed the asset owners using TPA added 1.3 per cent in performance above those using SAA over 10 years.*

*“[That] 130 basis points is based on a small sample over a specific time, so I wouldn’t place too much reliance on that,” Gilmore says. “Conceptually however, if you’re optimising the portfolio as a whole rather than via asset classes, you should be able to do better by optimising for the whole.*

*“In terms of how much, I don’t think 130 basis points is likely. It’s ambitious. I’d like to be able to add somewhere between 50 and 60 basis points. It also comes down to how much active risk you take and what you expect to be rewarded. But I do expect there to be value add.”*