MEETING

STATE OF CALIFORNIA

PUBLIC EMPLOYEES' RETIREMENT SYSTEM

BOARD OF ADMINISTRATION

PERFORMANCE, COMPENSATION &

TALENT MANAGEMENT COMMITTEE

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

FECKNER AUDITORIUM

LINCOLN PLAZA NORTH

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SACRAMENTO, CALIFORNIA

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JAMES F. PETERS, CSR
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APPEARANCES

COMMITTEE MEMBERS:

Jose Luis Pacheco, Chairperson

Mullissa Willette, Vice Chairperson

Lisa Middleton

Eraina Ortega

Kevin Palkki

Theresa Taylor

Yvonne Walker

BOARD MEMBERS:

Malia Cohen, represented by Lynn Paquin

David Miller, Vice President

Ramón Rubalcava

Gail Willis, PhD

STAFF:

Marcie Frost, Chief Executive Officer

Doug Hoffner, Chief Operating Officer

Matthew Jacobs, General Counsel

Michelle Tucker, Chief, Human Resources Division

APPEARANCES CONTINUED

ALSO PRESENT:

Tim Behrens, California State Retirees

Jerry Fountain, California State Retirees

Brad Kelly, Global Governance Advisors

Peter Landers, Global Governance Advisors

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PROCEEDINGS

CHAIRPERSON PACHECO: Good morning. I would like to -- good morning, everyone. I'd like to call the Performance, Compensation and Talent Management Committee to order. The first order of business in open session is to call the roll call.

Thank you.

BOARD CLERK TRAN: Jose Luis Pacheco?

CHAIRPERSON PACHECO: Present and good morning.

BOARD CLERK TRAN: Mullissa Willette?

VICE CHAIRPERSON WILLETTE: Here.

BOARD CLERK TRAN: Lisa Middleton?

COMMITTEE MEMBER MIDDLETON: Present.

BOARD CLERK TRAN: Eraina Ortega?

COMMITTEE MEMBER ORTEGA: Here.

BOARD CLERK TRAN: Kevin Palkki?

COMMITTEE MEMBER PALKKI: Good morning.

BOARD CLERK TRAN: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Here.

BOARD CLERK TRAN: Yvonne Walker?

COMMITTEE MEMBER WALKER: Here.

CHAIRPERSON PACHECO: Thank you, everyone.

I'd like to move on to the next item is the Executive report. Mr. Hoffner, please.

CHIEF OPERATING OFFICER HOFFNER: Thank you, Mr.

Chair. Doug Hoffner, CalPERS team member. Today, we have two items before you. The first item is 5A, your primary consultant, GGA, will provide and present alternatives to this item as it relates to the Committee's consideration to align compensation for the executive investment management classifications with the market. And two is Item 6A, an annual incentive metrics review. It's being presented as an information item today, so the Committee can gain information and clarification, and provide feedback to GGA before they bring back a formal recommendation at the June meeting for the new fiscal year.

With that, that concludes my report. Thank you, Mr. Chair.

CHAIRPERSON PACHECO: Thank you very much. I see no questions on that.

I'd like to move on to the action consent item. What is the pleasure of the Committee?

COMMITTEE MEMBER MIDDLETON: Move approval.

COMMITTEE MEMBER TAYLOR: Second.

CHAIRPERSON PACHECO: I have first from Ms. Middleton, a second from Ms. Taylor.

Is there any discussion?

All in favor?

(Ayes.)

CHAIRPERSON PACHECO: All opposed?

The motion carries.

COMMITTEE MEMBER TAYLOR: Do we need to do roll call?

BOARD CLERK ANDERSON: No.

CHAIRPERSON PACHECO: The next item on the agenda is number 4, information consent item. I didn't have -- there was no request for -- to pull any item from the informational consent item, so we are now moving to action Agenda Item number 5a, and compensation review and recommendation for statutory position. And Ms. Tucker. Thank you.

HUMAN RESOURCES DIVISION CHIEF TUCKER: Thank you, Mr. Pacheco. Good morning, Mr. Chair, and members of the Committee. Michelle Tucker, CalPERS team member.

Item 5a presents GGA's recommendations for adjustments to the current salary and incentive ranges for classifications covered by the Board's compensation setting authority under Government Code section 20098 and in alignment with the Board's approved market comparator group.

In February of 2023, McLagan presented updated compensation survey data for covered executive and investment management positions. This was a follow-up from February 2022 when McLagan presented similar compensation survey data. At that time, the Committee decided to reassess the comparator group and have McLagan return with revised data.

To better align CalPERS compensation opportunities with the Board's defined comparator group, GGA has proposed alternatives focused primarily on positioning the annual and long-term incentives more competitively, as well as adjusting the base salary ranges for a few classifications that are under market. The proposed alternatives are intended to align total compensation opportunities for these positions with the total compensation opportunities of the comparator group.

With regard to the Chief Health Director position, CalPERS team members worked with GGA to identify comparable compensation data for the Committee's consideration, including a number of California-based health organizations and districts. Any changes adopted by the Board to salary or incentive ranges will become effective July 1st, 2023 or phased in as directed by the Board. CalPERS team members will incorporate any approved changes to base salary ranges, incentive schedules, and any other plan design options into the Board's policy.

That concludes my opening remarks and we can bring forward and invite Mr. Kelly and Mr. Landers to begin their presentation.

CHAIRPERSON PACHECO: Thank you. Yes. Thank you, Mr. Kelly and Mr. Lander[SIC].

Please present.

(Thereupon a slide presentation).

MR. KELLY: Excellent. Thank you very much and good morning, everybody.

Just for everyone's background just to add to Michelle's initial commentary, this has been a long process. As -- for the information of the new Board members particularly, this was started last year. When we first did the benchmark study, there was some questions around the composition of the peer group. We were asked to come back and readdress that. We had interviews, if you recall, with everyone of you to get your views and opinions on how the peer group should be constructed. And then in November of last year at the workshop, it was agreed that you would follow a prescriptive methodology around the peer group, which is one-third, one-third, one-third. And then that direction was given to McLagan and McLagan reran the data with that prescriptive methodology applied.

So this is the results of all of that work. And so we just want to make sure that we've addressed all the concerns of the Board up to this point. One of the issues -- or not -- I wouldn't say issues. One of the things that has led to the situation we're in today is that the last adjustments that were made were, our understanding, roughly 2020. And there was this -- the decisions of the Board not to run a benchmark survey to look at, you know, market data. It was the decision to age existing data. And so there was some adjustments that were made to the pay bands and there was an addition of the long-term incentive, which really hasn't materialized yet, because it's a five-year performance period. And so the real impact of that decision hasn't really taken hold until you hit the end of that first performance period and there's a potential payout or non-payout based on that five-year performance.

So that being said, running the data again for the first time in a number of years, there's been a lot of progression that has been made in the pension world around incentives and incentivization of employees. And that is -- you know, it's fortunate in that the real -- and you'll see in the data, the real delta is between your current compensation and what we're recommending is mostly around the at-risk pay, the pay for performance. And I would direct your attention to the appendices that we provided with the pie charts on what the -- what the value-add would be if everyone was to hit that actuarial threshold and what the cumulative payout -- associated payout would be.

So as you can see on the slides, you're paying out a minor, minor, minor fraction of the performance that you're putting before your employees. And so with that going forward, Peter is going to walk you through the objective findings and the recommended pathway forward, because we wanted to give you some options, because, you know, there's some adjustments that are required. And how you want to make those adjustments is totally up to -- up to this Committee and up to the Board.

Okay. And with that, I'll turn it over to Peter.

MR. LANDERS: Thanks, Brad. Can everyone hear me okay.

CHAIRPERSON PACHECO: Yes.

MR. KELLY: And just for point of reference, for those of you who don't know though, Peter unfortunately could not join us today. His wife is due any day now and it would not be a good spousal decision to be here, if --

(Laughter).

MR. KELLY: -- as you would all agree. And so, you know, Peter is able to join via Zoom here. So just for everyone's knowledge, that's why I'm here and Peter is not.

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MR. LANDERS: Thanks, Brad. Appreciate that. So you know, what we want to do today is really walk through some recommendations we observed, if you recall, in February, the gaps that existed.

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MR. LANDERS: Next slide.

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MR. LANDERS: So again, as a recollection, we looked at executive positions as well as Investment staff. Again, the key findings of the competitiveness were from the February PCTM meeting. If you recall, again, there were some large gaps, material gaps that were found that were very similar to the findings of last year's review as well. So even with the change and more prescriptive peer group methodology, the results stayed very similar in terms of those gaps, with the gaps continuing to be largely on the at-risk incentive compensation side that Brad has just mentioned, both on he annual incentive, as well as the long-term incentive side.

So while there are some adjustments that we are recommending to the base salary ranges, the lion's share of our recommendations are driven by at-risk incentive pay, meaning that, yes, there is an increased opportunity to earn a higher level of pay, but that level of pay will only be earned if results are generated for CalPERS, both from an investment perspective, but also for certain folks as well against other important criteria, whether it's member satisfaction, whether it's engagement scores, whether it's cost effectiveness.

So needless to say, the at-risk incentive means its there, but if you don't get the results for the plan members, you don't get that value-added returns. On the long-term incentive side, you're not beating that actuarially required rate of return of 6.8 percent, then these incentives will not a pay out or pay out at lot lower level than the potential target opportunity.

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MR. LANDERS: Just to be clear how we have set our recommendations is to be targeting the median or the midpoint of that combined peer group of that weighted methodology, which for the executive staff is one-third public sector agencies, one-third public pension funds, and one-third private sector. And then for the investment staff, two-thirds public funds and one-third private sector. So again, we've looked at the median of that combined peer group as being -- and as this Committee and the Board directed us back in November, being indicative of, you know, the competitive level that you want to be targeting pay to.

We did reference the Chief Health Director. That role is quite unique and is not something that is typical in the investment world, even in most pension funds, even within, you know, a lot of public agencies. So we have had to use a slightly refined peer group for that role, which again as the CalPERS team member had mentioned, Ms. Tucker, that was a group of similar California-based agencies with similar types of health roles to the Chief Health Director role. And we've again targeted the median of those California-based agencies as a whole as being again indicative of a market competitive level.

And just a reminder when we talk about things like total cash compensation or total compensation, total cash compensation means salary plus that annual incentive, award that is, you know, paid, yes, based on multi-year investment returns, but is paid on an annual basis. Total compensation is your salary, your annual incentive, as well as then that long-term incentive, which is tied to five-year absolute total share return performance being that 6.8 percent required rate of return.

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MR. LANDERS: Next slide.

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MR. LANDERS: Perfect.

Just as a reminder, these were the gaps that were identified back at the February meeting. And again, these gaps are to the median, so it's the midpoint of the CalPERS range to the median of the market of that combined peer group. And we've added in the Chief Health Director position as well against that group of California-based agencies. So you can see the sizable gaps, largely again due to, you know, a lower-than-market incentive or at-risk incentive pay that we are trying to solve through our recommendations today.

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MR. LANDERS: So the rationale -- as a reminder, four recommendations. One is, of course, to align your compensation levels more competitively with the median of your policy aligned peer group that you as a Board and as a Committee have said is where you want to be targeting pay. We're going to ensure that base salary range levels are competitive with the peer group, so they're not above market, but they're also not below the market that -- of that combined peer group.

We want to reflect the fact that for many of the executive staff member roles that are seeing some of the salary range adjustments, some of these haven't been adjusted in -- materially in three plus years. There was a small adjustment made to the maximums I believe at the January meeting, but more material increases that may have been warranted have not been made in three plus years. We want to ensure that a meaningful and competitive amount of compensation is placed at risk through incentives. We at GGA are very much proponents of tying a large portion of anyone's pay opportunity to at-risk incentives.

And lastly, especially for the executive management positions, that there is, you know, some hesitancy, and we can understand why, to make certain roles eligible for the long-term incentive at this time, ones that, you know, based on the market data, you could argue, you know, some roles within public agencies and that, and even certain pension funds may not be eligible for long-term incentive. And so we're wanting to reflect that as well for our recommendations.

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MR. LANDERS: So we wanted to provide the Committee with a couple of alternatives, both for the executive management staff as well as the Investment staff. And we've sort of bucked -- bucketed them into two sort of strategies, one is an align-to-median strategy, which would literally say, you know, where is generally the median of this policy-aligned peer group and realign everyone to the median of that combined peer group or within a small variance of that range.

The second alternative is internally equal below CEO strategy, meaning that even if there is some differences between certain roles that would say that, you know, some roles maybe deserve to be paid a little bit higher incentive opportunity than others, we recognize that all of the management staff working below the CEO as their direct reports are all generally valued equally and therefore, we're going to structure the pay opportunities so that they are all paid equally and in a more similar pay structure, if you will. So those are just the two main source strategies.

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MR. LANDERS: So on the salary adjustment side, you can see that when we looked at the CEO position, we did not see a material gap to the market, and so therefore there was no need to adjust the CEO salary range. We felt it was still market competitive and gave you, you know, space to work with. But you can see that for the CFO, the General Counsel, COO, and the Chief Actuary, all of which we were able to find good meaningful data from the McLagan research from public agencies and that, there was a gap to market from a salary perspective comparing the current midpoints to the midpoints in the market or the median of the market. And so you'll see that we've, you know, made sure to recommend salary adjustments that place those roles generally more in line with the median of that combined peer group.

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MR. LANDERS: The Chief Health Director, and this is something we wanted to highlight, and it came out through the analysis and through the market research that we did. This role is quite unique. I think everyone probably around this table would admit that this role is quite unique compared to other roles within CalPERS, but even within many other State agencies in the State of California, even with other pension funds, definitely even when you look at the private sector. And what came out through the analysis working with the CalPERS team members was currently CalPERS you make this role eligible for an incentive, just like all the other direct reports to the CEO.

But when you look at the market data, and it's included in the appendix for your reference, most, if not all, of the similar roles in California are actually just paid a salary only and are not made incentive eligible. And there's, you know, a variety of reasons for that. But it then provides, you know, a couple of different alternatives of how you could potentially structure the pay of this unique Chief Health Director role potentially differently than the other roles, which have very high market prevalence of a salary and incentive, for some even long-term incentives as well.

And so we've put forth a couple of different strategies in terms of how you could adjust the salary range for the Chief Health Director. One is to acknowledge this role is unique. It's quite different than the other roles at CalPERS. It recognizes that similar roles in the market typically pay a higher salary and no incentive at-risk pay. And so you would adjust the current band materially to focus on a salary-only approach to this one specific role. And you can see that, you know, that leads to a midpoint of about 425,000, which aligns with approximately the median of those California-based groups.

The second alternative you would still adjust the salary, but you would do so maintaining the at-risk incentive for the Chief Health Director role. So making sure that the structure of pay for this role is similar to the other direct reports to the CEO. So you can see a -- you know, it's still a meaningful, but not as high of an adjustment to the salary range if you continue to include that at-risk incentive.

So those are a couple of alternatives I would -- you know, we'll go through this presentation, but I would encourage this Committee to think through and, you know, come up with -- it really is a philosophical discussion at the end of the day and what you feel most comfortable with. Do you want to position this role in terms of the pay structure, more towards what other similar roles are in the marketplace or do you want to keep it generally, you know, while maybe not eligible for as much incentive pay as others, still have a structure that is similar to all of the other CEO's direct reports with a salary and an incentive.

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MR. LANDERS: So this is Alternative 1. This is an align to median strategy. And you'll see what we've done in this slide on this stable is we've highlighted the current opportunities from -- as a percentage of salary for each of the executive roles, and as well the long-term incentive opportunities. And what we've highlighted in red, in those red boxes, are the adjustments, the recommended adjustments. And you'll see some, you know, very material adjustments for most of the roles.

The one thing I will point out is you will see that the market data, if you want to solely align everyone to the median of the market data, of that combined peer group, shows that the General Counsel, COO, and Chief Actuary should actually get a higher at-risk incentive, and the CFO would actually have a slightly lower increase to their annual incentive. And you will see that that compares to the current practice, which is to have everyone have the same incentive opportunity that maxes out at that 40 percent. So this is sort of our Alternative 1.

This Alternative 1 also for the Chief Health Director would remove the incentive altogether from the role, because it would say the market data supports just paying this role with a salary only and no incentive. So this very much -- this alternative aligns to, again, the median of the market in a pay structure that generally aligns to the market.

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MR. LANDERS: And this just shows the resulting basically analysis of what the gap to the market is, if these recommendations are made. And you can see, you know, other than the CEO role, which, you know, to make the cycle adjustments to align perfectly to the median would require decoupling or basically separating out how the long-term incentive opportunity is determined from the annual incentive, because right now they are very much linked. What you generally generate on the annual incentive side then leads to what you are eligible for as a long-term incentive moving forward.

We would have to make a very sizable shift that is not recommended at this time for the CEO role. We're still recommending very material increases and adjustments to that role, but we wanted to be at least more conservative of that side. And you'll see though what we've done for the other five direct reports to the CEO is generally positioned total cash, so that's salary and annual incentive, around the median of the market. And because you're within, you know, plus/minus 10 percent of the market, these recommendations would generally get you within that sort of, again that range, that competitive range for the roles.

You will see, you know, there is some prevalence in the combined peer group of a long-term incentive for some of those roles, CFO, General Counsel, COO. And you'll see that that is creating still a gap from a total compensation perspective. But we feel, you know, at least getting these roles from a total cash perspective for now, leaving them not eligible for long-term incentive is a good strategy to at least again phase in some of the potential adjustments you may want to make in the future, but get them into a competitive range now from that perspective.

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MR. LANDERS: This Alternative 2, if you recall, is what we call internally equal below the CEO. This would, as you can see with the red box, put all of the CEO's direct reports at the same annual incentive opportunity levels. So the CFO would get a slight bump up to 70 percent from Alternative 1, which was at 60. And the Chief Health Director, we wouldn't necessarily, you know, bring them to the same level as everyone else, because the market data for that role does not support it, but that role would still remain eligible for an incentive. And so from a structure perspective, they would be paid in a similar structure to all of the CEO's direct reports. So those are the only slight differences that.

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MR. LANDERS: And you will see again the resulting impact in terms of the market positioning. What I'll note is the CFO role becomes -- still within that plus/minus 10 percent range, but becomes a little bit more competitively positioned in the market. And you'll notice the Chief Health Director, while we've done it through salary and an incentive, still is positioned right at the median of the peer group.

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MR. LANDERS: So, Mr. Chair, maybe I'll just stop there. I don't know if you want to wait and have us go through the entire presentation or if you want to stop and have a discussion on just the executive roles for now. I'll leave that up to you and your discretion.

CHAIRPERSON PACHECO: Thank you. No, I would like to continue on. Thank you.

MR. LANDERS: Okay. So next slide, please.

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MR. LANDERS: Perfect. Just a reminder, this is again the investment management positions. You'll see again, as we mentioned earlier, a lot of the salaries were adjusted around 2020 or so. And you'll see they still remain generally pretty competitive outside of a couple roles that we would, you know, make some smallish adjustments to. You can see again though the lion's share of the gap to the market is through the at-risk incentive pay, and that's highlighted in those red boxes. If you can move to the next slide, please.

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MR. LANDERS: In terms of the investment management positions, the rationale for those recommendations again continues to be aligned competitively with the median of the peer group. Again, ensure the base salary range levels are competitive, reflect that movement in the market that has increased the level of compensation that is placed at risk through incentive pay for these types of roles, and generally reflect a mix between salary, annual, and long-term incentive that aligns with market practice. So all of that has gone into the recommendations we've brought forward.

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MR. LANDERS: Similar to the executive staff, we've outlined the alternatives with two alternatives, one again being an align to median strategy, where again we're generally targeting the median of that peer group from a total compensation perspective, and aligning the incentive opportunities and salary levels accordingly. The second alternative being that while the -- and I'll get into this when I talk about this alternative a little bit more, but would position the Deputy CIO position, which I think everyone would agree is a -- you know, a more senior and larger role with larger amounts of responsibilities, with a higher incentive opportunity than the Managing Investment Director level that is below it. But I'll get into a little bit more detail when we walk through some of the numbers.

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MR. LANDERS: So in terms of salary adjustments, there were three roles that we saw that could require some slight adjustments to the salary levels. I think the most material change needing to be made for the Associate Investment Manager. That was where the largest gap to the market existed, but we did note a couple of housekeepings that would position, you know, CIO and COIO positions slightly more competitively in the market.

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MR. LANDERS: So Alternative number 1 which is that aligned to median strategy, you will again see that the current incentive opportunities on sort of the left side and then the recommended -- recommendations on the right-hand side highlighted in red boxes. And you will see again -- as we talked about the largest gap being at-risk incentive pay, you will see some sizable more material adjustments that are required to put these roles competitively in the marketplace. I note under this alternative in particular the Deputy CIO and the Managing Investment Director having the same incentive opportunity as a percentage of salary. Whereas, currently, the Deputy CIO has a 10 percent higher at target incentive opportunity.

So I highlight that under this strategy those roles would have the same incentive opportunity as a percentage of salary. Obviously, the Deputy CIO has a higher salary, so it will lead to higher numbers, but there is that sort of -- you know, that more senior level role with more responsibilities right now at the same level as more of a direct report. And we wouldn't necessarily always see that very often in the marketplace.

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MR. LANDERS: This then shows the resulting alignment to the median. You'll note that we've, you know, gotten everyone with say a plus/minus two percent range. I note for the COIO, and this was one position that we saw, you know, to us, we looked at the data, even last year versus this year, and, you know, to our role and our understanding of this role in the marketplace didn't necessarily require as much of an increase as the market data indicated for that role. And so you'll see there is a slightly higher gap to market for that role, but we still feel our recommendations will position that role competitively with the -- with the marketplace.

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MR. LANDERS: This is now Alternative number 2. And you'll notice the one difference -- everything else is pretty much the same. The one difference being that we have positioned the Deputy CIO with a 10 percent higher annual and a 10 percent higher long-term incentive opportunity as a percentage of salary at target than the Managing Investment Director. So this would again recognize that the Deputy CIO is a larger role, has more responsibilities, and so from an internal equity perspective, you know, we want to acknowledge that. Just like we do currently with the 80/70 currently, we want to acknowledge that through giving that Deputy CIO a slightly higher incentive opportunity.

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MR. LANDERS: And you'll see that market position generally remains the same for all the roles except the Deputy CIO is positioned slightly more higher in the marketplace from a total compensation perspective than they were under Alternative 1.

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MR. LANDERS: We do note that, you know, these are more material increases, just like we noted last year. And if you were to look at last year's analysis and recommendations and compared them to this year's recommendations, you'll see that most of -- most of it has stayed relatively the same. There's some that maybe have gone slightly up and some that our recommendations have gone slightly lower than last year, but we do recognize that, you know, these are material increases. Because you haven't necessarily made adjustments over time, and it has been a few years, that has led to a larger gap being observed to the market. And so we understand that you may not want to make all these changes all at once.

And so what we've done is we've also given you for consideration as a Committee a potential phase-in strategy. And we've worked in the past with other public funds, other financial organizations and just clients in general that have had, you know, larger adjustments that they needed to make to compensation levels. And we've worked with them over the years to develop a phase-in strategy over a two- to three-year period. So you make them over time as opposed to doing it all at once. And so we'll move to the next slide, but essentially we've --

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MR. LANDERS: -- highlighted that potential phase-in on the next two slides. So you can see here for the executive management staff, we're proposing, you know, if you want -- if you don't want to do it all at once, a two-year phase-in strategy. So you can see right now the target annual incentive is 27 percent of salary. For the CEO, you would move it to 65 percent in year one, which would be fiscal 23-24. Then in 24-25, you would move from 65 percent up to 100 percent.

So you essentially do -- you know, go about half the way in year one and then the other half first for year two, and so on and so forth through the remaining roles that you see there. It was a similar strategy. I note for the CFO and Chief Health Director we've provided two numbers for each. That's really depending on whether you were to go with Alternative 1 or Alternative 2 for those roles. But you can see a similar sort of go half the way in year one, half the way in year two.

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MR. LANDERS: The same approach applies to the investment management staff. So you'll see again a phase-in strategy where you make half of the sort of adjustment in year one and then the other half is made in year two. And you can see again for the Deputy CIO, depending on which alternative you choose, 1 or 2, you request see, you know, how that phase-in would work under either of those approaches, so the double numbers there.

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MR. LANDERS: And then very quickly, before I maybe pass it back to the Chair, we just want to highlight and we want to -- you know, we talk about making sure that, you know, you're equipped with understanding of yes, you know, these are, in dollar terms, material adjustments, but let's look at, you know, holistically if you were to achieve these level of incentives, what is sort of that sharing ratio? What is that percentage that you are actually sharing of the added returns that this group and this team has worked and achieved for members? And you can see just through this slide here, if you were to achieve maximum annual long-term incentives -- so we're not talking about target. We're talking about the highest level of incentive payouts that you could. Over a five-year period, the math shows that less than 0.1 percent of the benefit to members would be shared as incentive pay to these folks. And that again takes into account achieving that 6.8 percent and ends -- being that benchmark much, of course, by the maximum allowable.

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MR. LANDERS: We looked at and said over a five-year period, what is the maximum of your percentage of growth over the actuarial threshold? And you'll see that it's less than 0.6 percent. So going over that 6.8 percent, you know, actuarial threshold, you're only going to be sharing 0.6 -- less than 0.6 percent of that with team members through the incentive pay.

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MR. LANDERS: And then lastly, we actually looked and said, okay, you know, we understand that, but let's look at, you know, if we just barely beat the actuarial threshold, so we get 6.9 percent or, you know, we get up to around 8.1 percent, which essentially is, I think, the maximum of where like the long-term incentive would pay out, what are our sort of incentive levels at different rates of return?

And you can see that even if you just barely beat the actuarial threshold, you annualize 6.9 percent, you're still only sharing about five -- just over five percent. And the lion's share, so over 94 percent of that benefit is going back to the members. And then what you'll see is as you generate higher and higher rates of return, that sharing ratio becomes smaller and smaller.

And you might ask, well, why didn't we show 6. -- 6.7, 6.8? If you recall, the plan especially the long-term incentive plan, does not pay out anything if you don't generate 6.8 percent. So if you earn 6.7, that long-term incentive isn't paying you out anything. So, you know, any of the value there is being kept solely by the members and not shared with incentives to the -- to the -- to the team members.

Next slide, please.

--o0o--

MR. LANDERS: And next slide.

--o0o--

MR. LANDERS: So in terms of next steps, before we pass -- I pass it back to the Chair, you know, in our view, the next steps that we see is, you know, having a good discussion and approving the required adjustments to the base salary ranges that we've aligned to position CalPERS more competitively, also approving the required adjustments to the annual long-term incentive opportunities to position you more competitively. And again, just for clarity, as you're -- you know, as your primary consultant for the CFO and the Deputy CIO roles, we recommend an Alternative number 2 strategy, which would position these roles accordingly internally with others. So it would position the CFO at the same incentive opportunity levels all the other of the CEO's direct reports, and it would recognize the greater responsibilities and role of the Deputy CIO. And so it would position that role as slightly above the Managing Investment Director.

And then for the Chief Health Director role, we actually recommend moving away from a salary-incentive structure to a salary-only structure that aligns with again the types of individuals and the types of roles that you'd be recruiting from for this role in the future, and trying to retain your current Chief Health Director on the market. You know, and it removes that need to figure out, you know, any unique incentive sort of metrics that need to be done for that role given how unique it is compared to others within CalPERS.

Lastly, a couple other things. Approve, if you desire, the use of a two-year phase-in strategy. Either -- either approach making the change all at once or phasing it in would be considered, I think, in -- aligned with what -- how others have approached those things in the past, because you could do it in either way all at once, rip it off like a band-aid or sort of phase it in.

And then lastly, of course, assuming you make these adjustments and these approvals today, direct CalPERS HR to reflect any of these adjustments within an updated Compensation Policy that I believe would come forth at the June meeting.

So, you know, there's other appendices. Happy to go through them, if there are questions. But in the interests of time, I'll maybe pass it back to the Chair and open it up for any, you know, questions that people may have.

CHAIRPERSON PACHECO: Thank you. Thank you, Peter, and thank you, Brad, for your comments here, for your comp -- for the compensation analysis and presentation on the comprehensive -- comprehension alternatives for the executive and investment positions here at CalPERS.

I also want to appreciate your thought process in highlighting the gaps between the current composition levels of these covered statutory positions within the executive and the management groups in order to arrive at a place with the following alternative recommendations in closing those gaps. I really do appreciate that.

I want to mention during our February 2023 Performance, Compensation and Talent Management Committee, I mentioned some remarks. And these remarks were I see the compensation conversation regarding these covered positions as not only a local matter, but also a global recruitment issue, as we look to add more active risk to our portfolio. You know, this is one of the reasons that I wanted to be Chair of the Performance, Compensation and Talent Management Committee, recognizing the folks in the Investment Office are valued for their hard work and dedication, so our two 2.1[SIC] CalPERS members are able to retire with dignity and with respect after working decades as public employees.

You know, however, in order for us to get the types of returns in the CalPERS fund in the long run, our attention must be laser, laser focused on rock bottom performances across our asset classes and awarding those investment folks who put in the work and effort to achieve the types of risk-adjusted rate of returns in our portfolio, so our fund moves forward in the long run.

Outperforming the passive benchmarks alone will no longer suffice. As we add more direct investing, which will require and advanced skill set to accomplish over time, these compensation levels will give us a better chance of recruiting and awarding direct strategies moving forward in the long run.

Thus, after careful consideration and after enormous amount of study on these recommendations, I would like to entertain the following motion.

To approve the required adjustments to base salary ranges to position CalPERS more competitively, to approve the required adjustments to annual and long-term incentive opportunity levels to position CalPERS more competitively, specifically for the Chief Financial Officer and Deputy Chief Investment Officer respectively, opting for Alternative number 2, given its understanding of how CalPERS has historically positioned the Chief Financial Officer and Deputy Chief Investment Officer in relation to other roles internally within the system. For the Chief Health Director role, opting for alternative number 1, given its understanding of the criticality of this role to CalPERS, the structure of the composition paid to similar roles in the market, and to ensure its competitiveness in the long run. And finally, to approve the use of a two-year strategy to phase in incentive opportunity adjustments over time.

VICE CHAIRPERSON WILLETTE: So moved.

CHAIRPERSON PACHECO: Moved by Mrs. Willette.

COMMITTEE MEMBER PALKKI: Second.

CHAIRPERSON PACHECO: Second by Mr. Palkki. I'd like to open it for discussion.

Just -- let me get this first of all. And Theresa, you are on.

COMMITTEE MEMBER TAYLOR: Thank you very much.

I agree with the motion. The only -- I think this has been a long time coming. I'm very happy to see the motion. The only thing I think -- I don't know. Maybe we should rip off the band-aid. The use of two-year strategy feels like -- so we'll be trying to phase this in for a couple years, and then they get their raise, right? And then like two years later will we be looking at another market analysis to do this over again? So I'm wondering is it kind of clumsy to do the two-year phase-in strategy? Should we just -- and maybe, Ms. Tucker, you can respond to that or GGA. Go ahead. Whichever wants to.

HUMAN RESOURCES DIVISION CHIEF TUCKER: Thank you for that question, Ms. Taylor. So certainly we can execute whichever you decide, the two-year phase-in for the incentive or the immediate implementation of the full ranges that are adjusted. The Board did discuss last time about a strategy to sort of set regular times to review compensation, so that would be occurring regardless. But certainly we can do whichever method you prefer.

Anything else, Brad?

MR. KELLY: I would just say from an administrative standpoint, it would be much easier just to do it one fell swoop, considering that you want to get on a regular cycle to start making these adjustments to make sure that you're always being competitive to market. The reason why we provided the alternative is because sometimes it's too material for people to get beyond that hurdle. But I'd also remind this Committee that it's been a significant amount of time since you've truly benchmarked to the marketplace. So that's why you've gotten to this situation you're in.

But the main -- as Peter pointed out and as I also pointed out, the lion's share of these adjustments are on that performance section of their compensation. So if you're comfortable with that knowing that if you don't realize the performance, if these employees don't realize the performance that you've put forward, then they don't get paid, you know, what is in the package. And if you're comfortable with that, then we would fully support the bandage removal and to do it in one fell swoop.

COMMITTEE MEMBER TAYLOR: Okay. I appreciate that. Yeah, I kind of -- I feel like we just need to get it done. So, Mr. Chair, I'm wondering if -- I can't make it, because I'm asking questions, but get back in line and make a friendly amendment to the motion, so --

CHAIRPERSON PACHECO: That would -- that would be done by the maker of the motion, which would be Mrs. Willette, I believe. I believe that's --

COMMITTEE MEMBER TAYLOR: No. It's a friendly amendment. She doesn't -- does she make --

VICE CHAIRPERSON WILLETTE: I have to accept it.

CHAIRPERSON PACHECO: She has to accept it.

COMMITTEE MEMBER TAYLOR: Pardon me?

Well, I'm not -- I'm not supposed to make the motion right now, anyway.

CHAIRPERSON PACHECO: Yes, Mr. Jacobs.

GENERAL COUNSEL JACOBS: Good morning. You can make a friendly suggestion. The maker then would need to adopt it, and -- as would the seconder of the motion.

COMMITTEE MEMBER TAYLOR: Okay. Friendly suggestion?

VICE CHAIRPERSON WILLETTE: Yeah. Or should I -- I'll accept that friendly amendment to instead of a two-year phase-in to just do it immediately, or the one-year.

COMMITTEE MEMBER TAYLOR: Appreciate it. Thank you. Who was the seconder? That was you.

VICE CHAIRPERSON WILLETTE: And the seconder.

COMMITTEE MEMBER PALKKI: Yeah, I'll second that as well.

COMMITTEE MEMBER TAYLOR: All right. Thank you.

CHAIRPERSON PACHECO: So, Mr. Jacobs. Mr. Jacobs. So do I need to repeat that again or -- with the entertainment of that or not?

GENERAL COUNSEL JACOBS: No, you don't need to repeat it. I think that before you vote it -- vote on the motion, you should restate it, so that everybody is clear on what exactly the motion is.

CHAIRPERSON PACHECO: And the motion would be to -- would be to use the one-year instead of a two-year, correct?

GENERAL COUNSEL JACOBS: That's the -- that's the amendment to the motion, right.

CHAIRPERSON PACHECO: Immediate phase -- immediate phase -- immediate. Thank you. Thank you. Thank you, Mr. Jacobs.

GENERAL COUNSEL JACOBS: You're welcome.

CHAIRPERSON PACHECO: Mrs. Ortega, you're up.

COMMITTEE MEMBER ORTEGA: Thank, you Mr. Chair. Am I on?

Yeah. Thank you. I would have like to support the recommendations on the Investment staff and the Health Director change that's proposed, but I don't support the changes for the executive staff largely related to my objection to the comparator group, the one-third, one-third, one-third, and the objections I've raised in the past about that comparison.

Given that this motion has been structured as kind of an all or nothing, I will be forced to vote no on the entire motion. Thank you.

CHAIRPERSON PACHECO: Thank you.

Mr. Rubalcava.

BOARD MEMBER RUBALCAVA: Thank you, Mr. Pacheco. I want to commend you and the Committee for taking this issue on. It is distressing that we have -- these gaps have been created.

I did have a question - I'm not sure it's for you or for the consultants - on the Chief Health Director position. The recommendation number one, which would, as I understand it, take out the long-term -- the annual incentive eligibility, I guess, but recognizing in the rationale because we're unique. We are unique. We have the second largest health population in the contract. So I just want to make sure that under that alternative, we still -- we stayed unique and recognized the complexity of our health program. I just want to make sure that we're not losing anything by going to Alternative 1 versus Alternative 2, but I'm sure --

MR. LANDERS: I can try --

BOARD MEMBER RUBALCAVA: -- the Committee can deal with that. Thank you.

MR. LANDERS: I can try and address that very quickly. You will see, of course, that with that adjustment, the base salary range does go to a much higher level than under Alternative 2. And again, to be in line with this Board and this Committee's philosophy of targeting the median of the market or of the suitable care group, we've, you know, structured it, so that the midpoint of that salary range is competitive with others. If you wanted to, you know, be more aggressive and, you know, target a midpoint that's slightly higher than what the other California organizations are doing, you could do that. And the justification to your point, Mr. Rubalcava, was, you know, that this is even more unique. Second largest health care.

You would definitely have that -- I think there's a rationale for that. But what we have done in our recommendation is again aligning to your general philosophy to target the median or the midpoint of the market of the suitable peer group. We just have -- we've set it in that -- in that sort of philosophy and in that -- with that spirit in mind. And we do feel that, you know, with the material adjustment that would be made to the salary level for that role, it would give you a lot of room to take into account, within the actual placement of your current Chief Health Director or any future Chief Health Director in the role, you could align them accordingly within that range based on how you view the incumbent in that role's performance.

You know, if it's really exceptional, you'd probably position them at the higher end of the role. If they're newer or starting out and still learning and developing into the role, maybe on the lower end of that range. But we feel like the adjustment that is recommended puts you and places you competitively in the market for this current incumbent but also for future Chief Health Directors in the -- in the future.

BOARD MEMBER RUBALCAVA: Thank you for the answer.

CHAIRPERSON PACHECO: Ms. Walker.

COMMITTEE MEMBER WALKER: Thank you.

I appreciate the recommendations from the consultants and the thoughtfulness that went into it. I know that it is not easy to -- well, for the consultants maybe it is, but it's not easy at least for the Board to look at compensation, look at higher compensation. You know, people typically have a feeling in them that goes, eww, do I want to do -- that's a lot. Should we do that?

But I fully believe that, one, I agree with your recommendations, Mr. Chair. I thought that they were well thought-out. I thought you made the appropriate case. I believe that -- I appreciate the amendment that was made and accepted, because I think that that's the right way to go.

And I think this sets us on a path, not only for today, but it will make it a lot smoother as we go forward into the future. I mean, it is hard to initially think like, oh, this is a lot, and maybe we should just like chunk it off a little bit. But I think in this instance, I think that is more painful than just recognizing that we have a problem. It has been an ongoing problem. Let's take care of this problem and have an even playing field to move forward.

So with that, I support the recommendation as amended.

CHAIRPERSON PACHECO: Thank you. Thank you, Ms. Walker.

Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: Thank you. Thank you, Mr. Chair.

If possible, I would like to hear from Mr. Toth specifically on issues related to the investment incentive programs. And let me begin, Tom, by apologizing for not giving you advanced notice I was going to ask these questions, but here we are. As you look at these incentive programs and the needs of our Investment Office, do you have any recommendations regarding the direction we should follow?

MR. TOTH: Ms. Middleton, Tom Toth, Wilshire Advisors, the Board's investment consultant. I think I'd start by echoing some early comments and complimenting the Board on the thorough of the process. And process is really critical when you're talking about these types of structures.

I support the recommendations as stated here. And one of the primary reasons, which I think is important for the Board to keep in mind is what it does, the type of investor that this structure with higher upside potential when performance is reached, that type of investor is going to be attracted to this structure, more so than one which is tilted more towards non-at-risk pay salaries.

And I think that's a really important component as we look to continue Building out a world class organization, money management organization. And at the end of the day from an investment standpoint, this is a, you know, $450 billion plus asset management organization. And I don't need to tell you this, but the competitiveness for finding and retaining talent is very intense. And this, I think, puts you in a very strong position to get the right people, the right investors in the right seats.

COMMITTEE MEMBER MIDDLETON: All right. Thank you.

Mr. Chair, that's my question. I do have some comments. And if you'll bear with me --

CHAIRPERSON PACHECO: Absolutely.

COMMITTEE MEMBER MIDDLETON: -- I've got more than the usual number of comments that I'm going to make.

CHAIRPERSON PACHECO: I -- for -- you -- it's all your -- it's all yours, Ms. Middleton.

COMMITTEE MEMBER MIDDLETON: All right. Thank you.

First, I would have supported moving forward with the investment recommendations, but I will be also forced to vote no, because we are including the executive officers. I believe fundamentally that we are underpaying our CEO and all of our executives and that they have earned and deserve a raise. And if we are going to competitively compete, we do need to pay a greater salary than we're paying now.

But from the day that I was placed on this Board, I've expressed my reservations with the incentive-ladened programs that we have for our executives. Our members work for a salary and a pension. We should be the standard-bearer of salaries and pensions. I understand completely when it comes to the Investment Office, the need to have a different strategy.

But what we have tried to do during the years that I've been on this Board is adapt a private sector model to a public sector model, where it will never work. An illustration of the failure of the ability of this to work is I am not permitted to ask the CEO or the CIO what their opinion would be on any of the incentive programs that are before us. The very people that have the fundamental responsibility for carrying out this organization's responsibility cannot be comment on the incentive programs that we are being told are going to give us the kind of performance that we need in this organization. That is the definition of a broken system.

It's not broken because of any of the work on this Committee, most particularly our Chair and our Vice Chair who have done a remarkable job of trying to make this work. It's not broke because of the quality of the recommendations we get -- received from GGA. If anyone could make this system work, I believe Brad and Peter could. And with deep respect, I fundamentally disagree with their approach to what we should be doing when it comes to paying salaries.

The argument for incentives is that they will produce a performance that we would not otherwise receive. The performance that we've received from our executives is absolutely exemplary. It is so, because of their commitment to their profession, and their commitment to this organization, and to the mission of this organization. We should be paying them the salary they deserve. We should not be engaging in a process that instead of incenting them, at the end of the day is going to lead to discussions as to whether or not they should receive a midpoint, a two-thirds point, or a four-fourths point of their incentive. And that conversation will take place here on this dais with wonderfully committed people. But it is going to be a subjective conversation. And if it is a different conversation than everyone that I've had before on this Board, instead of leading to increased incentives and increased desire to perform, it will lead to days of disillusion on the part of the individuals that were trying to perform.

We need to stop this and move forward with a process for our executives that is based solely on salary. And if they underperform, then we have an opportunity to take and rectify that underperformance by doing our job, which is to sit down with them and talk about their underperformance, and what it's going to take to move forward. We should be doing that kind of conversation always directly and not through the indirect means of providing a less-than-optimal incentive payment.

Respectfully, I will vote no.

(Applause).

MR. KELLY: Mr. Chair, I was wondering if I could respond to that?

CHAIRPERSON PACHECO: Yes, you -- yes, sir.

MR. KELLY: Mr. Middleton, I completely respect your opinion. I always respect your views on these things. I would like to point out the fact that I am unaware of a pension fund that is fully funded or overfunded that does not have a progressive incentive structure in its place for all employees, for executive staff and investment staff.

Being Canadian, I ware it proudly. But I'd also like to remind you that north of this border, based -- if I recall the data correctly, Mercer does an annual study. And in -- at the end of 2021, if I recall this correctly, the median in the entire country was 108 percent funded, the entire country, all the pension funds in Canada within the Mercer portfolio.

I can also say that less than four percent, if I recall correctly, were under 80 percent funded. It's an envious position to be in. But the way they got there is by having the fortitude and the courage to implement really strong performance-based pay structures that have those conversations -- those performance conversations, as you mentioned, Ms. Middleton, about, you know, how do you overcome barriers, how do we always consistently improve, what are the challenges that you see before you and how do we work collectively to make these things work.

But if you can't perform and if you've shown a track record for not performing, then this may not be the organization for you. It's a different way of approaching it, but it is the structure that has been adopted. And I can tell you that that structure has got these funds into the envious position they're in. Particularly, one of the first funds was the very fund that your CIO spent a huge part of her early career in, Ontario Teachers. They were kind of the pioneers in this.

And so I think you have the right pieces in place. It's just about evolving them and consistently focusing on a strong pay-for-performance culture that can help incentivize, and drive performance, and get people to -- and I'm not saying that your employees are not driven, absolutely not. But what I am saying is that incentives have been proven -- incentive structures have been proven to really help move that needle and get you into that, you know, fully funded position. And that is what we're advocating here. And I respect your opinion and your views, but I would just say that the data and that -- the trend that we're seeing would actually -- would say the contrary.

COMMITTEE MEMBER MIDDLETON: Brad, thank you.

CHAIRPERSON PACHECO: Sorry. So I would like to thank you, Ms. Middleton. Thank you, Mr. Kelly, for that information. It's very. Useful

I'd like to now open it up to public comments. And I'd like to get -- like to call up Mr. Behrens to the floor, please.

Mr. Behrens, please identify yourself and --

MR. BEHRENS: Thank you, Mr. Pacheco and Committee members. I really like the engagement between the Committee members here and the experts presenting their recommendations this morning. I'm speaking in favor of the motion. And I understand Ms. Middleton's concerns and kind of agree with that too. So it's hard -- it's hard for me to separate what I'm about to say, but I'm going to try it anyway.

I think the salary has got to remain competitive. I've seen far too many talented CalPERS management teams in all different levels leave, because the public sector offers them a better deal than CalPERS can. And I think that's a tragedy that maybe the Board can start to overcome by having these kinds of discussions.

You know, years ago, I gave testimony to the Little Hoover Commission regarding compaction for State employees, between the management team and rank and file. And at that time, there was 400 different types of State employees where there was less than five percent difference between the management leader and the rank and file employee. It never went anywhere, but at least I got a change to voice my opinion. I kind of feel like this is the same kind of discussion you're having this morning.

But I would like to separate the pay-for-performance bonus part of what you've had in your discussion this morning, because it's always been a mystery to me, at least for the last 12 years I've been coming to these meetings, how the Board decides to give a bonus. It feels like they take a bow and arrow and shoot at a target, and wherever the arrow lands that's what happens. They get a bonus.

I don't see a clock, so I don't know how much time I have.

CHAIRPERSON PACHECO: There's some sort of technical difficulty.

MR. BEHRENS: Well, good. I can keep talking then.

(Laughter).

MR. BEHRENS: So I would like to see the Committee and the Board in the future try to separate those two items. CSR is fully supportive in having competitive salaries for the management team and all those different categories of the team that they were covering this morning. When it comes to the bonuses that they look at every year, I would like the Committee and the Board to take a closer look at how they come to an end result for granting that bonus or not.

And I also would agree fully with Ms. Middleton that I think it would be great. It would be the only time I would ever support a closed meeting, if the Board would meet with all of the people we're talking about, all the different categories of people we're talking about and discuss those kinds of things face to face, and give them an opportunity to give their side of the story, so you all have more insight into the -- making a informed decision.

Thank you.

CHAIRPERSON PACHECO: Thank you, Mr. Behrens.

Ms. -- next up is Ms. Fountain.

Mr. Fountain, excuse me, so sorry.

Good morning, sir. Please identify yourself and you have three minutes.

MR. FOUNTAIN: Yes. Good morning. I'm Jerry Fountain, Chief Financial Officer for the California State Retirees. And I speak strongly in support of the motion that's on the board. And I agree tremendously with Mr. Pacheco and Ms. Middleton's comments.

I've sat through a number of these meetings and it's always come out with the same result, increase, increase, increase, and let's not worry about performance.

And it's time to rip the band-aid off. You know, what we're talking about here can be properly renamed is annual salary adjustments, not anything to do with incentive. And if we have to pay our employees, not use the term I heard a few minutes ago to encourage them to do their job, then it's time to let that employee go.

So, I appreciate this opportunity to speak to the Board and I also apologize for any high frequency whistling you heard previously. It's new hearing aids and a hearing device. So thank you for this opportunity.

CHAIRPERSON PACHECO: Mr. Fountain, there's no apology. Thank you, sir.

Are there any more discussions from the floor or from the public?

BOARD CLERK ANDERSON: (Shakes head).

CHAIRPERSON PACHECO: I see none, so I would like to call the question. And the -- and the roll call, have a roll call vote on this motion.

BOARD CLERK TRAN: Mullissa Willette?

VICE CHAIRPERSON WILLETTE: Aye.

BOARD CLERK: Lisa Middleton?

COMMITTEE MEMBER MIDDLETON: No.

BOARD CLERK: Eraina Ortega?

COMMITTEE MEMBER ORTEGA: No.

BOARD CLERK: Kevin Palkki?

COMMITTEE MEMBER PALKKI: Aye.

BOARD CLERK: Theresa Taylor?

COMMITTEE MEMBER TAYLOR: Aye.

BOARD CLERK: Yvonne Walker?

COMMITTEE MEMBER WALKER: Aye.

CHAIRPERSON PACHECO: Based on the ayes, the motion carries. Thank you.

Next item on the agenda.

Oh, yeah. And then finally, there's just one more thing I forgot to ask. I'd like to also add some direction, based on the comment -- public comments that we received and so -- and other -- others. I'd like to direct CalPERS HR to reflect any adjustments to the base salary ranges, annual and long-term incentive opportunity levels within an updated Compensation Policy, which I believe would be brought in June, is that -- is that my understanding?

HUMAN RESOURCES DIVISION CHIEF TUCKER: Yes, Mr. Chair. We'll bring the policy back in June.

CHAIRPERSON PACHECO: Thank you. And that will be it for this particular motion.

I'd like to take five minutes until we move to the next item, or actually maybe -- no, or 10 minutes, or do you want to -- do you need -- do we need a break or no.

There's no -- I guess we don't need a break, so we'll move on to the next item on the agenda, which is the information agenda item, the annual review of the 2023-2024 incentive matrix.

Ms. Tucker, please.

HUMAN RESOURCES DIVISION CHIEF TUCKER: Thank you, Mr. Chair. Thank you, members of the Committee. Item 6a is an information item. To comply with the Board's policy, incentive metrics are reviewed annually by the Board's primary compensation consultant, GGA. GGA will present their initial analysis and observations on the incentive metrics for the Committee's consideration and discussion. Based on the Committee's feedback, they'll return in June of 2023 with final recommendations for implementation in fiscal year 23-24. Final Board-approved metrics will be included in some combination on incentive plans for eligible executive and investment management positions.

That does conclude my opening remarks and I can invite Mr. Landers and Mr. Kelly to begin their presentation. Thank you.

CHAIRPERSON PACHECO: That would be wonderful. Thank you, Mr. Landers and Mr. Kelly.

(Thereupon a slide presentation).

MR. KELLY: Excellent. Thank you very much.

To start, if I can get the opinion letter up there, or --

CHIEF OPERATING OFFICER HOFFNER: No, it's just in the materials. It's not in the presentation.

MR. KELLY: It's in the materials. Okay. Well, if I can direct everyone's attention to the opinion letter that was in the materials for today's meeting. The first item I'd like to address is the title, which is, "Incentive Metrics Review". And I appreciate everyone's comments on incentives -- their opinions on incentives, the Honorable Member's comment on incentives.

We always advocate that we shy away from the use of the word "bonus". Bonus would, you know, basically indicate that it's almost a right. It's expectation. That it is like, you know, Christmas Vacation, where you expect to get it, it's the end of the year, and you're going to invest in a pool. That's not the case and that's never what we've advocated for any of our clients. We strongly, strongly support objective pay for performance. And this opinion letter is kind of the beginning of the process going into the next fiscal year.

So that being said, in terms of the general background, we're always asked to comment on, you know, is it the right element or the right structure? There's five key elements that are used on an annual basis, one is fund performance, the other is enterprise operational effectiveness, the third is Investment Office performance based on CEM benchmarking against other comparable pension funds, customer service provided to your members, stakeholder engagement to your general stakeholders.

We believe that these five key areas are definitely the areas that you should continue measuring and including in the annual incentive. And so we wholeheartedly approve and support their inclusion in the incentive program going forward.

In terms of a timeline, as Ms. Tucker had pointed out, the next meeting we will be coming forward with specific objective metrics for these elements that would be tested and made fair. So if you recall, what we've done in the past is we've done a historic prevalence assessments of it to make sure that it's both fair from an organizational standpoint, but also fair from an employee standpoint, so that both sides, their views, concerns are being met.

And so that -- that will be the -- in terms of the timeline, that will be the next step we'll be coming forward with objective metrics, similar to the metrics that were provided in the materials for today, which we're -- the objectives -- or the metrics that are being applied to the 22-23 fiscal year will be coming forward with similar metrics for 23-24. Okay. So that being said.

In terms of our specific recommendations, we've broken them down, because part of the recommendations fall under the Boards delegated authority -- Board's authority, and then some of the other recommendations fall under the delegated authority that you appoint to your CEO and her team.

So that being said, the first recommendation we have under the Board's authority is to continue measuring stakeholder engagement. We believe that it is a valued element that should continue to be tracked, but we have recognized that participant engagement has started to dwindle. The first question that was asked of us was around specific groups within the -- your stakeholder makeup and what is fair an objective to include, if, you know, specific groups just aren't responding or if other groups are dominating. And so, you know, we said definitely there's a concern there and we should be looking at possibly just not having a group waiting, but just wait all the responses collectively. So that was the first one.

But then we found out that just the overall participation has continued to dwindle. And so the question is, at what point do you include objective measurements and objective results in something like this, when it really is only recognizing a very, very small portion of your stakeholders. And so the worry there, the concern is that if it dwindles down to such a minimal number or percentage of your stakeholders, it could actually reflect, well, one of two things, because this is what we typically see in participation around these things.

You can get two extremes. It will either overweight everyone who's extremely satisfied and is just so overwhelmed with the -- with the engagement that they've got, that they have to give you great marks, or the exact opposite, people are so upset that they feel compelled to send in a response. Either extremes are not useful, because they're weighted on, you know, specific groups.

So we want to get basically an understanding of what are the metrics, what objectively statistically makes sense to make sure that you're basing these objectives on realistic data that truly is reflective of your overall stakeholder makeup.

And so we -- as I say, our recommendation is to continue to include it, but we will be working with the CalPERS team to come up with some objective numbers that will go into your policy that will say if certain stakeholder groups fall below a certain level or if overall participation falls below this certain level, here is what we would recommend applying that year.

Again, it provides a bit more objective -- more of an objective process for you to follow, but I think it would be much -- it would be fairer for your employees, because it wouldn't be holding them against data that could be misleading. And so that's our concern for the first one.

Any questions on that element?

CHAIRPERSON PACHECO: I do have a question about that. I really do appreciate that comment about the stakeholder engagement. You know, I see this -- we need objective information. I don't want -- as is more commonly out there in the world, you know, when you go to a restaurant and you do the Yelp thing, I don't want us to be using Yelp as our benchmark on these kind of things.

And you never know what's going to be out there. Having some objective data, making it data -- and then also, your comment, regarding having perhaps a floor. You know, that there's a certain minimum that we need in order for something to be statistically valid for us. So I feel those are quite important elements that we need to incorporate and a thought process carried forward. So those are my -- those are comments. Nothing really about that, but I definitely do not want to be Yelp.

Thank you.

MR. KELLY: Absolutely. The second recommendation we have that falls under your Board authority is to continue to support the exclusion of lump sum retirement payments, because the overall operational performance and expenses associated with that includes lump summary retirement payments that you've assumed, through employee that have worked in other State agencies, and now just by virtue them finishing off their careers in CalPERS, you're now obligated to take the full load of that pension obligation.

It's not necessarily fair. It doesn't truly reflect the overall operational performance of your fund. It's just the nature of the migratory opportunities that public employees have, which is fantastic, but it has a negative impact. So what we would never want to happen is for you to shy away from bringing in really good capable people who are in the latter end of their career, because you know it will negatively impact your overall performance. We don't want that.

So we feel that the fairest way to move forward is to take those lump sum payments that you have now adopted and not include them, because then that is truly relfect -- reflective of the operational performance of your organization and not through the historic patterns of employment throughout the state.

Any questions on that one?

No.

CHAIRPERSON PACHECO: I see none.

Continue.

MR. KELLY: Excellent. And the third one for your Board is again to continue the alignment. We recognize that you've gone through the painstaking, but absolutely crucial process of coming up with a new strategy. And that is definitely required of your fund, especially a fund of your size, to continue being that guiding light for your Board and for your staff. And we like the fact that there is direct alignment between the metrics used in your strategy and the metrics used in the incentive plan, and we would just encourage that that direct and philosophy continue to be applied moving forward.

Any questions with regard to that one?

CHAIRPERSON PACHECO: No.

MR. KELLY: In terms of recommendations for the delegated authority of Marcie and her staff, the first one we have is around investment staff, in creating -- increasing the weighting on quantitative performance to 75 percent of their annual incentive performance. And we see -- and again, this is to further reinforce the objective performance of your fund, and the objectives that you're putting forward, and the strategy that you have in place. We feel that the objective metrics help to move that needle, continue to help move that needle, and we would support increasing the weight on the objective side.

We would also recommend the increasing waiting for total fund going from 50 to 65 percent. And that is aligned -- if you recall, the decision that your Board made a number of years ago in terms of focusing solely on total fund, we feel that total fund is a very, very important objective to focus on and it helps to galvanize your entire staff and the Board, because ultimately if you're not getting your actuarial threshold, you're not actually -- you're not mathematically sustainable. Okay. So it's critical that you focus on that. And having a strong weighting on total fund performance is a great way to keep everyone focused on that principal goal of maintaining a sustainable fund for your members.

Any questions on that?

No.

CHAIRPERSON PACHECO: I see no questions.

MR. KELLY: I think I'm preaching to the choir here.

(Laughter).

MR. KELLY: The next one again, we want to maintain consistency and we don't want to continue to belabor the point here, but we still consider that the decision that this Board made a number of years ago to exclude asset class performance was something that is not necessarily aligned to market practice and best practices out there. We understand, as I said before, the philosophy behind it in terms of galvanizing your staff, but we feel that by doing so, two things can happen, one people who are not performing at the level that they could or should are not actually able -- or they're able to basically still retain some level of incentive based on other's performances around them, but more importantly, it's about your high performers --

CHAIRPERSON PACHECO: Um-hmm.

MR. KELLY: -- your stars -- your rock stars that you want to have a -- you want to have a way of recognizing them objectively and recognizing the performance that they've made to their team, to their asset class of their portfolio, and helping to reward them, so that they can stand out within the organization itself and be recognized for the stellar performance that they're putting in above and beyond the people around them. And again, that's part of that pay for performance motivating factor.

So we do recognize that you do have a relatively new CIO who's coming in and is working with the team and has a game plan that she would like to put in place. And so as you saw in our note, we would support the reinsertion or the inclusion of asset class portfolio performance at some point in the future, recognizing that there's some changes that are underway, but we just don't want to stray away from the recommendations that we've always provided this Board. We want to maintain some consistency around that.

Any questions with regard to that?

CHAIRPERSON PACHECO: I see none, so continue on, sir.

MR. KELLY: And finally, the last recommendation we had is for the COO, the CFO, and the General Counsel. Again, we feel that everyone should be focused on, you know, similar principle goals, which is total fund performance. And so therefore, we feel that there should be an element of -- an inclusion of that element within their incentive package to again further focus all efforts. We do recognize that there have been some concerns about that in the past, but we know that there are ways to get around some of the concerns that you've had, and -- but we still think that it's really important to keep everyone focused on the same things. And these are three key roles within your organization that can, you know, continue to help move the overall performance of your organization. So that's why we recommend the inclusion of that element within their incentive plans.

Any other questions?

CHAIRPERSON PACHECO: I see no other questions.

MR. KELLY: The one thing that -- going into the appendices and I won't go into them in detail here, but what I will say is there was a question around the comparasive -- the comparative data that we provided for CalPERS and CalSTRS. Basically, this is something that we typically would have in an appendice -- in the appendices, but we brought this forward, because it was point of conversation in a number of our meetings in the past and we wanted to bring it up front to say that there was some concern around the difference in the compensation design of CalPERS and CalSTRS. And that really, you know, the data shows that CalSTRS is not as qualitatively focused as people would suspect.

Their -- the data that we put together here, and we apologize if there was some confusion, some of the roles in this list no longer exist. There's been some restructuring that has gone on, some reclassification, but we based it on the historic practice and historic application of their incentive plans in these comparative roles.

So that being said, we apologize. There was more substantive footnotes that were included in the appendices in the past, but we deleted those just to be more succinct and precise. And because of that, I think we muddied the waters a bit too much, and we apologize for that. But basically what we're trying to do is show from a historic comparative nature, here's how the rule have been treated in CalSTRS.

CHAIRPERSON PACHECO: I see no questions at all. I just want to -- first of all, Mr. Kelly, I'd like to thank you for this presentation and thank you for these -- for this lively discussion. And I appreciate it very much.

So I would like to now move on to summary of Committee direction.

Mr. Hoffner.

CHIEF OPERATING OFFICER HOFFNER: Thank you, Mr. Chair. The one piece of feedback I did hear from you was making sure we bring back the updated Incentive Comp Plan Policy in the June meeting, which we will by do.

CHAIRPERSON PACHECO: Yes, the adjustments to the base salary ranges, annual --

CHIEF OPERATING OFFICER HOFFNER: Yeah, so we'll make modifications --

CHAIRPERSON PACHECO: Yeah, within the --

CHIEF OPERATING OFFICER HOFFNER: -- to that. And that will be brought back as part of the other agenda items for June.

CHAIRPERSON PACHECO: Very good. Are there any other?

I see none.

I'd know like to open up for public comments. Are there any public comments?

BOARD CLERK ANDERSON: (Shakes head).

CHAIRPERSON PACHECO: No public comments.

So I would like to -- I would to adjourn the meeting and begin the Finance and Administration Committee to begin at 11:10 a.m.

Thank you.

(Thereupon the California Public Employees' Retirement System, Board of Administration, Performance, Compensation, & Talent Management Committee open session meeting adjourned at 10:56 a.m.)

CERTIFICATE OF REPORTER

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 open session 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 21st day of April, 2023.

James F. Peters

JAMES F. PETERS, CSR
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