



GLOBAL  
GOVERNANCE  
ADVISORS

# Opinion Letter

May 18, 2023

## Annual Incentive Plan Metrics & Additional Considerations

Prepared for:

Performance, Compensation & Talent  
Management Committee

400 Q Street  
Sacramento, California 95811



California  
Public Employee  
Retirement  
System

Peter Landers  
Senior Partner  
Global Governance Advisors

[peter.landiers@ggainc.com](mailto:peter.landiers@ggainc.com)  
416.799.6640  
ggainc.com

Brad Kelly  
Partner  
Global Governance Advisors

[brad.kelly@ggainc.com](mailto:brad.kelly@ggainc.com)  
416.707.4614  
ggainc.com



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 2023-2024.

## 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 (both Total Fund and Asset-Class based)
- Enterprise Operational Effectiveness
- Investment Office CEM Results
- Customer Service
- Stakeholder Engagement

CalPERS continues to use these metrics but, in recent years, proactively set adjusted performance expectations for the Total Fund, Customer Service and Stakeholder Engagement metrics. In Fiscal Year 2019-2020, CalPERS changed the objectives for investment team members to solely focus on Total Fund performance and not place any weighting on Asset Class performance or Individual investment performance. The additional 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.

## Summary of GGA’s Assessment

GGA has reviewed the proposed annual incentive metrics for Fiscal Year 2023-2024 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.

While GGA is comfortable with the proposed annual incentive metrics and performance expectations, upon further analysis, GGA recommends a change in the methodology surrounding the measurement of Stakeholder Engagement performance. It is unclear why, but in recent years CalPERS has been receiving lower response rates from certain stakeholder groups to the point that there is some concern over the relevancy of the results in determining performance under the Annual Incentive plan. GGA has examined this further with CalPERS’ Survey and Research team and the results as a whole are considered reliable and within typical market norms in terms of response rates. That said, the setting of a minimum response rate threshold with which to base performance results is warranted to ensure the statistical validity of Stakeholder Engagement results in determining Annual Incentive payouts on a go forward basis. In addition, GGA feels there is merit at reviewing in more detail the response profile of Stakeholder Engagement results during the 2023-2024 fiscal year and considering

the use of a weighted approach to calculating the Stakeholder Engagement results based on each of the different stakeholder groups (e.g., retirees, active members, employers etc.). This analysis would include back-testing of historical performance results under the current calculation formula against the results of an updated formula that would apply specific weights to the results from different stakeholder groups, which may lead to the setting of updated performance expectations under the new methodology. This work may also lead to the establishment of a minimum response rate threshold for each stakeholder group measured for them to be included in the final scoring results.

Provided below are details surrounding GGA’s exact recommendations for the proposed annual incentive metrics for Fiscal Year 2023-2024.

## Corporate Performance Metric Review Details:

### Metric #1: Total Fund Performance

#### NO CHANGE FOR FISCAL YEAR 2023-2024

This metric is based on fund performance against the policy benchmark for the five-year period of July 1, 2019 through June 30, 2024. Payout ratio for intermediate results will be determined by interpolation.

Performance (bps)	Payout Ratio
+10	1.50 (150%)
+5	1.00 (100%)
0	0.00 (0%)

The rationale and historical analysis that led to the performance expectations outlined above were discussed in detail in advance of fiscal year 2022-2023 based on GGA’s assessment of the historical performance of CalPERS’ Total Fund and typical minimum performance levels expected by pension fund stakeholders.

**Metric #2: Enterprise Operational Effectiveness**

**NO CHANGE FOR FISCAL YEAR 2023-2024**

This metric for 2023-24 is defined as Overhead Operating Costs as a percentage of Total Operating Costs (“OOC”).

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

Score	Payout Ratio
< -1.1%	1.50 (150%)
-1.1% to < -0.6%	1.25 (125%)
-0.6% to 0.0%	1.00 (100%)
> 0.0% to 1.0%	0.75 (75%)
> 1.0% to 1.5%	0.50 (50%)
> 1.5%	0.00 (0%)

Technical changes in terms of the inclusion/exclusion of certain costs in the calculation of OOC were made for Fiscal Year 2023-2023 and will continue moving forward.

**Metric #3: Investment Office CEM**

**NO CHANGE FOR FISCAL YEAR 2023-2024**

This metric for Fiscal Year 2023-2024 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 0.2% and 5 bps, respectively	1.50 (150%)
Outperforms US Benchmark on Returns <b>and</b> Cost by .001% and 1 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 2023-2024**

This metric for Fiscal Year 2023-2024 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
≥ 96%	1.50 (150%)
95% to < 96%	1.25 (125%)
94% to < 95%	1.00 (100%)
93% to < 94%	0.75 (75%)
92% to < 93%	0.50 (50%)
< 92%	0.0 0%)

**Metric #5: Stakeholder Engagement**

**NO MATERIAL CHANGE FOR FISCAL YEAR 2023-2024**

This metric for Fiscal Year 2023-24 is based on results of the following three Stakeholder Engagement Survey questions:

- Is CalPERS sensitive to the needs of Stakeholders?
- Does CalPERS do a good job of keeping its stakeholders informed?
- On a scale of one to ten, how would you rate CalPERS being effective in engaging and communicating with stakeholders?

Score	Payout Ratio
≥ 83%	1.50 (150%)
81% to < 83%	1.25 (125%)
80% to < 81%	1.00 (100%)
79% to < 80%	0.75 (75%)
78% to < 79%	0.50 (50%)
< 78%	0.00 (0%)

GGA notes recent concerns about the number of responses provided by respondents in totality through Stakeholder Engagement questions. It is GGA's recommendation that CalPERS set a threshold response rate at 5% or higher to ensure meaningful results are determined in this area. This rate is a commonly observed minimum rate of response received for online, e-mail-based surveys in the market. In the case of CalPERS, a 5% response rate would still result in receiving a sufficient breadth of survey responses which is felt to be a material number with which to gauge performance in this area. In the event a 5% overall response rate is not achieved, GGA would recommend that Stakeholder Engagement results not be included in the Annual Incentive calculation and its respective weighting distributed equally over the four (4) remaining metrics. From GGA's understanding of historical trends at CalPERS, an overall response rate below 5% is highly unlikely to occur, which means the probability of re-distributing the weighting on this metric within the Annual Incentive calculation is low.

During Fiscal Year 2023-2024, GGA will work with CalPERS' Stakeholder Relations and Policy Research & Data Analytics teams to analyze alternative weighted approaches to calculating Stakeholder Engagement performance results. This process will assign specific weightings to different stakeholder groups within the historic data calculations as opposed to the current approach which aggregates responses from all stakeholders into one collective score. GGA will work with the CalPERS teams to identify an ideal methodology and any proposed changes coming out of this analysis will be recommended for adoption, starting in Fiscal Year 2024-2025.

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 within this letter, please let us know.

Sincerely,

**Global Governance Advisors**



Peter Landers  
Senior Partner



Brad Kelly  
Partner

cc: Karen Van Amerongen, CalPERS