



Performance, Compensation & Talent Management Committee

Agenda Item 5a

June 12, 2024

Item Name: Annual Review: 2024-25 Incentive Metrics

Program: Administration

Item Type: Action

Recommendation

Approve incentive metrics for fiscal year 2024-25 as presented by the board's compensation consultant, Global Governance Advisors.

Executive Summary

This item presents recommendations from the Board's Primary Executive and Investment Compensation Consultant, Global Governance Advisors (GGA), for fiscal year 2024-25 incentive metrics for executive and investment management positions. Metrics include Total Fund Performance, Enterprise Operational Effectiveness, Investment Office CEM, Customer Service, and Stakeholder Engagement. Incentive metrics are reviewed annually by the Performance, Compensation, and Talent Management Committee (Committee). GGA will present their recommendations for the Committee's consideration as a follow-up to the information they presented at the April 2024 meeting. Final Board-approved incentive metrics will be included in some combination on incentive plans for eligible executive and investment management positions.

Strategic Plan

This agenda item supports CalPERS' Strategic Goal to cultivate a risk-intelligent and innovative culture through our team and processes in the 2022-27 Strategic Plan. The Executive and Investment Compensation Program provides a means for recruiting, retaining, and empowering highly skilled executive and investment management professionals to meet the Board's organizational priorities.

Background

In August 2016, the Board approved five shared organizational metrics, including: Total Fund Performance, Investment Office CEM, Customer Service, Stakeholder Engagement, and Enterprise Operational Effectiveness. Some combination of these metrics has been included on the incentive plans of covered executive and investment management positions, as well as

other senior leadership positions since fiscal year 2016-17. As part of the initial implementation plan, it was recommended the metrics be reviewed annually and adjusted, if necessary, for the subsequent fiscal year.

For fiscal years 2018-19 and 2019-20, the Committee approved scoring threshold adjustments for the Stakeholder Engagement metric to align with Key Performance Indicator (KPI) aspirations. Also, for fiscal year 2019-20, the Committee approved a change to extract Board and Third-Party Administrator Costs from the data used to calculate the outcome for the Enterprise Operational Effectiveness metric.

For fiscal year 2020-21, the Committee approved retaining the metrics from fiscal year 2019-20 with no changes, and for fiscal year 2021-22, they approved slight scoring threshold changes to the Customer Service and Stakeholder Engagement metrics. At that time, GGA suggested the Committee consider potential future changes to the fund performance hurdle rates to address payout levels for performance below the relative benchmark.

For fiscal year 2022-23, the Committee adjusted the performance hurdles for Total Fund Performance to provide a narrower range between threshold and maximum performance. The Committee also directed annual lump sum retirement payments to be excluded from the calculation of overhead costs when measuring Enterprise Operational Effectiveness performance and aligned to the CalPERS Strategic Plan.

For fiscal year 2023-24, the Committee approved retaining the scoring and payout ratios from fiscal year 2022-23 for all five of the incentive metrics. The Committee also set an overall response rate of 5% for the Stakeholder Engagement metric to ensure meaningful results are determined for incentive purposes. In the event a 5% response rate is not achieved, results will not be included in the annual incentive calculation and its respective weighting will be distributed equally over the remaining metrics on each impacted participant's respective plan.

Analysis

Based on GGA's review of the existing incentive metrics and input from the Committee at the April 2024 meeting, GGA will present their recommendations today for fiscal year 2024-25 incentive metrics for executive and investment management positions. Their analysis and recommendations are discussed in their opinion letter, included as Attachment 1.

For fiscal year 2024-25, GGA is recommending minor adjustments to the following metrics: Enterprise Operational Effectiveness, Investment Office CEM, Customer Service, and Stakeholder Engagement. These recommended adjustments are intended to align performance expectations with probabilities of attainment over time, ensuring performance hurdles are set at a challenging yet reasonable level for plan participants while ultimately ensuring a high level of performance for CalPERS stakeholders.

Budget and Fiscal Impacts

CalPERS' 2024-25 Authorized Budget includes \$37.1 million for annual incentive awards and \$10.4 million for long-term incentive awards. This amount is an estimate based on budgeted salaries and the 2022-23 metric outcomes. In fiscal year 2022-23, actual annual incentive awards paid across all incentive programs was approximately \$19 million. Actual incentive

payouts are subject to several factors (e.g., metric outcomes, fund performance, and individual performance) and cannot be quantified until after the end of the fiscal year.

Benefits and Risks

The incentive metrics were intended to be reviewed annually for incentive compensation purposes. The Committee's annual review of these metrics ensures incentive goals are aligned with the Board's organizational priorities for executive and investment management teams. Without a periodic and systematic review, there is a risk of misalignment with the overarching goals of the organization.

Attachments

Attachment 1 – Incentive Metrics Review for Fiscal Year 2024-25 by GGA

Michelle Tucker, Chief
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