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# Long-Term Incentive Plan Design Discussion

March 2021

Prepared for:

**CALSTRS**<sup>®</sup>  
HOW WILL YOU SPEND YOUR FUTURE?

# Key Themes from 2019 Board Session on Compensation Policy

Recognize internal equity issues and look to improve over time

Collaborative model requires entire organization to work together

Success needs to be linked to investment returns, but also cost savings & sustainability

Need to use more Quantitative measures to measure performance

When moving to collaborative model, a Long-Term Incentive Plan should be considered

# Rationale for Adopting a Long-Term Incentive Plan at CalSTRS

Positions compensation more competitively

Can be tied to long-term investment returns

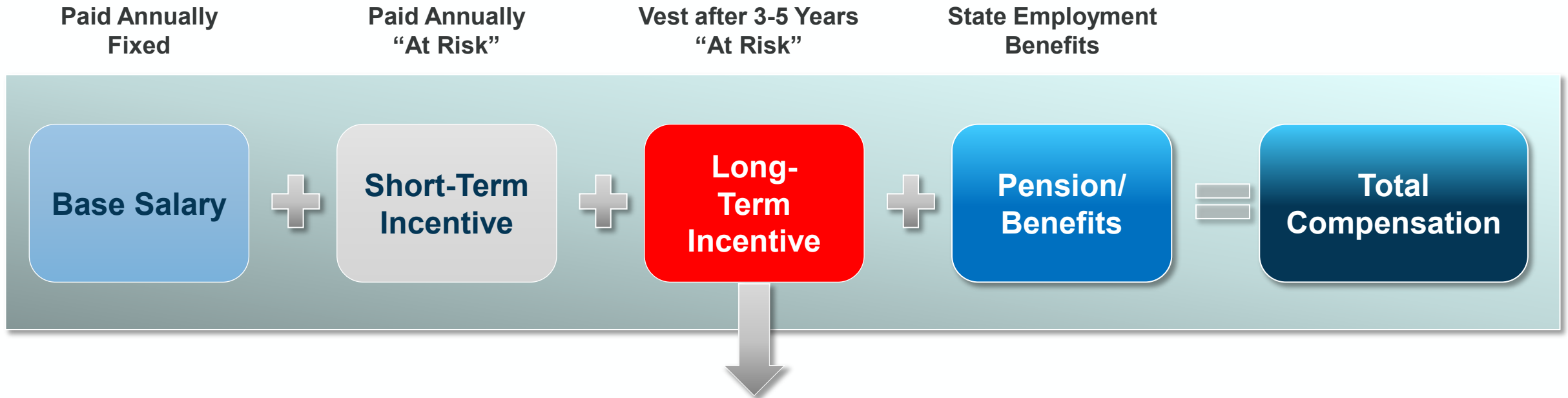
Can be tied to collaborative model cost savings

Better enables CalSTRS to compete for talent it needs under collaborative model

Assists during market downturns and “black swan” events

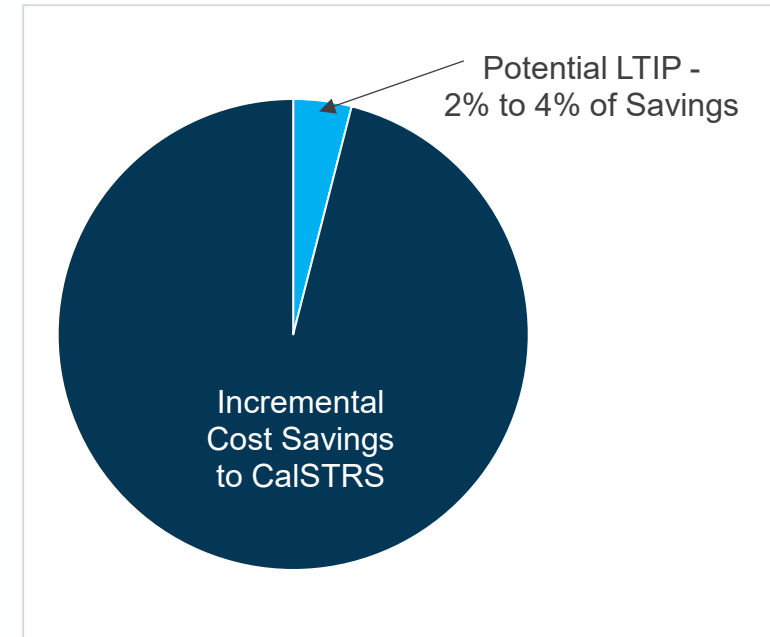
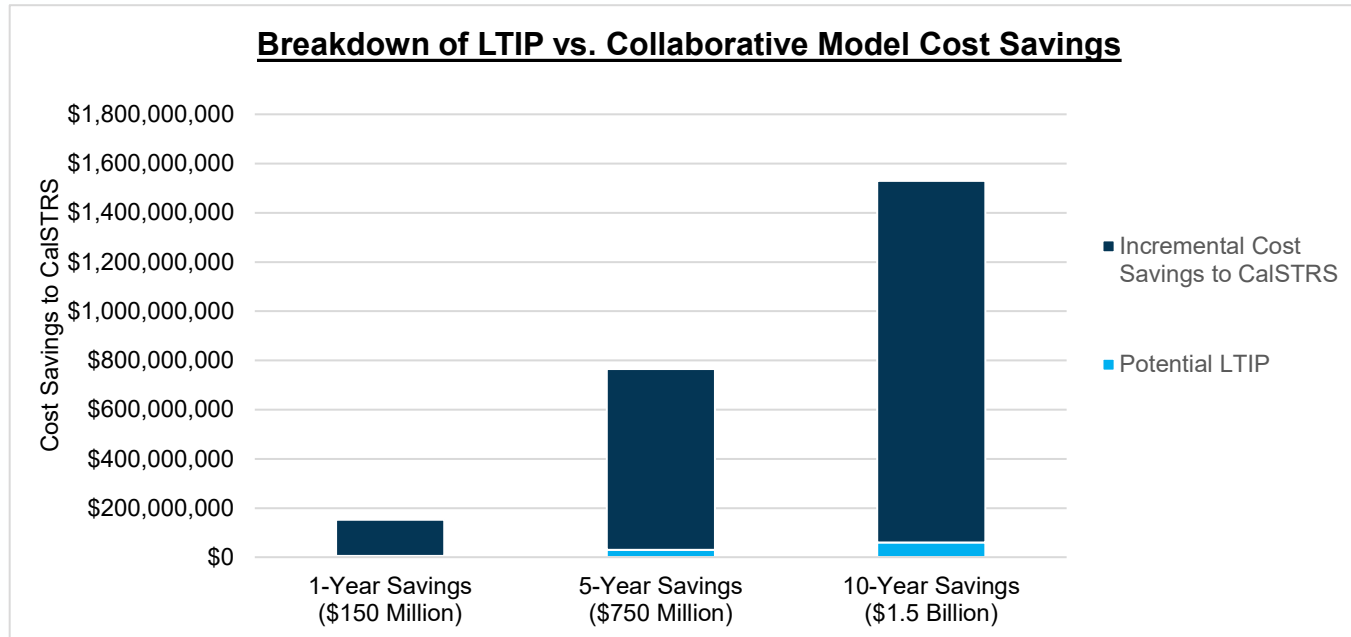
Assists in Closing the Funding Gap by Reducing External Compensation Costs

# Typical Compensation Structure in Marketplace



CalSTRS' Board has been assessing for some time whether a Long-Term Incentive, which is utilized by many organizations in its peer group(s), should be introduced. Postponing the LTIP will increase the opportunity cost of not implementing the collaborative investing model sooner with the necessary talent.

# Sharing of Cost Savings under Collaborative Model



## Estimated External Compensation Cost Savings of \$1.5 Billion over 10 years

It is typical to share a small portion of cost savings with professionals who helped achieve those savings.

\* Typical market practice for LTIPs at pension funds is to only base the design off Total Fund Value Add Returns.

# GGA's Recommended LTIP Design for CalSTRS

GGA recommends that CalSTRS adopt a Long-Term Incentive Plan ("LTIP") with the following features:

- Performance period of **4 years**.
- LTIP opportunity provided on an **annual** basis starting with the 2021-2022 fiscal year to cover subsequent 4-year period.
- Performance is measured in **2 areas** over the 4-year performance period:
  1. Absolute Total Fund Return Performance (4-year rolling average)
  2. Savings from Collaborative Model
- Actual LTIP payouts can range from **0% to 100% of Maximum** incentive opportunity.
- If staff achieves performance goals, **payout will not be made until after FY2024-2025.**

The LTIP design recommended above best meets CalSTRS' needs by:

- Taking into account the feedback of the CalSTRS Board.
- Keeping the plan simple to communicate and administer.
- Tying LTIP payouts directly to cost savings and absolute return performance of Total Fund.
- Providing a plan design that is tailored for CalSTRS, but still defensible when compared to market.

# Long-Term Incentive vs. Short-Term Incentive

	Year 1	Year 2	Year 3	Year 4	Year 5
Short-Term Incentive	Performance Period	Paid Based on Performance			
Long-Term Incentive	Performance Period (Employee Leaves Then No Payout)				Paid Based on Performance

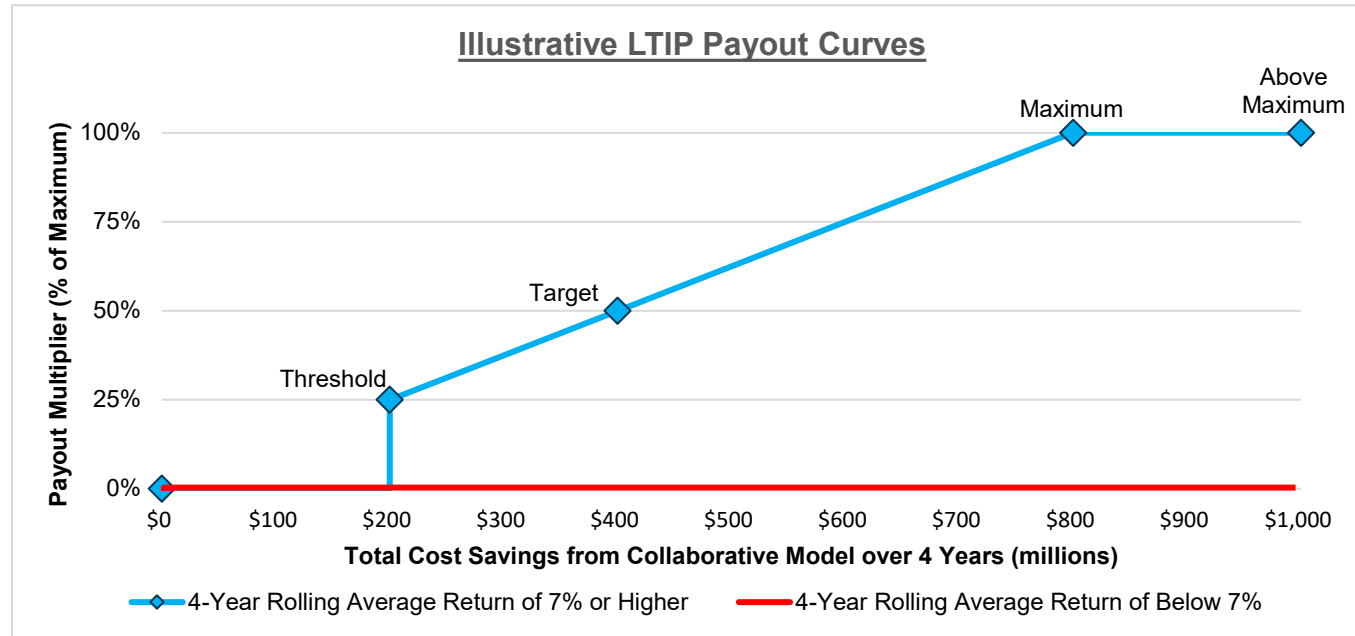
## Short-Term Incentive:

- Focus short-term objectives
- Use minimum of 3 to 5 performance measures (Total Fund, Asset Class, Individual)
- Paid out annually at the end of each year based on performance

## Long-Term Incentive:


- Focus key employees on longer-term objectives
- Use 1 to 2 performance measures (Total Fund)
- Paid out at the end of a 3 to 5 year period based on performance

# Illustration of LTIP Payout Curve



The graph above illustrates the payout multipliers associated with different levels of savings. If the 4-Year Rolling Average Total Fund Return is Below 7%, there is NO PAYMENT.





# Q&A



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