



Regular Meeting

Item Number 13 – Open Session

Subject: Benchmarking Review Project

Presenter(s): Melissa Norcia/Stephen McCourt and Allan Emkin, Meketa Investment Group

Item Type: Information

Date & Time: January 28, 2022 – 30 minutes

Attachment(s): Attachment 1 – Benchmark Overview

PowerPoint(s): Benchmarking Review Project

PURPOSE

The purpose of this item is to provide the board with an overview of investment benchmarking, per the request of the Investment Committee. This report, combined with the accompanied presentation, will focus on three areas pertaining to benchmarks: (1) existing CalSTRS benchmark governance, (2) public pension peers, and (3) board survey results.

BACKGROUND

At the September 2018 Investment Committee meeting, the committee requested board education on benchmarks. [At its January 2019 meeting](#), staff presented [Benchmark Education – Part One](#). This report and presentation discussed in detail the following items: (1) the different uses of benchmarks to evaluate and measure performance and risk of investments, (2) the selection process and implications of benchmarks, (3) the properties of appropriate benchmarks, (4) the major types of benchmarking methods, (5) customizing benchmarks, (6) governance and roles, (6) challenges with benchmarks and (6) the breadth of benchmarks used by CalSTRS.

At the September 2021 Investment Committee meeting, the committee requested Meketa Investment Group to present by the end of the 2021-22 fiscal year an overview of investment benchmarks, including their suggestions and recommendations.

DISCUSSION

CalSTRS Benchmark Governance

As outlined in the Investment Policy and Management Plan, the general investment objectives designed a framework for the operation of the investment function. The performance objectives can be divided into three components: (1) performance objectives for the overall Investment Portfolio, (2) performance objectives for each asset class, and (3) performance objectives for the individual investment managers within each asset class. CalSTRS incorporates all three levels of analysis in its monitoring of the investment portfolio performance. This includes identifying a comparative benchmark that reflects CalSTRS' unique asset allocation policy.

As outlined in the Compensation Policy's [Administrative Procedures](#), the incentive pay plan is intended to: reinforce the System's investment, governance, and compensation philosophies and objectives; help CalSTRS attract, motivate, and retain top-performing executives and investment staff; align incentive payouts with overall System, functional area, and individual performance, and to focus staff on key investment objectives/benchmarks that are measured on a long-term basis. The incentive plan's quantitative performance components focus on actual relative investment performance (net of fees) at the Total Fund and Asset Class levels compared with external benchmarks.

Discussion related to new benchmarks or changes to existing benchmarks starts within the Investment branch. Staff engage with Performance and Compliance teams on policy revisions related to strategy implementation and new benchmarks to ensure transparency and alignment to Board policies. Investments' governance requires review of benchmark analysis and approval by the asset class Director, Chief Investment Officer and Deputy Chief Investment Officer prior to receiving the consultant's independent opinion for the Board item. Only authorized Investment Services' staff in the Performance team can instruct the custodian on benchmark changes. Internal controls and oversight within the Investment branch require Board approval prior to implementation.

For the purposes of compensation, any Investment Policy changes to portfolio benchmarks are then presented to the board to establish quantitative performance measures at the Total Fund level to be adopted into the Compensation Policy's Administrative Procedures. Pursuant to the Chief Executive Officer's delegated authority, any Investment Policy changes to portfolio benchmarks at the Asset Class level are presented to the CEO to establish quantitative performance measures, (in consultation with the board's compensation consultant, and or investment consultants, and CIO where appropriate) to be adopted into the Compensation Policy's Administrative Procedures.

An illustrative example of how benchmarks impact annual incentive compensation for staff in Private Equity is as follows:

Criteria	Weight	Performance Measure	Scale
Asset Class Private Equity Portfolio alpha (net of fees)	50%	Return of the total Private Equity portfolio less the policy index lagged one quarter. <ul style="list-style-type: none"> Fund: TC00A67 Index: STRSPEC 	Zero basis points to a maximum of 70 basis points.
Total Fund Total CalSTRS Portfolio Return (net of fees)	30%	Total portfolio return less the total fund benchmark return, weighted at the target asset allocation, recalculated at fiscal year-end: <ul style="list-style-type: none"> Fund: Total Fund, TC00A1CP Index: Total Fund Index: STRT01 	Zero basis points to a maximum of 40 basis points.
Qualitative Personal Performance	20%	Comprehensive annual review of personal performance factors	Assign a factor rating of zero to 1.
Originates in Investment Committee	Adopted by Board		Approved by CEO

Stephen McCourt and Allan Emkin, of Meketa Investment Group will provide an update on the board’s request to conduct an overview of investment benchmarks. They will facilitate board discussion on comparative benchmarks and their use in monitoring investment performance and their use as measures in determining annual incentive compensation. Meketa provides a benchmark overview in Attachment 1.

CONCLUSION

Key themes from today’s discussion will be used to assist the board in its oversight of the benchmark program and to determine if changes to the benchmark and/or compensation program are warranted to ensure alignment with key objectives of the organization.

NEXT STEPS

Based on today’s discussion, feedback, and direction from the board, recommendations will be brought to the board at a future meeting.