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Compensation Policy Interview Themes & Preliminary Recommendations

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Josh Wilson
Susan Lemke

Introduction & Context

CalSTRS partnered with Mercer to review and refresh the compensation policy:

- Covering **investment and executive management staff**
- Encompasses the comparator groups used, desired pay positioning, pay mix, and the process for determining salary range adjustments and proposed salary increases for covered roles
- Policy has not been comprehensively reviewed in over 15 years

As part of the review, Mercer conducted interviews to gather input on potential refinements to the current policy:

- **18 interviews** lasting 45 minutes to 1 hour
- Included **all board members,** select **members of management,** and two **outside advisors** with unique insights

This presentation summarizes:

- **Key themes** emerging from those discussions
- Mercer's **preliminary recommendations** for further consideration

	Interviewees
BOARD	Management
	Karen Yamamoto
	State Controller's Office (Deborah Gallegos)
	Michael Gunning
	Sharon Hendricks
	Steve Juarez
	Harry Keiley
	State Treasurer's Office (Patrick Henning)
	Department of Finance (Michele Perrault & Jennifer Whitaker)
	Ken Tang
	State Superintendent of Public Institutions (Geqigula Dlamini)
MGMT	Cassandra Lichnock
	Scott Chan
	Melissa Norcia
	Brian Bartow
	Kristel Turko
Other	Amy McDuffee (Mosaic Governance Advisors)
	Stephen McCourt (Meketa Investment Group)

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Key Interview Themes

Policy Document Structure

Improvement of Overall Efficiency & Clarity of Policy Document

- Viewed as comprehensive but overly long and difficult to navigate / understand
- Roles, responsibilities, and decision-making authority should be more clearly defined

Compensation Philosophy

Preferred Approach for Comparator Groups & Weighting Unclear

- Views were mixed on the preferred comparator group approach (i.e., one vs. two) and public vs. private weighting methodology (e.g., 50/50 for investment staff and 67/33 for executive management staff)

Market Median Positioning

- General support for maintaining market median positioning, with flexibility, for base salary and total cash compensation
- Total Cash Compensation vs Total Compensation(include long-term incentives or not) and how benefits would be factored in

Salary Management

Two-Year Salary Review & Interim Adjustments

- Stakeholders supported maintaining two-year cadence for formal salary reviews
- Broad support for allowing interim salary range adjustments in off years

Relocation Reimbursements

- Stakeholders supported reviewing current relocation reimbursement policy, as the costs are unpredictable, can be expensive, and are administratively cumbersome in paperwork and processing time

Incentive Plan

Effective but Needs Clarity

- Generally functions well and supports broad participation during strong fund performance, but needs clearer policy language and communication
- Impact of move toward total fund approach should be considered
- Mixed views on the necessity of the triggers

Proposed Recommendations – for Discussion (1 of 2)

Key Interview Themes

Policy Document Structure

Improvement of Overall Efficiency & Clarity of Policy Document

- Viewed as comprehensive but overly long and difficult to navigate / understand
- Roles, responsibilities, and decision-making authority should be more clearly defined

Recommendations

- Addition of an executive summary
- Separate incentive plan section from policy
- Highlight key decision points for board
- Establish clear governance and sequencing

Compensation Philosophy

Preferred Approach for Comparator Groups & Weighting Unclear

- Views were mixed on the preferred comparator group approach (i.e., one vs. two) and public vs. private weighting methodology (e.g., 50/50 for investment staff and 67/33 for executive management staff)

Market Median Positioning

- General support for maintaining market median positioning, with flexibility, for base salary and total cash compensation
- Less certainty around total compensation positioning (base salary + incentives including both short- and long-term) and how benefits would be factored in

- Retain two comparator groups to recognize difference in market of talent
- Reconfirm the public vs. private weighting approach, considering the associated trade-offs
- Clarify policy language to establish market median as the baseline for base salary and total cash compensation
- Consider using language such as “around median” or “median as the basis for compensation” to preserve flexibility based on performance, market conditions, and strategic priorities
- Consider defining a target positioning for total compensation (base salary + incentives including both short- and long-term), potentially at a lower percentile (e.g., 25th percentile) given the inclusion of long-term incentives within the market

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Proposed Recommendations – for Discussion (2 of 2)

Key Interview Themes

Salary Management

Two-Year Salary Review & Interim Adjustments

- Stakeholders supported maintaining two-year cadence for formal salary reviews
- Broad support for allowing interim salary range adjustments in off years

Relocation Reimbursements

- Stakeholders supported reviewing current relocation reimbursement policy, as the costs are unpredictable, can be expensive, and are administratively cumbersome in paperwork and processing time

Incentive Plan

Effective but Needs Clarity

- Generally, functions well and supports broad participation during strong fund performance, but needs clearer policy language and communication
- Impact of move toward total fund approach should be considered
- Mixed views on the necessity of the triggers

Recommendations

- Retain two-year cadence of formal salary reviews
- Allow for automatic adjustments to salary ranges in the off years based on market increase data or a steady index
- Consider incorporating a flat amount for relocation into the recruitment pay differential for more predictability of costs and reduced administrative burden

- Use plain, consistent language throughout the policy and consider adding summary tables to clearly outline executive compensation eligibility and adjustment provisions
- Defer any changes to total fund vs. asset class weighting until the total fund approach has been implemented
- Remove triggers to avoid unintended action by future Board members, as the existing plan already serves as a safeguard by adjusting payout based on performance and providing the Board the discretion to make other payout adjustments if needed

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Next Steps

- Board to discuss and consider Mercer’s preliminary recommendations
- Guidance received will be used to develop updated policy language and document for review and approval at upcoming meetings

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Appendix

Detailed Interview Findings (1 of 2)

Topic	Key Themes
People & Talent	• **Talent attraction & retention are critical:** CalSTRS must recruit and retain highly skilled investment and executive management staff to deliver on complex strategies, keeping in mind notable racial and ethnic diversity shortfalls within investment teams; this is complicated by pay disparities caused by classifications/legislation, market competition (especially private sector), and public scrutiny of high pay for investment/executive management staff • **Culture & total rewards sustain retention even where pay lags:** mission, strong benefits, stability, internal career paths and work/life balance drive low turnover; compensation (base + incentives) matters for recruiting/retention, particularly at senior investment level, but is typically one of several motivators
Competitive Market & Comparator Design	• **Designated Investment Staff:** broad acceptance of the current comparator set, but no clear consensus on public vs. private weighting – Views range from ~50/50 public/private to heavier public weighting (align with large U.S. public investment funds) or heavier private weighting (private firms seen as the most direct competitor for senior investment talent) – Views are mixed on inclusion of Canadian investment funds (recruitment linkages with Canada vs divergent pay practices) – CalSTRS needs to consider trade-offs amongst different weighting options: 50/50, 60/40, 70/30, 75/25 or matching the Executive Management split (67/33) for consistency and simplicity • **Designated Executive Management Staff:** primary reason to make changes would be to align with the Investment Staff to avoid inconsistency – Additional comparators to consider may include public pensions, major CA public entities and municipalities with similar construct/complexity and an investment arm (e.g., Earthquake Authority and Workers Comp), and higher education institutions with comparable governance/compensation packages (e.g., University of California institutions, Stanford, etc.) • **Unified comparator group approach:** some interest expressed in a unified, transparent framework with role-specific sub-pools and explicit weights – Investment sub-pool tilt toward private firms and large U.S. institutional investors; executive sub-pool tilt toward public pension peers and CA public-sector comparators – Caution around geography/recruitment risk in weighting or positioning, use of endowments/foundations for executive comparators given different pay structures, and use of any Canada/international comparators (ensure clear rationale) • **Market positioning:** target market median with flexibility – Target base pay and total cash at the market median as a baseline, while including policy language that permits deviation based on performance, market conditions, and strategic priorities – Allow a guardrail option to position total compensation (base salary + incentives including both short- and long-term) lower (e.g., 25th percentile) given the inclusion of long-term incentives and deferrals within the market – Consider inclusion of policy language such as “around median” or “use median as basis of compensation”

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Detailed Interview Findings (2 of 2)

Topic	Key Themes
Salary Review & Structures	• **Two-year salary review with interim adjustments:** maintain a two-year cadence for formal salary reviews with automatic adjustments to salary ranges in the off years based on market movement. This approach will minimize the gap to market between full reviews and avoids overburdening the board with an annual salary study • **Relocation Reimbursements:** support for reviewing current relocation reimbursement policy, as the costs are unpredictable, can be expensive, and are administratively cumbersome in paperwork and time it takes to process
Incentive Plan	• **Effective but needs clarity:** the incentive plan generally functions well and supports broad participation during strong fund performance, but needs clearer policy language and communication to ensure consistent application and understanding – Preference for incentive structures that emphasize collective success across the entire fund rather than asset-class silos – Interest expressed in aligning to CalPERS approach including developing long-term incentive plans to align with sustained organizational goals • **Shift towards total fund approach ("One fund approach"):** CalSTRS is piloting the idea to move real estate, risk mitigation and SISS weighting towards total fund in July 2026 with the intention of the full plan to kick in July 2027 – Qualitative measures are valued but raise issues around subjectivity, leadership discretion, and the need for clear controls and communication about expectations – Opportunities for refinement and expansion by increasing the weight of quantitative measures tied to customer service and benchmarking as incentives grow, incorporating diversity metrics as qualitative factors, and exploring structured incentive pools with constrained discretion to balance reward distribution • **Triggers & governance:** mixed views on necessity and complexity around when they should be used causing confusion and unintended action by new Board members

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