



December 22, 2021

Prabhu Palani
Chief Investment Officer
San Jose Office of Retirement Services
1737 N 1st Street, 6th Floor
San Jose, CA 95112

Prabhu:

Following up on our call, this letter describes how McLagan can help the City of San Jose's Retirement System ("San Jose") review its CEO and Investment Department's compensation program. In particular, this letter describes McLagan's proposed approach to helping San Jose and the project's estimated timing and fees. If you have any questions or suggestions about this letter, please do not hesitate to contact us.

Project Objectives

Based on our discussion, we understand that San Jose would like to complete a holistic review of the competitiveness and appropriateness of the CEO and Investment Department's compensation program. More specifically, San Jose would like to ensure that:

- Individual pay levels are aligned with the competitive market.
- The pay program is considered fair, reasonable and appropriate by key Board and employee stakeholders.
- The pay program reflects market best practices relative to incentive plan design.
- The pay program continues to help San Jose attract, retain, and motivate qualified investment talent.

Project Approach

This project has four broad steps:

1. Review Background Material & Conduct Interviews

First, McLagan would learn more about San Jose, its pay program, and the roles and responsibilities of each investment position by:

- Reviewing background material, including: organization charts, job descriptions (if available) and employee census data.
- Interviewing key management stakeholders to learn more about:
 - San Jose's investment strategy and its operating approach and culture.
 - San Jose's HR strategy, including, but not limited to, San Jose's approach to recruiting, staff development and performance management.
 - The desired features of any future incentive plan. For example:
 - To what extent should performance focus on relative versus absolute returns? And, should these measures focus on portfolio, asset class or total fund results?
 - To what extent should the incentive plan include discretionary/qualitative components?
 - To what extent should San Jose implement a compensation philosophy with a structured compensation comparator group?



- Where on the competitive continuum should base salary and, if applicable, future incentive compensation levels be targeted? At the median? At the upper quartile?
- How, if at all, should the compensation program be impacted by absolute returns?
- The roles and responsibilities of San Jose's investment positions. That is, we would meet with management to learn about the roles, responsibilities, knowledge and skill requirements, and expected experience of individual San Jose investment positions. These learnings would help McLagan confirm survey benchmark job descriptions for as many investment positions as possible.

2. Prepare and Present a Summary Report Focusing on Compensation Philosophy & Plan Design

Based on input from the interviews and our knowledge of competitive market practice, McLagan would draft and present an outline report that identifies:

- Gaps, if any, between: (a) San Jose's current pay program; (b) stakeholders' program objectives; and (c) competitive best practices.
- Education for the Board on a typical incentive plan within other US Public Funds.
- On a conceptual level, pay design and/or pay philosophy alternatives that would incorporate the use of an incentive plan. For each of these plan alternatives/concepts, we would identify the:
 - Key design features/mechanics.
 - Relative advantages and disadvantages.

Using our initial report as a basis for discussion, McLagan would facilitate a working session of key stakeholders to (1) review our findings and (2) identify optimal changes, if any, to the Investment Department pay program.

During this working session, McLagan would:

- Work collaboratively to identify the optimal pay program for San Jose – which likely reflects combinations and permutations of the proposed changes.
- Answer questions about competitive pay approaches. That is, based on our work with other leading public funds, endowments and foundations, and asset management firms, we could readily comment on how any of the possible program modifications compares with competitive market practice.

3. Competitive Pay Level Analysis

To help San Jose assess the competitiveness of its CEO, CIO and investment professional's pay levels, McLagan would:

- Help identify and/or confirm benchmark survey position matches for as many positions as possible (i.e., by reviewing job descriptions and through discussions with San Jose managers).
- Confirm the compensation comparator group or blended compensation comparator group using McLagan's existing survey compensation databases (see Appendix).
- Using the survey matches and comparator groups identified/agreed to above, complete a comprehensive analysis of the competitiveness of San Jose's pay levels. This analysis would include:
 - A detailed incumbent-by-incumbent analysis of pay levels (including base salary and cash incentives). This analysis would show:
 - Each incumbent's survey position match and their actual pay levels.
 - The corresponding 25th, 50th and 75th percentile competitive market data.



- Each incumbent's quartile pay positioning versus the competitive market.
- Detailed analysis of San Jose's pay versus multiple comparator groups.
- Summary analyses comparing San Jose's pay levels to the competitive market on a total spend basis.

4. Prepare and Present Final Report to San Jose's Board

McLagan would prepare and present a final report that includes:

- Proposed pay program changes, if any, resulting from the compensation design working session.
- The results of the competitive pay level analysis.

During our presentation we review our findings and recommendations and respond to questions or suggestions from the Board.

Estimated Timing & Fees

Assuming that we can readily schedule interviews and project meetings, we should be able to complete the work described above by June 2021.

The fees associated with the project described above will not exceed \$70,000. This amount:

- Includes all professional fees and administrative expense.
- Assumes that no more than three to five electronic meetings are required: one/two to conduct the interviews; the second to facilitate the compensation working session; and the third to present our findings.
- Includes two versions of each deliverable: an initial draft and a second draft that includes San Jose's comments and suggestions.
- Excludes work associated with detailed plan design that builds on the final recommendations (e.g., defining performance / alpha target assessment, benchmark review, drafting the revised plan text document, stress/back testing recommended changes, etc.). We should be able to complete the work described above by June. This estimate assumes that we can readily schedule the management interviews and the compensation working session.

* * *



We look forward to the possibility of working with you on this project. Please let us know if you have any questions or suggestions about this letter.

Regards,

A handwritten signature in black ink that reads "Michael Oak".

Michael Oak
Associate Partner

A handwritten signature in black ink that reads "Maureen Reilly".

Maureen Reilly
Director

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Accepted by City of San Jose's Retirement System:

Name, Title

Date

McLagan's 2021 Public Fund Pay Survey Participant List	
Alaska Permanent Fund Corporation	North Carolina Retirement Systems
Arizona State Retirement System	Ohio Public Employees Retirement System
California Public Employees' Retirement System	Oklahoma Public Employees Retirement System
California State Teachers' Retirement System	Orange County Employees Retirement System
Colorado PERA	PA State Employees' Retirement System
Contra Costa County Employees' Retirement Association	Public Employee Retirement System of Idaho
Employees' Retirement Fund of the City of Dallas	Public Employees' Retirement System of Nevada
Employees Retirement System of Texas	Public Schools Retirement Systems of Missouri
Fire and Police Pension Association of CO	School & Institutional Trust Funds Office
Idaho Endowment Fund Investment Board	School Employees Retirement System of Ohio
Indiana Public Retirement System	South Carolina Retirement System Investment Commission
Iowa Public Employees Retirement System	South Dakota Investment Council
Kansas Public Employees Retirement System	State Board of Administration of Florida
Kentucky Teachers' Retirement System	State of Michigan Retirement System
Maine Public Employees Retirement System	State of New Jersey Pension Fund
Maryland State Retirement and Pension System	State of Wisconsin Investment Board
Massachusetts PRIM	State Teachers Retirement System of Ohio
Minnesota State Board of Investment	State Universities Retirement System
Missouri Highway and Trans. Retirement System	Teacher Retirement System of Texas
Missouri Local Government Employees Retirement System	Teachers' Retirement System of Louisiana
Missouri State Employees' Retirement Fund	Teachers' Retirement System of Oklahoma
Montana Board of Investments	Tennessee Consolidated Retirement System
Municipal Employees' Retirement System of Michigan	Texas County & District Retirement System
Municipal Fire & Police Retirement System of Iowa	Texas Municipal Retirement System
Nebraska Investment Council	Utah Retirement Systems
New Mexico Educational Retirement Board	Virginia Retirement System
New York State Common Retirement Fund	Washington State Investment Board
New York State Teachers' Retirement System	West Virginia Investment Management Board
NM State Investment Council	Wyoming Retirement System

Typical Private Sector Firms:

All Private Sector				
	# Firms	12/31/20 AUM (\$Billions)		
		LowQ	Median	HighQ
Investment Management Firms	162	\$14.9	\$53.1	\$218.6
Banks (Investment Management Department)	24	15.8	38.6	88.6
Insurance Companies (Investment Management Departments)	39	26.1	63.1	97.3
Endowments, Foundations, & Corporate Plan Sponsors	54	1.9	3.3	7.2
Corporate Plan Sponsors	11	1.7	6.0	17.6
Total	290	\$7.0	\$28.4	\$101.2