
MEMORANDUM

TO: JOINT PERSONNEL COMMITTEE
FROM: TOM IANNUCCI, CORTEX APPLIED RESEARCH
SUBJECT: CEO/CIO PERFORMANCE EVALUATION METRICS
DATE: JULY 30, 2019

BACKGROUND – SAN JOSE

- The Retirement Boards have each established a policy outlining a process for evaluating the performance of the CEO of the Office of Retirement Services (“ORS”) and have applied them over each of the past several years. To further enhance the above policies, the Joint Personnel Committee (“JPC”) has indicated it wishes to develop and recommend more measurable criteria for evaluating the performance of both the CEO and CIO.
- Several years ago, the Board of the Police and Fire Department Plan (“P&F”) also developed dashboard reports that identify various measures for monitoring and assessing the health of the P&F Plan. These dashboard reports are provided to the P&F Board on a regular basis and are continually being refined.
- The 2017 City Audit Report recommended that the Boards adopt a formal set of performance measures to be included in the retirement plans’ budgets for both plan administration and the investment program.
- The Civil Grand Jury of Santa Clara issued a report on the retirement systems in June 2019 with the following recommendation (Recommendation 4. b)):

The Boards of Administration should implement employee reviews based on measurable goals and performance metrics for the CEO and CIO. The goals and performance metrics should be completed and made public by December 31, 2019.

Given the common interest in developing more quantitative performance measures, Cortex has prepared this memorandum, which sets out general principles, a suggested evaluation framework, and preliminary metrics for evaluating the CEO and CIO.

The goal of the August 6 JPC meeting is to obtain feedback on the proposed framework and preliminary metrics in order to allow ORS staff and Cortex to develop more detailed metrics for review at a subsequent JPC meeting(s) and ultimately gain Board approval by December 2019.

BACKGROUND -- INDUSTRY PRACTICE

In Cortex's experience, performance evaluations of public fund CEOs often rely on having board members complete performance evaluation surveys that are subjective in nature. (CIOs on the other hand are more likely to be evaluated based on investment performance, depending on the level of discretion they exercise over the investment program).

In the private sector, boards typically evaluate CEOs against objective and measurable criteria such as revenue growth, share price appreciation, market share, etc. Increasingly, however, there is a recognition in the private sector that focusing solely on objective, measurable criteria may not be appropriate and in fact may be detrimental to the long-term health of the company. Accordingly, using a mix of quantitative and qualitative assessments may be advisable; i.e. a blend of the approaches typically used by public retirement systems and private sector companies.

The balance of this memorandum sets out general principles, a suggested evaluation framework, and preliminary metrics for the JPC's consideration.

PRINCIPLES & GUIDELINES

Our suggested evaluation framework is based on the following principles and guidelines:

- 1) An effective evaluation process for the CEO and CIO should include **two** components: performance *measurement* and performance *management*:
 - a) **Performance measurement** involves determining whether agreed-upon performance outcomes were achieved. These outcomes can and should be objective and measurable. The goal of performance measurement is to determine whether the CEO and CIO have created value for stakeholders.
 - b) **Performance management** is usually more subjective in nature and involves providing feedback to the CEO and CIO on those factors that are *expected* to drive or lead to the desired performance outcomes. The goals of the performance management process are to:
 - i) Help the CEO and CIO improve their management skills;
 - ii) Identify potential concerns, problems, and improvement opportunities **before** they begin to impact performance.
- 2) It can be appropriate and useful to assign weights and calculate a quantitative score during the performance measurement component of the evaluation process. On the other hand, assigning weights and calculating scores is less appropriate and useful for the performance management component. (It should be noted, however, that serious concerns identified in the performance management process may nevertheless over-ride the results of the performance measurement process, regardless of how positive the performance may be).
- 3) The performance **measurement** component of the evaluation process is more appropriate for determining incentive compensation, due to its more objective and measurable nature. Boards should refrain from using the performance **management** component of the process to determine incentive compensation, as it is generally more subjective.
- 4) There may be value in having some common Metrics (but with different weights) for evaluating both the CEO and CIO. Doing so can create an alignment of interests between the two positions and may help ensure the CEO and CIO will support one another for the common benefit of the organization.

PROPOSED FRAMEWORK

A framework for evaluating the CEO and CIO is summarized in the following tables. Table 1-3 apply to the CEO while Tables 4-6 apply to the CIO.

TABLE 1: CEO PERFORMANCE EVALUATION PROCESS – AN OVERVIEW				
PERFORMANCE MEASUREMENT COMPONENT				WEIGHTS & SCORES?
CORE PERFORMANCE OUTCOMES				YES (weights will differ from CIO)
Investment Performance	Member Service Quality	Benefit Administration Cost- Effectiveness	Operations/ Compliance	
SPECIAL/AD HOC PERFORMANCE OUTCOMES				
Project A	Project B	Project C		
PERFORMANCE MANAGEMENT COMPONENT				NO (feedback only*)
PERFORMANCE MANAGEMENT FACTORS				
Human Resource Management	Stakeholder Relations	Personal Management Style	Enterprise Risk Management	

* Performance management factors will generally not be given any weight in the annual evaluation. If concerns regarding these factors are severe or persist over an extended period, they may affect the continued employment of the CEO.

TABLE 2 DETAILS OF CEO PERFORMANCE MEASUREMENT COMPONENT			
CORE PERFORMANCE OUTCOMES			
Outcomes	Weight (total 100%)	Rationale/Description	Potential Metrics
Investment performance	TBD (but less than for CIO)	Central to the mission. The CEO must support/coordinate with CIO; alignment of interests with CIO is beneficial.	<ul style="list-style-type: none"> 4-year total fund (risk-adjusted) performance relative to policy benchmark (net of costs)
Member Service Quality	TBD	Central to the mission	<ul style="list-style-type: none"> Member/employer satisfaction Service level standards
Benefit Administration Cost-effectiveness	TBD	Central to the mission	<ul style="list-style-type: none"> Admin. cost/member
Operations/ Compliance	TBD	Central to the mission	<ul style="list-style-type: none"> Successful financial audit No major exceptions identified relative to governing legislation/terms of the plans.
SPECIAL/AD HOC PERFORMANCE OUTCOMES			
Special/ad hoc projects or outcomes	Varies & TBD	Specific one-time projects specifically assigned to the CEO. They may not arise each year.	<ul style="list-style-type: none"> Will vary from project to project.

TABLE 3
DETAILS OF CEO PERFORMANCE MANAGEMENT COMPONENT

Performance Management Factors	Rationale	Potential Metrics
Human Resource Management	Skilled, productive, motivated staff are critical to achieving the performance outcomes.	<ul style="list-style-type: none"> • Staff climate survey • Staff turnover trends • Staff exit survey
Stakeholder Relations	Satisfied and supportive stakeholders (City Council, unions, retirees, etc.) are important to achieving the performance outcomes.	<ul style="list-style-type: none"> • Surveys • Meetings • Focus groups
Personal Management Style/Skills	CEO's management style is important to achieving the performance outcomes. This however is highly subjective.	<ul style="list-style-type: none"> • Board survey on CEO's management style/skills
Enterprise Risk Management	Failure to engage in effective enterprise risk management (technology, operations, etc.) may eventually undermine the performance outcomes.	<ul style="list-style-type: none"> • External/internal audit reports • Compliance monitoring reports • No major lapses in system of controls
Ethics	Lapses in ethical behaviour may undermine the integrity of the organization and the achievement of the performance outcomes.	<ul style="list-style-type: none"> • Ongoing monitoring and observation for: <ul style="list-style-type: none"> ○ Breach of fiduciary duty ○ Breach of generally accepted standards of professional conduct

TABLE 4: CIO PERFORMANCE EVALUATION PROCESS – AN OVERVIEW					
PERFORMANCE MEASUREMENT COMPONENT					WEIGHTS & SCORES?
CORE PERFORMANCE OUTCOMES					YES (weights will differ from CEO)
Investment Performance	Member Service Quality	Investment Cost- Effectiveness	Investment Policy Compliance		
SPECIAL/AD HOC PERFORMANCE OUTCOMES					
Investment Project A	Investment Project B		Investment Project C		
PERFORMANCE MANAGEMENT COMPONENT					NO (feedback only*)
PERFORMANCE MANAGEMENT FACTORS					
Human Resource Management	Stakeholder Relations	Personal Management Style	Investment Operations Risk Mgmt.	Ethics	

* Performance management factors will generally not be given any weight in the annual evaluation. If concerns regarding these factors are severe or persist over an extended period, they may affect the continued employment of the CIO.

TABLE 5 DETAILS OF CIO PERFORMANCE MEASUREMENT COMPONENT			
CORE PERFORMANCE OUTCOMES			
Outcomes	Weight (total 100%)	Rationale/Description	Potential Metrics
Investment performance	TBD (but more than for CEO)	Central to the mission.	<ul style="list-style-type: none"> 4-year total fund (risk-adjusted) performance relative to policy benchmark (net of costs)
Member Service Quality	TBD (but less than for CEO)	CIO plays a role in member communication. Alignment of interests with CEO is beneficial.	<ul style="list-style-type: none"> Member/employer satisfaction Service level standards
Investment Cost-effectiveness	TBD	Central to the mission	<ul style="list-style-type: none"> Investment cost/\$ of assets adjusted for complexity of investment program
Investment Policy Compliance	TBD	Central to the mission	<ul style="list-style-type: none"> Successful financial audit No major exceptions identified relative to investment policies and procedures.
SPECIAL/AD HOC PERFORMANCE OUTCOMES			
Special/ad hoc projects or outcomes	Varies & TBD	Specific one-time investment projects assigned to CIO. May not arise each year.	<ul style="list-style-type: none"> Will vary from project to project.

TABLE 6 DETAILS OF CIO PERFORMANCE MANAGEMENT COMPONENT		
PERFORMANCE MANAGEMENT FACTORS		
Performance Management Factors	Rationale	Potential Metrics
Human Resource Management	Skilled, productive, motivated investment staff are critical to achieving performance outcomes.	<ul style="list-style-type: none"> • Staff climate survey • Staff turnover trends • Staff exit survey
Stakeholder Relations	Satisfied and supportive stakeholders (City Council, unions, retirees, etc.) are important to achieving the performance outcomes.	<ul style="list-style-type: none"> • Surveys • Meetings • Focus groups
Personal Management Style/Skills	CIO's management style is important to achieving the performance outcomes. This however is highly subjective.	<ul style="list-style-type: none"> • Board survey on CIO's management style/skills
Investment Operations Risk Management	Failure to engage in effective investment operations risk management (e.g. technology) may eventually undermine the performance outcomes.	<ul style="list-style-type: none"> • External/internal audit reports • Compliance monitoring reports • No major lapses in system of controls
Ethics	Lapses in ethical behaviour may undermine the integrity of the investment program and the achievement of the performance outcomes.	<ul style="list-style-type: none"> • Ongoing monitoring and observation for: <ul style="list-style-type: none"> ○ Breach of fiduciary duty ○ Breach of generally accepted standards of professional conduct

DISCUSSION/COMMENTARY

JPC members should note the following regarding the above framework:

1. We have not included funded status as a performance outcome. This is because we believe funded status is beyond the direct control of the CEO and CIO (and beyond the control of the Boards, though they do have influence).
2. We would like to emphasize the distinction between performance outcomes and performance management factors:
 - a. Performance outcomes are the reason the retirement systems exist; i.e. they define the very purpose of the systems.
 - b. Performance management factors are the *means* by which the CEO and CIO achieve the outcomes; e.g., the retirement system was not created to ensure the staff of the ORS are satisfied and motivated, but, in the long run, satisfied and motivated employees are a pre-requisite for achieving the performance outcomes.

Questions to be considered by the JPC:

1. Does the framework presented herein provide a useful starting point to develop performance metrics? What changes should be considered?
2. What preliminary weights does the JPC believe are appropriate for the core performance outcomes?

Based on any feedback received, ORS staff and Cortex will develop more detailed Metrics for the JPC's review.

We trust the above memorandum will provide a useful starting point for discussions. We look forward to discussing it at the upcoming JPC meeting. If any JPC member has questions before then, please do not hesitate to contact me at tiannucci@cortexconsulting.com or at (416) 967-0252 ext. 223.