

THE REGENTS OF THE UNIVERSITY OF CALIFORNIA
OFFICE OF ETHICS, COMPLIANCE AND AUDIT SERVICES



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SENIOR VICE PRESIDENT
CHIEF COMPLIANCE AND AUDIT OFFICER

February 6, 2024

**CHIEF INVESTMENT OFFICER BACHHER
VICE PRESIDENT LLOYD**

**RE: Final Report Project No. P24A007: Senior Management Incentive Plans: Office of the
Chief Investment Officer Annual Incentive Plan**

Attached is a copy of the final report for: Audit Services Project No. P24A007 Senior Management Incentive Plans: Office of the Chief Investment Officer Annual Incentive Plan. With the issuance of this final report, please destroy any previous draft versions. We very much appreciate the assistance provided to us by you and members of your staff during our review. If you should have any questions please feel free to contact me at 510-987-9646 (email: matthew.hicks@ucop.edu).

A handwritten signature in black ink, appearing to read "Matt Hicks".

Matt Hicks
Systemwide Deputy Audit Officer

Attachment

cc: Senior Vice President Bustamante
Executive Vice President Brostrom
Executive Vice President Nava
Chief Operating Officer Guimaraes
Associate Vice President Henderson
Director Fernandez
Director Huang
Systemwide Associate Audit Director Bishin
Contractor Harrigan

UNIVERSITY OF CALIFORNIA
ETHICS, COMPLIANCE AND AUDIT SERVICES
OFFICE OF THE PRESIDENT

Senior Management Incentive Plans:
Office of the Chief Investment Officer Annual Incentive Plan
Audit No. P24A007
February 2024

Work Performed by:
Contract Auditor Harrigan

Work Reviewed by:
Systemwide Associate Audit Director Bishin
Systemwide Deputy Audit Officer Hicks

Executive Summary

Introduction

As part of the University of California Office of the President (UCOP) 2023-24 fiscal year audit plan, Internal Audit completed a review of the Office of the Chief Investment Officer (OCIO) Annual Incentive Plan (AIP or the Plan).

The purpose of the AIP is to provide a risk-variable financial incentive to employees responsible for attaining key objectives in the OCIO. Participants may receive an annual incentive award based on investment performance and individual performance. The AIP Administrative Oversight Committee (AOC) approves participant performance objectives at the beginning of the Plan year. Eligible participants include senior management, professional investment and trading staff, and other key positions in the office as recommended by the Chief Investment Officer (CIO). The Regents Investments Committee approves investment performance objectives.

The AIP Administrative Guidelines (Guidelines) document serves to assist all involved parties in the application of the AIP provisions. The Guidelines may change from year to year to reflect AOC-approved changes to the Plan or processes.

Annually, the Regents approve investment performance benchmarks for asset classes such as global equity, absolute return, liquidity, and others. State Street Bank is the fund custodian, and in addition to safekeeping and recordkeeping for all publicly traded assets, is responsible for calculating investment performance for all such portfolios, and for providing the investment returns of the several market indexes used as benchmarks. It also calculates and provides, for each performance objective, the difference between the portfolio and benchmark return, which is the basis of award calculations.

UC retained Mercer to recommend new investment performance standards for FY 2022-23. Once the Regents approved these, Mercer updated the AIP award calculation model taking into account changes in the investment component. The model is updated as needed when the Plan or Guidelines are updated.

UC Human Resources (HR) and the OCIO are the sources of additional input data such as participant names, salaries, performance measure weightings, and participant qualitative performance ratings, which the CIO approves. The model contains investment and participant performance measures and results (Threshold, Target, and Maximum levels). The Office of the Chief Financial Officer (OCFO) inputs investment performance data provided by State Street Bank and the remaining data is entered by Compensation Programs & Strategy (HR Compensation).

For Investment Officers and more senior positions, awards are payable in three annual payments comprised of 50 percent paid in the current Plan year, 25 percent paid in the next year and 25 percent paid in the year thereafter, plus interest. Interest is based on the three-year average of Global Equity returns. Other participants receive 100% payout in the current year.

The AOC was established to provide oversight of Plan development, governance and interpretation. It is comprised of the Executive Vice President and Chief Operating Officer, the Executive Vice President and Chief Financial Officer, the Vice President - Human Resources, and the Executive Director – Compensation Programs and Strategy. The AOC was also delegated authority by the Regents to approve non-material Plan changes, with material or substantive changes requiring the approval of the President and the Regents Governance Committee. The AOC was also given authority to review and approve participant performance objectives and award recommendations. Performance objectives and award recommendations for the CIO remain under the purview of the Board of Regents, thus requiring its approval. Incumbents with total cash compensation at or above the current Indexed Compensation Level (ICL) of \$387,700 are reported to the Regents via the Annual Report on Executive Compensation for calendar year 2023.

The AOC consults with the Senior Vice President and Chief Compliance and Audit Officer (CCAO) in an independent advisory capacity during its review of Plan participants' objectives and proposed awards. The CCAO assures that periodic auditing and monitoring of the Plan occurs, as appropriate.

Objective and Scope

The primary objectives of the OCIO AIP audit were to assess the accuracy of FY 2022-23 award calculations and annual payouts (including deferred portions of awards) and verify compliance with the Plan. We evaluated the following AIP award criteria for accuracy and compliance: individual participant performance objectives, performance ratings, and payout calculations. In reference to performance ratings, we did not make a judgment on the performance and contribution towards goals. We relied on management's documented evaluation of performance level achievement for Plan participants.

We reviewed the FY 2022-23 award calculations and verified the eligible participants. For each participant, we verified the following:

- FY 2022-23 actual salary earnings
- AIP award opportunity percentages
- Performance measure weightings
- Subjective performance rating
- Award opportunity

We reviewed the FY 2022-23 payout calculations and verified:

- Award amounts for each participant
- FY 2020-21 and FY 2021-22 deferred award payouts for Investment Officer level and above,
- Spreadsheet formulas used for calculations for the FY 2022-23, FY 2021-22, and FY 2020-21 components of the payout calculation, including interest allocations,
- Interest amounts used in the payout calculations tied to the amounts provided by State Street, and

- Payout amount for each participant included on the Payroll Payout Worksheet, prepared by the OCIO for the Payroll Office, agreed to the payout calculation.

For the FY 2023-24 plan year, we verified the AOC approved:

- Participant list
- Participant qualitative objectives
- Investment performance standards (objectives)
- AIP plan document changes

As part of our audit, we also performed:

- An evaluation of annual investment performance results against source documents provided by State Street. See Appendix A for further details on the results of this review.
- A trend analysis of participant awards and noted that the percentage of participants rated higher than meets expectations (solid performance) was 67.74% (21 out of 31 participants), an increase compared to FY 2021-22's 58.8% (20 of 34 participants) and FY 2020-21's 59% (23 of 41 participants).

Overall Conclusion

Based on the information provided, we did not identify any errors in the calculations of the FY 2022-23 AIP award recommendations that were presented for approval to the AOC and the Regents Governance Committee. In addition, we did not identify any errors in the final FY 2022-23 payout calculations (50% of current year award plus prior year deferred amounts and related interest for Investment Officer level and above). We also verified that the FY 2023-24 documents were approved by the AOC.

We noted the following opportunity for improvement:

Timeliness

- As of October 2023, Internal Audit had not received the following documentation required to complete the audit:
 - FY 2023-24 Investment performance standards (objectives)
 - FY 2023-24 participant list
 - FY 2023-24 participant objectives
 - FY 2023-24 AIP plan document
 - AOC Approval of the above
 - FY 2023-24 AIP Guidelines document

HR Systemwide had not received the OCIO's go-ahead to forward the items to the AOC for approval. We later verified the documents were approved by a quorum of the AOC on November 21, 2023. Audit received all the outstanding items in November 2023. This is a repeat issue from prior year's report. Further, three items from the bulleted list above have not been approved or available until the second quarter of the fiscal year for three years in a row: Investment performance standards, participant objectives, and the

posting of the plan document.

- The FY 2023-24 AIP plan document could not be posted on-line in a timely manner as it had not been approved.

For a detailed discussion of this issue, including the management action plans, please refer to the subsequent pages of this report.

Opportunity for Improvement and Action Plan

1. As of October 2023, Internal Audit had not received documentation required to complete the audit.

Documentation needed to complete the audit included:

- FY 2023-24 participant list
- FY 2023-24 Investment performance standards (objectives)
- FY 2023-24 participant objectives
- FY 2023-24 AIP plan document updates
- AOC approval of the above
- FY 2023-24 AIP Guidelines document

Also, the FY 2023-24 AIP plan document had not been posted online as it had not been approved. This is an outstanding corrective action from the prior year.

Per the AIP Plan document:

Participant List – **“Prior to the beginning of the Plan year, or as soon as possible thereafter,** the AOC will provide the President and the Chair of the Regents’ Investments Committee with **a list of Plan participants** for that Plan year, including appropriate detail regarding each Plan participant.”

As new participants must be employed by January 15th of the plan year, this list should be available for review and approval in advance of the plan year.

Also, per the AIP Plan document:

Investment Performance Standards (Objectives) – **“The quantitative investment performance objectives** will be reviewed and approved by the AOC in consultation with the CIO, the President, and Chair of the Regents’ Investments Committee, and an independent investment consultant **prior to the beginning of the Plan year or as soon as possible thereafter.**”

Participant Objectives – **“Prior to the beginning of the Plan year or as soon as possible thereafter,** the supervisor of each Plan participant will provide him/her with written documentation that (a) identifies the **participant’s individual performance objectives** applicable to the Plan, (b) defines the performance standards and metrics that will be used to measure threshold, target, and maximum performance for each investment objective, and assigns performance weightings to the participant’s objectives.”

Per OCIO and HR Compensation, the investment standards, which are provided by State Street, a third party, are not available prior to the start of the plan year unless there are no changes. They are usually provided in August and sometimes not until September. Likewise, the participant objectives are not finalized until receipt of the investment standards (objectives).

Regarding the investment standards (objectives) and the participant objectives, the plan document needs to be updated to remove “prior to the beginning of the Plan year” and that text replaced with a specific date in the first quarter and wording that includes “not later than.”

Regarding the AIP Plan document, there is no specific written requirement regarding when plan updates must be approved and when the updated Plan must be posted. However, based on prior discussions with OCIO, to ensure Plan objectives are defined and communicated in a timely manner, the updated Plan should be approved and posted online prior to or soon after the start of the plan year, July 1.

Regarding the AIP Guidelines, as they include the current plan year investment standards (objectives), like the standards, they cannot be updated until after the standards are approved.

Audit received all the outstanding items in November 2023.

Action Plan:

- a. HR Compensation will consult with OCIO regarding proposed changes to the AIP plan document to address specific requirements regarding when plan updates must be approved and posted. Agreed edits will be vetted with UC Legal prior to forwarding them to the AOC or the Regents, as appropriate, for approval.*
- b. If other items are available during the plan year, such as the list of plan participants and updates to the plan document, OCIO will provide them to HR Compensation as available, for review and approval by the AOC.*
- c. All supporting documents for FY25 participants and objectives will be reviewed and approved by the AOC no later than the end of the first quarter of the fiscal year.*
- d. After the investment standards are approved, the AIP Guidelines will be updated no later than September 30, 2024.*

Target dates:

- a. May 31, 2024 – revised plan*
- b. June 30, 2024*
- c. September 30, 2024*
- d. September 30, 2024*

Appendix A

UC Investments Annual Incentive Plan FY 2022-23 Investment Performance Review Results

Pursuant to the University of California (UC) Office of the Chief Investment Officer (OCIO) Annual Incentive Plan (AIP), the Systemwide Vice President of Human Resources, requested the UC Office of the President (UCOP) Audit Services to review the investment data used to perform the OCIO Annual Incentive Plan calculations. Accordingly, we obtained the investment benchmark data and the investment performance results and verified they were accurately reflected in the calculation model.

In connection with the FY 2022-23 data provided by State Street Bank that was used in the AIP calculations, we performed the following:

- Obtained the actual performance data for the investments managed by the Office of the Chief Investment Officer, from Human Resources - Compensation Programs & Strategy who received the data directly from the State Street Bank. We verified the basis point differentials between actual performance and benchmarks provided on the spreadsheets were used in the incentive awards calculations.
- Verified that the basis point differentials were accurately transferred to the summary spreadsheets in the calculation model and to the “Exhibit 2: Benchmark Performance - Actual Fiscal Year 2022-2023 Performance” versus Annual Incentive Plan Performance Results.”