

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



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Alexander Bustamante  
SENIOR VICE PRESIDENT  
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April 2, 2021

**CHIEF INVESTMENT OFFICER BACHHER  
ACTING VICE PRESIDENT LLOYD  
DIRECTOR FERNANDEZ**

**RE: Final Report Project No. P21A003: 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. P21A003 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](mailto:matthew.hicks@ucop.edu)).



Matt Hicks  
Systemwide Deputy Audit Officer

Attachment

cc: Senior Vice President Bustamante  
Executive Vice President Nava  
Chief Operating Officer Guimaraes  
Director Huang  
Systemwide Associate Audit Director Cataldo  
Contractor Harrigan

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

Senior Management Incentive Plans:  
Office of the Chief Investment Officer Annual Incentive Plan  
Audit No. P21A003  
December 2020

Work Performed by:  
Contract Auditor Harrigan

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

# **Executive Summary**

## **Introduction**

As part of the University of California Office of the President (UCOP) 2020-21 fiscal year audit plan, Internal Audit completed a review of the Office of 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). Investment performance objectives are approved by the Regents Investment Committee.

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 2019-20. Once these were approved by the Regents, Mercer updated the AIP award calculation model taking into account changes in the investment component. The model will be 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 are approved by the CIO. The model contains investment and participant performance measures and results (Threshold, Target, and Maximum levels). Investment performance data from State Street is input by the Office of the Chief Financial Officer (OCFO), and the remaining data is input 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. Beginning with the current year awards, 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, which is currently a vacant position. Effective FY 2011-12, 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, and 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. As of September 1, 2019, awards that place an incumbent's total cash compensation at or above \$323,700 are reported to the Regents via the Annual Report on Executive Compensation.

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 occurs, as appropriate.

### **Objective and Scope**

The objectives of the OCIO AIP audit were to assess the accuracy of FY 2019-20 award calculations and annual payouts (including deferred portions of awards) and verify compliance with the Plan. The following AIP award criteria were evaluated 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 accepted management's assurance that these were met.

We reviewed the FY 2019-20 award calculations and verified the eligible participants. For each participant, we verified the following:

- FY 2019-20 actual salary earnings
- AIP award opportunity percentages
- performance measure weightings
- subjective performance rating
- award opportunity

We reviewed the FY 2019-20 payout calculations and verified the:

- initial award amounts for each participant (FY 2017-18, FY 2018-19, FY 2019-20),
- FY 2019-20 year one payout and FY 2018-19 and FY 2017-18 deferred award payouts for each participant, as applicable,
- spreadsheet formulas used for calculations for the FY 2019-20, FY 2018-19, FY 2017-18, components of the payout calculation, including interest allocations,
- interest amounts used in the payout calculations tied to the amounts listed in the general ledger, 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.

As part of our audit, we also:

- verified that the FY 2020-21 participant qualitative objectives were approved by the AOC.
- reviewed the status of management's action plans from the prior reviews.
- performed an annual evaluation of investment performance results against source documents provided by State Street. We verified these monthly averages to the final calculation model. No issues were noted. See Appendix A for further detail on the results of this review.
- verified that any changes made to the AIP, as reflected in the plan document and the Guidelines, were appropriately approved.
- performed a five-year trend analysis of participant awards and noted that the percentage of participants rated higher than meets expectations increased in FY 2019-20 to 61% (27 participants) compared to 51% (20 participants) in FY 2018-19 and 92% (28 participants) in FY 2017-18.

## **Overall Conclusion**

Based on the information provided, we did not identify any errors in the calculations of the FY 2019-20 AIP award recommendations that were presented for approval to the AOC and the Regents Governance Committee. Also, we did not identify any errors in the final FY 2019-20 payout calculations (50% of current year award plus prior year deferred amounts and related interest for Investment Officer level and above).

We noted the following opportunities for improvement:

- The AOC has not approved the FY 2020-21 participant or investment performance objectives.
- Updated AIP Guidelines were not provided and the current version of the Plan document has not been posted to the UCOP web site.

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

## Opportunities for Improvement and Action Plans

### 1. The AOC has not approved the FY 2020-21 participant or investment performance objectives.

Per HR Compensation, the Investment Committee is considering changes to the investment performance objectives which may lead to revisions in the FY 2020-21 objectives. As of October 21, 2020, the objectives had not been reviewed or approved by the AOC. Per the plan, objectives should be approved in advance of the plan year or as soon as possible thereafter. Awards are based on fiscal year performance against objectives and if objectives are not approved timely, participants may remain uncertain regarding performance expectations and related award achievement levels.

***Action Plan:***

*Once the FY 2020-21 objectives are finalized, HR Executive Compensation will provide them to the AOC for their review and approval.*

***Target date:***

*April 30, 2021*

### 2. Updated AIP Guidelines were not provided and the AIP Plan document was not posted.

Our review noted the following concerns regarding the AIP Guidelines and AIP Plan document:

- FY 2020-21 Guidelines were not provided during fieldwork. The Guidelines should be updated annually, as needed, and should include investment performance objectives for the current Plan year.
- As of October 21, 2020, only the FY 2019-20 AIP Plan document was posted on the UCOP website. By the beginning of each Plan year, July 1, the current year Plan document should be posted. For transparency purposes, the current Plan should be available for participants and interested parties to review.

***Action Plan:***

*HR Executive Compensation will update and distribute the FY 2020-21 Guidelines. HR will also post the approved FY 2020-21 AIP Plan document to the website.*

***Target date:***

*Updated Guidelines: Provided prior to report issuance*

*Posting of AIP Plan: April 30, 2021*

## Appendix A

### **Office of the Chief Investment Officer Annual Incentive Plan FY 2019-20 Investment Performance Review Results**

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

In connection with the FY 2019-20 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 Treasurer's Office, from Human Resources - Compensation Programs & Strategy who received the data directly from the State Street Bank. The basis point differentials between actual performance and benchmarks provided on the spreadsheets were used in determining the incentive awards levels. We verified the calculations utilized the actual performance data, benchmark data and the basis point differentials from the State Street supporting spreadsheets.
- Confirmed that the basis point differentials were accurately transferred to the summary spreadsheets in the calculation model and to the "Benchmarks and Exhibit 2: Actual Fiscal Year 2019-2020 Performance Versus Annual Incentive Plan Performance Standards."