



Agenda Item 6b

May 14, 2012

ITEM NAME: Global Governance Program Review

PROGRAM: Global Governance

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

This item provides a quarterly update on the CalPERS Global Governance Program.

- **Principles and Proxy Voting** – CalPERS has cast 11,154 votes at company meetings worldwide, supporting 88 percent of management proposals and 47 percent of shareowner proposals. Votes are cast in line with CalPERS Global Principles of Accountable Corporate Governance, as approved by the Board.
- **Financial Market Reform** – CalPERS led an investor coalition in recommending the Securities and Exchange Commission (SEC) reinforce investor protection by addressing six financial market reform priorities. CalPERS recommended improvements to “going concern” standards to the Public Companies Accounting Oversight Board (PCAOB). CalPERS supported the SEC’s position regarding the Jumpstart Our Business Startups Act (JOBS Act), specifically requesting that investor protections be preserved.
- **Corporate Engagement** – CalPERS is engaging 200 plus domestic companies to explain our position on executive compensation practices and call for change where we voted against “say-on-pay” proposals in 2011. In addition, staff continues to engage companies on the issue of majority voting for director elections. Apple has agreed to adopt a majority vote standard for director elections following two years of CalPERS continued engagement.
- **Institutional Relations** – CalPERS participated in investor forums and meetings such as the Council of Institutional Investors (CII), Principles for Responsible Investment (PRI), and Ceres. Outcomes include Anne Simpson being elected to the CII Board.
- **Integration of Environmental, Social and Governance (ESG)** – CalPERS launched its first portfolio wide report, “Toward Sustainable Investment – Taking Responsibility” on ESG at the *April 25-26 Ceres Conference 2012 – Igniting Innovation, Scaling Sustainability*.

BACKGROUND

The Global Governance Program (Program) supports the Total Fund and is overseen by a Global Governance Working Group, which includes CalPERS Board President, Chief Executive Officer, Chief Investment Officer, Chief Operating Investment Officer, Deputy Executive Officer for External Affairs, General Counsel and the Director of Corporate Governance.

The Program, illustrated below, operates through five work streams with quarterly program reviews brought forward to the Investment Committee.



ANALYSIS

1. Principles and Proxy Voting:

Quarterly Update

CalPERS Investment Policy for Global Proxy Voting (April 21, 2008) states that proxy voting rights must be diligently exercised as part of our fiduciary duty. Staff reviews information provided by companies, market experts, like-minded investors and research from proxy advisory firms, to ensure that votes are cast in line with CalPERS Global Principles of Accountable Corporate Governance.

Attachment 1 provides a summary report of CalPERS proxy voting for the first quarter of 2012. CalPERS voted 11,154 proposals in the quarter, supporting 88% of management proposals and 47% of shareowner proposals. Attachment 1 also includes examples where CalPERS voted for or against particular proposals in the

U.S. and overseas, to illustrate how CalPERS Principles have been applied in practice on a range of issues including board independence, compensation, voting thresholds, compensation, political donations, sustainability and takeovers.

2. Financial Market Reform

SEC – Financial Market Reform Priorities

In March, a CalPERS led investor coalition met with SEC Chairman Mary Schapiro and each of the other four Commissioners to recommend the SEC focus on six priority areas (Attachment 2):

1. Creation of the SEC Investor Advisory Committee.
2. Re-initiating rulemaking on universal proxy access.
3. Finalizing rules required by Dodd-Frank governing certain executive compensation disclosures.
4. Advancing a work plan for establishing a single set of high-quality global accounting standards.
5. Finalizing rules related to the regulation of credit rating agencies.
6. Reviewing impact of disclosure rules on sustainability and board diversity issues.

In April, the SEC addressed the first of CalPERS six priority areas by appointing the 21-member Investor Advisory Committee. Joe Dear, Chief Investment Officer, will represent CalPERS on the committee. Under Dodd-Frank, the Investor Advisory Committee is charged with advising the SEC on regulatory priorities; the regulation of securities, trading strategies and fee structures; the effectiveness of disclosure; and initiatives to protect investors and promote confidence in the financial markets. Going forward, CalPERS will continue to address its financial market reform priorities effectively and in a timely manner through building an investor coalition to amplify the investor voice with the SEC.

Accounting and Auditing

CalPERS believes regulators should do more to improve transparency, credibility and accountability of financial statements by improving rules relating to “going concern” issues for public companies. CalPERS expressed this position in March at a PCAOB Public Meeting on Auditor Firm Independence and Rotation; and through its participation on the PCAOB Investor Advisory Group Taskforce (Taskforce), which CalPERS co-chairs. Specifically, the Taskforce:

1. Conducted an investor survey which demonstrated over 90% of respondents believed the concept of “going concern” to be very to somewhat important.
2. Recommended the PCAOB revise its audit standards to require an auditor to use information gathered during the audit and also from other sources.
3. Recommended SEC consider enhanced disclosures of risks, and also how risks are mitigated, that could affect a company’s financial health.

Jumpstart Our Business Startups (JOBS) Act

President Obama signed into law H.R. 3606, the Jumpstart Our Business Startups (JOBS) Act in April. The JOBS Act, intended to spur job creation by increasing business's access to capital, includes a new category of public companies dubbed emerging growth companies (EGCs). Under Title I of the JOBS Act, an EGC is exempt for up to five years from a variety of securities law requirements.

As a significant provider of capital to the U.S. markets, CalPERS recognizes the important role capital formation plays in job growth and the overall health of the U.S. economy. However, the EGC exemptions enacted by the JOBS Act eliminate or undermine important investor protections. Prior to passage, CalPERS submitted letters to Senate leadership supporting testimony by SEC Chairman Schapiro recommending strengthening investor protections in the JOBS Act. Ultimately, investor protections were not strengthened in the JOBS Act which is now law as signed by the President.

In April, the SEC initiated the comment period as it sets out to make rules implementing the provisions in the JOBS Act. Staff is currently considering CalPERS response to SEC requests for comment. Staff are also exploring strategies for encouraging EGCs to opt-out of securities law exemptions referenced by the JOBS Act.

3. Corporate Engagement

“Say-on-Pay”

The Dodd-Frank Market Reform Act requires U.S. companies to hold a non-binding proxy vote on executive compensation (“say-on-pay”) at least once every three years. CalPERS believes well-designed compensation programs should be clearly disclosed to provide investors a full understanding of total pay and ensure compensation is linked to long-term sustainable performance. We also highlight the need for compensation committees to pay attention to risk, and to consider relevant environmental and social targets in performance assessments.

CalPERS is following up with over 200 companies in its US portfolio, having voted against their “say-on-pay” proposals in 2011. The purpose is to explain why CalPERS voted against the proposal, highlight our approach to compensation and request that companies reform their practice on pay. To date staff has had constructive dialogue with 49 companies. We are seeing positive response on performance links, focus on long-term horizons, and disclosure. For example, the 2011 say-on-pay vote failed at Jacobs Engineering Group – with the company receiving only 44% support. Subsequently, the company engaged investors (CalPERS included) and worked with independent consultants to re-evaluate and restructure the company's pay program. These changes resulted in overwhelming shareholder support in 2012.

At Citigroup's April 17, 2012 Annual Meeting the company failed to win majority approval from investors for its say-on-pay vote. CalPERS voted "against" the company's say-on-pay proposal over concerns the company had not adequately linked pay with performance and disclosed a risk framework surrounding awards made to CEO Vikram Pandit.

Majority Voting in Director Elections

CalPERS has engaged a wide range of domestic companies to request reform on director elections. At these companies, "plurality voting" allows directors to be elected with a single vote, regardless of the number of votes "withheld." In 2010 staff began engaging portfolio companies within our top 300 holdings that had a plurality vote standard for uncontested director elections. The engagement has been positive, with 37 out of 38 companies identified agreeing to introduce a majority vote standard.

In 2011, staff launched its next round of corporate engagement with an additional 56 companies that use a plurality vote standard in uncontested elections. To date, 44 companies have agreed to adopt majority voting, while engagement continues with the remaining companies. Staff continues to file shareowner proposals as needed, including again at Apple in February. CalPERS proposal at Apple received just over 80% support from shareowners prompting the company to agree to adopt a majority vote standard.

4. Institutional Relations

Council of Institutional Investors

Anne Simpson, CalPERS Senior Portfolio Manager, Investments and Director of Corporate Governance, has been elected to the Board of the Council of Institutional Investors (CII).

Principles for Responsible Investment (PRI)

CalPERS board member Priya Mathur is a member of the PRI Advisory Council while staff sit on the PRI Clearinghouse Steering Committee, Sudan Engagement Group, and Responsible Business Practice in Conflict-Affected Areas Working Group. CalPERS will be piloting a new annual PRI Reporting and Assessment Framework (Assessment) this upcoming summer. Staff contributed to a PRI consultation process in late 2011 for the purpose of assisting PRI's goal to improve both the approach and content of the organization's assessment of responsible investment practices by signatories.

International Corporate Governance Network (ICGN)

CalPERS is a founding and active member of the International Corporate Governance Network (ICGN.) In 2012, Janine Guillot, Chief Operating Investment Officer, was appointed as co-chair of the ICGN Auditing and Accounting Practices

Committee (Committee). The mission of the Committee is to address accounting and auditing practices from an international investor perspective. The Committee, through comment and engagement, strives to ensure the quality and integrity of financial reporting globally.

Los Angeles Trustees Network

The Los Angeles Trustees Network (Network) is a group of public and private pension fund trustees working together to improve national dialogue on issues such as increased investment transparency. CalPERS attended and led panel discussions at the Network's February 27-28, 2012 Roundup, addressing our focus on majority voting standards for director elections, director independence, and board diversity. CalPERS also spoke on retirement security, ESG, and financial market reform.

Robert F. Kennedy Center for Justice & Human Rights (RFK)

The RFK Center's human rights advocacy programs focus on the power of the individual, working through alliances and organizations to generate change. CalPERS co-hosted the RFK Compass West Coast Conference April 10-12, 2012 with both CalPERS board members and staff contributing panel presentations addressing shareowner engagement issues.

5. ESG Integration

"Towards Sustainable Investment – Taking Responsibility"

CalPERS launched its first portfolio wide report (Attachment 3) on ESG at the *April 25-26 Ceres Conference 2012 – Igniting Innovation, Scaling Sustainability*. The annual report:

1. Outlines CalPERS journey to create a fiduciary framework to integrate sustainability across the pension fund's \$235 billion investment portfolio.
2. Describes how CalPERS puts sustainable principles in practice in its own Sacramento, California-based operations.
3. Expands on CalPERS view of three forms of capital companies need to create value: financial, physical, and human capital.
4. Provides examples of CalPERS initiatives and accomplishments regarding sustainable investing.

Ceres

At the *April 25-26 Ceres Conference 2012 – Igniting Innovation, Scaling Sustainability*, CalPERS communicated progress on commitments to collaborate and scale strategies to achieve a sustainable future, including the following:

1. Integration of ESG into its investment decision-making.
2. Integration of the Ceres Roadmap for Sustainability into its Focus List company engagement process.

3. Joining investors in writing to Russell 1000 companies to encourage focus on sustainability issues across their organizations which can enhance long-term company and shareholder value.

ATTACHMENTS

Attachment 1 – Proxy Voting Quarterly Report: January – March, 2012

Attachment 2 – An Investors’ Framework for the Future – SEC Priorities

Attachment 3 – Report, “Toward Sustainable Investment – Taking Responsibility”

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