



Agenda Item 7b

August 13, 2012

ITEM NAME: Global Governance Program Update

PROGRAM: Global Governance

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

This item provides a quarterly update on the activities and accomplishments of the CalPERS Global Governance Program.

- **Principles and Proxy Voting** – CalPERS cast 67,072 votes at company meetings worldwide, supporting 88% of management proposals and 65% of shareowner proposals. Votes were cast in line with CalPERS Global Principles of Accountable Corporate Governance, as approved by the Board. CalPERS filed proposals at three companies that won support from a majority of shareowners – Nabors Industries, Chesapeake Energy, and New York Bancorp. Chesapeake Energy and Nabors Industries also became the first two companies where proxy access proposals won support from a majority of shareowners.
- **Financial Market Reform** – In compliance with the Dodd-Frank Act, the Securities and Exchange Commission (SEC) has named its new Investor Advisory Committee and appointed CalPERS Chief Investment Officer, Joe Dear, as Chairman. In addition, CalPERS testified before the U.S. House Financial Services Committee's Capital Markets and Government Sponsored Enterprises Subcommittee that the Dodd-Frank Act established an effective framework for promoting the safety and soundness of capital markets.
- **Corporate Engagement** – CalPERS and CalSTRS joined Governance Metrics International (GMI) in announcing that the Diverse Director DataSource (3D) is open to the corporate community with over 700 candidate profiles initiated. In addition, CalPERS joined a group of investors with over \$1.1 trillion in assets under management in writing to urge S&P 500 Index companies to address board diversity.
- **Institutional Relations** – The Global Peer Exchange, led by CalPERS, met to discuss environmental, social, and governance (ESG) priorities for future collaboration including integrated reporting and ESG investment manager expectations.

BACKGROUND

The Global Governance Program supports the Total Fund and is overseen by a Global Governance Working Group, which includes the 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 Governance Program is organized into five major work streams as follows:

WORK STREAM	OBJECTIVES
Principles and Proxy Voting	<ul style="list-style-type: none"> • Advocate CalPERS Global Principles of Accountable Corporate Governance • Vote 9,500+ proxies • Implement shareowner proposal campaigns to support corporate engagement strategies
Financial Market Reform	<ul style="list-style-type: none"> • Comment to regulators on legislative proposals • Advocate for shareowner rights and investor protections • Participate in regulatory hearings
Corporate Engagement	<ul style="list-style-type: none"> • Focus List Program • Principles based engagement – majority voting standards for director elections • Ad hoc engagement • Diverse Director Datasource
Institutional Relations	<ul style="list-style-type: none"> • Build coalitions for support of issues • Share best practices • Leverage staff resources by sharing work across organizations
ESG Integration	<ul style="list-style-type: none"> • Integrate ESG into investment decision making across asset classes • Refresh CalPERS Report: Toward Sustainable Investment

An update of activity and accomplishments within each of the work streams follows.

ANALYSIS

1. Principles and Proxy Voting:

Quarterly Proxy Voting 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, investors, and proxy advisory firms to ensure votes are cast in line with CalPERS Global Principles of Accountable Corporate Governance (Principles).

Attachment 1 provides a summary report of CalPERS proxy voting for the second quarter of 2012. CalPERS voted 67,072 proposals in the quarter, supporting 88% of management proposals and 65% 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.

Share blocking is the “freezing” of shares for trading purposes at the custodian/ sub-custodian bank level in order to vote proxies. During the second quarter of 2012, staff did not vote at 16 company meetings due to share blocking as casting votes at these meetings would have prevented the rebalancing of portfolios. All other votes were successfully cast on behalf of CalPERS.

CalPERS Shareowner Proposals

CalPERS filed proposals and implemented proxy solicitation campaigns at three companies that won support from a majority of shareowners, described as follows:

- **Nabors Industries** – CalPERS shareowner proposal seeking shareowner approval for severance agreements passed, receiving support from 66% of votes cast. CalPERS solicited support for a shareowner proposal seeking proxy access which also passed, receiving support from 56% of votes cast. This was the first proxy access proposal to win support from a majority of shareowners.
- **Chesapeake Energy Corporation** – CalPERS shareowner proposal seeking adoption of supermajority voting requirements passed, receiving support from 86% of votes cast. In addition, CalPERS solicited support for a shareowner proposal seeking proxy access which also passed, receiving support from 60% of votes cast. Both directors up for election, V.Hargis and R.Davidson, received support from less than 30% of the voting shares. CalPERS voted against both directors. Chesapeake management’s advisory vote on execution compensation did not pass, receiving support from only 20% of votes cast.

- **New York Community Bancorp** – CalPERS proposal to seek majority vote standards for director elections passed, receiving support from 53% of votes cast.

2. Financial Market Reform

Security & Exchange Commission (SEC) – Investor Advisory Committee

Joseph Dear, CalPERS Chief Investment Officer, was named and appointed as Chairman to the SEC's new Investor Advisory Committee (IAC). The IAC is a newly formed board of 21 members who will advise the SEC on financial policy issues as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Committee members were nominated by the five sitting SEC commissioners who sought individuals to represent a wide range of interests, including those of senior citizens, mutual fund investors, pension funds, and state securities regulators.

The IAC will have the authority to submit findings for review and recommendation to the SEC on issues relating to the regulations of securities, trading and fees, and initiatives to protect investor interests, as well as to help the SEC set regulatory priorities.

CalPERS Testimony - The Impact of Dodd-Frank

Anne Simpson, CalPERS Senior Portfolio Manager, appeared before a congressional panel in July, 2012, telling lawmakers that the 2010 Dodd-Frank financial regulations reform law is important to establish an effective framework for promoting the safety and soundness of capital markets. At the hearing (Attachment 2 – Full Testimony), Anne described CalPERS six criteria for smart regulation:

- Be “complete and coordinated”
- Allow for the proper exercise of roles and responsibilities
- Ensure transparency
- Address “conflicts of interest and perverse incentives”
- Allow for the financing of “legitimate strategies”
- Be proportionate

CalPERS testimony emphasized critical elements of Dodd-Frank unfinished business which we regard as vital to establishing an effective framework for ensuring the safety and soundness of capital markets and protecting the rights of institutional investors. These critical elements are:

ELEMENT	OBJECTIVE
Derivatives Regulation	Ensure risks are disclosed, and conflicts of interest are addressed.
Volcker Rule	Impose careful constraints on proprietary trading by federally insured financial institutions.
Alignment of Interest	Ensure interests are aligned between company executives and providers of long term capital, through incentive structures that reflect the potential rewards and downside risk.
Credit Rating Agencies	Improve transparency and accountability of credit rating agencies.
Shareowner Rights/Protections	Provide investors with better tools and information to hold directors more accountable going forward.
Regulatory Agency Funding	Provide for well-managed and well-staffed regulatory agencies charged with the oversight of investor protections through appropriate funding.

3. Corporate Engagement

Individual Company Engagement

CalPERS engages individual companies in the Fund's capacity as a public equity shareowner through both annual structured programs and on an ad hoc basis, including the following:

- **Focus List:** Staff engages 7-10 underperforming companies per year to address a multitude of governance practices including board structure, risk management, executive compensation, diversity, director accountability, transparency, and sustainability.
- **Majority Voting Standards for Director Elections:** Staff engages approximately 50-75 companies each year to seek adoption of majority voting standards in director elections.
- **Say-on-Pay Analysis:** Staff analyzes and votes approximately 2,800 domestic say-on-pay proxy items each year. In each of the last two years, CalPERS has voted AGAINST approximately 200 of these resolutions. For these AGAINST votes, CalPERS proactively reaches out to each company to communicate the rationale for voting AGAINST and to seek the appropriate resolution to CalPERS concerns.
- **Ad Hoc Engagements:** Staff is currently engaging a portfolio of 14 Ad Hoc companies on a wide range of issues including compliance with California Iran Act legislation, corporate responsibility in conflict-affected regions of the world, and violations of human rights and fair labor practices.

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 a director 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, 47 of the 2011 companies have agreed to adopt majority voting, while engagement continues with the remaining companies.

Staff is in the process of expanding this majority voting initiative to the next round of targeted companies within the Russell 3000 where plurality voting still exists.

Diverse Director DataSource & Candidate Searches

The Diverse Director DataSource (3D) has been commissioned by CalPERS in partnership with CalSTRS, as a new resource for finding talent to serve on corporate boards. Applicants with the relevant skills and experience to be considered a director candidate can submit their profiles at www.GMI3D.com. Now that a deep pool of candidates has been established, shareowners, companies, diversity groups and other organizations will be able to use 3D to recruit potential board directors.

At the July 19, 2012, New York Stock Exchange (NYSE) Moving the Needle event, CalPERS, CalSTRS and GMI announced that 3D is open to the corporate community. Over 700 candidate profiles have been started since the initial launch in August, 2011, and over 400 candidate profiles representing a wide variety of industries, geographies, areas of functional expertise as well as ethnicities, genders and ages are fully submitted and searchable.

The Moving the Needle event was sponsored by the NYSE and brought nominating/governance committee chairs and members and search firms together with board candidates for a peer exchange and networking session.

Alongside work on 3D, best practice guidelines for director nominations were developed out of our collaborative engagement with UnitedHealth Group to appoint an independent director to their board of directors. These guidelines are being utilized internally to assist other asset classes with their board appointments. In partnership with our retained search advisor, the Infrastructure Program successfully appointed an independent director to a portfolio company's board. We are now working closely with the Real Estate Program to fill two board positions.

Diversity – 30% Coalition

CalPERS joined a group of investors with over \$1.1 trillion in assets under management in writing to S&P 500 Index companies calling for board diversity to be addressed. The letter was sent on June 29, 2012, to 41 companies within the S&P 500 who have no women on their boards. Based on recent research by Catalyst, ION and GMI, women only hold 12-16% of corporate board seats. The letter requests that companies embrace diversity on their boards by moving towards women holding 30% of board seats by 2015.

A Catalyst study published in 2011 found that companies with the most diverse boards outperform those with the least by 26% based on return on invested capital. The research also suggests that companies with sustained diverse boards, defined as those with three or more diverse directors for at least five years outperformed those with the less diverse representation. The initiative is led by the 30% Coalition, which has set this as a voluntary target, not dictating quotas.

IPO Governance Expectations

Several significant events in 2012 related to companies seeking capital from investors through initial public offerings (IPO) have resulted in a spotlight being focused on poor corporate governance structures:

- The Jumpstart our Business Startups Act (JOBS Act) was signed into law which provides for the exemption of emerging growth companies (EGC) from certain securities laws and investor protections for up to five years.
- Carlyle Group attempted to include a provision in its IPO governing documents preventing shareowners from resolving claims against the company through the courts.
- Increasing prevalence of dual class voting structures.

Global Governance, Global Equity and Private Equity are currently developing an IPO governance strategic plan. The objective is to seek an improvement in either the initial valuation or future long-term stock price performance of private companies that become public corporations through the adoption of corporate governance best practices. The strategy is expected to be implemented using the following tactics:

- Develop an IPO governance expectations document, explaining the governance expectations CalPERS has for public companies, vis-à-vis the JOBS Act.
- Address core governance standards of accountability and transparency such as removing dual class, classified, or plurality voting structures.

- Seek support for CalPERS IPO governance expectations from our private equity partners, private equity industry associations, and the investment banking industry.
- Seek support through coalition building including other global investors, outreach to fund managers, and investor forums and networks to which CalPERS is a member.
- Explore an equity trading strategy that does not provide capital for IPOs coming to market which do not meet CalPERS governance expectations.

4. Institutional Relations

ESG Global Peer Exchange

On June 25, the Global Peer Exchange, led by CalPERS, met to discuss environmental, social, and governance (ESG) priorities for future collaboration including assessment of executive compensation, integrated reporting (which brings together financial and ESG disclosures), and ESG investment manager expectations. The Global Peer Exchange, consisting of 11 leading asset owners, was formed in 2010 to benchmark CalPERS sustainable investment efforts. The meeting was attended by 12 representatives from CalPERS, APG Asset Management (Netherlands), AustralianSuper (Australia), Government Employees Pension Fund (South Africa), Ontario Teachers' Pension Plan (Canada), PGGM (Netherlands), PREVI (Brazil), Public Investment Corporation (South Africa), and Universities Superannuation Scheme (United Kingdom).

International Corporate Governance Network (ICGN)

ICGN was founded in 1995 and has evolved into a global membership organization of over 500 leaders in corporate governance whose mission is to raise standards of corporate governance worldwide.

CalPERS is a founding member of ICGN and active through membership and committee participation. CalPERS COIO, Janine Guillot was appointed as Co-Chair the ICGN Accounting and Auditing Practices Committee (AAPC.) Staff participated in the ICGN Annual Conference, June 25-27, 2012. This year's sessions included a focus on compliance with corporate governance rules and regulations, investor protections in companies with concentrated ownership, governance of institutional investors, governance of state owned companies, and integrated reporting.

As AAPC Co-Chair, Janine Guillot conducted an open ICGN members meeting, prepared and presented the annual AAPC report to the ICGN membership, and co-hosted an AAPC meeting with Vania Maria da Costa Borgerth, Special Advisor for Corporate Reporting and Corporate Governance to the CEO of BNDES (Brazilian Development Bank.)

Principles for Responsible Investment (PRI)

The United Nations-backed PRI initiative is a network of asset owners, asset managers, and service providers working together to implement responsible investment practices.

CalPERS is a PRI founding signatory and in 2011 CalPERS Board member, Priya Mathur, was elected to the PRI Advisory Council (PRIAC) by asset owner signatories. Staff participated in the PRI Annual Meeting, June 28-29, 2012. This year's sessions included a focus on executive remuneration and the role of incentives, responsible investment in infrastructure, integration of ESG in private equity, managing human capital, and governance of PRI.

As an elected member of PRIAC, Priya Mathur contributed to robust discussions on improvements to how PRI is governed and its strategic priorities going forward. Staff contributed to working sessions on universal ownership and the role of human capital in ESG. In addition, staff led a panel discussion on investing in conflict-affected and high-risk areas.

Governance Program Priorities

Staff is currently preparing material for its annual Global Governance Program review which will be presented to the Investment Committee at its November, 2012 meeting. A comprehensive review of the Program's work streams, scope and priorities will be included in staff's annual review.

ATTACHMENTS

Attachment 1 – Proxy Voting Quarterly Report: April – June, 2012

Attachment 2 – Testimony of Anne Simpson Senior Portfolio Manager, Investments Director of Corporate Governance, CalPERS, before the United States House of Representatives Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises (July 10, 2012): *The Impact of Dodd-Frank on Customers, Credit, and Job Creators*

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