



Agenda Item 9a

November 13, 2012

ITEM NAME: Global Governance Program Update

PROGRAM: Global Governance

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

This item provides a Global Governance Program (Program) annual update on accomplishments over the last year, and key initiatives for the coming year.

Attachment 1 presents an overview of the Program, its key 2012 accomplishments and 2013 initiatives.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal of improving long-term pension and health benefit sustainability. Providing effective updates that support the Board in its oversight role ultimately enhance the ability of the Investment Committee and the System to monitor performance, initiatives, and contributions to the System's investment objectives.

BACKGROUND

The Program seeks good governance practices to ensure that CalPERS funds are being used for the benefit of our members to produce sustainable long-term returns that pay pensions. The 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 Global Governance. The Program operates through the following five work streams:

1. Principles and Proxy Voting

The Program is framed by CalPERS Global Principles of Accountable Corporate Governance (Principles), which are reviewed and approved by the Board. These Principles set out CalPERS expectations on governance, in particular shareowner rights, board quality and diversity, corporate reporting, executive compensation, and sustainability. The objective of the Principles is to ensure high standards of governance in order to underpin long-term value creation. The Principles guide proxy voting decisions at over 9,000 public companies in 47 markets worldwide, and shareowner proposal campaigns to seek improved governance practices at portfolio companies.

2. Corporate Engagement

CalPERS works directly with companies in the Total Fund portfolio to improve shareowner rights, board structure (quality, accountability and diversity), and corporate reporting in order to protect investment returns. The flagship engagement initiative is the Focus List Program, in which CalPERS engages with financially underperforming companies to improve governance practices and contribute to improved performance. CalPERS also engages boards of directors on specific issues such as proxy access, majority voting, executive compensation, and environmental disclosure. CalPERS often coordinates closely with other investors to support corporate engagement initiatives.

3. Capital Market Stability

This work stream is responsible for CalPERS analysis and advocacy for market-wide regulation which protects investors. CalPERS developed a statement on regulation focusing on the importance of transparency, independent oversight by regulators, the need to avoid restrictions on investment opportunity, and the need to support systemic risk oversight. Within this work stream CalPERS is focusing on the integrity of corporate financial reporting (accounting and auditing) and regulatory effectiveness.

4. ESG Integration

The Program leads a cross-asset class team to integrate relevant environmental, social and governance (ESG) factors across the Total Fund. This work stream has delivered CalPERS first baseline Total Fund report on ESG and catalogued a wide range of activity across the asset classes under three forms of capital: physical capital (climate change), human capital (labor practices) and financial capital (alignment of interest). The next phase will deliver a portfolio-wide statement of principles in place of multiple guidelines, an “expectations document” on ESG for internal and external investment managers across the portfolio, and a review of evidence on the impact of ESG factors on investment risk and returns, in order to highlight where further work may be needed.

5. Institutional Relations

CalPERS provides thought leadership by participating in investor forums, networks and regulatory committees to leverage resources, build partnerships, achieve effective consensus building, share best practices, and advocate for CalPERS capital market and corporate engagement agenda. Examples of groups where CalPERS has a leadership role include: the Council of Institutional Investors (CII), Ceres, the International Corporate Governance Network (ICGN), and the UN-backed Principles of Responsible Investment (PRI), the Investor Advisory Group to the Public Company Accounting Oversight Board (PCAOB), the Investor Advisory Committee to the U.S. Securities and Exchange Commission (SEC) and the Systemic Resolution Advisory Committee to the Federal Deposit Insurance Corporation (FDIC).

ANALYSIS

The last twelve months have resulted in a number of accomplishments within each of the Program’s five work streams which are described as follows.

1. Principles and Proxy Voting Work Stream

Over the last year, CalPERS achieved proxy voting support from over 50% of all shares voted at each of the six companies where CalPERS ran a shareowner proposal including at Apple Inc. where CalPERS proposal received support from 80% of all votes cast. CalPERS also exercised over 97,000 proxy votes in compliance with CalPERS Statement of Investment Policy for Global Proxy Voting (Global Voting Policy). In addition, CalPERS voted “AGAINST” say-on-pay proxy proposals at over 200 U.S. companies followed up with communicating the Fund’s voting rationale and seeking improvement in compensation practices with the boards of each company. Compared to 2011, say-on-pay vote outcomes appear to be triggering change for the better in 2012. CalPERS voted “FOR” the say-on-pay proxy resolution at 87 companies in 2012 due to improvement in pay practices where the Fund’s votes had previously been cast “AGAINST” in 2011.

CalPERS Global Voting Policy states that proxy voting rights must be diligently exercised as part of the Fund’s fiduciary duty. Staff reviews information provided by companies, market experts, investors, and proxy advisory firms to ensure votes are cast in line with CalPERS Principles.

For the third quarter of 2012, CalPERS voted on 9,001 proposals, supporting 88% of management proposals and 78% of shareowner proposals. CalPERS voted “FOR” or “AGAINST” proposals in the U.S. and overseas on a range of issues including board independence, compensation, voting thresholds, compensation, political donations, sustainability and takeovers. During this period, staff did not vote at one company meeting due to share blocking as casting votes at these meetings would have prevented the rebalancing of portfolios. Share blocking is the “freezing” of shares for trading purposes at the custodian/ sub-custodian bank level in order to vote proxies. All other votes were successfully cast.

Attachment 2 provides accomplishments for shareowner proposals filed by CalPERS and say-on-pay proxy vote decisions over the last year and a summary of CalPERS proxy voting for the third quarter of 2012.

Key initiatives in the coming year are described as follows:

Scope	Principles and Proxy Voting 2013 Initiatives
Global Principles of Accountable Corporate Governance	<ul style="list-style-type: none"> • Complete annual review and update of Principles to incorporate the total fund.

Scope	Principles and Proxy Voting 2013 Initiatives
Proxy Voting	<ul style="list-style-type: none"> • Execute proxy voting and reporting duties for CalPERS 9,500+ Global Equity portfolio holdings. • Correspond with companies and shareowners about significant proxy votes. • Disclosure of Top 300 proxy votes on CalPERS website in advance of annual meetings.
Executive Compensation: Say-on-Pay Analysis	<ul style="list-style-type: none"> • Analysis, voting, and reporting for 2,800 U.S. company proxies as a result of Dodd-Frank Act. • Communicating “AGAINST” vote rationale and seeking improvement to portfolio company compensation plans.
Shareowner Proposal Campaigns	<ul style="list-style-type: none"> • Launch shareowner proposal campaigns to support core corporate engagement issues.

2. Corporate Engagement Work Stream

Over the last year, CalPERS impacted \$1.1 billion of its public equity portfolio through the adoption of majority voting standards for director elections, launched the first of its kind Diverse Director Datasource (3D), and collaborated with like-minded investors to seek improved gender diversity at over 40 portfolio companies. In addition, CalPERS monetized its Focus List which will result in an additional investment of up to \$250 million over the next five years. Wilshire Associates’ examination of CalPERS corporate engagement activities through the Focus List Program shows that CalPERS good governance agenda has added value to the share prices with targeted companies collectively producing stock returns of 17.08% above the Russell 1000 Index.

Attachment 3 provides additional information on accomplishments for CalPERS Corporate Engagement work stream through the Focus List Program, majority voting, and diversity initiatives.

Key initiatives in the coming year are described as follows:

Scope	Corporate Engagement 2013 Initiatives
Annual Focus List	<ul style="list-style-type: none"> • Invest additional capital in companies engaged through the Focus List Program. • Engage 7-10 underperforming companies. • Seek improved governance practices related to board structure, risk management, executive compensation, board quality and diversity, and sustainability disclosure (environmental and social factors)
Principles Based Engagement	<ul style="list-style-type: none"> • Engage 50-75 companies on majority voting standards for director elections.

Scope	Corporate Engagement 2013 Initiatives
Ad Hoc Company Engagements	<ul style="list-style-type: none"> Engage companies regarding compliance with the California Iran and Sudan Acts. Engage companies on core issues consistent with CalPERS corporate engagement work stream such as executive compensation and sustainability.
Board Diversity	<ul style="list-style-type: none"> Use Diverse Director Datasource to support engagement of public portfolio companies. Use Diverse Director Datasource to support CalPERS asset classes including Real Estate and Infrastructure.

3. Capital Market Stability Work Stream

CalPERS responded to requests for comment, provided testimony, and participated in roundtable discussions to demonstrate thought leadership and advocacy for CalPERS core issues over the last twelve months. In addition, to provide thought leadership on such core issues as systemic risk and capital market reform, CalPERS staff has been appointed to sit on U.S. regulatory advisory bodies including the SEC Investor Advisory Committee (Joseph Dear), FDIC Advisory Board (Janine Guillot), and PCAOB Investor Advisory Group (Anne Simpson). In addition, CalPERS has initiated a strategy to address poor governance practices at emerging growth companies in response to the JOBS Act.

Attachment 4 summarizes CalPERS advocacy and thought leadership via comment letter, testimony, and meetings with regulatory leaders over the last twelve months.

Key initiatives in the coming year are described as follows:

Scope	Capital Market Stability 2013 Initiatives
Dodd-Frank Wall Street Reform and Consumer Protection Act	<ul style="list-style-type: none"> Support enactment of unfinished rulemaking which pertains to derivatives regulation, proprietary trading by banks, credit rating agency reform, and corporate governance provisions designed to strengthen shareholder rights and investor protections.
U.S. Securities & Exchange Commission	<ul style="list-style-type: none"> Support rulemaking on proxy access, executive compensation, financial reporting standards, sustainability disclosure, and board diversity.
Accounting & Auditing Integrity	<ul style="list-style-type: none"> Advocate for high-quality global accounting standards.
IPO Governance Expectations	<ul style="list-style-type: none"> Adopt governance best practices for emerging growth companies seeking capital from public markets.

4. ESG Integration Work Stream

The ESG has continued its ongoing effort to integrate sustainability factors into investment decision making across the Total Fund. The work stream has framed its scope around three forms of capital (financial, physical, and human), focusing on strategic themes which include alignment of interest through good governance, climate change, and fair labor practices. Over the last year significant milestones have been achieved including the establishment of an ESG Cross-Asset Class Team and the launch of CalPERS first total fund report – Towards Sustainable Investment: Taking Responsibility.

Attachment 5 summarizes CalPERS achievements as well as the progress being made on three core ESG initiatives.

Key initiatives in the coming year are described as follows:

Scope	ESG Integration 2013 Initiatives
Chair/facilitate Internal ESG Cross-Asset Class Team	<ul style="list-style-type: none"> Support asset class objectives to implement specific measures to integrate ESG into investment decision making processes.
Global Peer Exchange	<ul style="list-style-type: none"> Facilitate collaborative ESG work with a number of CalPERS largest asset owner and pension fund peers from around the world.
ESG Reporting & Disclosure	<ul style="list-style-type: none"> Conduct a refresh of CalPERS sustainability report.
Manager ESG Expectations	<ul style="list-style-type: none"> Deliver internal and external expectations for how CalPERS managers and partners integrate ESG into investment decision making processes.
Total Fund Principles on Sustainability	<ul style="list-style-type: none"> Develop Total Fund sustainability principles.
ESG Investment Beliefs	<ul style="list-style-type: none"> Conduct ESG Board Workshop to support CalPERS adoption of ESG investment beliefs.
Integrated Reporting	<ul style="list-style-type: none"> Interface with relevant industry bodies regarding integrated reporting. Integrate financial and sustainability information into the corporate reporting cycle.

5. Institutional Relations

Over the last year, CalPERS has achieved a number of thought leadership positions. Staff and board members have been elected to the boards of leading governance organizations including CII and PRI. In addition, CalPERS staff has been appointed to governance organizations and regulatory oversight bodies

including the SEC Investor Advisory Committee, PCAOB Investor Advisory Committee, FDIC Investor Advisory Board, and ICGN Accounting and Auditing Practices Committee.

Attachment 6 provides a summary of the governance organizations where CalPERS exhibits thought leadership.

Key initiatives in the coming year are described as follows:

Scope	Institutional Relations 2013 Initiative
Investor Forums & Networks	<ul style="list-style-type: none"> • Support CalPERS participation in investor forums and networks.
Regulatory Advisory Committees	<ul style="list-style-type: none"> • Support CalPERS participation on regulatory advisory committees.
Investor Coalition Building	<ul style="list-style-type: none"> • Build core issue specific coalitions of pension funds and other asset owners. • Lead/facilitate Global Peer Exchange to address ESG priorities, key performance indicators, and procurement.
External Communications	<ul style="list-style-type: none"> • Manage governance website, governance issues related press, social media, and external governance inquiries.
State Law Compliance	<ul style="list-style-type: none"> • Ensure Iran/Sudan Act compliance. • Ensure Northern Ireland and Holocaust reporting requirements.
Internal Relations Management	<ul style="list-style-type: none"> • Support Global Governance Working Group. • Respond to ad hoc Board inquiries. • Enable cross-enterprise business unit collaboration on governance issues.
ESG Organizations Index	<ul style="list-style-type: none"> • Evaluate leadership, participation and resources.

ATTACHMENTS

- Attachment 1 – Global Governance Program Accomplishments and Key Initiatives
- Attachment 2 – Compilation: Principles and Proxy Voting Accomplishments
- Attachment 3 – Compilation: Corporate Engagement Accomplishments
- Attachment 4 – Capital Market Stability
- Attachment 5 – ESG Integration
- Attachment 6 – Institutional Relations

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