

CalPERS ESG Integration January 2012 – October 2012

CalPERS has a long-standing commitment to environmental, social and governance issues – known as ESG – with a broad range of innovative activity in the field. Sustainable investment is a complex arena with each ESG issue, each asset class and each sector of the economy all presenting unique challenges to overcome.

Sustainable investment means taking account of the full gamut of sustainability issues across all our day-to-day investment business. As a significant institutional investor with a long-term investment time horizon, CalPERS has a vested interest and a fiduciary duty to manage issues such as climate change, unfair treatment of labor and poor corporate governance as these may create material risks and opportunities for our investment portfolio.

We see that companies need three forms of capital to create wealth: financial, physical and human capital. We have developed three themes around these (Climate Change, Alignment of Interest and Human Capital), which set the framework for our ESG Integration work. Significant accomplishments and progress has been achieved to integrate sustainability factors into investment decision making across the Total Fund summarized as follows in Tables 1 and 2:

Table 1

Accomplishments	Key Points
Formalized ESG Cross-Asset Class Team	<ul style="list-style-type: none"> • Established in 2012, the ESG Cross-Asset Class Team (Team) comprised of Investment Office senior executives and staff from each asset class, functions to support the implementation of CalPERS Total Fund ESG Integration initiative. • The Team facilitates development of policy and strategic direction through a forum for cross-asset class coordination and input specifically focusing on CalPERS sustainability integration work.
Published CalPERS First Sustainable Investment Report – <i>Towards Sustainable Investment: Taking Responsibility</i>	<ul style="list-style-type: none"> • Launched in April 2012 at the Ceres Conference in Boston, Massachusetts, CalPERS released its first stand-alone Total Fund sustainable investment report chronicling the Fund's leadership and next steps in sustainable investment. • The report, which is the first of its kind by a large public pension in the United States, seeks to demonstrate CalPERS active commitment to transparently managing the fund in as sustainable a way as possible. • This report was well received by the global sustainable investor community.

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Accomplishments	Key Points
Integrating ESG factors into the Focus List Program	<ul style="list-style-type: none"> We engage companies in our U.S. portfolio that we believe are significantly underperforming on both stock returns and environmental, social and governance factors.

Table 2

Progress on Future Deliverables	Key Points
ESG Investment Beliefs – Review of Evidence	<ul style="list-style-type: none"> There remains a lack of global consensus on the evidence for how ESG factors influence financial performance. There is a need for clarity on the definition of sustainability and its impact on investment risk and return across each asset class. CalPERS commissioned the University of California, Davis, Graduate School of Management (UCD), to undertake an independent appraisal and analysis of existing academic and market evidence of the impact of ESG factors on investment risk and return. This research will inform CalPERS Total Fund ESG strategy and development of investment beliefs. It will also provide insight into what ESG factors and tools each asset class may seek to consider in the ESG integration process. CalPERS and UCD will host a symposium with leading investment practitioners and academics in April 2013 to discuss the findings from the review of evidence. The results will be presented to the CalPERS Board in June 2013.
Total Fund Principles on Sustainability	<ul style="list-style-type: none"> CalPERS seeks to reduce and rationalize the list of more than 100 initiatives on ESG issues that affect CalPERS across the total fund, in line with CalPERS core sustainability themes. To achieve this, CalPERS will establish a set of Total Fund Principles on Sustainability and a list of ESG initiatives based on their outcomes, their applicability to our fiduciary duty, capacity to deliver and impact. Global Governance will be working closely with the ESG Cross-Asset Class Team to facilitate the development of the

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	Total Fund Principles on Sustainability.
Internal and External Manager Expectation on ESG	<ul style="list-style-type: none"> • CalPERS largely uses internal managers for its public asset classes and external managers for its private assets. Across the range of asset managers, ESG factors are not articulated consistently. • Global Equity has piloted a manager questionnaire on ESG and is working to translate responses into a score which can be included in the qualitative assessment of manager skill. • This concept will be rolled out across the other asset classes to establish a core set of ESG questions to be included in manager appraisal and tailored as needed for the strategy being considered. • These questions will address two aspects of the potential manager’s capacity: their institutional policy and practices on ESG; and their investment policy and practices on ESG, if any. The result of this work will be a CalPERS “expectations document” on ESG for both internal and external managers.