

Global Governance Quarterly Program Update

May 13, 2013

Agenda

- Program Overview: Scope and Objectives, Mission and From-To Vision
- Sustainable Long Term Value Creation Framework
- Core Issues Evaluation Criteria
- Core Issues: Accomplishments and Progress

Program Overview: Scope and Objectives, Mission and From-To Vision

Program Scope and Objectives

- **We Aim to be a Principled and Effective Investor:** To deliver sustainable, risk-adjusted returns
- **Grounded in Economics:** Long-term value creation requires effective management of three forms of capital - financial capital, physical capital, human capital
- **Core Issue Driven:** Shareowner rights, board quality and diversity, corporate reporting, executive compensation, regulatory effectiveness
- **Work Streams:** Principles and Proxy Voting, Corporate Engagement, Capital Market Stability, Sustainable Investment, Institutional Relations
- **Thought Leadership and Coalition Building:** Investor Forum Leadership and the CalPERS Global Governance Website

Mission

Investment Office (INVO) Vision: We are known as an effective and principled investor, grounding everything we do with a commitment to serve our beneficiaries with excellence and be true to our fiduciary duty.

Global Governance Program Mission: Supports INVO's Vision by advocating sustainable risk adjusted returns via:

- Alignment of interest across corporations, markets, and external managers to address:
 - Shareowner Rights
 - Board Quality and Diversity
 - Incentive Structures – Executive Compensation
 - Corporate Reporting
 - Regulatory Effectiveness
- Transparent and stable capital markets
- Integration of relevant sustainability factors into long-term investment decision making

From – To Vision

FROM	TO
<ul style="list-style-type: none"> Inconsistent and partial reporting on CalPERS sustainable investment initiatives 	<ul style="list-style-type: none"> Total Fund report, "Towards Sustainable Investment"
<ul style="list-style-type: none"> Multiple guidelines on sustainability across asset classes and initiatives / programs 	<ul style="list-style-type: none"> Total Fund Principles on Sustainability and agreed list of priority initiatives
<ul style="list-style-type: none"> Varied internal and external manager expectations on sustainable investment 	<ul style="list-style-type: none"> Total Fund sustainability expectations document for internal and external managers
<ul style="list-style-type: none"> Lack of consensus on the evidence linking sustainability factors to performance 	<ul style="list-style-type: none"> Definition and analysis of sustainability factors and their impact on risk and return
<ul style="list-style-type: none"> Financial market reform priorities focused on U.S. capital markets 	<ul style="list-style-type: none"> Advancing reform priorities in global capital markets based on investment exposure
<ul style="list-style-type: none"> Unstructured process for managing CalPERS institutional relationships 	<ul style="list-style-type: none"> Leadership through partnerships with investors
<ul style="list-style-type: none"> Domestic Focus List Program 	<ul style="list-style-type: none"> Monetized Focus List Program

Sustainable Value Creation Framework

Sustainable Value Creation Framework

Sustainable investment in its simplest form is the ability to continue, and for a long-term investor like CalPERS with long-term liabilities, it is critically important. Long-term value creation requires the effective management of three forms of capital: this is why we are concerned with environmental, social, and governance issues.

Physical Capital - Environment

Includes managing risk posed by climate change, and the use of natural resources and buildings

Human Capital - Social

Includes health, safety, and labor practices



Financial Capital - Governance

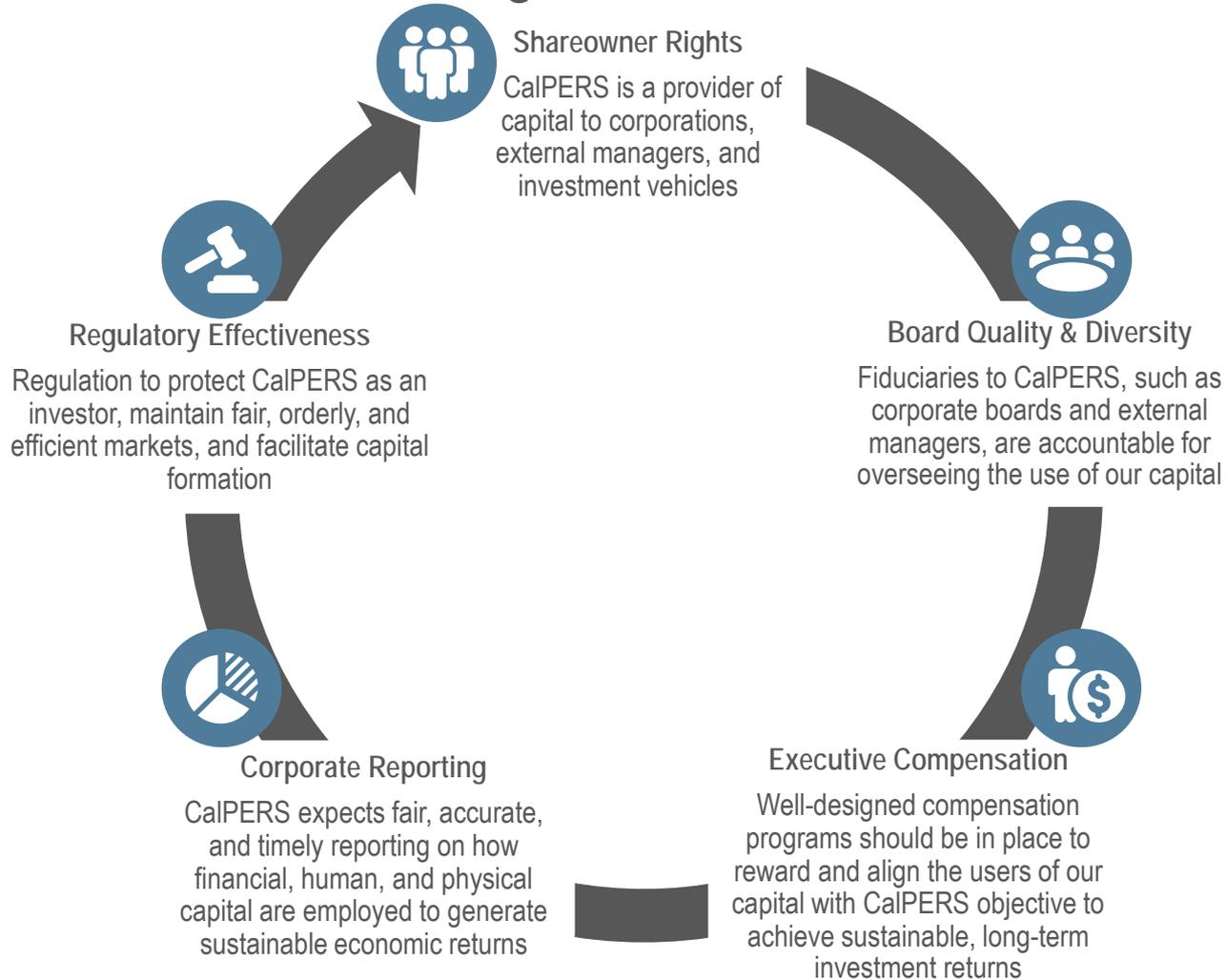
To ensure alignment of interest over equity, debt, public and private investments

Physical Capital Example – Climate Change

We've set out a strategy for our work to address the unifying theme of climate change in the following areas:

- **Advocacy** – with policy makers at home and globally
- **Engagement** – with our portfolio companies
- **Targeted Investments** – to deploy capital into opportunities
- **Research** – through our Sustainable Research Initiative (SIRI)
- **Operations** – we have also cut CalPERS impact on climate change from operations in significant ways

The Virtuous Circle of Long-term Value Creation



Core Issues Evaluation Criteria

Given the number of stakeholders and views, we need clear criteria for narrowing our focus on issues which can be clearly linked to furthering the Global Governance Program's mission and for deciding what type of role CalPERS should play.

Materiality Does the issue have the potential for a meaningful impact on portfolio risk or return?

Principles To what extent is the issue supported by CalPERS Principles of Accountable Corporate Governance?

Capacity Do we have the expertise and resources to influence a meaningful outcome?

Timeliness Is the issue time sensitive with a clearly defined deadline?

Definition and Likelihood of Success Is there a likelihood of success in that CalPERS action will influence an outcome which can be measured? Can we partner with others to achieve success?

Core Issues: Accomplishments and Progress

Core Issues: Where CalPERS Plays an Extensive Role

There are five priorities which staff believes have a material long term impact on risk and return, can effectively resource, and are considered to have a high likelihood of impacting the achievement of CalPERS goals.



Shareowner Rights: structural mechanisms that define the formal relationship between CalPERS as the capital provider and those charged with protecting and growing CalPERS capital



Board Quality & Diversity: diverse characteristics, experience, and competencies to ensure effective board leadership and oversight of CalPERS capital



Executive Compensation: incentive structures designed to protect and grow CalPERS capital which are aligned with the long-term sustainable economic interests of CalPERS Total Fund



Corporate Reporting: includes strong accounting and auditing standards, and sustainability reporting which leads to informed financial, physical, and human capital allocation decision making



Regulatory Effectiveness: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation



Shareowner Rights

Accomplishment

- **Apple Majority Vote:** In February 2013, Apple Inc. sponsored a management proposal to implement Majority Vote for Directors after two successful years of CalPERS shareowner resolutions. CalPERS collaborated with Apple Inc. management to solicit support for the Proposal No. 2, which received 98% support of proxies prior to the meeting . The passage of Proposal No. 2 would have amended Apple’s charter to provide for majority voting for directors, established a par value for Apple stock and eliminate Apple’s ability to issue preferred shares without shareholder approval. Greenlight Capital, a hedge fund pressing for issuance of preferred stock without recourse to shareowners, sought an injunction to block the vote. The court stopped the vote on the grounds that the three items were improperly bundled and should be voted on separately. Apple Inc. has promised to bring the vote back to shareowners at a later date.
- **Amicus Brief on the Timing of Annual Meetings:** Through work with the CalPERS Legal Office, we submitted an amicus brief to the Commonwealth of Massachusetts Supreme Judicial Court on the issue of the interpretation of the phrase “annual basis”, as applicable to the scheduling of shareholder meetings. We believe shareholder meetings should be held within a period of twelve months or in consecutive fiscal years.



Shareowner Rights

Progress

- **Majority Vote Campaign:** Staff identified and began engaging 50 companies in the Fall of 2012. To date, 34 of the 50 companies have or will be adopting the CalPERS request to adopt Majority Voting. We will continue engagement efforts at the remaining 16 companies. CalPERS has filed a Majority Voting shareowner resolution at Hatteras Financial, which will go to the vote at their May 21, 2013, Annual General Meeting. Staff will be running a full proxy solicitation in connection with this resolution.
- **Summary Proposal Votes:** CalPERS voted on 9,524 proposals, supporting 92% of management proposals and 77% of shareowner proposals. CalPERS voted “FOR” or “AGAINST” proposals in the U.S. and overseas on a range of issues including board independence, voting thresholds, compensation, board oversight and disclosure of charitable and political donations, sustainability and takeovers. During this period, all proxy votes were successfully cast.
- **Share Blocking:** During the first quarter of 2013, staff did not cast our vote at Norwegian Energy’s 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 on behalf of CalPERS.
- **Sustainability-Related Proposals:** Over the past three years, on average, we voted “FOR” sustainability-related shareowner proposals 93% of the time. These cover a wide variety of sustainability issues, including increased transparency of critical sustainability risks in the oil and gas sector and corporate suitability reporting.



Shareowner Rights

Progress

- Proxy Access has been a longstanding priority for CalPERS. We continue to advocate for shareowners' right to access the company proxy and nominate candidates to company boards by supporting Proxy Access proposals. Previously, 14 shareowner resolutions were filed in 2012. Nabors Industries and Chesapeake Energy both received a majority of shareowner support where CalPERS ran a proxy solicitation. The following Proxy Access proposals have been filed over this past quarter. CalPERS will be voting "FOR" each of these resolutions as they are consistent with our support of proxy access at the SEC level of a 3% shareholder or group with a 3-year holding period or a threshold falling below that.

Company	AGM Date	Proposal Type
Hewlett Packard (HPQ) – 97% support	March 20, 2013	Management
Chesapeake Energy (CHK)	June 8, 2013	Management
Walt Disney (DIS) – 36% support	March 6, 2013	Shareholder
Verizon (VZ)	May 2, 2013	Shareholder
Bank of America (BAC)	May 8, 2013	Shareholder
Charles Schwab (SCHW)	May 16, 2013	Shareholder



Shareowner Rights

Progress

- **Hospitality Properties Trust (HPT):** CalPERS fifth consecutive proposal to declassify the board which will be put before shareowners at HPT's 2013 Annual Meeting on May 15, 2013. Last year, CalPERS proposal received support from 90% of the votes cast and 67% of the shares outstanding. To date, the company has not agreed to implement the proposal.
- **Focus List (FL) :**Continuing to engage 2012 FL companies and will be screening and selecting up to 10 Focus List companies that we will present and seek approval for at the September 2013 Investment Committee Meeting.
- **Relationship Index:** A draft of the total fund index cataloging staff participation in investor forums/networks has been completed. Next, staff will draft a framework for evaluating prioritization of CalPERS participation in sustainable investment related organizations.



Board Quality & Diversity

Accomplishment

- **Hewlett Packard (HP) Director Withhold Vote:** At the March 20, 2013, HP Annual General Meeting CalPERS withheld its vote from Board Chairman Raymond Lane, John Hammergren, and G. Kennedy Thompson due to failures at the company. After receiving a high opposition vote, Mr. Lane stepped down as chairman and both Mr. Hammergren and Mr. Thompson are leaving the board.

Progress

- **CII “Zombie” Directors Campaign – Directors who have lost the vote:** The Council of Institutional Investors (CII) started an initiative in 2012 to identify and engage companies where directors who fail to obtain at least a majority support in uncontested elections step down from their board and not be reappointed. In 2012, 62 directors failed to meet the 50.1% hurdle and CII has sent letters to these companies requesting boards remove these “zombie” directors. As of April 3, 2013, 53 of these directors remain on company boards. CalPERS will be targeting Nominating/Governance Committee Chairs at companies where directors received a majority of withhold votes and failed to step down.



Board Quality

Progress

- **S&P 500 Companies Board Diversity Engagement:** CalPERS and CalSTRS sent a joint letter to the 41 S&P 500 companies we contacted in June 2012 on board quality and diversity. The 41 companies were identified for having all male boards. Since the initial letters were sent, two companies nominated a woman to their board: AvalonBay Communities, Inc. and QEP Resources. A number of the companies have also made positive changes in the form of adoption of a board diversity policy. We are writing to follow-up and continue encouraging improved diversity on their boards as well as share the National Association of Corporate Directors' (NACD) recent Blue Ribbon Commission Report, *The Diverse Board: Moving from Interest to Action*.
- **UnitedHealth Group (UNH) Board Appointment:** CalPERS co-authored an article with Michele Hooper, Chair of the Nominating and Governance Committee at UNH, which was recently published in the NACD Directorship Magazine. The article, *How to Engage Shareholders when Selecting New Directors*, highlights CalPERS and UNH's collaborative work to appoint a new independent director to the UNH board and details the nomination process that was developed along the way.
- **NACD Panel on Board Quality:** CalPERS is coordinating with the National Association of Corporate Directors to develop a panel on Board Quality for their Chapter Meeting on June 20, 2013. CalPERS recently became a member of the NACD. Directors and executives from public, private and non-profit companies look to the NACD as a source of research, best practice, board development and director education.

Executive Compensation

Accomplishment

- **Say on Pay Letter Writing Campaign:** We have successfully communicated (via letter) CalPERS Say on Pay “AGAINST” votes to 231 U.S. companies. CalPERS engagement efforts highlight us voting “FOR” 87 companies where votes had previously been cast “AGAINST” – a demonstration of positive change with portfolio company compensation practices.

Progress

- **Say-on-Pay Director Withhold Vote Campaign:** As of the year-ending 2012 CalPERS voted “AGAINST” 52 portfolio company Say-on-Pay proposals for two consecutive years. Of these companies 15 failed to receive greater than 50 percent shareowner support in 2012. As we enter into the 2013 proxy season staff is recommending a withhold vote campaign for responsible directors at companies that have not adequately addressed shareowner concerns on executive compensation.
- **Nabors Industries:** CalPERS filed its second consecutive proposal to limit executive severance payouts without shareowner approval at the company’s 2013 Annual Meeting on June 4, 2013. Last year the same proposal received support from 66% of votes cast and 52% of shares outstanding. Consistent with CalPERS Global Principles of Accountable Corporate Governance, the proposal asks the company to seek shareowner approval of future severance agreements with senior executives that provide total benefits exceeding 2.99 times that sum of the executive’s base salary plus bonus.



Corporate Reporting

Accomplishments

- **Review of Evidence:** The Sustainable Investment Research Initiative (SIRI) call for papers yielded 94 academic papers; seven papers have been selected for presentation at the upcoming Sustainability & Finance Symposium, a technical academic discussion, hosted by the UC Davis Graduate School of Management, and co-chaired by the Columbia Law School.
- **Sustainability Accounting Standards Board (SASB):** As of January of this year, Jameela Pedicini of CalPERS was appointed to the standards setting council of Sustainability Accounting Standards Board. This newly formed organization is engaged in the development and dissemination of industry-specific sustainability accounting standards. SASB will provide investors with something they vitally need to address climate risks: standardized information on material sustainability factors alongside financial information. On April 16, 2013, CalPERS spoke on a panel at the SASB Delta Series Financial Sector conference in New York. The discussion focused on the newly developed draft financial industry standards – looking at the need for reporting of relevant sustainability factors in the Form 10-K (annual report). SASB will next develop standards for the Technology & Communications and the Non-Renewable Resources Sectors. The Harvard Business Review's recent paper, *The Performance Frontier*, examines the link between relevant sustainability factors and financial performance and highlights the work SASB is undertaking.
- **Asset Owner Disclosure Project:** CalPERS was ranked 15th out of 1,000 global asset owners.



Corporate Reporting

Progress

- **Climate Change Scenarios – Implications for Strategic Asset Allocation:** CalPERS commissioned a study to examine the potential impacts for climate change factors on strategic asset allocation and we continue to assess the impact of climate risks across our total fund.
- **The Sustainability & Finance Symposium,** hosted by the UC Davis Graduate School of Management, will convene leading academics and practitioners to foster a rigorous debate and discussion on sustainability, long-term value creation and capital market stability. The Symposium will be a technical academic inquiry into the definitions and relevance of sustainability factors and related policy issues for long-term capital providers. Research findings from the Symposium will be presented at the Investment Committee Board Workshop on June 17, 2013. It is expected that the results of the symposium will help inform the Investment Committee's discussion on investment beliefs.
- **Total Fund Principles on Sustainable Investment:** The next step in CalPERS work to integrate relevant sustainability factors across the portfolio is to develop Total Fund Principles on Sustainable Investment (Principles). We've commissioned Mercer Consulting to rationalize the existing list of the 111+ sustainability initiatives and policies by applying the criteria for evaluating core issues and ensuring alignment with the three forms of capital (financial, physical, human). The Global Governance Program will use the recommendations from Mercer's review to collaborate with the Sustainable Investment Cross-Asset Class Team and develop a total fund level Principles document that encompasses sustainability themes across all asset classes.



Corporate Reporting

Progress

- **Towards Sustainable Investment Report (2nd edition):** The Governance Program will begin working with the Sustainable Investment Cross-Asset Class team to draft the next edition of the report in time for release at the PRI In Person Conference on October 1, 2013.
- **Auditing and Accounting Comment Letters:** In coordination with International Corporate Governance Network (ICGN), CalPERS responded to the Financial Accounting Standards Board's (FASB) request for comment on Financial Statement Disclosures and European Financial Reporting Advisory Group's (EFRAG) discussion paper on a Disclosure Framework for the Notes of the Financial Statements. Also, through this coordination we are in the process of drafting a letter to the International Accounting & Auditing Standards Board (IAASB) on a framework for audit quality as well as to the Financial Reporting Council (FRC) on revisions requiring the auditor's report to address risks of material misstatement, materiality and a summary of the audit scope.
- **CII Audit Policy:** Revisions to the CII Corporation Governance Policies went to a vote at the April 19, 2013, CII General Members' Meeting. A portion of the revisions address the role of the audit committee in oversight of the independent auditor and further calls upon audit committees to proactively carry out their responsibilities and facilitate auditor independence, audit quality and auditor rotation.



Corporate Reporting

Progress

- **Corporate Reporting White Paper:** In partnership with the CalPERS Legal Office, we've begun drafting a corporate reporting white paper, which sets out the corporate reporting issues, proposed best practices and our long-term vision.
- **Investor Network on Climate Risk (INCR):** CalPERS was a founding member of INCR and continues to actively participate in regular calls, events, and webinars on topics such as Sustainable Stock Exchanges. INCR is a leading network of 100 institutional investors representing more than \$10 trillion in assets committed to addressing the risks and opportunities resulting from climate change.



Corporate Reporting

Progress

- **Company Engagement on Disclosure:** CalPERS firmly believes engagement is the first call of action with companies. Our Global Principles of Accountable Corporate Governance (Principles) set out our expectations on corporate governance, executive compensation, sustainability risks, diversity and market conduct. Specifically, we request companies to “provide accurate and timely disclosure of environmental risks and opportunities through adoption of policies or objectives, such as those associated with climate change.” Our Principles also state our expectations on climate risk disclosure, calling for companies to use the *Global Framework on Climate Risk Disclosure* which recommends disclosure on greenhouse gas emissions, strategic analysis of climate risk and emissions management, assessment of physical climate risks, and an analysis of regulatory risks.
- **Ceres Campaign:** Our Global Governance Program also engages with more than 100 companies on an annual basis to ensure the high standards of corporate governance that underpin effective climate change risk management. As part of our engagement work we lent our support to Ceres’ Campaign asking Russell 1000 companies to provide comments on the *21st Century Corporate: The Ceres Roadmap to Sustainability* which calls for corporate reporting on sustainability factors, including climate change risks.



Regulatory Effectiveness

Accomplishments

- **Congressional Meetings:** We've met with Congressional staff and regulators on both the unfinished business of Dodd-Frank and financial benchmarks in the wake of the London Interbank Offered Rate (LIBOR) scandal. (The meetings are in alignment with the CalPERS 2012-14 Enterprise Business Plan initiatives to impact regulatory oversight by engaging legislative, regulatory, securities exchange, or other policy makers to address CalPERS capital market stability priorities.)
- **Re-election to the Council of Institutional Investors' (CII) Board :** Anne Simpson, Senior Portfolio Manager and Director of Global Governance, was re-elected to the CII's Board as one of the nine public fund directors. Serving on the Board this past year, Anne contributed to the vitally important work of promoting good governance, shareowner rights and sustainable financial markets. She has been active on the governance and activism committees, championed CII campaigns by engaging companies that did not implement shareowner proposals, and elevated the issues of "zombie" directors and rogue pay arrangements.
- **Public Company Accounting Oversight Board (PCAOB) Investor Advisory Group:** Anne Simpson was re-appointed to the PCAOB Advisory Group (IAG). The IAG consists of 20 members who will serve three-year terms ending October 2015. This group was established as a forum for the investor community to provide views and advice on matters affecting investors and the work of the PCAOB.

Regulatory Effectiveness

Progress

- **New SEC Chair** : CalPERS wrote to the new SEC Chair, Mary Jo White, to send our congratulations and looks forward to working with her on investor issues.
- **SEC Investor Advisory Committee**: Joseph Dear, Chief Investment Officer, continues to serve on the SEC Investor Advisory Committee as Chairman. The most recent meeting was held on April 11, 2013. Section 911 of the Dodd-Frank Act established the Committee, which meets to advise the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, and on initiatives to protect investor interests and promote investor confidence and the integrity of the securities marketplace.
- **SEC Climate Change Risk Disclosure**: Our CEO, Anne Stausboll, Co-Chair's Ceres, who successfully advocated the US Securities and Exchange Commission (SEC) to issue guidance requiring disclosure of climate change risks in corporate filings.
- **Global Investor Statements**: In connection with the United Nations Climate Change Conferences in Copenhagen (2009), Cancun (2010), Durban (2011), and Doha (2012), we have endorsed global investor statements and action plans on climate change calling for effective domestic and international policy frameworks to catalyze the development of clean energy and well-designed carbon markets.

Global Governance website:
www.calpers-governance.org/

View and download Full Sustainable Investment Report at:
<http://ow.ly/aoHfm> or scan the QR code

