



## Agenda Item 7a

August 19, 2013

**ITEM NAME:** Global Governance Program Update

**PROGRAM:** Global Governance

**ITEM TYPE:** Program Review – Information

### **EXECUTIVE SUMMARY**

This item provides a quarterly update on the Global Governance Program (Program) in line with the core issues framework, which sets out a vision of sustainable investment focused on long-term value creation. The attached presentation (Attachment 1) provides an update on the following:

- **Program Overview** – Scope and Objectives, Mission and From-To Vision
- **Sustainable Value Creation Framework** – Three Forms of Capital: Financial, Physical, and Human
- **Evaluation Criteria** – Principles, Materiality, Capacity, Timeliness, Definition and Likelihood of Success
- **Core Issues, Accomplishments and Progress** – Shareowner Rights, Board Quality and Diversity, Executive Compensation, Corporate Reporting and Regulatory Effectiveness

### **STRATEGIC PLAN**

This agenda item supports the CalPERS Strategic Plan goal of improving long-term pension and health benefits sustainability. Regular program updates support the Investment Committee in its oversight capacity.

### **BACKGROUND**

The Program's sustainable value creation framework is built upon effective management of the three forms of capital: financial, physical and human. The Program seeks good governance practices to ensure that CalPERS capital is deployed to produce sustainable long-term returns and meets pension obligations. The Program focuses on five core issues, which support long-term value creation: shareowner rights, board quality and diversity, executive compensation, corporate reporting and regulatory effectiveness.

As a provider of capital, CalPERS has a deep interest in shareowner rights. These help us define the relationship between CalPERS and fiduciaries, such as corporate boards and external managers that are accountable for overseeing the use of our capital. In addition, we want to ensure the boards and leadership responsible for oversight represent a diverse mix of characteristics, experience and competencies.

Well-designed compensation programs should be in place to reward and align the users of our capital with CalPERS objective to achieve sustainable, long-term value creation. CalPERS expects fair, accurate, and timely reporting on how financial, human and physical capital are employed to generate sustainable economic returns. Finally, we look to regulation to protect CalPERS as an investor, maintain fair, orderly, and efficient markets, and facilitate capital formation.

## **ANALYSIS**

The second quarter of 2013 (Q2) resulted in a number of accomplishments and continued progress for our five core issues. Details on the Program's accomplishments and progress are included in Attachment 1, with highlights as follows:

### **Core Issue – Shareowner Rights**

- Voted in compliance with the Statement of Investment Policy for Global Proxy Voting at 7,150 shareowner meetings. Attachment 2 provides an overview of global proxy votes cast.
- Filed proposals and ran proxy solicitation campaigns at three companies which won proxy voting support from a majority of shareowners – Hospitality Properties Trust, Hatteras Financial Corp., Nabors Industries.
- Identified and began engaging 50 companies in the Fall of 2012 to request adoption of majority voting standards in director elections with 42 agreeing to adopt CalPERS request.
- Requested the Board of Nabors Industries to amend the company's voting methodology to a standard that counts uninstructed broker votes for quorum purposes only.
- Attended the Wal-Mart annual meeting to express concern surrounding allegations of corruption within the company's operations in Mexico; questions around the company's supply chain code of conduct, following recent tragedies in Bangladesh; and the company's guilty plea and significant fines for violation of laws on hazardous waste disposal charges in California

### **Core Issue – Board Quality & Diversity**

- Directors David Cote and Ellen Futter will be stepping off the JP Morgan board while Occidental Petroleum Executive Chairman Ray Irani announced his resignation from the board due to high shareowner vote opposition. CalPERS voted AGAINST all three directors.

- The National Association of Corporate Directors (NACD) joined with CalPERS to present an in-depth discussion on Board Quality with Bonnie Hill, Director at Home Depot and Peggy Foran, Director at Occidental Petroleum.
- As part of the Council of Institutional Investors' "Zombie" Directors Campaign, CalPERS identified 53 directors who had received a majority withhold vote in 2012. To date, 22 directors and their respective companies have taken positive steps to address the underlying issue driving the high levels of opposition.
- The Diverse Director DataSource currently includes 600 potential director candidates with half of the pool of talent having current public board experience. CalPERS and CalSTRS are partnering to advocate for improved board quality and diversity at 41 companies within the S&P 500 Index.

#### **Core Issue – Executive Compensation**

- Voted AGAINST 212 say-on-pay resolutions or 9% of the total proposals that have come to vote through the first two quarters of 2013.
- Continues to implement a withhold vote campaign for directors responsible for the oversight of executive compensation practices at 15 companies who failed to achieve a majority of proxy votes cast in 2012.
- Expanded focus on poor executive compensation practices at portfolio companies in countries outside of the United States and leveraged CalPERS relationship with Global Peer Exchange asset owner partners in the United Kingdom to enable more informed analysis of executive compensation proxy vote decisions.
- Voted AGAINST the Nabors Industries say-on-pay proposal – which received a high level of opposition at 64%. Staff also withheld support from compensation committee chair John Lombardi who also failed to receive majority shareowner support.
- Staff is engaging 19 energy companies on the integration of sustainability performance into executive compensation and incentive plans.

#### **Core Issue – Corporate Reporting**

- On June 7, 2013, CalPERS and its academic partners presented findings at a co-led Sustainability & Finance Symposium, and launched a searchable database of more than 700 academic studies on sustainability factors that examine the impact of these factors on investment risk and return. Attachment 3 provides CalPERS Sustainable Investment Research Initiative Review of Evidence as compiled by UC Davis Graduate School of Management.

- Submitted a joint asset owner response letter to the International Integrated Reporting Council in support of integrated reporting. An integrated report addresses how an issuer's strategy, governance, performance and prospects lead to long-term value creation. It communicates an issuer's use and deployment of the three forms of capital – financial, human, and physical.
- Participated in the quarterly Sustainability Accounting Standards Board (SASB) Council meeting after which SASB released its first set of provisional sustainability accounting standards for six industries within the health care sector. SASB is engaged in developing industry-based sustainability standards to guide U.S. corporations and their investors on material environmental, social and governance (ESG) issues that should be disclosed and considered for a complete view of performance.
- CalPERS received a Commendation for the Best Responsible Investment Report by a Large Pension Fund from Responsible Investor for its publication titled, "Toward Sustainable Investment: Taking Responsibility." CalPERS is the only North American fund to be honored for an award in all pension categories.

#### **Core Issue – Regulatory Effectiveness**

- Provided written testimony to the U.S. House of Representatives Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises on the topic of examining the market power and impact of proxy advisory firms.
- Wrote letters to members of the U.S. House of Representatives California Delegation expressing concern and opposition to the Audit Integrity and Job Protection Act (HR 1564) and SEC Regulatory Accountability Act (HR 1062).
- Contributed thought leadership to the May 2013 Ceres Blueprint for Sustainable Investing for the 21<sup>st</sup> Century Investor. CalPERS is directly referenced for making a strong case for being an active advocate in financial market reforms due to the impact financial regulation can have on CalPERS investment objectives.
- Met with the Honorable Mary Jo White and her senior staff following her appointment as Chairman of the United States Securities and Exchange Commission (SEC, Commission). In alignment with the CalPERS Enterprise Strategic Business Plan, staff presented near term financial market reform priorities (Attachment 4).

#### **BUDGET AND FISCAL IMPACTS**

Not applicable

**ATTACHMENTS**

Attachment 1 – Global Governance Program Quarterly Update

Attachment 2 – Q2 2013 Overview of Global Proxy Votes Cast

Attachment 3 – Sustainable Investment Research Initiative Review of Evidence:  
Database of Academic Studies

Attachment 4 – CalPERS SEC Regulatory Priorities

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