

Global Governance Quarterly Program Update

August 19, 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, and 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, and 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"> Capital market stability 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

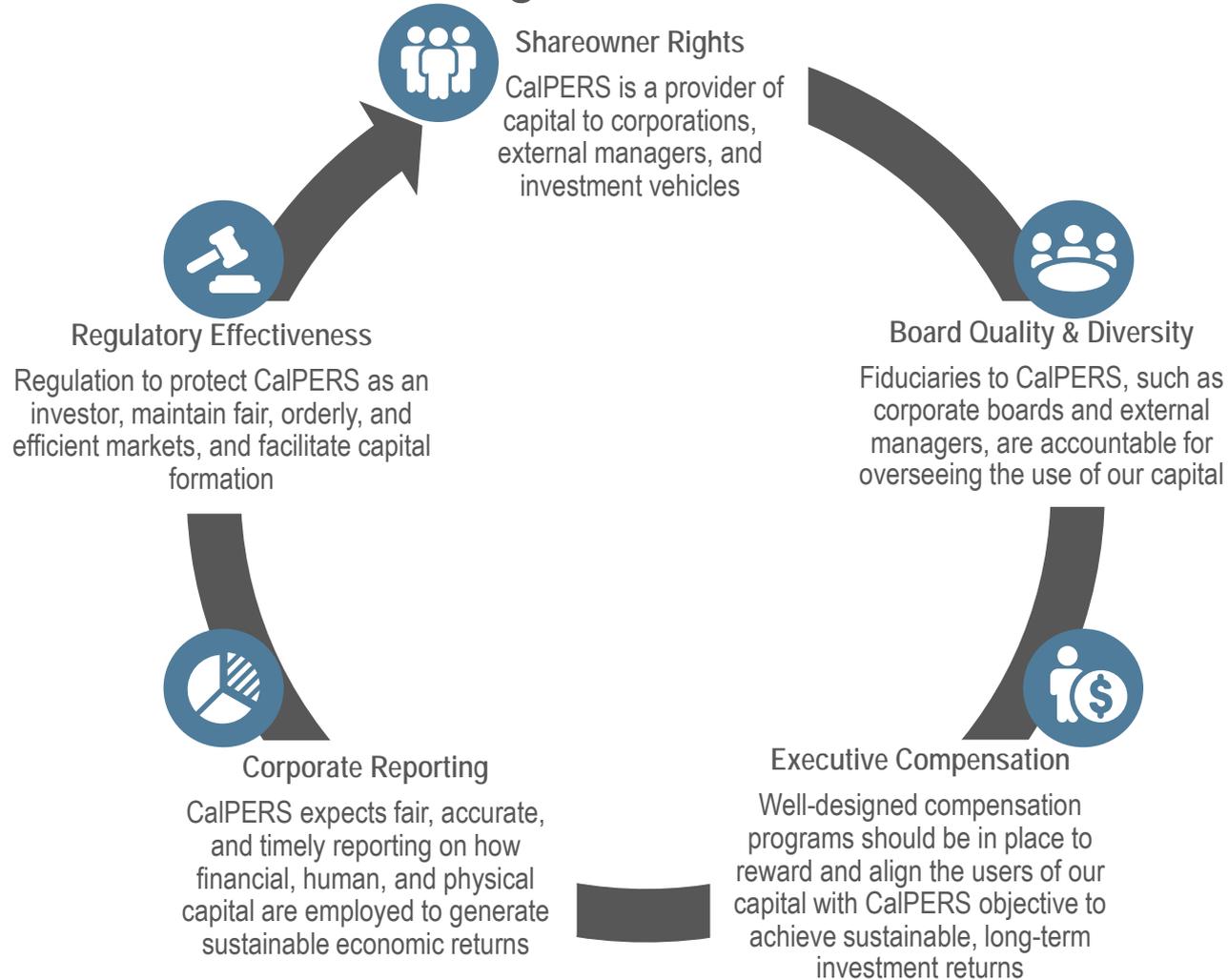
Includes health, safety, and labor practices



Financial Capital - Governance

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

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.

Principles

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

Materiality

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

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

- **Global Proxy Voting Execution** – CalPERS voted in compliance with its Global Proxy Voting Policy at 7,150 company meetings including votes for 79,108 individual proposals, supporting 88% of management proposals and 65% of shareowner proposals. Staff did not cast our vote at six company meetings 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.
- **Supporting Shareowner Rights** – CalPERS has been a longstanding proponent in the advancement of shareowner rights through proxy voting activity as highlighted by the number of shareowner rights resolutions CalPERS voted FOR through the first two quarters of 2013.

Shareowner Resolution	# of Proposals	Average Proxy Vote Support Level
Repeal Classified Board	29	80.4%
End Supermajority Vote Requirement	17	70.4%
Majority Voting for Director Elections	29	58.1%
Appoint Independent Board Chairman	56	41.9%
Right to Call Special Meetings	10	41.9%
Allow for Written Consent	26	40.7%
Proxy Access	11	32.2%



Shareowner Rights

- **Majority Vote Campaign** – Since 2010 CalPERS has engaged a wide range of domestic companies surrounding the adoption of majority vote for director elections. In 2012 staff began engagement efforts at another 50 companies with continued success – year to date we can confirm 42 of the 50 companies have agreed to adopt the CalPERS request. Staff will continue to engage the remaining eight companies and file shareowner resolutions where necessary.
- **Focus List (FL)** – Continuing to engage 2012 FL companies and will be screening and selecting up to 10 2013 FL companies that we will present and seek approval for at the October 2013 Investment Committee Meeting.
- **Hospitality Properties Trust (HPT)** – Following the 5th consecutive year of shareowners strong support for a proposal filed by CalPERS, HPT issued a press release stating the company would include a management proposal within the 2014 proxy to implement annual director elections. They also indicated they would be moving up the expiration date of its poison pill, from 2017 to December 31, 2013.
- **Hatteras Financial Corp (HTS)** – CalPERS proposal requesting majority vote for director elections received 67% shareowner support. The HTS board has indicated they will be discussing the vote result at an upcoming board meeting.



Shareowner Rights

- **Nabors Industries (NBR)** – For the second consecutive year a CalPERS proposal seeking shareowner approval of severance agreements received majority shareowner support at NBR. As a result, NBR has amended the CEO's contract limiting future severance payouts. Because of ongoing executive compensation concerns CalPERS voted AGAINST the NBR say-on-pay proposal – which received a high level of opposition at 64%. Staff also withheld support from compensation committee chair John Lombardi who failed to receive majority shareowner support. Staff will continue engaging the company these issues.
- **Nabors Industries (NBR) Vote Calculation** – CalPERS has concerns with NBR's unconventional vote calculation methodology. NBR considers uninstructed broker votes in the vote calculation for nondiscretionary items. CalPERS believes uninstructed broker votes should be used for quorum purposes only. Including uninstructed broker votes in the vote calculation is dilutive and produces an outcome that does not accurately represent voting shareowners. Therefore, CalPERS has requested that NBR immediately amend the company's voting methodology to a standard that counts uninstructed broker votes for quorum purposes only.
- **Wal-Mart (WMT)** – CalPERS voted AGAINST director nominees Aida Alvarez, James Cash, Michael Duke, H. Lee Scott, Christopher Williams, and Linda Wolf due to concerns surrounding the Board's oversight of operational and reputational risk. Examples of issues which have prompted this concern include: 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. Staff attended Wal-Mart's annual meeting and conveyed CalPERS concerns directly to Chairman and CEO Michael Duke. Staff is considering next steps including collaborative shareowner engagement initiatives with respect to human capital issues at Wal-Mart.



Shareowner Rights

- Proxy Access – We continue to advocate for shareowners' right to access the company proxy and nominate candidates to company boards by supporting Proxy Access proposals. The following Proxy Access proposals came to vote over this past quarter. CalPERS voted "FOR" each of the shareowner and management 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 at a level falling below either threshold.

Company Name	Meeting Date	% Support	Outcome
Microwave Filter Co.	4/10/2013	15.1	Fail
Verizon Communications Inc.	5/2/2013	53.3	Pass
Bank of America Corporation	5/8/2013	8.8	Fail
The Charles Schwab Corporation	5/16/2013	31.7	Fail
CenturyLink, Inc.	5/22/2013	71.5	Pass
iRobot Corporation	5/22/2013	18.2	Fail
CME Group Inc.	5/22/2013	32.9	Fail
The Goldman Sachs Group, Inc.	5/23/2013	5.3	Fail
Staples, Inc.	6/3/2013	36.9	Fail
Nabors Industries Ltd.	6/4/2013	51.0	Pass
Netflix, Inc.	6/7/2013	4.4	Fail
Chesapeake Energy (Management Proposal)	6/8/2013	98.2	Pass



Board Quality & Diversity

- **JP Morgan** – Governance reform continues as directors David Cote and Ellen Futter will be stepping off the JP Morgan board due to high opposition at the 2013 vote. CalPERS had withheld vote from each nominee due to their membership on the board’s risk committee and related oversight failures during a period when the company experienced more than \$6 billion in trading losses. Staff will continue to engage board leadership.
- **Occidental Petroleum** – At the 2013 Occidental Petroleum annual meeting CalPERS withheld its vote from Executive Chairman Ray Irani due to independent board leadership concern. These concerns were highlighted in the director vote where Irani received only 24 percent support. Mr. Irani resigned from the board after the meeting.
- **National Association of Corporate Directors (NACD) Panel on Board Quality** – NACD’s Northern California Chapter 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. 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.
- **Council of Institutional Investors (CII) “Zombie” Directors Campaign** – As part of the CII “Zombie” Directors Campaign, CalPERS had 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. However, six companies (Senior Housing Properties Trust, Cablevision Systems, Vornado Realty Trust, Healthcare Services Group, Omega Protein Corp., and Gold Resources Corp.) had not adequately addressed the high withhold votes – in each of these instances staff withheld votes from Nominating/Governance Committee member of the board.



Board Quality & Diversity

- **Diverse Director DataSource** – The Diverse Director DataSource (3D) provides a new pool of board talent. It is a resource for shareowners, company nominating committees and executive search firms seeking skilled individuals who can bring a fresh perspective to a board room, advance a company's business strategy and help investors achieve long-term, risk-adjusted returns. Currently, the pool includes over 600 potential director candidates. The pool includes some exceptional talent with half of the candidates having current public company board experience. 67 percent of the candidates are female and 26 percent of the candidates have gone through a board certification program. The success in gathering potential candidates reflects the wide and extensive consultation, with the 150 or more groups in our various roundtables. The candidates cut across a range of industries and functional expertise, with 25 percent having international experience. Together the candidates speak 41 different languages.
- **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.



Executive Compensation

- **McKesson Corp. (MCK)** – CalPERS withheld vote from Compensation Committee Chairman Alton Irby and voted against MCK’s advisory vote on executive compensation due to significant concerns surrounding MCK’s compensation program design and increasing elements of non-performance based pay for CEO John Hammergren. CalPERS also voted AGAINST Nominating and Governance Committee Chair Jane Shaw due to the boards failure to implement majority passed shareowner resolutions in 2012 – resolutions requesting an Independent Board Chairman and the Ability to Act by Written Consent. Staff attended the 2013 annual meeting where the company announced “preliminary” vote results indicating all directors were re-elected by a majority of the vote and the company’s Advisory Vote on Executive Compensation had failed.
- **Say-on-Pay Letter Writing Campaign** – Staff continued to analyze and vote domestic say-on-pay resolutions – then proactively reach out to companies we voted “against” to communicate our rationale and seek appropriate resolution to CalPERS concerns. Year to date CalPERS had voted “against” 212 say-on-pay resolutions or 9% of the total proposals voted. Staff is in the process of completing delivery of letters to communicate company votes.
- **Say-on-Pay Director Withhold Vote Campaign** – For two consecutive proxy seasons, 15 companies failed to receive greater than 50 percent shareowner support for their say-on-pay proposal. For the 2013 proxy season staff is recommending a withhold vote campaign at these companies for directors that have not adequately addressed shareowner concerns on executive compensation.

Executive Compensation

- Say on Pay Voting Outcomes – CalPERS voted AGAINST 39 say-on-pay resolutions which failed to receive a majority shareowner support. Below is a listing of companies where there was significant shareowner opposition (greater than 70% “against”).

Company Name	Outcome	% AGAINST
Alexandria Real Estate (ARE)	Fail	91%
The Children's Place Retail Stores (PLCE)	Fail	83%
Boston Properties Inc. (BXP)	Fail	81%
Navistar International Corp.	Fail	81%
Abercrombie & Fitch Co. (ANF)	Fail	81%
Verifone Systems Inc. (PAY)	Fail	80%
Kilroy Realty Corp. (KRC)	Fail	78%
Morgan Hotel Group Co. (MHGC)	Fail	73%
Annaly Capital Management Inc. (NLY)	Fail	72%

Executive Compensation

- **Global Peer Benchmarking on Executive Compensation** – Magnified our focus on CalPERS largest country holdings to expand discussions on executive remuneration and to improve CalPERS global voting practices. Staff leveraged CalPERS Global Peer Exchange (GPE) to improve analysis and market leadership on executive compensation. The GPE, consisting of 13 leading global asset owners representing \$1.5 trillion, seeks to exchange best practices, collaborate in order to improve impact, and leverage resources. Specifically, working with three U.K. institutional asset owners to determine voting differences and policy approaches to then sharpen our global vote practices on executive remuneration. We are continuing country by country within our top holdings to analyze differences and alignments.
- **Integrating Sustainability Performance Metrics in Executive Compensation** – Engaging 19 energy companies (utilities, oil/gas and extractives) on integration of sustainability performance (environmental, social, and governance) into corporate executive compensation packages and incentive plans. Utilizing discussions to recommend inclusion and measurement of sustainability metrics within remuneration that are material to the company's long-term business strategy and industry sector.



Corporate Reporting

- **Sustainable Investment Research Initiative: Review of Evidence** – CalPERS partnered with the UC Davis Graduate School of Management (UC Davis) to conduct a comprehensive review of academic evidence and to host the inaugural Sustainability & Finance Symposium on June 7, 2013. The Symposium convened leading academics and practitioners, including CalPERS Board members and senior investment staff. The purpose of this event was to engage in a rigorous technical debate on the findings of the seven presented papers in order to further our understanding of the definitions and relevance of sustainability factors and the impact they may have on long-term value creation from the perspective of a large, global, long-term, and multi-class institutional asset owner.
- **Sustainable Investment Research Initiative, Review of Evidence: Database of Academic Studies** – CalPERS and its academic partners 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. The database is believed to be the most comprehensive collection of research of its kind.
- **Investor Collaboration** – CalPERS led the fifth meeting of the Global Peer Exchange (GPE) hosted by TIAA-CREF on June 26, 2013 in New York. The meeting focused on such issues as aligning expectations of manager reporting, executive remuneration, developing infrastructure sustainability standards, and integrating reporting.



Corporate Reporting

- **Integrated Reporting Framework – International Integrated Reporting Council (IIRC):** CalPERS submitted a joint asset owner response letter to IIRC in support of integrated reporting along with comments on the draft integrated framework. An integrated report is a concise communication about how an organization’s strategy, governance, performance and prospects lead to the creation of value over the short, medium and long-term. It communicates an issuers use and deployment of the three forms of capital – financial, human, and physical. The IIRC will review comments and plans to develop a global framework for integrated reporting. Review of responses and follow-up discussion will drive the timeline for adoption.
- **Integrated Reporting Framework:** Staff continues to support and participate in the International Corporate Governance Network (ICGN) Accounting and Auditing Practices Committee (AAPC). Staff also participates as a liaison on behalf of the AAPC on the Non-financial Business Reporting Committee (NFBR) and assisted in drafting a response letter to the IIRC on the integrated framework. The ICGN NFBR submitted a response on July 4, 2013 and continues to engage members on the benefits and development of integrated reporting.



Corporate Reporting

- **Sustainability Accounting Standards Board (SASB)** – Staff participated in the quarterly SASB Standards Council meeting to review the standards development process for the technology and communications, and financials sectors. 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. In late July, 2013, SASB released its first set of provisional standards—for the six industries in the health care sector, designed for use by U.S. and foreign publicly companies in their annual filings (Form 10-K or 20-F) with the SEC.
- **Award for Best Responsible Investment Report** – CalPERS received a Commendation for the Best Responsible Investment Report by a Large Pension Fund from Responsible Investor for its recent publication titled, “Toward Sustainable Investment: Taking Responsibility.” CalPERS is the only North American fund to be honored for an award in all pension categories. Responsible Investor, a respected sustainable finance and governance news source, announced the winners at the RI Reporting Awards during its London summit in June. The Awards are based on research of more than 1,000 pension funds from around the world and recognize those funds that are most transparent about how they are putting responsible investment into action.



Regulatory Effectiveness

- **Congressional Testimony** – CalPERS provided written testimony to the United States 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. CalPERS testimony discussed our proxy voting and engagement efforts which underpin effective governance. This is a vital element in our fund achieving its long term risk adjusted returns and proxy firms provide useful research which supplements the analyses we perform in making proxy voting decisions.
- **California Delegation to the U.S. House of Representatives (California Delegation)** – CalPERS wrote letters to members of the California Delegation expressing concern and opposition to the Audit Integrity and Job Protection Act (HR 1564) and SEC Regulatory Accountability Act (HR 1062).
 - HR 1564: CalPERS urged opposition as we believe this legislation would unnecessarily restrict the ability of the Public Company Accounting Oversight Board to impose an auditor rotation requirement for registered public auditing firms, in the event they determine rotation is necessary.
 - HR 1062: CalPERS expressed strong concern that this legislation would threaten the efficient implementation of many important financial regulatory rules by imposing unnecessary requirements upon the Securities and Exchange Commission.
- **Thought Leadership** – CalPERS contributed thought leadership to the May 2013 Ceres Blueprint for Sustainable Investing for the 21st 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.



Regulatory Effectiveness

- Meeting with SEC Chair – In alignment with CalPERS Enterprise Business Plan strategic initiatives, CalPERS extended its sincere congratulations to the Honorable Mary Jo White on her appointment as Chairman of the United States Securities and Exchange Commission (Commission). Staff met with Chairman White for the purpose of advocating for the Commission to continue its work and mission to improve accountability, transparency, and ethical responsibility in the capital marketplace while addressing the following priorities:
 - Investor Advocate
 - Universal proxy access
 - Private Ordering
 - Proxy Plumbing
 - SEC Enhanced Disclosure for Board Quality and Diversity
 - Majority Voting
 - Executive Compensation
 - Climate Risk Disclosure
 - Global Accounting and Audit
 - Corporate Charitable and Political Expenditures
 - Credit Rating Agencies
 - Volcker Rule
 - Swaps Regulation

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

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

