

Global Governance Annual Program Review

November 18, 2013

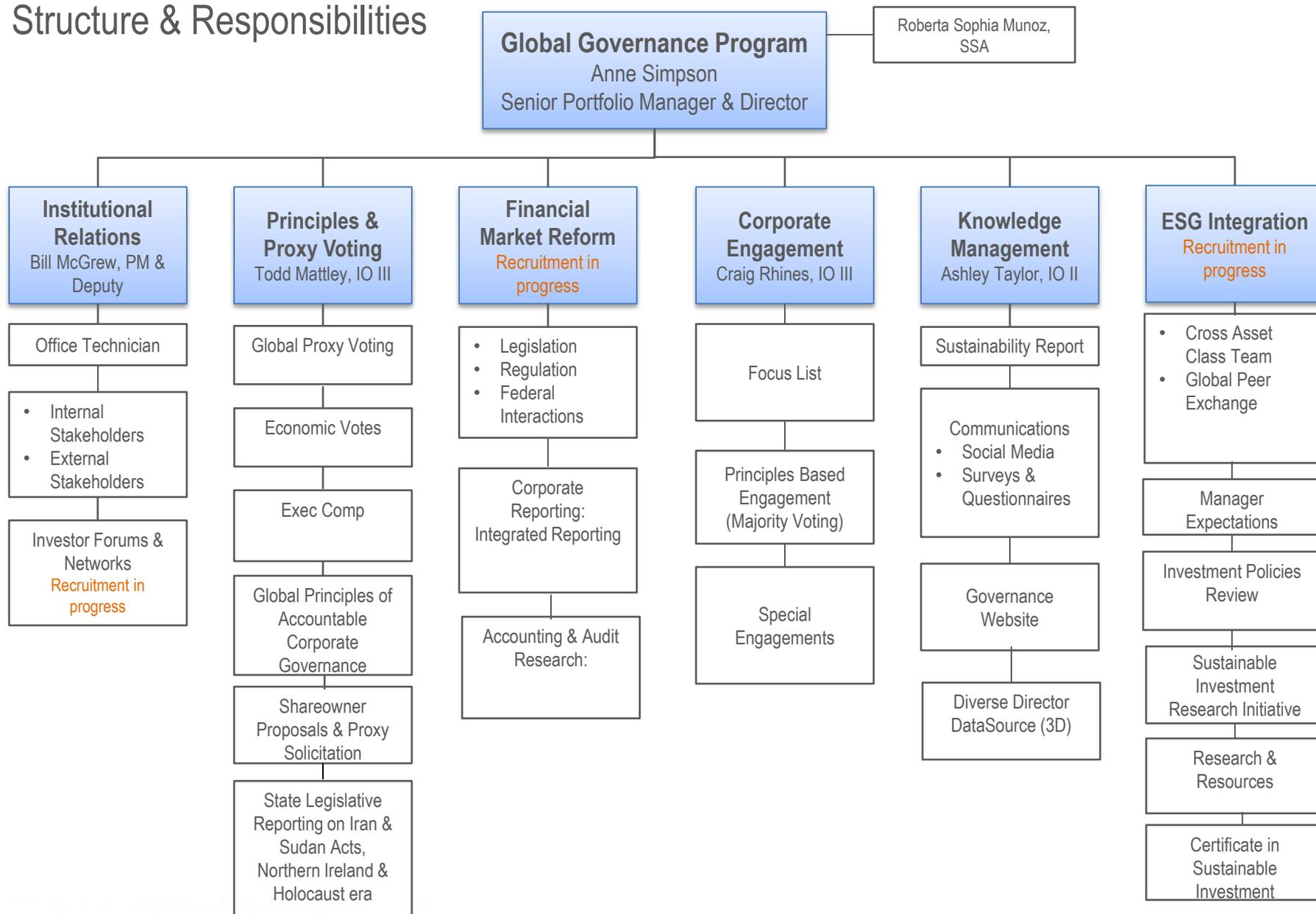
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Who We Are: Global Governance

- **We Aim to be a Principled and Effective Investor:** To deliver sustainable, risk-adjusted returns guided by CalPERS Investment Beliefs.
- **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:** Investor rights, board quality and diversity, corporate reporting, executive compensation, regulatory effectiveness
- **Work Streams:** Principles and Proxy Voting, Corporate Engagement, Financial Market Reform, ESG Integration, Institutional Relations and Knowledge Management.
- **Thought Leadership and Coalition Building:** Investor Network Leadership and the CalPERS Global Governance Website

Structure & Responsibilities



CalPERS Investment Beliefs – Global Governance

Investment Belief 2

A long time investment horizon is a responsibility and an advantage

Investment Belief 3

CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries

Investment Belief 4

Long-term value creation requires effective management of three forms of capital: financial, physical and human

CalPERS Investment Beliefs – Global Governance

Investment Belief 9

Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility and tracking error

Investment Belief 10

Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

Global Governance Work Streams

Principles and Proxy Voting

Framed by CalPERS Global Principles and Accountable Corporate Governance (Principles)

Corporate Engagement

Through the Focus List program, CalPERS works directly with Companies to improve investor rights, corporate reporting, and board quality and diversity in order to protect investment returns

Global Governance Work Streams

Financial Market Reform

Responsible for CalPERS analysis and advocacy for market-wide regulation which protects investors and addresses systemic risk

Environmental, Social, Governance (ESG) Integration

Leads a Cross Asset Class team which is developing the tools needed to integrate relevant ESG factors across the Total Fund

Global Governance Work Streams

Institutional Relations

CalPERS provides thought leadership through partnerships in investor networks and regulatory committees

Knowledge Management

Responsible for coordinating the significant and growing information, communication, and research needs within and across the Global Governance program

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

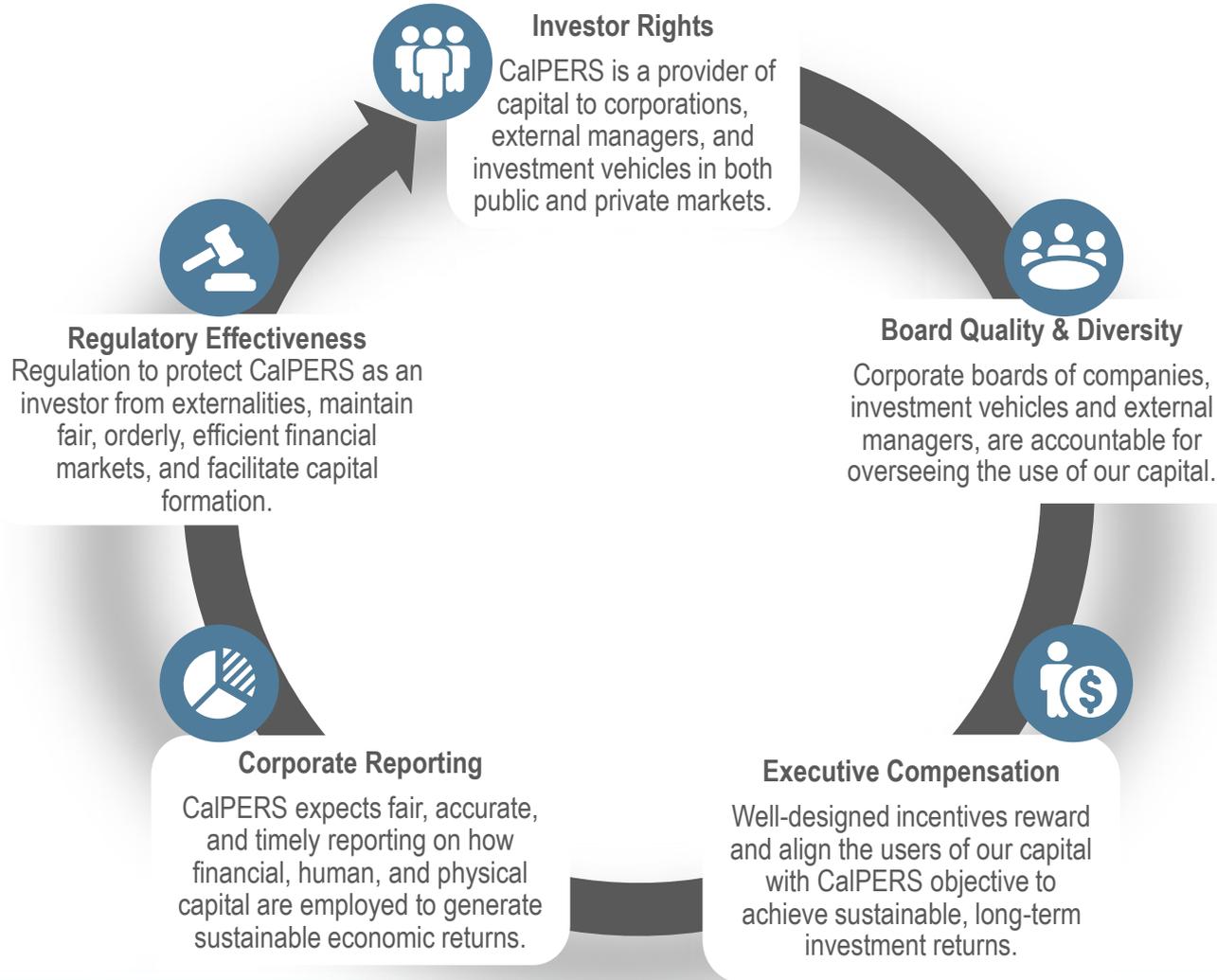
Includes health, safety, and labor practices



Financial Capital - Governance

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

The Virtuous Circle of Governance: Core Issues





2012-13 Investor Rights

- **Global Proxy Voting**
 - CalPERS voted at 9,790 company meetings including votes for 90,080 individual proposals, supporting 88% of management proposals and 62% of shareowner proposals.
 - Staff did not vote at 11 company meetings due to share blocking - the “freezing” of shares by the custodian.
- **Majority Vote for Director Election Campaign – 98% Success**
 - Since 2010, CalPERS engaged 133 domestic companies on the adoption of majority vote for director elections.
 - 130 of the 133 companies have adopted or agreed to adopt the CalPERS request.

CalPERS Steps Up to Back Apple

- In February 2013, Apple sponsored a management proposal to implement Majority Vote for Directors after two successful years of CalPERS shareowner resolutions.
- CalPERS backed Apple’s management to solicit votes 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, elimination of “blank check” preferred stock, and introduce par value.
- Greenlight Capital, a hedge fund, 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 has promised to bring the vote back to shareowners at a later date and to abide by majority voting policy meanwhile.



2012-13 Investor Rights

Proxy Access - We advocate for investor rights to nominate candidates through shareholder proposals to company boards by supporting Proxy Access proposals. CalPERS carried out proxy solicitation for several companies to support the vote.

| Company Name | Meeting Date | % Support | Outcome |
|---|--------------|-----------|---------|
| Hewlett Packard | 3/20/2013 | 97 | Pass |
| 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 |



2012-13 Investor Rights

- **“Voting Arithmetic” Research**
 - 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.
 - CalPERS has concerns with Nabors (NBR) unconventional vote calculation methodology. NBR considers uninstructed broker votes in the vote calculation for nondiscretionary items.
 - On that basis, NBR considered CalPERS shareowner proposal did not pass. CalPERS disagrees.
 - CalPERS has requested that NBR amend the company’s voting methodology to a standard that counts uninstructed broker votes for quorum purposes only. CalPERS recently commissioned research through Governance Metrics International (GMI) to understand how frequent broker non-votes are used in vote calculations.
 - GMI found that only 36 companies in the Russell 1000 Index consider broker non-votes when determining the outcome of proposals.



2012-13 Board Quality & Diversity

Accountability in Action

- **JP Morgan:**

- Governance reform continues as directors David Cote and Ellen Futter stepped off the JP Morgan board due to high opposition in 2013.
- 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 significant trading losses.
- Since the 2013 the company has added two new directors and formalized the lead Independent director role.

- **Occidental Petroleum:**

- At the 2013 Occidental Petroleum Annual General 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.

- **Hewlett Packard (HP) Director Withhold Vote:**

- At the 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.



2012-13 Board Quality & Diversity

- **Diverse Director DataSource (3D)**
 - Launched Diverse Director DataSource at NYSE with CalSTRS and GMI Ratings
 - Over 700 candidate profiles are fully submitted and searchable
 - Over two thirds of the candidates are female and half have board experience and speaks over 40 languages.
- **Advisory Committee Financial Times Agenda Project**
 - CalPERS for the 3rd year running helped identify new candidates - this year's focus in "technology".
- **Diversity Engagement**
 - Engaged over 40 companies in the S&P 500 jointly with CalSTRS
- **CalPERS Sponsored Event with National Association of Corporate Directors (NACD)**
 - Debate on board quality and diversity, in San Francisco addressed by Peggy Forn, Prudential and Bonnie Hilll, Home Depot.
 - Published best practice guidelines with NACD Vice Chair, Michele Hooper, "How to Engage Shareholder When Selecting New Directors"
- **Toigo Groundbreakers Event**
 - CalPERS co-sponsored the 2013 Groundbreakers event to widen awareness of board diversity.



2012-13 Executive Compensation

- **Say on Pay Voting**
 - CalPERS voted against 231 Say on Pay resolutions in the USA
 - Staff reviews Say on Pay proposals for:
 - Pay for performance discipline
 - Severance/Change in Control Arrangements
 - Disclosure of compensation philosophy and policy (to include how pay is determined, disclosure of metrics and weights)
 - Compensation plan design (for example use of performance based awards, multiple performance metrics, minimum vesting periods of 3 years for equity awards, stock ownership requirements)
 - Linkage of health, safety, environmental and sustainability performance to compensation
 - CalPERS voted “FOR” say-on-pay resolutions at 160 companies where votes have previously been voted against in 2012.

- **McKesson Corp. (MCK)**
 - Withheld vote from Compensation Committee Chairman Alton Irby
 - 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.
 - Voting Results: Alton Irby received a 40% withhold vote and the advisory vote on executive compensation failed with obtaining only 22% support.



2012-13 Executive Compensation

Say on Pay Impact: Year to date, CalPERS voted AGAINST 41 say-on-pay resolutions which in turn failed to receive majority shareowner support. Below is a listing of companies where there was significant shareowner opposition (greater than 70% “against”):

| Company Name | Outcome | % AGAINST |
|---------------------------------------|---------|-----------|
| Abercrombie & Fitch | Failed | 80% |
| Alexandria Real Estate Equities, Inc. | Failed | 91% |
| Annaly Capital Management, Inc. | Failed | 71% |
| Boston Properties | Failed | 81% |
| Children’s Place Retail Stores, Inc. | Failed | 83% |
| Everest Re Group Ltd. | Failed | 71% |
| Freeport McMoran Copper & Gold | Failed | 70% |
| Helen of Troy Ltd. | Failed | 87% |
| Kilroy Realty Corp. | Failed | 78% |
| McKesson Corp | Failed | 76% |
| Navistar International Corp. | Failed | 74% |
| Verifone Systems, Inc. | Failed | 79% |

2012-13 Executive Compensation

- **Integrating Sustainability Performance Metrics in Executive Compensation**
 - 19 global energy companies with a market cap of \$297 billion that did not disclose sustainability metrics linked to executive compensation.
 - Staff recommended inclusion and measurement of sustainability metrics within remuneration that are material to the company's long-term business strategy and industry sector.
 - To date, four companies committed to improve disclosure on sustainability metrics in 2014.



2012-13 Corporate Reporting

- **Integrated Reporting Framework - bringing together financial and sustainability factors**
 - Joint asset owner response to International Integrated Reporting Council (IIRC) on the draft integrated framework.

- **Accounting & Audit**
 - Engaged International Accounting Standards Board (IASB) on Conceptual Framework and Insurance Standards
 - Commented to various regulatory bodies on proposed standards for Audited Financial Statements, Auditor's Report on an Audit of Financial Statements, and Conceptual Framework for Accounting Standards.

- **Sustainability Accounting Standards Board (SASB)**
 - CalPERS joined SASB's Standards Council which is developing material, sector based reporting standards on ESG.
 - Investment staff joined the Non-Renewable Resources Sector Industry Working Group on identifying material ESG issues. Industries included Oil & Gas Exploration & Production, Oil & Gas Midstream, Construction Materials, Iron & Steel Producers, Coal, and Metals & Mining.



2012-13 Regulatory Effectiveness

- **Smart Regulation**

- Complete and coordinated
- Allows market players to exercise their proper role and responsibilities
- Needs to ensure transparency
- Address conflicts of interest and preserve incentives
- Not prevent institutional investors from taking advantage of new opportunities
- Regulation need to be proportionate.



2012-13 Regulatory Effectiveness

- **JOBS Act – Encouraging Exemptions**
 - Concept Paper: Emerging Growth Company (EGC) Governance Expectations to communicate CalPERS governance principles before initial public offering and avoid exemption from Sarbanes-Oxley and Dodd Frank.

- **Congressional Testimony**
 - 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.

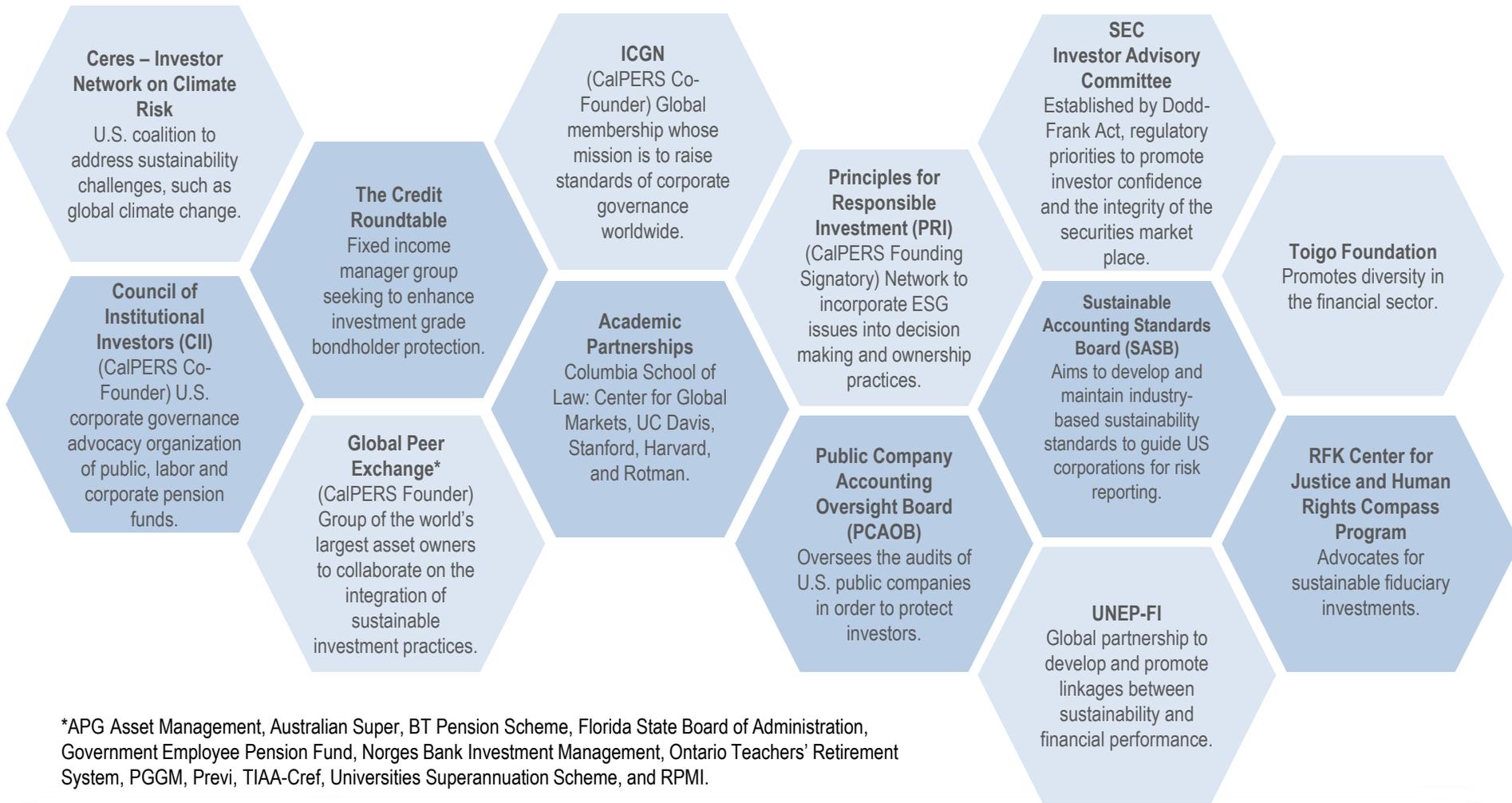
- **California Delegation Briefings**
 - Letters to members of the California Delegation on:
 - HR 1564: CalPERS urged opposition as we believe this legislation would unnecessarily restrict the ability of the Public Company Accounting Oversight Board to impose an auditor rotation requirement for registered 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.



2012-13 Regulatory Effectiveness

- **U.S. Commodities Futures Trading Commission (CFTC)**
 - Briefings with the Chairmen of CFTC and Commissioners to discuss derivatives and financial benchmarks and co-ordinate comments with other funds.
- **Carbon Pollution Standards for New Power Plants**
 - Through Ceres led Investor Network on Climate Risk (INCR), joined investors with more than \$900 billion in assets to support carbon pollution standards proposed by the Environmental Protection Agency for new power plants.
- **Securities and Exchange Commission (SEC)**
 - Meeting with SEC Chairman White to communicate CalPERS views on financial market regulation industry:
 - Appointment of 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 Disclosure
 - Credit Rating Agencies
 - Volcker Rule
 - Derivatives Regulation

Investor Networks: CalPERS Leadership Role



What's Next: From – To Vision

| FROM | TO |
|---|--|
| <ul style="list-style-type: none"> Inconsistent and partial reporting on CalPERS ESG investment initiatives | <ul style="list-style-type: none"> ✓ Total Fund report, “Towards Sustainable Investment: Taking Responsibility” – wins RI award |
| <ul style="list-style-type: none"> Multiple guidelines on the 111 ESG projects across asset classes and initiatives / programs | <ul style="list-style-type: none"> ✓ Investment Beliefs integrate sustainability |
| <ul style="list-style-type: none"> Varied internal and external manager expectations on ESG | <ul style="list-style-type: none"> • Manager Expectations work to begin in 2014 |
| <ul style="list-style-type: none"> Lack of consensus on the evidence linking ESG factors to performance | <ul style="list-style-type: none"> ✓ Launch of Sustainable Investment Research Initiative(SIRI): Review of Evidence and Symposium |
| <ul style="list-style-type: none"> Reactive work focused on U.S. capital markets | <ul style="list-style-type: none"> ✓ Identified reform priorities in Dodd-Frank |
| <ul style="list-style-type: none"> Unstructured process for managing CalPERS multiple institutional relationships | <ul style="list-style-type: none"> ✓ Map of relationships and vision of a Grand Alliance |
| <ul style="list-style-type: none"> Domestic Focus List Program | <ul style="list-style-type: none"> ✓ Monetized Focus List Program Integrating Sustainability and Board Diversity |

What's Next: 2013-14 Priorities

| WORK STREAMS | PRIORITIES |
|---------------------------|---|
| Principles & Proxy Voting | <ul style="list-style-type: none"> Review Investment Policies for Global Governance and develop Statement of Investment Policy for the Focus List Update CalPERS Global Principles for Accountable Corporate Governance Integrate Investment Beliefs through Global Governance. |
| Corporate Engagement | <ul style="list-style-type: none"> Carbon Asset Review with Ceres on climate risk Human Capital Group – global supply chain in retail Diverse Director DataSource (3D) Focus List & Majority Voting Initiative |
| Financial Market Reform | <ul style="list-style-type: none"> Develop financial market reform priorities and define a plan to communicate these per the CalPERS Strategic Plan to promote safety and soundness in capital marks. |
| ESG Integration | <ul style="list-style-type: none"> Launch Phase 2 Cross Asset Class Team on ESG Integration – analysis and due diligence tools Manager Expectations: Collaboration with Global Peer Exchange members Pilot Certificate in Sustainable Investment with Columbia University and the RFK Center |
| Institutional Relations | <ul style="list-style-type: none"> Leverage the “Grand Alliance” of investor networks to support CalPERS priorities. |
| Knowledge Management | <ul style="list-style-type: none"> Publish new edition “Towards Sustainable Investment” Report. Review Global Governance website and social media |

Investment Policies Review

| Global Governance Policies | What's Next |
|--|---|
| Global Principles of Accountable Corporate Governance | Staff is reviewing and will bring an updated version of the Principles to the Investment Committee in February 2014 as part of the annual revision process. |
| Global Proxy Voting Policy | Staff is reviewing the Policy. |
| Director Nominations Policy | Staff is reviewing the Policy. |
| Representation on Corporate Boards of Directors Policy | Staff is reviewing the Policy. |
| Corporate Engagements | Staff identified the need for a policy for the Focus List Engagement Program and will be drafting a new policy for review and approval by the Investment Committee. |
| Other Related Policies | Connection to the Governance Program |
| Investment & Risk Management - Divestment Policy | CA Iran & Sudan Acts, Tobacco, Northern Ireland, and Holocaust-Era Reporting; Manufacturers of Assault Weapon Divestment |
| Fixed Income – Securities Lending | Ability to recall shares on loan in order to cast votes |
| Global Equity Statement of Investment Policy | Incorporate CalPERS values in investing to influence sustainable change in ESG |
| Global Equity – Emerging Equity Markets Principles | Identifies, engages, and excludes investments in emerging equity markets companies with high risk |
| Global Equity – Corporate Governance Program Policy | Corporate Governance Investment Vehicles, Co-investments, & External Managers |
| Investment Beliefs | To be reflected in program priorities and practices. |

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

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

