

Global Governance Program Quarterly Update

February 18, 2014

Table of Contents

Overview of Program

- Who We Are: Global Governance
- Structure & Responsibilities
- Global Governance Work Streams
- Core Issues
- From –To Vision & 2013-14 Priorities

Focus on Corporate Engagement

- Financial Capital – Apple
- Physical Capital – Carbon Asset Risk
- Human Capital – Human Capital Management Group

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.

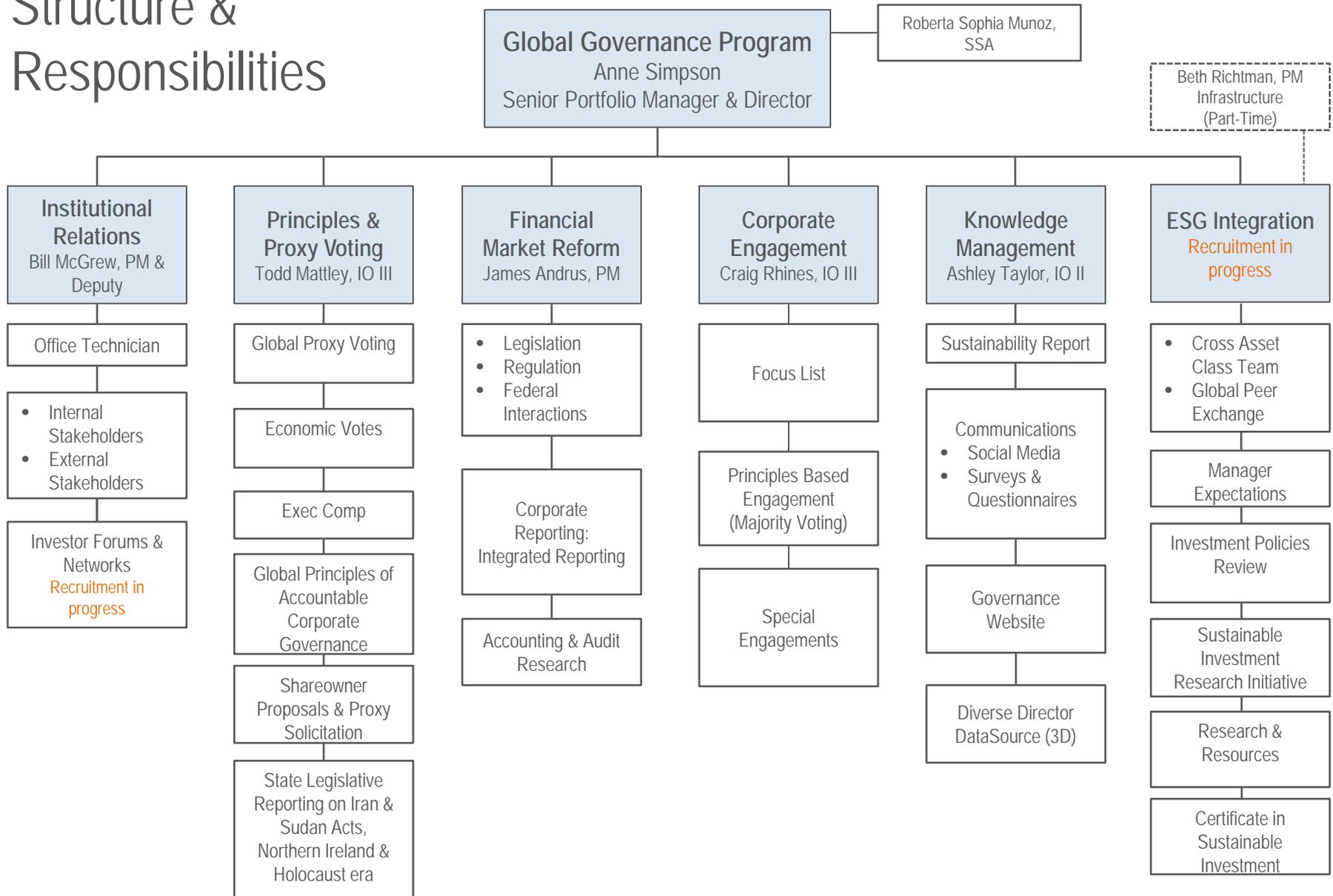
Grounded in Economics: Long-term value creation requires effective management of three forms of capital - financial capital, physical capital, and human capital

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

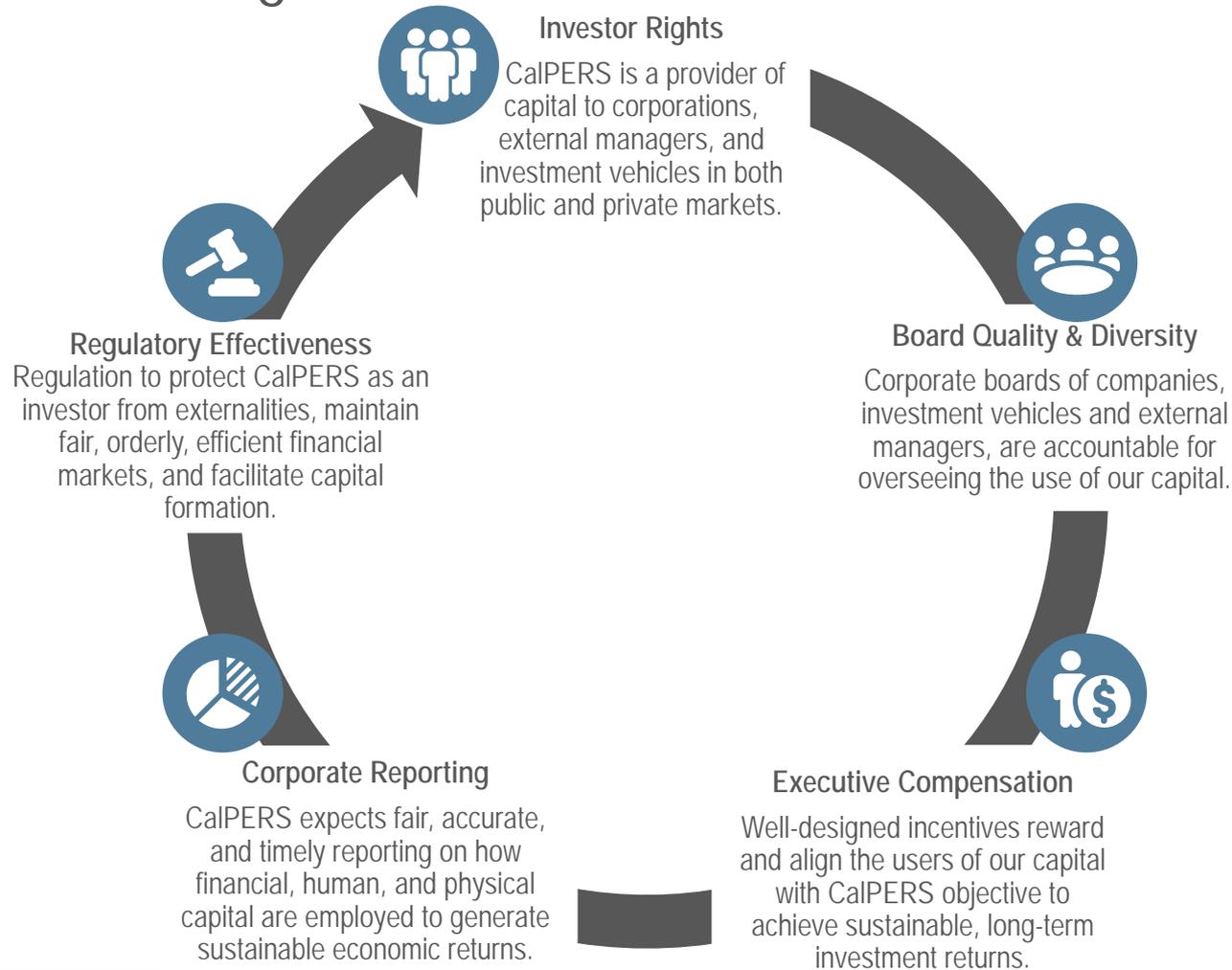
Structure & Responsibilities



Global Governance Work Streams

Principles & Proxy Voting	Framed by CalPERS Global Principles of 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
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
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

Governance Program: Core Issues



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 • New report with expanded financial and operations information
<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 • Rapid Results project working group
<ul style="list-style-type: none"> Varied internal and external manager expectations on ESG 	<ul style="list-style-type: none"> • Manager Expectations • Cross asset class team
<ul style="list-style-type: none"> Lack of consensus on the evidence linking ESG factors to performance 	<ul style="list-style-type: none"> ✓ Sustainable Investment Research Initiative(SIRI): Review of Evidence and Symposium • Asset class and issue papers
<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 • Financial Market Reform strategy and roundtable
<ul style="list-style-type: none"> Unstructured process for managing CalPERS multiple institutional relationships 	<ul style="list-style-type: none"> ✓ Map of relationships • Leverage 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 • Corporate engagement on three forms of capital

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 (Principles for Responsible Investment, Council of Institutional Investors, Ceres, International Corporate Governance Network, etc.)
Knowledge Management	<ul style="list-style-type: none"> Publish new edition “Towards Sustainable Investment” Report. Review Global Governance website and social media



Focus on Corporate Engagement: 3 Forms of Capital

This quarterly update focuses on one work stream – corporate engagement – to illustrate how we are reflecting the Investment Beliefs:

Investment Belief 4

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

- **Financial Capital – Governance**
Apple – Share Buyback Proposal
- **Physical Capital – Environment**
Oil, Gas, and Coal Industry – Carbon Asset Risk Initiative
- **Human Capital – Social**
Global Retail Companies – Human Capital Management Group

Financial Capital – Governance



CalPERS 2014 vote at Apple's February 28th Annual General Meeting:

- Apple is CalPERS largest portfolio holding with a total exposure of \$1.65 billion as of December 31, 2013.
- Management will be sponsoring a resolution to implement Majority Vote for Director Elections via new Articles of Association.
- CalPERS a proposal for Majority Vote for Director Election in 2011 & 2012 – both won a majority of shareowner support.
- Defended the company against an activist investor in 2013.

Financial Capital – Governance



CalPERS 2014 vote at Apple's February 28th Annual General Meeting:

- **Proposal #10** – Request the company to complete a share repurchase of up to \$50 billion, funded by new debt to be completed during the current fiscal year.
- CalPERS has been involved in extensive and ongoing dialogue with Apple surrounding the merits of the proposal as it relates to the company's long-term capital allocation strategy.

CalPERS Vote Rationale on Proposal #10

- **Apple is returning capital already:** Apple announced a program for returning capital to shareholders in 2012, with plans to return \$100 billion via dividends and share buybacks.
- The company will review the plan shortly in light of new cash flow data.

Financial Capital – Governance



CalPERS Vote Rationale on Proposal #10

Proposal #10 is prescriptive on method, dollar amount and date:

- Carl Icahn first proposed that Apple buy back \$150 billion worth of shares, before the end of the current fiscal year. He has since revised this down to \$50 billion.
- The proposal is prescriptive, in attempting to specify the mechanism, the amount and the timing for the additional capital to be returned. The buyback would require additional borrowing. Moody's commented this may affect Apple's credit rating.

Governance for the long term:

- CalPERS has not dealt with a shareholder proposal calling for a buy back in the 14 years for which we have proxy voting records.
- Apple has made significant changes in recent years, in response to shareowner engagement by CalPERS and others.

Financial Capital – Governance

Other large investors echo CalPERS support for Apple:

“...[Apple’s] board has overseen the creation of extraordinary long-term value for shareowners and, in response to investor concerns, put in place a substantial dividend and repurchase program.”

Scott M. Stringer

New York City Comptroller
February 2013

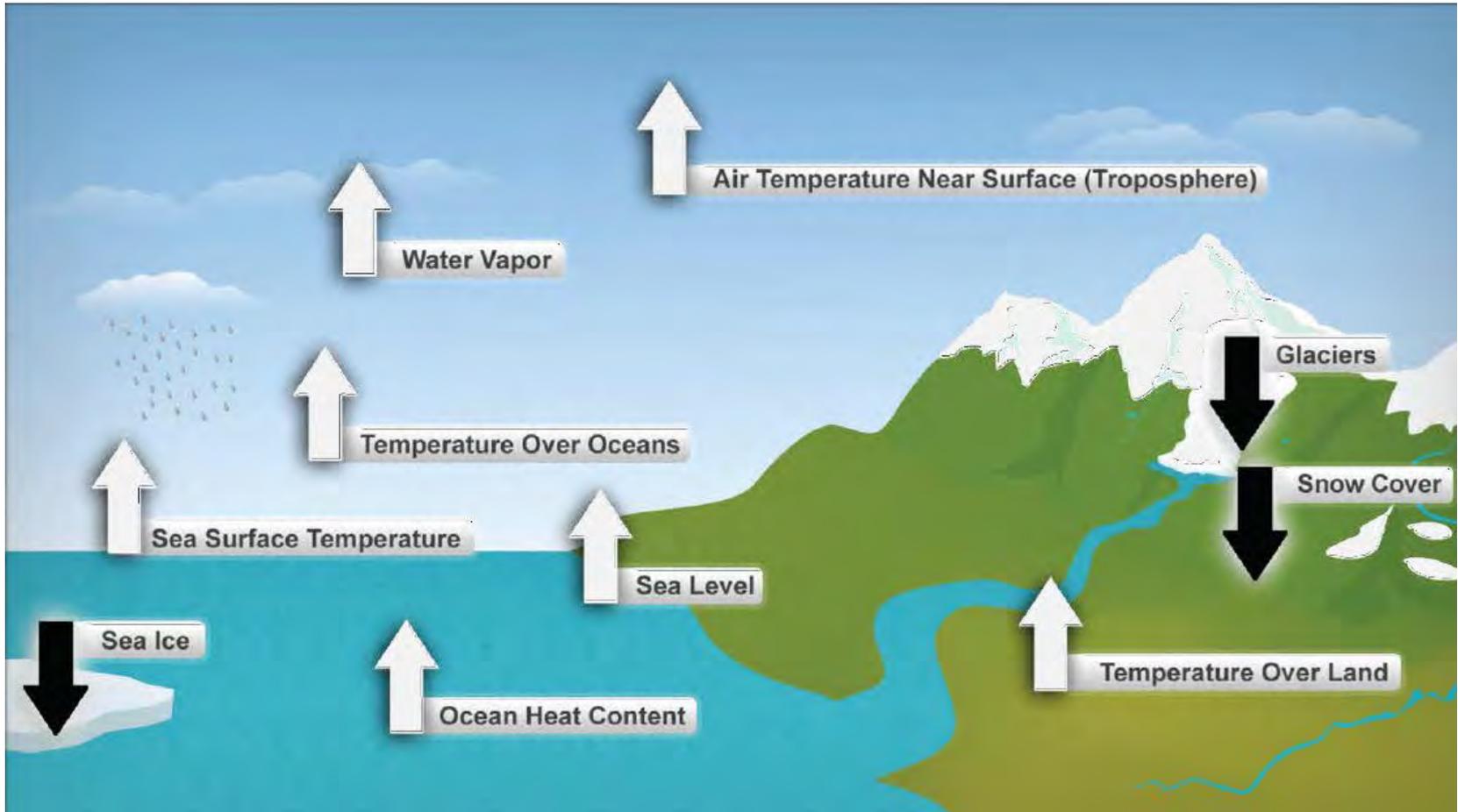
“I think Apple management and directors have done a pretty darned good job of running the company, and so my vote would be with them. I do not think that companies should be run primarily to please Wall Street, and large shareholders who are going to sell.”

Warren Buffett

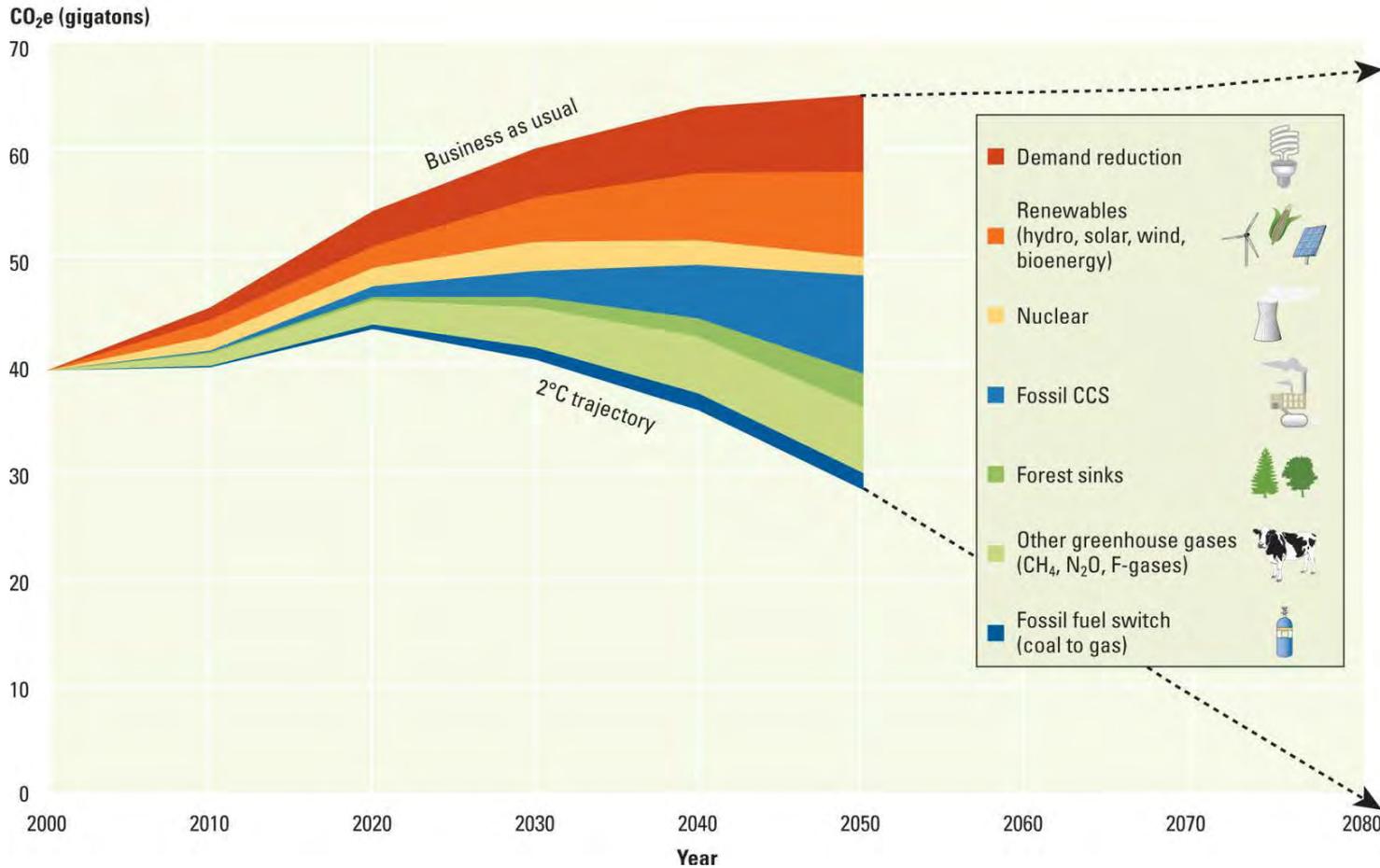
Chairman & CEO
Berkshire Hathaway
October 16, 2013

Physical Capital – Climate Change

10 indicators of Global Warming



Adapting to climate change – Opportunities for engagement



Source: World Development Report 2010

Corporate Engagement – Carbon Asset Risk Initiative

Launched in the Fall of 2013, CalPERS is actively collaborating in a Ceres led **Carbon Asset Risk Initiative**.

- Investor collaboration drawing together 70 global investors managing more than \$3 trillion of collective assets.
- Asks major oil and gas, coal and electric power companies to assess the financial risks that climate change poses to corporate business plans – companies include ExxonMobil, Royal Dutch Shell, BHP Billiton, Rio Tinto, American Electric Power and Vale.

The ExxonMobil logo consists of the word "ExxonMobil" in a bold, red, sans-serif font.The BHP Billiton logo features three stylized, rounded shapes in shades of orange and red above the text "bhpbilliton" in a lowercase, black, sans-serif font.

bhpbilliton

The Vale logo is a stylized, abstract shape composed of teal and yellow colors, resembling a mountain or a checkmark, positioned to the left of the word "VALE" in a bold, black, sans-serif font.

VALE

The Shell logo is a red and yellow scallop shell icon above the word "Shell" in a bold, black, sans-serif font.

Shell

The Rio Tinto logo is the word "RioTinto" in a bold, red, sans-serif font.The American Electric Power logo features the letters "AEP" in white on a red square background, followed by the words "AMERICAN ELECTRIC POWER" in a bold, black, sans-serif font.

AEP AMERICAN
ELECTRIC
POWER

Corporate Engagement – Carbon Asset Risk Initiative

The companies listed received the investor Carbon Asset Risk Letter:

Coal	Utility	Oil & Gas Cont'd
Alpha Natural Resources	AES Corporation	ConocoPhillips
Anglo American plc	American Electric Power	Devon
Arch Coal	China Power International Development	Energy
BHP Billiton	Limited	Corporation
China Shenhua Energy Company Limited	Duke Energy	Eni S.p.A.
CONSOL Energy	FirstEnergy	EOG Resources, Inc.
Exxaro	NTPC	ExxonMobil
Glencore Xstrata	Southern Company	Gazprom
Mitsubishi Corporation		Hess Corporation
Peabody Energy	Oil & Gas	Lukoil
Rio TintoAnad	Anadarko Petroleum Corporation	Occidental Petroleum
Severstal	Apache Corporation	Oil and Natural Gas Corporation Ltd.
Shanxi Coking Co., Ltd.	BG Group	Petro China
Vale	BP	Royal Dutch Shell
	Canadian Natural Resources	Sinopec Corp.
	Chesapeake Energy	Statoil
	Chevron	Suncor
	CNOOC Limited	Total

Corporate Engagement – Carbon Asset Risk Initiative

The Investor Letter asks the companies to:

- Review exposure to long-term, climate change-related risks and its plans for managing them.
- Conduct a risk assessment under at least two main scenarios:
 1. business-as-usual;
 2. low-carbon scenario consistent with reducing GHG emissions by 80% by 2050 to achieve the 2°C goal

Corporate Engagement – Carbon Asset Risk Initiative

It is recommended that the risk assessment evaluate the following:

- Capital expenditure plans for finding and developing new reserves, including consideration of rates of return and payback periods and alternative uses of capital;
- The potential GHG emissions associated with the production of all unproduced reserves categorized by resource type;
- The risks to unproduced reserves, due to factors such as carbon pricing, pollution and efficiency standards, removal of subsidies and/or reduced demand;
- The risks to assets, particularly oil and gas infrastructure, posed by the physical impacts of climate change, including extreme weather, water stress, and sea level rise; and
- The impacts of the above-referenced risks associated with climate policies and the physical impacts of climate change on the Company's current and projected workforce.

Corporate Engagement – Human Capital Management Initiative

Launched in the Winter of 2013, CalPERS is actively collaborating in an investor led **Human Capital Management Initiative**:

- Comprehensive follow-on industry approach to CalPERS continued engagement of Wal-Mart to address the company's ongoing financial, physical and human capital management concerns.
- Investor collaboration drawing together nine global investors representing more than \$1.2 trillion of collective assets asking retail companies to enter into a constructive multi-shareowner dialogue to address financial, legal and reputational risks inherent in human capital management.

Corporate Engagement – Human Capital Management Initiative

- **The Alliance** - Following the building collapse the Bangladesh Worker Safety Initiative was developed and signed by 17 retailers including: Wal-Mart, Gap, J.C. Penney , Kohl's, Macy's, Sears, Target, The Children's Place, L.L. Bean and Nordstorm.
- This is a five year initiative calling for an inspection of all Bangladesh factories, common safety standards and a hotline for workers and an independent chair of the board responsible for oversight.











Corporate Engagement – Human Capital Management Initiative

- **The Accord** – This is an independent and legally-binding international agreement calling for independent safety inspection of factories and public reporting of the inspection results.
- In May 2013, over 100 apparel corporations from 19 countries in Europe, North America, Asia and Australia; two global trade unions, IndustriALL and UNI; and a number of Bangladeshi unions
- Clean Clothes Campaign, Workers’ Rights Consortium, International Labor Rights Forum and Maquila Solidarity Network are NGO witnesses to the Accord.
- The International Labour Organisation (ILO) acts as the independent chair.

Source: <http://www.bangladeshaccord.org/>

Corporate Engagement – Human Capital Management Initiative

The investor coalition has developed a baseline set of questions used to engage each company.

Topic	Sample Questions
Board Oversight	<ul style="list-style-type: none"> How does the board exercise oversight over human capital management (HCM) throughout the organization?
Operational Integration	<ul style="list-style-type: none"> What resources are committed to managing human capital best practices not only through out he company's domestic and international operations, but also throughout the company's supply chain?
Data Collection, Risk Management, Accountability	<ul style="list-style-type: none"> What are the major challenges or risks for human capital management that the company has identified; and, how does the company mitigate these risks?
Employee Engagement	<ul style="list-style-type: none"> What information is collected through employee outreach and engagement, and how is this information used to monitor or improve human capital management?
Incentives and Compensation Structure	<ul style="list-style-type: none"> How is human capital management aligned with incentive pay structures or other compensation practices?
Investor Engagement and Disclosure	<ul style="list-style-type: none"> What data (and how), if any, is disclosed to investors pertaining to the company's risk assessment and management of human capital?

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

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

