



Agenda Item 6a

May 19, 2014

ITEM NAME: Amendments to the Global Principles of Accountable Corporate Governance

PROGRAM: Global Governance

ITEM TYPE: Total Fund – Action

RECOMMENDATION

Approve amendments to the CalPERS Global Principles of Accountable Corporate Governance which include updates on Board Independence & Leadership, Executive Compensation, Risk Oversight, and Shareowner Rights.

EXECUTIVE SUMMARY

This agenda item requests approval from the Investment Committee (IC) on updates to the Global Principles of Accountable Corporate Governance. In the table below, staff has outlined the specific amendments being requested surrounding Board Independence & Leadership, Executive Compensation, Risk Oversight, and Shareowners Rights. Additionally, staff has included a complete mark-up of the requested amendments within the Global Principles document (Attachment 1) along with the Wilshire Associates opinion letter (Attachment 2).

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. The achievement of long-term sustainable investment returns through accountable corporate governance structures is the foundation of the Global Principles.

INVESTMENT BELIEFS

This agenda item supports CalPERS Investment Belief 4 that long-term value creation requires effective management of three forms of capital – financial, physical, and human.

BACKGROUND

The underlying tenet for the Global Principles is that fully accountable governance structures produce, over the long-term, the best returns to shareowners. The Global Principles create a framework by which CalPERS executes its proxy voting responsibilities, and provide a foundation for supporting CalPERS corporate engagements and governance initiatives. In addition to the recommended Global Principles staff is currently reviewing several other areas of principle development for presentation to the IC in late 2014.

ANALYSIS

The table below is an outline of the proposed amendments to the Global Principles. Please note underlined text indicates new language proposed for insertion into the Global Principles.

Section	Page	Topic	Principle Amendment	Rationale
1.5	8	Board Independence & Leadership	<p><u>Board Member Tenure:</u> <u>Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent. These considerations include the director's years of service on the board. Extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom. Additionally, there should be routine discussions surrounding director refreshment to ensure boards maintain the necessary mix of skills and experience to meet strategic objectives. Boards should also develop and disclose a policy on director tenure.</u></p>	<p>This new principle is to ensure companies are monitoring board tenure and continue to explore the refreshment of corporate boards with new talent to support board quality and diversity. The amendment will align Global Principles with the recently approved Council of Institutional Investors (CII) principles on board tenure.</p>
1.12	9	Board Independence & Leadership	<p><u>Board Responsibilities:</u> <u>The Board should be responsible for reviewing, approving and guiding management's development of corporate strategy, capital discipline and allocation, major plans of action, risk policies, business plans, setting performance</u></p>	<p>This new principle will clarify a board's responsibilities and oversight role surrounding the strategic direction of the company. The amendment will provide support to CalPERS proxy voting and</p>

Section	Page	Topic	Principle Amendment	Rationale
1.12 (continued)	9	Board Independence & Leadership (continued)	<u>objectives, monitoring implementation and corporate performance, overseeing major capital expenditures, and acquisitions/divestitures.</u>	engagement activities in relation to proposals which address the company's capital structure.
3.3a	12-13	Equity Compensation	Equity Ownership: Executive equity ownership should be required through the attainment and continuous ownership of a significant equity investment in the company. Executive stock ownership guidelines and holding requirements should be disclosed to shareowners on an annual basis. <u>In addition to equity ownership, a company should make full disclosure of any pledging policies. Further, stock subject to the ownership requirements should not be pledged or otherwise encumbered.</u>	This principle amendment includes a statement on the “pledging” of company stock – which requires executives to put up equity ownership as collateral for a loan. This practice is not aligned with shareowner interest, as a forced sale of the pledged position could have a negative impact on stock price.

Section	Page	Topic	Principle Amendment	Rationale
3.3b	13	Equity Compensation	<p>Hedging: <u>The use of derivatives or other structures to hedge director or executive stock ownership undermines the alignment of interest that equity compensation is intended to provide. Companies should therefore prohibit the activity and provide full disclosure of any hedging policies.</u></p>	<p>Hedging and the use of derivatives or other structures to off-set risk can have a negative impact on executive incentive plans. The practice diminishes the incentive nature of equity compensation and interferes with the intended alignment of interests with shareholders.</p>
5.c	17	Risk Oversight	<p>Risk Oversight: The board should set out specific risk tolerances and implement a dynamic process that continuously evaluates and prioritizes risks. An effective risk oversight process considers both internal company related risks such as operational, financial, credit, liquidity, corporate governance, <u>cyber-security</u>, environmental, reputational, social, and external risks such as industry related, systemic, and macro economic.</p>	<p>This amendment includes a new provision to elevate “cyber-security” within a board risk framework process as cybercrimes are becoming more sophisticated and prevalent.</p>

Section	Page	Topic	Principle Amendment	Rationale
7.3	19	Shareowner Rights	<p>Universal Proxy: <u>To facilitate the shareowner voting process in contested elections, opposing sides engaged in the contest should utilize a proxy card naming all management nominees and all dissident nominees, providing each nominee equal prominence on the proxy card.</u></p>	<p>This amendment includes a statement on Universal Proxy. Currently in contested director elections, shareowners only have the ability to vote either the management or dissident proxy card when voting for director nominees. There is no ability to mix votes between the two sides. Allowing for Universal Proxy would provide shareowners the ability to vote for any combination of director nominees they wish. Approval of this amendment would align the Global Principles with recently adopted CII principles on Universal Proxy.</p>
Appendix A		CII Principles	Board Tenure and Universal Proxy	Staff is updating Appendix A of the Global Principles to incorporate recently approved CII Principles on Board Tenure and Universal Proxy.

BUDGET AND FISCAL IMPACTS

Not Applicable

BENEFITS/RISKS

These revisions will provide benefit by giving staff the ability to fully execute proxy voting and corporate engagement activities. Failure to amend the Global Principles of Accountable Corporate Governance would limit staff's ability to execute proxy voting responsibilities and expose CalPERS to reputational risk.

ATTACHMENTS

Attachment 1 – Revised CalPERS Global Principles of Accountable Corporate
Governance

Attachment 2 – Wilshire Associates Opinion Letter

ANNE SIMPSON
Senior Portfolio Manager & Director
Global Governance

THEODORE ELIOPOULOS
Interim Chief Investment Officer