

Global Governance Program Quarterly Update

May 19, 2014

Table of Contents

Overview of Program

Quarterly Update Items:

1. CalPERS Report, “Towards Sustainable Investment & Operations: Making Progress”
2. Principles for Responsible Investment Assessment
3. Proxy Voting – Quarterly Update (Jan – March 2014)
4. Special Company Engagements
 - Financial Capital – Domino’s Pizza
 - Physical Capital – Duke Energy
 - Human Capital – California Companies
5. Emerging Equity Markets Principles – Issues for Review

Overview – Global Governance

We Aim to be a Principled and Effective Investor: To deliver sustainable, risk-adjusted returns guided by CalPERS Investment Beliefs.

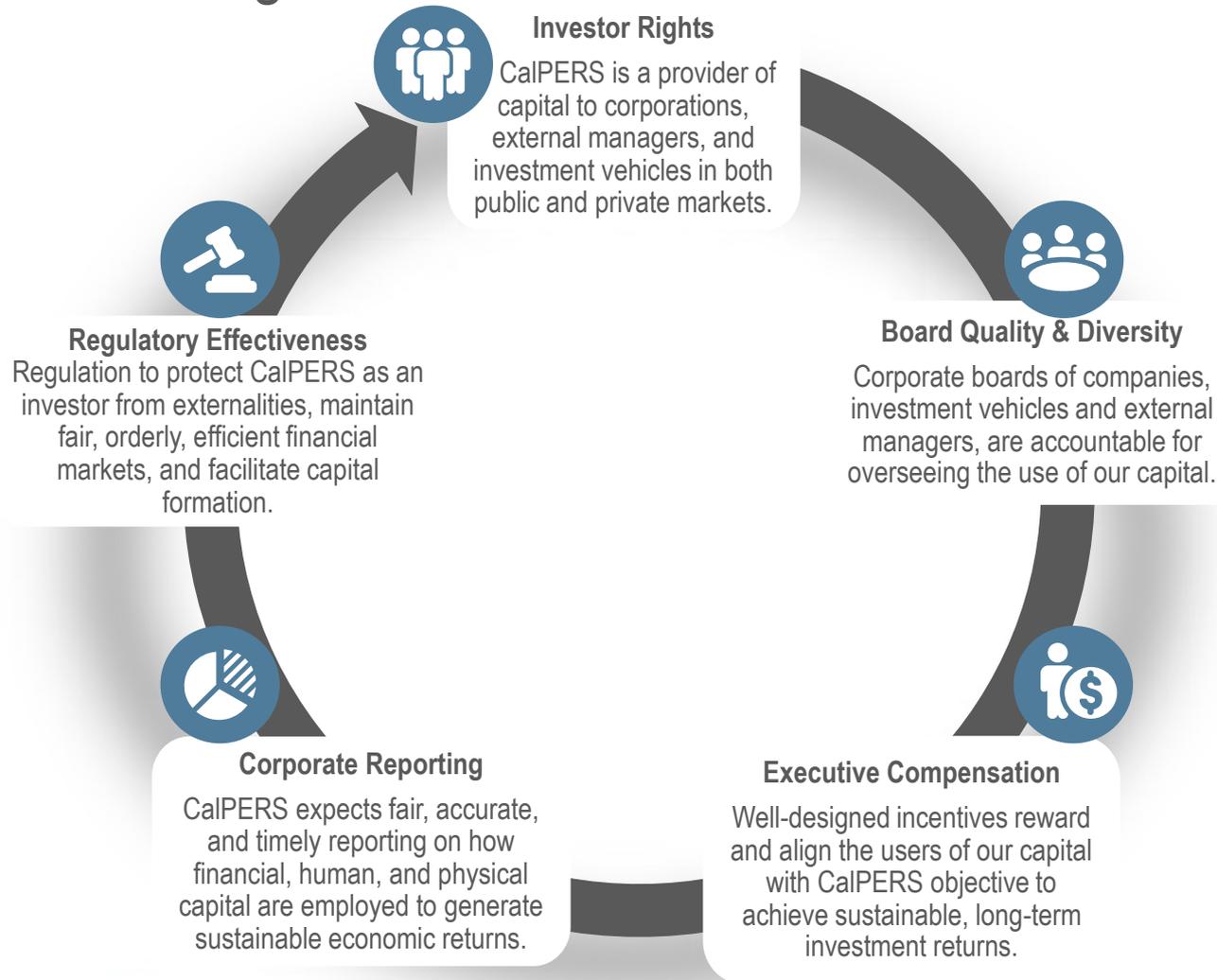
Grounded in Economics: Long-term value creation requires effective management of three forms of capital - financial capital, physical capital, and human capital.

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.

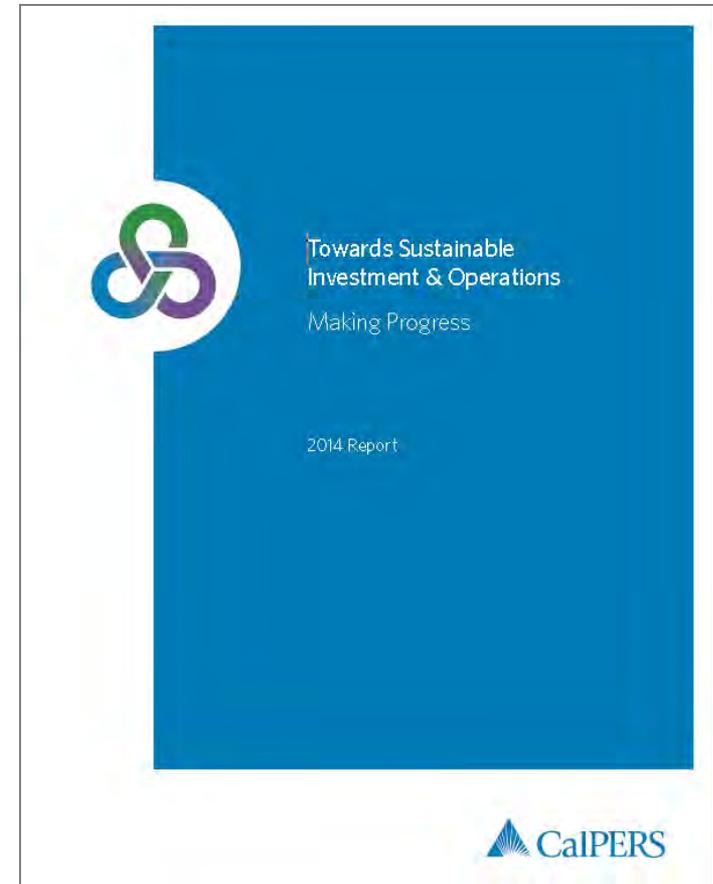
Governance Program: Core Issues



1. Towards Sustainable Investment & Operations: Making Progress

CalPERS launched the second edition of our report (Attachment 2) at the Ceres Conference on May 1, 2014. The report highlights:

- CalPERS Investment Beliefs
- The Sustainable Investment Research Initiative (SIRI)
- Cross Asset Class Team on Sustainable Investment
- Asset Liability Management Work
- Asset Class Initiatives
- Partnerships - Working with others
- Sustainability efforts within our own operations



1. Towards Sustainable Investment & Operations: Making Progress

The report includes work across the asset classes as well as details of our own sustainable operations for each of the three forms of capital. Such as:

Financial Capital – Governance

- Financial Market Reform work – including development of the Principles of Financial Regulation
- Proxy voting activity – with examples of key votes such as Apple, JP Morgan & Walmart
- Private Equity Program’s ESG Disclosure Framework, which asks General Partners and Limited Partners about their ESG integration
- CalPERS Board’s own governance work – governance review leading to the adoption of the six Principles for Effective Public Pension Fund Governance.

1. Towards Sustainable Investment & Operations: Making Progress

Physical Capital – Environment

- The Carbon Asset Risk Initiative– detailing our engagement with 45 of the world’s largest fossil fuel companies.
- Case studies from the asset classes including Blackstone’s solar program for portfolio companies and CIM Group’s renewable resources project, which invested in a natural aquifer to develop it as a groundwater storage bank.
- Corporate Reporting – CalPERS support of the Sustainability Accounting Standards Board (SASB) to develop industry-specific sustainability accounting standards for publicly listed companies.
- CalPERS shares internal sustainability practices aimed at water conservation, energy reduction and energy efficiency through green buildings and café operations.

1. Towards Sustainable Investment & Operations: Making Progress

Human Capital – Social

- Human Capital Management Initiative, which shares the questions developed by the investor coalition when they engage companies on human capital management.
- Board Quality & Diversity – Our work on the Diverse Director DataSource (3D), the Agenda Digital 50 Directors list, and our engagement with 41 S&P 500 companies.
- Highlights from Global Fixed Income on their sovereign team’s credit analysis including a list of the various quantitative and qualitative factors that are evaluated.
- CalPERS provides an overview of our Diversity & Inclusion practices in the workforce and workplace along with mention of the programs to encourage healthy living.

2. Principles for Responsible Investment (PRI) Framework

As a founding signatory to the PRI, CalPERS completes the Framework each year to demonstrate how we are implementing the PRI's six principles across all of our asset classes.

- The Framework became mandatory for all signatories to complete in 2014.
- CalPERS completed response will be made public after June 30, 2014.
- The PRI will also provide a confidential assessment of each signatory's progress in implementing the Principles on a peer relative basis – highlighting areas and activities needing improvement.
- Staff across the Investment Office worked over a five month period to compile content for the PRI Framework in the following areas: Direct – Listed Equity Incorporation; Direct – Private Equity; Direct – Listed Equity Active Ownership; Direct – Fixed Income; and Indirect – Manager Selection, Appointment and Monitoring.

3. Proxy Voting – Quarterly Update (Jan – March 2014)

- CalPERS cast 1,444 votes at company meetings worldwide, supporting 92 percent of management proposals and 65 percent of shareowner proposals. Votes are cast in line with CalPERS Global Principles of Accountable Corporate Governance, as approved by the Investment Committee.
- A summary of proxy votes and examples for the quarter can be found in Attachment 3.

4. Special Company Engagements

This quarterly update focuses on 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**
Domino’s Pizza – Vote on Executive Compensation
- **Physical Capital – Environment**
Duke Energy – Focus on Board Oversight of Environmental Risk
- **Human Capital – Social**
California Companies – Board Quality & Diversity Joint Letter with CalSTRS

4. Financial Capital – Governance

Domino's Pizza (DPZ) – April 29, 2014 Annual General Meeting

Due to egregious pay practices at Domino's Pizza CalPERS voted against the company's advisory vote on executive compensation and withheld vote from Compensation Committee chair Andrew Balson.

We note the following problematic features contributing to our pay-for-failure concerns at the company:

- Large discretionary equity awards in 2013 to the CEO, executives, and directors. To further concerns over the use of discretionary awards – there is limited disclosure on why the Compensation Committee chose to make the special grants. This raises serious questions regarding the Compensation Committee's oversight of the pay program.
- No disclosure of metrics within the long-term incentive plan.
- No clawback policy or stock holding requirements.

4. Physical Capital – Environment

Duke Energy

Due to the significance of the coal ash spill CalPERS withheld vote from members of the company's Regulatory Policy and Operations Committee – Alex Bernhardt, James Hyler, James Rhodes and Carlos Saladrigas for failing to oversee environmental and regulatory risks.

- These directors lack experience in hazardous waste disposal, environmental management and regulatory matters, as well as expertise in the coal industry.
- The company is facing serious financial, legal, regulatory and reputational risks as a result of the spill.
- Since the spill, the company's total shareholder returns are the lowest within a Bloomberg-defined 16-company peer group.

4. Human Capital – Social

We continue to engage companies on the issue of board quality and diversity because research continues to show that there is a positive impact on performance.

“Positive return on equity occurred when boards were made up of about 30 percent women – when critical mass was achieved.”

“A greater number of women in management and senior leadership positions was tied with better performing organizations.”

“Beyond gender, other dimensions of diversity are also found to be good for business: race, board member background, LGBT identity, nationality.”

Source: Catalyst, July 2013 Report, “Why Diversity Matters”

4. Human Capital – Social

Board Quality & Diversity

CalPERS and CalSTRS are engaging 160 California companies that were included in the 2012-13 UC Davis Study of California Women Business Leaders – highlighting that these companies have no women on their boards making the business case for greater board quality and diversity and providing resources such as:

- National Association of Corporate Directors (NACD) Blue Ribbon Commission Report, “The Diverse Board: Moving From Interest to Action.”
- Details on the Diverse Director DataSource (3D).
- Best practices on our work with UnitedHealth Group to appoint an independent director to their Board.

4. Human Capital – Social

Board Quality & Diversity Events

- National Association of Corporate Directors (NACD) Event: CalPERS partnered with NACD to host a second event, on March 20, 2014. The discussion, “A Conversation with the People You Wish You Could Speak with Before Proxy Season.”
- Council of Institutional Investors (CII) Events: CalPERS, CalSTRS and GMIRatings hosted a discussion forum titled, “Board Diversity: Why Investors Should Care” at the CII Conference on May 8, 2014, to talk about the progress that has been made and how achieving greater diversity among board directors can be good for shareholders.
- CalPERS also co-convened a meeting at CII’s Conference titled, “Promoting Good Human Capital Management for Long-term Sustainable Value Creation.” CalPERS discussed how our Investment Beliefs frame our approach to human capital management, with reference to our recent work on fair labor practices, diversity and human rights in the Governance Program.

5. Emerging Equity Markets Principles – Background

- CalPERS adopted the Statement of Investment Policy on Emerging Equity Markets Principles (Policy) in November 2007 to ensure prudent and careful action is taken while evaluating emerging equity markets investments.
- Prior to 2007, we had a “Permissible Country List” that screened out any equity investments in these applicable countries. In 2007, we concluded that eliminating entire countries limited potential investment opportunities and reduced our ability to have a positive influence on these markets.
- Global Equity staff applies the Policy to internally and some externally managed portfolios to delineate a principles-based approach to investing in emerging equity markets. The Policy does not currently apply to other asset classes.

5. Emerging Equity Markets Principles – Issues for Review

In order to reflect the total fund approach set out in the Investment Beliefs, a number of issues should be addressed to improve consistent application to internally and externally managed portfolios invested in emerging markets securities, as well as all global securities.

- CalPERS allocates capital to emerging markets across the Total Fund; yet, the Emerging Equity Markets Principles are managed by one asset class, Global Equity.
- The Policy only applies to capital managed by external Global Equity emerging markets managers. CalPERS allocates capital to external money managers or partners investing in emerging markets within other asset classes
- Two independent sets of principles – Global Principles of Accountable Corporate Governance (Global Principles) and the Policy – pose the risk of inconsistent communication and application.

5. Emerging Equity Markets Principles – Revisions Overview

Staff is considering alternatives to amending the Emerging Equity Markets Principles and their application to investment decision making which could reflect:

1. Transitioning ownership and implementation of the Emerging Equity Markets Principles (Attachment 4) from Global Equity to Global Governance, while considering broader coverage beyond just Emerging Markets.
 2. Applying the Emerging Equity Markets Principles to all securities across the Total Fund rather than just to Global Equity managers.
 3. Harmonizing CalPERS Board's Global Principles of Accountable Corporate Governance (Attachment 5) with the Emerging Equity Markets Principles, which would foster consistency with CalPERS Investment Beliefs.
- These changes would anchor all asset classes to a single uniformly applied set of principles and reflect CalPERS Investment Beliefs consistently across the Total Fund.

5. Emerging Equity Markets Principles – Internal Application

- In applying the Emerging Equity Markets Principles internally to emerging equity markets portfolios, CalPERS contracts with an external research provider (MSCI) to annually screen CalPERS universe of emerging equity markets constituents in alignment with the principles described in the Policy.
- The screening process results in an MSCI assessed grade of “Pass,” “Watch” or “Red Flag” for each company within CalPERS investable emerging markets universe. “Pass” and “Watch” list companies are designated as appropriate for inclusion in internally managed portfolios.

5. Emerging Equity Markets Principles – Internal Application

- Global Equity excludes, from its internally managed portfolios, all companies assessed as “Red Flag” by MSCI. External Global Equity emerging markets managers are responsible for security selection and reporting in general accordance with the Policy, only if they invest solely in emerging markets for CalPERS.
- Staff also seeks individual company research from MSCI on an ad hoc basis to re-assess company ratings. This process allows staff to take into account more current information when considering investment in emerging markets companies. For example, MSCI recently re-assessed two Russian companies, Mail.Ru and MegaFon, and determined both to be “Red Flag” companies resulting in exclusion from internally managed portfolios. The reason was information relating to both companies and affiliates of the companies investing in a website, which hosts a neo-Nazi group called “Occupy Pedophilia.”

5. Emerging Equity Markets Principles – Next Steps

Staff will return with recommendations, after further discussion, for review and approval later in the year.

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

View and download Full Sustainable Investment Report at:
<http://goo.gl/J9BMHz> or scan the QR code

