Global Governance
Annual Program Review

Anne Simpson
Senior Portfolio Manager, Director of Global Governance

November 17, 2014
Executive Summary

• Key Accomplishments
  – Refreshed the Financial Market Reform Principles and identified policy priorities
  – Cross-Asset Class Team on Sustainable Investment established
  – Successful second year of the monetized Focus List and Carbon Asset Risk Initiative
  – Executed over 100,000 proxy votes across 47 markets in line with the Global Principles
  – Continue to promote board quality and diversity through company engagements
  – Published CalPERS second total fund report, *Towards Sustainable Investment & Operations: Making Progress*

• 2015 Priorities
  – Strategic Review: 5 Year Business Plan focused on articulating priorities and internal organizational governance to effectively integrate the Investment Beliefs across the total fund including ESG, Financial Market Reform, Proxy Voting and Corporate Engagement
  – Continue work on: Financial Markets Priorities, Cross Asset Class work on ESG Manager Expectations, Board Quality and Diversity
  – Physical Capital: Continue Climate Risk Engagement
  – Human Capital: Explore Income Inequality as an Investor Issue
  – Financial Capital: Launch Proxy Access Initiative

• Talent Management
  – Recruiting for the Investment Officer III to lead the Sustainable Investment Work
# Global Governance Program Annual Review

## Review Outline

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</table>
### Investment Beliefs Key

<table>
<thead>
<tr>
<th>Short Name</th>
<th>Investment Belief (IB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Liabilities</td>
<td>Liabilities must influence the asset structure.</td>
</tr>
<tr>
<td>2 Long-Time Horizon</td>
<td>A long time investment horizon is a responsibility and an advantage.</td>
</tr>
<tr>
<td>3 Stakeholders</td>
<td>CalPERS investment decisions may reflect wider stakeholder views.</td>
</tr>
<tr>
<td>4 3 Forms of Capital</td>
<td>Long-term value creation requires effective management of three forms of capital:</td>
</tr>
<tr>
<td></td>
<td>financial, physical and human.</td>
</tr>
<tr>
<td>5 Accountability</td>
<td>CalPERS must articulate its investment goals and performance measures and</td>
</tr>
<tr>
<td></td>
<td>ensure clear accountability for their execution.</td>
</tr>
<tr>
<td>6 Strategic Allocation</td>
<td>Strategic asset allocation is the dominant determinant of portfolio risk and return.</td>
</tr>
<tr>
<td>7 Risk Reward</td>
<td>CalPERS will take risk only where we have a strong belief we will be rewarded.</td>
</tr>
<tr>
<td>8 Costs</td>
<td>Costs matter and need to be effectively managed.</td>
</tr>
<tr>
<td>9 Multi-faceted Risk</td>
<td>Risk to CalPERS is multi-faceted and not fully captured through measures such as</td>
</tr>
<tr>
<td></td>
<td>volatility or tracking error.</td>
</tr>
<tr>
<td>10 Resources/Process</td>
<td>Strong processes and teamwork and deep resources are needed to achieve</td>
</tr>
<tr>
<td></td>
<td>CalPERS’ goals and objectives.</td>
</tr>
</tbody>
</table>
1. Program Overview
Program Role

Investment Office 2013-15 Roadmap

Ensure CalPERS acts as a principled and effective investor by advocating corporate governance and financial reform; overseeing the effective management of the three forms of capital: financial, physical and human; and, effectively engaging with portfolio companies and policy makers.
Program Investment Philosophy

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.

Thought Leadership, Partnerships, and Innovation

• Investor network leadership, Global Peer Exchange, Sustainable Investment Research Initiative, Sustainability Report and the Diverse Director DataSource (3D).
Program Investment Philosophy | CalPERS Partnerships

- **Ceres** – Investor Network on Climate Risk
  U.S. coalition to address sustainability challenges, such as global climate change.

- **Council of Institutional Investors (CII)** (CalPERS Co-Founder)
  U.S. corporate governance advocacy organization of public, labor and corporate pension funds.

- **The Credit Roundtable**
  Fixed income manager group seeking to enhance investment grade bondholder protection.

- **ICGN** (CalPERS Co-Founder) Global membership whose mission is to raise standards of corporate governance worldwide.

- **Academic Relationships**

- **Global Peer Exchange**
  (CalPERS Founder) Group of the world’s largest asset owners to collaborate on the integration of sustainable investment practices.

- **ICGN**
  U.S. coalition to address sustainability challenges, such as global climate change.

- **Principles for Responsible Investment (PRI)** (CalPERS Founding Signatory)
  Network to incorporate ESG issues into decision making and ownership practices.

- **UNEP-FI**
  Global partnership to develop and promote linkages between sustainability and financial performance.

- **Public Company Accounting Oversight Board (PCAOB)**
  Oversees the audits of U.S. public companies in order to protect investors.

- **International Financial Reporting Standards (Advisory Council)**
  Develop a single set of high quality, understandable, enforceable and globally accepted reporting standards.

- **Sustainable Accounting Standards Board (SASB)**
  Aims to develop and maintain industry-based sustainability standards to guide US corporations for risk reporting.

- **Toigo Foundation**
  Promotes diversity in the financial sector.

- **Principles for Responsible Investment (PRI)**
  Network to incorporate ESG issues into decision making and ownership practices.

- **Toigo Foundation**
  Promotes diversity in the financial sector.

*APG Asset Management, Australian Super, BT Pension Scheme, Florida State Board of Administration, Government Employee Pension Fund, Norges Bank Investment Management, Ontario Teachers’ Retirement System, PGGM, Previ, TIAA-Cref, Universities Superannuation Scheme, and RPMI.*
Staff use the following criteria to prioritize core issues:

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CalPERS Principles</strong></td>
<td>To what extent is the issue supported by CalPERS’ Investment Beliefs, Principles or Statements of Investment Policy?</td>
</tr>
<tr>
<td><strong>Materiality</strong></td>
<td>Does the issue have the potential for a meaningful impact on portfolio risk or return?</td>
</tr>
<tr>
<td></td>
<td>• Net Portfolio Performance: Relevant to improving portfolio returns or reducing risk.</td>
</tr>
<tr>
<td></td>
<td>• Capital Exposure: Relevant to CalPERS’ capital exposure in $$ terms.</td>
</tr>
<tr>
<td></td>
<td>• Scale: Relevant to the number of companies in which CalPERS invests.</td>
</tr>
<tr>
<td></td>
<td>• Evidence: Supported by empirical data, broad market consensus, or strong CalPERS conviction that the issue will improve returns or reduce risk.</td>
</tr>
<tr>
<td><strong>Capacity</strong></td>
<td>Do we have the expertise and resources to influence a meaningful outcome? Do we have prior experience with engaging on the issue?</td>
</tr>
<tr>
<td><strong>Timeliness</strong></td>
<td>Is the issue time sensitive with a clearly defined deadline?</td>
</tr>
<tr>
<td><strong>Likelihood of Success</strong></td>
<td>Is there a likelihood of success that CalPERS’ action will influence an outcome which can be measured? Can we partner with others to achieve success? Can we add value to the debate?</td>
</tr>
</tbody>
</table>

*Note: These criteria have been incorporated into Investment Belief 3*
Core Issues

Investor Rights
CalPERS is a provider of capital to corporations, external managers, and investment vehicles in both public and private markets.

Regulatory Effectiveness
Regulation to protect CalPERS as an investor from externalities, maintain fair, orderly, efficient financial markets, and facilitate capital formation.

Board Quality & Diversity
Corporate boards of companies, investment vehicles and external managers, are accountable for overseeing the use of our capital.

Corporate Reporting
CalPERS expects fair, accurate, and timely reporting on how financial, human, and physical capital are employed to generate sustainable economic returns.

Executive Compensation
Well-designed incentives reward and align the users of our capital with CalPERS objective to achieve sustainable, long-term investment returns.
## Policy Benchmark

<table>
<thead>
<tr>
<th>Global Governance Policies</th>
<th>What’s Next</th>
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<tbody>
<tr>
<td>Global Principles of Accountable Corporate Governance</td>
<td>Annual review of the Global Principles in February 2015</td>
</tr>
<tr>
<td>Global Proxy Voting Policy</td>
<td>Staff is proposing to consolidate these policies into one Statement of Investment Policy for Global Governance, which will also include corporate engagement. To be presented to the Investment Committee in February 2015.</td>
</tr>
<tr>
<td>Global Equity – Emerging Equity Markets Principles</td>
<td></td>
</tr>
<tr>
<td>Representation on Corporate Boards of Directors Policy</td>
<td>Staff to review the Policy</td>
</tr>
<tr>
<td>Director Nominations Policy</td>
<td>Staff to review the Policy</td>
</tr>
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</table>

### Other Related Policies

<table>
<thead>
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<th>Other Related Policies</th>
<th>Connection to the Governance Program</th>
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<tr>
<td>Divestment Policy</td>
<td>CA Iran &amp; Sudan Acts, Tobacco, Northern Ireland, and Holocaust-Era Reporting; Manufacturers of Assault Weapon Divestment, Carbon Asset Risk Initiative</td>
</tr>
<tr>
<td>Fixed Income – Securities Lending</td>
<td>Ability to recall shares on loan in order to cast votes</td>
</tr>
<tr>
<td>Investment Beliefs</td>
<td>To be reflected in program priorities and practices</td>
</tr>
</tbody>
</table>
Program Characteristics

Support the Investment Office’s objectives by advocating for:

• Alignment of interest across corporations, markets, and external managers to address core issues:
  — Investor Rights
  — Board Quality and Diversity
  — Executive Compensation
  — Corporate Reporting
  — Regulatory Effectiveness

• Transparent and stable capital markets

• Integration of environmental, social, and governance (ESG) factors (3 forms of capital - financial, physical and human) into investment decisions to support long-term value creation and risk-adjusted returns.
2. Investment Review
Investor rights significantly improved in the U.S. – largely in response to shareowner action.

Shareholder Proposal Trends

- Declassify the Board of Directors
- Majority Vote Election Standard
- Independent Chair
- Repeal Supermajority Vote Requirement (Charter & Bylaws)
Market Review | Investor Rights

Shareowners continue to be active across a widening range of issues including sustainability.

Environmental and social (E&S) issues took center stage on the shareowner proposal front as the E&S resolutions hit an all time high. For the first time in a decade, E&S proposals accounted for more than half of the seasons overall proposal volume.

Independent Board Leadership outpaced all other shareowner proposals with average investor support nearly unchanged from 31 percent in 2013.
Market Review | Investor Rights

Management proposals are increasingly common on the same issues that we’ve seen shareowners actively promote.

- **Declassify Board**: 96.6%
- **Provide Right to Call Special Meeting**: 98.8%
- **Implement Majority Director Election**: 94.9%
- **Adoption of Poison Pill**: 75.4%
- **Eliminate Supermajority Vote Req.**: 98.3%
- **Permit Action by Written Consent**: 97.5%

Although management proposals seeking to declassify the board were less frequent, shareholder support for these proposals remain high, with most companies responding to majority approved shareholder proposals seeking declassification.

Glass Lewis & Co. Season Review (U.S.) 2014

Universe: Russell 3000
Market Review | Board Quality & Diversity

Progress on the issue of board diversity in the U.S. remains stagnant with women holding only 11% of board seats at the world’s largest companies\(^1\) and minorities representing 13.3% of Fortune 500 board seats\(^2\).

Companies with Women Directors (California’s 400 Largest Companies)

<table>
<thead>
<tr>
<th>Number of women on the board</th>
<th>0</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>40.5%</td>
<td>36.3%</td>
<td>17.5%</td>
<td>4.3%</td>
<td>1.3%</td>
<td>0.3%</td>
<td></td>
</tr>
</tbody>
</table>

Fortune 500 Percentage of Board Seats by Gender & Minority\(^2\)

- Caucasian Women: \(n = 737\), 13.4%
- Minority Women: \(n = 176\), 3.2%
- Minority Men: \(n = 555\), 10.1%
- Caucasian Men: \(n = 4020\), 73.3%

The four pillars of the business case:
- Improve financial performance
- Leverage talent
- Reflect the marketplace and build reputation
- Increase innovation and group performance

Source: Catalyst, Why Diversity Matters July 2013

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1. GMI Ratings 2013 Women on Boards Survey
2. Alliance for Board Diversity 2012 Missing Pieces Study
Market Review | Executive Compensation

In 2014, shareowner support for executive compensation programs slightly increased from 2013 levels.

- Average shareowner support for “Say on Pay” proposals was 91.6 percent – in 2013, average support was 91.2%.
- Average shareowner opposition for “Say on Pay” proposals was 8.4 percent – in 2013, average opposition was 8.8%.
- 98 percent of the “Say on Pay” proposals in 2014 passed with a majority support – results unchanged since 2013.
- 2 percent failed to receive majority support – results unchanged since 2013.

“Concerns over executive compensation practices drove a number of Vote No campaigns during the 2014 proxy season.”

“A disproportionate number of these campaigns were observed in the quick service food industry, which has come under pressure in the national debate over minimum wage policy and income inequality.”

Source: ISS, Proxy Season 2014 in Review
Market Review | Corporate Reporting

Over the past decade, there has been growth in both sustainability reporting by companies and investors calling for sustainability reporting.

Principle 3 – We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Assets Under Management (AUM) for signatories exceeds $45 trillion.

Source: http://www.unpri.org/signatories/signatories/

Source: http://database.globalreporting.org/
As of October 1, 2014, a total of 280 Dodd-Frank rulemaking requirement deadlines have passed. Of the 280 passed deadlines, 115 have been missed and 165 have been met with finalized rules. Regulators have not yet released proposals for 42 of the 115 missed rules.
## Program Performance | Highlights

<table>
<thead>
<tr>
<th>FROM</th>
<th>TO</th>
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</thead>
<tbody>
<tr>
<td>• Inconsistent and partial reporting on CalPERS' ESG initiatives</td>
<td>• Total Fund Report, “Towards Sustainable Investment”</td>
</tr>
<tr>
<td>• Multiple guidelines on ESG across asset classes and ESG initiatives / programs</td>
<td>• Sustainability issues are integrated into the Investment Beliefs</td>
</tr>
<tr>
<td>• Varied internal and external manager expectations on sustainable investment</td>
<td>• Total Fund ESG expectations for internal and external managers being developed by the Cross-Asset Class Team</td>
</tr>
<tr>
<td>• Lack of consensus on the evidence linking sustainability factors to performance</td>
<td>• Review of academic literature completed (SIRI), tools and data for the total fund being assessed</td>
</tr>
<tr>
<td>• Financial market reform priorities reactive and focused on U.S. capital markets</td>
<td>• Advancing financial market principles and priorities in global capital markets based on investment exposure (derivatives, credit rating agencies, housing finance reform)</td>
</tr>
<tr>
<td>• Unstructured process for managing CalPERS' institutional relationships</td>
<td>• Prioritizing, monitoring and advancing CalPERS' leadership through investor networks</td>
</tr>
<tr>
<td>• Domestic Focus List Program</td>
<td>• Global Focus List Program</td>
</tr>
</tbody>
</table>
CalPERS is a provider of capital to corporations, external managers, and investment vehicles in both public and private markets.
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Program Performance | Investor Rights

CalPERS Focus List Program

- Wilshire's study shows that CalPERS' engagement has added value to the share prices of targeted companies.
- For the three years prior to the initiative date, the engaged companies have produced returns that averaged 38.91% below the Russell 1000 Index and 36.13% below the appropriate Russell 1000 sector indices.

"CalPERS has a long history of active involvement and discussion of best practices...the data supports the contention that engagement has improved investment results."

Source: Wilshire, Corporate Governance Engagement Analysis, September 19, 2014

For the first five years after the initiative date, targeted companies collectively produced stock returns of 14.44% above the Russell 1000 Index and 11.21% above the appropriate Russell 1000 sector indices on a cumulative basis.
Global Proxy Voting

- CalPERS voted at 10,107 company meetings in 47 markets including votes for 107,302 individual proposals, supporting 90.1% of management proposals and 53.2% shareowner proposals.
- Internal audit evaluated policies, procedures and relevant resources and did not identify any issues that require any additional risk mitigations.

Nabors Industries (NBR) Vote Calculation Shareowner Resolution – Passed w/ 62% Support

- 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 identified concerns with Nabors Industries (NBR) unconventional vote calculation methodology. NBR considers uninstructed broker votes in the vote calculation for nondiscretionary items.
- CalPERS has requested that NBR amend the company’s voting methodology to a standard that counts uninstructed broker votes for quorum purposes only. CalPERS 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.
- Leading up to the June 3, 2014, Annual Meeting staff ran a full proxy solicitation and the CalPERS proposal ultimately passed – receiving 62% of shareowners support.
Program Performance | Investor Rights

Majority Vote Campaign

- Since 2010, CalPERS has engaged 203 major U.S. companies regarding the adoption of majority vote for director elections. 198 of the 203 companies have adopted or agreed to adopt the CalPERS request.

- Staff will continue to engage the remaining companies and file shareowner resolutions where necessary.

Majority Vote Implemented at Apple Following a Multiyear Engagement

- CalPERS voted ‘For’ a 2014 management proposal to implement majority voting for director elections and other proposals designed to enhance shareowner rights.

- This was a result of three years of engagement with Apple to change its voting standard for Board candidates from a plurality model to a majority vote standard.

- The proposal would also establish a par value for Apple stock and eliminate Apple’s ability to issue preferred shares without shareholder approval.

- We strongly supported Apple’s position that preferred stock should not be issued without shareowner approval.
Proxy Access: We advocate for investor rights to nominate candidates through shareholder proposals to company Boards by supporting Proxy Access proposals. Since 2012, 44 varied proxy access shareowner proposals have been filed and received on average support of 33%.

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Meeting Date</th>
<th>% Support</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walgreens Company</td>
<td>1/8/2014</td>
<td>43.4</td>
<td>Fail</td>
</tr>
<tr>
<td>Apple Inc.</td>
<td>2/28/2014</td>
<td>4.2</td>
<td>Fail</td>
</tr>
<tr>
<td>International Game Technology</td>
<td>3/10/2014</td>
<td>57.8</td>
<td>Pass</td>
</tr>
<tr>
<td>Citigroup, Inc.</td>
<td>4/22/2014</td>
<td>5.5</td>
<td>Fail</td>
</tr>
<tr>
<td>Bank of America Corporation</td>
<td>5/07/2014</td>
<td>6.5</td>
<td>Fail</td>
</tr>
<tr>
<td>Comstock Resources, Inc</td>
<td>05/08/2014</td>
<td>47.0</td>
<td>Fail</td>
</tr>
<tr>
<td>The Goldman Sachs Group, Inc</td>
<td>05/08/2014</td>
<td>3.2</td>
<td>Fail</td>
</tr>
<tr>
<td>Boston Properties, Inc</td>
<td>05/20/2014</td>
<td>64.4</td>
<td>Pass</td>
</tr>
<tr>
<td>Big Lots, Inc.</td>
<td>05/29/2014</td>
<td>56.8</td>
<td>Pass</td>
</tr>
<tr>
<td>Nabors Industries Limited</td>
<td>06/03/2014</td>
<td>48.3</td>
<td>Fail</td>
</tr>
<tr>
<td>Abercrombie &amp; Fitch Company</td>
<td>06/19/2014</td>
<td>55.2</td>
<td>Pass</td>
</tr>
<tr>
<td>SLM Corporation</td>
<td>06/25/2014</td>
<td>66.3</td>
<td>Pass</td>
</tr>
<tr>
<td>FedEx Corporation</td>
<td>09/29/2014</td>
<td>3.2</td>
<td>Fail</td>
</tr>
</tbody>
</table>
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Program Performance Review | Investor Rights

**Target Corporation (TGT)**

- On December 19, 2013 Target confirmed the company was exposed to a massive data breach that included unauthorized access to credit card data of approximately 40 million customer accounts between Nov. 27 and Dec. 15, 2013.
- The Data Breach revealed that the company may not have been prepared for the significant risk in the area of cyber-security surrounding the company’s business in electronic commerce.
- Consistent with the CalPERS Principles related to risk and cyber-security, CalPERS withheld support from Audit Committee Chair Roxanne Austin (received 28% opposition) due to risk oversight failures leading up to the data breach.

**Vornado Realty Trust (VNO)**

- After four consecutive years of failing to adopt a majority passed shareowner resolution to Declassify the Board of Directors
- CalPERS withheld support from director nominees David Mandelbaum, Michael Lynne, and Daniel Tisch (the nominees received opposition levels of 75%, 61%, and 61% respectively).
Board Quality & Diversity

Corporate boards of companies, investment vehicles and external managers, are accountable for overseeing the use of our capital.
Program Performance | Board Quality & Diversity

We view board quality and diversity as critical to a company’s performance, which is why we continue to engage companies where we see reform is needed.

California Initiative

- CalPERS and CalSTRS wrote to 131 California companies identified in the *UC Davis Study of California Women Business Leaders* as having no female representation on their boards.
- To date, 35 companies have responded and 15 companies added at least one woman to their board.

Urban Outfitters 2014 Annual Meeting

- Most recently CalPERS wrote an Op-Ed jointly with other funds representing Connecticut, New York City, New York State and North Carolina.
- This was in response to Urban Outfitters and in support of a shareholder proposal calling on the board to take action and address the lack of diversity on their board shown by a nearly entirely male board with an average age over 60 overseeing a company whose core business is selling fashion and accessories to young women.

“Board quality is vital to a company’s success and diversity is an essential element to robust decision-making. The point is to strengthen the board’s independent thinking and oversight.”
Russell 1000 Initiative

- CalPERS, alongside CalSTRS and a number of other signatories who are members of the 30 Percent Coalition, wrote to 100 Russell 1000 companies with no female representation on their boards.
- This builds on our efforts to engage companies where we see opportunities to promote board quality and diversity.
- The letter includes an example of Nominating Committee Model Charter Language on Board Diversity, which was developed by Calvert and is intended to serve as guidelines for companies looking to create an inclusive board.

“...companies that embrace gender diversity are better-governed, better-managed and have better long-term growth prospects. This is a win-win proposition for both companies and their shareholders.

While women are the predominant group affected by the present-day exclusion from corporate senior leadership and board of director positions, they are in fact a proxy for a broad definition of diversity that includes race, ethnicity, age, skills and experience.”
Program Performance | Board Quality & Diversity

National Association of Corporate Directors (NACD)

- CalPERS partnered with National Association of Corporate Directors (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,” included the theme of board quality and diversity and featured Ralph Whitworth of Relational Investors, LLC, and Katherine Rabin of Glass, Lewis & Co. and was moderated by Anne Simpson from CalPERS.

Council of Institutional Investors Events

- CalPERS worked with CalSTRS, New York City Pension Fund and North Carolina Retirement System, GMI Ratings and BlackRock to host events at the Council of Institutional Investors Conferences to talk about the progress that has been made, challenges ahead, and how achieving greater diversity among board directors can be good for shareowners.

“Diversity of talent (including a broad range of education, experience, perspectives and skills) at all levels (Board, staff, external managers, and corporate boards) is important”
In partnership with New York City Comptroller, CalPERS highlighted Duke Energy due to significance of the coal ash spill that released 39,000 tons of coal ash into the North Carolina’s Dan River. The spill has raised serious concerns over Duke Energy Board’s oversight of environmental risks and director expertise as it relates to the coal industry.

CalPERS withheld votes 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. We argued in a joint Op-Ed with New York City that:

- 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 shareowner returns were the lowest within a Bloomberg-defined 16 company peer group (at the time of writing).
Diverse Director DataSource (3D)

- CalPERS is the co-founder and we developed this new pool of talent for companies looking for skilled individuals who can bring a fresh perspective to the boardroom and help advance their business strategy and help investors achieve long-term, risk-adjusted returns.
- This August, MSCI completed its acquisition of GMI Ratings – the previous owner and operator of 3D.
- CalPERS and CalSTRS are working closely with MSCI through this transition.
- 3D has grown to over 750 searchable candidates from across the country.
- Nearly a quarter of the candidates have current public company board experience.
- The candidates cut across a range of industries and functional experience, with a quarter having international experience.

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

_Catalyst_  
_Why Diversity Matters_  
_July 2013_

- 2/3 are female
- Over 1/3 have board certification training
- They speak 41 different languages
New Securities and Exchange Commission (SEC) Petition on Enhanced Disclosure

- CalPERS is working with a small group of funds, led by North Carolina, to draft a new petition for amendment of the SEC Rules Regarding Board Disclosure.

- The petition will request disclosure related to nominees for corporate board seats to be expanded.

SEC Enhanced Disclosure Rule
Approved December 16, 2009

Included in the current rule are specifics for companies to disclose in regards to board diversity, such as:

- Experience, qualifications, attributes or skills that led the company’s board to conclude that the person should serve as a director of the company.

- Required disclosure of whether, and if so how, a nominating committee considers diversity in identifying nominees for director.

- If the nominating committee or the board has a policy with regard to the consideration of diversity in identifying director nominees, the final rules require disclosure of how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy.

Executive Compensation

Well-designed incentives reward and align the users of our capital with CalPERS' objectives to achieve sustainable, long-term investment returns.
Program Performance | Executive Compensation

Say on Pay Voting

- Staff reviews Say on Pay proposals for:
  - Pay for performance discipline
  - Severance/change in control arrangements
  - Disclosure of compensation philosophy and policy
  - Compensation plan design
  - Linkage of health, safety, environmental and sustainability performance to compensation

CalPERS U.S. Say on Pay Voting

- 2,385 Proposals Voted ‘For’
- 339 Proposals Voted ‘Against’

2,724 Advisory Vote Proposals
Executive Compensation Trends

- In 2014 a disconnect between pay and performance continued to be the primary driver of negative say on pay votes.

- A factor appearing with greater frequency within this pay for performance disconnect was the use of outsized, poorly structured, and/or poorly justified one-time awards (retention bonuses or sign-on agreements).

- While we do not oppose the occasional use of one-off awards, we believe there should be robust disclosure explaining the award and then be adequately tied to company performance.

McKesson Say on Pay Engagement Success

- In 2003 CalPERS voted against MCK’s advisory vote on executive compensation due to significant concerns surrounding compensation program design and increasing elements of non-performance based pay for the CEO.

- The vote would fail obtaining only 22% support. Following the 2013 AGM the company engaged shareowners representing over 50% of the outstanding shares (this included extensive dialog with CalPERS) to begin the process of addressing shareowner concern.

- In 2014 the company would make a number of meaningful changes within the compensation program to more closely align pay with performance. As a result of these changes, CalPERS supported the company’s say on pay proposal in 2014 which would receive overwhelming support at 95%.
Say on Pay Impact

- Year to date, CalPERS voted AGAINST 52 Say-on-Pay resolutions which in turn failed to receive majority shareowner support.

- In 2015, staff will be voting against Compensation Committee members that failed to adequately address unresolved compensation concerns.

- To the right is a listing of companies where there was significant shareowner opposition (greater than 70% “against”)

<table>
<thead>
<tr>
<th>Company Name</th>
<th>% AGAINST</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBL &amp; Associates Properties, Inc.</td>
<td>70.2%</td>
</tr>
<tr>
<td>Forest Oil Corporation</td>
<td>71.3%</td>
</tr>
<tr>
<td>Medifast Inc.</td>
<td>72.1%</td>
</tr>
<tr>
<td>Lexington Realty Trust</td>
<td>72.2%</td>
</tr>
<tr>
<td>CommVault Systems, Inc.</td>
<td>72.3%</td>
</tr>
<tr>
<td>CYS Investments, Inc.</td>
<td>72.9%</td>
</tr>
<tr>
<td>BroadSoft, Inc.</td>
<td>73.9%</td>
</tr>
<tr>
<td>Riverbed Technology</td>
<td>73.2%</td>
</tr>
<tr>
<td>Chipotle Mexican Grill, Inc.</td>
<td>76.6%</td>
</tr>
</tbody>
</table>
CalPERS continues to have executive compensation concerns with Domino’s Pizza (DPZ). CalPERS voted AGAINST their 2014 Say on Pay proposal and withheld support from the Compensation Committee Chair Andrew Balson due to egregious pay practices at the Company. CalPERS identified the following problematic features at the company:

• Large discretionary equity awards in 2013 to the CEO, executives, and directors, with limited disclosure on why the Compensation Committee chose to make the special grants. This raises serious questions regarding the Compensation Committee oversight of the pay program.

• No disclosure of metrics within the long-term incentive plan.

• No clawback policy or stock holding requirements.

Nabors Industries 2014 Advisory Vote on Executive Compensation

• Due to continued executive compensation concerns CalPERS voted against the NBR Say-on-Pay proposal – which received a high level of opposition at 60 percent.

• Due to the ongoing pay issues at the company CalPERS withheld support from Compensation committee Chair John Lombardi who failed to receive majority shareowner support with 54 percent opposition. Going into 2015, staff will continue to engage the company on these executive compensation and other governance concerns.
Global Governance Program Annual Review

Corporate Reporting

CalPERS expects fair, accurate and timely reporting on how financial, human, and physical capital are employed to generate sustainable economic returns.
Program Performance | Corporate Reporting

Accounting & Audit

• Through our membership with the International Corporate Governance Network (ICGN) we engage the:
  – International Accounting and Auditing Assurance Standards Board on auditor reporting
  – International Accounting Standards Board (IASB) on conceptual framework
  – Institute of Internal Auditors (IIA) on their global strategic planning process

• Participated in a roundtable on the SEC’s Effective Disclosure Initiative

• A member of the PCAOB’s Investor Advisory Group to provide investor perspective on audit standards, improvement of audit quality and integrity of financial reporting


Public Company Accounting Oversight Board

Commented to the PCAOB on improving the transparency of audits – requiring the engagement partner signature, audit quality and enhancing and comment letter to improve the auditor’s report – requiring the disclosure of audit tenure, independence of the auditor, limiting non-audit fees, and enhancing the auditor’s report.
Sustainability Accounting Standards Board

- Appointed to the SASB Standards Council where they are focused on establishing sustainability accounting standards for use by publicly-listed corporations in the U.S. in disclosing material sustainability issues for the benefit of investors and the public.

Integrated Reporting Framework

- We wrote a letter to support this through our work with the Global Peer Exchange, which APG led.
- Supported the Investor Network on Climate Risk (INCR) Investor Initiative for Sustainable Exchanges which provided input into INCR’s March report on stock exchange listing standard focused on corporate sustainability disclosure.

Principles for Responsible Investment

- CalPERS successfully completed the 2013-14 new Reporting Framework which reflected our sustainable investment practices again the six PRI Principles.
- CalPERS response is posted publicly on the PRI website
Program Performance | Corporate Reporting

CalPERS Sustainability Report


- The report provides an update on the Investment Beliefs, the Asset Liability Management work and highlights initiatives that fall within each of the three forms of capital (financial, physical and human) across each asset class and the enterprise.

- Case studies from our partners and our engagements are woven throughout.

- We show how sustainability practices are being promoted through our internal operations in the “CalPERS Putting Principles into Practice” sections.

- Principles for Responsible Investment (PRI) Index is included again to show exactly how we are implementing the six Principles.
Regulatory Effectiveness

Regulation to protect CalPERS as an investor from externalities, maintain fair, orderly, efficient financial markets, and facilitate capital formation.
Program Performance | Regulatory Effectiveness

Building on the framework established in 2009 CalPERS’ previously-adopted Principles of Financial Regulation Reform, Investment Office Senior staff have refocused CalPERS’ Financial Markets Principles to the following, which were presented at the August Investment Committee Meeting:

- **Transparency**
  To promote full disclosure so that the market provides incentives that price risk and opportunity.

- **Governance**
  To foster alignment of interest, protect investor rights and independence of regulators.

- **Systemic Risk**
  For earlier identification by regulators of issues that give rise to overall market risk that threaten global markets and foster action that mitigates those risks.
Program Performance | Regulatory Effectiveness

Identified and agreed three Financial Markets priorities:

1. **Derivatives**
   - Risks involved in derivatives are often hidden
   - Failed contracts or a failed major counterparty could wreak havoc in the system – critical issues not yet addressed.
   - $700 Trillion Dollar Notional Value Market.
   - Engaged in derivatives related issues since the financial crisis.

2. **Housing Finance Reform**
   - As seen during the financial crisis, a failure in the housing finance market will have a significant impact on the financial system.
   - $10 trillion market in direct finance and provides the base for a derivatives market that is several multiples of the base market.
   - Regulations have moved slowly in this area. Various plans are under consideration in Congress.

3. **Credit Rating Agencies**
   - Play an important role in providing information to the market which enhances transparency. They failed in this role prior to and immediately after the 2008 financial crisis.
   - Credit rating agencies had a significant role in the mortgage crisis which weakened the system.
   - Certain markets cannot be created without Credit Rating Agencies.
   - Regulations have moved slowly in this area.
We have submitted comment letters on issues that contribute to the safety and soundness of the financial markets.

- **2 Dec 2013**: Securities and Exchange Commission
  - Pay Ratio Disclosure

- **12 Dec 2013**: Committee on the Judiciary, Banking, Housing & Urban Affairs
  - Limits rights or ability to seek legal remedies against issuers involved in corporate malfeasance – Prohibit the use of mandatory, pre-dispute arbitration provisions, Section 921 of Dodd Frank

- **21 Feb 2014**: California State Senate
  - Senate Resolution 18, human rights violations in Russia

- **17 Mar 2014**: Public Company Accounting Oversight Board
  - Improving the transparency of audits - audit partners signature – Docket 29

- **2 May 2014**: Public Company Accounting Oversight Board
  - Auditor Reporting Docket 34

- **8 Aug 2014**: Environmental Protection Agency
  - Carbon Pollution Standards Emissions Guidelines for Existing Power Plants
Investment Risk | ESG Integration
Investment Risk | Human Capital Management Coalition

CalPERS is collaborating with 16 investors with the following engagement goals:

• Elevate human capital management as a critical component in company performance.

• Understand and improve how human capital management contributes to the creation of long-term shareholder value.

• Risk oversight and effective human capital management practices are relevant in all industries, but the Coalition has begun its work with a focus on the retail industry, due to its high number of employees.

• New industries will be incorporated as the Coalition’s capacity increases.

• Views human capital management as encompassing a broad range of corporate practices related to employees, including, but not limited to, hiring and retention, training, compensation, fair labor practices, health and safety, responsible contracting, and diversity, both with respect to a company’s direct employees and to the employees of vendors throughout the company’s supply chain.
The Coalition frames its engagement of companies around the following topics:

| Board Oversight – Tone at the Top | • How does the Board ensure that its expectations on human capital management are reflected throughout the management chain?  
• What have been the Board’s priorities on human capital management in the past year, and what are its priorities going forward? |
<table>
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<tbody>
<tr>
<td>Performance/Long-Term Value Creation &amp; Operational Integration</td>
<td>• What metrics does the Company view as the main material drivers of long-term shareholder value-creation? Which of these metrics does the Company view as directly related to human capital management practices as long-term value drivers?</td>
</tr>
<tr>
<td>Incentives and Compensation Structure</td>
<td>• What specific incentive metrics are in place to encourage proper human capital management and risk oversight?</td>
</tr>
</tbody>
</table>
| Data Collection, Risk Management, and Accountability through Employee Engagement | • What methods does the Company use to collect information from, and otherwise communicate with, its employees?  
• Is the Board provided with any information (report, stats, etc.) on this feedback? By whom? How is it integrated in the Board’s decision-making process?  
• Does the Company collect information on human capital management and HCM risks in its supply chain? |
| Investor Engagement and Disclosure | • Are operational changes to address human capital management risk mitigation disclosed internally and/or externally? |
Investment Risk | Carbon Asset Risk Initiative

CalPERS is working on Ceres led Carbon Asset Risk Initiative, which is engaging major oil and gas, coal and electric power companies looking for:

- 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 greenhouse gas emissions by 80% by 2050 to achieve the 2°C goal
Investment Risk | Carbon Asset Risk Initiative

It is recommended that the energy companies’ 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 greenhouse gas 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.
Investment Risk | UN Climate Summit

The 2014 UN Climate Summit was attended by world leaders, from government, finance, business, and civil society. Participants shared announcements and actions with the aim to reduce emissions, strengthen climate resilience, and mobilize political will for a meaningful climate agreement in Paris 2015.

- CalPERS participated in the UN Climate Summit where we shared our work on climate risk and highlighted the Ceres led Global Investor Statement on Climate Change, which calls for: (1) putting a price on carbon, and (2) removing subsidies from fossil fuel.

- CalPERS was a signatory to “The Pocantico Statement,” with a commitment to identify and evaluate investment opportunities in climate-resilient infrastructure.

“This Summit was not about talk. History is made by action. And now we have seen that the world is ready to act.”

Ban Ki-moon
Secretary-General
United Nations
September 23, 2014
Internal Activities | Cross Asset Class Team

Purpose

• To work collaboratively to integrate relevant environmental, social and governance risk and opportunity considerations into investment processes and decision making across the Total Fund.

• In line with the Investment Beliefs, our activities will help drive objectives outlined in Goal A of the Enterprise Strategic Plan to improve long-term pension and health benefit sustainability and support the 13/15 Roadmap Performance Objective of ESG Investment Strategy.

Membership

• Each asset class and program area are represented including Global Equity, Global Fixed Income, Real Assets, Private Equity, Asset Allocation/Risk, Global Governance, Targeted Investment Programs, Investment Compliance and Operational Risk, and Investment Servicing in addition our enterprise partners in Public Affairs and the Legal Office.
Internal Activities | Education

As part of the Cross-Asset Class Sustainable Investment Team’s work, the following speakers presented to CalPERS Investment staff:

- **Bob Litterman** – Developer of the Black-Litterman Global Asset Allocation Model, Mr. Litterman spoke to the Investment Office staff about the Investment implications of climate change from a risk perspective.


- **Ceres** – Leveraging our relationship with Ceres, they held a seminar for the Cross-Asset team focused on water risks for investors to consider.

- **Sustainable Accounting Standards Board (SASB)** – Educated Cross-Asset Team on SASB’s mission to standardize accounting on material sustainability issues.

- **Carbon Disclosure Project (CDP)** – Educated the Cross-Asset Team on their leading databases of corporate environmental information such as carbon emissions, water usage and what investors are doing with the information.
Manager Expectations

- Manager Expectations project launched and defined by the Cross-Asset Class Team
- First Manager Expectations guidelines completed by Infrastructure.
- Timelines were developed for each asset class to deliver Manager Expectations by June 30, 2015

INVO identified a need to establish a monitoring framework to understand and assess exposure to ESG issues

- Staff conducted an evaluation and assessment of reporting tools that would support ESG monitoring needs
- Project goal is to implement monitoring and analytical tools to support the integration of Environmental, Social and Governance topics into the investment process at CalPERS

The following objectives will be met as part of the project:

- Monitoring tools will support evaluation of ESG positioning on absolute and relative basis
- Analytics will allow for assessment and internal reporting on ESG topics
- Company research tools will allow for deep dive on target companies
- Tools will support ability to identify and engage on CalPERS prioritized ESG topics
## Forward Looking Commentary

<table>
<thead>
<tr>
<th>Core Issue</th>
<th>2014 Accomplishment</th>
<th>Upcoming Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor Rights</td>
<td>• Majority vote Initiative – To date, 203 companies we engaged adopted a majority vote standard for director elections.</td>
<td>• Engage the next set of 50 companies on Majority Voting in Director Elections.</td>
</tr>
<tr>
<td></td>
<td>• Monetizing the Focus List Program: Influencing positive governance reforms while generating positive returns from inception.</td>
<td>• Proxy Access – launch initiative</td>
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<tr>
<td>Board Quality &amp; Diversity</td>
<td>• Engaged 131 California Companies with no female representation on their boards with positive responses from 35 companies.</td>
<td></td>
</tr>
<tr>
<td>Executive Compensation</td>
<td>• Reached out to companies we voted against to communicate our rationale and seek appropriate resolution to CalPERS concerns. Year to date, CalPERS has voted against 319 say-on-pay resolutions or 13% of the total proposals voted</td>
<td>• Staff will monitor 49 companies that failed to receive greater than 50 percent shareowner support for their say-on-pay proposal in 2014</td>
</tr>
<tr>
<td>Corporate Reporting</td>
<td>• Completed the new 2013-14 PRI Reporting Assessment Framework</td>
<td></td>
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<tr>
<td></td>
<td>• Published second total fund report, “Towards Sustainable Investment &amp; Operations: Making Progress”</td>
<td>• 2014-15 PRI Reporting Assessment</td>
</tr>
<tr>
<td>Regulatory Effectiveness</td>
<td>• Refreshed the 2009 Financial Markets Principles</td>
<td>• ESG Manager Expectations</td>
</tr>
<tr>
<td></td>
<td>• Identified priorities: Housing Finance Reform, Derivatives and Credit Rating Agencies</td>
<td>• Montreal Pledge</td>
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</table>
3. Business Review
**Business Model**

We accomplish our mission through the following six work streams:

<table>
<thead>
<tr>
<th>Work Stream</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principles &amp; Proxy Voting</td>
<td>Guided by CalPERS Global Principles of Accountable Corporate Governance, execute CalPERS’ proxy voting responsibilities and pursue corporate governance reform at portfolio companies by filing shareowner resolutions.</td>
</tr>
<tr>
<td>Sustainable Investment</td>
<td>Work collaboratively with the asset classes to integrate relevant ESG risk and opportunity considerations into investment processes and decision-making across the Total Fund.</td>
</tr>
<tr>
<td>Financial Markets</td>
<td>Analyze and engage policymakers on issues that impact investors and financial markets.</td>
</tr>
<tr>
<td>Corporate Engagement</td>
<td>Work directly with companies to improve investor rights, corporate reporting, and board quality and diversity in order to protect investment returns through programs such as the Focus List, Carbon Asset Risk and Human Capital Management initiatives.</td>
</tr>
<tr>
<td>Institutional Relations</td>
<td>Prioritize, monitor, and advance CalPERS thought leadership through investor networks, partnerships and organizations.</td>
</tr>
<tr>
<td>Knowledge Management</td>
<td>Coordinate the significant and growing information, communication, and research needs including the Diverse Director DataSource (3D), the Sustainability Report, Sustainable Investment Research Initiative and the Global Governance website.</td>
</tr>
</tbody>
</table>
**Staffing Overview**

**Global Governance Staff**
- 1 Senior Portfolio Manager
- 2 Portfolio Managers, 1 Portfolio Manager Part-time (Infrastructure)
- 10 Investment Officers (2-IO3s, 4-IO2s, 4-IO1s)
- 3 Administrative Support, 2 Seasonal Clerks

**Staffing Updates**
- Portfolio Manager hired to lead the Financial Markets work
- Two Investment Officer I positions filled – Sustainable Investment & Financial Markets
- Administrative Assistant joined
- Completed Diversity & Inclusion Training as a team
- Two staff members earned their CFAs

**Current Vacancies**
- Investment Officer III, Lead for ESG (Sustainable Investment) (Re-opened recruitment)
Global Governance Program Annual Review

Strategic Plans
Strategic Plans | 2015 Priorities

1. The Program will conduct a strategic review and develop a 5 Year Business Plan focused on articulating priorities and internal organizational governance to effectively integrate the Investment Beliefs across the total fund including ESG, Financial Market Reform, Proxy Voting and Corporate Engagement.

2. Physical Capital: Continue to engage on Climate Risk

3. Human Capital: Explore the issue of Income Inequality

4. Financial Capital: Launch Proxy Access engagement
Modeling Climate Change | The engagement challenge

Physical Capital | Engage on Climate Risk

Engagement

- Engage companies individually and through our institutional relationships (Ceres, PRI) through efforts such as supporting director campaigns where appropriate, filing shareholder proposals as part of the Carbon Asset Review and taking the debate further into risk management, capital expenditure, return on capital, and board accountability

Advocacy

- Continue to advocate a price on carbon and an end to fossil fuel subsidies in run up to Conference of the Parties (COP 15) – Paris climate talks

Analysis

- Assess methodology to perform a carbon footprint analysis for the Total Fund
“When the rate of return on capital exceeds the rate of growth of output and income, as it did in the nineteenth century and seems quite likely to do again in the twenty-first, capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based.”

Thomas Piketty
Capital in the Twenty-First Century
March 10, 2014

“[Piketty fails] to identify the tradeoff between the societal goals of reduced income/wealth inequality on the one hand, and higher economic growth and living standards on the other. This was a serious oversight.”

Dr. Woody Brock
Capitalism, Inequality, and Piketty
October 2014

Top Decile Income Share in the United States, 1917-2012 (including capital gains)

Source: World Top Income Database
Human Capital | Income Inequality

CalPERS Investment Belief 2
A long time investment horizon is a responsibility and an advantage

Long time horizon requires that CalPERS:

- Consider the impact of its actions on future generations and members and taxpayers
- Encourage the investee companies and external managers to consider the long-term impact of their actions
- Favor investment strategies that create long-term, sustainable value and recognize the critical importance of a strong and durable economy in the attainment of funding objectives
- Advocate for public policies that promote fair, orderly and effectively regulated capital markets

“[Income inequality is destabilizing and] responsible for the divisions in the country. The divisions could get wider…If you can't legislate, you can't deal with problems. [If] you can't deal with problems, you can't drive growth and you can't drive the success of the country. It's a very big issue and something that has to be dealt with.”

Lloyd Blankfein
CEO and Chairman
Goldman Sachs

CBS This Morning
June 10, 2014

“There is no good reason to believe that rent-seeking by the rich is more pervasive today…The story of rising inequality…is not primarily about politics and rent-seeking but rather about supply and demand.”

N. Gregory Mankiw
Professor of Economics
Harvard University

“Defending the One Percent”
Journal of Economic Perspectives
June 8, 2013
Human Capital | Income Inequality

“Indeed, some variation in outcomes arguably contributes to economic growth because it creates incentives to work hard, get an education, save, invest, and undertake risk. However, to the extent that opportunity itself is enhanced by access to economic resources, inequality of outcomes can exacerbate inequality of opportunity, thereby perpetuating a trend of increasing inequality.”

Janet Yellen
Chair of the Board of Governors of the Federal Reserve System
October 17, 2014

“We believe that pay ratio disclosure, required by Section 953(b) of Dodd-Frank, will provide important supplementary information on the financial incentives that drive performance throughout the company, vertically, as well as horizontally, across markets. We believe that companies should use this disclosure as an opportunity to provide insights on the role effective management of human capital plays with regard to value creation and risk mitigation.”

CalPERS Comment Letter on Pay Ratio Disclosure to the Securities and Exchange Commission
December 2, 2013
The SEC Rule – On August 25, 2010 the SEC adopted final proxy access rules giving shareholders the ability to nominate and elect company directors given that they meet the eligibility requirements of owning at least 3% of the company shares continuously for three years.

In 2011 prior to universal proxy access being implemented the US Chamber of Commerce and Business Roundtable filed suit to challenge the rule and won in court.

In 2012, shareowners were allowed to file shareowner proposals on a company by company basis requesting proxy access (also known as Private Ordering).

CalPERS has been a firm proponent of shareowner proposals modeled under the vacated SEC rule (3% ownership for 3 years). Since 2012, these proposals have received average support levels of 55% and 10 have received majority shareowner support.

In our view, compressive shareholder proxy access is the single tool that provides the greatest chance of meaningful director elections.

Shareholder proxy access achieves the Holy Grail of meaningful corporate democracy by invading the “sacred space” of a company’s own proxy statement.

“For while …the number of actual candidates under a shareholder access regime may very well be small, we believe [skeptics] give too little weight to the potential for more meaningful “constructive engagement” between large shareholders and the company under a proxy access regime.”

Improving Director Elections
Bo Becker and Guhan Subramanian
Vol. 3, 2013
Financial Capital | Proxy Access

- Proxy access proposals at these 10 companies during 2012 - 2014 won a majority of support:

<table>
<thead>
<tr>
<th>Company</th>
<th>Company</th>
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<th>Company</th>
</tr>
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<tbody>
<tr>
<td>Nabors Industries</td>
<td>Chesapeake Energy Corporation</td>
<td>Verizon Communications</td>
<td>CenturyLink, Inc.</td>
<td>Abercrombie &amp; Fitch Co.</td>
</tr>
<tr>
<td>Darden Restaurants, Inc.</td>
<td>International Game Technology</td>
<td>Boston Properties, Inc.</td>
<td>Big Lots, Inc.</td>
<td>SLM Corporation</td>
</tr>
</tbody>
</table>

- The CFA Institute’s report\(^1\) concludes that Proxy Access can have a positive impact in the US market and in boardrooms.

- We see our work with the Majority Vote Initiative as the model we will want to use for Proxy Access by targeting companies based on our economic exposure, sustainability, governance and/or financial failures.

- **Next Steps**: We will focus on proxy access, by filing and supporting fellow investors with proposals or proxy solicitation campaigns.

Evidence has piled up in support of proxy access in the U.S., calling into question whether it is time for the SEC to re-propose the rule. The evidence includes:

- the equity markets like proxy access;
- proxy access increases board accountability;
- abuse by special interest groups difficult and highly unlikely; and
- the kind of ex-ante cost-benefit analysis the court asked for is nearly impossible.

\(^1\) CFA Institute, “Proxy Access in the United States: Revisiting the Proposed SEC Rule,” August 2014.
Conclusion

• **Key Accomplishments**
  – Refreshed the Financial Market Reform Principles and identified policy priorities
  – Cross-Asset Class Team on Sustainable Investment established
  – Successful second year of the monetized Focus List and Carbon Asset Risk Initiative
  – Executed over 100,000 proxy votes across 47 markets in line with the Global Principles
  – Continue to promote board quality and diversity through company engagements
  – Published CalPERS second total fund report, *Towards Sustainable Investment & Operations: Making Progress*

• **2015 Priorities**
  – Strategic Review: 5 Year Business Plan focused on articulating priorities and internal organizational governance to effectively integrate the Investment Beliefs across the total fund including ESG, Financial Market Reform, Proxy Voting and Corporate Engagement
  – Continue work on: Financial Markets Priorities, Cross Asset Class work on ESG Manager Expectations, Board Quality and Diversity
  – Physical Capital: Continue Climate Risk Engagement
  – Human Capital: Explore Income Inequality as an Investor Issue
  – Financial Capital: Launch Proxy Access Initiative

• **Talent Management**
  – Recruiting for the Investment Officer III to lead the Sustainable Investment Work
Global Governance website:
www.calpers-governance.org/

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