



Agenda Item 9a

February 17, 2015

ITEM NAME: Global Governance Program Update

PROGRAM: Global Governance

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

This agenda item provides the Global Governance Program (the Program) quarterly update on our strategic priorities for the year: proxy access, climate risk, and income inequality, plus our continuing work on Financial Markets reform and the integration of environmental, social and governance (ESG) factors across the portfolio. Attachment 2 provides an overview of global proxy voting for the fourth quarter.

STRATEGIC PLAN

This agenda item supports the goal of CalPERS Strategic Plan to improve long-term pension and health benefit sustainability. The Program review supports the Investment Committee (IC) in its oversight role to monitor performance, initiatives, and contributions to the System's investment objectives.

BACKGROUND

The Program seeks improved governance practices across markets and by companies to ensure that CalPERS funds are being used for the benefit of our members to produce sustainable long-term, risk adjusted returns that pay pensions.

This quarterly update highlights recent work in the Program reflecting CalPERS Investment Belief 2 that a long term investment horizon is both a responsibility and an advantage; Investment Belief 4, that long-term value creation requires effective management of three forms of capital: financial, physical, and human, and Investment Belief 9 that risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.

ANALYSIS

CalPERS has three strategic priorities for the governance program in 2015: proxy access, climate change and a project to explore income inequality.

Proxy Access has long been a central issue for CalPERS, as a fundamental shareowner right to ensure Board accountability. Working closely with other investors, CalPERS is making the issue a priority by filing proposals, engaging companies, regulators, proxy voting firms and solicitation efforts to ensure there is a high voting turnout. To date, proposals have been filed at over 100 major companies,

with a focus on the energy sector, boards of directors which lack diversity and other companies where there have been governance failures. Furthermore, investors have been filing proposals at a wide range of other companies, arguing that proxy access should be a market standard, much like majority voting. The first shareowner proposal of the season at Monsanto, has passed with a majority of support by investors.

Climate change has been identified in CalPERS Investment Beliefs as an example of a risk which is not captured by traditional measures, such as volatility or tracking error. CalPERS has been actively engaging energy sector companies in the Carbon Asset Review, led by Ceres. This engagement calls upon energy companies to report on their risk scenarios and how these are stress tested against the International Energy Agency's goal to bring down projected global warming from 4 degrees centigrade to the 2 degrees centigrade rise which is needed and viable based on a transition which includes energy efficiency, renewables, carbon capture and sequestration. We note that one of the energy companies which have been engaged through the Carbon Asset Review, Shell, has advised that they support investors voting to support a shareowner proposal on climate risk reporting.

CalPERS has been participating in the Investor Network on Climate Risk, also led by Ceres, which is a part of a Global Investor Coalition representing \$24 trillion in assets. These networks are focusing upon the policy agenda to support mitigation of risk and expansion of opportunity due to climate change. A central objective is to have carbon pricing introduced and the termination of public subsidies to the fossil fuel industry. The goal is to catalyze market forces to better address the risks and opportunities that are presented. CalPERS built on its participation at the UN Climate Change Summit in New York in September 2014, by attending the preparatory meetings in Lima, Peru, speaking at the formal and informal events that were arranged, and ensuring that the message from the Global Investor Coalition was carried into the final communique. The next Convention of the Parties to address inter-governmental targets for climate change policy will be held in Paris, France in December 2015.

Staff has begun to explore the issue of income inequality and its relevance – if at all – to long term investment. Staff is planning to identify an academic partner through the University of California, who can provide specialist assistance with a literature review, and hosting a seminar on the issue which can inform CalPERS' understanding of this complex issue.

This quarterly update also provides a progress report on the work of the Cross Asset Class Team on Sustainable Investment, highlighting the completion of a project to review data and analytical tools for monitoring relevant ESG factors across various asset classes. The review highlighted the need to consider the potential for the analytical tool to integrate with existing data platforms. Staff reviewed leading providers and have recommended MSCI as the source, initially for assets in public

markets. The Cross Asset Class Team has also made progress on the development of ESG Manager Expectations which will be presented to the Investment Committee before the fiscal year end. The ESG Expectations will be embedded in the asset class and program procedures which are attached to the proposed Total Fund Policy, and the Principles.

We also provide an update on recent developments in the Financial Markets work stream highlighting the impact of Congressional elections on CalPERS priorities, the decision making bodies within the House and Senate, and planning which is underway to build out the work supported by the new Federal Representative.

A question was raised at the November 2014 Investment Committee meeting on the Collins Amendment. To explain further, the Collins Amendment is named after Senator Susan Collins, Republican for Maine and is contained in Section 171 of the Dodd Frank Wall Street Reform and Consumer Protection Act. It directs federal banking agencies to establish minimum leverage and risk-based capital requirements for institutions supervised by the Federal Reserve.

BUDGET AND FISCAL IMPACTS

Not applicable

BENEFITS/RISKS

The Global Governance program supports CalPERS fiduciary duty to provide sustainable, risk adjusted returns for its members. The risks relate to not fulfilling Board policies and principles.

ATTACHMENTS

Attachment 1 – Global Governance Program Update

Attachment 2 – Overview of Global Proxy Votes Cast – Q4 2014

ANNE SIMPSON
Senior Portfolio Manager and Director
Global Governance

THEODORE ELIOPOULOS
Chief Investment Officer