



Global Governance Policy Ad Hoc Subcommittee

California Public Employees' Retirement System

Agenda Item 4

June 17, 2015

ITEM NAME: Review Section A – Core Principles of Global Governance Principles

PROGRAM: Global Governance

ITEM TYPE: Information

EXECUTIVE SUMMARY

This agenda item initiates a review of the Global Governance Principles (Global Principles) starting with Section A, Core Principles (Core Principles) and follows agreement of the work program for the Global Governance Policy Ad Hoc Subcommittee (Subcommittee) at its May 2015 meeting. Staff will review each of the Core Principles with the Subcommittee in order to discuss and seek feedback on:

1. Relevance and origin of each Core Principle.
2. Alignment of Core Principles with elements of the Global Governance Program (Program) “core issues”: Investor Rights, Board Quality and Diversity, Executive Compensation, Corporate Reporting, and Regulatory Effectiveness.
3. Plans to wrap all input received from the Subcommittee into a new format for communicating the written Global Principles document upon completion of this review by December 31, 2015.

STRATEGIC PLAN

This agenda item is not part of the CalPERS Strategic Plan.

INVESTMENT BELIEFS

This agenda item supports the CalPERS Investment Beliefs (Beliefs) including direct alignment with the following:

1. Investment Belief 2 – A long time investment horizon is a responsibility and an advantage. A Long time horizon requires that CalPERS advocate for public policies that promote fair, orderly and effectively regulated capital markets.
2. Investment Belief 3 – CalPERS’ investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.
3. Investment Belief 4 – Long-term value creation requires effective management of three forms of capital: financial, physical and human. CalPERS may engage investee companies and external managers on their governance and sustainability issues, including governance practices, risk management practices, human capital practices, and environmental practices.

4. Investment Belief 9 – Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error. As a long-term investor, CalPERS must consider risk factors, for example climate change and natural resource availability that emerge slowly over long time periods, but could have a material impact on company or portfolio returns.

BACKGROUND

At its March 2015 meeting, the Investment Committee (Committee) consolidated three legacy policies into the Statement of Investment Policy for Global Governance (Attachment 1) and then established the Subcommittee consisting of Henry Jones, JJ Jelincic, Ron Lind, Bill Slaton, and Betty Yee at its April 2015 meeting for the purpose of reviewing CalPERS Global Principles. At its May 2015 meeting, the Subcommittee elected Henry Jones to serve as Chair, and Bill Slaton to serve as Vice Chair of the Subcommittee while agreeing to its scope and work plan to make the following recommendations to the Committee by December 31, 2015:

1. Modifications to the Statement of Investment Policy for Global Governance
2. Modifications to the Legislative and Policy Engagement Guidelines
3. Process for determining when CalPERS Board members can represent the organization as directors of third party organizations, and
4. Evaluation of establishing the Subcommittee on a permanent basis.

ANALYSIS

The Global Principles state the Core Principles should be adopted by all companies and markets – from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures. There are currently seventeen individual Core Principles summarized as follows:

Core Principle	Summary of Origin and Modification Consideration
1	<p>Origin: Approved by Committee at its March 2015 meeting to align Core Principles with Investment Belief 4 while clearly recognizing CalPERS expectations of companies and external managers to optimize operating performance, profitability and investment returns in a risk-aware manner.</p> <p>Modification Considerations:</p> <ul style="list-style-type: none"> • 1a. – c. describes three forms of capital: financial, physical, and human. Staff plans to identify Domestic and International Principles, and Appendices going forward which are duplicative of Core Principle 1 for the purpose of eliminating or consolidating similar language so as to clear up redundancy and provide enhanced clarity.

	<p>Example: 1b. (Physical Capital – Environment) – The Global Principles address principles related to the “E” of ESG in a number of sections and appendixes which support CalPERS Enterprise, Investment Office, and Program business planning related to engaging on climate risk. While outdated and redundant language is expected to be addressed throughout this project, the Subcommittee may want to consider a dedicated Core Principle related to Physical Capital (Environment).</p>
<p>2 – 8</p>	<p>Origin: Language for each of these Core Principles has been generally unchanged over the last decade.</p> <p>Modification Considerations:</p> <ul style="list-style-type: none"> • Staff will identify language which could be considered redundant or confusing throughout the review process with the Subcommittee for the purpose of eliminating or consolidating similar language. <p>Example: Core Principles 3 and 10 are both currently labeled “Transparency” while Core Principle 5 addresses transparency related to proxy materials and Core Principle 16 addresses “Disclosure” related to corporate reporting providing an opportunity to consolidate. The term “Transparency” and “Disclosure” can be found in a number of places throughout the Global Principles providing a number of additional opportunities to consolidate.</p> <ul style="list-style-type: none"> • Core Principles 2 (Director Accountability) could be considered for amendment with the objective of clearly aligning the Program’s “core issue” of Board Quality and Diversity and each of the existing locations where related principles on the topic of board quality and diversity exist within the Global Principles. • Core Principle 4 (One-share/One-vote) represents one of a number of important shareowner rights and could be considered for amendment with the objective of clearly aligning the Program’s “core issue” of Investor Rights. Core Principle 8 (Access to Director Nominations or Proxy Access) is also an important investor right which would fit nicely into this rationale. • Core Principle 6 (Code of Best Practices) applies to capital markets in general and could be consolidated to align with the Program’s “core issue” of Regulatory Effectiveness and include a number of the emerging markets principles which were transitioned to the Global Principles for application to all markets in March, 2015 – such as Core Principles 9, 13, 14, and 15.

	<ul style="list-style-type: none"> Core Principle 7 (Long-term Vision) could be consolidated with Core Principle 1.
9 –16	<p>Origin: Approved by Committee at its March 2015 meeting to consolidate a legacy Global Equity Policy related to principles applied to emerging markets.</p> <p>Modification Considerations:</p> <ul style="list-style-type: none"> As described related to Core Principles 2 – 8 above, a number of these principles could be considered for consolidation into a dedicated principle related to the Program’s core issue “Regulatory Effectiveness”.
17	<p>Origin: Approved by the Committee at its March 2015 meeting to reflect the Committee’s subsequent adoption of Financial Market Reform Principles.</p> <p>Modification Considerations:</p> <ul style="list-style-type: none"> Staff plans to identify Domestic and International Principles, and Appendices going forward which are duplicative of Core Principle 17 for the purpose of eliminating or consolidating similar language so as to clear up redundancy and provided enhanced clarity.

Staff believes a new format will evolve over the course of its review with the Subcommittee that will ultimately result in a framework which provides for one, simplified set of Global Principles as opposed to three independent and occasionally duplicative sections (Core, Domestic, and International), and a number of appendices.

BUDGET AND FISCAL IMPACTS

Work associated with this Subcommittee is expected to be addressed with existing staff and Subcommittee resources.

BENEFITS/RISKS

Review of CalPERS Global Principles is consistent with the Target Operating Model objectives to design, develop, and implement a robust operating model that minimizes complexity, improves transparency, and strengthens processes, systems, governance, and controls. Identified amendments will enhance transparency into investment and financial markets policy making processes and strategy.

A misalignment with Investment Office strategic planning and the Board's adopted Global Principles can increase the risks of missed opportunities and ambiguous implementation.

ATTACHMENTS

Attachment 1 – Global Governance Policy and Principles

ANNE SIMPSON
Senior Portfolio Manager
Director of Global Governance

THEODORE ELIOPOULOS
Chief Investment Officer