

Investment Beliefs Implementation Review Presentation

September 15, 2015

Overall Implementation Review Findings Summary

Towers Watson assessed CalPERS' implementation of Investment Beliefs and found:

- CalPERS' adoption and implementation as “above average” overall compared to a peer reference group of 15 funds
- Strong Board and staff values and talent are driving the organization forward
- CalPERS has the ability to undertake complex change processes successfully
- Even on comparatively “unsettled issues” Board and staff are, as a whole, united on many issues.

July Offsite Starting Point - May Recap

May 2015 Presentation Recap

- Towers Watson presented findings of their Implementation Review
- Included a recommendation to conduct a session focusing on areas where the Beliefs were not leading to settled positions
- July Offsite session structured to support strategic dialogue through interactive voting and small group discussion

July Offsite Voting Results

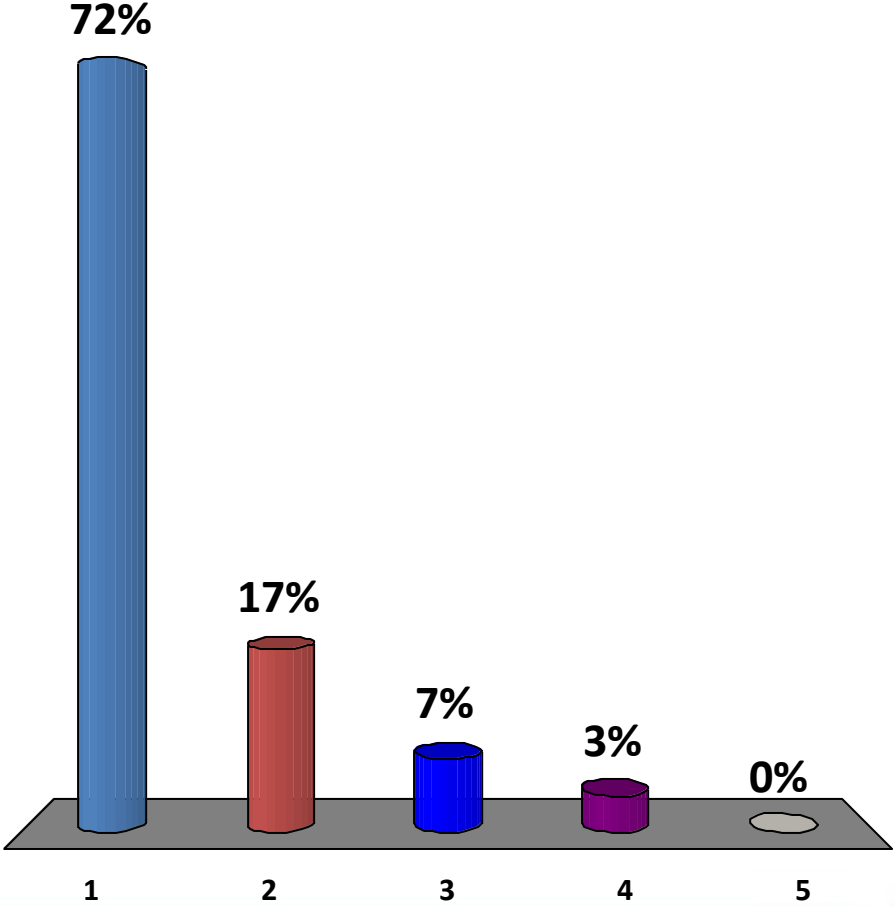
— Risk Related Beliefs Section

— ESG Related Beliefs Section

Offsite Session| Voting Results – Risk Section

1. A future global financial crisis is a significant risk to the fund

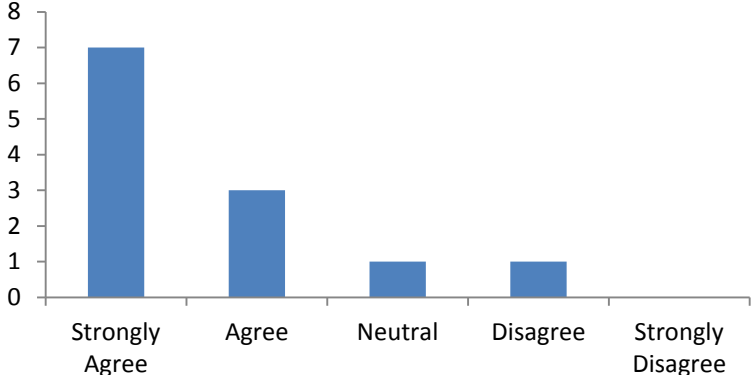
- 1.Strongly Agree
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- 3.Neutral
- 4.Disagree
- 5.Strongly Disagree



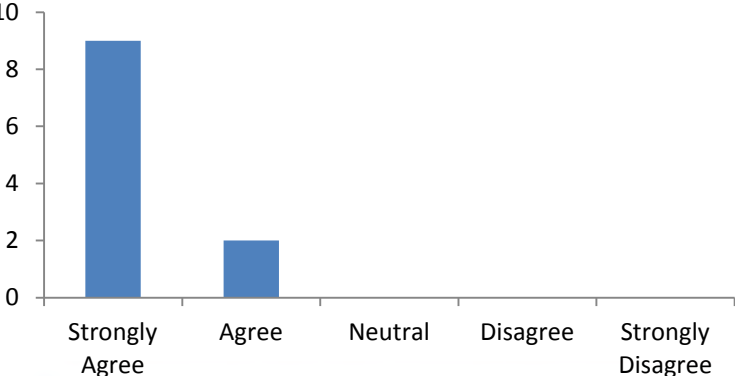
Voting Detail

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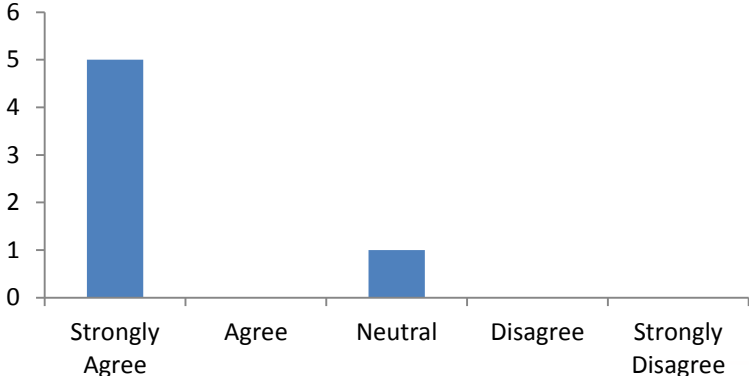
Board Members



Staff



Investment Consultants



Offsite Session| Voting Results – Risk Section

2. Resource constraints/ limits to growth are significant risks to the fund

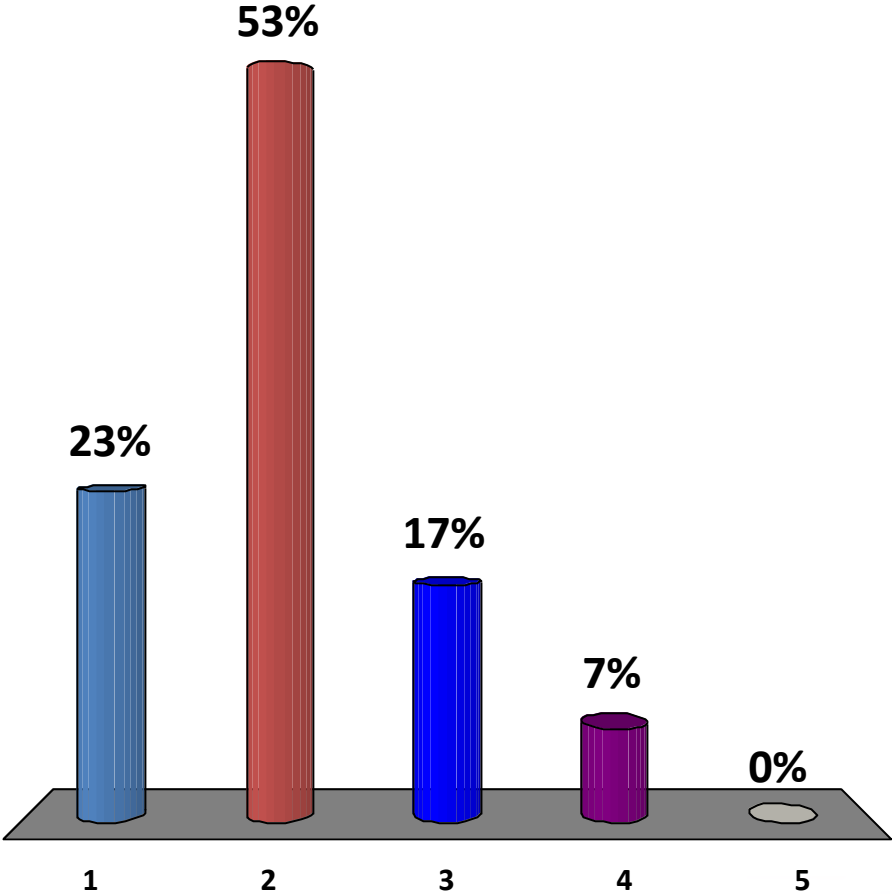
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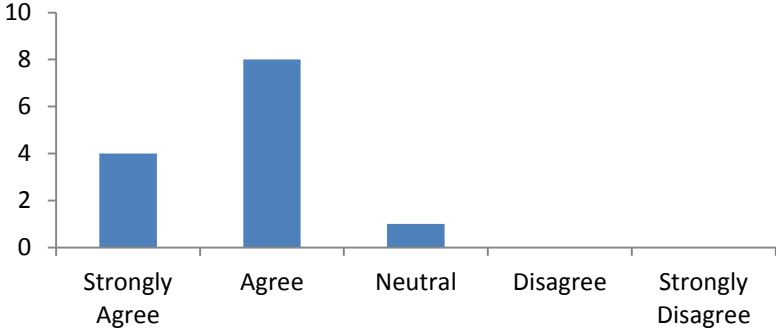
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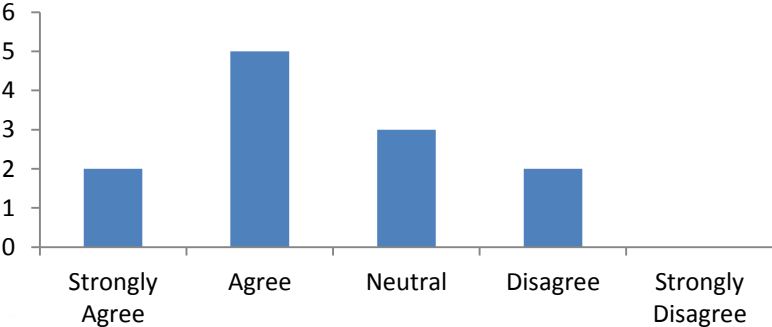
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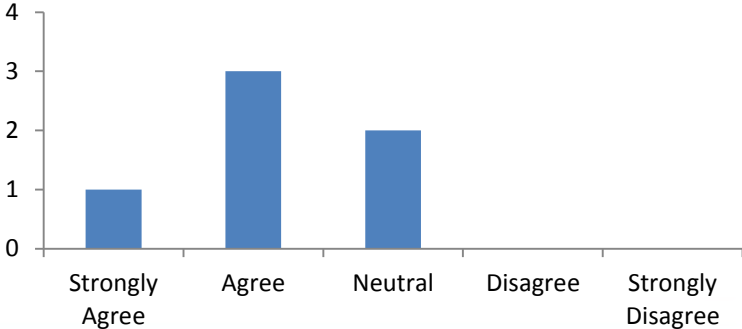
Board Members



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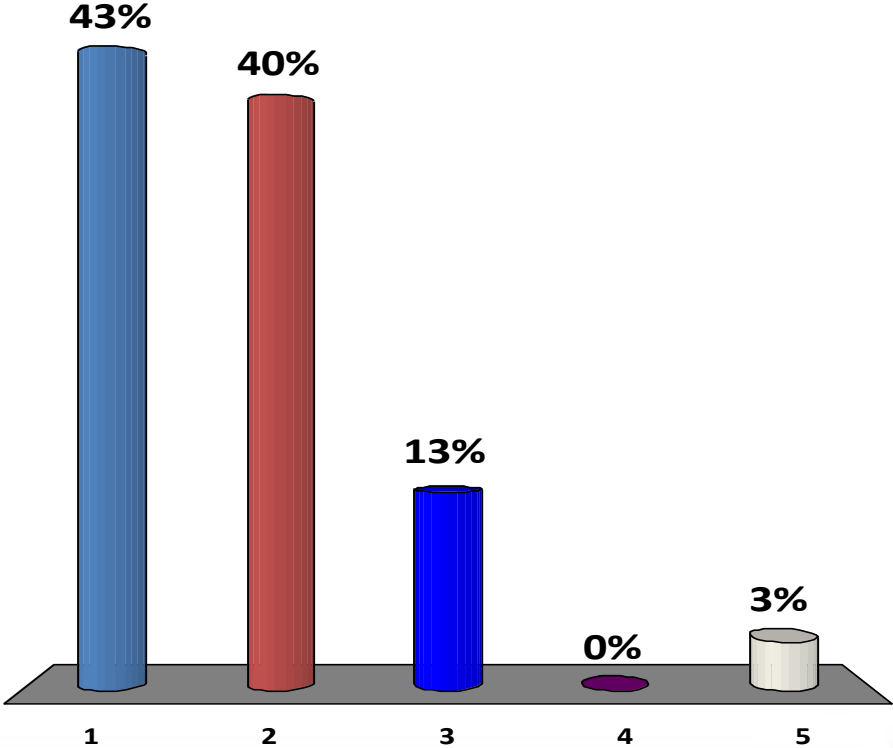
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Offsite Session| Voting Results – Risk Section

5. CalPERS will find it difficult to attain the actuarially required rate of return on its PERF* assets in the next decade or so

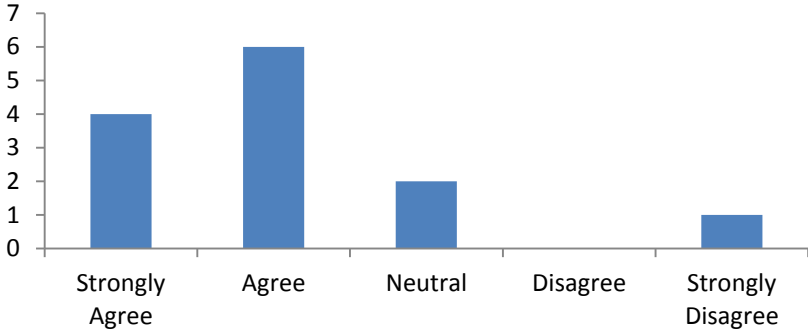
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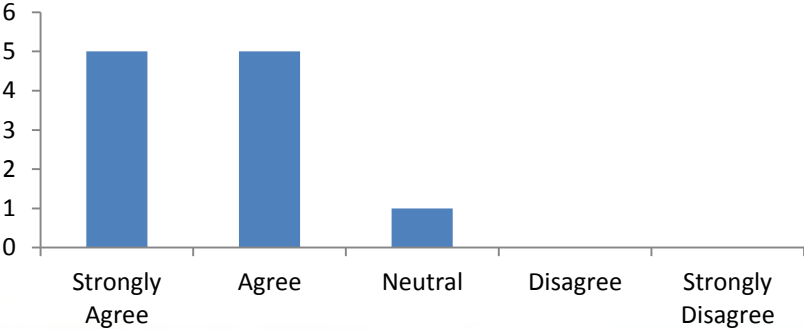
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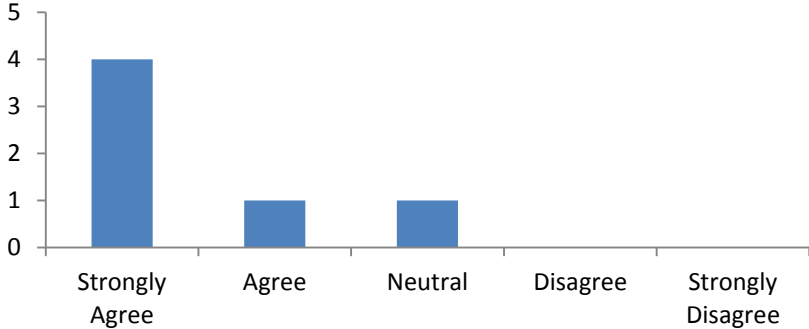
Board Members



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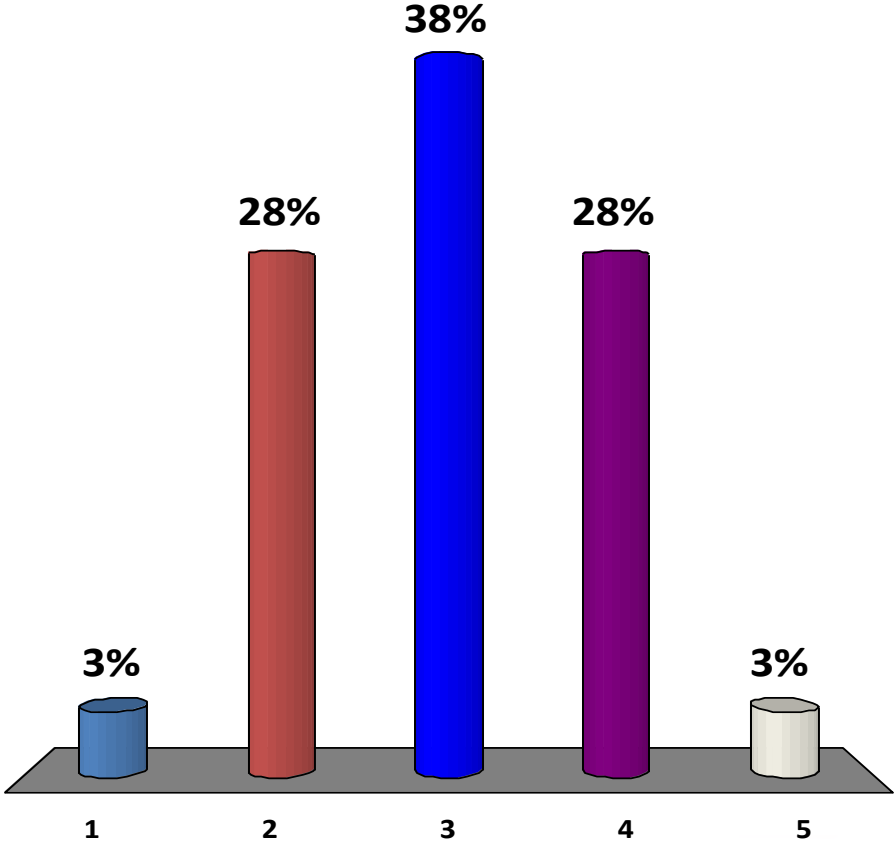
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Offsite Session| Voting Results – Risk Section

6. The Board receives an appropriate and effective feed of risk information on CalPERS funds

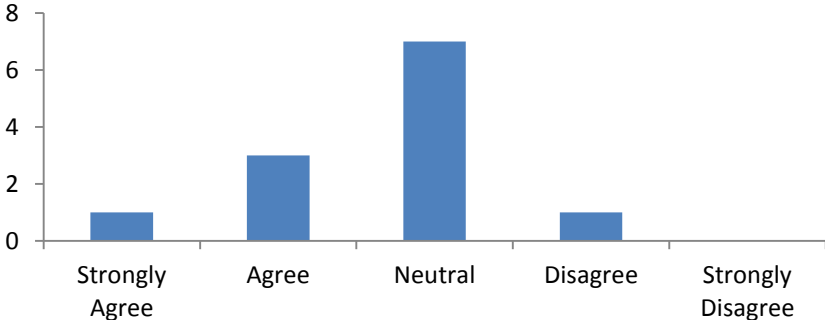
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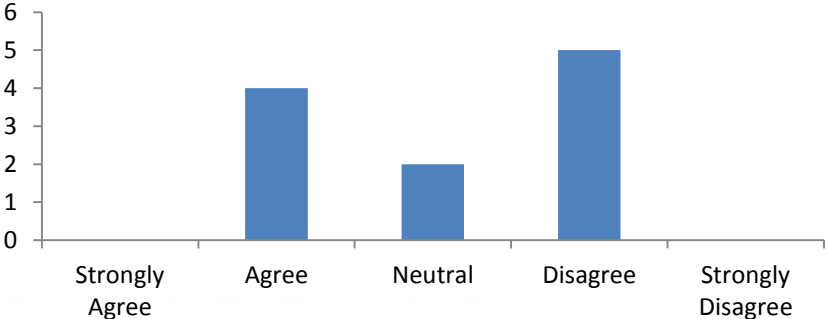
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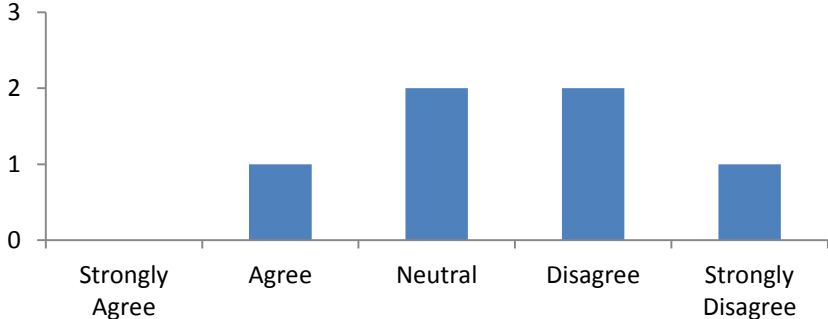
Board Members



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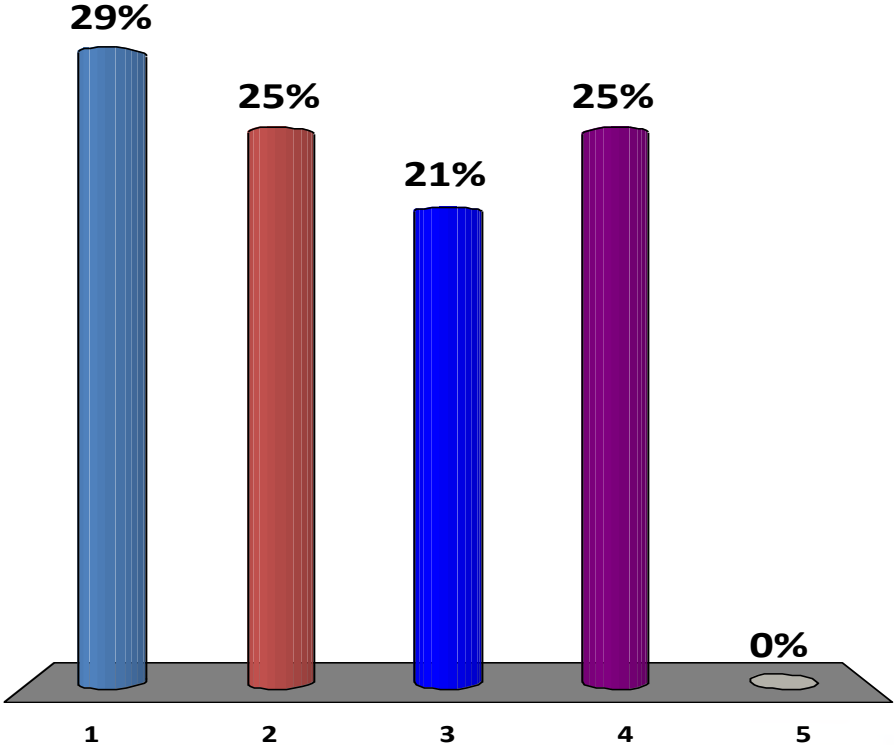
Investment Consultants



Offsite Session| Voting Results – Risk Section

7. The probability of mission impairment is a more helpful risk for the fund to focus upon than other measures of risk

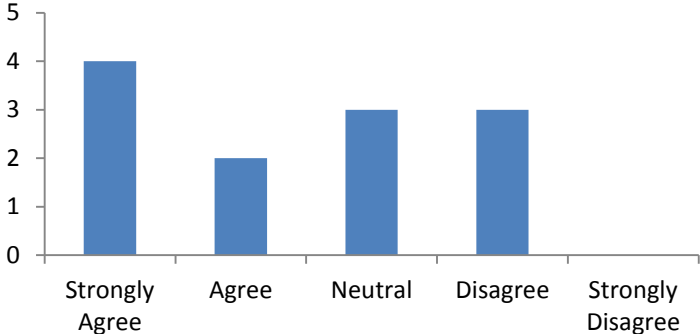
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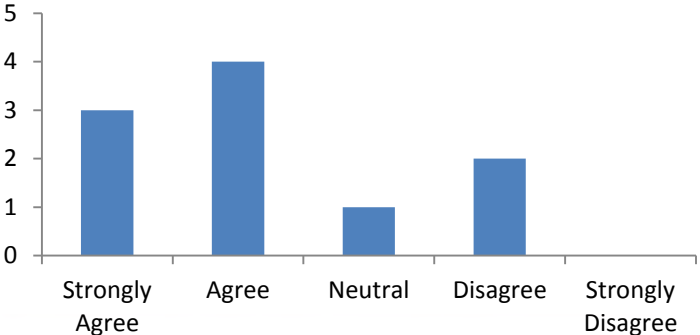
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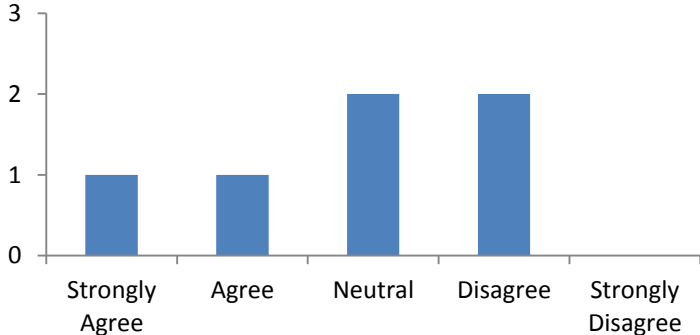
Board Members



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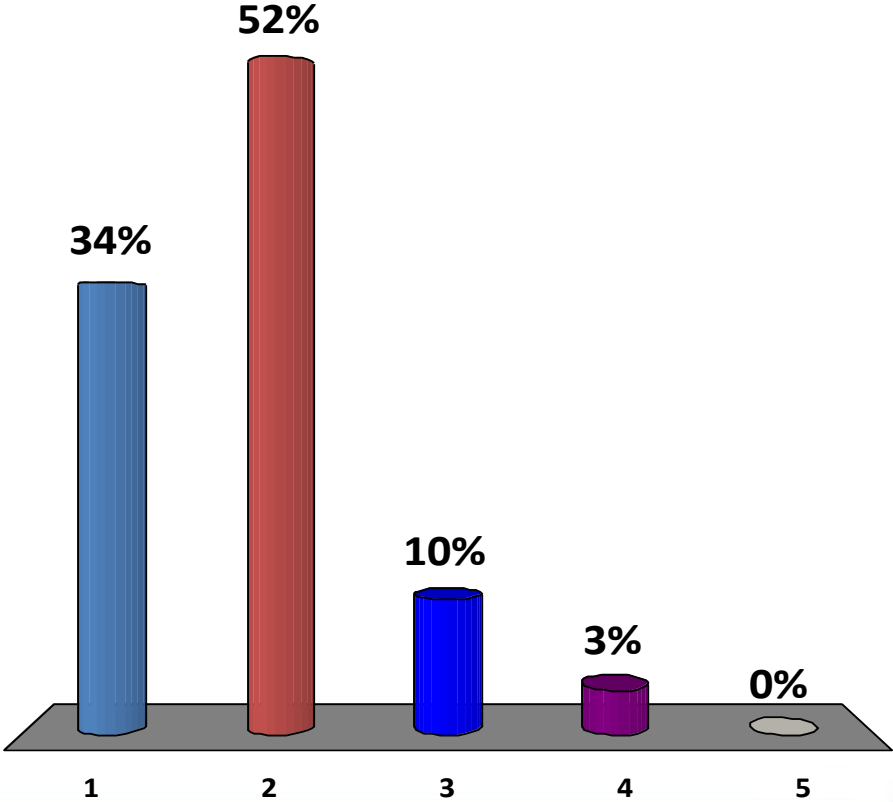
Investment Consultants



Offsite Session| Voting Results – Risk Section

8. Risk factors and return drivers provide a better investment framework for the fund than do asset class divisions

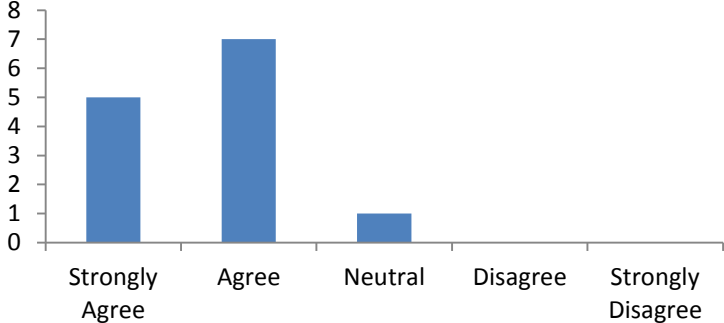
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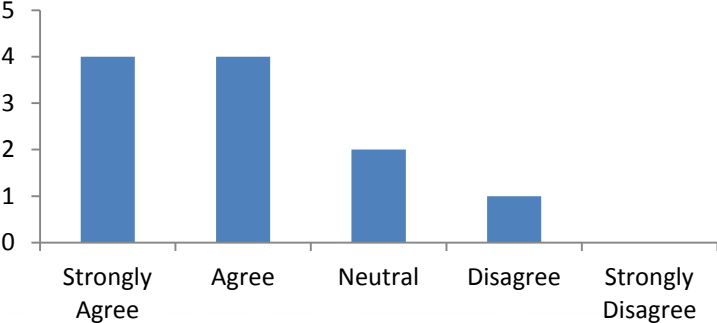
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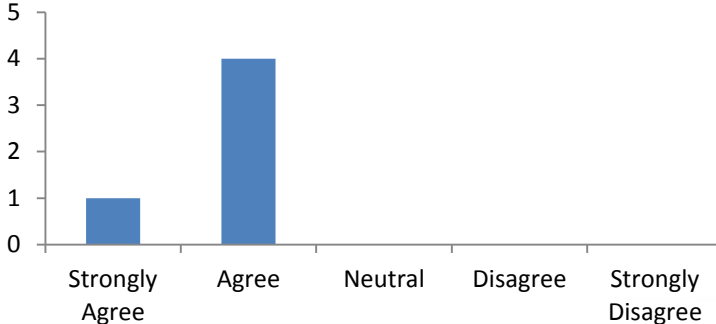
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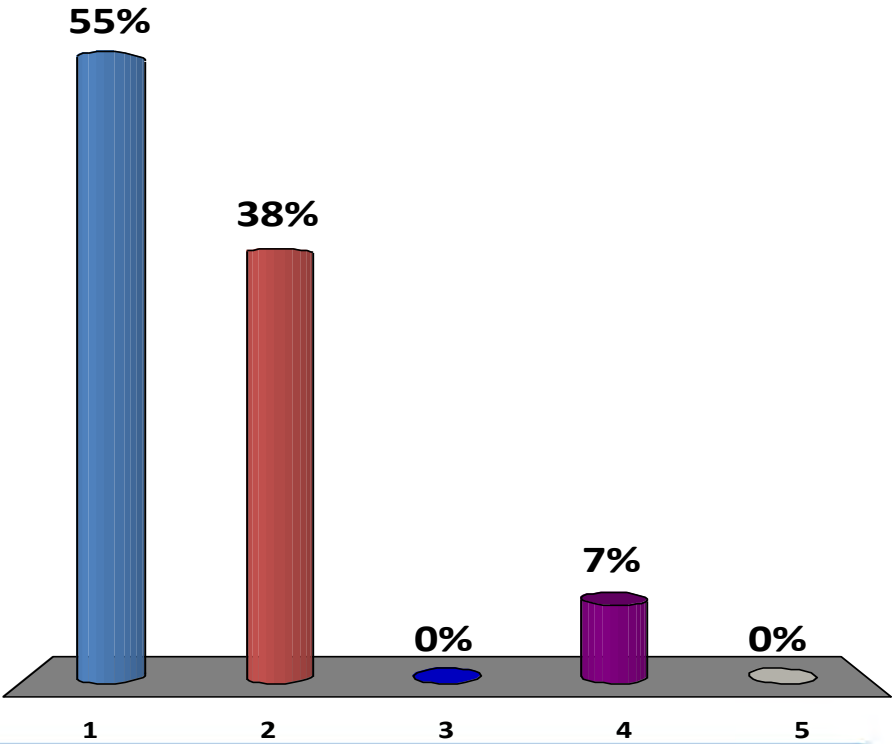
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Offsite Session| Voting Results – Risk Section

9. The long-term is materially different to the sum of multiple short-term periods, and therefore long-term risk management requires a different focus and set of measures

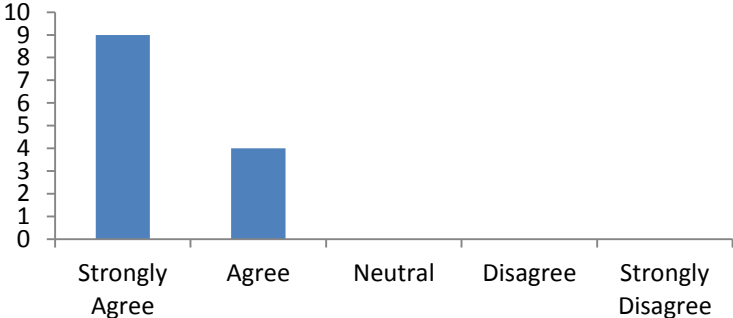
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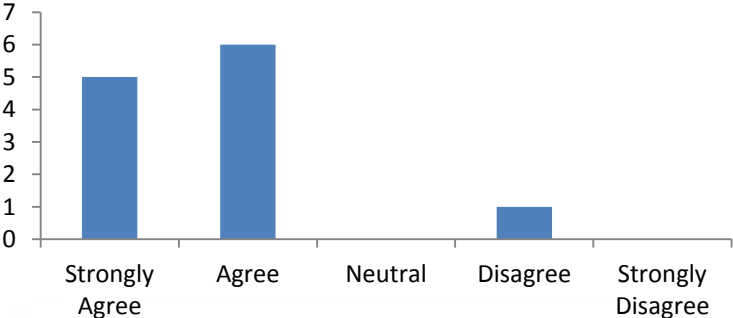
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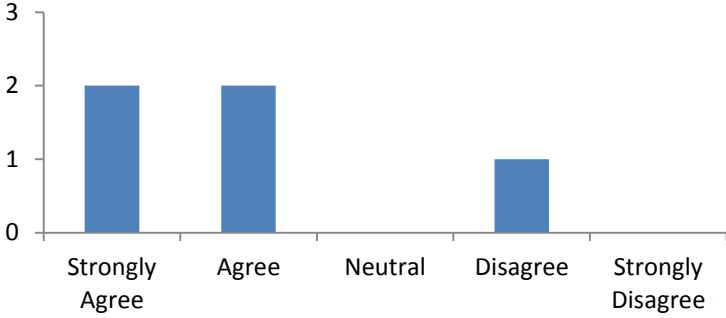
Board Members



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July Offsite Voting Results

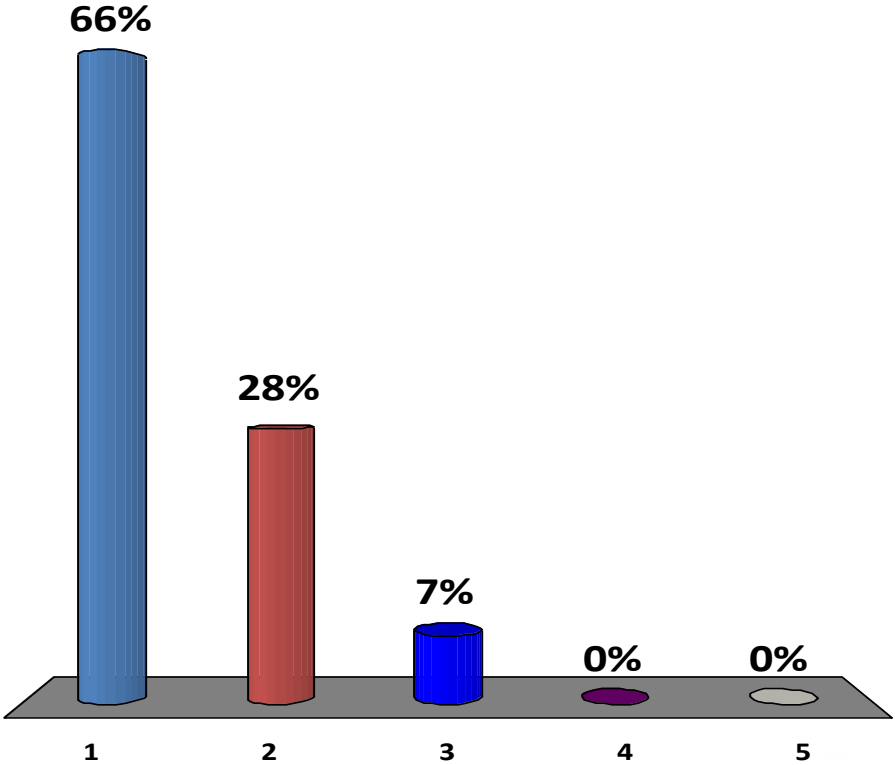
— Risk Related Beliefs Section

— **ESG Related Beliefs Section**

Offsite Session| Voting Results – ESG Section

1. There is evidence that carbon is causing material climate change

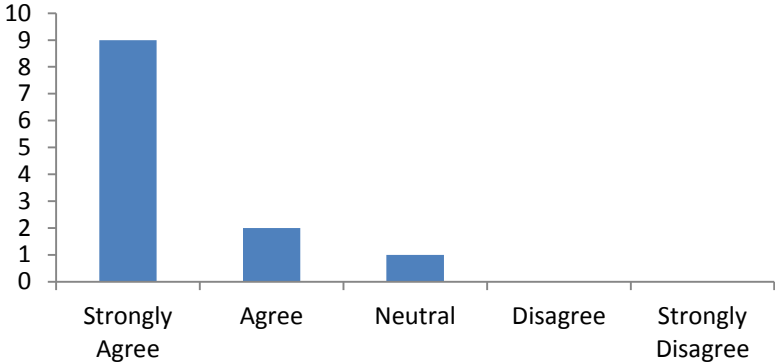
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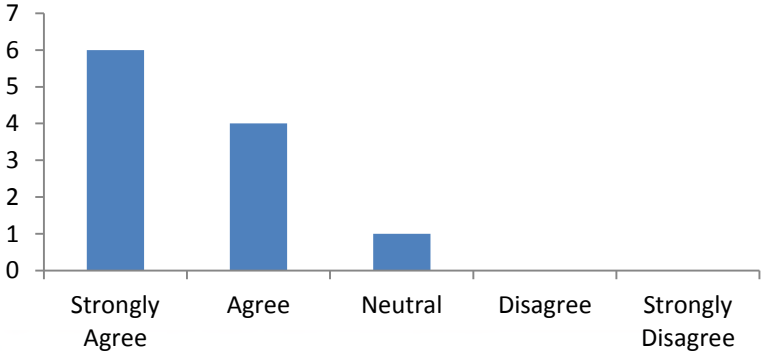
Voting Detail

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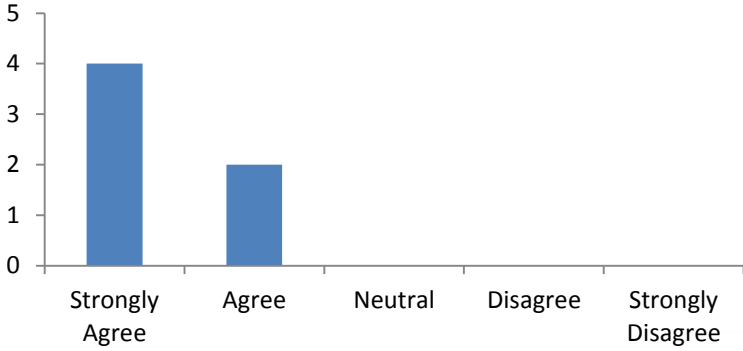
Board Members



Staff



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Offsite Session| Voting Results – ESG Section

2. There is evidence that high carbon/fossil fuel companies are structurally overpriced

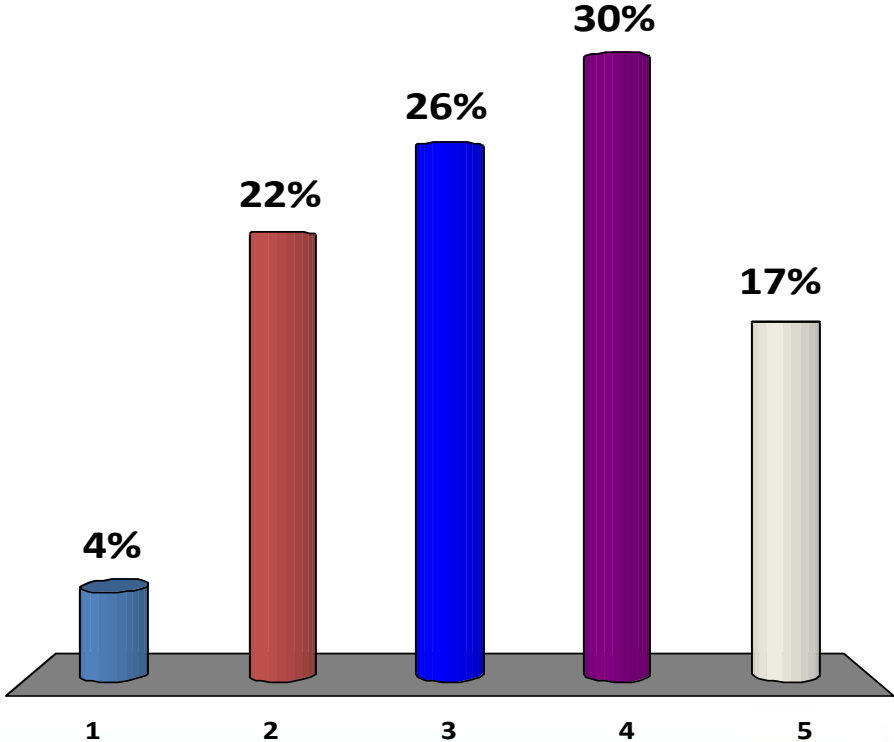
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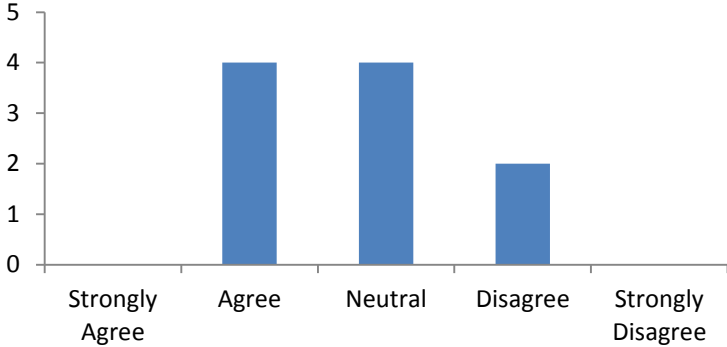
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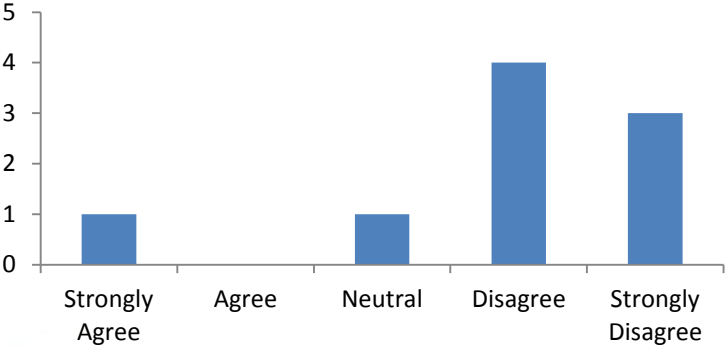
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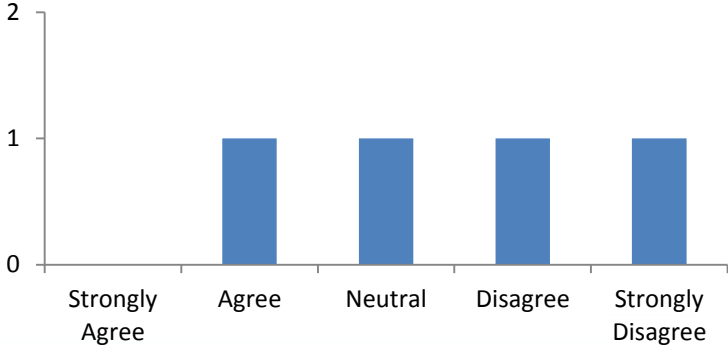
Board Members



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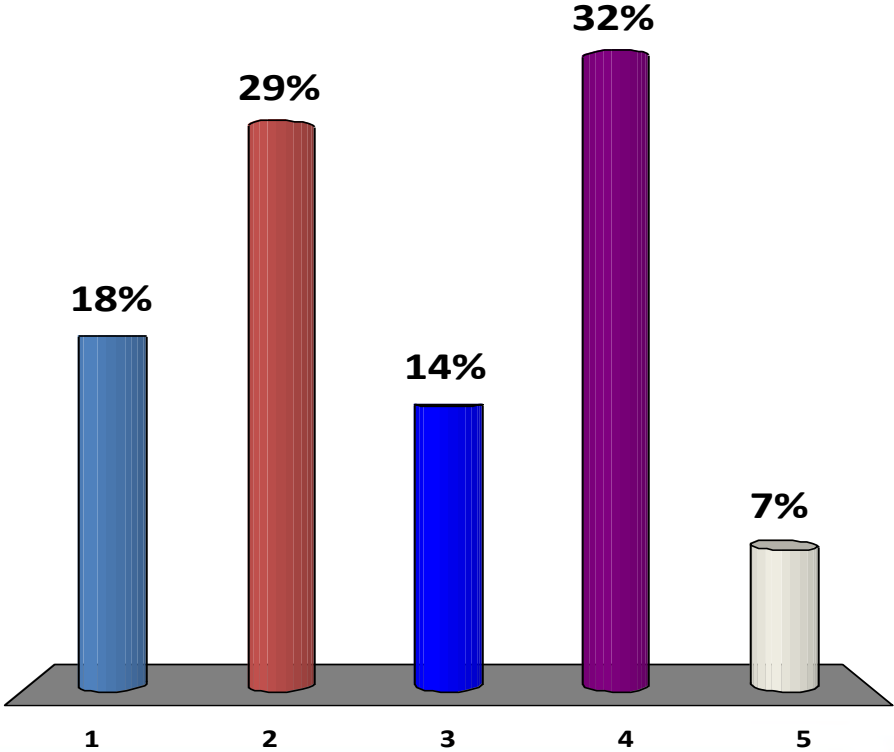
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Offsite Session| Voting Results – ESG Section

3. It is likely that ESG factors have been priced into assets by the market (whether accurately or not)

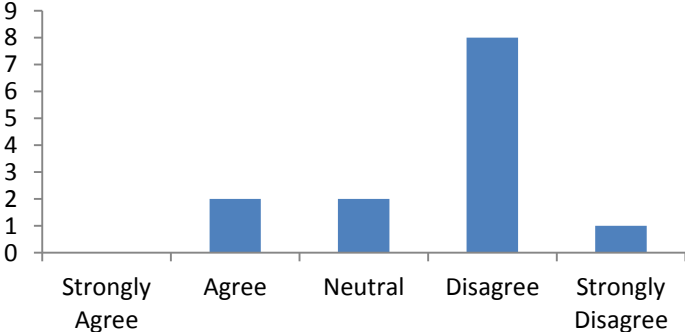
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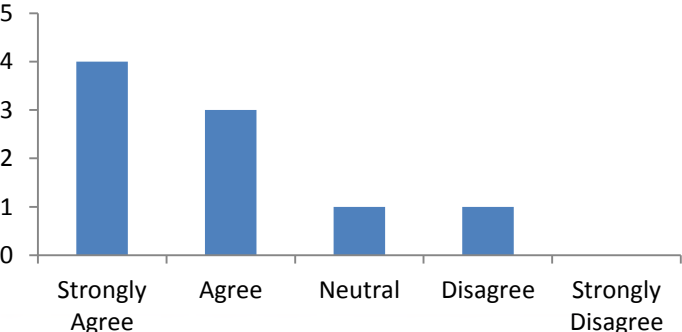
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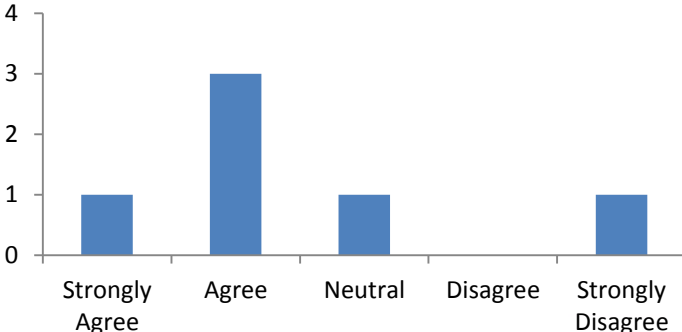
Board Members



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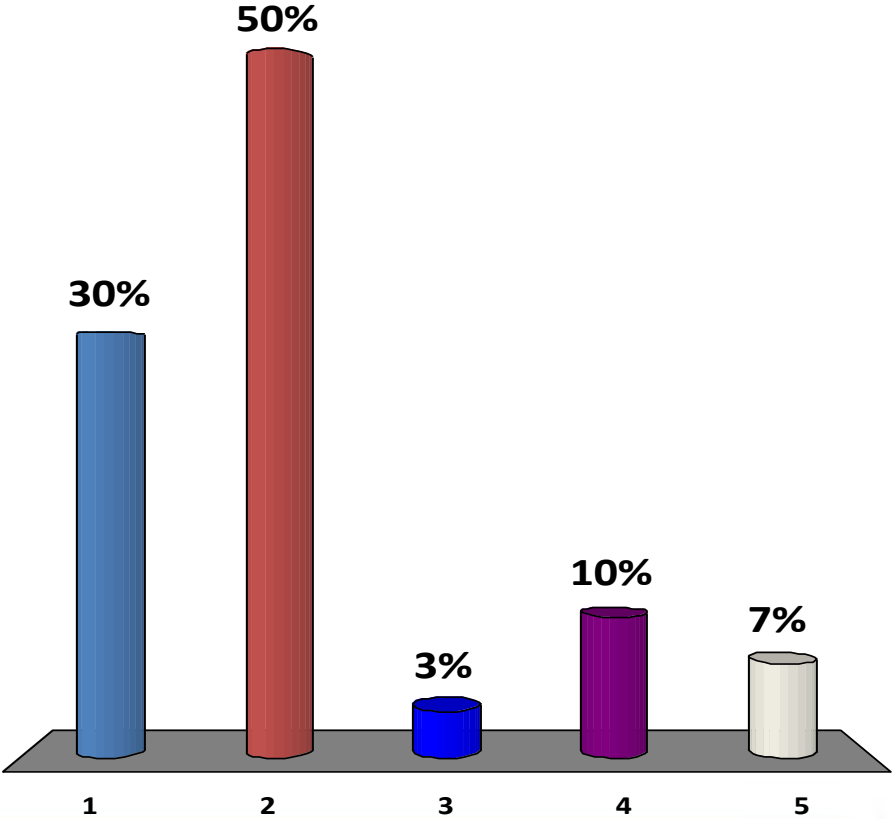
Investment Consultants



Offsite Session| Voting Results – ESG Section

4. The lack of performance evidence is a limitation for the fund to take any systematic positions to ESG factors

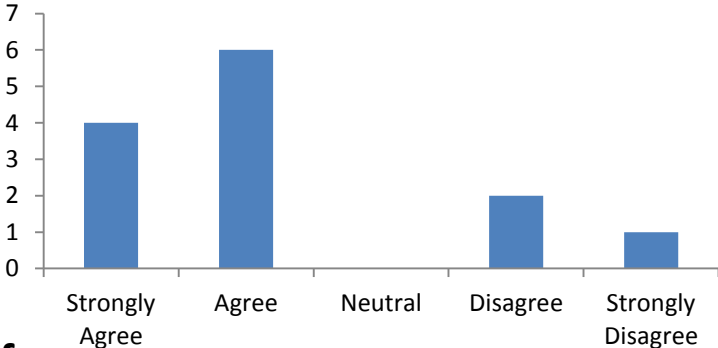
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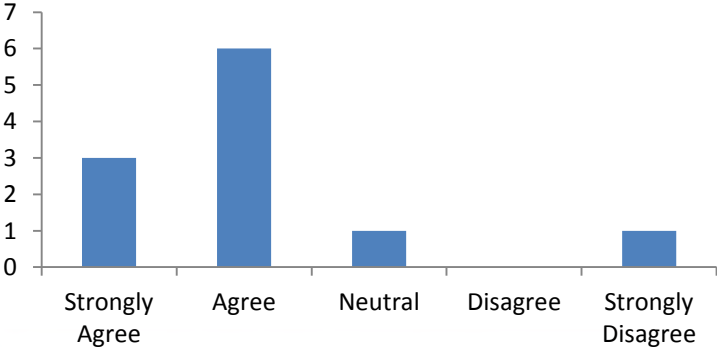
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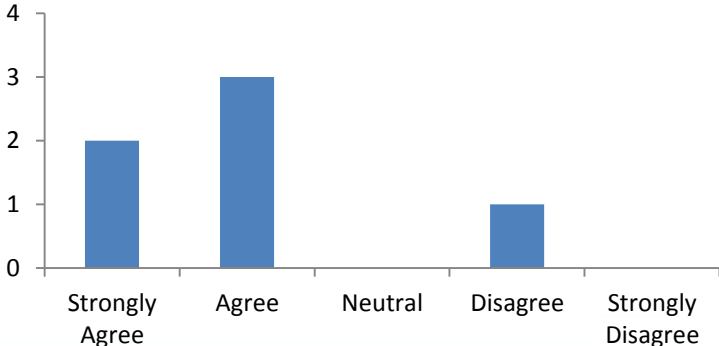
Board Members



Staff



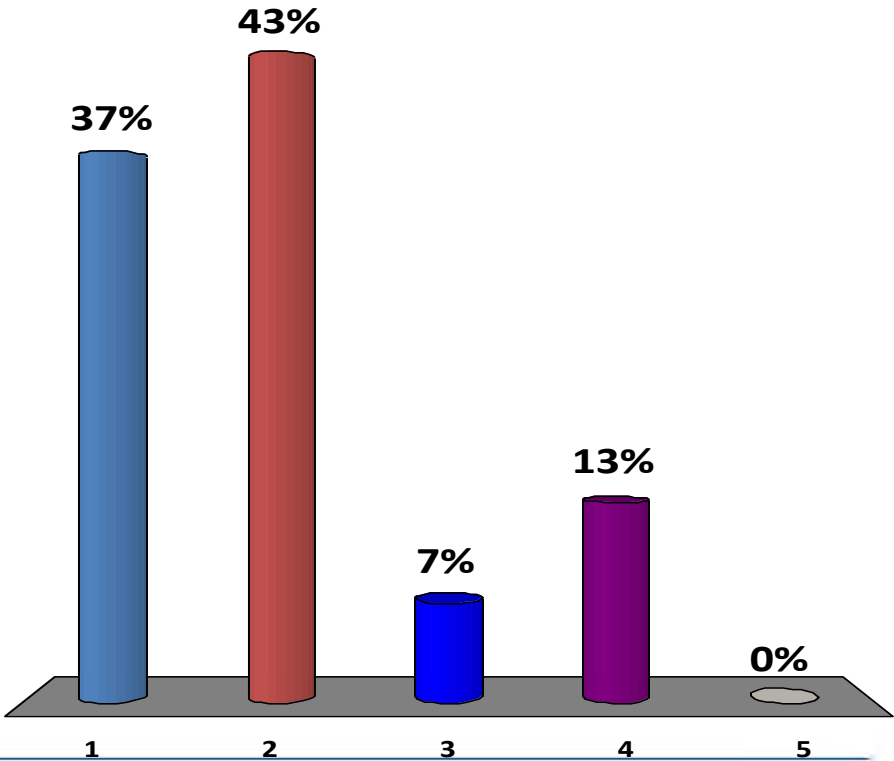
Investment Consultants



Offsite Session| Voting Results – ESG Section

5. ESG metrics are relatively untested/ can be subjective and this acts as a limitation to ESG factors being significant in investors' decisions

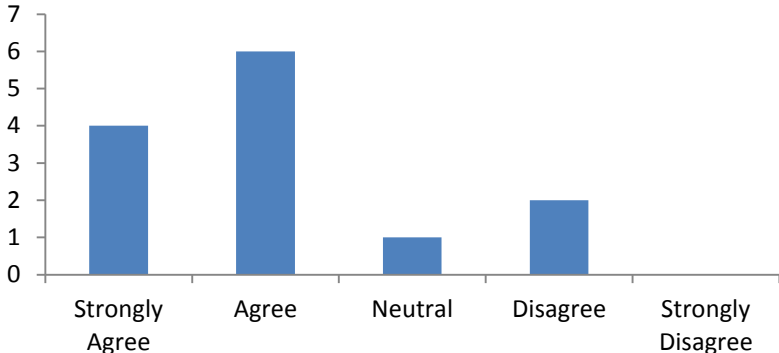
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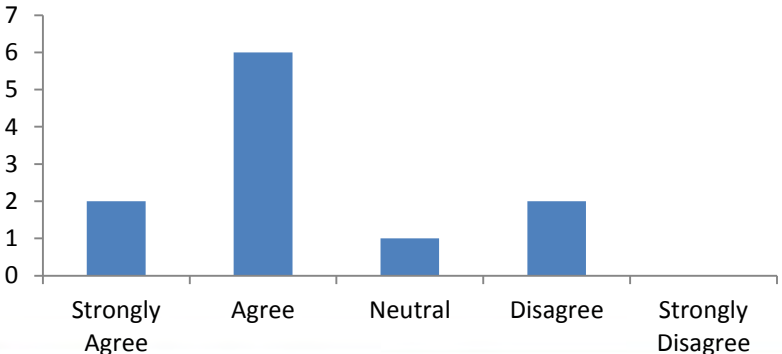
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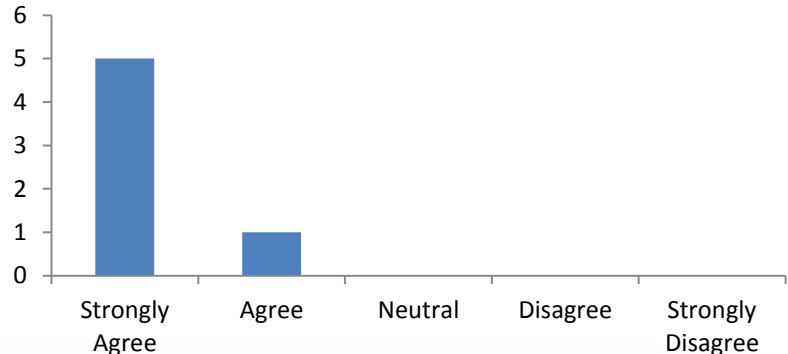
Board Members



Staff



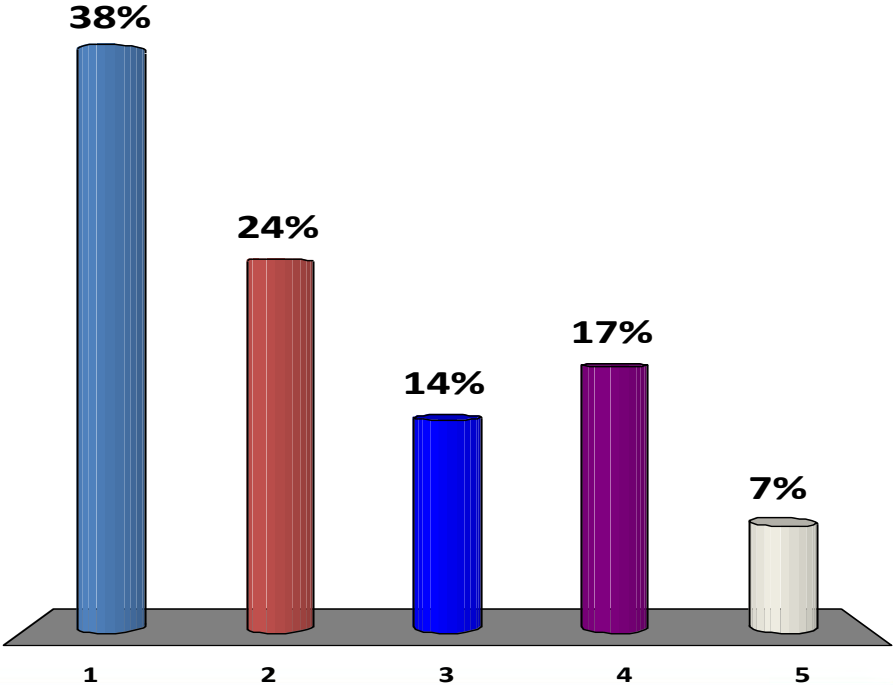
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Offsite Session| Voting Results – ESG Section

12. Any Board-directed policies should be captured in the CalPERS “reference portfolio” so that performance impacts of that stance can be isolated and attributed to the Board’s decision

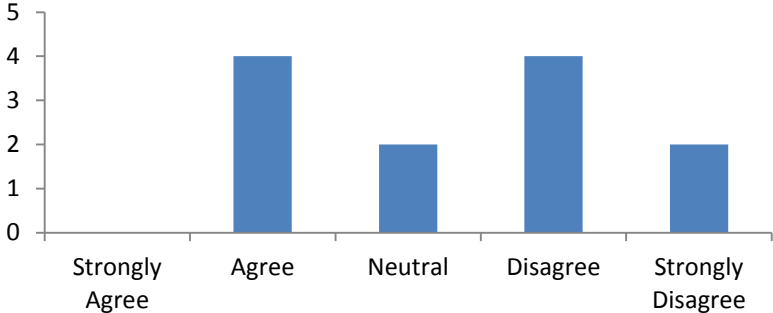
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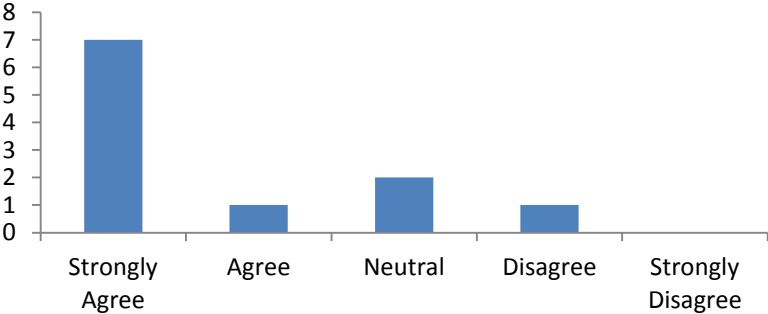
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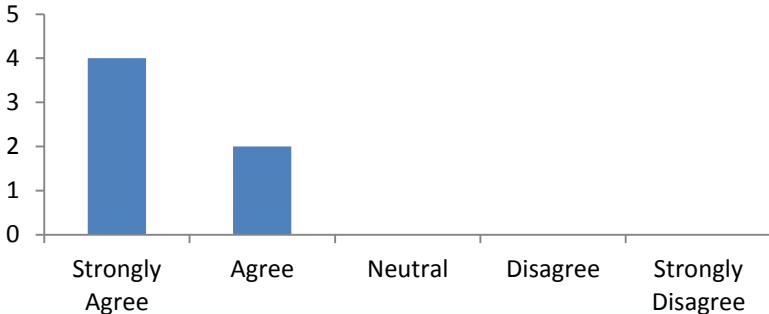
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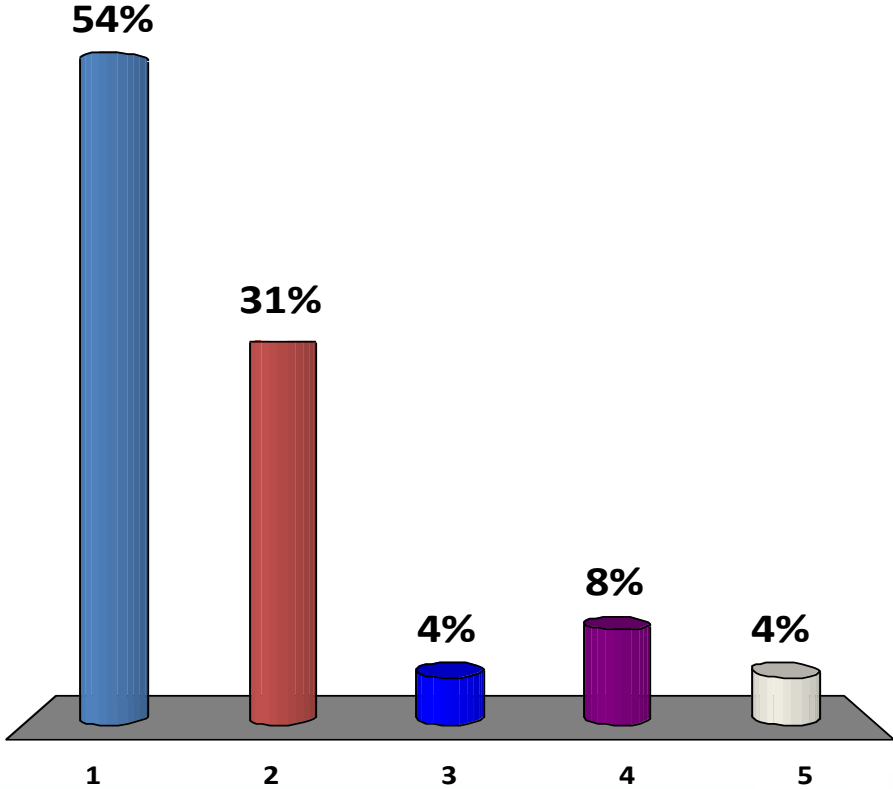
Investment Consultants



Offsite Session| Voting Results – ESG Section

13. CalPERS’ current ESG positions on active ownership/global governance are appropriate for CalPERS’ future plans

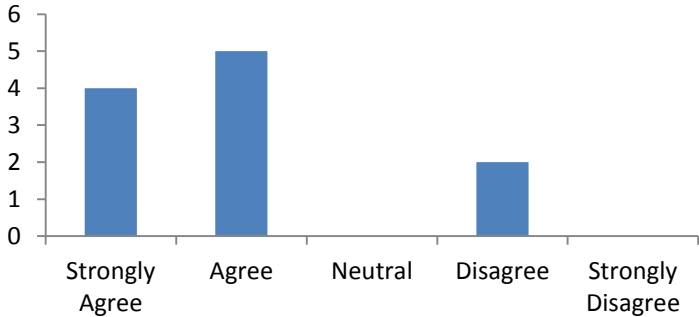
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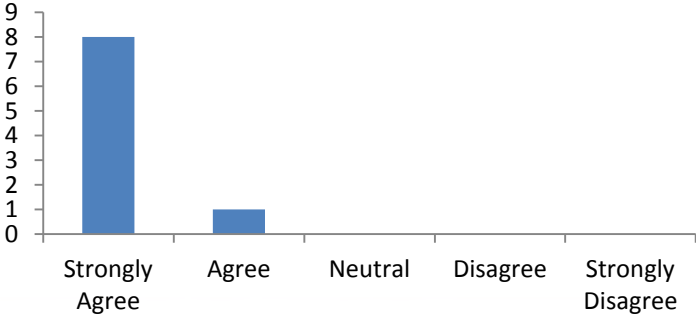
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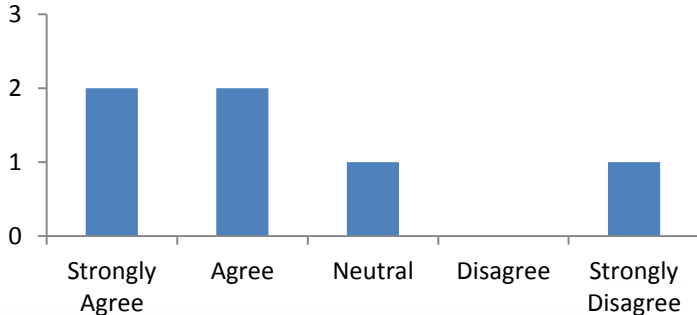
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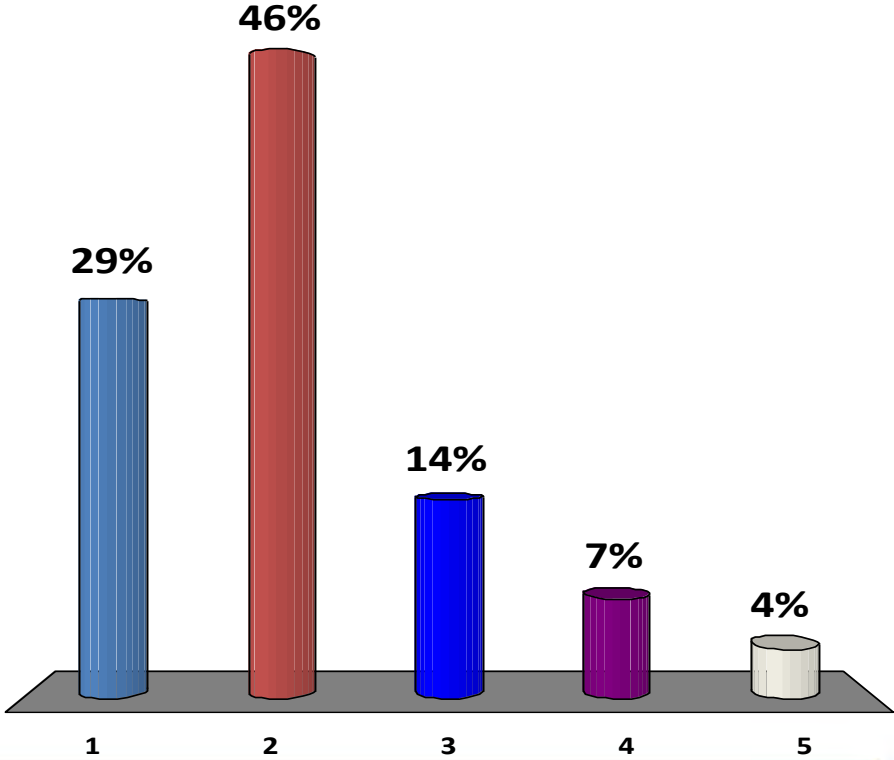
Investment Consultants



Offsite Session| Voting Results – ESG Section

14. CalPERS’ current positions on integrated ESG/ ESG manager expectations are appropriate for CalPERS’ future plans

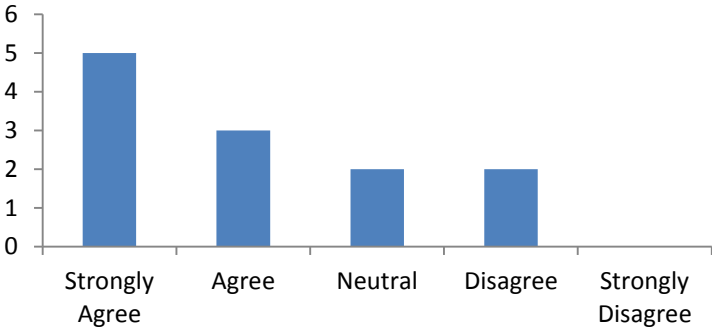
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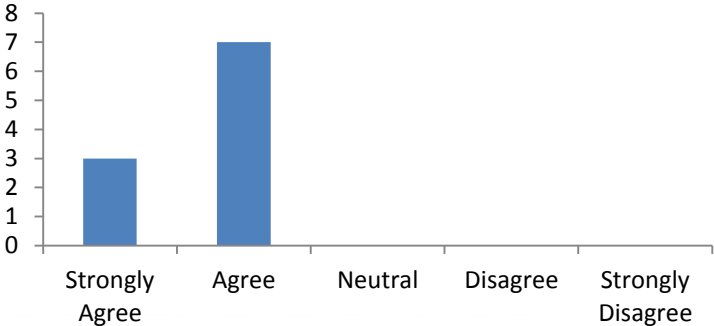
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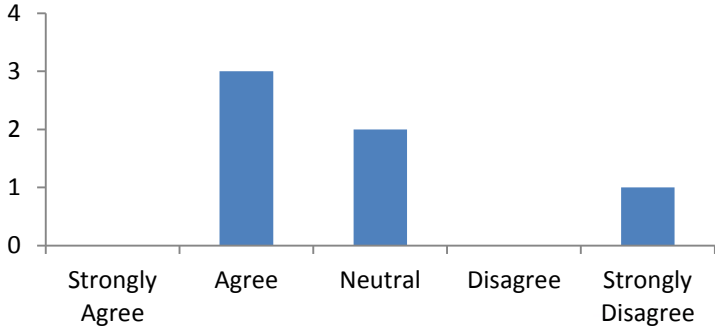
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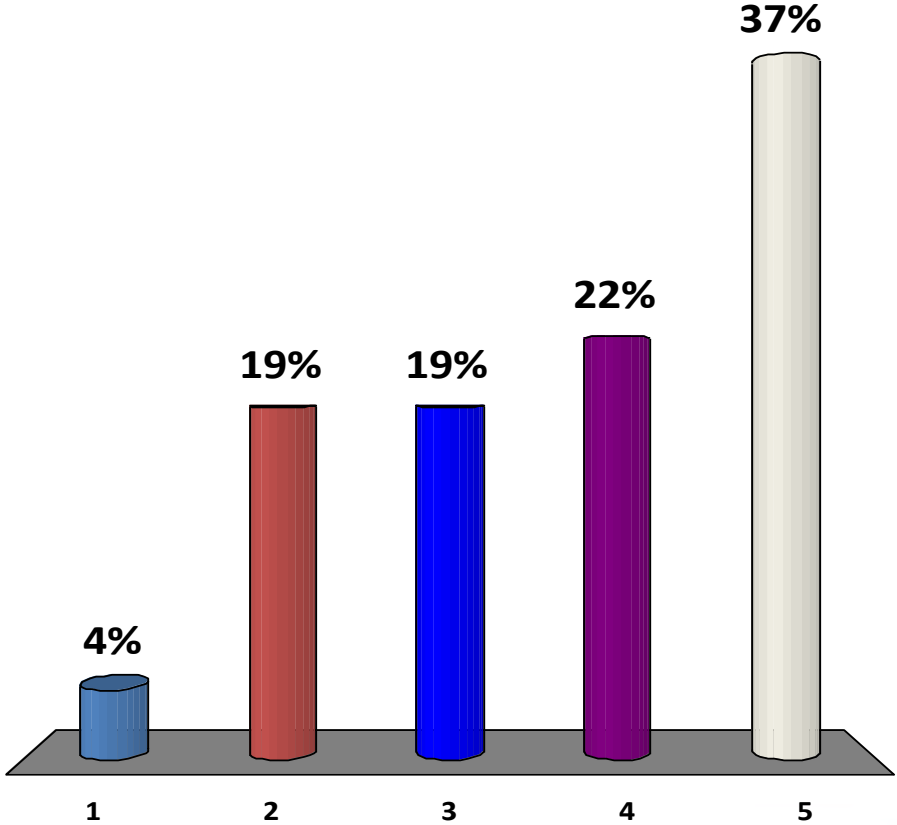
Investment Consultants



Offsite Session| Voting Results – ESG Section

15. CalPERS should do more with divestments

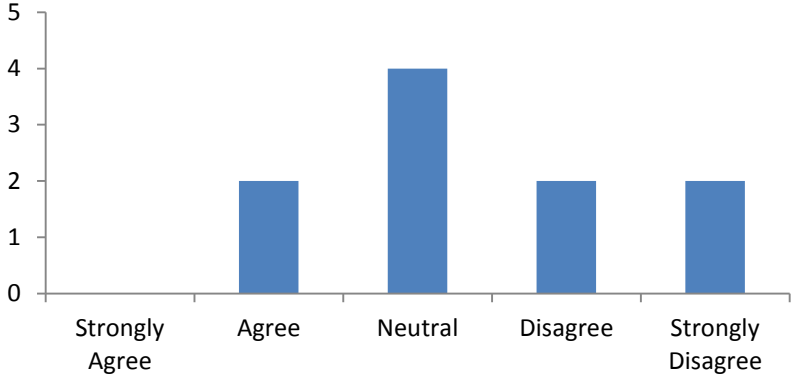
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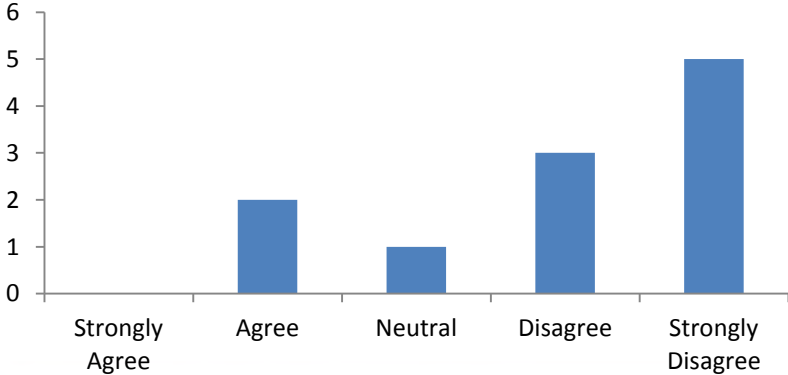
Voting Detail

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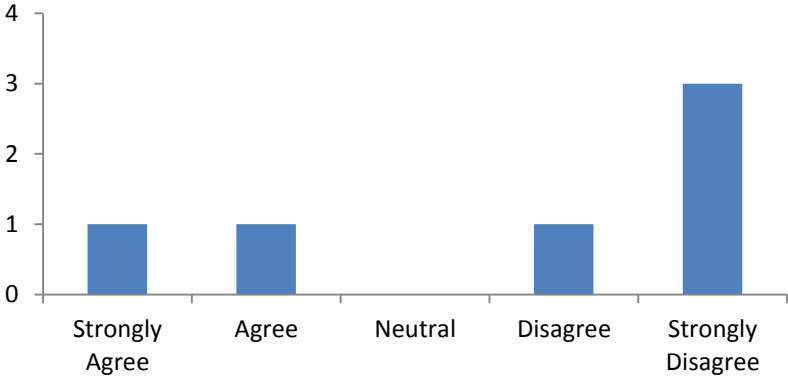
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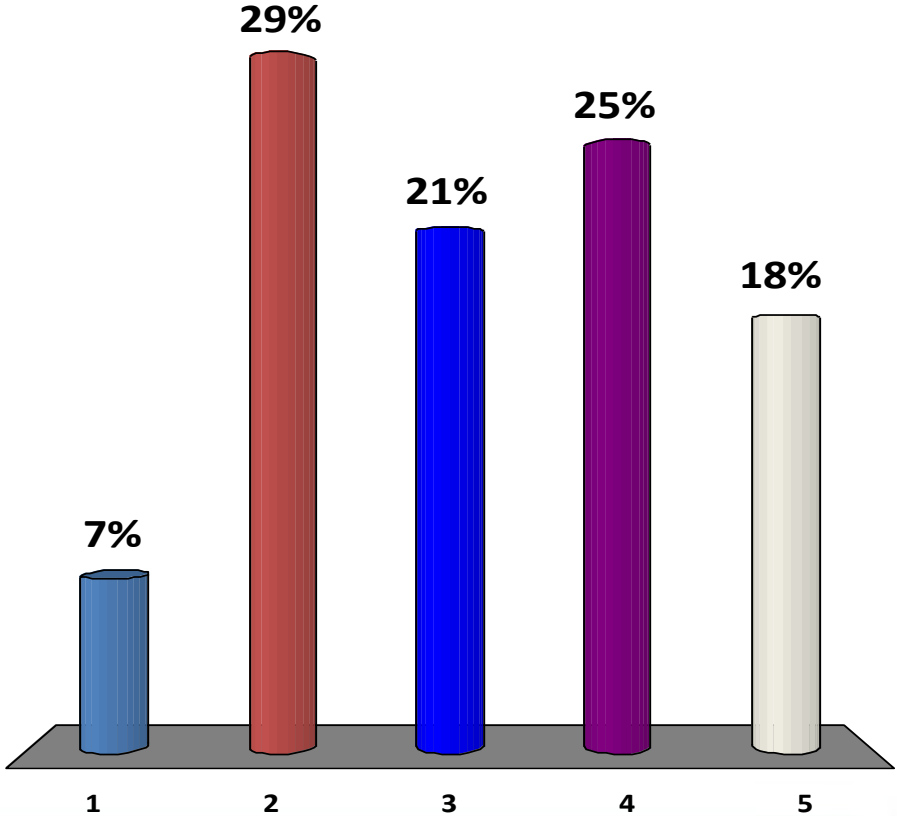
Investment Consultants



Offsite Session| Voting Results – ESG Section

16. CalPERS should do more on targeted ESG/ targeted capital/ strategic tilting

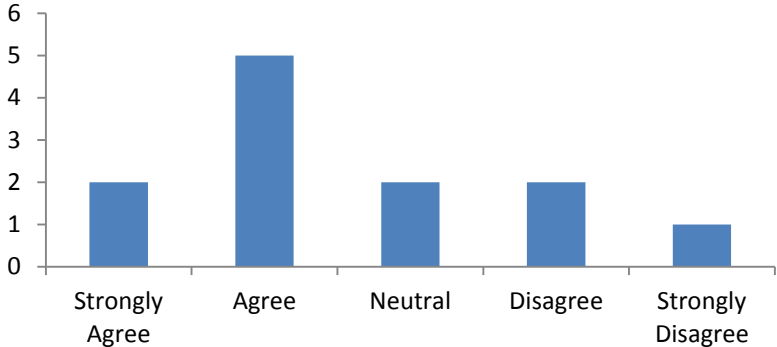
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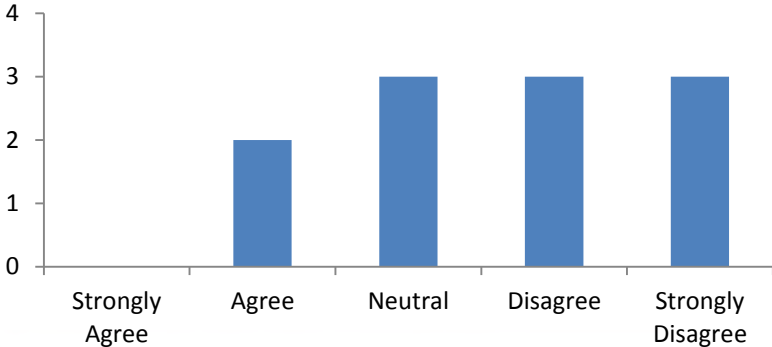
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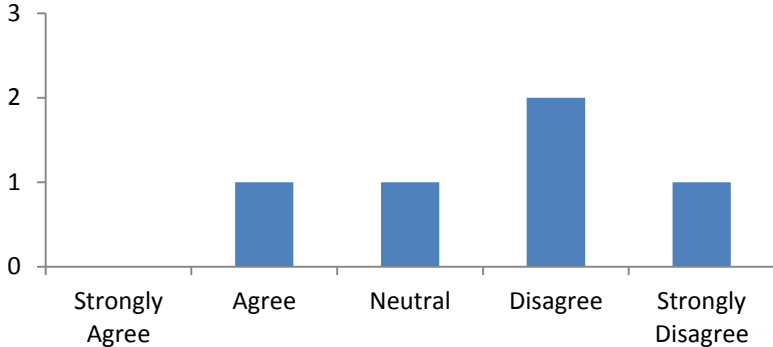
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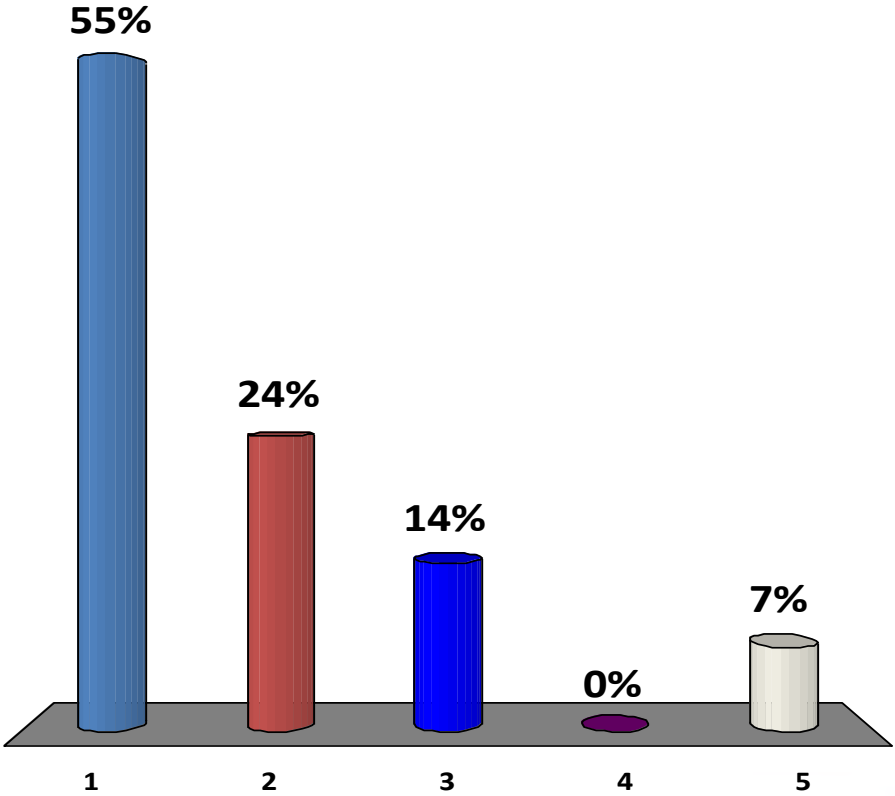
Investment Consultants



Offsite Session| Voting Results – ESG Section

17. CalPERS should do more on wider engagement/ working with others/ collaboration

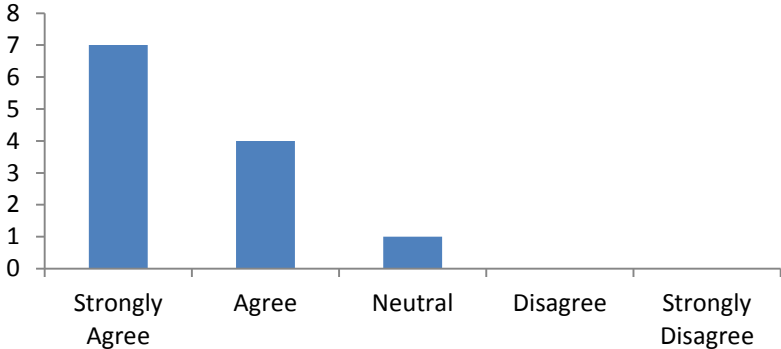
- 1.Strongly Agree
- 2.Agree
- 3.Neutral
- 4.Disagree
- 5.Strongly Disagree



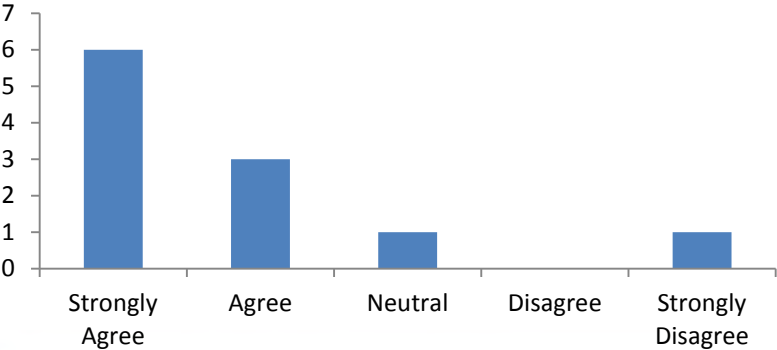
Voting Detail

17. CalPERS should do more on wider engagement/ working with others/ collaboration

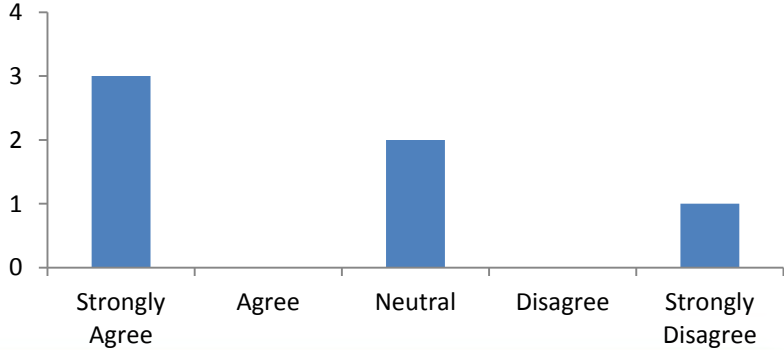
Board Members



Staff



Investment Consultants



July Offsite Summary | Risk Session

- Staff and the Board were generally in agreement
- Further evaluation of “mission impairment” as a way to frame risk will add value
- Enhancing our understanding of risk is a key priority for the enterprise
 - Enhanced risk and performance reporting is a priority initiative for the Investment Office 2020 Vision
 - Further exploration of risk factor concept and ongoing enhancement of ALM process

July Offsite Summary | ESG Session

- Board and staff results indicated:
 - Moderately different stances on targeted ESG investing and divestment
 - Different opinions on “pricing evidence”
 - Agreement that additional data and evidence are needed and wanted
 - The issue of accountability for Board-directed investment policy stances deserves additional discussion
- Further dialogue on accountability for policy stances and performance attribution will strengthen governance

Proposed Path Forward

- While CalPERS has successfully embedded and applied the Investment Beliefs since adoption, as expected in this type of process there continues to be room for improvement.
- Many of Towers Watson's recommendations are in alignment with existing initiatives and workstreams, some in the near-term, and others which are undoubtedly multi-years efforts.
- Attachment 2 provides a summary of the key recommendations identified in the course of the Review.

Proposed Path Forward Highlights| Unsettled Issues

Area	Item	Near-Term Path Forward
Risk Related Beliefs	a. Further explore concept of “probability of mission impairment” as an area to focus on for the fund	<ul style="list-style-type: none">• Dedicated Investment Office 2020 Vision Initiative to enhance risk, performance and exposure reporting for the fund• Continued focused discussions in ALM Workshops and Special Sessions
ESG Related Beliefs	b. Question 12- Disparity of opinion on attribution of Board-directed policies	b. Staff supports additional discussion to address this issue Upcoming Committee agenda items regarding divestments may provide opportunities for additional dialogue (2015)

Proposed Path Forward Highlights | Unsettled Issues

Continued

Area	Item	Near-Term Path Forward
ESG Related Beliefs	c. Board and staff desire additional data, evidence, and information on ESG issues	c. Establish a dedicated subcommittee to staff's internal Investment Strategy Group focusing on governance and sustainability issues Continue efforts to gather additional research and evidence, such as: <ul style="list-style-type: none"> • The environmental investment strategy underway in Global Equity • Phase 2 of the Sustainable Investment Research Initiative (2015-16) • Manager ESG Expectations Pilot (2015-16) Build opportunities for further discussion into Committee calendar - Focus on carbon/fossil fuel footprint and views on pricing at January 2016 Offsite Session

Questions & Comments