

# Corporate Engagement Enhanced Focus List Program Strategy Update

September 15, 2015

# Today's Objective

Provide the IC with an update on the Enhanced Focus List strategy - as agreed in November 2014:

1. The purpose of the Enhanced Strategy is to increase scale and broaden the candidate pool by establishing the Global Equity Aggregate top ~100 investment position overweights as the primary screening universe with flexibility to expand across the total fund based on relative and absolute dollar investment.
2. Refine the selection criteria by leveraging external manager and strategic partner research and expertise for global engagement.
3. Inform the Investment Committee on Focus List Program strategy enhancements and accomplishments.
4. Continue to engage on the alignment of CalPERS' core issues at global portfolio companies: investor rights, board quality and diversity, executive compensation, and corporate reporting.

# Mandate: Enhanced Focus List Program

## 2014-16 CalPERS Business Plan | Goal A

Improve long-term pension and health benefit sustainability

- Objective: Deliver target risk-adjusted investment returns
- Initiative: Environmental, Social, Governance (ESG) Investment Strategy

## 2014-16 Investment Office Roadmap

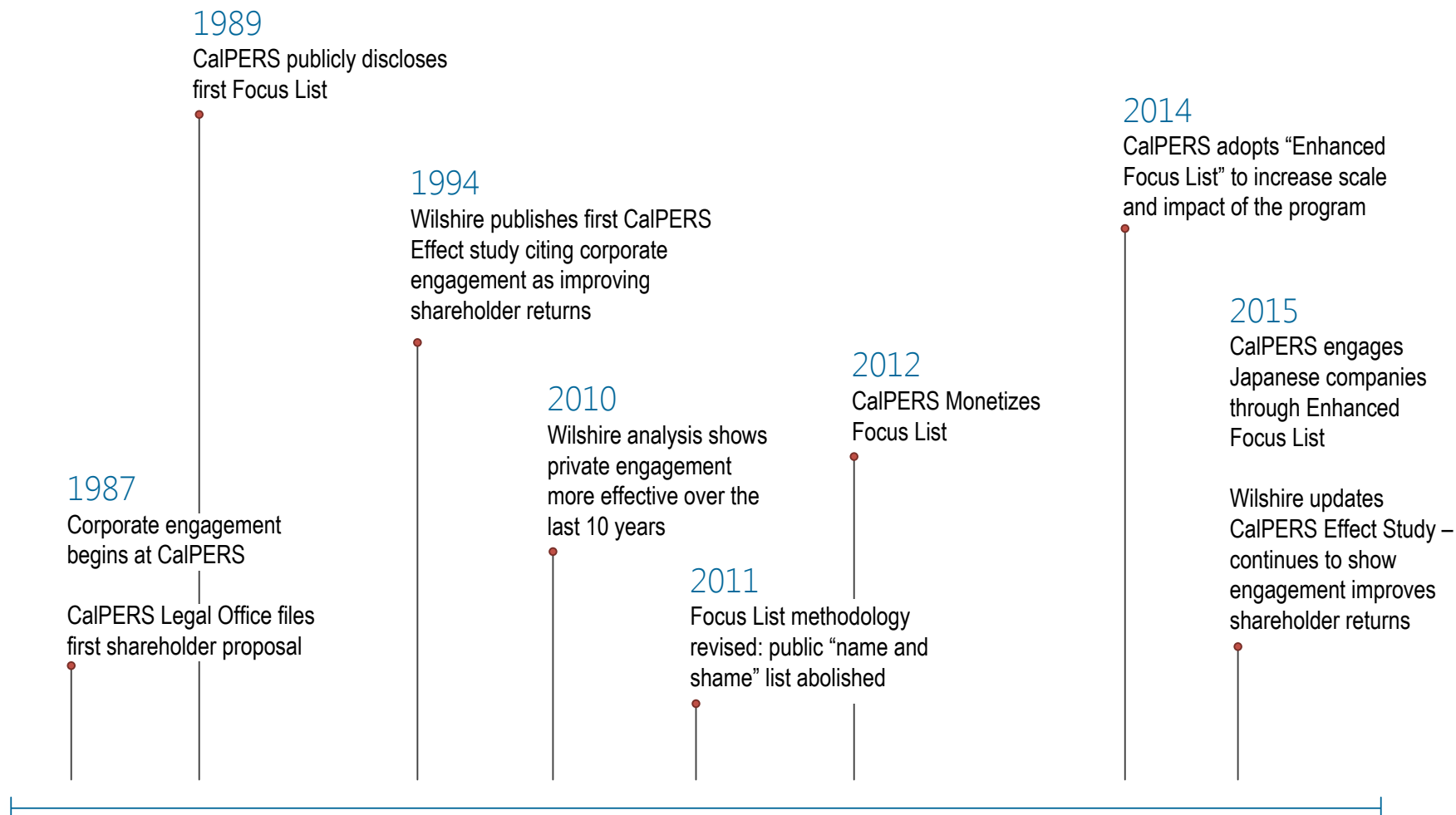
### ESG Investment Strategy

- Ensure CalPERS acts as a principled and effective investor by advocating corporate governance and financial market reform, overseeing the effective management of the three forms of capital: financial, physical and human; and effectively engaging with portfolio companies and policymakers

## CalPERS' Investment Beliefs

Applying the Program to material investments further demonstrates CalPERS' commitment to sustainable investment initiatives and is consistent with the Investment Beliefs, including 2, 4 and 6.

# History of the CalPERS Focus List



# Increasing Scale of Focus List Program

Year	\$ millions*
2015 Enhanced Focus List	645
2013 Focus List	53
2012 Focus List	222
2011 Focus List	330
2010 Focus List	217

\*Represents CalPERS' total equity holdings of Focus List company cohort

## Global Equity Exposure - CalPERS' Top 10 Countries

Country	Portfolio Weight (%)	Market Value (\$billions)
United States	50.2	72.7
Japan	9.9	14.3
United Kingdom	6.9	10.0
Hong Kong	3.4	5.0
Canada	3.3	4.7
France	3.0	4.4
Germany	2.9	4.3
Switzerland	2.8	4.1
Australia	2.0	3.0
South Korea	1.7	2.5

Source: FactSet as of 6/30/2015

# Why Japan Engagement?

## Investment Exposure

- Second largest market in our global equity portfolio

## Opportunity

- Staff identified numerous governance issues systemic to the Japanese market: traditionally poor capital efficiency and low valuation relative to other developed markets

## Timing

- Significant market push within Japan for governance reforms
- Companies more receptive to shareholder engagement due to increasing foreign ownership

## Impact

- Concentrated market engagement has the potential for greater market-wide impact

## Efficiency

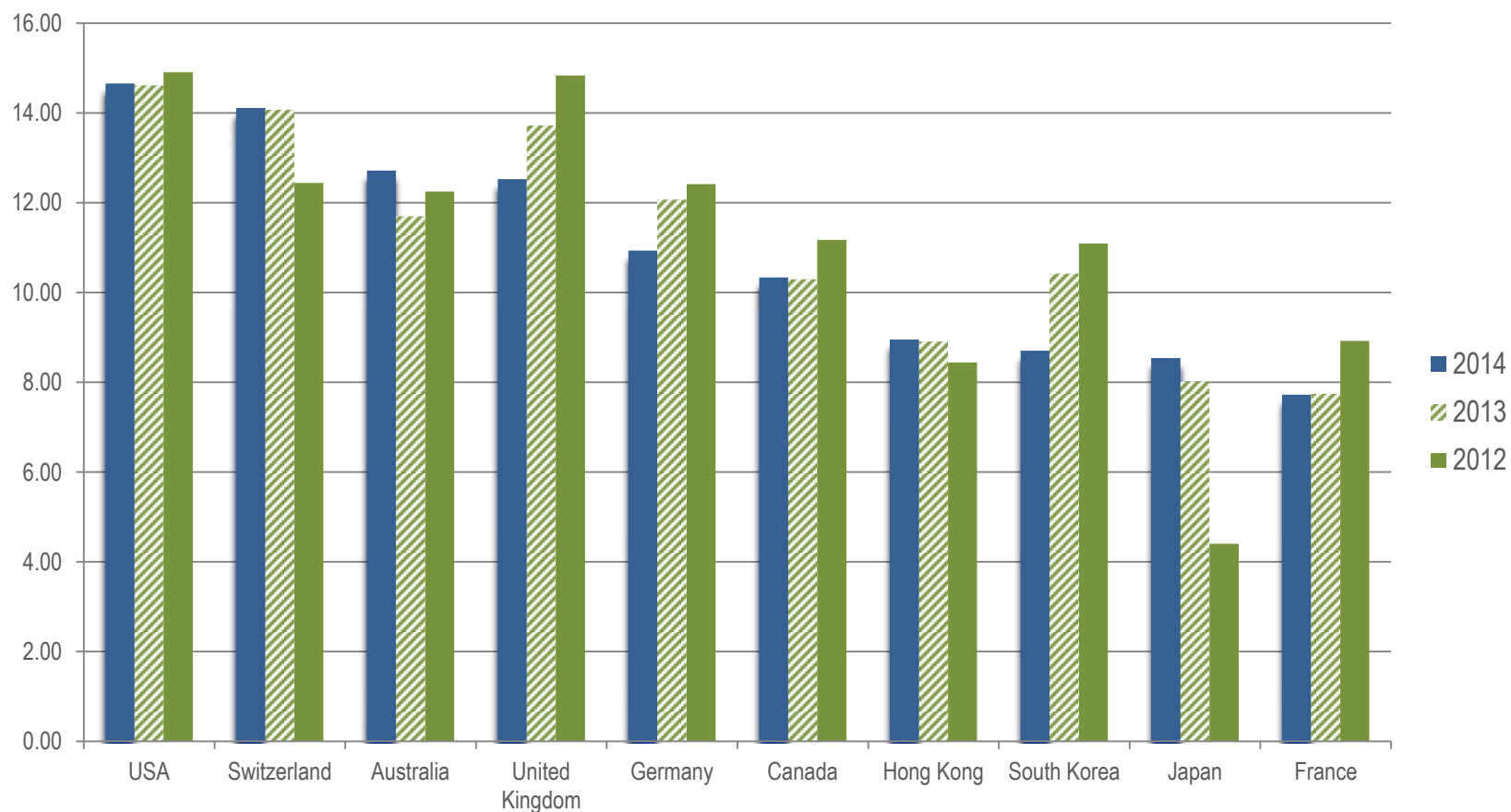
- Focus on a single market to make efficient use of staff resources and travel expenditures

## CalPERS' History of Engagement

- 2008: Endorses Asian Corporate Governance Association (ACGA) Japan White Paper
- 2010 & 2014: Attends ACGA Investor Delegations in Japan
- 2015: Supports new Corporate Governance Code

# Capital Efficiency Trends - CalPERS' Top 10 Countries

## Return on Equity

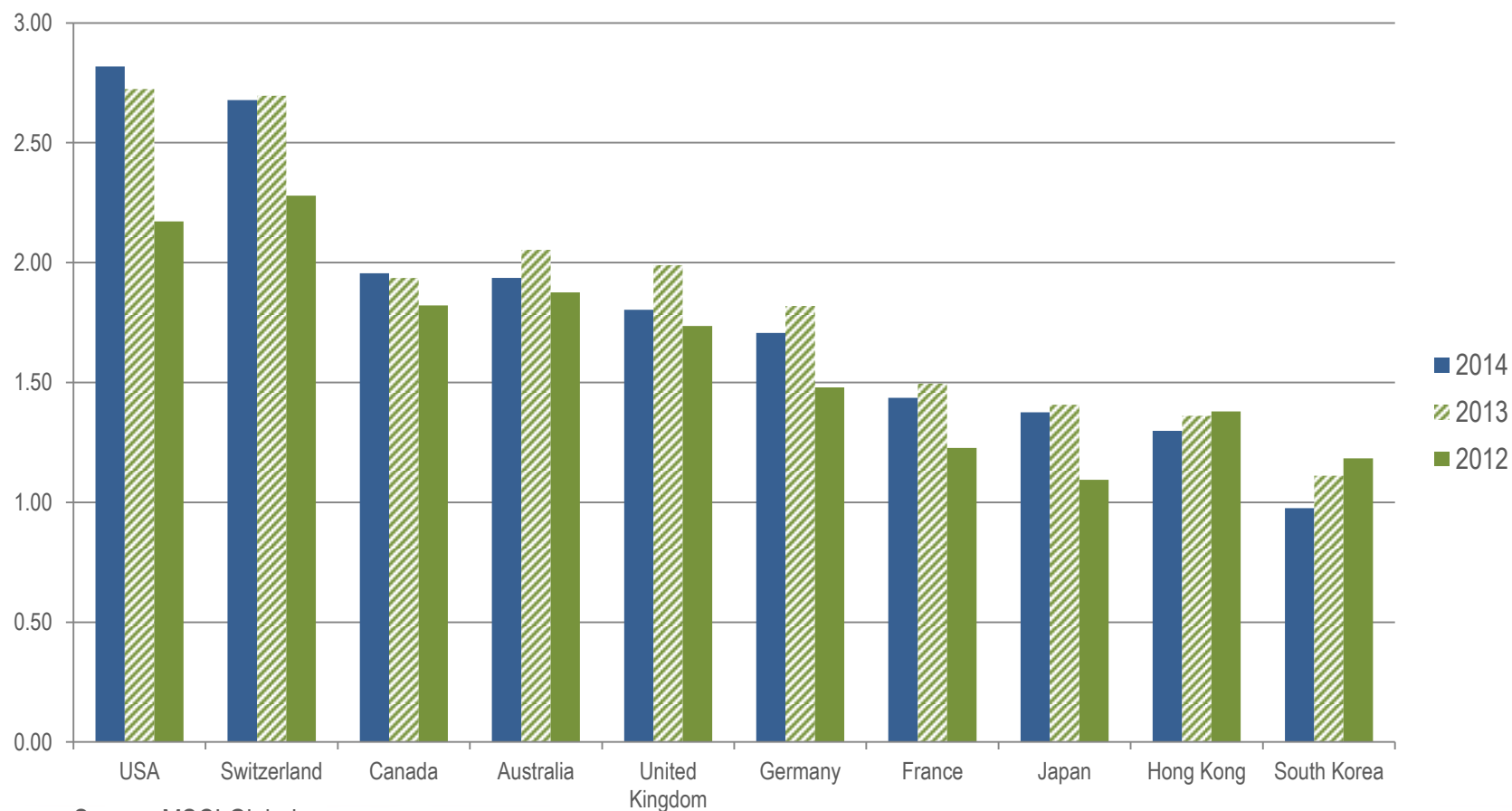


Source: MSCI Global



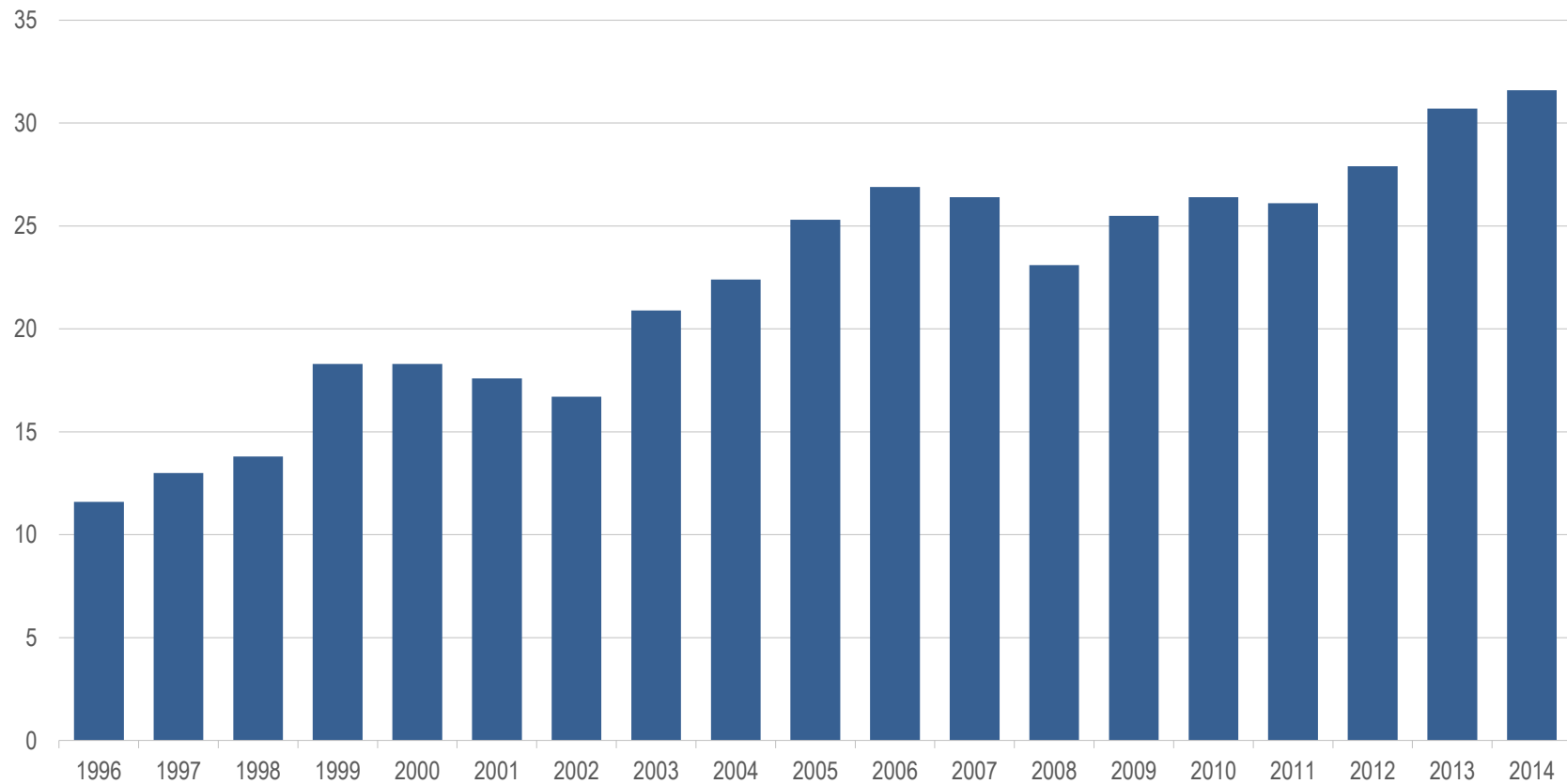
# Valuation Trends - CalPERS' Top 10 Countries

## Price to Book Values



Source: MSCI Global

# Foreign Ownership of Japanese Shares



Source: Tokyo Stock Exchange

# Market Initiatives to Improve Corporate Governance

2008	<b>Asian Corp. Gov. Association - Japan White Paper</b>	Emphasis of the Paper was to improve capital efficiency, board independence and shareholder rights. CalPERS is an active member of the ACGA and endorsed the Paper back in 2008.
2013	<b>Japan Prime Minister's Revitalization Strategy</b>	Strategy set out to re-invigorate the economy. Includes structural reform initiatives to improve capital efficiency and governance reform at companies.
2014	<b>Nikkei JPX400 Index</b>	The core criteria consider profitability indicators and corporate governance measures such as board independence.
2014	<b>Japan Investor Stewardship Code</b>	Principles-based framework to encourage dialogue between companies and shareholders. Goal is to enhance medium to long-term investment returns. Supported by influential local investors such as the GPIF.
2014	<b>Japanese Government Pension Investment Fund (GPIF) Reform</b>	The largest global pension fund with over US\$1.2 trillion assets under mgmt. Implemented reform initiatives designed to boost investment returns. Reforms include altering the oversight committee structure by including outside professional investment advisors and increasing the asset allocation to equities from approximately 25% to 50%.
2015	<b>Japan Corporate Governance Code</b>	Comply or explain framework of ESG best practices: Categories are shareholder rights, cooperation with stakeholders, disclosure and transparency, responsibilities of the board, and dialogue with shareholders.

# Objectives for Initial Engagements in Japan

- Meet with Executive Management and Board Members to introduce CalPERS as a long-term investor
- Share the framework of CalPERS' Investment Beliefs – translated to Japanese
- Express CalPERS' support of:
  - The Japan Investor Stewardship Code
  - The new Japan Corporate Governance Code
- Evaluate opportunity for a long-term engagement
- Request governance reforms aligned with CalPERS' Global Governance Principles
- Engage with other influential organizations in Japan

# Engagement Update

- Staff identified a group of companies for engagement using the enhanced selection criteria.
- Identified and collaborated with an external manager to research companies and coordinate engagements.
- Identified core engagement opportunities at each company.
- Corresponded with each company by letter - set out the meeting agenda and shared CalPERS' Investment Beliefs (translated to Japanese).
- Completed in-person company meetings in Japan with Executive Management and company Board Members.
- Corresponded with each company by letter, expressing our appreciation for engagement and suggesting specific governance reforms (translated to Japanese) – responses pending.
- Executed company proxy votes for Japanese proxy season in June 2015. Notified each engaged company of CalPERS' vote underpinned by CalPERS' Global Governance Principles.

# Initial Requested Reforms

Staff selected the following reforms as they are both systemic to the Japanese market and identified in Japan's new Corporate Governance Code. These reforms are aligned with CalPERS' core issues and supported by CalPERS' Global Governance Principles.

- Increase Board Independence, quality and diversity
- Define Independence Standards for Board Members
- Disclose Board Member Biographies, Skill-Sets & Expertise
- Enhance Board Member Search Process
- Disclose Cross-Shareholdings

# Next Steps

- Consider company responses to CalPERS' requested governance reforms
- Report back to CalPERS IC in case study format
- Carry out additional engagement as needed to accomplish governance reforms

# Appendix



# CalPERS Investment Beliefs



## 投資に関する信念 1

支払い責任は資産構造に影響を与えるべきである

---

## 投資に関する信念 2

投資における長期的な視野は責務かつ優位性である

---

## 投資に関する信念 3

CalPERSは、受託者としてメンバーおよび受益者に対する責務を一貫して守る限り、投資の決定において広範なステークホルダーの視点を反映することができる

---

## 投資に関する信念 4

長期的な価値の創造には金融資本、物理的資産、そして人材の3つの資本の効果的な管理が必要である

---

## 投資に関する信念 5

CalPERSは投資の目標とパフォーマンスの指標を明確に示し、それらの実施にあたり、明確な説明責任を保証しなければならない。

# CalPERS Investment Beliefs



## 投資に関する信念 6

戦略的なアセットアロケーションはポートフォリオリスクとリターンの主要な決定要因である

## 投資に関する信念 7

CalPERSは見返りがあると強く確信する場合にのみリスクを取る

## 投資に関する信念 8

費用は重要であり、効果的に管理すべきである

## 投資に関する信念 9

CalPERSに対するリスクには様々な面があり、ボラティリティやエラー追跡といった手段では完全に把握できない

## 投資に関する信念 10

CalPERSが目標と目的を達成する上で強力なプロセスとチームワーク、そして十分なリソースが必要である