

THE CALIFORNIA PUBLIC EMPLOYEES'  
RETIREMENT SYSTEM



**GLOBAL GOVERNANCE PRINCIPLES**

Second Reading – 10/20/15

**California Public Employees' Retirement System  
Lincoln Plaza - 400 Q Street - Sacramento, CA 95811**

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## I. INTRODUCTION

The California Public Employees' Retirement System (CalPERS, System) is the largest U.S. public pension fund, with assets totaling approximately \$~~300~~ 301 billion spanning domestic and international markets as of June 30, ~~2014~~ 2015. Our mission is to provide responsible and efficient stewardship of the System to deliver promised retirement and health benefits, while promoting wellness and retirement security for members and beneficiaries. This mission was adopted by the CalPERS Board of Administration to guide us in serving our more than 1.6 million members and retirees.

The CalPERS Investment Office ~~Board of Administration~~ is guided by the CalPERS Board of Administration ~~Board's Investment Committee~~, Investment Beliefs<sup>1</sup> and Core Values: Quality, Respect, Accountability, Integrity, Openness, and Balance. CalPERS management and more than 380 Investment Office staff carry out the daily activities of the investment program. Our goal is to efficiently and effectively manage investments to achieve the highest possible return at an acceptable level of risk. In doing so, CalPERS has generated strong long-term returns.

CalPERS Global Governance Program has evolved since the mid-80's when it was solely reactionary: reacting to the anti-takeover actions of corporate managers that struck a dissonant chord with owners of the corporate entity concerned with accountability and fair play. The late 1980s and early 1990s represented a period in which CalPERS learned a great deal about the "rules of the game" – how to influence corporate managers, what issues were likely to elicit fellow shareowner support, and where the traditional modes of shareowner/corporation communication were at odds with current reality. Beginning in 1993, CalPERS turned its focus toward companies considered by virtually every measure to be "poor" financial performers. By centering its attention and resources in this way, CalPERS could demonstrate very specific and tangible results to those who questioned the value of corporate governance.

Over the years, we've learned that shareowners can be instrumental in encouraging responsible corporate citizenship. CalPERS believes that environmental, social, and corporate governance issues can affect the performance<sup>2</sup> of investment portfolios (to varying degrees across companies, sectors, regions, and asset classes through time.) In 2005, CalPERS joined 19 other institutional investors from 12 countries to develop and become a signatory to the United Nations supported Principles for Responsible Investment (Appendix A).

In 2011, CalPERS Global Governance Program transitioned into an Investment Office- wide role to support the Total Fund; and, the CalPERS Board approved the adoption of a Total Fund process for integrating environmental, social, and governance (ESG) issues across the investment portfolio as a strategic priority. This transition recognizes CalPERS' ongoing effort<sup>3</sup> to integrate ESG factors into investment decision making across asset classes, grounded in the

<sup>1</sup> In October 2013, CalPERS adopted a set of ten Investment Beliefs intended to guide decision-making, facilitate the management of a complex portfolio, and enhance consistency. The Investment Beliefs can be found at [www.calpers-governance.org](http://www.calpers-governance.org)

<sup>2</sup> CalPERS launched the Sustainable Investment Research Initiative (SIRI) in 2013. SIRI was designed to promote innovative thought leadership that would advance and inform CalPERS understanding of environmental, social and governance factors and the impact they may have on companies, markets, and investment intermediaries. SIRI produced to The Review of Evidence: Bibliography of Academic Studies – an online searchable database of more than 700 studies on sustainability factors and investment spanning four decades. More information on SIRI can be found at [www.calpers-governance.org](http://www.calpers-governance.org).

three forms of economic capital – financial, human, and physical – that are needed for long-term value creation. This work has also been integrated into CalPERS Investment Beliefs which address sustainable investment, risk management, and CalPERS engagement with companies, regulators, managers, and stakeholders.

What have we learned over the years? We have learned that (a) company managers want to perform well, in both an absolute sense and as compared to their peers; (b) company managers want to adopt long-term strategies and visions, but often do not feel that their shareowners are patient enough; and (c) all companies – whether governed under a structure of full accountability or not – will inevitably experience both ascents and descents along the path of profitability.

We have also learned, and firmly embrace the belief that good corporate governance – that is, accountable corporate governance – means the difference between wallowing for long periods in the depths of the performance cycle, and responding quickly to correct the corporate course.

*“Long-term value creation requires effective management of three forms of capital: financial, physical and human – CalPERS Investment Belief 4.”  
(October, 2013)*

## II. PURPOSE

The CalPERS Board, through its Investment Committee, has adopted the Global Governance Principles (Global Principles). The Global Principles create the framework by which CalPERS:

- Executes its shareowner<sup>4</sup> proxy voting responsibilities.
- Engages investee companies to achieve long-term sustainable risk-adjusted returns.
- Requests internal and external managers of CalPERS capital to take into consideration when making investment decisions.

Inherent within the concept of prudence is the duty to monitor investment performance<sup>5</sup>. The U.S. Department of Labor (DOL), entrusted with oversight of the Employee Retirement Income and Security Act of 1974 (ERISA), has warned private pension fiduciaries that they may be held accountable for screening the performance of holdings, even those held under passive strategies.<sup>6</sup>

<sup>3</sup> CalPERS discloses its progress of the System's efforts, sustainability work, and goals towards sustainable decision making in its publicly available report, *Towards Sustainable Investment & Operations*, which can be found at [www.calpers-governance.org](http://www.calpers-governance.org).

<sup>4</sup> Throughout this document, CalPERS has chosen to adopt the term "shareowner" rather than "shareholder." This is to reflect a view that equity ownership carries with it active responsibilities and is not merely passively "holding" shares. "For corporate governance structures to work effectively, Shareowners must be active and prudent in the use of their rights. In this way, Shareowners must act like owners and continue to exercise the rights available to them." (2005 CFA Institute: Centre for Financial Market Integrity, *The Corporate Governance of Listed Companies: A Manual for Investors*) CalPERS also has other rights via other forms of capital and investment vehicles with the Global Principles adapted accordingly.

<sup>5</sup> Richard H. Koppes and Maureen L. Reilly, *An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor and Index Fund*, *The J. Of Corp. Law*, Univ. of Iowa (Summer 1995).

<sup>6</sup> See 29 C.F.R. sec. 2550.404a-1, DOL preamble to proposed regulations for the investment of plan assets, at fn. 7.

CalPERS implements its proxy voting responsibility and global governance initiatives in a manner that is consistent with the Global Principles unless such action may result in long-term harm to the company that outweighs all reasonably likely long-term benefit; or, unless such a vote is contrary to the interests of the beneficiaries of the System.

In 1988, the DOL issued its so-called Avon Letter, putting private pension plan trustees on notice that proxy voting rights must be diligently exercised as an aspect of fiduciary duty<sup>7</sup>. In 1994 the DOL updated its Avon Letter in a bulletin that consolidates the voting requirements of ERISA fiduciaries. The DOL now advocates a corporate activist role for pension plan trustees, to include ". . . activities intended to monitor or influence corporate management."<sup>8</sup>

The execution of proxies and voting instructions is an important mechanism by which shareowners can influence a company's operations and corporate governance. It is therefore important for shareowners to exercise their right to participate and make their voting decisions based on a full understanding of the information and legal documentation presented to them. CalPERS will vote in favor of, or "For", an individual or slate of director nominees up for election that the System believes will effectively oversee CalPERS interests as a shareowner consistent with the Global Principles.

CalPERS will withhold its vote from, or vote "Against", an individual or slate of director nominees at companies that do not effectively oversee CalPERS interests as a shareowner consistent with the Global Principles. CalPERS will also withhold its vote in limited circumstances where a company has consistently demonstrated long-term economic underperformance.

CalPERS has a long history of constructively engaging companies that fail to meet CalPERS standards of conduct as defined by the Global Principles. CalPERS prefers constructive engagement to divesting as a means of affecting the conduct of entities in which it invests. Investors that divest lose their ability as shareowners to influence the company to act responsibly.

CalPERS expects all internal and external managers of CalPERS capital to integrate the Global Principles into investment decision making including proxy voting, consistent with fiduciary duty. CalPERS recognizes that countries and companies are in different developmental stages and that CalPERS investment managers will need to exercise their best judgment after taking all relevant factors, principles, and trends into account.

CalPERS requires internal and external managers across the total fund to consider these Global Principles among the decision factors employed in the investment process.

<sup>7</sup> DOL Op. Ltr. To Helmuth Fandl, Avon Products, Inc. (Feb. 29, 1988).

<sup>8</sup> DOL Interp. Bulletin 94-1 (July 1994).

### III. GLOBAL GOVERNANCE PRINCIPLES

There are many features that are important considerations in the continuing evolution of governance best practices. However, the underlying tenet for CalPERS Principles is that fully accountable governance structures produce, over the long term, the best returns to shareowners. CalPERS believes the following Principles should be adopted by companies and markets – from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable governance structures.

#### A. Investor Rights

Investor rights<sup>23</sup> – or those structural devices that define the formal relationship between providers of investment capital and those to whom they delegate corporate control – should be featured in the governance principles adopted by corporate boards.

Therefore, CalPERS recommends that corporations adopt the following shareowner rights:

1. **One-share/One-vote:** A shareowners' right to vote is inviolate and should not be abridged. All investors must be treated equitably and upon the principle of one-share/one-vote.
  - a. **Redress:** Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. Proper remedies and procedural rules should be put in place to make the protection effective and affordable. Where national legal remedies are not afforded the board is encouraged to ensure that sufficient shareholder protections are provided in the company's bylaws.
2. **Access to Director Nominations:** Shareowners should have effective access to the director nomination process. Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least three percent of a company's voting stock, to nominate ~~less than a majority of the directors~~ up to twenty-five percent of the board. Eligible investors must have owned the stock for at least ~~two~~ three years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors.

To allow for informed voting decisions, it is essential that investors have full and accurate information about access mechanism users and their director nominees. Therefore, shareowners nominating director candidates under an access mechanism should adhere to the same SEC rules governing disclosure requirements and prohibitions on false and misleading statements that currently apply to proxy contests for board seats.

3. **Shareowner Approval Rights:** The board should ensure that shareholders have the right to vote on major decisions which may change the nature of the company in which they have invested. Such rights should be clearly described in the company's governing documents and include:

- a. **Sale or Pledge of Corporate Assets:** Major corporate decisions concerning the sale or pledge of corporate assets that would have a material effect on shareowner value. Such a transaction will automatically be deemed to have a material effect if the value of the assets exceeds 10 percent of the assets of the company and its subsidiaries on a consolidated basis.
- b. **Mergers and Acquisitions:** material and extraordinary transactions such as mergers and acquisitions.
- c. **Debt Issuance:** Issuing debt to a degree that would excessively leverage the company and imperil its long-term viability.
- d. **Share Repurchases (buy-backs):** The corporation's acquisition of five percent or more of its common shares at above-market prices other than by tender offer to all shareowners
- e. **Issuance of New Shares:** The board should be mindful of dilution of existing shareholders and provide full explanations where pre-emption rights are not offered
- f. **Poison Pill Approval:** No board should enact nor amend a poison pill (shareowner rights plan) ~~(shareholder rights plans ("poison pills"))~~ except with shareowner approval. Only non-conflicted shareholders should be entitled to vote on such plans and the vote should be binding. Plans should be time limited and put periodically to shareholders for re-approval
  - i. **Continuing Directors:** Corporations should not adopt so-called "continuing director" provisions (also known as "dead-hand" or "no-hand" provisions, which are most commonly seen in connection with a potential change in control of the company) that allow board actions to be taken only by: (1) those continuing directors who were also in office when a specified event took place or (2) a combination of continuing directors plus new directors who are approved by such continuing directors.
- g. **Significant Related Party Transaction:** Shareholders should have the right to approve significant related party transactions and this should be based on the approval of a majority of disinterested shareholders. The board should submit the transaction for shareholder approval and disclose (both before concluding the transaction and in the company's annual report):
  - i. the identity of the ultimate beneficiaries including, any controlling owner and any party affiliated with the controlling owner with any direct / indirect ownership interest in the company;
  - ii. other businesses in which the controlling shareholder has a significant interest; and
  - iii. shareholder agreements (e.g. commitments to related party payments such as license fees, service agreements and loans).

The board should disclose the process for reviewing and monitoring related party transactions which, for significant transactions, includes establishing a committee of independent directors. This can be a separate committee or an existing committee comprised of independent directors, for example the audit committee. The committee should review significant related party transactions to determine whether they are in the best interests of the company and, if so, to determine what



terms are fair and reasonable. The conclusion of committee deliberations on significant related party transactions should be disclosed in the company's annual report to shareholders.

4. **Majority Vote Requirements:** Shareowner voting rights should not be subject to supermajority voting requirements. A majority of proxies cast should be able to:
  - a. **Bylaw and Charter Amendments:** Amend the company's governing documents such as the Bylaws and Charter by shareowner resolution.
  - b. **Director Removal:** Remove a director with or without cause.
  - c. **Director Elections:** In an uncontested director election, a majority of proxies cast should be required to elect a director. In a contested election, a plurality of proxies cast should be required to elect a director. Resignation for any director that receives a withhold vote greater than 50% of the votes cast should be required. Unless the incumbent director receiving less than a majority of the votes cast has earlier resigned, the term of the incumbent director should not exceed 90 days after the date on which the voting results are determined.
  - d. **Auditor Ratification by Shareowners:** The selection of the independent external auditor should be ratified by shareowners annually.
  
5. **Corporate Proxy and Voting Mechanisms:** The board should promote efficient and accessible voting mechanisms that allow shareholders to participate in general meetings either in person or remotely, preferably by electronic means or by post, and should not impose unnecessary hurdles.
  - a. **Universal Proxy:** To facilitate the shareowner voting process in contested elections – opposing sides engaged in the contest should utilize a proxy card naming all management nominees and all dissident nominees, providing every nominee equal prominence on the proxy card.
  - b. **Sponsoring and Implementation of Shareowner Resolutions:** Shareowners should have the right to sponsor resolutions. A shareowner resolution that is approved by a majority of proxies cast should be implemented by the board.
  - c. **Proxy Confidentiality:** Proxies should be kept confidential from the company, except at the express request of shareowners.
  - d. **Cumulative Voting Rights:** Shareowners should have the right to cumulate votes in a contested election of directors. Such a right gives shareowners the ability to aggregate their votes for directors and either cast all of those votes for one candidate or distribute those votes for any number of candidates
  - e. **Shareholder Identification:** The board should ensure that the company maintains a record of the registered owners of its shares or those holding voting rights over its shares. Registered shareholders, or their agents, should provide the company (where anonymity rules do not preclude this) with the identity of beneficial owners or holders of voting rights when requested in a timely manner. Shareholders should be able to review this record of registered owners of shares or those holding voting rights over shares.
  - f. **Bundled Voting:** Shareowners should be allowed to vote on unrelated issues separately. Individual voting issues (particularly those amending a company's charter), bylaws or anti- takeover provisions should not be bundled.
  - g. **Broker Votes:** Uninstructed broker votes and abstentions should be counted only for purposes of a quorum.
  - h. **Advance Notice, Holding Requirements and Other Provisions:** Advance

notice bylaws, holding requirements, disclosure rules and any other company imposed regulations on the ability of shareowners to solicit proxies beyond those required by law should not be so onerous as to deny sufficient time, limit the pool of eligible candidates, or otherwise make it impractical for shareowners to submit nominations or proposals and distribute supporting proxy materials.

6. **Special Meetings and Written Consent:** Shareowners should be able to call special meetings or act by written consent.
7. **Judicial Forum:** Companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum. Nor should companies attempt to bar shareowners from the courts through the introduction of forced arbitration clauses.

## B. Board Quality: Diversity, Independence and Competence

1. **Director Accountability:** As a fiduciary, a director owes a duty of loyalty to the corporation and its shareowners and must exercise reasonable care in relation to his or her duties as a director. Directors should be accountable to shareowners, and management accountable to directors.
  - a. **Long-term Vision:** Corporate directors and management should have a long-term strategic vision that, at its core, emphasizes sustained shareowner value and effective management of both risk and opportunities in the oversight of financial, physical, and human capital. In turn, despite differing investment strategies and tactics, shareowners should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.
  - b. **Accessibility to Shareowner Inquiry:** To ensure this accountability, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company's strategic direction.
  - c. **Annual Director Elections:** Every director should be elected annually. Accountability mechanisms may require directors to stand for election on an annual basis or to stand for election at least once every three years.
  - d. **Board Size:** The board periodically reviews its own size, and determines the size that is most effective toward future operations.
  - e. **Director Attendance:** Absent compelling and stated reasons, directors should be expected to attend at least 75% of the board and key committee meetings on which they sit.
  - f. **Director Time Commitment:** The board adopts and discloses guidelines<sup>10</sup> in the company's proxy statement to address competing time commitments that are faced when directors, especially acting CEOs<sup>11</sup>, serve on multiple boards.
2. **Informed Directors:** Directors should receive training from independent sources on their fiduciary responsibilities and liabilities. Directors have an affirmative obligation to become and remain independently familiar with company operations; they should not rely exclusively on information provided to them by the CEO to do their jobs. Directors should be provided meaningful information in a timely manner prior to board meetings and should be allowed reasonable access to management to discuss board issues.
  - a. **Board Access to Management:** The board should have a process in place by which all directors can have access to senior management.

- b. New Director Induction:** The board should have in place a formal process of induction for all new directors so that they are well-informed about the company as soon as possible after their appointment. Directors should also be enabled to regularly refresh their skills and knowledge to discharge their responsibilities.
- 3. Board Independence:** Independence is the cornerstone of accountability. It is now widely recognized that independent boards are essential to a sound governance structure. Nearly all corporate governance commentators agree that boards should be comprised of at least a majority of “independent directors.” But the definitional independence of a majority of the board may not be enough in some instances. The leadership of the board must embrace independence, and it must ultimately change the way in which directors interact with management. Independence also requires a lack of conflict between the director’s personal, financial, or professional interests, and the interests of shareowners.
- a. Majority of Independent Directors:** At a minimum, a majority of the board consists of directors who are independent. Boards should strive to obtain board composition made up of a substantial<sup>9</sup> majority of independent directors.
- b. Independent Executive Session:** Independent directors meet periodically (at least once a year) alone in an executive session, without the CEO. The independent board chair or lead (or presiding) independent director should preside over this meeting.
- c. Board Role of Retiring CEO:** Generally, a company’s retiring CEO should not continue to serve as a director on the board and at the very least be prohibited from sitting on any of the board committees.
- 4. Board Committee Independence:** The full board is responsible for the oversight function on behalf of shareowners. Should the board decide to have other committees (e.g. executive committee) in addition to those required by law, the duties and membership of such committees should be fully disclosed. Committees who perform the audit, director nomination and executive compensation functions should consist entirely of independent directors. The board (not the CEO) should appoint the committee chairs and members. Committees should be able to select their own service providers. Some regularly scheduled committee meetings should be held with only the committee members (and, if appropriate, the committee’s independent consultants) present. The process by which committee members and chairs are selected should be disclosed to shareowners.
- 5. Board Chairperson Independence and Leadership:** The board should be chaired by an independent director. The chair is responsible for leadership of the board and ensuring its effectiveness. The chair should ensure a culture of openness and constructive debate that allows a range of views to be expressed. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interest of shareowners, and it should name a lead independent director to fulfill the following duties:  
Coordinate the scheduling of board meetings and preparation of agenda material for board meetings and executive sessions of the board’s independent or non-management directors.

- a. Coordinate the scheduling of board meetings and preparation of agenda material for board meetings and executive sessions of the board's independent or non-management directors.
  - b. Lead board meetings in addition to executive sessions of the board's independent or non-management directors.
  - c. When selecting a new CEO, boards should re-examine the traditional combination of the "chief executive" and "chair" positions.
  - d. Define the scope, quality, quantity and timeliness of the flow of information between company management and the board that is necessary for the board to effectively and responsibly perform their duties.
  - e. Oversee the process of hiring, firing, evaluating, and compensating the CEO.
  - f. Approve the retention of consultants who report directly to the board.
  - g. Advise the independent board committee chairs in fulfilling their designated roles and responsibilities to the board.
  - h. Interview, along with the chair of the nominating committee, all board candidates, and make recommendations to the nominating committee and the board.
  - i. Assist the board and company officers in assuring compliance with and implementation of the company's Governance Principles.
  - j. Act as principal liaison between the independent directors and the CEO on sensitive issues.
  - k. Coordinate performance evaluations of the CEO, the board, and individual directors.
  - l. Recommend to the full board the membership of the various board committees, as well as selection of the committee chairs.
  - m. Be available for communication with shareowners.
- 6. Director Independence:** The board should ensure that policies and procedures on conflicts of interest are established, understood and implemented by directors, management, employees and other relevant parties. If a director has an interest in a matter under consideration by the board, then the director should promptly declare such an interest and be precluded from voting on the subject or exerting influence. Each company should disclose in its annual proxy statement the definition of "independence" relied upon by its board. The board's definition of "independence" should address, at a minimum, a director who:
- a. Is not currently, or within the last five years<sup>31</sup> has not been, employed by the Company in an executive capacity.
  - b. Has not received more than \$50,000<sup>32</sup> in direct compensation from the Company during any 12-month period in the last three<sup>33</sup> years other than:
    - i. Director and committee fees including bona fide expense reimbursements.
    - ii. Payments arising solely from investments in the company's securities.
  - c. Is not affiliated with a company that is an adviser or consultant to the Company or a member of the Company's senior management during any 12-month period in the last three years that has received more than \$50,000 from the Company.
  - d. Is not a current employee of a company (customer or supplier) that has made payments to, or received payments from the Company that exceed the greater of \$200,000<sup>34</sup> or 2%<sup>35</sup> of such other company's consolidated gross revenues.
  - e. Is not affiliated with a not-for-profit entity (including charitable organizations) that receives contributions from the Company that exceed the greater of \$200,000 or 2% of consolidated gross revenues of the recipient for that year.
  - f. Is not part of an interlocking directorate in which the CEO or other

employee of the Company serves on the board of another company employing the director.

- g. Has not had any of the relationships described above with any parent or subsidiary of the Company.
- h. Is not a member of the immediate family<sup>36</sup> of any person described in 5a-h.

**7. Board Responsibilities:** The board responsibilities should include:

- a. **CEO Performance:** Independent directors establish CEO performance criteria focused on optimizing operating performance, profitability and shareowner value creation; and regularly review the CEO's performance against those criteria.
- b. **Corporate Strategy:** Review, approve and guide corporate strategy, capital discipline and allocation, major plans of action, risk policies, business plans.
- c. **Corporate Performance:** Set performance objectives, monitor implementation and corporate performance, and oversee major capital expenditures, and acquisitions/divestitures.
- d. **Corporate Annual Report and Accounts:** Affirm that the company's annual report and accounts present a true and fair view of the company's position and prospects. As appropriate, taking into account statutory and regulatory obligations in each jurisdiction, the information provided in the annual report and accounts should:
  - i be relevant to investment decisions, enabling shareholders to evaluate risks, past and present performance, and to draw inferences regarding future performance;
  - ii enable shareholders, who put up the risk capital, to fulfil their responsibilities as owners to assess company management and the strategies adopted;
  - iii be a faithful representation of the events it purports to represent;
  - iv generally be neutral and report activity in a fair and unbiased way except where there is uncertainty. Prudence should prevail such that assets and income are not overstated and liabilities and expenses are not understated. There should be substance over form. Any off-balance sheet items should be appropriately disclosed;
  - v be verifiable so that when a systematic approach and methodology is used the same conclusion is reached;
  - vi be presented in a way that enables comparisons to be drawn of both the entity's performance over time and against other entities; and
  - vii recognize the 'matching principle' which requires that expenses are matched with revenues.
  - viii recognize the establishment and maintenance of an effective system of internal control which should be measured against internationally accepted standards of internal audit and tested periodically for its adequacy. Where an internal audit function has not been established, full reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance of the effectiveness of the system of internal controls has been obtained.
- e. **Reincorporation:** When considering reincorporation, corporations should analyze shareowner protections, company economic, capital market, macro-economic, and corporate governance considerations. Companies should not reincorporate to offshore locations where corporate governance structures are weaker, which reduces management accountability to shareowners.
- f. **Charitable and Political Contributions:** Robust board oversight and disclosure of corporate charitable and political activity is needed to ensure alignment with business

strategy and to protect assets on behalf of shareowners. We recommend the following:

- i **Policy:** The board should develop and disclose a policy that outlines the board's role in overseeing corporate charitable and political contributions, the terms and conditions under which charitable and political contributions are permissible, and the process for disclosing charitable and political contributions annually.
- ii **Board Monitoring, Assessment and Approval:** The board of directors should monitor charitable and political contributions (including trade association contributions directed for lobbying purposes) made by the company. The board should ensure that only contributions consistent with and aligned to the interests of the company and its shareowners are approved.
- iii **Disclosure:** The board should disclose on an annual basis the amounts and recipients of monetary and non-monetary contributions made by the company during the prior fiscal year. If any expenditure earmarked or used for political or charitable activities were provided to or through a third-party to influence elections of candidates or ballot measures or governmental action, then those expenditures should be included in the report.

**8. Board, Committee, and Director Evaluation:** No board can truly perform its function of overseeing a company's strategic direction and monitoring management's success without a system of evaluating itself. The board should establish preparation, participation and performance expectations for itself (acting as a collective body), for the key committees and each of the individual directors. A process by which these established board, key committee and individual director expectations are evaluated on an annual basis should be disclosed to shareowners. Directors must satisfactorily perform based on the established expectations with re-nomination based on any other basis being neither expected nor guaranteed.

**9. Board Talent Assessment and Diversity:** The board should facilitate a process that ensures a thorough understanding of the diverse characteristics necessary to effectively oversee management's execution of a long-term business strategy. Board diversity should be thought of in terms of skill sets, gender, age, nationality, race, sexual orientation, gender identity, and historically under-represented groups. Consideration should go beyond the traditional notion of diversity to include a more broad range of experience, thoughts, perspectives, and competencies to help enable effective board leadership. A robust process for how diversity is considered when assessing board talent and diversity should be adequately disclosed and entail:

- a. **Director Talent Evaluation:** To focus on the evolving global capital markets, a board should disclose its process for evaluating the diverse talent and skills needed on the board and its key committees.
- b. **Director Attributes:** Board attributes should include a range of skills and experience which provide a diverse and dynamic team to oversee business strategy, risk mitigation and senior management performance. The board should establish and disclose a diverse mix of director attributes, experiences, perspectives and skill sets that are most appropriate for the company. At a minimum, director attributes should include expertise in accounting or finance, international markets, business or management, industry knowledge, governance, customer-base experience or perspective, crisis response, risk

- assessment, leadership and strategic planning. Additionally, existing directors should receive continuing education surrounding a company's activities and operations to ensure they maintain the necessary skill sets and knowledge to meet their fiduciary responsibilities.
- c. **Director Nominations:** With each qualified director nomination recommendation, the board should consider the issue of competence, independence, continuing director tenure, as well as board diversity, and take steps as necessary to ensure that the board maintains openness to new ideas, a willingness to re-examine the status quo, and able to exercise judgment in the best interests of the corporation free of any external influence that may attempt to be or may appear to be exerted upon them.
  - d. **Director Tenure:** Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent. These considerations include the director's years of service on the board – extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom. Additionally, there should be routine discussions surrounding director refreshment to ensure boards maintain the necessary mix of skills and experience to meet strategic objectives.
- 10. Role of the Audit Committee:** At least one member of the audit committee should have recent and relevant financial experience. The main role and responsibilities of the audit committee should be described in the committee's terms of reference. This includes:
- a. **Auditor Liability:** To strengthen the auditor's objective and unbiased audit of financial reporting, audit committees should ensure that contracts with the auditor do not contain specific limits to the auditor's liability to the company for consequential damages or require the corporation to use alternative dispute resolution.
  - b. **Auditor Selection:** Audit committees should promote expanding the pool of auditors considered for the annual audit to help improve market competition and thereby minimize the concentration of only a small number of audit firms from which to engage for audit services. To allow audit committees a robust foundation to determine audit firm independence, auditors should provide 3 prior years of activities, relationships, and services (including tax services) with the company, affiliates of the company and persons in financial reporting oversight roles that may impact the independence of the audit firm.
  - c. **Auditor Rotation:** Audit committees should promote rotation of the auditor to ensure a fresh perspective and review of the financial reporting framework.
  - d. **Audit Committee Communication with Auditor:** The auditor should articulate to the Audit Committee, risks and other matters arising from the audit that are significant to the oversight of the financial reporting process, including situations where the auditor is aware of disputes or concerns raised regarding accounting or auditing matters. The Audit Committee should consider providing to investors a summary document of its discussions with auditors to enhance investor confidence in the audit process.
  - e. **Monitoring the integrity of the accounts:** and any formal announcements relating to the company's financial performance, and reviewing significant

- financial reporting judgments contained in them;
- f. **Oversight of key accounting policies and accounting judgments:** which should be in accordance with generally accepted international accounting standards, and disclosing such policies in the notes to the company's accounts;
  - g. **Audit Scope:** agreeing the minimum scope of the audit as prescribed by applicable law and any further assurance that the company needs. Shareholders (who satisfy a reasonable threshold shareholding) should have the opportunity to expand the scope of the forthcoming audit or discuss the results of the completed audit should they wish to;
  - h. **Auditor Independence:** assuring itself of the quality of the audit carried out by the external auditors and assessing the effectiveness and independence of the auditor each year. This includes overseeing the appointment, reappointment and, if necessary, the removal of the external auditor and the remuneration of the auditor. There should be transparency in advance when the audit is to be tendered so that shareholders can engage with the company in relation to the process should they so wish;
  - i. **Auditor Dialogue:** having appropriate dialogue with the external auditor without management present and overseeing the interaction between management and the external auditor, including reviewing the management letter provided by the external auditors and overseeing management's response; and reporting on its work and conclusions in the annual report.
  - j. **Assertion of Internal Financial Controls:** The Audit Committee should require the auditor's opinion to include commentary on any management assertion that the system of internal financial controls is operating effectively and efficiently, that assets are safeguarded, and that financial information is reliable as of a specific date, based on a specific integrated framework of internal controls.
  - k. **Audit Committee Expertise:** Audit committee financial expertise at a minimum should include skill-sets as outlined by Section 407(d)(5)(i) of Regulation S-K and the Exchange listing requirements. Boards should consider the effectiveness of the audit committee and designated financial expert(s) in its annual assessment. Firms may be able to reduce their cost of capital as related to the quality of its financial reporting. The quality of financial reporting can be increased by appropriately structuring the audit committee with effective financial expertise.
  - l. **Annual Reporting:** disclosing in the annual reporting the following:
    - i Assessment of the independence and objectivity of the external auditor to assure the auditors and their staff have no financial, business, employment or family and other personal relationships with the company;
    - ii Assessment of the appropriateness of total fees charged by the auditors;
    - iii Assessment of non-audit services and fees charged including limitations or restrictions tied to the provision of non-audit services;
    - iv Explanation of why non-audit services were provided by the auditor rather than by another party and how the auditor's independence has been safeguarded;
    - v Rational for recommending the appointment, reappointment or removal of the external auditor including information on tendering frequency, tenure, and any contractual obligations that acted to restrict the choice of external auditors;
    - vi Auditor rotation period;
    - vii Assessment of issues which resulted in auditor resignation.



viii Assessment of all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit clients or persons in a financial reporting oversight role that may have a bearing on independence

- 11. Role of the Nomination Committee:** The main role and responsibilities of the nomination committee should be described in the committee's terms of reference. This includes:
- a. Skills Matrix:** developing a skills matrix, by preparing a description of the desired roles, experience and capabilities required for each appointment, and then evaluating the composition of the board.
  - b. Board Appointments:** leading the process for board appointments and putting forward recommendations to shareholders on directors to be elected and re-elected;
  - c. Director Conflicts of Interest:** upholding the principle of director independence by addressing conflicts of interest (and potential conflicts of interest) among committee members and between the committee and its advisors during the nomination process;
  - d. Independent Consultants:** considering and being responsible for the appointment of independent consultants for recruitment or evaluation including their selection and terms of engagement and publically disclosing their identity and consulting fees; and
  - e. Shareowner Dialogue:** entering into dialogue with shareholders on the subject of board nominations either directly or via the board; and
  - f. Board Succession Planning.**
- 12. Role of the Compensation Committee:** The main role and responsibilities of the compensation committee should be described in the committee terms of reference. This includes:
- a. Compensation Philosophy:** determining and recommending to the board the remuneration philosophy and policy of the company;
  - b. Oversight of Plan Design, Implementation, Monitoring and Evaluation:** short-term and long-term share-based incentives and other benefits schemes including pension arrangements, for all executive officers;
  - c. Director Conflicts of Interest:** ensuring that conflicts of interest among committee members and between the committee and its advisors are avoided;
  - d. Independent Consultants:** appointing any independent remuneration consultant including their selection and terms of engagement and disclosing their identity and consulting fees; and
  - e. Shareowner Dialogue:** maintaining appropriate communication with shareholders on the subject of remuneration either directly or via the board.
- 13. Risk Oversight:** In response to the turmoil in the financial markets and economic uncertainties, CalPERS has elevated the importance of risk oversight and management. The primary goal is to ensure companies adopt policies, operating procedures, internal controls, federal and state law compliance programs, reporting, and decision-making protocols to effectively manage, evaluate, and mitigate risk.

The ultimate outcome is to ensure that companies function as “risk intelligent” organizations. CalPERS recommends the following:

- a. The board is ultimately responsible for a company’s risk management philosophy, organizational risk framework and oversight. The board should be comprised of skilled directors with a balance of broad business experience and extensive industry expertise to understand and question the breadth of risks faced by the company. Risk management should be considered a priority and sufficient time should be devoted to oversight.
- b.a. The company should promote a risk-focused culture and a common risk management framework should be used across the entire organization. Frequent and meaningful communication should be considered the “cornerstone” for an effective risk framework. A robust risk framework will facilitate communication across business units, up the command chain and to the board. The company’s culture with regard to risk and the process by which issues are escalated and de-escalated within the company should be evaluated at intervals as appropriate to the situation.
- c.a. The board should set out specific risk tolerances and implement a dynamic process that continuously evaluates and prioritizes risks. An effective risk oversight process considers both internal company related risks such as operational, financial, credit, solvency, liquidity, corporate governance, cyber-security, environmental, reputational, social, and external risks such as industry related, systemic, and macro economic.
- d.a. Executive compensation practices should be evaluated to ensure alignment with the company’s risk tolerances and that compensation structures do not encourage excessive risk taking.
- e.a. At least annually, the board should approve a documented risk management plan and disclose sufficient information to enable shareowners to assess whether the board is carrying out its risk oversight responsibilities. Disclosure should also include the role of external parties such as third-party consultants in the risk management process. While ultimate responsibility for a company’s risk management approach rests with the full board, having a risk committee (be it a stand-alone risk committee, a combined risk committee with nomination and governance, strategy, audit or other) can be an effective mechanism to bring the transparency, focus and independent judgment needed to oversee the company’s risk management approach.
- f.a. While the board is ultimately responsible for risk oversight, executive management should be charged with designing, implementing and maintaining an effective risk program. Roles and reporting lines related to risk management should be clearly defined. At a minimum, the roles and reporting lines should be explicitly set out for the board, board risk committees, chief executive officer, chief financial officer, the chief risk officer, and business unit heads. The board and risk related committees should have appropriate transparency and visibility into the organization’s risk management practices to carry out their responsibilities.

- 14. CEO Succession Plan:** The board should proactively lead and be accountable for the development, implementation, and continual review of a CEO succession plan. Board members should be required to have a thorough understanding of the characteristics necessary for a CEO to execute on a long-term strategy that optimizes operating performance, profitability and shareowner value creation. At a minimum,

the CEO succession planning process should:

- a. Become a routine topic of discussion by the board.
- b. Extend down throughout the company emphasizing the development of internal CEO candidates and senior managers while remaining open to external recruitment.
- c. Require all board members be given exposure to internal candidates.
- d. Encompass both a long-term perspective to address expected CEO transition periods and a short-term perspective to address crisis management in the event of death, disability or untimely departure of the CEO.
- e. Provide for open and ongoing dialogue between the CEO and board while incorporating an opportunity for the board to discuss CEO succession planning without the CEO present.
- f. Be disclosed to shareowners on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely CEO succession plan.

- 15. Director Succession Plan:** The board should proactively lead and be accountable for the development, implementation, and continual review of a director succession plan. Board members should be required to have a thorough understanding of the characteristics necessary to effectively oversee management's execution of a long-term strategy that optimizes operating performance, profitability, and shareowner value creation. At a minimum, the director succession planning process should:
- a. Become a routine topic of discussion by the board.
  - b. Encompass how expected future board retirements or the occurrence of unexpected director turnover as a result of death, disability or untimely departure is addressed in a timely manner.
  - c. Encompass how director turnover either through transitioning off the board or as a result of rotating committee assignments and leadership is addressed in a timely manner.
  - d. Provide for a mechanism to solicit shareowner input.
  - e. Be disclosed to shareowners on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely director succession plan.

- 16. Human Capital Management Practices:** Corporations should adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates. Additionally, these practices should emphasize and focus on preventing discrimination and/or violence based on race, color, religion, national origin, age, disability, sexual orientation, gender identity, marital status, or any other status protected by laws or regulations in areas of a company's operation. Boards should be accountable for companies to develop and implement company policies, procedures, training and internal reporting structures to ensure commitment to:
- a. **Universal Human Rights:** Express our support for universal human rights and, particularly, those of our employees, the communities within which we operate, and parties with whom we do business.
  - b. **Equal Employment Opportunity:** Promote equal opportunity for our employees at all levels of the company with respect to issues such as color, race, gender, age, ethnicity or religious beliefs, and operate without unacceptable worker treatment such as the exploitation of children, physical punishment, female abuse, involuntary servitude, or other forms of abuse.

- c. **Freedom of Association:** Respect our employees' voluntary freedom of association.
- d. **Eliminate all Forms of Forced and Compulsory Labor:** Compensate our employees to enable them to meet at least their basic needs and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities.
- e. **Provide a safe and healthy workplace:** protect human health and the environment; and promote sustainable development.
- f. **Promote fair competition:** including respect for intellectual and other property rights, and not offer, pay or accept bribes.
- g. **Strategic Social Investment:** Work with governments and communities in which we do business to improve the quality of life in those communities – their educational, cultural, economic and social well-being – and seek to provide training and opportunities for workers from disadvantaged backgrounds.
- h. **Application to Supply Chain:** Promote the application of these principles by those with whom we do business.

## C. Compensation

Compensation programs are one of the most powerful tools available to the company to attract, retain, and motivate key employees to optimize operating performance, profitability and sustainable long-term shareowner return. CalPERS considers long-term to be five or more years for mature companies and at least three years for other companies. Well-designed compensation programs will be adequately disclosed and align management with the long-term economic interests of shareowners.

CalPERS believes shareowners should have an effective mechanism by which to periodically promote substantive dialogue, encourage independent thinking by the board, and stimulate healthy debate for the purpose of holding management accountable for performance through executive compensation programs. However, CalPERS does not generally believe that it is optimal for shareowners to approve individual contracts at the company specific level.

Implicit in CalPERS Principles related to executive compensation, is the belief that the philosophy and practice of executive compensation needs to be performance- based. Through its efforts to advocate executive compensation reform, CalPERS emphasizes improved disclosure, the alignment of interests between executive management and shareowners, and enhanced compensation committee accountability for executive compensation. With this in mind, CalPERS recommends the following:

### 1. Total Executive Compensation – Structure and Components

- a. **Board Designed, Implemented, and Disclosed to Shareowners:** To ensure the alignment of interest with long-term shareowners, executive compensation programs are to be designed, implemented, and disclosed to shareowners in the annual proxy statement by the board, through an independent compensation committee. Executive compensation programs should not restrict the company's ability to attract and retain competent executives.
- b. **Mix of Cash and Equity:** Executive compensation be comprised of a combination of cash and equity based compensation.
- c. **Quantum:** Compensation should be reasonable and equitable and the

- quantum should be determined within the context of the company as a whole. Compensation committees should set appropriate limits on the size of long-term incentive awards granted to executives. So-called “mega-awards” or outsized awards should be avoided, except in extraordinary circumstances, because they can be disproportionate to performance.
- d. **Shareowner Advisory Vote on Executive Compensation:** Companies submit executive compensation policies to shareowners for non-binding approval on an annual basis.
  - e. **Targeting Total Compensation Components:** Overall target ranges of total compensation and components therein including base salary, short-term incentive and long-term incentive components should be disclosed. When setting performance goals for “target” bonuses, the compensation committee should set performance levels below which no bonuses would be paid and above which bonuses would be capped. Except in extraordinary situations, the compensation committee should not “lower the bar” by changing performance targets in the middle of bonus cycles. If the committee decides that changes in performance targets are warranted in the middle of a performance cycle, it should disclose the reasons for the change and details of the initial targets and adjusted targets.
  - f. **Peer Relative Analysis:** Disclosure should include how much of total compensation is based on peer relative analysis and how much is based on other criteria. Annual disclosure of the companies in peer groups used for benchmarking and/or other comparisons. If the peer group used for compensation purposes differs from that used to compare overall performance, such as the five-year stock return graph required in the annual proxy materials, the compensation committee should describe the differences between the groups and the rationale for choosing between them. In addition to disclosing names of companies used for benchmarking and comparisons, the compensation committee should disclose targets for each compensation element relative to the peer/benchmarking group and year-to-year changes in companies composing peer/benchmark groups.
  - g. **Pay for Performance:** Compensation of the executive oversight group should be driven predominantly by performance. The compensation committee should establish performance measures for executive compensation that are agreed to ahead of time and publicly disclosed.
  - h. **Alignment with Business Strategy:** Compensation committees should have a well-articulated philosophy that links compensation to long-term business strategy.
  - i. **Sustainability Objectives and Executive Compensation:** Executive compensation plans should be designed to support sustainability performance objectives particularly with regard to risk management, environmental, health, and safety standards. Sustainability objectives that trigger payouts should be disclosed.
2. **Salary:** Since salary is one of the few components of executive compensation that is not “at risk,” it should be set at a level that yields the highest value for the company at least cost. In general, salary should be set to reflect responsibilities, tenure and past performance, and to be tax efficient—meaning no more than \$1 million
    - a. **Above-median Salary:** The compensation committee should publicly disclose

its rationale for paying salaries above the median of the peer group.

- a-b.** Employee Compensation: Compensate our employees to enable them to meet at least their basic needs and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities.

### 3. Incentive Compensation

- a. Performance Link:** A significant portion of executive compensation should be comprised of “at risk” pay linked to optimizing the company’s operating performance and profitability that results in sustainable long-term shareowner value creation.
- b. Types of Incentive Compensation:** The types of incentive compensation to be awarded should be disclosed such as the company’s use of options, restricted stock, performance shares or other types. Compensation committees should disclose the size, distribution, vesting requirements, other performance criteria and grant timing of each type of long-term incentive award granted to the executive oversight group. Compensation committees also should explain how each component contributes to the company’s long-term performance objectives.
- c. Establishing Performance Metrics:** Performance metrics such as total stock return, return on capital, return on equity and return on assets, should be set before the start of a compensation period while the previous years’ metrics which triggered incentive payouts should be disclosed. The compensation committee should approve formulaic bonus plans containing specific qualitative and quantitative performance-based operational measures designed to reward executives for superior performance related to operational/strategic/other goals set by the board. Such awards should be capped at a reasonable maximum level. These caps should not be calculated as percentages of accounting or other financial measures (such as revenue, operating income or net profit), since these figures may change dramatically due to mergers, acquisitions and other non-performance-related strategic or accounting decisions.
- d. Multiple Performance Metrics:** Plan design should utilize multiple performance metrics when linking pay to performance.
- e. Performance Hurdles:** Performance hurdles<sup>12</sup> that align the interests of management with long-term shareowners should be established with incentive compensation being directly tied to the attainment and/or out-performance of such hurdles. Provisions by which compensation will not be paid if performance hurdles are not obtained should be disclosed to shareowners.
- f. Retesting Incentive Compensation:** Provisions for the resetting of performance hurdles in the event that incentive compensation is retested<sup>13</sup> should be disclosed.
- g. Clawback Policy:** Companies should recapture incentive payments that were made to executives on the basis of having met or exceeded performance targets during a period of fraudulent activity or a material negative restatement of financial results for which executives are found personally responsible.

### 4. Equity Compensation

- a. Equity Ownership:** Executive equity ownership should be required through the attainment and continuous ownership of a significant equity investment in the company. Executive stock ownership guidelines and holding requirements should be disclosed to shareowners on an annual basis. In

- addition to equity ownership, a company should make full disclosure of any pledging policies. Further, stock subject to the ownership requirements should not be pledged or otherwise encumbered.
- b. Employee Share Dealing:** The board should develop clear rules regarding any trading by directors and employees in the company's own securities. Individuals should not benefit directly or indirectly from knowledge which is not generally available to the market.
  - c. Hedging:** The use of derivatives or other structures to hedge director or executive stock ownership undermines the alignment of interest that equity compensation is intended to provide. Companies should therefore prohibit the activity and provide full disclosure of any hedging policies.
  - d. Post-retirement Holdings:** Executives should be required to continue to satisfy the minimum stock holding requirements for at least six months after leaving the company.
  - e. Equity Grants Linked to Performance:** Equity based compensation plans should incorporate performance based equity grant vesting requirements tied to achieving performance metrics. The issuance of discounted equity grants or accelerated vesting are not desirable performance based methodologies. Stock awards should not be payable based solely on the attainment of tenure requirements.
  - f. Unvested Equity Acceleration upon a Change-in-Control:** In the event of a merger, acquisition, or change-in-control, unvested equity should not accelerate but should instead convert into the equity of the newly formed company.
  - g. Recapturing Dividend Equivalent Payouts:** Companies should develop and disclose a policy for recapturing dividend equivalent payouts on equity that does not vest. In addition, companies should ensure voting rights are not permitted on unvested equity.
  - h. Equity Grant Vesting Period:** Equity grants should vest over a period of at least three years.
  - i. Equity Grant Repricing:** Equity grant repricing without shareowner approval should be prohibited.
  - j. Grant Timing:** Except in extraordinary circumstances, such as a permanent change in performance cycles, long-term incentive awards should be granted at the same time each year. Companies should not coordinate stock award grants with the release of material non- public information. The grants should occur whether recently publicized information is positive or negative, and stock options should never be backdated.
  - k. Evergreen or Reload Provisions:** "Evergreen"<sup>14</sup> or "Reload"<sup>15</sup> provisions should be prohibited.
  - l. Distribution of Equity Compensation:** How equity-based compensation will be distributed within various levels of the company should be disclosed.
  - m. Equity Dilution and Run Rate Provisions:** Provisions for addressing the issue of equity dilution, the intended life of an equity plan, and the expected yearly run rate of the equity plan should be disclosed.
  - n. Equity Repurchase Plans:** If the company intends to repurchase equity in response to the issue of dilution, the equity plan should clearly articulate how the repurchase decision is made in relation to other capital allocation alternatives.

- o. Shareowner Approval:** All equity based compensation plans or material changes to existing equity based compensation plans should be shareowner approved.
- p. Cost of Equity Based Compensation:** Reasonable ranges which the board will target the total cost of new or material changes to existing equity based compensation plans should be disclosed. The cost of new or material changes to existing equity based compensation plans should not exceed that of the company's peers unless the company has demonstrated consistent long-term economic outperformance on a peer relative basis.
- q. Gross-ups:** Senior executives should not receive gross-ups beyond those provided to all the company's employees.
- r. Tabular Disclosure:** The annual proxy statement should include a table detailing the overhang represented by unexercised options and shares available for award and a discussion of the impact of the awards on earnings per share.

#### 5. Stock Options:

- a. Board Approval:** The board's methodology and corresponding details for approving stock options for both company directors and employees should be highly transparent and include disclosure of: 1) quantity, 2) grant date, 3) strike price, and 4) the underlying stock's market price as of grant date. The approval and granting of stock options for both directors and employees should preferably occur on a date when all corporate actions are taken by the board. The board should also require a report from the CEO stating specifically how the board's delegated authority to issue stock options to employees was used during the prior year.
- b. Performance Options:** Stock options should be: (1) indexed to peer groups or (2) premium-priced and/or (3) vest on achievement of specific performance targets that are based on challenging quantitative goals.
- c. Discount Options:** Discount options should not be awarded.
- d. Option Repricing:** "Underwater" options should not be repriced or replaced (either with new options or other equity awards), unless approved by shareowners. Repricing programs, with shareowner approval, should exclude directors and executives, restart vesting periods and mandate value-for-value exchanges in which options are exchanged for a number of equivalently valued options/shares.

- 6. Use of "Other" Forms of Compensation:** Compensation policies should include guidelines by which the company will use alternative forms<sup>19</sup> of compensation ("perquisites"), and the relative weight in relation to total compensation if perquisites will be utilized. To the degree that the company will provide perquisites, it should clearly articulate how shareowners should expect to realize value from these other forms of compensation.

#### 7. Retirement Plans:

- a. Defined Contribution/Benefit Plans:** should be clearly disclosed in tabular format showing all benefits available whether from qualified or non-qualified plans and net of any offsets.
- b. Supplemental Executive Retirement Plans (SERPs):** Supplemental plans



- should be an extension of the retirement program covering other employees. They should not include special provisions that are not offered under plans covering other employees, such as above-market interest rates and excess service credits. Payments such as stock and stock options, annual/long-term bonuses and other compensation not awarded to other employees and/or not considered in the determination of retirement benefits payable to other employees should not be considered in calculating benefits payable under SERPs.
- c. Deferred Compensation Plans:** Investment alternatives offered under deferred compensation plans for executives should mirror those offered to employees in broad-based deferral plans. Above-market returns should not be applied to executive deferrals, nor should executives receive “sweeteners” for deferring cash payments into company stock.
- 8. Severance Agreements**
- a. Severance Agreement Disclosure:** In cases where the company will consider severance agreements<sup>16</sup>, the policy should contain the overall parameters of how such agreements will be used including the specific detail regarding the positions within the company that may receive severance agreements; the maximum periods covered by the agreements; provisions by which the agreements will be reviewed and renewed; any hurdles or triggers that will affect the agreements; a clear description of what would and would not constitute termination for cause; and disclosure of where investors can view the entire text of severance agreements.
- b. Severance Agreement Amendments:** Material amendments to severance agreements should be disclosed to shareowners.
- c. Shareowner Approval of Severance Payments:** Severance payments that provide benefits<sup>17</sup> with a total present value exceeding market standards<sup>18</sup> should be ratified by shareowners.
- 9. Employment Contracts:** Companies should only provide employment contracts to executives in limited circumstances, such as to provide modest, short-term employment security to a newly hired or recently promoted executive. Such contracts should have a specified termination date (not to exceed three years); contracts should not be “rolling” on an open-ended basis.
- 10. Change-in-control Payments:** Any provisions providing for compensation following change-in-control event should be “double-triggered.” That is, such provisions should stipulate that compensation is payable only: (a) after a control change actually takes place and (b) if a covered executive's job is terminated because of the control change.
- 11. Director Compensation:** Pay for a non-executive director and/or a non-executive chair is structured in a way which ensures independence, objectivity, and alignment with shareholders’ interests. The annual director compensation disclosure included in the proxy materials should include a discussion of the philosophy for director pay and the processes for setting director pay levels.
- a. Combination of Cash and Equity:** Director compensation should be a combination of cash and stock in the company.
- b. Equity Ownership:** Director equity ownership should be required through the

- attainment and continuous ownership of an equity investment in the company. Director stock ownership guidelines and holding requirements should be disclosed to shareowners on an annual basis. Equity obtained with an individual's own capital provides the best alignment of interests with other shareowners.
- c. **Vesting of Equity-based Awards:** Equity-based compensation to non-employee directors should be fully vested on the grant date. The main benefits are the immediate alignment of interests with shareowners and the fostering of independence and objectivity for the director.
  - d. **Amount of Annual Retainer:** The annual retainer should be the sole form of cash compensation paid to non-employee directors. Ideally, it should reflect an amount appropriate for a director's expected duties, including attending meetings, preparing for meetings/discussions and performing due diligence on sites/operations (which should include routine communications with a broad group of employees). In some combination, the retainer and the equity component also reflect the director's contribution from experience and leadership. Retainer amounts may be differentiated to recognize that certain non-employee directors—possibly including independent board chairs, independent lead directors, committee chairs or members of certain committees—are expected to spend more time on board duties than other directors.
  - e. **Performance-based Compensation:** Performance-based compensation for directors creates potential conflicts with the director's primary role as an independent representative of shareowners and is therefore not recommended.
  - f. **Perquisites:** Directors should not receive perquisites other than those that are meeting-related, such as air-fare, hotel accommodations and modest travel/accident insurance. Health, life and other forms of insurance; matching grants to charities; financial planning; automobile allowances and other similar perquisites cross the line as benefits offered to employees. Charitable awards programs are an unnecessary benefit; directors interested in posthumous donations can do so on their own via estate planning. Infrequent token gifts of modest value are not considered perquisites.
  - g. **Employment Contracts, Severance and Change-of-control Payments:** Non-employee directors should not be eligible to receive any change-in-control payments or severance arrangements.
  - h. **Retirement Benefits:** Since non-employee directors are elected representatives of shareowners and not company employees, they should not be offered retirement benefits, such as defined benefit plans or deferred stock awards, nor should they be entitled to special post-retirement perquisites.
  - i. **Deferred Compensation Plans:** Directors may defer cash pay via a deferred compensation plan for directors. However, such investment alternatives offered under deferred compensation plans for directors should mirror those offered to employees in broad-based deferral plans. Non-employee directors should not receive "sweeteners" for deferring cash payments into company stock.
  - j. **Disgorgement:** Directors should be required to repay compensation to the company in the event of malfeasance or a breach of fiduciary duty involving the director.

## D. Corporate Reporting

1. **Integrated Financial Reporting:** Financial reporting plays an integral role in the

capital markets by providing transparent and relevant information about the economic performance and condition of businesses. Effective financial reporting depends on high quality accounting standards, as well as consistent application, rigorous independent audit and enforcement of those standards. Companies should provide for the integrated representation of operational, financial, environmental, social, and governance performance in terms of both financial and non-financial results in order to offer investors better information set for assessing risk. The board should provide an integrated report that puts historical performance into context, and portrays the risks, opportunities and prospects for the company in the future, helping shareholders understand a company's strategic objectives and its progress towards meeting them. Such disclosures should:

- a. be linked to the company's business model;
- b. be genuinely informative and include forward-looking elements where this will enhance understanding;
- c. describe the company's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities;
- d. be accessible and appropriately integrated with other information that enables shareholders to obtain a picture of the whole company;
- e. use key performance indicators that are linked to strategy and facilitate comparisons;
- f. use objective metrics where they apply and evidence-based estimates where they do not; and
- g. be strengthened where possible by independent assurance that is carried out annually having regard to established disclosure standards.

2. **Transparency:** Operating, financial, and governance information about companies must be readily transparent to permit accurate market comparisons; this includes disclosure and transparency of objective globally accepted minimum accounting standards, such as the International Financial Reporting Standards ("IFRS").
  - a. **Comprehensive Disclosure:** The board should present a balanced and understandable assessment of the company's position and prospects in the annual report and accounts in order for shareholders to be able to assess the company's performance, business model, strategy and long-term prospects.
  - b. **Materiality:** The board should disclose relevant and material information on a timely basis so as to allow shareholders to take into account information which assists in identifying risks and sources of wealth creation. Issues material to shareholders should be set out succinctly in the annual report, or equivalent disclosures, and approved by the board itself.
  - c. **Board Governance Principles:** The board adopts and discloses a written statement of its own governance principles, and re-evaluates them on at least an annual basis.
  - d. **Corporate Responsibility:** It is recommended that corporations adopt the Global Reporting Initiative Sustainability Reporting Guidelines<sup>22</sup> to disclose economic, environmental, and social impacts.
3. **Proxy Materials:** Proxy materials should be written in a manner designed to provide shareowners with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage

shareowner participation. All shareowner votes, whether cast in person or by proxy, should be formally counted with vote outcomes formally announced.

4. **Auditor's Enhanced Reporting to Investors:** Auditors should provide independent assurance and attestation to the quality of financial statements to instill confidence in the providers of capital. Auditors should bring integrity, independence, objectivity, and professional competence to the financial reporting process. The audit opinion should state whether the financial statements and disclosures are complete, materially accurate, and free of material misstatement, whether caused by error or fraud. Auditors should provide a reasonable and balanced assurance on financial reporting matters to investors in narrative reports such as an Auditor's Discussion and Analysis (AD&A) or a Letter to the Shareowners. Enhanced reporting should include:
  - a. Business, operational and risks believed to exist and considered;
  - b. Assumptions used in judgments that materially affect the financial statements, and whether those assumptions are at the low or high end of the range of possible outcomes;
  - c. Appropriateness of the accounting policies adopted by the company;
  - d. Changes to accounting policies that have a significant impact on the financial statements;
  - e. Methods and judgements made in valuing assets and liabilities;
  - f. Unusual transactions;
  - g. Accounting applications and practices that are uncommon to the industry;
  - h. Identification of any matters in the Annual Report that the auditors believe are incorrect or inconsistent, with the information contained in the financial statements or obtained in the course of their audit;
  - i. Audit issues and their resolution which the audit partner documents in a final audit memo to the Audit Committee;
  - j. Quality and effectiveness of the governance structure and risk management;
  - k. Completeness and reasonableness of the Audit Committee report.
  
5. **Stakeholder Relations:** CalPERS believes that corporations should strive for active cooperation with stakeholders<sup>20</sup> will be most likely to create wealth, employment and sustainable economies. With adequate, accurate and timely data disclosure of environmental, social, and governance practices, shareowners are able to more effectively make investment decisions by taking into account those practices of the companies in which the System invests.
  
6. **Physical Capital Management Practices:**
  - Board Oversight**
    - a. Board is actively engaged in climate change policy and has assigned oversight responsibility to board member, board committee or full board.
  
  - Management Execution**
    - b. Chairman/CEO assumes leadership role in articulating and executing climate change policy.
    - c. Top executives and/or executive committees assigned to manage climate change response strategies.

- d. Climate change initiatives are integrated into risk management and mainstream business activities.
- e. Executive officers' compensation is linked to attainment of environmental goals and ~~GHG~~greenhouse gas emission targets.

#### Public Disclosure

- f. Securities filings disclose material risks and opportunities posed by climate change.
- g. Public communications offer comprehensive, transparent presentation of response measures.

#### Emissions Accounting

- h. Company calculates and registers ~~GHG~~greenhouse gas emissions savings and offsets from operations.
- i. Company conducts annual inventory of ~~GHG~~greenhouse gas emissions and publicly reports results.
- j. Company has an emissions baseline by which to gauge future ~~GHG~~greenhouse gas emissions trends.
- k. Company has third-party verification process for ~~GHG~~greenhouse gas emissions data.

#### Strategic Planning

- l. Company sets absolute ~~GHG~~greenhouse gas emission reduction targets for facilities, energy use, business travel and other operations (including direct emissions.)
- m. Company participates in ~~GHG~~greenhouse gas emissions trading programs – up to 30.
- n. Company pursues business strategies to reduce ~~GHG~~greenhouse gas emissions, minimize exposure to regulatory and physical risks, and maximize opportunities from changing market forces and emerging controls.

**7. Codes of Conduct/Ethics:** The board should adopt high standards of business ethics through codes of conduct/ethics (or similar instrument) and oversee a culture of integrity, notwithstanding differing ethical norms and legal standards in various countries. This should permeate all aspects of the company's operations, ensuring that its vision, mission and objectives are ethically sound and demonstrative of its values. Codes should be effectively communicated and integrated into the company's strategy and operations, including risk management systems and remuneration structures.

- a. **Behavior and Conduct:** The board should foster a corporate culture which ensures that employees understand their responsibility for appropriate behavior. There should be appropriate board level and staff training in all aspects relating to corporate culture and ethics. Due diligence and monitoring programs should be in place to enable staff to understand relevant codes of conduct and apply them effectively to avoid company involvement in inappropriate behavior.
- b. **Bribery and Corruption:** The board should ensure that management has implemented appropriately stringent policies and procedures to mitigate the risk of bribery and corruption or other malfeasance. Such policies and procedures should be communicated to shareholders and other interested parties.

- c. **Whistleblowing:** The board should ensure that the company has in place an independent, confidential mechanism whereby an employee, supplier or other stakeholder can (without fear of retribution) raise issues of particular concern with regard to potential or suspected breaches of a company's code of ethics or local law.
  - d. **Prohibit Greenmail:** Every company should prohibit greenmail.
- 8. Company General Meetings:** the general meeting agenda is posted on the company's website at least one month prior to the meeting taking place. The agenda should be clear and properly itemized and include the date and location of the meeting as well as information regarding the issues to be decided at the meeting.
- a. **Vote Deadline:** The board should clearly publicize a date by which shareholders should cast their voting instructions.
  - b. **Share Blocking:** The practice of share blocking or requirements for lengthy share holdings should be discontinued.
  - c. **Selection and Notification of Meeting Time and Location:** Corporations should make shareowners' expense and convenience primary criteria when selecting the time and location of shareowner meetings. Appropriate notice of shareowner meetings, including notice concerning any change in meeting date, time, place or shareowner action, should be given to shareowners in a manner and within time frames that will ensure that shareowners have a reasonable opportunity to exercise their franchise.
  - d. **Record Date and Ballot Item Disclosure:** To promote the ability of shareowners to make informed decisions regarding whether to recall loaned shares: (1) shareowner meeting record dates should be disclosed as far in advance of the record date as possible, and (2) proxy statements should be disclosed before the record date passes whenever possible.
  - e. **Timely Disclosure of Voting Results:** A company should broadly and publicly disclose in a timely manner the final results of votes cast at annual and special meetings of shareowners. Whenever possible, preliminary results should be announced at the annual or special meeting of shareowners. If a board-endorsed resolution has been opposed by a significant proportion of votes, the company should explain subsequently what actions were taken to understand and respond to the concerns that led shareholders to vote against the board's recommendation.
  - f. **Election Polls:** Polls should remain open at shareowner meetings until all agenda items have been discussed and shareowners have had an opportunity to ask and receive answers to questions concerning them.
  - g. **Meeting Adjournment and Extension:** Companies should not adjourn a meeting for the purpose of soliciting more votes to enable management to prevail on a voting item. A meeting should only be extended for compelling reasons such as vote fraud, problems with the voting process or lack of a quorum.
  - h. **Electronic Meetings:** Companies should hold shareowner meetings by remote communication (so-called "virtual" meetings) only as a supplement to traditional in-person shareowner meetings, not as a substitute. Companies incorporating virtual technology into their shareowner meeting should use it as a tool for broadening, not limiting, shareowner meeting participation. With this objective in

- mind, a virtual option, if used, should facilitate the opportunity for remote attendees to participate in the meeting to the same degree as in-person attendees.
- i. **Director Attendance:** All directors should attend the annual shareowners' meeting and be available, when requested by the chair, to respond directly to oral or written questions from shareowners.
  - j. **Broker Non-Votes:** Broker non-votes should be counted for quorum purposes only.

## E. Regulatory Effectiveness

1. **Code of Best Practices:** Each capital market in which shares are issued and traded should adopt its own Code of Best Practices to promote transparency of information, prevention of harmful labor practices, investor protection, and corporate social responsibility. Where such a code is adopted, companies should disclose to their shareowners whether they are in compliance.
2. **Financial Markets:** Policy makers and standards setters which impact investment portfolio risk and return should promote fair, orderly, and effectively regulated financial markets through the following:
  - a. **Transparency:** To promote full disclosure so that the financial markets provide incentives that price risk and opportunity.
  - b. **Governance:** To foster alignment of interest, protect investor rights and independence of regulators.
  - c. **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.
3. **Global Accounting Standards:** Convergence to one set of high quality global accounting standards to ensure integrity of financial reporting without compromising quality is critical.
4. **Political Stability:** Progress toward the development of basic democratic institutions and principles, including such things as: a strong and impartial legal system; and, respect and enforcement of property and shareowner rights. Political stability encompasses:
  - a. **Political risk:** internal and external conflict; corruption; the military and religion in politics; law and order; ethnic tensions; democratic accountability; bureaucratic quality.
  - b. **Civil liberties:** freedom of expression, association and organization rights; rule of law and human rights; free trade unions and effective collective bargaining; personal autonomy and economic rights.
  - c. **Independent judiciary and legal protection:** an absence of irregular payments made to the judiciary; the extent to which there is a trusted legal framework that honors contracts, clearly delineates ownership and protects financial assets.
5. **Transparency:** Financial transparency, including elements of a free press, is necessary for investors to have truthful, accurate and relevant information. Transparency encompasses:

- a. **Freedom of the press:** structure of the news delivery system in a country; laws and their promulgation with respect to the influence of the news; the degree of political influence and control; economic influences on the news; the degree to which there are violations against the media with respect to physical violations and censorship.
  - b. **Monetary and fiscal transparency:** the extent to which governmental monetary and fiscal policies and implementation are publicly available in a clear and timely manner, in accordance with international standards.
  - c. **Stock exchange listing requirements:** stringency of stock exchange listing requirements with respect to frequency of financial reporting, the requirement of annual independent audits, and minimal financial viability.
  - d. **Accounting standards:** the extent to which U.S. Generally Accepted Accounting Principles, or International Accounting Standards is used in financial reporting; whether the country is a member of the International Accounting Standards Council.
6. **Productive Labor Practices:** No harmful labor practices or use of child labor. In compliance, or moving toward compliance, with the International Labor Organization (ILO) Declaration on the Fundamental Principles and Rights at Work. Productive Labor Practices encompasses:
- a. **ILO ratification:** whether the convention is ratified, not ratified, pending ratification or denounced.
  - b. **Quality of enabling legislation:** the extent to which the rights described in the ILO convention are protected by law.
  - c. **Institutional capacity:** the extent to which governmental administrative bodies with labor law enforcement responsibility exist at the national, regional and local level.
  - d. **Effectiveness of implementation:** evidence that enforcement procedures exist and are working effectively; evidence of a clear grievance process that is utilized and provides penalties that have deterrence value.
7. **Market Regulation and Liquidity:** Little to no repatriation risk. Potential market and currency volatility are adequately rewarded. Market regulation and liquidity encompasses:
- a. Market capitalization
  - b. Change in market capitalization
  - c. Average monthly trading volume
  - d. Growth in listed securities
  - e. Market volatility as measured by standard deviation
  - f. Return/risk ratio
8. **Capital Market Openness:** Free market policies, openness to foreign investors, and legal protection for foreign investors. Capital market openness encompasses:
- a. **Foreign investment:** degree to which there are restrictions on foreign ownership of local assets, repatriation restrictions or un-equal treatment of foreigners and locals under the law.
  - b. **Trade policy:** degree to which there are deterrents to free trade such as trade barriers and punitive tariffs.
  - c. **Banking and finance:** degree of government ownership of banks and allocation



of credit; freedom financial institutions have to offer all types of financial services; protectionist banking regulations against foreigners.

- 9. Settlement Proficiency/Transaction Costs:** Reasonable trading and settlement proficiency and reasonable transaction costs. Settlement proficiency/transaction costs encompass:
- a. Trading and settlement proficiency:** degree to which a country's trading and settlement is automated; success of the market in settling transactions in a timely, efficient manner.
  - b. Transaction costs:** the costs associated with trading in a particular market, including stamp taxes and duties; amount of dividends and income taxes; capital gains taxes.

## APPENDIX A

### Principles for Responsible Investment

Launched in April 2006, The Principles for Responsible Investment (PRI) provides the framework for investors to give appropriate consideration to environment, social and corporate governance (ESG) issues. The PRI was an initiative of the UN Secretary-General and coordinated by UNEP Finance Initiative and the UN Global Compact. An international working group of 20 institutional investors was supported by a 70-person multi-stakeholder group of experts from the investment industry, intergovernmental and governmental organizations, civil society and academia. CalPERS is one of the original signatories.

#### The Principles

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

Additional information can be found at [www.unpri.org](http://www.unpri.org).

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**APPENDIX B**

**LIST OF ENDORSEMENTS, MEMBERSHIPS, ETC.**

1. The Global Sullivan Principles
2. UN Global Compact Ten Principles
3. Council of Institutional Investors Corporate Governance Policies
4. International Corporate Governance Network Global Principles

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