Review Draft of Global Governance Principles alignment with Program Core Issues – Third Reading

November 18, 2015
Today’s Objectives

Today

• Recap new structure and framework
• Review new draft for tone and consistency
• Provide first draft of updated Introduction and Purpose
• Discussion of new principles:
  – Director Tenure
  – Properly Funded Regulators
• Respond to questions from October 21, 2015 meeting

Next Meeting – December 16, 2015

• Incorporate any new feedback received from today’s meeting
• Continue development of new principles for future discussion
• Provide “final” draft of the Global Principles
Global Governance Principle Revisions

Background

- In March 2015, the Global Governance Principles (Principles) were adopted as a Total Fund Policy.
- They provide the framework for CalPERS’ work through 1) integration into investment decision making 2) engagement and 3) advocacy in support of sustainable investment to reflect our Investment Beliefs.
- The Principles are intended to serve as a comprehensive best practice document and speak to our core issues of: Investor Rights, Board Quality & diversity, Compensation, Corporate Reporting and Regulatory Effectiveness.
- The Principles guide CalPERS’ engagement, advocacy, and proxy voting decisions, which span more than 10,000 companies in 47 markets.
- Each year, the Principles are revised and submitted for approval by the Investment Committee.
- On April 13, 2013, the Investment Committee agreed to form an Ad Hoc Global Governance Sub-Committee to oversee review of the Statement of Investment Policy for Global Governance, which includes the Principles, and related issues.
### From To Statement – Recap

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
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| **Lengthy and complex:** duplicative language and organized by capital market – 96 pages assembled over time | **Clarity** of Global Principles framed by the Investment Beliefs and organized by CalPERS’ 5 core issues  
- Investor Rights  
- Board Quality and Diversity  
- Corporate Reporting  
- Compensation  
- Regulatory Effectiveness |
| **Variety of origin:** mosaic of principles described through adoption of CalPERS specific and third party references and others in Appendices | **Simplified:** revised format which maintains content while communicating integration with CalPERS Investment Beliefs and application to managers of CalPERS capital across the Total Fund |
New Global Governance Principles Structure

I. Introduction
- Sets out CalPERS’ mission, Investment Beliefs and values
- Captures the history and evolution of the Global Governance Principles highlighting the transition to a wider scope that includes sustainable investment (environmental, social and governance) issues
- Value for investors and the intended audience
- Explains our approach
- Looks forward

II. Purpose
- Provides an overview of how the Principles are applied to integration, engagement and advocacy across the total fund
- Introduces the CalPERS’ Core Issues framework

III. Global Governance Principles
A. Investor Rights
B. Board Quality: Diversity, Independence, and Competence
C. Compensation
D. Corporate Reporting
E. Regulatory Effectiveness

IV. Appendices
- Principles for Responsible Investment (PRI)
- Includes a list of CalPERS’ memberships and supported groups (CII, ICGN, Ceres, etc.)
New Principle on Board Tenure – Background

• Board Tenure is an International Issue
  – The UK Corporate Governance Code (London Rule) suggests tenure beyond nine years compromises independence.
  – The European Commission recommends limiting director tenure to 12 years
  – Hong-Kong nine year maximum tenure unless shareowners separately vote for re-appointment
  – France recommends limits to director tenure at 12 years

• U.S. Corporate boards lack formal tenure policies
  – Only 3% (17 boards) in the S&P 500 have term limits in their guidelines

• Trend of raising mandatory retirement ages thereby extending board service
  – In the S&P 500, over the last 10 years, the percentage of boards with a mandatory retirement age of 70 has decreased from 51% to 11%, while the percentage of boards with retirement ages of 75 has increased from 3% to 24%.
  – Average director age is 68

• Director tenure overview
  – 10,700 directors within the Russell 3000 have a tenure of 9 years or more
  – 1,931 directors within the S&P 500 have a tenure of 9 years or more
Board Tenure | S&P 500 Directors

- 9 Years
  - London Rule
- 12 Years
  - European Commission

Source: 2014 GMI Analyst Data
Global Governance Principle Revisions

Board Tenure | S&P 500 Directors

- > 20 years: 374 directors (7%)
- > 12 years: 1225 directors (22%)
- > 9 years: 1931 directors (35%)

Total: 5506 directors

Source: 2014 GMI Analyst Data
Board Tenure – Views

Benefits – Support CalPERS view on board refreshment: board quality requires independence, competence, and diversity

- Shorter tenured directors may strengthen independence
- Term limits would increase the opportunity to refresh the board and thereby promote diversity
- Longer-tenured directors may not keep current with developments, thereby weakening competency
- Overseas markets have term limits (e.g. London, European Union, Hong Kong and France)
- Less tenured directors bring fresh perspectives and focus on the company and shareowners, rather than management views

Risks – Different views highlighting the challenges of tenure limits

- Term limits may be arbitrary and could keep valuable directors from service
- New directors require substantial time to gain company specific knowledge
- Optimal director tenure can vary by industry
- Longer tenured directors can enhance a board’s oversight capabilities due to in depth experience
- Restrictions on board service would shrink the pool of director talent
- Tenure policy could be an excuse for boards to avoid meaningful director evaluations
## New Revisions

<table>
<thead>
<tr>
<th>Section</th>
<th>Principle</th>
<th>Proposed Language</th>
<th>Section/Page Number</th>
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</thead>
<tbody>
<tr>
<td>Introduction and Purpose</td>
<td>See Attachment #2 with tracked changes.</td>
<td>Page 3-9</td>
<td></td>
</tr>
<tr>
<td>Board Quality: Director</td>
<td>Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent—these considerations should include the director’s years of service on the board as extended tenure may adversely impact a director’s ability to bring an objective perspective to the boardroom. We believe director independence can be compromised at 10 years of service—in these situations a company should carry out rigorous evaluations to either classify the director as non-independent or provide detailed annual explanation why the director can continue to be classified as independent. Additionally there should be routine discussions as part of a rigorous evaluation and succession planning process surrounding director refreshment to ensure boards maintain the necessary mix of skills, diversity, and experience to meet strategic objectives.</td>
<td>Section B-9d Page 20</td>
<td></td>
</tr>
<tr>
<td>Properly Funded Regulators</td>
<td>In order to fulfill their vital function regulators need to have funding which is independent, sufficient, and multi-year.</td>
<td>Section E (Intro) Page 37</td>
<td></td>
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<tr>
<td>General edits</td>
<td>The document has been edited to provide for a more consistent tone. See tracked changes throughout the document.</td>
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## Response to Questions at October 20, 2015 meeting:

<table>
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<tr>
<th>Board Member Questions:</th>
<th>Staff Response/Edit:</th>
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<tbody>
<tr>
<td>• Companies should at least adhere to minimum standard related to proxy access.</td>
<td>• The current approach is to support the SEC framework.</td>
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<td>• Request to address what is meant by “excessive debt leverage”.</td>
<td>• For future review and development.</td>
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<td>• Question on proxy confidentiality and allowing management to know how individual institutions voted.</td>
<td>• CalPERS discloses all proxy votes and views this as a best practice.</td>
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<td>• Question requesting to re-word the Global Sullivan principle on “Employee Compensation” in a consistent way.</td>
<td>• To be addressed in 4th reading.</td>
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<td>• Question to continue work on addressing clean air and water issues.</td>
<td>• For future review and development.</td>
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<td>• Question on Corporate Reporting specific to availability of corporate books and records for inspection.</td>
<td>• Follow-up discussion with Legal Office.</td>
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<td>• Interlocking directors and director overboarding.</td>
<td>• Director Overboarding – staff withholds vote from current CEO’s who sit on more than 2 public company boards (will not withhold vote at directorship where CEO position held). Staff will also withhold vote from directors who sit on more than 5 public company boards. • Interlocking Directors – For future review and development.</td>
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## Areas for future Review and Development

<table>
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<tr>
<th>Subject</th>
<th>Issue</th>
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<tbody>
<tr>
<td>Investor Rights</td>
<td>• Related Party Transactions</td>
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<td>• Judicial Forum – Loser Pays (fee shifting)</td>
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<td>• Further consider joint ventures</td>
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<td>Compensation</td>
<td>• Income Inequality – develop following CalPERS symposium</td>
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<td>• Share buybacks and executive compensation</td>
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<td></td>
<td>• Review of performance metrics linked to equity awards</td>
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<tr>
<td>Capital Allocation</td>
<td>• Share buybacks and dividends</td>
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<tr>
<td>Environment and Climate Change</td>
<td>• Water related issues</td>
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<td></td>
<td>• Clean Air</td>
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<td></td>
<td>• Review best practices following COP 21</td>
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<tr>
<td>Total Fund Emphasis</td>
<td>• Principles in the current form have a bias to equity (make reference to “investors” where appropriate)</td>
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<td>• Explore how to incorporate other asset classes</td>
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<td>Human Capital Management</td>
<td>• Review and develop supply chain principle</td>
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Global Governance Principle Revisions

Revision Timeline

- **September 17, 2015**
  Global Governance Sub-Committee

- **October 21, 2015**
  Global Governance Sub-Committee

- **November 18, 2015**
  Global Governance Sub-Committee

- **December 16, 2015**
  Global Governance Sub-Committee

**Final Review**
Global Governance Principles for acceptance by the Sub-Committee prior to presenting to the Investment Policy Sub-committee in February 2016

- **February 2016**
  Investment Committee

- **March 2016**
  Investment Committee

**2nd Review** with feedback incorporated
- Re-drafted Global Governance Principles document to address consistency across style and tone

**3rd Review**
- Re-drafted Global Governance Principles document to address consistency across style and tone

**1st Review** of the Global Governance Principles to sign-off:
- New structure
- Duplications – Material removed
- Permission to re-draft

**1st read by the IC – Policy Sub-Committee**
- Presenting proposed model for a simplified Principles document
- Separating GGP into two documents:
  1) Overarching Approach to each Core Issue
  2) Practice Document

**Seeking final approval by the IC before the Principles can be implemented**