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

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

From	To
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

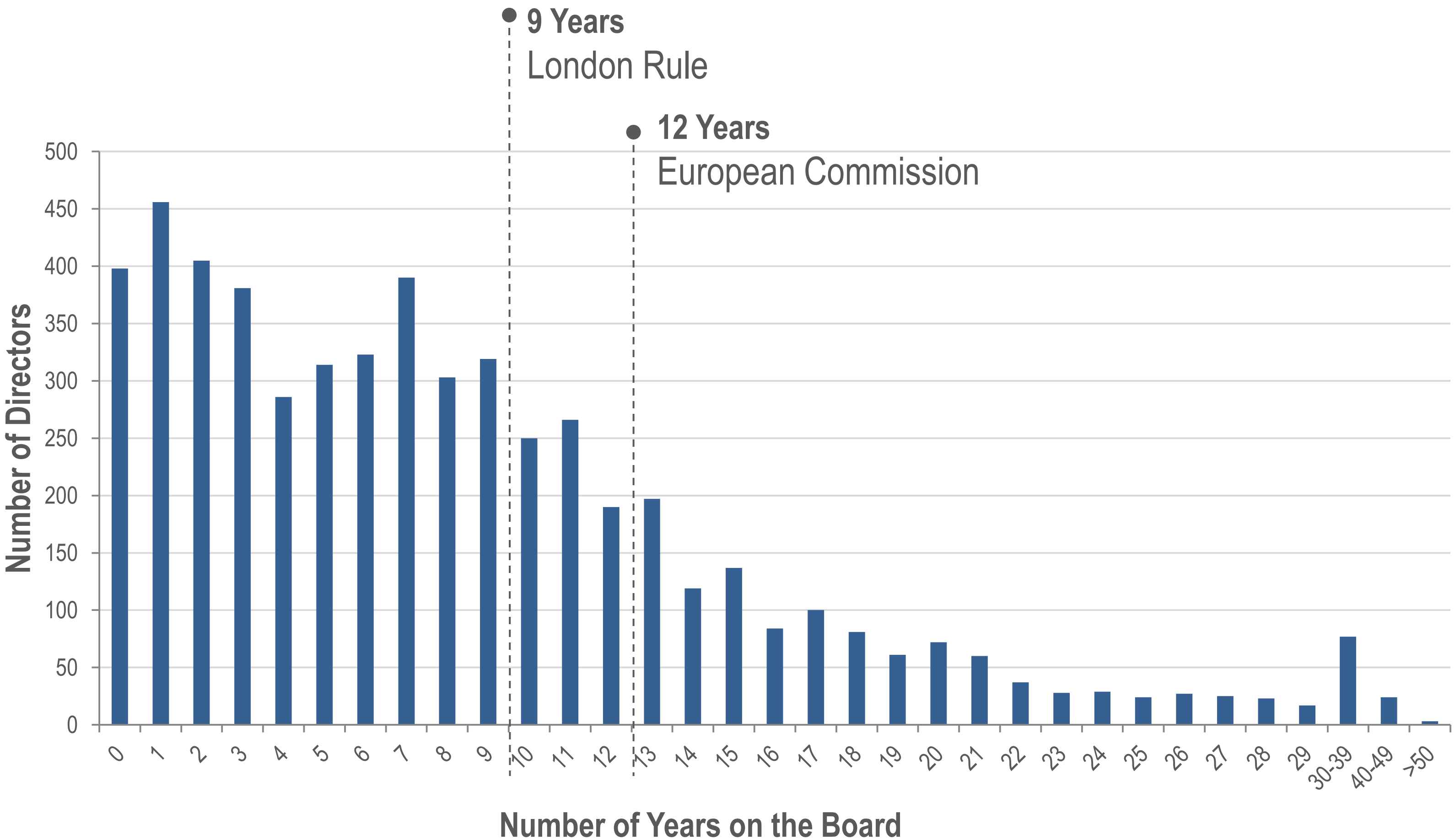
IV. Appendices

- Principles for Responsible Investment (PRI)
- Includes a list of CalPERS' memberships and supported groups (CII, ICGN, Ceres, etc.)

New Principle on Board Tenure – Background

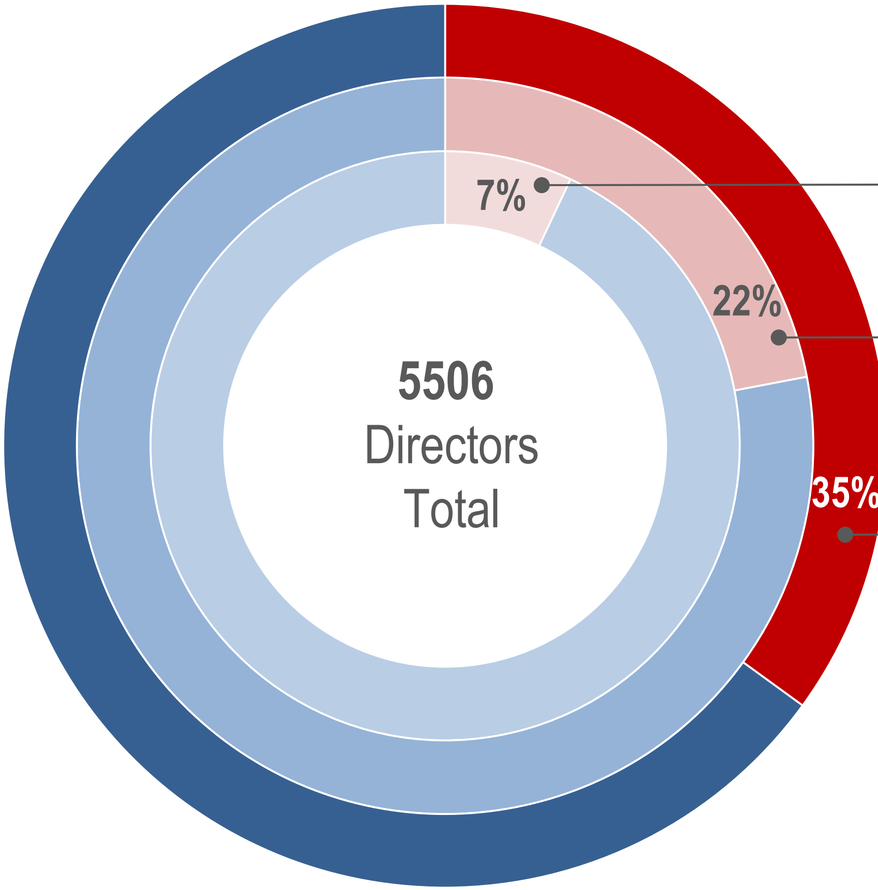
- Board Tenure is an International Issue
  - The UK Corporate Governance Code (London Rule) suggests tenure beyond nine years compromises independence.
  - The European Commission recommends limiting director tenure to 12 years
  - Hong-Kong nine year maximum tenure unless shareowners separately vote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



Source: 2014 GMI Analyst Data

Board Tenure | S&P 500 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

Section	Principle	Proposed Language	Section/Page Number
Introduction and Purpose		See Attachment #2 with tracked changes.	Page 3-9
Board Quality: Diversity, Independence, and Competence	Director Tenure (New language underlined)	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. <u>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.</u> Additionally there should be routine discussions <u>as part of a rigorous evaluation and succession planning process</u> surrounding director refreshment to ensure boards maintain the necessary mix of skills, <u>diversity</u>, and experience to meet strategic objectives.	Section B-9d Page 20
Regulatory Effectiveness	Properly Funded Regulators	In order to fulfill their vital function regulators need to have funding which is independent, sufficient, and multi-year.	Section E (Intro) Page 37
General edits		The document has been edited to provide for a more consistent tone. See tracked changes throughout the document.	

Response to Questions at October 20, 2015 meeting:

Board Member Questions:	Staff Response/Edit:
• Companies should at least adhere to minimum standard related to proxy access.	• The current approach is to support the SEC framework.
• Request to address what is meant by “excessive debt leverage”.	• For future review and development.
• Question on proxy confidentiality and allowing management to know how individual institutions voted.	• CalPERS discloses all proxy votes and views this as a best practice.
• Question requesting to re-word the Global Sullivan principle on “Employee Compensation” in a consistent way.	• To be addressed in 4th reading.
• Question to continue work on addressing clean air and water issues.	• For future review and development.
• Question on Corporate Reporting specific to availability of corporate books and records for inspection.	• Follow-up discussion with Legal Office.
• Interlocking directors and director overboarding.	• 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.

Areas for future Review and Development

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

Revision Timeline

September 17, 2015
Global Governance Sub-Committee

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

October 21, 2015
Global Governance Sub-Committee

- **2nd Review** with feedback incorporated
- Re-draft Introduction & Purpose
- Highlight gaps in coverage of principles

November 18, 2015
Global Governance Sub-Committee

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

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

- 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

March 2016
Investment Committee

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