

Review Draft of Global Governance Principles Revisions – 1st Reading

February 16, 2016

Today's Objectives

Today

- Overview of new structure and framework
- Recap individual Principle revisions
- Areas for future review and development
- Feedback on the Principle revisions

Next Steps

- Present the Global Governance Principles to the Investment Committee at the March 14, 2016 meeting for final approval.

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, 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 11,000 companies in 47 markets
- Each year, the Principles are reviewed and submitted for approval by the Investment Committee
- On April 13, 2015, the Investment Committee agreed to form an Ad Hoc Global Governance Subcommittee to oversee review of the Statement of Investment Policy for Global Governance, which includes the Principles, and related issues.
- On December 14, 2015, the Ad Hoc Subcommittee voted to approve the Global Governance Principle revisions.

From To Statement: The Review of the Global Governance Principles

From	To
Lengthy and complex: duplicative language and organized by capital market – 100 pages assembled over time	Clarity: Global Principles framed by the Investment Beliefs and organized by CalPERS' 5 core issues <ul style="list-style-type: none">• Investor Rights• Board Quality and Diversity• Corporate Reporting• Compensation• Regulatory Effectiveness
Variety of origin: mosaic of principles described through adoption of CalPERS specific, multiple third party references and others in Appendices	Simplified: revised format which maintains content while reflecting 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
- Briefly captures the evolution of the Global Governance Principles highlighting the transition to a wider scope that includes sustainable investment (ESG, financial markets and regulation) 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

- Investor Rights
- Board Quality: Diversity, Independence, and Competence
- Compensation
- Corporate Reporting
- Regulatory Effectiveness

IV. Appendices

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

Principle Revision Recap

Section	Principle	Proposed Language	Section/Page Number
Introduction and Purpose		Staff refreshed the Introduction and Purpose to include statement on regulatory environment, financial markets, ESG components, and remove historical focus.	Page 3-6
Board Quality: Diversity, Independence, and Competence (Tenure change from 10 years to 12 years)	Director Tenure (New language underlined)	<u>We believe director independence can be compromised at 12 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 16
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 34
Executive Compensation		At the request of the Sub-Committee staff replaced “Executive Compensation” with “Compensation”. The entire document has been edited to reflect this change.	Edits made throughout the principles document

Areas for Development: To Be Addressed During ESG Strategic Review

Subject	Issue
Investor Rights	<ul style="list-style-type: none"> • Related Party Transactions • Judicial Forum – Loser Pays (fee shifting) • Further consider joint ventures • Proxy Access – “minimum” standards (beyond SEC) for nominee disclosure • Board Turnover/Refreshment – Explore options and concepts for independent director refreshment • Interlocking Directorships
Compensation	<ul style="list-style-type: none"> • Employee Compensation (Sullivan Principle) – Income Inequality for future development following CalPERS’ symposium. Consideration of retirement security and fair wages. • Share buybacks and executive compensation • Review of performance metrics linked to equity awards • Review stock option weaknesses and short-term focus
Capital Allocation	<ul style="list-style-type: none"> • Share buybacks and dividends • Request to address what is meant by “excessive debt leverage”.
Environment and Climate Change	<ul style="list-style-type: none"> • Water related issues • Clean Air • Review best practices following Paris Climate Agreement - COP 21
Total Fund Emphasis	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • Review and develop supply chain principle
Vote Disclosure Language	<ul style="list-style-type: none"> • Develop post-AGM proxy vote disclosure language

Revision Timeline

