

# Review Draft of Global Governance Principles Revisions – 2<sup>st</sup> Reading

March 14, 2016

# Today's Objectives

## Today

- Highlight the new Principle language on climate risk management expertise on corporate Boards
- Recap and provide an overview of the new structure and framework
- Take feedback on the Global Governance Principles revisions
- Receive Investment Committee approval of the revised Global Governance Principles revisions

## Next Steps

- Implementation of the Global Governance Principles within CalPERS' strategy for engagement, including proxy voting, advocacy, and integration activities

## 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) engagement, including proxy voting 2) advocacy, to reflect our Investment Beliefs, and 3) integration into investment decision making.
- The Principles are intended to serve as a comprehensive best practice document which reflects CalPERS Investment Beliefs and speak to our core issues of: Investor Rights, Board Quality, 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.
- December 14, 2015, the Ad Hoc Subcommittee voted to approve the revised Global Governance Principle revisions.
- On February 16, 2016 presented the Global Governance Principles to the Investment Committee as a first reading, and received further direction on "climate competent boards".

# From – To Statement: The Review of the Global Governance Principles

| From  | To   |
|---|--|
| <p><b>Lengthy and complex:</b> duplicative language and organized by capital market – 100 pages assembled over time</p>                                       | <p><b>Clarity:</b> Global Principles framed by the Investment Beliefs and organized by CalPERS’ core issues</p> <ul style="list-style-type: none"> <li>• Investor Rights</li> <li>• Board Quality: diversity, independence, and competence</li> <li>• Corporate Reporting</li> <li>• Compensation</li> <li>• Regulatory Effectiveness</li> </ul> |
| <p><b>Variety of origin:</b> mosaic of principles described through and CalPERS specific, adoption of multiple third party references and many Appendices</p> | <p><b>Simplified:</b> revised format maintains content while reflecting CalPERS’ Investment Beliefs and application to managers of CalPERS’ capital across the total fund</p>  |

# New Global Governance Principles Structure

## I. Introduction

- Sets out CalPERS' mission, Investment Beliefs
- 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)
- Explains our approach and the intended audience
- Looks forward

## II. Purpose

- Provides an overview of how the Principles are applied to, engagement, advocacy and integration 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 (Council of Institutional Investors, International Corporate Governance Network, Ceres, the Investor Network on Climate Risk, Global Sullivan Principles, and UN Global Compact)

## Principle Revision Recap

| Section   | Principle                                     | Proposed Language   | Section/Page Number (Attachment #2) |
|---|---|---|-------------------------------------|
| Introduction and Purpose                                  |   | Staff refreshed the Introduction and Purpose to include statement on regulatory environment, financial markets, ESG factors, and remove historical focus.   | Page 3-6                            |
| Board Quality and Diversity: Independence, and Competence | Director Attributes (new language underlined) | Staff added language to the Director Attributes section of the Global Principles to address climate risk expertise on corporate boards.<br><br>"Director Attributes: 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, leadership, strategic planning, and <u>competence managing multifaceted risk – including expertise and experience in climate change risk management strategies.</u> "                              | Section B-9b<br>Page 16             |
| Board Quality and Diversity: Independence, and Competence | 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<br>Page 16             |
| Regulatory Effectiveness                                  | Regulator Funding                             | In order to fulfill their vital function regulators need to have funding which is independent, sufficient, and multi-year.  | Section E (Intro)<br>Page 34        |
| Executive Compensation                                    |   | At the request of the Sub-Committee staff replaced "Executive Compensation" with "Compensation".  | Edits made throughout document      |

## Areas for Future Review and Development: To Be Addressed During ESG Strategic Review

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

# Revision Timeline

