

May 16, 2016

Item Name: Global Governance Strategic Review: Alignment of Interests

Program: Global Governance

Item Type: Information

Executive Summary

This agenda item proposes CalPERS' focus on alignment of interest as its governance theme within its sustainable investment strategy. The new Environmental, Social, and Governance (ESG) strategy is being developed through an interactive process with the Investment Committee, intended to seek feedback on priorities for engagement, advocacy and integration, which are potentially material to risk and return whilst being aligned with CalPERS' fiduciary duty.

Strategic Plan

This agenda item supports the CalPERS Strategic Plan goals of improving long-term pension benefits sustainability and actively managing business risks with an enterprise-wide view.

Investment Beliefs

This agenda item supports the CalPERS Investment Beliefs:

1. Investment Belief 2: A long time investment horizon is a responsibility and an advantage. Long time horizon requires that CalPERS:
 - Consider the impact of its actions on future generations of members and taxpayers
 - Encourage investee companies and external managers to consider the long-term impact of their actions
 - Favor investment strategies that create long-term, sustainable value and recognize the critical importance of a strong and durable economy in the attainment of funding objectives
 - Advocate for public policies that promote fair, orderly and effectively regulated capital markets

2. Investment Belief 3: CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries. In considering whether to engage on issues raised by stakeholders, CalPERS will use the following prioritization framework:
 - Principles and Policy- to what extent is the issue supported by CalPERS Investment Beliefs, Principles of Accountable Corporate Governance or other Investment Policy?
 - Materiality- does the issue have the potential for an impact on portfolio risk or return?
 - Definition and Likelihood of Success- is success likely, in that CalPERS action will influence an outcome which can be measured? Can we partner with others to achieve success or would someone else be more suited to carry the issue?

- Capacity- does CalPERS have the expertise, resources and standing to influence an outcome?
3. Investment Belief 4: Long-term value creation requires effective management of three forms of capital: financial, physical and human. Strong Governance, along with the effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long-term and manage risk effectively. CalPERS may engage investee companies and external managers on their governance and sustainability issues, including:
 - Governance practices, including but not limited to alignment of interests;
 - Risk management practices;
 - Human capital practices, including but not limited to fair labor practices, health and safety, responsible contracting and diversity; and
 - Environmental practices, including but not limited to climate change and natural resource availability.
 4. Investment Belief 7: CalPERS will take risk only where we have a strong belief we will be rewarded for it. An expectation of a return premium is required to take risks; CalPERS aims to maximize return for the risk taken. Markets are not perfectly efficient, but inefficiencies are difficult to exploit after costs.
 5. Investment Belief 8: Costs matter and need to be effectively managed. CalPERS will balance risk, return and cost when choosing and evaluating investment managers and investment strategies.
 6. Investment Belief 9: Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error. CalPERS shall develop a broad set of investment and actuarial risk measures and clear processes for managing risk. As a long-term investor, CalPERS must consider risk factors, for example climate change and natural resource availability that emerge slowly over long time periods, but could have a material impact on company or portfolio returns.
 7. Investment Belief 10: Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives. Diversity of talent (including a broad range of education, experience, perspectives and skills at all levels (Board, staff, external managers, corporate boards) is important.

Background

In January 2016, the Investment Committee embarked on a six-month process to develop CalPERS' new 3-5 year Environmental, Social and Governance (ESG) strategy within investment objectives of risk and return.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

- Benefits – Continuing our focus on understanding and improving alignment of interest factors is consistent with our Investment Beliefs.
- Risks – Poor disclosure creates uncertainty around implementation of Investment Beliefs.



Attachments

Attachment 1 – Presentation - Review of ESG Strategy Governance Theme:
Alignment of Interest

Anne Simpson
Investment Director
Global Governance

Dan Bienvenue
Managing Investment Director
Global Equity

Theodore Eliopoulos
Chief Investment Officer