

Review of ESG Strategy Defining Key Performance Indicators

Investment Committee, June 2016

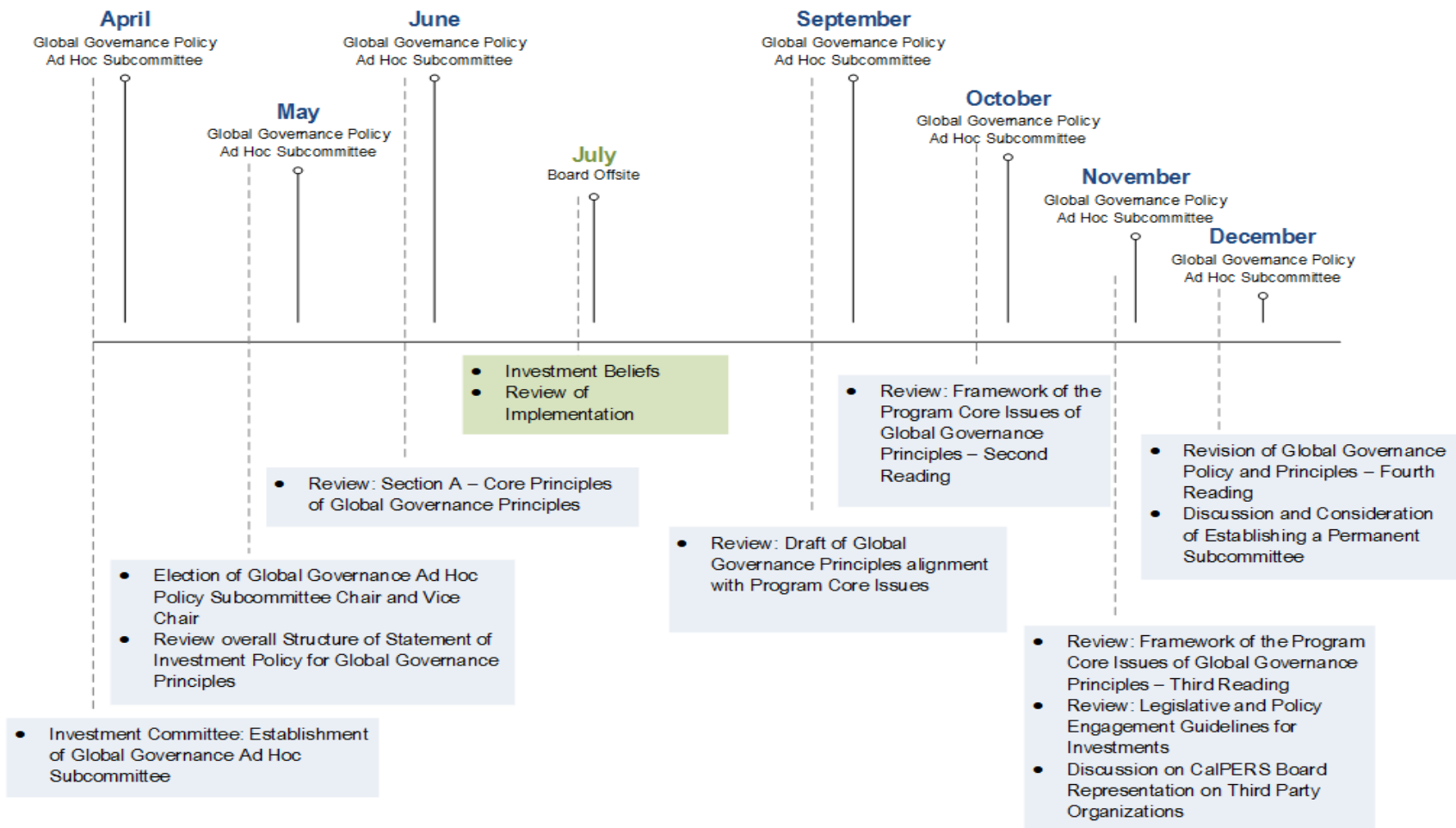
Objectives

- Review initiatives under strategic and core activities
- Seek Investment Committee feedback on the framework and process for developing Key Performance Indicators (KPIs) for the Environmental, Social, and Governance (ESG) strategy on sustainable investment

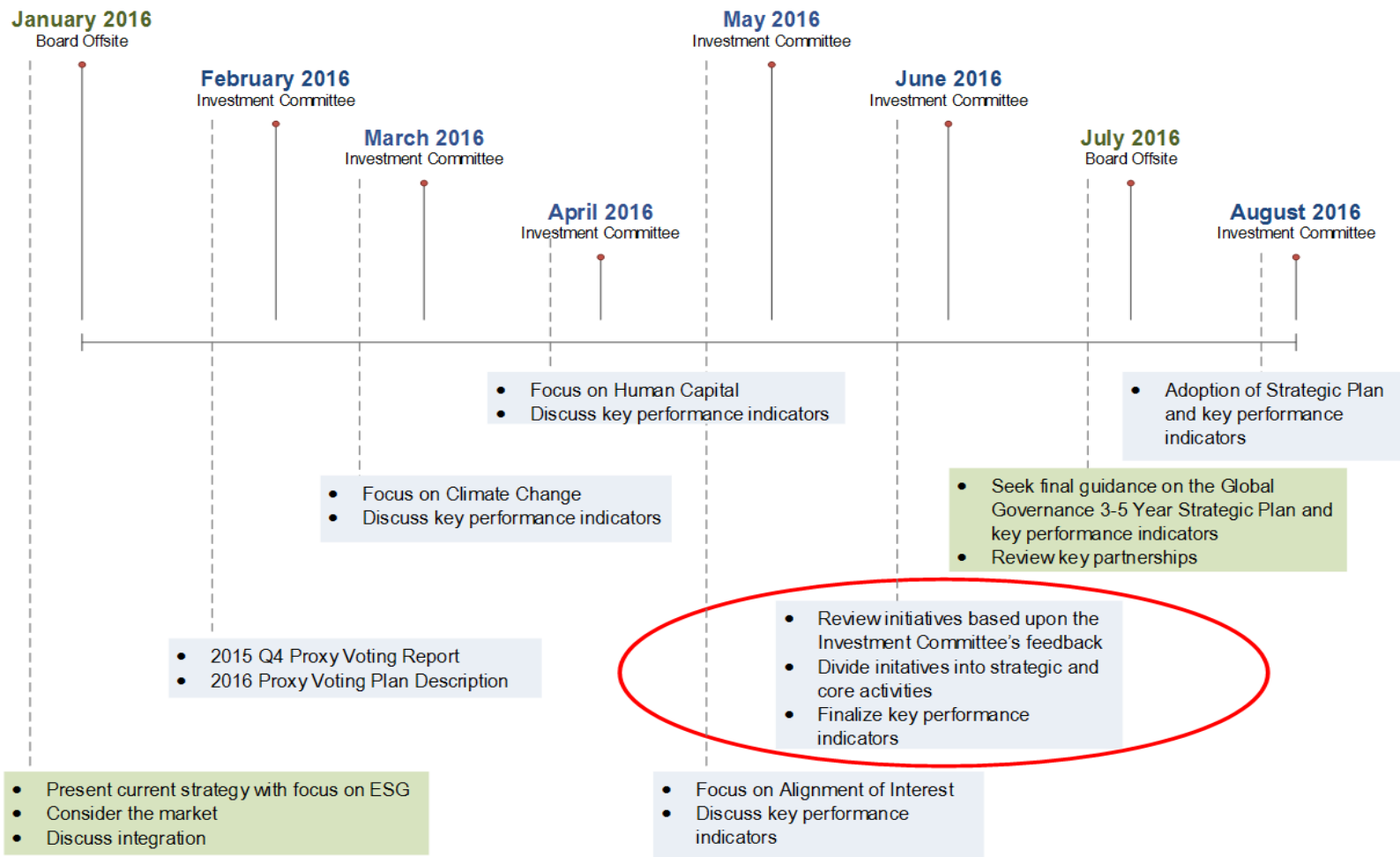
Summary of the 5-year plan for Governance and Sustainability

	Environmental	Social	Governance
S T R A T E G I C	<ul style="list-style-type: none"> Data and corporate reporting standards (includes water risk) 	<ul style="list-style-type: none"> Data and corporate reporting standards (includes human capital) 	<ul style="list-style-type: none"> Data and corporate reporting standards (focusing on the long-term)
	<ul style="list-style-type: none"> Manager Expectations (includes water risk) 	<ul style="list-style-type: none"> Manager Expectations 	<ul style="list-style-type: none"> Manager Expectations
	<ul style="list-style-type: none"> Research <ul style="list-style-type: none"> Sustainable Investment Research Initiative (SIRI) Global Equity Strategies 	<ul style="list-style-type: none"> Research <ul style="list-style-type: none"> SIRI Diversity Income inequality 	<ul style="list-style-type: none"> Research <ul style="list-style-type: none"> Topics from Global Governance Principles Review
	<ul style="list-style-type: none"> Engage 80 PRI Montreal Pledge Companies (identify water risk candidates) 	<ul style="list-style-type: none"> Diversity and Inclusion <ul style="list-style-type: none"> Engagement Voting 3D Advocacy 	<ul style="list-style-type: none"> Private Equity Fee and Profit Sharing Transparency (including AB 2833)
C O R E	<ul style="list-style-type: none"> Carbon Footprinting – Total fund Thermal Coal Companies – (SB185) 	<ul style="list-style-type: none"> Responsible Contractor Program Supply Chain Activities Income Inequality (placeholder) 	<ul style="list-style-type: none"> Proxy Voting Shareowner Campaigns (Proxy Access/ Majority Voting) Focus List Divestment: Mandates, Policy & Principles
	<ul style="list-style-type: none"> Corporate Engagements – (1,000 annually) Federal and Legislative Guidelines – tracking and comments Response to Ad Hoc Stakeholder Requests 		
	Work through Partnerships to leverage resources and impact		

2015 Timeline: Global Governance Principles Review



Proposed Timeline for Developing a 3-5 Year Strategic Plan



What are Key Performance Indicators (KPIs)?

The World Bank Approach

- “KPIs are measures of project outcomes, outputs, and inputs that are monitored during project implementation to assess progress toward project objectives.”

Source: The World Bank Group - *The Logframe Handbook : A Logical Framework Approach To Project Cycle Management*. http://www.afdb.org/fileadmin/uploads/afdb/Documents/Evaluation-Reports-Shared-With-OPEV_/00158077-EN-WB-LOGICALFRAMEWORK-HANDBOOK.PDF

World Bank KPIs – Applied for CalPERS

<p>OUTCOME</p>	<p>Sets the project objective to assure alignment with CalPERS' investment objectives and Investment Beliefs.</p> <ul style="list-style-type: none"> • Outcomes are intended goals which CalPERS does not control.
<p>INPUTS</p>	<p>Development of project design and plan for implementation. Marshal the resources (staff, partnerships, and analytics) needed for implementation.</p>
<p>OUTPUTS</p>	<p>Project deliverables from activities we will undertake.</p> <ul style="list-style-type: none"> • KPIs set out metrics for each activity. • Outputs are developed on the assumption that successful delivery will contribute to the Outcome. • Articulate key assumptions and risks in plan.

Framework for creating KPIs

<p>OUTCOME</p>	<p>What we want to achieve: measures that describe the objectives of the 3-5 year strategy. The value, benefit or return on investment to CalPERS' risk management and investment objectives.</p> <p>Diversity example: Corporate boards become more diverse, improving risk management and performance of CalPERS portfolio firms.</p> <p>Data and corporate reporting example: CalPERS has integrated corporate reporting to inform its investment decisions.</p>
<p>INPUTS</p>	<p>Work done by staff to marshal resources and plan steps needed to produce the outputs below.</p> <p>Diversity example: Develop plan and identify resources to engage companies.</p> <p>Data and corporate reporting example: Review existing voluntary standards, identify best practices and develop an engagement strategy with regulators.</p>
<p>OUTPUTS</p>	<p>What we produce or deliver - what the project can be held accountable for producing.</p> <p>Diversity example: Sustained multi-year engagement with a number of companies defined through the Input - plan.</p> <p>Data example: Develop partnerships and engage corporate reporting standard setters.</p>

Strategic Initiatives with KPIs:

- Data and corporate reporting standards (includes water risk, income inequality, and focus on the long-term)
- Manager Expectations (Pilot)
- Research (includes Sustainable Investment Research Initiative (SIRI), Global Equity Strategies, Diversity, Income Inequality, Topics from Global Governance Principles Review)
- Engage 80 companies identified through the United Nations Supported Principles for Responsible Investment (UN PRI) Montreal Pledge
- Diversity and Inclusion
- Private Equity Fee and Profit Sharing Transparency

Data and corporate reporting standards

<p>OUTCOME</p>	<p>CalPERS has integrated corporate reporting to inform investment decisions.</p>
<p>INPUTS</p>	<ul style="list-style-type: none"> • Marshal resources to review existing mandatory and voluntary standards, identify best practices. <p>Examples: Securities and Exchange Commission, Financial Stability Board, International Accounting Standards Board, Financial Accounting Standards Board, Sustainable Accounting Standards Board and others</p>
<p>OUTPUTS (possible KIPs)</p>	<ul style="list-style-type: none"> • Develop and implement strategy for engagement with regulators. • Engage standard setters to include disclosure on sustainable investment risk and opportunity in their agenda and work plans. • Key risks and assumptions: We will be able to leverage investor network partners for this work. Regulators and standard-setters will be open to discussion.

Manager Expectations Pilot

OUTCOME	Interests between CalPERS and Managers are aligned, enabling CalPERS to understand and manage sustainable investment risk and opportunity across the portfolio.
INPUTS	<ul style="list-style-type: none"> • All asset classes have documented, where possible, relevant and effective, the following items in contracts: <ul style="list-style-type: none"> – “Managers have, or will commit to have, an investment process which incorporates an assessment of relevant long-term Sustainable Investment activities; – Managers will incorporate relevant ESG factors and Sustainable Investment activities into reporting.” – <i>CalPERS Sustainable Investment Practice Guidelines, 2015 pilot</i>
OUTPUTS (possible KIPs)	<ul style="list-style-type: none"> • CalPERS asset classes have documented and implemented procedures for due diligence, contracting and monitoring to include relevant ESG metrics. • Key risks and assumptions: Managers have incentives which are aligned and relevant data are available. Staff have knowledge and resources available to monitor.

Sustainable Investment Research

<p>OUTCOME</p>	<p>Strengthen understanding of ESG factors relevant to risk and return specific to CalPERS investment objectives.</p>
<p>INPUTS</p>	<ul style="list-style-type: none"> • Learn from the market: <ul style="list-style-type: none"> – Findings from Sustainable Investment Research Initiative (SIRI) – Research led by Global Equity on sustainable investment strategies • Learn from CalPERS’ experience: <ul style="list-style-type: none"> – Real Assets staff on Clean Power – Private Equity staff on Clean Tech funds – Global Fixed Income review of current ESG data
<p>OUTPUTS (possible KIPs)</p>	<ul style="list-style-type: none"> • Conclude the SIRI • Global Equity strategy research • Develop an action plan supported by the research priorities listed under Inputs, consistent with Investment Beliefs. • Key assumptions: Academic and practitioner research is relevant to CalPERS. • Risks: The past is no guide to the future. Research findings may conflict. Data availability constrains results.

Engage UN PRI Montreal Pledge Companies

<p>OUTCOME</p>	<p>Manage and mitigate adverse financial impact of climate change on CalPERS portfolio. Reduce the carbon intensity of the Total Fund through engagement.</p>
<p>INPUTS</p>	<ul style="list-style-type: none"> • Review issues relevant to climate change engagement such as: <ul style="list-style-type: none"> – Greenhouse gas reduction targets – Capital allocation and research & development (R&D) – Risk management – Asset portfolio resilience – Energy efficiency – Natural resource scarcity – Board expertise and experience on climate change – Public policy strategy, including political contributions – Executive incentives / compensation
<p>OUTPUTS (possible KIPs)</p>	<ul style="list-style-type: none"> • Develop a strategy to engage the 80 companies identified through the Carbon Footprint (UNPRI’s Montreal Pledge) responsible for 50% of “greenhouse gas” emissions in CalPERS Global Equity Portfolio. • Key assumptions: We will be able to leverage investor networks. • Risks: Our influence is impacted by access to data and the full range of investor rights.

Diversity and Inclusion

<p>OUTCOME</p>	<p>Increase the diversity of portfolio firms, external managers and by integrating diversity research into risk management, and thereby enhance fund performance.</p>
<p>INPUTS</p>	<ul style="list-style-type: none"> • Raise awareness of the importance of diversity to CalPERS through the Diversity Forum. • Develop plan for engagement to improve board quality with a defined number of companies, focusing on those that lack board diversity. • Develop and implement an Established Manager Diversity and Inclusion engagement strategy, Talent Management initiatives under the INVO D&I 2020 Plan and elevate involvement with 5 strategic partners.
<p>OUTPUTS (possible KIPs)</p>	<ul style="list-style-type: none"> • Advocate for rulemaking, data and corporate reporting standards to improve disclosure on board diversity and inclusion. • Work across INVO program areas to engage companies. • Key assumptions: We will be able to leverage investor networks. • Risks: Our influence is impacted by access to the full range of investor rights.

Private Equity Fee and Profit Sharing Transparency

<p>OUTCOME</p>	<ul style="list-style-type: none"> Widespread adoption of Institutional Limited Partners Association (ILPA) framework for transparency of fees and profit sharing across private equity managers within the industry.
<p>INPUTS</p>	<ul style="list-style-type: none"> Develop engagement plan with managers including: <ul style="list-style-type: none"> Future commitments: Require managers to complete the ILPA Fee Reporting Template Existing commitments: Seek disclosure of profit sharing from all managers Continued engagement with ILPA Encouraging the SEC to secure sufficient resources for both Examination and Enforcement Divisions Work collaboratively with Legislative Affairs on any legislation introduced impacting private equity (e.g. transparency and fee disclosure) Continue engagement with both GPs and LPs to encourage industry adoption of the ILPA Fee Reporting template.
<p>OUTPUTS (possible KIPs)</p>	<ul style="list-style-type: none"> Track and report annually the number of managers completing the ILPA Fee Reporting Template and providing profit sharing information. PE Policy review to determine if changes related to transparency are appropriate as a part of the Annual Program Review. Key risks and assumptions: We will be able to continue leveraging the ILPA investor network and identify peer funds as partners for this work.