

CalPERS' Global Governance Principles

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Today's Objectives

Today

- Seek Investment Committee's feedback on:
 - Proposed new title "CalPERS' Governance & Sustainability Principles" to replace "CalPERS' Global Governance Principles"
 - Proposed new principle on capital allocation

Next Steps

- Revise Principles and publish on CalPERS website
- Consideration of the Principles across the Total Fund
- Continue to research areas for future development

Background

- In March 2015, the Global Governance Principles (Principles) were adopted as a Total Fund-level policy.
- The Principles are reviewed and submitted for annual consideration by the Investment Committee.
- The Principles provide the framework for CalPERS' work through: 1) engagement, including proxy voting 2) advocacy, and 3) integration into investment decision making.
- The Principles are intended to serve as a comprehensive best practice document which reflects CalPERS' Investment Beliefs. They speak to our core issues of: Investor Rights, Board Quality, Compensation, Corporate Reporting and Regulatory Effectiveness.
- As part of the 2016 detailed annual Principles review, staff established a list of areas to consider for future review and development. Capital allocation was one of these areas.

Areas for Future Review and Development

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 • 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 • Explore how to better incorporate reference to 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

Proposed Revisions

Section	Principle	Proposed Language	Page
Title & Footer		Staff proposes to update the title of the Principles in line with the new strategic plan for governance and sustainable investment to “CalPERS’ Governance & Sustainability Principles” from “CalPERS’ Global Governance Principles”.	Title & Footer
Board Quality: Diversity, Independence, and Competence	Board Responsibilities – Corporate Strategy	<p>Staff proposes to extend the language on “Board Responsibilities - Corporate Strategy” of the Principles to provide clarity on capital allocation.</p> <p>7. Board Responsibilities: The board responsibilities should include:</p> <ul style="list-style-type: none"> a. CEO Performance: Independent directors establish CEO performance criteria focused on optimizing operating performance, profitability and shareowner value creation; and regularly review the CEO’s performance against those criteria. b. Corporate Strategy: Review, approve, and guide corporate strategy, capital allocation discipline, major plans of action, risk policies, and business plans. i. Capital Allocation Discipline: Boards should provide shareowners with robust oversight and disclosure surrounding capital allocation decisions, including optimizing the capital structure to ensure discipline in prioritizing the most productive use of capital over the long-term. We recommend the following: <ul style="list-style-type: none"> a) Policy: The board should develop and disclose its policy on capital allocation that outlines the application of discretionary cash flows for organic growth projects, investments, strategic mergers and acquisitions, cash and scrip dividends, debt repayment, and share repurchases. The board should also communicate its philosophy on the use of debt leverage. b) Board Monitoring and Assessment: The board should monitor capital allocation decisions and the range of capital allocation alternatives and their corresponding risks. c) Disclosure: The board should disclose in regulatory filings: <ul style="list-style-type: none"> i. The board’s role in overseeing capital allocation decisions and how each decision aligns with the company’s strategic priorities for investment to ensure long-term value creation; ii. The controls and metrics in place to monitor capital allocation decisions; iii. The impact on performance targets in executive compensation plans; and iv. The board’s measures to address potential conflicts of interest with incentives impacted by capital allocation decisions, such as share buybacks. 	Attachment 3 - Page 14