Global Equity Corporate Governance Program Update

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CalPERS

Contents

Looking Back – 2018 Proxy Season Outcomes

- ✓ **Made progress in improving corporate board diversity**
  - ❖ 39% of companies engaged added a diverse director to their boards (198 of 504 companies)
  - ❖ Voted "against" 468 directors at 145 companies where diversity engagements did not result in constructive outcomes

- ✓ **Enhanced executive compensation voting**
  - ❖ Voted "against" 43% of executive compensation proposals, up from a prior 5-year average of 16%
  - ❖ Enhanced voting practice on compensation implemented in January 2018 following staff's 2017 internal proxy season review

- ✓ **Successfully executed shareowner campaigns**
  - ❖ Shareowner campaigns targeting 146 companies resulted in 125 settlements, 4 ongoing engagements, and 17 proxy solicitations
  - ❖ Companies were targeted on proxy access, climate risk reporting, majority vote, governance [opioids], and board diversity

Looking Ahead – 2019 Proxy Season Outlook

- **Climate Action 100+ :** Engage portfolio companies to ensure that their strategies take into account the risks and opportunities arising from climate change. Specifically, engage companies to improve governance of climate-related risks and opportunities, curb greenhouse gas (GHG) emissions, and strengthen climate-related financial disclosures

- **Corporate Board Diversity:** Continue to engage companies to improve corporate board diversity, and use proxy voting and shareowner campaigns to bring about change where engagements have not led to positive outcomes

- **Compensation:** Ensure that the design and practice of compensation at portfolio companies appropriately incentivizes management and employees to generate long-term sustainable returns in alignment with the interests of long-term investors

- **Proxy Voting Enhancements:** Apply enhanced voting practices specifically targeted at compensation (say-on-pay), board quality (competence, independence, and diversity), and global harmonization of voting practices (board independence, committee independence)

Appendix

Climate Action 100+

CalPERS is playing a leading role in both strategy and implementation

- Chair of the Steering Committee of the initiative with over 300 investors to engage 161 companies
  - CalPERS will step down from Chair role in March 2019 (annual rotation of Chair)
  - CalPERS staff will continue to have a seat on the Steering Committee
- 5 team members are devoting significant time to this initiative

CalPERS is leading engagements on 21 portfolio companies globally

- Close collaboration between Corporate Governance and Sustainable Investment teams
  - 15 of 21 company engagements underway
  - 6 engagements of Japanese companies to start later in 2019
  - Filed or co-filed climate risk proposals at 3 companies

Climate Action 100+| Engagement Goals

Investors signed on to Climate Action 100+ are requesting the boards and senior management of companies to:

1) **Implement a strong governance framework** which clearly articulates the board's accountability and oversight of climate change risks and opportunities;

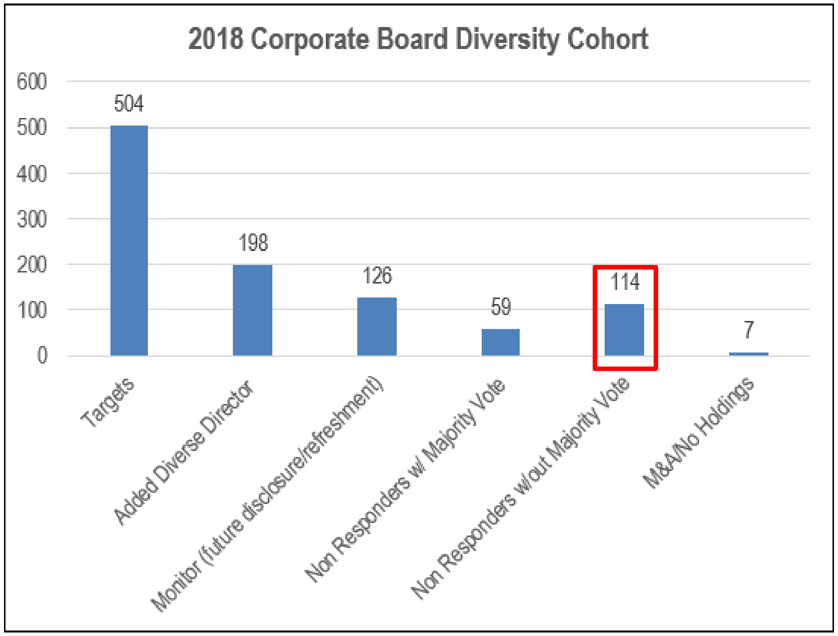
2) **Take action to reduce greenhouse gas emissions across the value chain,** consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2 degrees Celsius above pre-industrial level; and

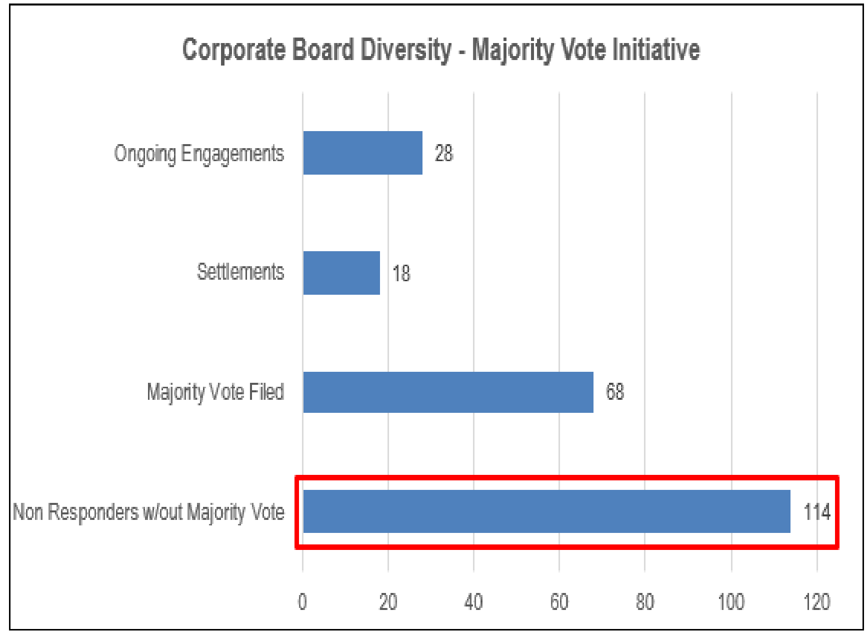
3) **Provide enhanced corporate disclosure** in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and, when applicable, sector-specific Global Investor Coalition on Climate Change Investor Expectations on Climate Change [1] to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below 2-degrees Celsius, and improve investment decision-making.

[1] The Global Investor Coalition on Climate Change Investor Expectations on Climate Change sector guides cover oil and gas, mining, utilities and auto manufacturers and provide additional sector specific disclosure recommendations, particularly regarding the oversight of public policy positions.

Source: http://www.climateaction100.org/

2018 Corporate Board Diversity Cohort

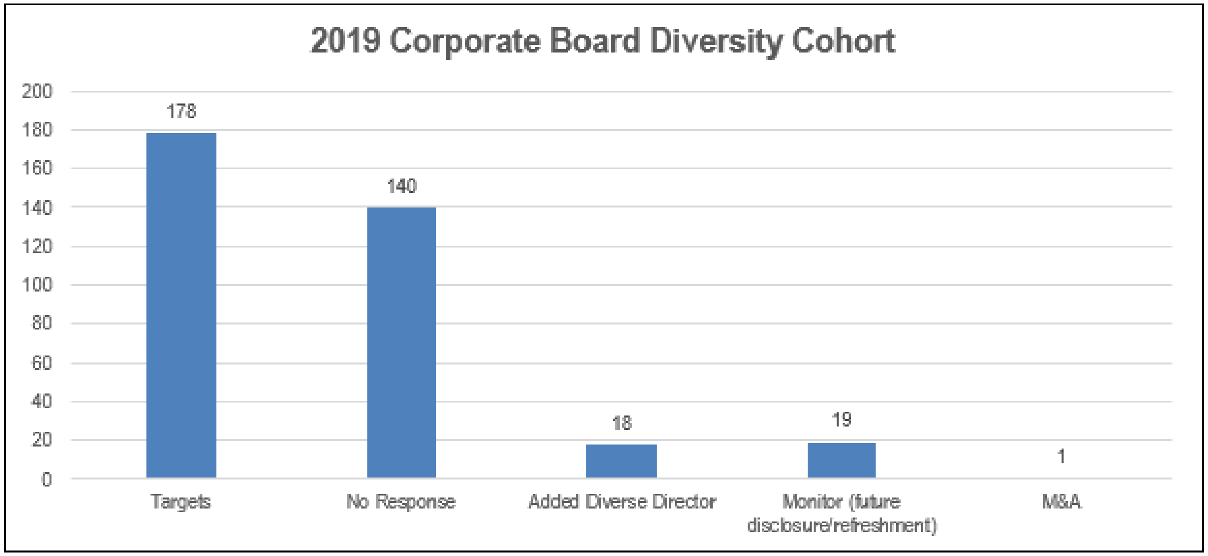




- Filed 79 majority vote shareowner proposals at non-responding companies that do not have majority voting for director elections for the 2019 proxy season. Withdrew 11 proposals due to settlements with companies

- Continue to use corporate engagement, proxy voting and shareowner campaigns to improve board diversity

2019 Corporate Board Diversity Cohort



- October 2018: Wrote letters to 178 companies lacking gender diversity that were added to the Russell 3000 index in 2018
- Continue to engage the 2019 diversity cohort companies to improve board diversity
- Withhold votes at non-responding companies during the 2019 proxy season
- File majority vote shareowner proposals at non-responding companies that do not have majority voting for director elections for the 2020 proxy season

2019 Proxy Voting Practice Enhancements

- **Global Harmonization of Voting Practices**
  - Apply majority board independence standard globally, with Japan as the only exception (1/3 board independence initiative for Japan will continue for another year)
  - Apply 100% independence standard for key committees globally. Key committees include compensation, audit and nominating/governance committees

- **Board Quality (Diversity, Independence, and Competence)**
  - Vote “against” non-executive directors who sit on more than 4 boards. The current practice is to vote “against” non-executive directors who sit on more than 5 boards
  - Vote “against” Nominating/Governance Committee members if the Board has more than 1/3 of directors with greater than 12-year tenure AND less than 1/3 of directors were appointed in the last 6 years

- **Executive Compensation Initiative**
  - Move from a 3-year to a 5-year quantitative model to assess pay-for-performance, and vote “against” bottom quartile of universe
  - Vote “against” Compensation Committee members in the same year the compensation plan fails the pay-for-performance quantitative model (effective 2020 proxy season)

Executive Compensation Analysis Framework Enhancement

Staff completed an intensive review of CalPERS executive compensation proxy voting practices for Say-on-Pay (SOP) proposals and equity plans voted in the United States

Research Considerations:

- ✓ Findings from academic research
- ✓ Voting practices of peer global asset owners
- ✓ Discussions with global asset managers
- ✓ Discussions with compensation consultants
- ✓ Input from proxy advisors

Next Steps:

1. Staff is developing a new enhanced approach to better access the alignment between compensation plans and the interests of long-term shareowners
2. CalPERS is collaborating with Equilar (data consultant) to develop a new custom five-year quantitative analysis using total CEO realizable pay and total stock performance relative to peers
3. Staff is recommending updates to the compensation section in the CalPERS' Governance & Sustainability Principles

Executive Compensation Analysis Framework Enhancement

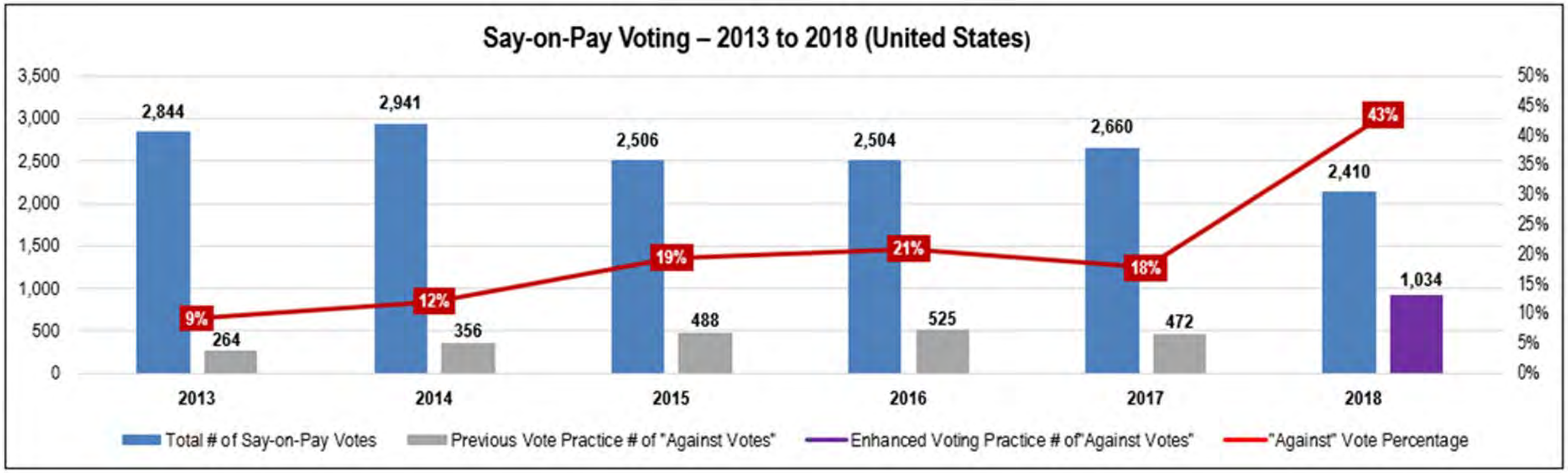
	Current Quantitative Model	Enhanced Quantitative Model
Evaluation Period:	3-Years	5-Years
Data Source:	Glass Lewis	Equilar
Methodology:	Proprietary pay-for-performance model (total shareholder return, earnings per share growth, change in operating cash flow, return on equity and return on assets)	Total CEO realizable pay and total stock performance relative to peers
CalPERS Voting Application:	Vote Against 'D' & 'F' Grade Companies	Vote Against Bottom Quartile Companies

Additional qualitative components will continue to be used to assess compensation plans, including:

1. Insufficient disclosure of performance goals
2. Insufficient or no clawback policies
3. Excise tax gross-ups
4. Short-term vesting periods for long-term awards
5. Internal pay inequity (CEO-to-median employee pay ratio, CEO-to-NEO pay ratio)
6. Excessive severance provisions
7. Insufficient holding period requirements on equity
8. Proxy advisory research

- **2019 Voting Expectations:** Staff expects SOP voting outcomes to be similar to 2018, where CalPERS voted against 43% of SOP plans

U.S. Executive Compensation Votes: 2013 to 2018



- Staff implemented an enhanced voting practice on executive compensation (“Say on Pay”) proposals in the United States starting with the 2018 proxy season
- CalPERS level of opposition increased at companies where compensation plans are not aligned with shareowner interests
  - In 2018 staff voted “against” 43% of “Say on Pay” proposals up for vote (18% in 2017, 5-year average of 16%)
  - Failure to align pay with performance was the primary reason to vote “against”
  - Other problematic features driving “against” votes included: short performance periods for long-term incentive awards, poor disclosure, short vesting periods for equity grants, discretionary awards, and similar metrics used for short and long-term incentive plans