



Agenda Item 8b

May 13, 2013

ITEM NAME: Global Governance Program Update

PROGRAM: Global Governance

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

This item provides a quarterly update on the Global Governance Program (Program) in line with the core issues framework, which sets out a vision of sustainable investment focused on long-term value creation. The attached presentation (Attachment 1) provides an update on the following:

- **Program Overview** – Scope and Objectives, Mission and From-To Vision
- **Sustainable Value Creation Framework** – 3 Forms of Capital: Financial, Physical, and Human
- **Core Issues Evaluation Criteria** – Materiality, Principles, Capacity, Timeliness, Definition and Likelihood of Success
- **Core Issues** – Shareowner Rights, Board Quality & Diversity, Executive Compensation, Corporate Reporting and Regulatory Effectiveness
- **Core Issues Accomplishments and Progress**

We also have included an overview of CalPERS work on climate change given the growing public interest.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal of improving long-term pension and health benefits sustainability. Regular program updates support the Investment Committee in its oversight capacity.

BACKGROUND

The Program's sustainable value creation framework is built upon effective management of the three forms of capital: financial, physical and human. The Program seeks good governance practices to ensure that CalPERS capital is deployed to produce sustainable long-term returns and meet pension obligations. The Program focuses on five core issues which support long-term value creation: shareowner rights, board quality and diversity, executive compensation, corporate reporting and regulatory effectiveness.

As a provider of capital, CalPERS has a deep interest in shareowner rights. These help us define the relationship between CalPERS and fiduciaries, such as corporate boards and external managers that are accountable for overseeing the use of our capital. In addition, we want to ensure the boards and leadership responsible for oversight represent a diverse mix of characteristics, experience and competencies. Well-designed compensation programs should be in place to reward and align the users of our capital with CalPERS objective to achieve sustainable, long-term value creation. CalPERS expects fair, accurate, and timely reporting on how financial, human and physical capital are employed to generate sustainable economic returns. Finally, we look to regulation to protect CalPERS as an investor, maintain fair, orderly, and efficient markets, and facilitate capital formation.

CalPERS Work on Climate Change

As an example of our work on the three forms of capital, we identified climate change as a theme that runs across our total fund. Environmental issues, and climate change in particular pose both risks and opportunities for CalPERS. The issues raised by climate change are complex and challenging. They require time, attention and coordination between investors, companies and policy makers.

We've set out a strategy for our work to address the unifying theme of climate change in the following areas: advocacy, engagement, targeted investments, research and operations – the details can be found in Attachment 1. Examples of work across the total fund include the following:

- **Advocacy**

CalPERS was a founding member of the Investor Network on Climate Change – a leading network of 100 institutional investors representing more than \$10 trillion in assets committed to addressing the risks and opportunities resulting from climate change.

In connection with the United Nations Climate Change Conferences in Copenhagen (2009), Cancun (2010), Durban (2011), and Doha (2012), we have endorsed global investor statements and action plans on climate change calling for effective domestic and international policy frameworks to catalyze the development of clean energy and well-designed carbon markets.

Our CEO, Anne Stausboll, Co-Chair's Ceres, who successfully advocated the US Securities and Exchange Commission (SEC) to issue guidance requiring disclosure of climate change risks in corporate filings.

CalPERS was recently appointed to the standards setting council of a newly established non-profit organization, the Sustainability Accounting Standards Board (SASB), engaged in the development and dissemination of industry-specific sustainability accounting standards. SASB will provide investors with something they vitally need to address climate change risks: standardized information on material sustainability factors alongside financial information.

- **Engagement**

CalPERS firmly believes engagement is the first call of action with companies. Our Global Principles of Accountable Corporate Governance (Principles) set out our expectations on corporate governance, executive compensation, sustainability risks, diversity and market conduct. Specifically, we request companies to “provide accurate and timely disclosure of environmental risks and opportunities through adoption of policies or objectives, such as those associated with climate change.”

Our Principles also state our expectations on climate risk disclosure, calling for companies to use the Global Framework for Climate Risk Disclosure which recommends disclosure on greenhouse gas emissions, strategic analysis of climate risk and emissions management, assessment of physical climate risks, and an analysis of regulatory risks.

Every year, we use our shareowner voting rights to ensure our interests and values are aligned with companies across the 47 markets that we invest in. All our votes are cast in line with CalPERS Global Principles of Accountable Corporate Governance. Over the last three years, on average, we voted ‘for’ sustainability-related shareowner proposals 93 percent of the time. These cover a wide variety of sustainability issues, including increased transparency of critical sustainability risks in the oil and gas sector and corporate sustainability reporting.

Our Global Governance Program also engages with more than 100 companies on an annual basis to ensure the high standards of corporate governance that underpin effective climate change risk management. As part of our engagement work we lent our support to Ceres’ campaign asking Russell 1000 companies to provide comments on the *21st Century Corporation: The Ceres Roadmap to Sustainability*⁷ which calls for corporate reporting on sustainability factors, including climate change risks.

- **Targeted Investments**

Global Equity: In 2010, we allocated \$500 million to an internally managed public stocks environmental index fund. This strategy is modeled on the HSBC Global Climate Change Benchmark Index and invests in approximately 380 securities around the world that derive a material portion of their revenues from environmentally friendly sectors such as low-carbon energy production, energy efficiency management and carbon trading.

Private Equity: We have approximately \$1.2 billion of aggregate exposure to the alternative energy sector. Our investments are spread across hundreds of companies with particular emphasis on solar power and biofuels.

Real Estate: In 2004, we established a goal of reducing energy consumption of the underlying assets in its Core Real Estate portfolio by 20 percent by 2009. At the end of this five-year program, the investment managers exceeded this target, reporting a total energy reduction of 22.8 percent. The Real Estate Unit continues to work with managers on ways to better track and reduce energy usage and measure the carbon footprint of our property investments.

Forestland: CalPERS has a long-standing investment in forestlands that represents approximately \$2.3 billion of the total fund. Timber is a renewable resource and with high growth rates, plantations can reduce CO2 emissions through carbon sequestration.

- **Research**

We commissioned a study, *Climate Change Scenarios – Implications for Strategic Asset Allocation*, to examine the potential impacts of climate change factors on strategic asset allocation and we continue to assess the impact of climate risks across our total fund. Most recently, we have partnered with UC Davis to further research sustainability factors, including environmental innovation, and their impact on risk and return. This research will inform CalPERS Investment Committee's development of investment beliefs. We will hold an Investment Committee Board Workshop on June 17, 2013, to discuss the findings of this research.

- **CalPERS Operations**

We have been reporting our greenhouse gas emissions since 2006, and we reduced them by almost 30 percent, from 9,099 metric tons in 2008 to 6,443 metric tons in 2010. Many of these savings result from our LEED certification program, which identified steps we could take to improve our performance. We also purchase 50 percent certified green renewable power through our local utility company, the Sacramento Municipal Utility District.

CalPERS also has a Green Club dedicated to learning about and discussing ways to save energy, reduce our carbon footprint, reduce waste and other green initiatives. This group includes volunteer representatives from divisions across the enterprise and is sponsored by the Sustainable Operations Program.

Addressing climate change is no small undertaking and we continue to partner with other like-minded investors to advocate for change on this important issue. CalPERS was also ranked 15th out of 1,000 global asset owners in the ranking of institutional investors on climate change disclosure by the Asset Owner Disclosure Project.

ANALYSIS

The last quarter resulted in a number of accomplishments for our five core issues. Details on the Program's progress are included in the attached presentation, Global Governance Program Quarterly Update (Attachment 1), with highlights on the following pages.

Core Issues Accomplishments and Progress

- **Shareowner Rights**

Accomplishments: Apple's Management Proposal to Implement Majority Voting received 98% support of proxies prior to the meeting following CalPERS proxy solicitation. The vote was cancelled by the court following a lawsuit, which challenged the "bundling" of the different elements of the proposal, from Greenlight Capital – a hedge fund pressing for issuance of preferred stock without recourse to shareowners. Apple has promised to bring the proposal back to shareowners in the future.

Through work with the CalPERS Legal Office, we submitted an amicus brief to the Commonwealth of Massachusetts Supreme Judicial Court on the issue of the interpretation of the phrase "annual basis", as applicable to the scheduling of shareholder meetings. We believe shareholder meetings should be held within a period of twelve months or in consecutive fiscal years.

Progress: For the first quarter of 2013, CalPERS voted on 9,524 proposals, supporting 92% of management proposals and 77% of shareowner proposals. Staff is entering into the height of the 2013 Proxy Season and will vote an estimated 7,000 meetings. CalPERS has also filed a board declassification proposal at Hospitality Properties Trust to be presented at the Annual Meeting on May 15, 2013. We've also filed a Majority Vote proposal at Hatteras Financial, which will be presented at the upcoming May 21, 2013, Annual Meeting.

Proxy Access has been a longstanding priority for CalPERS. We continue to advocate for shareowners' right to access the company proxy and nominate candidates to company boards by supporting Proxy Access proposals. Previously, 14 shareowner resolutions were filed in 2012. Nabors Industries and Chesapeake Energy both received a majority of shareowner support – following CalPERS proxy solicitation.

The following management and shareholder Proxy Access proposals in Table 1 have been filed over this past quarter. CalPERS will be voting "FOR" each of these resolutions as they are consistent with our support of proxy access at the SEC proposed level of a 3% shareholder or group with a 3-year holding period or a threshold falling below that.

Table 1 – Proxy Access Proposals

Company	AGM Date
Walt Disney (DIS) – 36% support	March 6, 2013
Hewlett Packard (HPQ)* – 97% support	March 20, 2013
Verizon (VZ)	May 2, 2013
Bank of America (BAC)	May 8, 2013
Charles Schwab (SCHW)	May 16, 2013
Chesapeake Energy (CHK)*	June 8, 2013

*Management Proposals

- **Board Quality & Diversity**

Accomplishment: At Hewlett Packard, governance reform continues with Board Chairman Raymond Lane stepping down and both John Hammergren and G. Kennedy Thompson leaving the board.

Progress: As part of the Council of Institutional Investors' (CII) "Zombie" Directors Campaign, CalPERS is targeting Nominating/Governance Committee Chairs where directors received a majority of withhold votes and failed to step down.

CalPERS in partnership with CalSTRS, sent a letter to the 41 S&P 500 companies we contacted back in June 2012, on board quality and diversity. A number of companies have made positive changes since our initial letter.

We are also including two attachments in our letter to the companies: the National Association of Corporate Directors' Blue Ribbon Commission Report, *The Diverse Board: Moving From Interest to Action* and the NACD Directorship Article that CalPERS co-authored with UnitedHealth Group, *How to Engage Shareholders When Selecting New Directors* (Attachment 3).

- **Executive Compensation**

Accomplishment: We have engaged 200 companies as part of CalPERS Say on Pay letter writing campaign – 87 have reformed.

Progress: CalPERS filed a proposal at Nabors Industries to limit executive severance payouts without shareowner approval to be presented for vote at the Annual Meeting on June 4, 2013.

- **Corporate Reporting**

Accomplishment: The Sustainable Investment Research Initiative (SIRI) call for papers sought empirical and theoretical papers from scholars and investment practitioners in the fields of finance, economics, accounting, law and business. We received 94 submissions, with seven selected by the selection committee, co-chaired by UC Davis and the Columbia Law School, for presentation at the upcoming technical Symposium.

CalPERS was recently appointed to the standards setting council of a newly established non-profit organization, the Sustainability Accounting Standards Board (SASB),⁴ engaged in the development and dissemination of industry-specific sustainability accounting standards. SASB will provide investors with something they vitally need to address climate change risks: standardized information on material sustainability factors that can be integrated with financial information.

On April 16, 2013, CalPERS spoke on a panel at the Sustainability Accounting Standards Board (SASB) Delta Series Financial Sector conference in New York. The discussion focused on the newly developed draft financial industry standards – looking at the need for reporting of relevant sustainability factors in the Form 10-K (annual report). The Harvard Business Review's recent paper, *The Performance Frontier* (Attachment 4), examines the link between relevant sustainability factors and financial performance and highlights the work SASB is undertaking.

Progress: The UC Davis Graduate School of Management is hosting the Sustainability & Finance Symposium, co-chaired by the Columbia Law School, on June 7, 2013, and will facilitate a technical academic inquiry into the definitions and relevance of sustainability factors and related policy issues for long-term capital providers. Findings from the Symposium will be presented at the Investment Committee Board Workshop on June 17, 2013.

- **Regulatory Effectiveness**

Accomplishment: CalPERS met with Congressional staff and regulators on both the unfinished business of Dodd-Frank and financial benchmarks in the wake of the London Interbank Offered Rate (LIBOR) scandal.

Anne Simpson, Senior Portfolio Manager and Director of Global Governance, was re-elected to the CII's Board and has also been re-appointed to the Public Company Accounting Oversight Board (PCAOB) Investor Advisory Group.

Progress: CalPERS wrote to the new SEC Chair, Mary Jo White, to send our congratulations and looks forward to working with her on investor issues. Joseph Dear, Chief Investment Officer serves as Chairman of the SEC Investor Advisory Committee, which was established as a result of Section 911 of the Dodd-Frank Act.

ATTACHMENTS

Attachment 1 – Global Governance Quarterly Program Update

Attachment 2 – Q1 2013 Overview of Global Proxy Votes Cast

Attachment 3 – NACD Directorship Article, *How to Engage Shareholders When Selecting New Directors*

Attachment 4 – Harvard Business Review's paper, *The Performance Frontier*

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