CalPERS:
Presentation to The Regents of the University of California

CalPERS Corporate Governance and
US Financial Reform Perspectives

California Public Employees’ Retirement System --
Corporate Governance Unit
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CalPERS Overview

- Largest Public Pension Fund With Assets of Approximately $136 Billion (August 2002)
- CalPERS trust assets are invested for exclusive benefit of over one million members
- CalPERS is guided solely by the principles of obtaining the highest investment return for the fund
- Pre-Funded System
  - Member Contributions of $1.52 Billion (year)
  - Employers’ Contributions of $1.6 Billion (year)
- $6 Billion in Benefits Paid (June 2002)
Corporate Governance

What is It? Corporate Governance refers to the relationship between investors and corporate management in determining the direction and performance of a corporation.

What is its purpose? The purpose of corporate governance is to have a demonstrable impact on a corporation’s financial performance.
Six Principles of Corporate Governance

- Accountability to Shareholders
- Transparency of information and uniformity of Accounting Methods
- Equitable treatment to all Shareholders, including foreign investors
- Voting Methods and Proxy Materials must be clear, concise, and informative
- Adopt a Code of Best Practices
- Long Term Vision that emphasizes shareholder value
Corporate Governance
Why Do We Do Governance?

- In a sense, we are a permanent investor; We do not consider selling out of a stock a desirable option (contrary to an index strategy)
- At the same time, we have a fiduciary duty to maximize the value of our investment
- There is a “Corporate Governance Premium” that can be captured to increase shareholder value
Corporate Governance
How Do We Do Governance?

- Financial Market Reform
- Education and Influence Program
- Focus List Program/Legal action
- “Relational” investing
- Proxy Voting
Corporate Governance
How Do We Do Governance?

- Financial Market Reform
  - In response to financial crisis, CalPERS’ Investment Committee adopted the Financial Market Reform Program

Matrix Addresses:
- Role of Audit Committees
- Auditor Independence
- Accounting Standards
- Accounting Industry Oversight
- Director Independence
- Governance System Model
Corporate Governance
How Do We Do Governance?

Education and Influence
- Governance awards
- U.S. Corporate Governance Core Principles and Guidelines
- Global Governance Principles
  - Market specific principles (International)
- CalPERS web site and shareowner forum
  - www.calpers.ca.gov
Corporate Governance
How Do We Do Governance?

- Focus List Program
  - Annual Selection Process
  - Quantitative & Qualitative Analysis
  - Stock Performance; EVA; Governance Profile
  - Company Engagement & Governance Agreements
  - Three-year Monitoring Process: Follow Up
CalPERS Focus List Selection Methodology

Current Holdings of Wilshire 2500 Index Fund
Approx. 1900 Companies

Remove:
- Utilities
- REITs
- ADRs
- Performance or EVA Data N/A
- CalPERS position <$2.0 million

Approx. 1200 Companies

EVA Fundamental Screen
5 Year Absolute & Relative Price-Performance Screen
Proprietary Governance Issues Screen

100 Companies

Consider:
- Likely Corp Gov Partners
- Change Agent / Catalyst?
- Changes in Business Strategy
- Unusual Circumstances
- Recent Performance
- Size, Industry Diversification

Focused Fundamental Research

Corporate Governance Group Finalist Selection

Preliminary Focus List 15 Companies

Remove 5 Companies

Consider:
- Response to CalPERS Recommendations
- Performance Improvement
- Error in Analyses
- Executive Compensation

Private Meetings with Each Company

Recommended for Focus List & Governance Partners List 10 Companies

Focus List Companies

Ad-hoc Ability For Adding Companies

Report to Committee

Previous Year’s Focus List Companies

3 Year (Rolling) Monitoring List
Focus List Performance

- To date, CalPERS has focused on over 100 public companies in the US
- Studies: Governance Adds Value
  - 2001 Wilshire Associates Inc. Study
  - Excess Returns Before & During Governance
    - -95.4% VS. +14.7%
Focus List Performance

Corporate Governance Activities
Excess Return Before and During

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<th>Time</th>
<th>Excess Return</th>
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<tr>
<td>-5 Years</td>
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<tr>
<td>5 Years</td>
<td>14.7%</td>
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CalPERS Corporate Governance Program

- CalPERS currently invests in three active external managers that employ a governance strategy:
  - Relational Investors (US)
  - Hermes Focus Asset Management (UK)
  - Active Value Advisors (UK)
- Current commitment to this strategy is approximately $3 billion
CalPERS Corporate Governance Program

CalPERS recently announced plans to establish a corporate governance fund in Japan

- Partnership with SPARX Asset Management and Relational Investors LLC
Company Examples

- **TYCO** - Re-establishing credibility
  - Replace top management
  - Replace the board

- **Mattel** - Focusing on the fundamentals
  - Sell The Learning Company
  - Increase Barbie sales
Proxy Voting Function

- Voting Process - Review/analyze, research, discuss, vote, and release
- CalPERS’ Shareowners’ Forum: Web site postings (approximately 350 companies) and Guest Book inquiries
- As of June, over 2,000 domestic and 1,500 international companies voted