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TREASURER
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February 19, 2015

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Board President
CalPERS Board of Administration
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Harry Keiley
Chair
CalSTRS Teachers' Retirement Board
100 Waterfront Place
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Dear Mr. Feckner and Mr. Keiley:

In 2008, as State Controller and ex officio board member, I asked CalPERS and CalSTRS to consider a new initiative to better address corporate board diversity. I asked each fund to analyze the most recent data on board diversity, revise existing corporate governance and proxy voting policies to increase the emphasis on board diversity, and develop strategies to engage with companies to advocate for more diversity in the boardrooms.

Both systems answered the call. CalPERS now includes board diversity as an engagement topic when placing companies on its Focus List for poor corporate governance or performance, encourages proxy voting firms to adopt its board diversity principles, and has developed best practices for companies to follow when seeking diverse board candidates. CalSTRS has been involved in shareholder resolutions that have resulted in companies agreeing to actively consider diversity as a criterion to be considered when recruiting new board members. To date, CalSTRS has filed or co-filed more than 40 diversity related shareholder proposals. During the past year, CalSTRS and CalPERS engaged 126 of the largest California-headquartered companies that did not have any women on their board of directors. Both systems collaborated in the development of a database of diverse director candidates that could be used by companies seeking to fill vacant board seats.

As a result of both systems' pioneering efforts, which are too numerous to list completely in this letter, the push for greater corporate board diversity has become mainstream.

One recent example is the 2014 U.S. launch of the 30% Club, a group of Chairs and CEOs committed to better gender balance at all levels of their organizations. The founding members include chairpersons and CEOs of 27 companies including Warren Buffett of Berkshire Hathaway and Larry Fink of BlackRock. Support for diversity proposals by shareholders has increased from an average of 12 percent during 2006 to over 30 percent during the last two years.

Despite these efforts, we have barely moved the needle on diversity in corporate board rooms. A 2008 report by the Alliance for Board Diversity found only 28 percent of board seats on Fortune 100 companies were held by women and minorities ("Women and Minorities on Fortune 100 Boards." Alliance for Board Diversity. 2008). A 2013 update of the report finds that as of 2012, the ranks of women and minorities in Fortune 100 board positions has improved by only four percentage points to approximately 32 percent ("Missing Pieces: Women and Minorities on Fortune 500 Boards." Alliance for Board Diversity. 2013.). Clearly, it is time to redouble our efforts and sharpen our focus.

First, I would like the staff of both systems to examine, and report to their boards, trends in proxy voting initiatives related to board diversity. Are there certain types of diversity proposals that are more successful than others? Are there new opportunities for engaging companies on the issue of board diversity that would be worth pursuing?

Second, we need to focus on the lack of vacant board seats, which is a significant barrier to creating more diverse boards. According to a June 2013 report by GMIRatings over one-quarter of board seats in the U.S. are held by men with at least 10 years' tenure ("Director Tenure and Gender Diversity in the United States: A Scenario Analysis. GMIRatings. June 2013). The same report showed that if less than half of the male directors in S&P 500 companies with 10-plus years were replaced by female directors, 30 percent of that index's board seats would be held by women.

We will not see more diversity until we see more turn-over on corporate boards. To this end, CalPERS and CalSTRS should continue advocating for proxy access, which will provide shareowners with a cost-effective means of nominating their own candidates and provide investors with greater ability to shape the composition of a board. A 2014 study found that companies who give investors a greater role in the selection of directors appear to have greater market values than companies that do not ("Proxy Access in the United States: Revisiting the proposed SEC rule. CFA Institute. August 2014.).

CalPERS and CalSTRS staff have been working with the office of New York City Comptroller Scott Stringer on an initiative to submit proposals at 75 companies, asking the companies to adopt a bylaw allowing shareowners who have owned at least three percent

of its stock for three years or more to nominate directors for election to the board. I would like to ask my colleagues on both boards to support staff efforts and to encourage staff to broaden the initiative and to broaden the alliance of investors working on the issue of proxy access.

At CalPERS, I would like to address the issue of tenure on corporate boards by considering possible revisions to its Proxy Voting Policy. The Policy currently states that directors should “serve for an appropriate length of time,” and that the tenure of each director should be “reviewed regularly by the nomination committee.” I would like CalSTRS to address the same concerns in its Corporate Governance Principles. I would like to ask both staffs to examine whether the policies should specify an appropriate length of tenure and also to examine the extent to which nominating committees adhere to best practices with respect to regularly reviewing director tenure. Long tenure not only impedes progress toward diversity, it may impair independence.

Most directors on corporate boards are brought to the attention of a board through their network of acquaintances. I would like CalPERS and CalSTRS staff to examine ways in which qualified diverse candidates could be made more visible to corporate boards and their nominating committees. This could include making improvements to the way in which the Diverse Director Database is marketed to diverse candidates and to corporate boards. This could also include examining ways to develop and support networking opportunities that would help connect qualified diverse candidates with corporate boards.

Finally, I would like to ask my colleagues at CalPERS and CalSTRS to consider revising their definitions of board diversity. CalPERS’ Proxy Voting Policy currently defines diversity as “skill sets, gender, age, nationality, race, and historically under-represented groups,” while CalSTRS Corporate Governance Principles use “skills, background, experience, age, gender, cultural and ethnic composition.” I think sexual orientation and gender identity should be added to both boards’ definitions of diversity.

There is broad agreement that a diverse corporate board is good for business. Boards with directors who possess a wide range of skills and experiences are better positioned to oversee company strategy, risk mitigation and management performance. The pursuit of increased diversity on corporate boards is about enhancing financial performance and the value of a company. A 1998 study of S&P 500 companies found that increases in ethnic and gender diversity on corporate boards correlates with increases in stock performance (Hillman, Amy J., et al. "Diversity on the board: an examination of the relationship between director diversity and firm performance." *Annual Meeting of the Academy of Management, San Diego, CA, August. 1998.*). It is about ensuring companies keep up with a changing customer base. Companies wishing to remain competitive in the

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global economy will benefit from drawing on diverse experiences and perspectives that reflect a changing customer base. A diverse board makeup improves employee morale and productivity and sends a message to employees throughout the organization that a company is committed to the advancement of women and minorities. At the same time, it enhances a company's reputation and attractiveness at a time when many investors are increasingly using a variety of nonfinancial metrics, such as board diversity, as criteria in investment decision-making.

I know my colleagues share my strong belief that there is strength in diversity. I hope you will consider the proposals I offer for pursuing greater diversity.

Sincerely,

Original signed by

JOHN CHIANG
California State Treasurer

cc: CalPERS Board
Anne Stausboll, Chief Executive Officer, CalPERS
Ted Eliopoulos, Chief Investment Officer, CalPERS
CalSTRS Board
Jack Ehnes, Chief Executive Officer, CalSTRS
Chris Ailman, Chief Investment Officer, CalSTRS