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Controller Westly Unveils CalPERS Reform Plan

Compensation Watch List a Centerpiece of Policy Overhaul

NEW YORK – California State Controller Steve Westly today proposed overhauling corporate governance policies at the nation's largest pension fund with a five-point reform plan that includes singling out poor-performing companies with overpaid executives.

Westly's plan addresses growing concern that CalPERS' current policies are proving counterproductive in the effort to prevent future accounting scandals and reign in excessive executive pay.

"Our policies may look good on paper, but they're not working in the real world," Westly said. "If we're serious about corporate reform, it's time to give our policies at CalPERS an extreme makeover."

Controller Westly's plan calls for CalPERS to publish a watch list on executive compensation as a way to encourage companies to link the pay of top executives to long-term performance.

The plan also includes:

- Establishing an independent auditor policy that focuses on the real risks to CalPERS.
- Rewarding companies that have a positive record on independent auditors and executive compensation.
- Advocating for national reform, including calling on the Securities and Exchange Commission (SEC) to clarify fee disclosure language.
- Building broad institutional investor coalitions to create a unified voice on corporate governance reform.

Like many corporate reform advocates, Westly questioned the effectiveness of withholding proxy votes at nearly 80 percent of public companies, as CalPERS did in the 2004 proxy season. The votes were required under a blanket policy targeting all companies that allow auditors to perform non-audit work – a standard that few companies were able to meet.

"With $166 billion in investments, CalPERS is a powerful voice in the marketplace," Westly said. "To stay that way, we must promote real reform and adopt sound policies that protect our beneficiaries' interests."

The letter to CalPERS board members follows.

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STEVE WESTLY
California State Controller

August 23, 2004

Sean Harrigan, Board President and
Members, CalPERS Board of Administration
400 P Street
Sacramento, California 95814

Dear President Harrigan and Members:

As institutional investors across the United States review the past proxy season and begin to prepare for 2005, we all face many tough questions. What makes up a responsible executive compensation package? How many non-independent board members are too many? Can an Audit Committee responsibly approve other services provided by their external auditor?

After WorldCom and Enron, long-term investors like CalPERS must ensure that our investments are managed under sound corporate governance principles. How we accomplish this objective is the $166 billion question before the Board.

We should listen to the advice we have received from Arthur Levitt, Warren Buffett and others and revise our corporate governance strategy. As a national leader, we should not expect to win every cause we pursue – but we need to make sure that we're not tilting at windmills either. Casting too many protest votes – sometimes as a small minority of shareholders – may be diminishing our effectiveness. The discussion at the CalPERS offsite last month underscored the need for a more outcome-oriented strategy for achieving our corporate governance objectives.

I urge the Board to develop a focused corporate governance strategy that will enable us to build a broader coalition of national support. Our strategy should:

1. **Focus on the Real Risks –** CalPERS should establish an independent auditor policy that focuses on companies where CalPERS has the most exposure and where fees for non-audit services are highest. The policy should be targeted to a smaller group of companies, and should also distinguish between different services provided by audit firms.

2. **Raise the Bar on Executive Compensation Plans** – CalPERS should take a leadership position on executive compensation. One way to kick-start this dialogue would be to publish the CalPERS executive compensation watch list.

3. **Reward Good Companies** – CalPERS should establish a Best Practices Company List for independent audit and executive compensation. Shareowners should recognize executives and boards of directors that get it.

4. **Advocate for National Reform –** CalPERS should pursue reforms at the national level, recognizing that our resources are most effectively used to lead a national dialogue. We should press the Securities and Exchange Commission (SEC) to clarify the fee disclosure language under the Sarbanes-Oxley Act. Increasing the consistency of fee reporting will enable CalPERS and other investors to better understand a company's management choices.

5. **Coordinate with Broad Investment Coalitions –** CalPERS should coordinate its activities with national institutional investor coalitions to achieve reforms on audit independence and executive compensation. We will be more successful bringing about real changes if our votes and calls to action represent a majority.

CalPERS has a long history of shareholder action and a reputation as one of the most powerful voices in the marketplace. That doesn't happen just because of our size. It happens through leadership, credibility and long-term commitment to end goals that improve shareholder value. We need to redefine our corporate governance strategy and return to our roots of shareownership.

The offsite provided members with a real opportunity to review the past year and refocus our efforts. We owe it to the beneficiaries to not only adopt sound policies to protect their interests, but to also bring about real reform. Let us build on our momentum and continue toward a more outcome-oriented strategy on corporate governance.

I look forward to discussing our strategy at the October Investment Committee meeting. If you would like to discuss these concepts ahead of time, please contact Toni Symonds or me at (916) 445-2636.

Sincerely,

Original signed by:

STEVE WESTLY

cc: Fred Buenrostro, Chief Executive Officer
Mark Anson, Chief Investment Officer
Christine Wood
Ted White

SW:jh:ab