JOHN CHIANG
California State Controller

May 17, 2010

Patricia Clarey
Chair, Performance and Compensation Committee
CalPERS
Lincoln Plaza North
400 Q Street
Sacramento, CA 95811

Dear Ms. Clarey:

I write to voice my concern that the proposals developed by Mercer in response to my September 2009 letter urging the Board to reduce or eliminate incentive awards when there is a negative total investment return have fallen short.

We all acknowledge that CalPERS needs a compensation plan that not only rewards leadership and significant contributions to the plan, but also assists in recruitment and retention. However, we cannot turn a blind eye to the historic losses recently suffered by the CalPERS' portfolio and the resulting increases in employer contributions that are needed to ensure the long-term health of the system. To continue to pay handsome bonuses under these circumstances would rightfully draw comparisons between CalPERS and those private-sector financial institutions that stubbornly protected their executives' bonuses while taxpayers were asked to boost their bottom line with bailouts.

I have reviewed the proposals that have been developed by Mercer and will be voted on by the Performance and Compensation Committee on Wednesday. None deserves your support.

The proposals either provide the Board with no discretion to address underperformance or they provide the Board with discretion to reduce bonus compensation, along with the authority to provide **an additional bonus on top of the existing incentive award**. CalPERS already provides a carrot for good performance. What was missing was the stick. The options that give the Board discretion to reduce or eliminate incentive pay during bad times but allow for additional incentive pay during good times would provide the stick, plus two carrots.

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I strongly encourage the Committee to consider my original proposal for full Board discretion only when there is a negative total return of the fund. This event has occurred only four times in the past 20 years, including three times in the past decade, a period which represents the worst 10 years in history for performance of equity markets. Other reasons for adopting this proposal are it is simple and easy to administer, it considers the expected investment return assumption of the fund, and it provides the Board the opportunity to further exercise its fiduciary obligations to the fund.

This proposal will not disrupt staff recruitment and retention efforts by decreasing the competitiveness of the CalPERS' incentive award program relative to other large public or private institutional investors. As a matter of fact, at my urging, CalSTRS has already directed staff to draft a policy that will provide its board with the authority to reduce incentive awards when the investment return of the fund is negative or when the relative investment return of an individual asset class is materially less than the investment benchmark for that asset class. The CalSTRS Board is expected to adopt this policy early next month.

CalPERS is a nationally-recognized leader in corporate governance, and one of the fundamental principles of good corporate governance is that compensation, especially bonus compensation, be correlated to overall shareowner return. We are now presented with an opportunity to lead by example.

Thank you for allowing me to address this important issue, and I look forward to continuing to work with your committee. My representative, Terry McGuire, will be present at the meeting to contribute to the discussion of this recommendation.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

cc: CalPERS Board of Administration