BETTY T. YEE
California State Controller

September 20, 2017

Henry Jones
Chair, Investment Committee
California Public Employees' Retirement System Board
400 Q Street
Sacramento, CA 95811

SUBJECT: Executive Compensation – Pay Despite Inadequate Performance

Dear Mr. Jones:

Over the last few years, it seemed as if congressional reforms, SEC requirements, and shareholder activism helped turn the corner on excessive executive compensation for corporate managers so that it was more closely aligned to performance. Enhanced disclosure requirements, say on pay, and clawbacks for compensation awarded when based on materially misstated financials have helped reign in excessive compensation that was not in the long-term interest of the companies or their shareholder investors and have raised awareness of the elements of reasonable compensation.

Both the California Public Employees' Retirement System and the California State Teachers' Retirement System have played a lead role in these reforms, addressing excessive executive compensation through disclosure and pay-parity advocacy, engagement, and partnership with other likeminded investors. Unfortunately, this work is not yet done as compensation committees and consultants are still not factoring in the true costs (financial and reputational) of substantive legal settlements caused by inadequate oversight and management when calculating pay and awarding performance compensation.

Many have been stunned by the recent headlines relating to Equifax, Volkswagen, and Wells Fargo – both as consumers and as fiduciaries for our state pension fund member shareholders. Actions and decisions made by top executives at these companies have exposed their organizations to expensive legal liabilities and impaired their long-term reputations. These are grave and relevant concerns for our pension funds that invest in these companies for their long-term value. While legal liability can be an ordinary course of business expense, there are certain risks that are not ordinary and should not be treated as such when determining performance compensation for the top executives whose oversight was inadequate or who were directly responsible for jeopardizing their company's reputation and success.

This is why I am requesting that an action item be scheduled for an upcoming Investment Committee hearing on this practice as soon as feasible. The CalPERS corporate governance team has led in many of the pay-for-performance reforms over the last decade. I welcome suggestions and direction relating to options, above and beyond engagement efforts, on how to address this issue going forward. Without incorporating the costs of gross mismanagement that demonstrated complete disregard for a company's mission and the commitment and support of long-term shareholders in that mission into compensation awards, and by not automatically requiring compensation to be clawed back when this gross mismanagement comes to light, we are fostering the pay without performance we thought we had long ago addressed.

Sincerely,

Betty T. Yee

BETTY T. YEE

cc: Marcie Frost, Chief Executive Officer, CalPERS
Ted Eliopoulos, Chief Investment Officer, CalPERS
Rob Feckner, Board Chair, CalPERS
Bill Slaton, CalPERS Board Member
Michael Bilbrey, CalPERS Board Member
John Chiang, CalPERS Board Member
Richard Costigan, CalPERS Board Member
Richard Gillihan, CalPERS Board Member
Dana Hollinger, CalPERS Board Member
JJ Jelincic, CalPERS Board Member
Ron Lind, CalPERS Board Member
Priya Mathur, CalPERS Board Member
Theresa Taylor, CalPERS Board Member

BETTY T. YEE
California State Controller

September 20, 2017

Harry M. Keiley
Chair, Investment Committee
California State Teachers' Retirement System Board
100 Waterfront Place
West Sacramento, CA 95604

SUBJECT: Executive Compensation – Pay Despite Inadequate Performance

Dear Mr. Keiley:

Over the last few years, it seemed as if congressional reforms, SEC requirements, and shareholder activism helped turn the corner on excessive executive compensation for corporate managers so that it was more closely aligned to performance. Enhanced disclosure requirements, say on pay, and clawbacks for compensation awarded when based on materially misstated financials have helped reign in excessive compensation that was not in the long-term interest of the companies or their shareholder investors and have raised awareness of the elements of reasonable compensation.

Both the California Public Employees' Retirement System and the California State Teachers' Retirement System have played a lead role in these reforms, addressing excessive executive compensation through disclosure and pay-parity advocacy, engagement, and partnership with other likeminded investors. Unfortunately, this work is not yet done as compensation committees and consultants are still not factoring in the true costs (financial and reputational) of substantive legal settlements caused by inadequate oversight and management when calculating pay and awarding performance compensation.

Many have been stunned by the recent headlines relating to Equifax, Volkswagen, and Wells Fargo – both as consumers and as fiduciaries for our state pension fund member shareholders. Actions and decisions made by top executives at these companies have exposed their organizations to expensive legal liabilities and impaired their long-term reputations. These are grave and relevant concerns for our pension funds that invest in these companies for their long-term value. While legal liability can be an ordinary course of business expense, there are certain risks that are not ordinary and should not be treated as such when determining performance compensation for the top executives whose oversight was inadequate or who were directly responsible for jeopardizing their company's reputation and success.

300 Capitol Mall, Suite 1850, Sacramento, CA 95814 P.O. Box 942850, Sacramento, CA 94250 Fax: (916) 322-4404
www.sco.ca.gov

This is why I am requesting that an action item be scheduled for an upcoming Investment Committee hearing on this practice as soon as feasible. The CalSTRS corporate governance team has led in many of the pay-for-performance reforms over the last decade. I welcome suggestions and direction relating to options, above and beyond engagement efforts, on how to address this issue going forward. Without incorporating the costs of gross mismanagement that demonstrated complete disregard for a company's mission and the commitment and support of long-term shareholders in that mission into compensation awards, and by not automatically requiring compensation to be clawed back when this gross mismanagement comes to light, we are fostering the pay without performance we thought we had long ago addressed.

Sincerely,

Betty T. Yee

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cc: Jack Ehnes, Chief Executive Officer, CalSTRS
Christopher J. Ailman, Chief Investment Officer, CalSTRS
Dana Dillon, Board Chair, CalSTRS
Sharon Hendricks, CalSTRS Board Member
John Chiang, CalSTRS Board Member
Michael Cohen, CalSTRS Board Member
Joy Higa, CalSTRS Board Member
Paul Rosenstiel, CalSTRS Board Member
Tom Torlakson, CalSTRS Board Member
Thomas Unterman, CalSTRS Board Member
Nora E. Vargas, CalSTRS Board Member
Karen Yamamoto, CalSTRS Board Member