



California State Teachers'
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June 5, 2017

The Honorable Maxine Waters
Ranking Member, Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Re: The Financial CHOICE Act of 2017

Dear Ranking Member Waters:

CalSTRS was established more than 100 years ago to provide retirement benefits for California's public school teachers and is the largest educator-only pension fund in the world. The CalSTRS portfolio is currently valued at approximately \$208 billion, which we carefully invest, as patient capital with a long-term investment horizon, to meet the retirement needs of more than 900,000 plan participants and their families.¹

As the CEO of CalSTRS, I am writing to express our opposition to the Financial CHOICE Act of 2017 (the CHOICE Act or Act), which is scheduled to be considered by the full House the week of June 5th. The Financial CHOICE Act is shrouded in rhetoric about fixing the United States economy and lifting the regulatory burden on our financial institutions when, in fact, it unwinds important shareholder rights, allows for riskier public companies, and decimates the Securities and Exchange Commission's (SEC or the Commission) ability to protect investors. We respectfully request that our letter be entered in to the public record when the bill is considered by the House.

Shareholder Proposal Process

The CHOICE Act includes a provision to dramatically change the shareholder proposal process. Currently under the SEC's Rule 14a-8, shareholders who own one percent or \$2,000 worth of outstanding shares for at least one year can submit a proposal to be included on the company's proxy statement. The CHOICE Act would eliminate the \$2,000 threshold and require investors to own a minimum of one percent of the issuer's voting securities over a three year period. While one percent may sound like a small amount, even a large investor like the \$200 billion CalSTRS fund does not own one percent of publicly traded companies.

¹ California State Teachers' Retirement System Current Investment Portfolio as of April 30, 2017.
<http://www.calstrs.com/current-investment-portfolio> and At-a-Glance <http://www.calstrs.com/glance>.

In fact, one percent of Apple Inc., the largest U.S. company by market capitalization, would equate to more than \$7 billion worth of stock. If enacted, we believe these changes would effectively prevent investors, like CalSTRS from participating in the shareholder proposal process. The current shareholder proposal process allows shareholders, even small investors, the ability to communicate their concerns to public companies and, in fact, has had a significant and positive impact on corporate policies and practices on a wide range of issues. As a fund that has filed more than 300 proposals over the past five years, this provision would have a chilling impact on company/shareholder relations.

Proxy Advisory Firms

CalSTRS believes Sections 482 of the CHOICE Act that imposes new regulatory burdens and restrictions on proxy advisors is wholly unnecessary, could weaken the governance of public companies in the U.S. and does not reflect the needs of the customers of proxy advisory firms who are primarily institutional investors, such as CalSTRS. As a large institutional investor that holds more than 7,000 public companies in our investment portfolio, we use proxy advisors to help inform our proxy voting at our portfolio companies. Investors such as CalSTRS are the main clients of the services of proxy advisory firms. Proxy advisory firms provide useful research regarding the governance and finances at these companies to supplement our own due diligence and research, and they play an important and helpful role in enabling cost-effective proxy voting with respect to the 7,000 companies in our investment portfolio. We do not outsource our proxy voting to these proxy advisors. Rather, our Investment staff, in consultation with our governing Teachers' Retirement Board, develops carefully thought-out proxy voting guidelines, and then we vote our own proxies based on those well-established guidelines.

While we understand some funds may utilize proxy advisory firms to assist them in executing their proxy voting responsibilities, the SEC has taken steps to make sure investors are properly carrying out their due diligence obligations. In fact as recently as 2014, the SEC acknowledged the important role proxy advisors play in the oversight of proxy voting of fund fiduciaries and, in 2014, issued updated regulatory guidance on the responsibilities of Investment Advisers who utilize proxy advisory firms in their proxy voting. In addition, the SEC has authority under current law to address any conflicts at these proxy advisory firms and has taken steps to require additional disclosure of these conflicts by proxy advisors. Accordingly, we believe that the existing SEC regulatory regime already protects our interests with respect to proxy advisory firms and that the Act's provisions are both unnecessary and counter-productive.

The proposed legislation would result in higher costs for pension plans, like CalSTRS, and other institutional investors. The provision gives companies the right to review reports and lobby the advisory firms prior to the reports being distributed to their customers. This provision also requires firms to establish an "ombudsman" to address issues raised by the companies. Given the already short time period between when companies issue their proxy materials and the shareholder meeting date, the review and lobby process would severely limit CalSTRS ability to review and vote proxies in a timely manner. This multi-layered review

would substantially raise costs in order to meet deadlines and maintain the current level of scrutiny and due diligence over proxy voting. Moreover, the proposed legislation is likely to limit competition by reducing the current number of proxy advisors and imposing additional barriers to entry for potential new firms—again raising costs for investors.

Provisions Repealing Dodd-Frank Governance Reforms

Say-on-Pay

CalSTRS opposes the provision of the Act that amends Section 951 of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) by reducing the frequency of say-on-pay votes. Say-on-Pay currently provides shareholders the ability to vote on the executive compensation packages of publicly traded companies either annually, biennially, or triennially. To date, over 90 percent of public companies have opted for annual votes consistent with CalSTRS policy. We take our responsibility to vote on these pay packages very seriously and carefully scrutinize these pay packages every year to ensure there is a proper alignment of interests. This provision of the CHOICE Act restricts these votes to only when the company has made a material change to the executive compensation package. Executives are awarded new pay packages year after year, and therefore, shareholders should be able to provide their input on those pay structures each and every year. While the plan structure may not change, payouts under the plan can change in unexpected ways due to company performance, complexity of the plan, and board discretion. In our experience, compensation structures that properly align the interests of shareholders and management can motivate executives to perform at their best, which benefits all shareholders. On the other hand, poorly structured pay packages harm shareholder value by enriching executives at the expense of their owners.

Proxy Access

CalSTRS opposes the provision of the Act that repeals Section 971 of Dodd-Frank, entitled Proxy Access. CalSTRS is an adamant supporter of proxy access, the mechanism that allows long-term shareholders to nominate candidates for the board of directors and have their nominees included on the company ballot. We believe this is a fundamental right of long-term shareholders. As shareholders, directors are our representatives inside the boardroom and proxy access allows shareholders a meaningful voice to determine who represents us.

Clawbacks

CalSTRS opposes the provision of the Act that amends Section 954 of Dodd-Frank to reduce the scope of the clawback requirement. Related to CalSTRS principles on compensation, companies should have broad policies that provide for the ability to recoup compensation in circumstances where it was later determined to have been unearned. The Act limits the clawback of compensation to only those individuals who had control over the company's financial reporting. CalSTRS believes these clawback policies should apply broadly to any

current or former executive that was unfairly enriched based on performance figures that were not accurate. We do not believe Congress should endorse executives receiving compensation they did not properly earn.

Hedging

CalSTRS opposes the provision of the Act that repeals Section 955 of Dodd-Frank regarding disclosure of employee and director hedging. CalSTRS believes that hedging by executives, removes the alignment of interest between the executive and the long-term shareholders. It is important that shareholders be aware of company policies regarding hedging practices. While many companies in the U.S. have already adopted policies consistent with the CalSTRS principles, we believe that the SEC should issue a final rule. The rule, as currently proposed, provides complete transparency as to those executives who are permitted to engage in hedging transactions and the types of transactions allowed.

Universal Proxy Ballot

In October of 2016, the SEC voted to propose amendments to the proxy rules requiring parties in a contested election to use universal proxy cards that would include the names of all board of director nominees. Subsequently, a public comment period opened, and CalSTRS submitted comments supporting the proposed rule.² At present if a shareholder wants to vote for candidates on different proxy cards, that shareholder must travel to the shareholder meeting. Not only does the current practice disenfranchise shareholders, it creates a different process for voting in contested elections, a mechanism designed solely to protect incumbent directors. This proposal would give shareholders the ability to vote by proxy for their preferred combination of board candidates and would replicate how shareholders can vote in person at the shareholder meeting. The CHOICE Act eliminates the SEC's ability to enact a universal proxy rule. Voting for director nominees is a fundamental right, and as a long-term investor, CalSTRS supports the ability to choose among the best suited candidates to represent its interests inside the boardroom.

Sarbanes-Oxley Act Sec. 404 (b) Exemptions

Section 404(b) of the Sarbanes-Oxley Act required companies to have an outside auditor attest to a company's internal financial controls. Following the scandals at Enron and WorldCom, investors welcomed the protection this would provide. Section 989G of Dodd-Frank allowed a permanent exemption for those companies with market capitalization of less than \$75 million. The CHOICE Act broadens this exemption to companies with market capitalizations of \$500 million or \$1 billion in assets for banks. There are approximately 680 companies currently in the Russell 2000 Index with market capitalizations less than \$500 million. Under this legislation, investors in these 680 companies, including CalSTRS, would not have the protection of an outside auditor's oversight of the company's financial

² <https://www.sec.gov/comments/s7-24-16/s72416-1471415-130426.pdf>.

The Honorable Maxine Waters

June 5, 2017

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statements. While we appreciate that the cost of compliance is often cited as a concern by small issuers, we believe it is a necessary cost for receiving investments from the public markets and an important source for risk mitigation.

Private Equity Fund Advisers

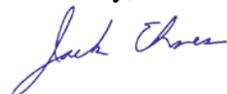
The term “private fund advisers” implies a certain type of investor — private. In fact, public pension funds such as CalSTRS are very much invested in these private funds and support the current law with respect to registration of these advisers and oversight by the SEC of these funds. The Act rolls back the important investor protections provided to funds like CalSTRS from Dodd Frank, which required transparency in the form of registration and certain data reporting from these fund advisers. This legislation enables private fund advisers to retreat back into the shadows by exempting them from specific disclosure requirements they must now undertake to supply investors and to the SEC with certain information. The information provided by these required disclosures has helped to expedite the elimination of certain types of fund adviser fees that we regard as inappropriate, such as monitoring fees charged by certain private fund advisers. Accordingly, we would strongly urge you and your colleagues to oppose this legislation and not rollback these important requirements, which provide critical investor protections to CalSTRS and other public pension funds.

Requirement to Conduct Cost-Benefit Analysis

CalSTRS opposes Sections 311 to 334 that includes the SEC as part of the cost-benefit analysis and Congressional review provisions of the CHOICE Act, which unnecessarily constrains the SEC from fulfilling its mission. The very mission of the SEC is to protect investors, maintain efficient markets and facilitate capital formation. We do not see how the Act improves this mission, especially since the rulemaking process is already governed by several legal requirements, including the Administrative Procedure Act, the Paperwork Reduction Act of 1980, the Small Business Regulatory Enforcement Fairness Act of 1996 and the Regulatory Flexibility Act. The benefits of protecting investors are not easily measured, and we believe the provision of the Act would limit the SEC.

Thank you for considering our views on this very important matter. We would be happy to discuss our perspectives with you or your staff at your convenience. Should you have any immediate questions or wish to discuss our concerns, please contact Aeisha Mastagni, Portfolio Manager by phone at 916-414-7418 or by email at amastagni@calstrs.com.

Sincerely,



Jack Ehnes

Chief Executive Officer

Cc: The Honorable Jeb Hensarling, Chairman, Committee on Financial Services, United States House of Representatives