



California State Teachers'
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Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number **S7-18-16**, Release No. 33-10198; 34-78687 – Request for comment – **Subpart 400 of Regulation S-K Disclosure Requirements Relating to Management, Certain Security Holders and Corporate Governance Matters**

Dear Mr. Fields,

I am writing on behalf of the members of the California State Teachers' Retirement System (CalSTRS) in response to the Securities and Exchange Commission's (SEC, Commission) request for comment on Subpart 400 of Regulation S-K. Thank you for the opportunity to provide a long-term investor's perspective on business and financial disclosures that registrants (issuers) include in their periodic reports to provide information that investors need to make informed investment and voting decisions. We appreciate this request is part of Division of Corporation Finance's initiative to review Regulation S-K, which is required by Section 72003 of the Fixing America's Surface Transportation Act (Fast Act).

CalSTRS' mission is to secure the financial future and sustain the trust of California's educators. We serve the investment and retirement interests of more than 896,000 plan participants.¹ CalSTRS is the largest educator only pension fund in the world, with a global investment portfolio valued at approximately \$193.2 billion as of September 30, 2016.² The long-term nature of CalSTRS liabilities, the composition of its portfolio and the CalSTRS Board's fiduciary responsibility to its members, makes the fund keenly interested in the rules and regulations that govern the securities market. We have a vested interest in ensuring shareholder protections are safeguarded within the SEC's rules and regulations.

As a long-term shareholder of more than 8,000 global securities, CalSTRS relies on the Subpart 400 of Regulation S-K in our research and analysis of our investments. However, we believe and appreciate that the SEC has the opportunity through this solicitation request to improve Section 229.401 through 229.407 to

¹ CalSTRS at a Glance, Fact Sheet: <http://www.calstrs.com/sites/main/files/file-attachments/calstrsataglance.pdf>

² CalSTRS Current Investment Portfolio for the period ending September 30, 2016.
<http://www.calstrs.com/current-investment-portfolio>

benefit all shareholders and other stakeholders with a vested interest in a company's business and financial disclosures.

Below we outline each of the 400 subpart sections and share our recommendations for your consideration.

Item 401 - Directors, Executive Officers, Promoters and Control Persons

The SEC adopted a final rule on proxy disclosure enhancements in 2009, amending item 401 of Regulation S-K to expand the disclosure requirements regarding the directors' and nominees' qualifications, past directorships held by directors and nominees, and the time period for disclosure of legal proceedings involving directors, nominees and executive officers.³

Although the final rules require companies to disclose for each director and any nominee the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director, most disclosures are general and grouped, based on the overall board qualifications. Most disclosures provide similar statements such as "Our director nominees were nominated by the Board based on the recommendation of the Nominating and Corporate Governance Committee, or the Governance Committee. They were selected on the basis of outstanding achievement in their professional careers, broad experience, personal and professional integrity, ability to make independent and analytical inquiries, financial literacy, mature judgment, high performance standards, familiarity with our business and industry, ability to work collegially."

CalSTRS believes the intent of the rule was to allow investors to compare and evaluate the skills and qualifications of each director and nominee. Despite the fact that companies provide the broad statement of qualifications and biographies, we recommend the SEC require new board disclosures related to nominees in order to provide investors with necessary information to evaluate the nominees' gender, racial and ethnic diversity, as well as their mix of skills, experiences, and attributes needed to fulfill the corporation's mission and long-term strategy.

Since final amendments to Item 401 do not require disclosure of the specific experience, qualifications or skills that qualify a person to serve as a committee member and did not eliminate the disclosure requirements in item 407(c)(2)(v), we expand on these additional disclosure requirements in Item 407 below.

Additionally, CalSTRS would not eliminate the final rule disclosure requirements of Item 401 as it relates to disclosure of:

- *Directors' current positions and services on boards* of those companies for the past five years (even if the director or nominee serves on that board);
- *Legal proceedings* involving directors, director nominees and executives for the last ten years;
- *Additional legal proceedings* that include involvement in mail or wire fraud or fraud in connection with any business entity, violations of federal or state securities, commodities, banking or insurance laws and regulations or any settlement to such actions, any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization; and
- The board's role in the *oversight of risk management*. Although, all boards state they have a risk management in place, the Wells Fargo scandal is a current reminder of a failure in risk

³ SEC Final Rule, Proxy Disclosure Enhancements, File No. S7-13-09, 2009. <https://www.sec.gov/rules/final/2009/33-9089.pdf>

management.⁴ CalSTRS principles highlight the important role of the board in risk oversight. Boards need to ensure their risk management plan is evaluated on an ongoing basis. “The board should disclose its risk oversight process and responsibilities to ensure that the company is effectively managing, evaluating and mitigating its risk profile and risk management plan. The board should regularly review and approve its risk management plan.”⁵

Risk management needs to be an ongoing discussion and should not be relegated to a once a year overview. Increasingly, it is important for a board to collectively work with its management team to embrace the concept of enterprise risk management (ERM). When ERM is integrated into an organization, the alignment of risk with strategy and performance helps accelerate growth and enhance performance by linking strategy and objectives to risk and opportunity.⁶ However, boards need to be in tune with the company’s whistleblower policies and ensure these practices are effective and a part of the ERM. A good example is the recent release where a Wells Fargo employee tried to “whistle-blow” as early as 2007, in a letter to CEO John Stumpf to report “unethical (and illegal)” activities throughout Wells Fargo. This employee later won a federal whistleblower retaliation case against the company.⁷

We believe it is critical that the SEC require boards to align their overall role in risk oversight to ERM and the whistleblower policies of the company and believe Item 401 should be amended to state this.

Item 402 – Executive Compensation

CalSTRS believes companies should clearly communicate key components of executive compensation, and has been emphasizing five key areas where increased disclosure would be beneficial.

- 1) Executive Summary – A high-level overview of crucial compensation elements such as the structure, compensation mix, and changes from the preceding year, would facilitate evaluation of the compensation plan, and could include usage of graphical representations.
- 2) Historical pay vs. performance – As pay-for-performance is often a crucial factor in a shareholder’s consideration when voting on a company’s compensation plan, a form of peer-relative realizable pay vs. performance representation would greatly facilitate the evaluation of a company’s compensation plan, particularly for smaller institutional investors who may not subscribe to outside vendors to obtain this information.
- 3) Rationale of performance metrics – Discussion on the rationale of why certain elements were used as well as why certain elements were not incorporated, including the relative strengths and

⁴ “The Wells Fargo Scandal is a Failure in Risk Management”, Logic Manager, September 20, 2016.
<http://www.logicmanager.com/erm-software/2016/09/20/wells-fargo-scandal-risk-management/>

⁵ CalSTRS Corporate Governance Principles, Section 3 d. Roles and Responsibilities of the Board, Updated July 14, 2016.
http://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf

⁶ Enterprise Risk Management, “Aligning Risk with Strategy and Performance, Committee of Sponsoring Organizations of the Treadway Commission (COSO) Public Exposure, June 2016.
<http://erm.coso.org/Documents/COSO-ERM-Public-Exposure-Executive-Summary.pdf>

⁷ Letter warned Wells Fargo of widespread fraud in 2007 – exclusive, CNN Money, by Matt Egan, October 18, 2016.
<http://money.cnn.com/2016/10/18/investing/wells-fargo-warned-fake-accounts-2007/>

weaknesses of the various forms of compensation in relation to the company’s business objectives and situation. Analysis could also include discussion on how the thresholds for the metrics were determined, for example, justification for why certain targets were lowered from previous years. Additionally, if the same metrics and thresholds are used year-after-year with targets continuously met, then an explanation of why the executive compensation committee continues to believe these are justified. Executive compensation committees should continuously monitor for unintended consequences created by specific performance metrics and/or whether these metrics may provide incentive that would inappropriately increase risk to the point that shareholder value is jeopardized.

- 4) Peer group selection methodology – As the use of relative metrics becomes more prevalent, the procedure and rationale for the selection of peer groups becomes a critical factor in the effectiveness of an incentive plan. While CalSTRS believes peer analysis should be used as a reasonableness check and not as a starting point for determining pay, justification should be provided if target total compensation is significantly above median.
- 5) Clawback policies are an important component of executive compensation. Compensation committees should reassess their clawback policies and determine if they should be strengthened to allow for appropriate enforcement. CalSTRS Corporate Governance Principles, outlines, “Companies should adopt policies which provide significant flexibility to recoup incentive compensation in circumstances where it is later determined to have been unearned. CalSTRS believes these policies should extend beyond the basic protections in law, and should include circumstances beyond intentional misconduct. In addition to adopting and disclosing their clawback policies, a company should also disclose those instances when they have recouped compensation under this policy.”

CalSTRS continues to support the executive compensation disclosures outlined in Item 402. However, we recommend the five key areas listed above where the SEC could increase disclosure, to the benefit of shareholders and other stakeholders.

Item 403 - Security Ownership of Certain Beneficial Owners and Management

CalSTRS proposes additions to the beneficial ownership table to include:

- Ownership and voting power of beneficial owners for companies with multiple classes of stock. As a long-term shareowner, consistent with our Corporate Governance Principles of “one share, one vote”, we agree with the Council of Institutional Investors (CII), that “Each Share of common stock should have one vote. Corporations should not have classes of common stock with disparate voting rights. Authorized, unissued preferred shares that have voting rights to be set by the board should not be issued without shareowner approval.”⁸ CalSTRS also supports amending Item 403(a) to require issuers with multiple classes of outstanding common stock and disparate voting rights, to indicate separately the holder’s equity stake and control of total voting power in the existing beneficial ownership table.
- Listing of any derivative or other instrument holdings that reduce the economic interest of the registrant’s securities be disclosed to determine the net economic stake in the issuer’s stock.

⁸ CII letter to the SEC on Subpart 400 of Regulation S-K Disclosure Requirements, by Jeff Mahoney, General Counsel, October 26, 2016. <https://www.sec.gov/comments/s7-18-16/s71816-4.pdf>
http://www.cii.org/files/issues_and_advocacy/correspondence/2016/10_26_16_comment%20letter%20to%20SEC%20on%20Subpart%20400%20of%20Regulation%20S-K.pdf

Item 404 - Transactions with Related Persons, Promoters and Certain Control Persons

CalSTRS continues to support a description of the registrant’s policies and procedures for the review, approval or ratification of related party transactions covered under Item 404 to ensure adequate disclosures to achieve a fundamental objective to communicate the essence of these types of transactions in a sufficiently clear fashion to enable a reader to understand the substance of the related party transactions.⁹

Item 405 Compliance with Section 16(a) of the Securities Exchange

CalSTRS has no additional improvements to Item 405.

Item 406 Code of Ethics

A code of ethics helps ensure that directors act honestly, ethically and in the best interests of the shareholders in exercising their fiduciary duty. A well-articulated written code of ethics, along with training, and modeling of behavior can assist in the prevention of fraud. CalSTRS supports the robust disclosure, filing, and accountability for adherence and reporting of violations of the code. We support continued emphasis on the code of ethics requirements.¹⁰

Item 407 Corporate Governance – Director Diversity Disclosures, Audit Committee Financial Expert

Nominating Committee’s Search and Nominating Process Disclosures – Director Diversity Disclosures

In the final Proxy Disclosure Enhancements rule, file # S7-13-09, the SEC adopted amendments to Item 407(c) of Regulation S-K requiring disclosure of whether and if so, how, a nominating committee considers diversity in identifying nominees for director, and, if the board has a policy, disclosure of how this policy is implemented as well as how the board assesses the effectiveness of its policy.¹¹ The Commission did not define diversity in the amendments.

In 2015, CalSTRS and other institutional investors with assets of \$1.12 trillion in assets, filed a [proxy rule amendment petition](#) asking the SEC to require new disclosures related to nominees for corporate board seats in order to provide investors with necessary information to evaluate the nominees’ gender, racial and ethnic diversity, as well as their mix of skills, experiences and attributes needed to fulfil the corporation’s mission and long-term strategy. This proposal request builds on current Item 407(c)(2)(v) of Regulation S-K which requires issuers to identify the minimum skills, experiences and attributes that all board candidates and nominees are expected to possess. We believe the SEC should consider requiring issuers to outline

⁹ Related-Party Disclosure Issues, FindLaw. Com, <http://news.findlaw.com/wsj/docs/enron/sicreport/chapter8.pdf>

¹⁰ Starbucks Business Ethics and Compliance – Standards of Business Conduct for employees, 2011. <http://globalassets.starbucks.com/assets/eecd184d6d2141d58966319744393d1f.pdf>
Starbucks code of Ethics for CEO, COO, CFO & Finance Leaders (Board of Director) FY 2015. <http://globalassets.starbucks.com/assets/a626d16b18b74e209e4672b5829e274c.pdf>

¹¹ SEC Final Rule, Proxy Disclosure Enhancements, File No. S7-13-09, 2009. <https://www.sec.gov/rules/final/2009/33-9089.pdf>

nominees' gender, racial and ethnic diversity, as well as their mix of skills, experiences and attributes needed to fulfill the corporation's mission and long-term strategy in a matrix and or chart format.

As outlined in the petition, the chart and/or matrix approach allows shareholders to easily see the skills, experiences, and attributes identified by the board as *minimum requirements for all directors*, along with those identified by the board as *necessary for one or more of the directors* to possess. Shareholders can judge whether the listed skills, experiences, and attributes are appropriate in the light of the company's overall business strategy, and assess the suitability of the slate of nominees to the desired skills, experiences, and attributes.

What is the value of this matrix? Diversity on Boards of Directors is not only an indicator of good corporate governance there is growing evidence that diversity also improves the long term performance of a company. The business case for diversity is evident in the rapidly changing demographic profile of the United States as well as the continuing rise in purchasing power of women and various ethnic/racial groups. There are a myriad of studies that provide the value of diversity. Diversity in the workforce can supply a greater variety of solutions, varying points of view, a larger pool of ideas and experience to meet business needs and long-term strategies. The 2015 McKinsey & Co. study, "Why Diversity Matters," found a statistically significant relationship between a more diverse leadership team and better financial performance. The companies in the top quartile of gender diversity were 15% more likely to have financial returns that were above their national industry median. Companies in the top quartile of racial/ethnic diversity were 35% more likely to have financial returns above their national industry median.¹²

This change, would in our perspective, provide for more robust disclosures that will assist investors in facilitating investment and proxy decisions.

Audit Committee Financial Expert

Section 407(d) (5) (i) outline disclosure requirements and definition of an audit committee financial expert. We support the SEC reconciling the definition of audit committee financial expert to the requirements outlined in the Sarbanes-Oxley Act (SOX). We agree with SOX that the expertise necessary to be qualified as an audit committee financial expert should come from specified accounting or auditing positions from a position involving the performance of similar functions, vs. what is currently required in Section 407. Experience required from the SEC regulations allows qualifications to come from experience "activity supervising" specified functions, "overseeing or assessing the performance of companies or public accounts," or "other relevant experience".

There are too many examples where companies would have benefitted from a more stringent definition of audit committee financial expert. Specifically with the prevalence of non-GAAP reporting and the complexity of financial reporting, CalSTRS recommends the SEC strengthen the definition criteria for an audit committee financial expert and align it with the requirements of SOX.

¹² McKinsey & Company, "Why Diversity Matters," by Vivian Hunt, Dennis Layton, and Sara Prince, January 2015.
<http://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters>

Mr. Brent J. Fields, SEC
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Shareholder Communications

CalSTRS recommends the SEC amend item 407(f) (2) (I) to require better disclosure in which shareholders can directly communicate with the board of directors. Currently some issuers outline this information in the proxy, whereas others list on their website. It is difficult at times to understand consistently the method to address written and oral communication to the board of directors.

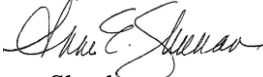
Annual Reporting Requirements

We continue to support the mandatory annual disclosure of governance information required under item 407.

We hope our summary perspective as a long-term investor provides insight into what we deem are critical disclosures related to Subpart 400 of Regulation S-K. If you would like to discuss this letter further, please feel free to contact me at my number above or Mary Hartman Morris at 916-414-7412,

MMorris@CalSTRS.com.

Sincerely,



Anne Sheehan
Director of Corporate Governance
California State Teachers' Retirement System