Jack Ehnes
Chief Executive Officer

CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

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September 12, 2016

The Honerable Jeb Hensarling
Chairman, House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honerable Maxine Waters
Ranking Member, House Committee on Financial Services
4340 Thomas P. O'Neill, Jr. Federal Office Building
Washington, DC 20515

RE: HR 5983 – The Financial CHOICE Act

Dear Chairman Hensarling and Ranking Member Waters:

CalSTRS was established over 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 $193 billion, which we carefully invest, as patient capital with a long-term investment horizon, to meet the retirement needs of over 900,000 plan participants and their families. [1]

As the CEO of CalSTRS, I am writing to share the concerns of our investment staff, about several specific provisions of the Financial CHOICE Act of 2016 (the CHOICE Act or Act) which your Committee is scheduled to mark-up on Tuesday, September 13th. 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) ability to protect investors. The CHOICE Act is voluminous in pages, and while most of it is focused on financial deregulation, there are many provisions beyond financial deregulation that CalSTRS adamantly opposes. Even the 124 page Comprehensive Summary of the bill, barely touches on the points we raise below. We respectfully request that our concerns be entered in to the public record when the Act is considered on Tuesday.

[1] California State Teachers' Retirement System Current Investment Portfolio as of July 31, 2016. http://www.calstrs.com/current-investment-portfolio and At-a-Glance http://www.calstrs.com/glance

Provisions Repealing Dodd-Frank Governance Reforms

Say-on-Pay

CalSTRS opposes the provision of the Act that would amend 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. 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 would reduce this vote 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 into those pay structures, each and every year. It is our experience, that 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 would repeal Section 971 of Dodd-Frank, entitled Proxy Access. CalSTRS has been adamant supporter of proxy access, the mechanism which allows long-term shareholders to nominate candidates for the board of directors and have their nominees included on the company ballot. 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 would amend Section 954 of Dodd-Frank that would reduce the scope of the clawback requirement. Related to CalSTRS principles on compensation, we believe companies should have broad policies which provide for the ability to recoup compensation in circumstances where it was later determined to have been unearned. This provision would limit 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 would repeal 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 United States have already adopted policies consistent with the CalSTRS principles, we believe that the SEC should issue a final rule. The rule, as currently proposed, would provide complete transparency as to those executives that are permitted to engage in hedging transactions and the types of transactions allowed.

Expanding Exemptions to Comply with Internal Controls

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 to those companies whose market capitalization was less than $75 million. A new provision in the CHOICE Act would raise this exemption for companies with market capitalizations of $250 million. There are approximately 300 companies currently in the Russell 2000 Index with market capitalizations less than $250 million. Under this proposed legislation, investors in these 300 companies, including CalSTRS, would not have the protection of an outside auditors' oversight of the company financial 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 public funds.

Proxy Advisory Firms

CalSTRS opposes Sections 1081 to 1083 of the CHOICE Act that that would impose new regulatory burdens and restrictions on proxy advisors. We believe these sections are 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 which holds over 7000 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 play an important and helpful role in enabling cost effective proxy voting with respect to these 7000 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 the proxy advisors play in the oversight of proxy voting of fund fiduciaries and 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 in fact 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 these provisions of the Act are both unnecessary and counter-productive.

Requirement to Conduct Cost-Benefit Analysis

CalSTRS opposes Sections 611 to 621 of the Act that would replace the SEC's existing economic analysis for rulemaking. The very mission of the SEC is to protect investors, maintain efficient markets and facilitate capital formation. We do not see how the provisions of the Act improve 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 is not easily measured and we believe the provision of the Act would unnecessarily constrain the SEC from fulfilling its mission.

In addition, to the above concerns we are opposed to the provision that repeals the registration and examination requirements on advisers to private equity funds, that was established by Dodd-Frank. As an investor with a large private equity portfolio, we support the current law with respect to registration of these advisers and oversight by the SEC.

We respectfully ask that our views be entered into the record. We would be happy to discuss our perspective on these issues with you or your staff at your convenience. Thank you for your consideration.

Sincerely,

Jack Ehnes
Chief Executive Officer