



California State Teachers'
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April 25, 2017

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

RE: The Financial CHOICE Act

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 \$202 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 in response to reports that the Financial Services Committee will be holding a hearing on a revised Financial CHOICE Act (the CHOICE Act 2.0 or revised CHOICE Act) on April 26. I want to preemptively highlight specific provisions of the discussion draft of the bill posted on April 19. We acknowledge that the primary goal of the revised CHOICE Act is financial deregulation, but there are several provisions that CalSTRS is deeply concerned about, beyond financial deregulation. We want to focus our letter on those revisions we find most alarming to ensure they are not lost amongst the rhetoric of financial deregulation. We respectfully request that our letter be entered in to the public record when the revised bill is considered by the Committee.

Shareholder Proposal Process

The discussion draft includes a provision to dramatically change the shareholder proposal process. Currently under the Securities and Exchange Commission's (SEC) 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 2.0 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. 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

¹ California State Teachers' Retirement System Current Investment Portfolio as of February 28, 2017. <http://www.calstrs.com/current-investment-portfolio> and At-a-Glance <http://www.calstrs.com/glance>.

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.

Universal Proxy Ballot

In October of 2016, the SEC voted to propose amendments to the proxy rules that would require 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, we have to 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 2.0 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 their 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 whose market capitalization was less than \$75 million. A new provision in the revised CHOICE Act would raise 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 proposed legislation, investors in these 680 companies, including CalSTRS, would not have the protection of an outside auditor's oversight of the company's 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 investments from the public markets and an important source for risk mitigation.

Proxy Advisory Firms

The CHOICE Act 2.0 includes provisions that would impose new regulatory burdens and restrictions on proxy advisors, 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 7,000 public companies in our investment portfolio, we use proxy advisors as a research tool to aide in making proxy voting decisions at our portfolio companies. 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 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

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

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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 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. Accordingly, we believe that the existing SEC regulatory regime already protects our interests with respect to proxy advisory firms and that new legislation is both unnecessary and counter-productive.

Private Equity Fund Advisers

“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. This proposed legislation would actually rollback the important investor protections provided to funds like CalSTRS from Dodd Frank, which required transparency in the form of registration and certain reporting from these fund advisers. This legislation will enable private fund advisers to retreat back into the shadows by exempting them from certain disclosure requirements they must now undertake to investors and to the SEC. 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, I 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.

We respectfully ask that our views be entered into the record. We plan to provide more detailed comments once we have reviewed the discussion draft in its entirety and would be happy to discuss our perspective on these issues with you or your staff at your convenience. Thank you for your consideration.

Sincerely,

A handwritten signature in blue ink that reads "Jack Ehnes". The signature is written in a cursive, flowing style.

Jack Ehnes

Chief Executive Officer