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September 1, 2010 **Via email: Markt-cg-fin-inst@ec.europa.eu**

Michael Barnier, Commissioner
DG Internal Market and Services/Company Law,
Corporate Governance and Financial Crime Unit
European Commission
SPA2 03/103 B-1049
Brussels

Dear Mr. Barnier:

Re: Green Paper – Corporate Governance in Financial Institutions and Remuneration Policies

I am writing on behalf of the California Public Employees' Retirement System (CalPERS) to provide comment on the European Commission (EC, Commission) "Green Paper" – Corporate Governance in Financial Institutions and Remuneration Policies. CalPERS is the largest public pension fund in the United States with approximately $206 billion in global assets and equity holdings in over 9,000 companies. CalPERS provides retirement benefits to more than 1.6 million public workers, retirees, their families and beneficiaries. As a significant institutional investor with a long-term investment time horizon, CalPERS has a vested interest in maintaining the integrity and efficiency of the capital markets.

CalPERS commends the Commission for formulating the "Green Paper" and providing us the opportunity to respond. Our significant holdings in European securities include substantial economic interests in Europe's largest financial institutions. For this reason, we consider the reforms addressed by the "Green Paper" to be vitally important.

In general, CalPERS advocates for measures that improve governance with the goal of ensuring a sustainable and stable financial system. We also acknowledge the important role shareowners play in governance and seek to improve shareowner monitoring. While shareowners' rights have grown tremendously over the past 20 years, the financial crisis demonstrates the need for more work in this area.

This letter highlights our key thoughts on each of the consultation's eight sections. We also have attached an appendix, which answers each of the consultation's 38 specific questions.

Boards of directors

In recent months, CalPERS has had many discussions with boards overseeing some of world's largest financial institutions. While our engagements have revealed examples of effective risk management, they have also highlighted failures of boards to identify key risks that ultimately harmed all market participants. We encourage the Commission to thoughtfully address these shortcomings by increasing board independence and accountability to shareowners. The systemic risk posed by financial institutions makes it imperative that effective, independent board oversight is ubiquitous.

In July of 2009, the Investors' Working Group (IWG), an independent taskforce sponsored by the Chartered Financial Analysts (CFA) Institute Centre for Financial Market Integrity and the Council of Institutional Investors (CII), released a report on U.S. financial regulatory reform.[1] In the report, the IWG recommends specific actions to improve corporate governance. CalPERS supports the IWG's perspective that investors need better tools to hold directors accountable so they will be motivated to challenge executives who pursue excessively risky strategies. We believe shareowners serve as the most effective monitors, given our financial interest in the company's performance and ability to make case-by-case judgments. Any regulatory measures should first seek to increase shareowner rights, which lead to better oversight of these institutions.

We also agree with the IWG's position that measures to make it easier for shareowners to nominate and elect directors are a good place to start in addressing the accountability of directors. Shareowners must be able to elect effective board members and hold them accountable. CalPERS supports majority vote standards, proxy access, and annual director elections to ensure director accountability. These measures will help create boards that truly represent the owners of the company.

Risk-related functions

The financial crisis exposed disturbing levels of greed and risk-taking in the financial services industry. A lack of internal controls enabled the irresponsibility. Every institution should have a comprehensive, dynamic, and effective risk strategy. The overall risk assessment should not only include financial risks but operational, strategic, compliance, reputation, and governance risks. The long-term viability of the institution depends on its commitment to working within its risk framework. CalPERS supports any measure that facilitates this practice, as long as the measure gives each institution ample flexibility to address its own specific risks.

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[1] U.S. Financial Regulatory Reform, The Investors Working Group, an independent taskforce sponsored by the CFA Institute and CII, July 2009.

External auditors

External auditors bring an independent and objective view to an institution's financial reporting process. Auditors play a vital role in helping to ensure the integrity of financial reporting, bringing standardization and discipline to corporate accounting, and enhancing investor confidence. Public and investor confidence and stability are critical to the success and effective functioning of the capital markets. Auditing helps bring these attributes to the marketplace.

Supervisory authorities

CalPERS believes that the Commission should take a measured approach to increasing the role supervisory authorities play in the internal governance of financial institutions. We view a company's management team as responsible for addressing risk, with board oversight. Thoughtful management should always avoid taking imprudent risk. The board's monitoring holds management accountable to this standard.

Any board failure in its oversight role is likely due to a lack of understanding of the institution's risk or a lack of power to address it. Board representatives include insiders with a deep knowledge of the company and independent directors chosen for their expertise. If a board cannot grasp the company's exposure to risk and fails at its task, it is unlikely supervisory authorities will succeed. On the other hand, a board may fail due to lack of autonomy or authority to enact change in the institution. In this case, the Commission must directly address the larger issue of board independence.

We do support the supervisory authority's obligation to share any and all examination reports and findings on a financial institution with the independent auditors. Supervisory authorities should also make available any and all agreements the regulator has entered into with the institution.

Conversely, the independent external auditor should make available to the supervisory authorities their audit work papers, audit reports, and management letters. The external auditor should be receptive to inquiries by the authorities regarding audit scope, significant audit risks and issues, and significant audit findings, including deficiencies in internal controls, governance, or management.

If a supervisory examination occurred in the most recent period under audit, the independent auditor should be required to inquire of the supervisory authority as to significant matters and risks that came to the attention of the examiner and document how those items will be addressed in the course of the audit.

Shareowners

The Commission has raised concerns about the effectiveness of shareowner control, citing a lack of shareowner interest in governance. CalPERS believes shareowners should have the right to participate in key corporate governance decisions, including the right to nominate, appoint, and remove directors on an individual basis. Shareowners naturally have a vested interest in monitoring their holdings. If anything, the financial crisis has shown the value-destroying effects of poor governance. Furthermore, academic studies have consistently linked good governance with greater shareowner value. As shareowners increasingly realize the benefits of strong governance, their interest will continue to grow.

Rather than dismissing shareowner control of institutions as unrealistic, the EC should work to remove barriers to effective shareowner engagement. This includes encouraging shareowners to take an active role in governance. The bullet points in section 5.5 highlight potential means of encouraging responsible share ownership. CalPERS broadly supports measures with this goal. At the same time, the EC must encourage directors to be accessible to shareowners and willing to openly discuss risk. Measures promoting shareowner advocacy and director accountability will allow for effective shareowner control and minimize the need for further monitoring.

Effective implementation of corporate governance principles

CalPERS believes that fully accountable corporate governance structures produce, over the long-term, the best returns to shareowners. In particular, implementing principles that encourage director accountability is paramount to shareowner advocacy. Directors should be accountable to shareowners and management accountable to directors. To promote this structure, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company's strategic direction.

We believe that the Commission should seek to hold directors liable for negligence and/or fraud. Furthermore, the Commission must carefully examine any additional regulatory measures with the goal of increasing director accountability without discouraging directorship.

Remuneration - director compensation

Director remuneration packages should align the interests of directors and long-term shareowners. The EC seems particularly concerned with the use of stock options in director remuneration packages. CalPERS believes that thoughtfully designed performance-based incentives can promote prudent oversight. Stock options, with appropriate vesting periods, reward directors for driving sustainable stock performance. Both directors and shareowners benefit from this value creation.
Conversely, certain option characteristics may undermine the original purpose of performance based pay: the alignment of interests. Some practices even reward

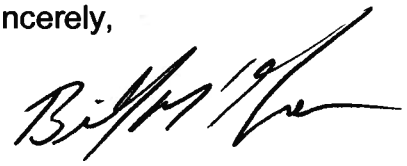
directors despite shareowners struggles. Specifically, CalPERS opposes repricing options without shareowner approval. Adjusting option prices midstream defeats the purpose of performance-based remuneration. The fixed remuneration component serves to mitigate the systemic risk of a down market, while the variable component should reward directors for increasing shareowner value. CalPERS also opposes the issuance of discount options and reload provisions. Discount options may reward the directors in the absence of share price appreciation. Reload provisions lead to excessive share dilution. CalPERS suggests the EC focus on addressing these specific issues, rather than prohibiting the use of stock options.

Conflicts of interest

The provision of greater transparency and visibility to investors, regulators and other market participants is of paramount importance. CalPERS recommends the EC pursue disclosure and market surveillance of conflicts of interest. Working towards adequate transparency will ensure all market participants have the relevant information to make an informed decision. We believe regulators must first question the adequacy of disclosure in cases where market supervision does not suffice. This is especially true in light of the substantial regulation targeting conflicts of interest. The EC must carefully consider any regulation beyond disclosure requirements, defaulting to the status quo.

The following appendix provides more detail on the open comments requested by the European Commission. Thank you for considering our comments. If you would like to discuss any of these points, please do not hesitate to contact me at 1-916-795-2431 or my colleague Mary Hartman Morris at 1-916-795-4129.

Sincerely,



Bill McGrew
Portfolio Manager
Global Equity Corporate Governance

cc: Joseph Dear, Chief Investment Officer – CalPERS
Eric Baggesen, Senior Investment Officer – CalPERS
Anne Simpson, Senior Portfolio Manager – CalPERS
Mary Hartman Morris, Investment Officer – CalPERS

Attachment: Independent Chair/ Lead-Director Position Duty Statement

Appendix

Boards of directors

1.1 Should the number of boards on which a director may sit be limited (for example, no more than three at once)?

CalPERS believes overextended directors may not be able to effectively monitor large, complex organizations. CalPERS current domestic voting practice is to vote against chief executive officers (CEOs) that sit on more than two boards and other directors that sit on more than five boards.

However, we believe prescribing the number of boards on which a director may sit sets a single standard for an issue best addressed by shareowners on a situational basis. Rather than setting limitations, the EC must ensure companies fully disclose each director's competing time commitments. All directors need to be able to allocate sufficient time to the board to perform their responsibilities, which includes allowing some leeway for occasions when greater than usual time demands are made. They should assess their time commitments on an ongoing basis to see if new activities may limit their ability to carry out the role of the company. Furthermore, boards should make substantive disclosures regarding the results of these regular assessments. Such disclosure will allow shareowners to consider these obligations and make informed voting decisions when the director comes up for election.

1.2 Should combining the functions of chairman of the board of directors and chief executive officer be prohibited?

CalPERS supports the International Corporate Governance Network (ICGN) principle that the role of the chair will be most effectively carried out where the chair of the board is neither the CEO nor a former CEO. Furthermore, the chair should be independent on the date of appointment as chair and should not participate in executive remuneration plans. However, a company may have compelling reasons to combine the roles. In these limited cases, the contemplated prohibition would rob investors of any benefits associated with this structure. Instead of prohibiting this structure, the EC should encourage companies to conform to best practices. These include (1) providing shareowners with a written statement explaining why this structure is in their best interest; (2) keeping the structure under review; and (3) appointing and empowering an independent lead director. The lead independent director is responsible for coordinating the activities of the board of directors. The duties of this role should be detailed and outlined on a company's website. Attached is a copy of CalPERS recommended Independent Chair/Lead-Director Position Duty Statement.

1.3 Should recruitment policies specify the duties and profile of directors, including the chairman, ensure that directors have adequate skills, and ensure that the composition of the board is suitably diverse? If so, how?

Corporate governance practices should focus the board's attention on optimizing the company's operating performance, profitability, and returns to shareowners. To accomplish this goal, the board must establish and disclose the mix of director attributes, experiences, diverse perspectives, and skill sets that are most appropriate for the company. The board must then discuss succession planning regularly and provide a mechanism for shareowner input. These steps will better enable the board to fill any openings with candidates who will maximize the board's effectiveness.

1.4 Do you agree that including more women and individuals with different backgrounds in the board of directors could improve the functioning and efficiency of boards of directors?

Corporate boards require a mix of director characteristics, perspectives, and skill sets to drive sustainable value creation. Core attributes of directors that make up a board should address accounting or finance, international markets, business or management experience, industry knowledge, customer-base experience or perspective, crisis response, leadership, and strategic planning as well as address historically under-represented groups on the board, including women and minorities.

1.5 Should a compulsory evaluation of the functioning of the board of directors, carried out by an external evaluator, be put in place? Should the result of this evaluation be made available to supervisory authorities and shareowners?

The board should establish preparation, participation, and performance expectations for itself (acting as a collective body), for the key committees and each of the individual directors. A process by which these established board, key committee, and individual director expectations are evaluated on an annual basis should be disclosed to shareowners. Directors must satisfactorily perform based on the established expectations with renomination based on any other basis being neither expected nor guaranteed. Furthermore, the board, through its committees should have access to adequate resources to provide independent counsel advice, or other tools that allow the board to effectively perform its evaluations.

1.6 Should it be compulsory to set up a risk committee within the board of directors and establish rules regarding the composition and functioning of this committee?

The risk monitoring practices of financial institutions vary significantly in design and effectiveness. Great care must be taken to avoid restraining an institution from creating an individualized strategy that best fits its needs. Furthermore, we believe overall risk assessment is the responsibility of the entire board. A formal risk committee must not

diminish that responsibility. That said, companies should give due consideration to establishing a separate and independent risk committee. However, regulation should not prohibit institutions from evaluating the merits of a risk committee within the context of the company's entire risk framework.

1.7 Should it be compulsory for one or more members of the audit committee to be part of the risk committee and vice versa?

Designating a director to serve on both the audit and risk committee ensures that both committees share all material information. It seems most companies would adopt this arrangement regardless of regulation. However, we do not see a downside to making it compulsory, while continuing to stress the importance of the overall board's review of risks.

1.8 Should the chairman of the risk committee report to the general meeting?

CalPERS believes the risk committee chairman, like all committee chairs, should be required to attend the general meeting and answer any of the shareowners' questions. In the U.S., CalPERS evokes the Council of Institutional Investors' (CII) principle which states that all directors should attend the annual shareowners' meeting and be available, when requested by the chair, to respond directly to oral or written questions from shareowners. In addition to those responsibilities, requiring the risk committee chairman to report at the annual general meeting does not seem unreasonable. Regardless, having the board properly disclose all relevant risk information in the annual proxy should be required.

1.9 What should be the role of the board of directors in a financial institution's risk profile and strategy?

Companies need to take risks, for without risks there will be no returns. However, boards need to understand and ensure that proper risk management is put in place for all material and relevant risks that the company faces. Boards should ensure that companies maintain a documented risk management plan. At least annually, the board should approve the risk management plan which it is then the responsibility of management to implement.

1.10 Should a risk control declaration be put in place and published?

A financial institution may benefit from a risk control declaration; however, a cosmetic declaration is of little use. Rather, it must be indicative of the board and management's consistent devotion to controlling risk. As an engaged shareowner, we look for substantive risk control, whether or not a company has a formalized a declaration. That said, we see little harm in the EC encouraging companies to formalize a declaration.

1.11 Should an approval procedure be established for the board of directors to approve new financial products?

The board has the responsibility to ensure that the company has implemented an effective, dynamic and ongoing process to identify risks, measure their potential outcomes, and proactively manage those risks to the extent appropriate. The board should also determine the company's risk-bearing capacity and the tolerance limits for key risks, to avoid the company exceeding an appropriate risk appetite. This process needs to be dynamic to respond to risks as they develop and as the company's business and marketplace develop. If necessary the board should seek independent external support to supplement internal resources.

1.12 Should a specific duty be established for the board of directors to take into account the interests of depositors and other stakeholders during the decision-making procedure ('duty of care')?

Members of company boards are fiduciaries who must act in the best interests of the company and its shareowners. As fiduciaries, directors owe a duty of care and diligence to, and must act in the best interests of, the company.

1.13 What measures are needed to strengthen implementation of corporate governance rules? For example, should the civil and criminal liability of executives be reinforced, in view of the fact that the rules governing criminal proceedings are not harmonised at European level?

See Question 1.12

Risk-related functions

2.1 How can the status of chief risk officer be enhanced? Should the status of chief risk officer be at least equivalent to that of the chief financial officer?

CalPERS is primarily concerned with the risk officer's autonomy, as facilitated by the officer's ability to report directly to the board (see Question 2.3). A risk officer must have the authority to access all the relevant data and elicit timely responses from the management team. To this extent, an officer's "status" appears consequential. However, the definition of status is somewhat arbitrary, and we foresee difficulties in regulating an officer's status. Instead, we feel the Commission should focus on enabling the risk officer to operate independently of management.

2.2 How can the communication system between the risk management function and the board of directors be improved? Should a procedure for referring conflicts/problems to the hierarchy for resolution be set up?

Boards should obtain assurance from management that the risk information provided to the board is complete and reliable with regards to identified risks and that the management has undertaken all reasonable endeavours to identify all material risks.

2.3 Should the chief risk officer be able to report directly to the board of directors, including the risk committee?

To effectively monitor risk, the chief risk officer (CRO) must have autonomy. A structure where the CRO reports to management can create conflicting incentives. For example, a CRO's motivation to decrease risk could conflict with management's desire to maximize profitability. A CRO who reports to a CEO may downplay certain risks to appease his/her boss. CalPERS endorses a structure where the CRO reports directly to the board and risk committee to address this concern.

2.4 Should IT tools be upgraded in order to improve the quality and speed at which information concerning significant risks is transmitted to the board of directors?

While insufficient IT tools could impair a board's ability to monitor risk, we are not aware of any specific cases.

2.5 Should executives be required to approve a report on the adequacy of internal control systems?

Internal controls are designed and owned by management of a company. In the US, with the enactment of the 2002 Sarbanes Oxley Act , Section 404 requires that all publicly traded companies establish internal controls and procedures for financial reporting. Companies must document, test, and maintain these controls and procedures to ensure their effectiveness. We believe management should be able to attest to the adequacy of internal control systems.

External auditors

3.1 Should the cooperation between external auditors and supervisory authorities be deepened? If so, how?

An external auditor brings an independent and objective view to an institution's financial reporting process which provides useful information to investors, management, audit committees, and other stakeholders. Supervisory or regulatory authorities, through examiners, focus on key aspects that would also be helpful to the external auditor. CalPERS agrees that cooperation between external auditors and supervisory/regulatory

authorities should be deepened. We agree that supervisory/regulatory authorities should also have a duty to inform external auditors of significant matters that may be material to the planning and execution of an audit.

3.2 Should their duty of information towards the board of directors and/or supervisory authorities on possible serious matters discovered in the performance of their duties be increased?

Yes, auditors play a key role in the integrity of financial reporting which is emphasized more keenly with the market crisis. Financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions.

In the U.S., the Public Company Accounting Oversight Board (PCAOB), in its oversight role, proposed an auditing standard with Audit Committees (Docket Matter No. 030) to enhance the relevance and effectiveness of the communications between the auditor and the audit committee to better achieve the objectives of an audit. CalPERS believes it is imperative that the auditor's duty of information on possible serious matters discovered in the performance of their duties should be shared with the board of directors. The confidence and stability of the markets rely heavily on the integrity of financial reporting. We believe increasing the quality of an audit and the auditor's role in providing this information to boards will only improve and restore this confidence. We are mindful that shareowners need to determine whether the increased role of the auditor will provide additional value equivalent to the possible increase in cost to the issuer.

3.3 Should external auditors' control be extended to risk-related financial information?

It is important that the Commission aim to strengthen the external auditors' role in alerting the financial institution's board to substantial risks they discover in their assessments. In this regard, we support the idea that auditors should validate more risk-related information than they do at present to improve investors' confidence.

An effective risk-based auditing program will cover all of an institution's major activities. Auditors currently determine where resources should be allocated in completing an audit and ensuring the effects of risks to a material misstatement in the financial statements.

Investors would value a more enlightened and informative opinion, as well as auditor reports on items that significantly impact the accounts. For example the introduction of an Auditor's Discussion and Analysis Report (AD&A) could highlight:

- Key business and audit risks the auditor believes exist and has considered when conducting the audit;

- Other relevant types of material risks, besides financial risks, including relevant information on operational, strategic, compliance, pension, liquidity, and governance risks;
- The auditor's perspective on what are the key assumptions used in judgments that materially affect the financial statements, and whether those assumptions are at the low, most likely, or high-end of the range of possible outcomes;
- Key audit issues and their resolution;
- Changes to accounting policies that have a significant impact, such as significant reclassifications;
- Unusual transactions, restatements, and significant changes in segmental reporting and consolidation;
- Accounting applications and practices that are unique to the industry;
- Explanation of changes in the view and interpretation of material information by the external auditor compared to prior reporting periods;
- Definitions used by the financial institution for disclosed performance ratios.

The auditor's role and relationship with the audit committee is an important part of the process and should be strengthened. The introduction of an Auditor's Discussion and Analysis Report would provide comprehensive disclosures which would assist investors in making their capital allocation decisions.

Supervisory authorities

4.1 Should the role of supervisory authorities in the internal governance of financial institutions be redefined and strengthened?

CalPERS agrees that the role of supervisory authorities in the internal governance of financial institutions should be redefined and that where a financial institution gives rise to systemic risks, the supervisory authorities' processes should consider these matters. The supervisory authorities should make public the methodology used to identify and rank systemic risks and their level of importance to the institution. Investors would benefit from receiving timely disclosures on these specific systemic risks.

4.2 Should supervisory authorities be given the power and duty to check the correct functioning of the board of directors and the risk management function? How can this be put into practice?

It may be necessary for supervisory authorities to be given the power and duty to check the correct functioning of the board of directors and the risk management function where systemic risks are apparent.

4.3 Should the eligibility criteria ('fit and proper test') be extended to cover the technical and professional skills, as well as the individual qualities, of future directors? How can this be achieved in practice?

In addition to any eligibility criteria ('fit and proper test") currently required, CalPERS believes that succession planning of future directors is key to assessing the technical skills, professional skills, and individual qualities of directors.
We believe this can be achieved through the board proactively leading the development, implementation, and continual review of a director succession plan. Board members should be required to have a thorough understanding of the characteristics necessary to effectively oversee management's execution of a long-term strategy that optimizes operating performance, profitability, and shareowner value creation. At a minimum, the director succession planning process should:

- Become a routine topic of discussion by the board;
- Encompass how expected future board retirements or the occurrence of unexpected director turnover as a result of death, disability, or untimely departure is addressed in a timely manner;
- Encompass how director turnover either through transitioning off the board or as a result of rotating committee assignments and leadership is addressed in a timely manner;
- Provide for a mechanism to solicit shareowner input;
- Be disclosed to shareowners on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely director succession plan.

Shareowners

5.1 Should disclosure of institutional investors' voting practices and policies be compulsory? How often?

CalPERS, in general, supports the disclosure of institutional investors' voting practices and policies. In the interest of improving investors' abilities to manage risk, CalPERS advocates for greater transparency in the market and believes in holding institutional investors accountable to the same standards.

5.2 Should institutional investors be obliged to adhere to a code of best practice (national or international) such as, for example, the code of the International Corporate Governance Network (ICGN)? This code requires signatories to develop and publish their investment and voting policies, to take measures to avoid conflicts of interest and to use their voting rights in a responsible way.

Recognition of the role institutional investors perform in the capital markets, and their abundant responsibilities and obligations is vital. While institutional investors support

greater shareowner rights, they also recognize the responsibility which comes with such rights and their need to stay vigilant in the capital markets. CalPERS believes institutional investors should adhere to a code of best corporate governance practices. It is CalPERS fiduciary duty to constituents to vote our shares accountably and diligently. In this regard, CalPERS has certainly benefited from ICGN membership and adherence to the organization's code.

5.3 Should the identification of shareowners be facilitated in order to encourage dialogue between companies and their shareowners and reduce the risk of abuse connected to 'empty voting'?

In principle, CalPERS supports increased disclosure in financial markets. While disclosure of the identification of shareowners could help mitigate the risk of empty voting, further regulation is necessary to address all the mechanical and economic issues that contribute to it.

That said, CalPERS is not aware of evidence that suggests compulsory disclosure of shareowner identity would promote additional dialogue between companies and their shareowners.

5.4 Which other measures could encourage shareowners to engage in financial institutions' corporate governance?

No additional comments

Effective implementation of corporate governance principles

6.1 Is it necessary to increase the accountability of members of the board of directors?

Director accountability is paramount to shareowner advocacy. Directors should be accountable to shareowners and management accountable to directors. To promote this structure, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company's strategic direction. Furthermore, CalPERS believes proxy access, majority vote standards for director elections, and annual director elections are the most effective ways to increase director accountability.

6.2 Should the civil and criminal liability of directors be reinforced, bearing in mind that the rules governing criminal proceedings are not harmonized at European level?

We believe that the Commission should seek to hold directors liable for negligence and/or fraud. Furthermore, the Commission must carefully examine any additional regulatory measures with the goal of increasing director accountability without discouraging directorship.

Director remuneration

7.1 What could be the content of possible additional measures at EU level on remuneration for directors of listed companies?

CalPERS believes effective director remuneration agreements have cash and equity components, strong pay for performance methodology, and the goal of aligning shareowner and director interests. The equity component must incentivize sustainable performance. Accordingly, we endorse a minimum three-year vesting period for any restricted stock or stock options.

7.2 Do you consider the problems related to directors' stock options should be addressed? If so, how? Is it necessary to regulate at Community level, or even prohibit the granting of stock options?

Stock options can be an effective tool to align the interests of directors and shareowners. Yet the board must design compensation arrangements with long-term performance in mind. The aforementioned three-year vesting period is essential to addressing the potential short-term incentives created by stock options. It should also be noted that discount options, reload provisions, and repricing without shareowner approval should be considered inappropriate characteristics. As previously discussed, these characteristics do not align shareowners' and directors' interests.

Additionally, CalPERS supports disclosing in full the fees and services provided by compensation consultants to allow for better management of conflicts of interests.

7.3 Do you think that the favourable tax treatment of stock options and other similar remuneration existing in certain Member States helps encourage excessive risk-taking?

No comment

7.4 Do you think that the role of shareowners, and also that of employees and their representatives, should be strengthened in establishing remuneration policy?

CalPERS believes the board, through an independent compensation committee, should maintain the sole authority to design and implement executive compensation packages.

7.5 What is your opinion of severance packages (so-called 'golden parachutes')? Is it necessary to regulate at Community level, or even prohibit the granting of such packages? If so, how?

Recommendation 2009/385/EC summarizes the main purpose of a director severance package, labeling it as a "safety net in case of early termination of the contract." The financial institution must set the duration and magnitude of severance packages with

this objective. More specifically, we endorse the ICGN's recommendation that employment agreements, severance, and change in control arrangements should be strictly limited. As a rule, these arrangements should not adversely affect the executive's alignment of interest with shareowners or their incentive to pursue superior long-term value.

Companies should provide full disclosure of the existence of all employment agreements, severance arrangements, change in control agreements, or any other contractual agreements with key executives. Disclosure should include a description of the agreement with sufficient detail of all material factors such that shareowners have a complete understanding of their terms. Companies should provide estimated payments under specific scenarios such that shareowners can determine the potential payouts under each agreement.

7.6 Do you think that the variable component of remuneration in financial institutions which received public funding should be reduced or suspended?

Theoretically, the variable component of a company's pay incentivizes strong performance. Extraordinary circumstances aside, it seems counterintuitive that directors of an institution in need of public funding would receive pay linked to the performance of the company. Such a situation exposes the need to improve the design of performance criteria. When designing variable pay packages, the EC must encourage companies to use quantifiable hurdles that truly reflect a firm's performance. In the absence of effectively designed performance criteria, CalPERS supports the proposed reduction or suspension.

Conflicts of interest

8.1 What could be the content of possible additional measures at EU level to reinforce the combating and prevention of conflicts of interest in the financial services sector?

All entities should have clear policies for identifying, recording, managing, and disclosing conflicts of interests and related party transactions.

8.2 Do you agree with the view that, while taking into account the different existing legal and economic models, it is necessary to harmonise the content and detail of Community rules on conflicts of interest to ensure that the various financial institutions are subject to similar rules, in accordance with which they must apply the provisions of MiFID, the CRD, the UCITS Directive or Solvency 2?

We support harmonizing the content and detail of Community rules on conflicts of interest to ensure that various financial institutions are subject to similar rules.

INDEPENDENT CHAIR/LEAD-DIRECTOR POSITION DUTY STATEMENT

The independent chairperson is responsible for coordinating the activities of the board of directors including, but not limited to, those duties as follows:

- Coordinate the scheduling of board meetings and preparation of agenda material for board meetings and executive sessions of the board's independent or non-management directors.
- Lead board meetings in addition to executive sessions of the board's independent or non-management directors.
- Define the scope, quality, quantity and timeliness of the flow of information between company management and the board that is necessary for the board to effectively and responsibly perform their duties.
- Oversee the process of hiring, firing, evaluating, and compensating the CEO.
- Approve the retention of consultants who report directly to the board.
- Advise the independent board committee chairs in fulfilling their designated roles and responsibilities to the board.
- Interview, along with the chair of the nominating committee, all board candidates, and make recommendations to the nominating committee and the board.
- Assist the board and company officers in assuring compliance with and implementation of the company's Governance Principles.
- Act as principal liaison between the independent directors and the CEO on sensitive issues.
- Coordinate performance evaluations of the CEO, the board, and individual directors.
- Recommend to the full board the membership of the various board committees, as well as selection of the committee chairs.
- Be available for communication with shareowners.