California Public Employees' Retirement System
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
TTY: (916) 795-3240
(916) 795-3400 phone • (916) 795-2842 fax
www.calpers.ca.gov

July 6, 2015 Via E-Mail: rule-comments@sec.gov

Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Mr. Fields:

Re: File No. S7-07-15, Pay versus Performance, Amendments to Item 402 of Regulation S-K, to implement Section 14(i) as added by Section 953(a) of the Dodd-Frank Act, new disclosure in item 402(v) of Regulation S-K **http://www.sec.gov/rules/proposed/2015/34-74835.pdf**

I write on behalf of the California Public Employees' Retirement System (CalPERS) regarding the Securities and Exchange Commission's (SEC) proposed rule to require registrants to disclose the relationship between executive compensation paid and the financial performance of the registrant, or more commonly referred to as "Pay versus Performance." CalPERS is the largest public defined benefit pension fund in the United States with approximately $309 billion in global assets.[1] CalPERS' Investment Office mission is to manage its assets in a cost effective, transparent and risk-aware manner in order to generate returns to pay benefits. We manage these assets on behalf of more than 1.7 million public employees, retirees, and beneficiaries.

Thank you for the opportunity to comment on the proposed rule on Pay versus Performance. CalPERS' Board of Administration has adopted a set of ten Investment Beliefs intended to provide a basis for strategic management of CalPERS investment portfolio. Investment Belief 4 states, "Long-term value creation requires effective management of three forms of capital – financial, physical and human."[2] Transparency around compensation is essential to shareowners assessing management incentives. Furthermore we state, "Strong governance with effective management of environmental and human capital factors, increases the likelihood that companies will perform over the long term and manage risk effectively."[3] In one

---

[1] CalPERS investment fund values as of market close on July 2, 2015, http://www.calpers.ca.gov/index.jsp?bc=/investments/assets/mvs.xml

[2] Investment Committee, Agenda Item 6a, Adoption of CalPERS Investment Beliefs, September 16, 2013. https://www.calpers.ca.gov/docs/board-agendas/201309/invest/item06a-00.pdf, Attachment 1, CalPERS Investment Beliefs PowerPoint, page 5 of 11, September 16, 2013. https://www.calpers.ca.gov/docs/board-agendas/201309/invest/item06a-01.pdf

[3] Investment Committee, Agenda Item 6a, Adoption of CalPERS Investment Beliefs, September 16, 2013.

study researchers found a negative link between incentive compensation and future firm performance which is magnified in firms with weaker corporate governance.[4]

CalPERS Supports Performance Based Compensation – Compensation of executives in publicly listed companies should be driven predominantly by performance.[5] As outlined in CalPERS Global Governance Principles, we advocate that:

> The Compensation committee should establish performance measures for executive compensation that are agreed to ahead of time and publicly disclosed. Multiple performance measures should be used in an executive's incentive program, and the measures should be sufficiently diverse that they do not simply reward the executive multiple times for the same performance. The measures should be aligned with the company's short- and long-term strategic goals, and pay should incorporate company-wide performance metrics, not just business unit performance criteria. Compensation Committees should have a well-articulated philosophy that links compensation to long-term business strategy. Any sustainability objectives that trigger payouts should be disclosed. [6]

Trends in Compensation Disclosure Requirements - The Sarbanes-Oxley Act in 2002 had an impact on many executive compensation arrangements and their administration. These included a prohibition on personal loans to directors and executive officers, accelerated Section 16 filing deadlines, restrictions on company stock sales during retirement and plan blackout periods, disgorging executive pay due to accounting restatements and a freeze on extraordinary payments to directors and officers.[7]

The financial crisis in 2008 was of a scale and severity not seen in generations prompting many regulatory bodies to review rules to foster safety and soundness.[8] The crisis raised many questions about the link between executive pay and risk-taking. [9]

---

[4] "Performance for pay? The Relation between CEO incentive compensation and future stock price performance" Michael J. Cooper, University of Utah, Huseyin Gulen, Purdue University, P. Raghavendra Rau, University of Cambridge, October 2014. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572085

[5] *CalPERS Global Governance Principles*, California Public Employees' Retirement System, Updated March 16, 2015, Role of Compensation Committee, Section 5.5 d. Pay for Performance, https://www.calpers.ca.gov/page/investments/governance/proxy-voting

[6] *CalPERS Global Governance Principles*, California Public Employees' Retirement System, Updated March 16, 2015, Role of Compensation Committee, Section 3.1.g & h, Executive Compensation Alignment with Business Strategy and Sustainability Objectives and Executive Compensation https://www.calpers.ca.gov/page/investments/governance/proxy-voting

[7] McDermott Will & Emery, Sarbanes-Oxley Action publication, "Implications for Executive Compensation, August 2002. http://www.mwe.com/publications/uniEntity.aspx?xpST=PublicationDetail&pub=5788

[8] "Wall Street Reform: The Dodd-Frank Act", White House Briefing room. https://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform

The Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July of 2010 was intended to prevent the excessive risk-taking that led to the financial crisis.[10] The Dodd-Frank Act has led to additional measures such as the advisory shareowner vote on executive compensation (Say on Pay), and requirements ensuring independent compensation committees and consultants. The SEC is currently working on pay clawbacks and pay ratio disclosures. Although the link between pay and performance is not currently adequately addressed, these new provisions will provide significant improvement to disclosures.

Proposed Rule on Pay versus Performance - We view compensation programs as one of the most powerful tools available to a company to attract, retain, and motivate employees to optimize company performance.

CalPERS supports the amendment to Item 402 of Regulation S-K that adds new disclosures in Item 402(v) requiring a clear description of:

1. The relationship between executive compensation actually paid to the registrant's Named Executive Officers (NEOs) and the cumulative total shareholder return (TSR) of the registrant, and
2. The relationship between the registrant's TSR and the TSR of a peer group chosen by the registrant, over each of the registrant's five most recently completed fiscal years.

Proposed Rule Adds Value - We believe the proposed rule adds value to information that investors will use in their analysis. CalPERS supports including the new Pay versus Performance table within the Compensation Discussion and Analysis (CD&A) section within the proxy, directly after the Summary Compensation Table. We recommend that graphs be shown for the most recent five years in addition to the tabular format and narrative to detail trends better. Totals from the Summary Compensation Table should be included in the new table for the Principal Executive Officer (PEO) and all Named Executive Officers (NEOs) with comparison to the measurements of:

1. Summary Compensation Table Total (from CD&A) for PEO over the last 5 years
2. Compensation actually (proposed adjustments) paid to PEO over the last 5 years
3. Average Summary Compensation Table Total for non-PEO NEOs
4. Average compensation actually (proposed adjustments) paid to non-PEO NEOs
5. Cumulative TSR for five most recently completed years
6. Cumulative TSR for five most recently completed years of a registrant peer group

Given the Summary Compensation Table includes all NEOs, the Pay versus Performance Table should also include all other NEOs in addition to the PEO.

---

[9] "Has Executive Compensation contributed to the Financial Crisis?" The World Bank, by Asli Demirguc-Kunt, January 30, 2012. http://blogs.worldbank.org/allaboutfinance/has-executive-compensation-contributed-to-the-financial-crisis

[10] Wall Street Reform: The Dodd-Frank Act", White House Briefing room. https://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform

Through the CalPERS Focus List[11] corporate engagement program,[12] we understand the need not only for multiple metrics in design of compensation plans but also in evaluating the long–term strategy of a company. Companies needing to make changes in strategy which in the long-term will drive shareowner value, may not be evident in TSR.

We agree that a consistent approach by issuers requiring disclosure on executive compensation actually paid in the Summary Compensation Table, along with TSR and peer group TSR over the most recently completed five fiscal years, in a prescribed table will be useful in evaluating a company's executive compensation policies and practices. TSR and peer group TSR are metrics that assist companies in articulating and providing justification for their compensation plans.

Support to Continue Tagging - CalPERS is a long-time supporter of tagging data through eXtensible Business Reporting Language (XBRL).[13&14] We think the SEC should continue to require tagging. XBRL is a structured data standard designed to foster a functioning after-market for securities – a market with robust liquidity, that can be accessed at minimal costs and that investors trust.[15] The future value of XBRL to investors is the efficiency in filtering large amounts of data, obtaining accurate and comparable information and having the ability to drill down multiple levels of information when analyzing companies.

No Exemption for Smaller Reporting Companies – As stated in past letters, CalPERS does not favor excluding any publicly listed companies from reporting requirements.[16] The cost of compliance may initially appear to be a larger cost for a smaller company, but research in similar contexts has shown that the lack of transparency ultimately penalizes such exempted companies in the market.[17] Although we agree that compensation must be

[11] Focus List Program, https://www.calpers.ca.gov/page/investments/governance/corporate-engagements/focus-list-program

[12] Corporate Engagements , https://www.calpers.ca.gov/page/investments/governance/corporate-engagements

[13] CalPERS letter to the SEC on Proposed Rule – Interactive Data to Improve Financial Reporting, Dennis Johnson, Senior Portfolio Manager, Corporate Governance, July 24, 2008. https://www.sec.gov/comments/s7-11-08/s71108-19.pdf

[14] CalPERS letter to the SEC Concept Release on the U.S. Proxy System, Data Tagging Proxy Related Materials, Bill McGrew, Portfolio Manager, Global Equity, October 14, 2010. https://www.sec.gov/comments/s7-14-10/s71410-177.pdf

[15] Letter to Honorable Robert Hurt, US House of Representatives opposing the exemption of smaller companies from XBRL filing, XBR.US in the national consortium for xml business reporting standards, October 22, 2013.

[16] CalPERS letter to the SEC, Proposed rule on Proxy disclosure and solicitation enhancements, against Item 402 of Reg. S-K which allows smaller reporting companies to provide scaled disclosure, page 2, #2

[17] "Going Public after the Jobs Act", page 33, by Carlos Berajo, Loyola Law School, August 2014. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2423683

tailored to meet unique company needs, we believe specific principles on executive compensation disclosures should apply to all companies.[18] Executive compensation practices should establish a foundation for aligning management with long-term shareowners of all publically listed companies.

CalPERS Global Governance Principles support Multiple Performance Metrics in Design of Long-Term Compensation Plans - CalPERS values its vote as a shareowner and utilizes a wide-range of analysis in reviewing a company's executive compensation plans. Among other items as part of our review process, we consider both absolute and relative returns over a one, three and five year periods in evaluating a company's executive compensation plans consistent with CalPERS Principles.[19]

CalPERS believes compensation plan designs should utilize multiple performance measures that include financial and relevant sustainability metrics when linking pay to performance.[20] Specifically, certain financial metrics may include TSR, earnings growth, economic value added (EVA), return on invested capital (ROIC), return on equity (ROE), return on assets (ROA), and other measures. A 2013 study found that among companies using performance-based long-term incentives; 53% use a mix of TSR and financial measures in their long term equity plans; 28% use financial measures only, and a smaller minority 15% use TSR only.[21]

CalPERS broadly supports the use of TSR and Peer TSR requirements. However, we acknowledge the limitations of TSR and the exogenous factors that can affect the measure. A recent study by IRRCi, shows that 17.3% of the S&P 1500 of listed companies over five years (2008-2012) had a positive relative TSR, while at the same time they achieved a five-year cumulative negative economic profit and a five-year return on invested capital which was less than their weighted average cost of capital (WACC). Additionally, this study and letter written to the SEC provides support that companies should use multiple metrics such as balance sheet and capital efficiency performance metrics relative to their weighted average cost of capital to drive long term value for a company.[22] Though no single performance measure is

[18] *CalPERS Global Governance Principles*, California Public Employees' Retirement System, Updated March 16, 2015, Appendix D: The Council of Institutional Investors Corporate Governance Policies (2014), Executive Compensation Section 5.1. https://www.calpers.ca.gov/page/investments/governance/proxy-voting

[19] *CalPERS Global Governance Principles*, California Public Employees' Retirement System, Executive Compensation Section 3.2.d, , Updated March 16, 2015, https://www.calpers.ca.gov/page/investments/governance/proxy-voting

[20] Sustainability Accounting Standards Board (SASB), Accounting for a Sustainable Future, Conceptual Framework. http://www.sasb.org/approach/conceptual-framework/

[21] Study sponsored by the State Board of Administration Florida with Farient Advisors," Performance Metrics and their Link to Value", February 2013. http://www.sbafla.com/fsb/Portals/Internet/CorpGov/ReportsPublications/February_2013_SBA_Governance_Brief_LinktoValue.pdf

[22] Letter to the SEC, May 6, 2015, Jon Lukomnik, Executive Director, IRRS Institute http://www.sec.gov/comments/s7-07-15/s70715.shtml, IRRCi Research Report, "*The Alignment Gap Between*

perfect, the study identifies opportunities for companies to enhance long-term shareowner value alignment and long term incentive plan design. [23]

It is important to further emphasize that we advocate use of metrics in the design of compensation plans which relate to long-term sustainable value creation. We encourage registrants to issue supplemental disclosures to ensure shareowners have the complete picture on how compensation plans are designed. Consideration should also be given to metrics that link compensation to sustainability objectives related to risk management, the environment, and health and safety standards. Compensation plans should be designed to drive and reward behavior that aligns with the company's long-term business strategy and are pertinent to the industry. The examples of Massey Energy and BP show that companies can be susceptible to risk and financial loss related to sustainability performance.[24] Although linking sustainability performance to senior executive compensation is in its infancy, a small but growing number of companies have begun including additional sustainability performance measures. A 2014 Ceres report evaluated over 600 U.S. Companies and found that 24 percent tie environmental, social and governance (ESG) performance to executive compensation, up from 15 percent in 2012.[25]

As a long-term shareowner, CalPERS firmly supports the idea that compensation plans should be designed to incentivize long-term performance. In fact, long-term incentive plan designs currently focus on the short-term. Ninety percent of Standard & Poor's 1,500 companies' long-term incentive plans have performance periods of three years or less.[26] CalPERS considers long-term to be five or more years for mature companies.

Annual Disclosure - Filed versus Furnished - In conclusion, we agree that the proposed disclosure should be included in the proxy and more specifically in the CD&A section on an annual basis. CalPERS believes information should be considered filed versus furnished taking advantage of Exchange Act Section 18a, providing enforcement against false or misleading statements or omissions. Although some companies have a three-year Say-on-Pay advisory vote, we recommend this information be included on an annual basis for better comparison.

Creating Value, Performance Measurement and Long-Term Incentive Design", IRRC, Organizational Capital Partners, and Shareholder Value Advisors, November 17, 2014. http://irrcinstitute.org/pdf/alignment-gap-study.pdf

[23] IRRCi Research Report, "*The Alignment Gap Between Creating Value, Performance Measurement and Long-Term Incentive Design*", IRRC, Organizational Capital Partners, and Shareholder Value Advisors, Page 28, Understanding TSR, November 17, 2014. http://irrcinstitute.org/pdf/alignment-gap-study.pdf

[24] Spring of 2010 an explosion killed 29 miners at Massey and also in 2010 BP's Deepwater Horizon explosion and oil spill in the Gulf of Mexico, following a fatal fire in 2005, a 2006 breach in an Alaskan Pipeline which resulted in 30 BP worker's deaths. New York Times, BP to Pay $18.7 Billion for Deepwater Horizon Oil Spill, by Campbell Robertson, John Schwartz and Richard Perez-Pena, July 2, 2015.

[25] ISS Linking Sustainability to Compensation 2015 Report,

[26] IRRCi Research Report, "*The Alignment Gap Between Creating Value, Performance Measurement and Long-Term Incentive Design*", IRRC, Organizational Capital Partners, and Shareholder Value Advisors, Page 12, November 17, 2014. http://irrcinstitute.org/pdf/alignment-gap-study.pdf

The proposed rule on Pay versus Performance is a substantive step towards better disclosures on executive compensation. We look forward to commenting on the other issues outstanding, such as pay ratio [27] and the recently released proposed listing standard rule on clawbacks. Again, thank you for the opportunity to provide our comments.

If you have any questions, please do not hesitate to contact James Andrus at 916-795-9058, james.andrus@calpers.ca.gov.

Sincerely,

ANNE SIMPSON
Senior Portfolio Manager, Investments
Director of Global Governance

cc: James Andrus, CalPERS Global Governance

[27] CalPERS letter to the SEC on the proposed rules on Pay Ratio , http://www.sec.gov/comments/s7-07-13/s70713-579.pdf
December 2, 2013.