HOW WILL YOU SPEND YOUR FUTURE?

California State Teachers'
Retirement System
Sustainable Investment & Stewardship Strategies
100 Waterfront Place, MS 4
West Sacramento, CA 95605

March 2, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: File Number S7-07-15 Pay Versus Performance

Dear Secretary Countryman:

California State Teachers' Retirement System (CalSTRS) provides a secure retirement to more than 980,000 members and beneficiaries whose CalSTRS-covered service is not eligible for Social Security participation. Established in 1913, CalSTRS is the largest educator-only pension fund in the world with $319.9 billion in assets under management as of November 30, 2021.

CalSTRS appreciates the Commission's continued effort to facilitate transparency and comparability in executive pay. This information helps us determine how to vote compensation plan proposals and specifically evaluate the alignment between pay and performance. The CalSTRS Corporate Governance Principles[1] describe our preference for executive compensation plans which align the interests of management and long-term shareholders.

CalSTRS supports the Commission's plan, as outlined in the 2015 Proposing Release and modified in the Reopening Release, to finalize a rule to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).[2]

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[1] Dated January 27, 2021: https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf?1555520993

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act § 953(a), Pub. L. No. 111–203, 124 Stat. 1376 (2010), https://www.govinfo.gov/content/pkg/STATUTE-124/pdf/STATUTE-124-Pg1376.pdf#page=1 ("DISCLOSURE OF PAY VERSUS PERFORMANCE.—Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n), as amended by this title, is amended by adding at the end the following: '(i) DISCLOSURE OF PAY VERSUS PERFORMANCE.—The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer a clear description of any compensation required to be disclosed by the issuer under section 229.402 of title 17, Code of Federal Regulations (or any successor thereto), including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions. The disclosure under this subsection may include a graphic representation of the information required to be disclosed.'").

However, CalSTRS urges the Commission to make two changes central to fostering useful information about the incentives that drive corporate executives' actions as they affect financial outcomes for shareholders. CalSTRS is a member of the Council of Institutional Investors (CII), which submitted a letter to the SEC dated February 24, 2022,[3] concerning this Release and provides further details supporting our recommendations:

1. The final rule should revise Item 402 of Regulation S-K[4] to explicitly require registrants to disclose *all* of the quantitative metrics, targets, and thresholds the registrant actually uses in determining the "named executive officers" (NEO) incentive compensation paid for the current year.

2. The final rule should also incorporate CII's 2019 SEC rulemaking petition (2019 Petition).[5] The 2019 Petition would amend Item 402(b) of Regulation S-K to close a loophole that permits the use of measures which are not aligned with generally accepted accounting principles (GAAP), i.e. non-GAAP metrics, in the Compensation, Discussion & Analysis section of a company's proxy statement without providing a quantitative reconciliation of those metrics to the most directly comparable GAAP financial measures. The quantitative reconciliation would provide an important new source of information to investors in evaluating executive compensation packages which are based on non-GAAP metrics.

Should registrants be required to disclose additional performance measures beyond total shareholder return? Would pre-tax net income and net income be useful additional financial measures if required?

A well-designed compensation plan will be structured around financial and qualitative metrics that drive sustainable long-term value in the business. Companies should describe and disclose the types of metrics that are used in the short-term and long-term and articulate how those metrics link to the strategy of the company. Careful consideration should be given to ensure short and long-term incentives are linked but not duplicative.

If the company intends to use any adjusted performance measures (non-GAAP metrics), the company should provide a detailed rationale, including a line item reconciliation of each metric and the impact on the program.

CalSTRS would find it useful to have pre-tax net income and net income presented in tabular format alongside the other metrics that would be required under the Reopening Release.

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[3]https://www.cii.org/files/issues_and_advocacy/correspondence/2022/February%2024,%202022%20CII%20P4P%20letter%20(final).pdf

[4] Executive Compensation, 17 C.F.R. § 229 (Item 402) (2019), available at https://www.law.cornell.edu/cfr/text/17/229.402.

[5] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission 1 (Apr. 29, 2019), https://www.sec.gov/rules/petitions/2019/petn4-745.pdf

CalSTRS understands that not all value-drivers can be captured in quantifiable metrics and in many cases it may be crucial to include qualitative or line-of-site metrics. If qualitative metrics are used, companies should describe and disclose their total weight in the overall plan, how the company will measure the performance of those metrics, and the board's involvement of the oversight of the total plan.

CalSTRS would encourage the Commission to direct companies which choose to select sustainability or ESG metrics for compensation to select metrics from a suitable standard such as those developed by the Sustainability Accounting Standards Board (SASB), which will become the basis for the forthcoming sustainability standards issued by the International Sustainability Standards Board (ISSB). SASB standards are rigorously developed under due process and with corporate and investor feedback about their relevance, usefulness, and the feasibility of preparing the metrics for investor disclosures; these are some of the reasons which make these standard metrics suitable for assurance, and if faithfully disclosed, comparable across companies in a given industry.

With respect to Commissioner Peirce's statement[6] about "whether we should permit companies greater flexibility to determine which financial performance measure is appropriate," CalSTRS would argue there is so much flexibility now that comparability has suffered. Pre-tax net income and net income could be helpful and standard GAAP measures to control against the stock-price gaming efforts from share buy-backs or financial engineering to achieve earnings per share targets which have helped line the pockets of corporate executives.

Should registrants be required to disclose the measure that in the registrant's assessment represents the most important performance measure used by the registrant to link compensation actually paid during the fiscal year to company performance (which is called the "Company-Selected Measure")?

In an answer, yes. Investors and owners need to know what drivers will determine how much cash is paid to NEOs rather than put to other corporate uses. Over the past few years—even before the COVID-19 pandemic emerged—there has been a disturbing trend wherein NEOs were awarded repeated "one-time" "special" payments for reasons more within the normal remit of a leader of a large, multinational corporation.

Should registrants also be required to disclose a tabular list of a registrant's five most important performance measures used to determine compensation actually paid?

Yes, a list of the most important performance measures to determine compensation actually paid would be helpful information and the tabular format could aid comparison.

[6] https://www.sec.gov/news/statement/peirce-dissent-pvp-20220127

“Small” companies

Commissioner Lee[7] and Commissioner Crenshaw[8] thoughtfully pointed out a 2018 redefinition would cause 45% of all SEC registrants to be considered “small” companies. Approximately half of CalSTRS’ fund is invested in equities, and CalSTRS manages most of those holdings to replicate a broad and diversified global benchmark, including thousands of small companies. We expect companies of all sizes to align NEO pay with financial performance. Therefore, CalSTRS encourages the Commission not to make an exception for “small” companies under the 2018 definition but rather require all registrants to follow the same rules and provide the same, comparable data investors need to execute informed votes at all our companies’ annual meetings.

CalSTRS thanks the Commission for its work to strengthen transparency and accountability in our markets for the benefit of long-term investors like California’s educators. I appreciate the Commission’s consideration of CalSTRS’ views to finalize this rule, and I welcome the opportunity to discuss our comments.

Sincerely,

Aeisha Mastagni

Aeisha Mastagni
Portfolio Manager

[7] https://www.sec.gov/news/statement/lee-statement-pvp-012722
[8] https://www.sec.gov/news/statement/crenshaw-statement-pvp-012722