



# Investment Committee

## Item Number 4a – Open Session

**Subject:** Updated Corporate Governance Principles

**Presenter(s):** Aeisha Mastagni

**Item Type:** Action

**Date & Time:** January 11, 2024 – 10 minutes

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**Attachment(s):** Attachment 1 – Meketa Concurrence Memo

Attachment 2 – Corporate Governance Principles – Redline Version

Attachment 3 – Corporate Governance Principles – Clean Version

Attachment 4 – CalSTRS Governance of Investment-related Sustainability Risks and Opportunities

**PowerPoint(s):** CalSTRS Corporate Governance Principles and Stewardship Priorities

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### **Item Purpose**

The purpose of this item is to present the Investment Committee with revisions to the CalSTRS Corporate Governance Principles (Corporate Governance Principles or the Principles).

### **Recommendation**

Staff recommends and the Board Consultant, Meketa Investment Group, concurs that the Investment Committee approve the revisions to the CalSTRS Corporate Governance Principles.

### **Executive Summary**

The CalSTRS Corporate Governance Principles lay the foundation for CalSTRS stewardship activities, including but not limited to proxy voting, portfolio company engagement, and advocacy efforts. These principles are based on best practices in the marketplace that support long-term value creation and mitigate risks to the portfolio. CalSTRS continues to support market-wide corporate governance initiatives that will improve the investing landscape for shareholders and our beneficiaries.

As stewardship practices evolve, staff seeks to ensure the structure and content outlined in the Corporate Governance Principles remains robust and current. While the Principles guide staff's stewardship activities, in coordination with the CalSTRS Stewardship Priorities (see companion agenda item 4b), the Corporate Governance Principles are also a public facing document that communicates CalSTRS position and rationale on a wide variety of sustainability-related issues. As part of the revision, staff undertook significant research, including reviewing the principles and policies of multiple global peers. While the Corporate Governance Principles are a 'living document', that can be updated frequently, staff anticipates significant updates will occur every three to five years. In addition, the Principles are purposely designed to provide staff flexibility when executing proxy votes, implementing portfolio company engagements, and advancing advocacy efforts.

While there are some minor edits throughout the Principles, the substantive amendments are outlined below and cover four broad areas: 1) Sustainability reporting, 2) Board of directors, 3) Human capital management and reporting, and 4) Environmental, Social, Governance (ESG) Risks and Opportunities.

## **1. II. E. Supporting Standardized Sustainability Reporting**

- CalSTRS is committed to sustainable business practices and endorses the [International Sustainability Standards Board \(ISSB\) Standards](#). This principle was added.

## **2. III. A. Board of Directors**

### **1. a. Director Qualifications**

- A skills and diversity matrix allows investors to assess the skills, experience and demographic of each board member in a consistent and comprehensive way. This principle was revised to outline the best format to disclose skills, experience, and director demographics.

### **1. b. Board and Director Independence**

- Independence is essential to ensure the board maintains effective oversight and acts in the best interests of the company and its shareholders. This principle was revised to clarify independence standards for board members.

### **2. e. iv. Board Diversity**

- Diverse boards play a vital role in effective oversight of management, business strategy, and risk mitigation. This section was revised to include stronger language around expectations for boards to identify diverse directors in every board search and to disclose director demographic information annually in the proxy.

### **3. b. Director Time Commitment**

- Directors that serve on an excessive number of boards may not have sufficient time or focus to fulfill their duties effectively on each board. This principle was revised to expand views on director over-boarding.

### **3. d. iii. Human Capital Management**

- Responsibilities for public company boards continue to evolve. CalSTRS believes boards play a vital role in company culture and setting standards for human capital management. This principle was revised to expand the list of approaches to human capital management to include incentives and compensation, retention and development, fair labor practices, and pay equality.

### **3. d. iv. Human Capital Reporting**

- Human capital reporting and disclosure is necessary to ensure the proper management of a company's workforce. This principle was added to include four foundational metrics all companies should provide investors: workforce headcount, total cost of the workforce, workforce stability metrics (such as turnover), diversity data, including an annual EEO-1 report.

### **3. f. iv. Shareholder Engagement**

- Boards should take into account the interests of their shareholders on material issues to create better alignment between the company and its shareholders' interests. This principle was added.

## **3. III. C. Executive Compensation**

### **3. c. ESG Metrics**

- Companies should determine how to best incorporate material environmental, social, or governance risks into compensation plans. Metrics should be measurable and linked to a company's ESG risks or key priorities. This principle was added.

## **4. III. G. ESG Risks and Opportunities**

- This section was updated to describe how CalSTRS incorporates ESG risks and opportunities into all aspects of the investment portfolio. References to [CalSTRS Investment Beliefs](#) and the [Investment Policy for](#)

[Mitigating Environmental, Social, and Governance Risks](#) were added as part of this principle.

In addition to the amendments above and as part of the modernization of all CalSTRS investment policies, staff recommends removing the two appendices to the Corporate Governance Principles for the following reasons:

- [Appendix A: State Teachers’ Retirement System Statement of Shareholder ESG Responsibility](#) (the Statement) was originally adopted in 1978 and last revised 14 years ago in 2009. To be clear, this is a statement and not a policy, that predates the establishment of CalSTRS Corporate Governance Principles. The Statement is extremely out of date with current practices and staff do not believe it is needed as it has been succeeded by the more recently introduced and updated Corporate Governance Principles, Sustainable Investment & Stewardship Strategies Program and Portfolio Policy and CalSTRS Investment Beliefs.
- [Appendix B: CalSTRS Investment Policy for Mitigating Environmental, Social and Governance Risks](#) continues to be a CalSTRS policy governed by the modernized Investment Policy Statement, so is not also needed as an Appendix to the Corporate Governance Principles.

## **Background**

The Sustainable Investments and Stewardship Strategies (SISS) unit was established, as the Corporate Governance Program, in 1978. It was renamed in 2019 to reflect the expanded scope of CalSTRS sustainable investment related activities. SISS undertakes three core pillars of activity: 1) SISS Investment Portfolio, 2) Stewardship, and 3) Strategic Relations Management.

While the SISS team plays a role in implementing and supporting policies that apply broadly to the CalSTRS Investment Portfolio, the [CalSTRS Corporate Governance Principles](#) and the [CalSTRS Stewardship Priorities](#) (see companion agenda item 4b) primarily govern CalSTRS Stewardship activities conducted by the SISS unit. Staff developed the graphic, included as Attachment 4, to illustrate how the Corporate Governance Principles and Stewardship Priorities (see companion item 4b) fit into the CalSTRS policy hierarchy.

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Strategic Plan Linkage: Goal 1 of the Strategic Plan. Trusted stewards – Ensuring a well-governed, financially sound trust fund.

Board Policy Linkage: This item is covered under the CalSTRS [Sustainable Investment & Stewardship Strategies Program and Portfolio Policy](#) (Teachers’ Retirement Board Policy Manual, Section 1000, C-1) and the [CalSTRS Corporate Governance Principles](#).

[Investment Beliefs](#) Linkage:

Investment Belief 7: Responsible corporate governance, including the management of environmental, social and governance (ESG) factors, can benefit long-term investors like CalSTRS.

Investment Belief 9: Investment risks associated with climate change and the related economic transition – physical and technology driven – materially impact the value of CalSTRS' investment portfolio.

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