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MEMORANDUM

TO: Investment Committee, CalSTRS
FROM: Stephen P. McCourt, Allan Emkin, Mika Malone, Stephanie Sorg, Meketa Investment Group
DATE: January 11, 2024
RE: Update to Corporate Governance Principles

Background

In December 2023, Staff asked Meketa Investment Group ("Meketa") to review proposed updates to the CalSTRS Corporate Governance Principles, for the Committee's review. ***Meketa has reviewed the proposed updates, and concurs with Staff's recommended changes, which are summarized below.***

Proposed Corporate Governance Principles Updates

Along with general clean-up of the document, based on their research (including reviewing the principles and policies of multiple global peers), Staff is proposing changes to 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**

   The Stewardship Code for Engagement was revised to include a principle on the endorsement of the International Sustainability Standards Board ("ISSB") Standards. The ISSB Standards establish a global baseline of sustainability-related disclosures, which are essential for evaluating a company's sustainability-related risks and opportunities, facilitating informed decision-making by investors.

2. III. A. – **Board of Directors**

   1. a. **Director Qualifications** - This principle was revised to outline the best format to disclose skills, experience and director demographics. Specifically, a skills and diversity matrix is a useful tool to highlight the skills, experience and demographic of each board member and assess the overall composition of the board.

   1. b. **Board and Director Independence** - This principle was revised to clarify independence standards for board members and explicitly include Directors within this principle.

   2. e. iv. **Board Diversity** - 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. Specifically, the revisions note that any company executive should not serve on more than two public boards and directors should not serve on an excessive number of boards. The quantity may be dependent upon various factors, like participation in key committees.

3. d. iii. **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, pay equality, and, importantly, fair labor practices.

3. d. iv. **Human Capital Reporting** - Human capital reporting and disclosure is necessary for stakeholders to monitor that the company has metrics for the 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), and diversity data, including an annual EEO-1 report.

3. f. iv. **Shareholder Engagement** – This principle was added to encourage boards to implement processes to take into consideration the perspectives of shareholders on materials issues. Additionally, the company should provide annual disclosure of how shareholders engagement contributed to board discussions.

3. III. C. – **Executive Compensation**

3. c. **ESG Metrics** – This principle was added as 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.

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 listed above, Staff recommends removing the following two appendix items within the Corporate Governance Principles in an effort to modernize CalSTRS' investment policies:

→ Appendix A: **Statement of Shareowner ESG Responsibility**

This statement was originally adopted in 1978 and predates the establishment of CalSTRS Corporate Governance Principles. Staff is recommending its removal as it is out of date with current practices and 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 ESG Risk Factors**

CalSTRS Investment Policy for mitigating Environmental, Social and Governance Risks continues to be a CalSTRS policy governed by the modernized Investment Policy Statement. Staff notes that this item is not also needed as an Appendix to the Corporate Governance Principles.

Summary

Meketa believes the changes made to this policy are aligned with the overall mission and objectives of CalSTRS and the SISS portfolio. We recommend that the Committee approve the changes as proposed by Staff.

If you have any questions, please feel free to contact us at (760) 795-3450.

SBS/SPM/AE/MLM/jls