

CALSTRS

CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM

**CORPORATE GOVERNANCE
PROGRAM AND
PORTFOLIO POLICY**

**INVESTMENT BRANCH
FEBRUARY 2014**

C. Corporate Governance

INTRODUCTION

The California State Teachers' Retirement System (CalSTRS) is committed to holding and managing equity investments and to exercising the shareholder rights appurtenant to those investments, all for the benefit of its participants and beneficiaries. It is the fiduciary responsibility of the Teachers' Retirement Board (TRB) to discharge its duty in the exclusive interest of the participants and beneficiaries and for the primary purpose of providing benefits to participants and their beneficiaries. The TRB should defray the reasonable expenses of administering the Fund; the investment policy of the Fund should reflect and reinforce this purpose. The TRB views its corporate governance role as that of a catalyst for enhanced management accountability, disclosure and performance. The objective of the TRB's corporate governance effort is to enhance long-term shareholder returns.

CalSTRS is a long-term investor; its long-term strategy is demonstrated through its significant commitment to passively managed portfolios in its three largest asset categories: Domestic Equities, Fixed Income, and non-U.S. Equities. CalSTRS' thrust in corporate governance is to maximize the longer-term value of the shares, consistent with its role as a significant capital allocator. CalSTRS recognizes that the lending of securities, especially equity common shares is an important practice in the investment world, improving market liquidity, reducing the risk of failed trades, and adds significant incremental return to investors. CalSTRS will use its best efforts to ensure that the portfolio's shares that are out on loan will not cast votes that are contrary to CalSTRS' stated corporate governance policies. As a long-term investor, CalSTRS believes that its beneficiaries' interests are more appropriately served when votes are cast by market participants who have an economic interest in the underlying company. CalSTRS will seek to coordinate the lending process with all the parties, including the investment lending officers and the custodial relationships in its effort to insure that under-voting or voting abuse is not suffered by the fund. It is understood that this effort will result in the recall of loaned shares and the restriction of lending certain shares; all of which will diminish the income received from CalSTRS' securities lending efforts; however as fiduciaries with a long-term investment horizon, CalSTRS is committed to exercising its proxy authority over portfolio investments.

Statutory Authority: Education Code Section 22354 requires the Board to retain investment managers who are experienced and knowledgeable in corporate management issues to monitor corporations whose shares are owned by the System plan and to advise the Board on the voting of the shares owned by the plan and on all other matters pertaining to corporate governance. While CalSTRS is not subject to the Employee Retirement Income Security Act (ERISA), applicable provisions of both the California Constitution and the Education Code make clear that CalSTRS' commitment to corporate governance is a diligent exercise of its fiduciary responsibility. As observed by the U.S. Department of Labor:

“In general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock. ... Moreover, because voting such proxies involves plan asset management, section 403(a) requires that plan trustees have the exclusive authority and responsibility for voting these proxies...”

Thus, CalSTRS’ legal authority for corporate governance springs from its fiduciary concerns as a prudent investor and the statutory obligation imposed on it by the Legislature.

The following represent the approved policies to be used in the exercise of CalSTRS’ shareholder rights and the implementation of its Corporate Governance Program. The policies are designed to set boundaries for the management of proxies and other corporate actions. As with all other plan assets, these corporate governance policies cannot be altered without explicit direction from the TRB.

1. **LAWS AND STATUTES:** The Corporate Governance Program (Program) for the California State Teachers’ Retirement System (CalSTRS) will be managed in a prudent manner for the sole benefit of the CalSTRS participants and beneficiaries, in accordance with the Teachers’ Retirement Law and other applicable State statutes.
2. **REGULATIONS:** For domestic equities, the Program will comply with the rules of the Securities and Exchange Commission (SEC), equity exchanges, and other regulatory agencies. For non-U.S. equities, the Program will comply with the appropriate regulatory body in the respective country.
3. **PROGRAM OBJECTIVE:** The Program shall be managed to provide long-term enhanced shareholder value through clear and certain disclosure and accountability. Enhancing shareholder value shall always take precedence, non-financial or collateral benefits notwithstanding.
4. **PROGRAM COMPONENTS:** The Program shall consist of the following components:
 - a. **Voting of Proxies:** CalSTRS will make a best effort to vote all domestic and non-U.S. proxies; exceptions may be made based on the legal requirements or local conventions of certain markets and where practical difficulties make an informed and meaningful decision impossible. Voting of proxies shall be in conformance with all approved documents such as the California State Teachers’ Retirement System Corporate Governance Principles, which can be found on the CalSTRS website.
 - b. **Annual Engagement Plan:** CalSTRS will continue its practice of identifying for enhanced shareholder action, on an annual basis; companies in which the System holds a significant passive investment

position that are underperforming applicable performance benchmarks. In the organization and completion of this work plan, staff shall consider the market value of the investment, CalSTRS' ownership percentage, priorities identified in the annual business plan and the resources required and the direct cost involved in seeking a desired result.

“Enhanced shareholder action” includes, but is not limited to:

- Informal or formal expressions of concern to company management concerning corporate governance practices that are adversely affecting shareholder value;
 - Development of shareholder proposals, either individually or in concert with other institutional investors;
 - Participation by CalSTRS in litigation, consistent with its policy with regards thereto, in the event that the subject company's underperformance is related to matters that are or may become the subject of such litigation.
- c. Corporate Governance Organizations: CalSTRS will continue its active participation in the Council of Institutional Investors (CII), International Corporate Governance Network (ICGN) and in other forums designed to have an impact on corporate governance practices.
- d. Recognizing Good Corporate Governance in Companies: To promote improved corporate governance, CalSTRS may recognize companies that represent best practices in corporate governance.
- e. Targeted Investor Coalitions: CalSTRS will, time and circumstances permitting, partner with other institutional investors in an effort to maximize its corporate governance efforts, exclusively on behalf of the plan beneficiaries and participants.
- f. Securities Litigation: CalSTRS will manage its interests in securities litigation matters as assets of the trust fund with the goal of enhancing the long-term value of the portfolio consistent with the Investment Management Plan. Consistent with this goal, CalSTRS will pursue the following objectives:
- Increasing the net monetary value of settlements;
 - Increasing the long-term value of shares in a company subject to shareholder litigation held in CalSTRS' portfolio;

- Deterring wrongful corporate conduct that undermines the integrity of the financial markets.

In most domestic cases, CalSTRS' interests in securities class action litigation claims will be adequately addressed solely through passive participation as a class member. However, in certain circumstances a higher level of involvement will be appropriate, including:

- ***Moving for Lead Plaintiff Status in Domestic Cases:*** In securities class action cases in the United States where CalSTRS' potential damages exceed \$15 million, or in other cases where there is an exceptional opportunity to preserve or enhance the long-term value of a significant portfolio holding or to deter wrongful corporate conduct, CalSTRS will consider moving for lead plaintiff status. If staff concludes that a securities class action meets one or more of these criteria, the case will be referred to an independent third party for legal evaluation and recommendation to the Board.

The independent third party shall perform work at the direction of the General Counsel and shall be familiar with the litigation of federal and state securities cases, including but not limited to class actions, so-called "opt-out" individual actions, and derivative cases. The independent third party shall be compensated on a flat fee basis to evaluate the case and make a recommendation thereto. If needed, the independent third party shall further represent CalSTRS in the filing of a motion for lead plaintiff status if such action is approved (for which counsel shall be separately compensated), but shall not otherwise represent CalSTRS as lead class counsel in that case if CalSTRS is selected as lead plaintiff.

If the independent third party and the General Counsel recommend moving for lead plaintiff status, the matter shall be brought before the Board for approval. If, pursuant to Board approval, lead plaintiff status is sought, CalSTRS will conduct a competitive selection of lead class counsel in order to secure the most qualified counsel at a fee structure that aligns the interests of the class and lead counsel.

- ***Alternatives to Lead Plaintiff Status in Domestic Cases Requiring Board Approval:*** In some instances where seeking lead plaintiff status is not sought or where the court has denied a motion therefore, CalSTRS may consider the following alternatives: 1) Participating as a co-lead plaintiff with other institutional investors; 2) Opting out of a class and filing a separate securities action in state or federal court; 3) Filing a shareholder derivative claim in state or federal court; and 4) Formal intervention in pending litigation. If the General Counsel, based upon an evaluation of the facts and circumstances of the proposed case, recommends pursuing any such alternatives, the matter shall be brought before the Board for approval.

- ***Litigation Alternatives Delegated to Staff:*** Any action beyond those specified in this policy that would be consistent with the goal and objectives of this program, may be acted upon on the recommendation of the General Counsel and approval of the Chief Executive Officer in consultation with the Chief Investment Officer.
- ***Non-Litigation Alternatives:*** In considering the appropriate response to a company that is subject to shareholder litigation, CalSTRS will evaluate the pursuit of alternatives to litigation that address the underlying cause of the company’s problem. For example, contacting appropriate regulatory and/or law enforcement agencies about potential prosecution of wrongdoers may deter similar conduct in the future that undermines the integrity of the financial markets. As another example, filing shareholder resolutions or negotiating for corporate governance changes like the addition of independent directors or the creation of an independent audit committee may address the problems that lead to the litigation and could aid in the long-term recovery of the company and the value of its stock.

Shares purchased on a foreign exchange are not protected by United States securities laws. Therefore, CalSTRS’ interests obtained on a foreign exchange may only be addressed through active participation in a foreign jurisdiction.

- ***Foreign Securities Litigation Cases:*** In situations where CalSTRS obtained shares of an entity on a foreign market, and there are allegations of improper conduct of such entity, and there is no reasonable expectation of full recovery through the domestic legal process, CalSTRS shall consider filing or joining a foreign action against such entity. In determining whether CalSTRS should file or join a foreign action, the General Counsel will consider the following factors: (1) the strength and legitimacy of the proposed action, (2) the legal and procedural issues particular to the foreign jurisdiction, including adverse party risks and discovery requirements, (3) the exposure of CalSTRS in the foreign market and the potential recovery CalSTRS may obtain, (4) the structure of the proposed action, including the legal representation, the funding of the case, and the compensation of the legal representation and funders, (5) in the case of joining an action, the other parties who have already joined, and (6) any other potential risks involved. Upon the recommendation of the General Counsel, in consultation with the Chief Investment Officer, and with approval by the Chief Executive Officer and Chair of the Investment Committee, CalSTRS may file or join a foreign action to recover losses incurred on a foreign market.
- g. **Statement of Investment Responsibility:** The “Statement of Shareowner ESG Responsibility” and “CalSTRS 21 Risk Factors” remain in effect.
- h. **Regulatory and Legislative Advocacy:** CalSTRS will, upon the completion of sound analysis, advocate for both the institution and the repeal of laws

and regulations to improve the financial and legal market place, relative to the stated Investment Management Plan and the exclusive benefit of the plan beneficiaries and participants.

5. **BUSINESS PLAN:** The Program will be managed in accordance with a business plan which will be prepared on an annual basis and will describe CalSTRS' objectives for the next twelve-month period. The annual business plan will emphasize CalSTRS' strategic and tactical corporate governance priorities; once approved, staff will present a general implementation plan to the Corporate Governance Committee and Investment Committee, with the expressed recognition that tactics may have to be altered in the course of the execution of the plan and that staff has the delegated authority to make the adjustments as needed and appropriate.
6. **MONITORING:** Staff shall monitor adherence to the corporate governance policy for all internal and external managed portfolios.
7. **AUTHORIZED ACCESS:** Authorization memoranda, delineating access and authority levels relating to CalSTRS corporate governance related business, will be provided to the master custodian, staff and proxy voting intermediary. Whenever there is a change in authorized personnel a written notice shall be provided to each affected party, within 48 hours of change.
8. **DELEGATION OF AUTHORITY:** The Chief Investment Officer (CIO) or designee has the authority to manage the Corporate Governance Program and may use other investment personnel to implement these policies.
9. **DECISION-MAKING AUTHORITY:** Subject to the review and approval of the Investment Committee and Corporate Governance Committee/ TRB, staff shall:
 - Review and make recommendations with regard to this Policy and the California State Teachers' Retirement System Corporate Governance Principles;
 - Report on the status of current proxy votes, and recommend to the Investment Committee and Corporate Governance Committee/TRB action to be taken on votes which do not fall within the guidelines;
 - Develop the Annual Corporate Governance Business Plan;
 - Present annual summaries of votes cast on behalf of the TRB;
 - Act as liaison between the TRB and organizations dedicated to advancing good corporate governance practices, such as the CII and ICGN;

- Monitor developments in the corporate governance area that may affect the value of shares held by CalSTRS;
 - Develop and propose various actions related to corporate governance, including, but not limited to, shareholder resolutions, criteria for selection of companies for engagement, criteria for entering into litigation related to securities fraud and/or to accomplish the purposes of the corporate governance policy, so long as these actions are consistent with the Investment Management Plan.
 - Hire, oversee, and manage the activist Corporate Governance Investment advisors within the portfolio.
10. REPORTING: Staff shall present regular reports to the Corporate Governance Committee and the Investment Committee on actions and major activity.

Approved by the Subcommittee on Corporate Governance: October 13, 1999
Adopted by the Investment Committee: October 13, 1999
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