CALSTRS

CORPORATE GOVERNANCE

2015 ANNUAL REPORT

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CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

California State Teachers' Retirement System
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CalSTRS is pleased to publish our third annual Corporate Governance Report. This is an opportunity for us as a large, long-term shareholder to communicate with our stakeholders, beneficiaries, investment partners and portfolio companies the priorities of our Corporate Governance Program.

CalSTRS is the largest educator-only pension fund in the world, with assets under management of approximately $186 billion. We are responsible for the retirement needs of more than 896,000 public school educators and their beneficiaries and have an obligation to be responsible stewards of the retirement funds of California's educators. CalSTRS has long been active in the corporate governance arena and expects the companies in our portfolio to also be responsible stewards on our behalf. As universal long-term owners, we actively monitor our holdings and expect our portfolio companies to govern themselves responsibly, acknowledging their duty to shareholders. In return, we seek a return on our capital that balances risks with rewards. When we believe any of our portfolio companies are not carrying out their duty, we will actually engage and communicate with them to share our concerns.

This report provides an overall framework for our corporate governance activities. We are happy to share our philosophy and principles as we continue to strengthen our stewardship role.

Sincerely,

Anne Sheehan
Director of Corporate Governance
CalSTRS

1 / OVERVIEW

It has been documented that well-governed companies significantly outperform poorly governed companies. One of the most definitive studies, Corporate Governance and Equity Prices, published in 2003 by economists Paul Gompers, Joy Ishii and Andrew Metrick, found that in the 1990s companies that promoted shareholder rights outperformed those that did not by 8.5 percentage points annually. This finding should not be a surprise: well-governed companies, with accountable management, are more likely to allocate capital efficiently and productively.

Like Gompers, Ishii and Metrick, CalSTRS has long recognized the importance of promoting best-practice governance. With the majority of our investment portfolio aligned with large global equity indexes, CalSTRS needs to be engaging market participants on issues that impact public equity security value. CalSTRS routinely engages corporate representatives, regulatory organizations, government officials and fellow investors on key issues that have demonstrated links to value.

Today, the CalSTRS Corporate Governance Unit has a suite of internal programs that cover a variety of governance issues. Staff focuses on executive compensation, diversity on corporate boards, director election standards, and sustainability risk awareness and integration. The Corporate Governance staff is also responsible for voting more than 7,900 domestic and international proxies annually; evaluating, processing and monitoring securities class actions; and providing support to the CalSTRS Legal and Legislative units. Through these various programs, the Corporate Governance team is able to provide a layer of risk management across the CalSTRS Investment Portfolio.

Additionally, the Corporate Governance Unit is responsible for managing our approximate $3.5 billion Public Equity Portfolio that features external managers who employ an activist investment philosophy. These managers work with undervalued and misunderstood public companies to improve their governance profiles and business practices. The improvements these managers advocate are designed to provide long-term value, not temporary price appreciation. As a long-term investor, CalSTRS will own these companies in other parts of our Public Equity Portfolio long after the activist manager sells them.

Lastly, since July 1, 2015, the Corporate Governance Unit has been managing the Public Equity Sustainable Manager Portfolio, which is composed of sustainable managers that consider and integrate environmental, social and governance factors in their investment strategy and process to achieve financial outperformance.

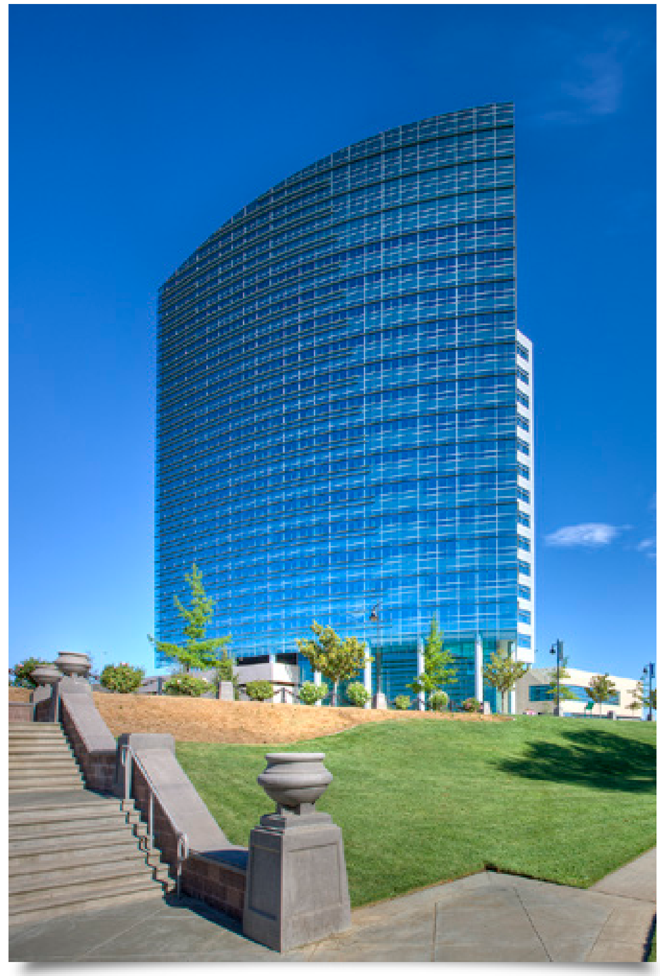
2 / POLICIES

CalSTRS has one of the longest standing corporate governance policies in the public pension community, with a detailed written policy that dates back to 1978. CalSTRS' policies affirm our position as a long-term investor with a significant commitment to passively managed portfolios in our two largest asset categories: Global Equities and Fixed Income. As long-term owners and lenders to corporations around the world, CalSTRS' duty is to protect those assets through the pursuit of good governance and operational accountability. The CalSTRS Corporate Governance Program is designed to maximize the long-term value of the CalSTRS Investment Portfolio, consistent with our role as a provider of patient, significant capital to the global financial markets.

CalSTRS has developed robust principles, policies and standards for fair and open governance of corporations. The Corporate Governance Program is guided by the *CalSTRS Corporate Governance Policies*, which include the *Corporate Governance Principles*, the *Investment Policy Regarding Geopolitical and Social Risks,* and the *Responsible Contractor Policy*. All of the corporate governance policies can be found at CalSTRS.com.

The *Corporate Governance Principles,* adopted in 1978 and last revised in 2015, lay the foundation for CalSTRS' proxy voting, as well as the foundation for all the activities of the Corporate Governance Unit. The *Corporate Governance Principles* are based on what is believed to be the best practices in the marketplace and staff conducts corporate engagements to move financial market participants toward these best practices.

The *Investment Policy Regarding Geopolitical and Social Risks*, adopted in 2006, is intended to address the financial and administrative risks associated with corporate decisions that violate the CalSTRS 21 Risk Factors adopted by the Teachers' Retirement Board.



3 / PARTNERSHIPS

CalSTRS recognizes the importance of working collaboratively with other institutional investors through organizations that promote best governance practices. Because of this recognition, CalSTRS is actively involved in many organizations and associations that allow staff to be more deeply and broadly engaged with a variety of financial market participants across a larger spectrum of issues.

Council of Institutional Investors
The Voice of Corporate Governance

The Council of Institutional Investors is a nonprofit association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed $3 trillion. CalSTRS has been a member of this organization since its inception in 1985. CII educates its members, policymakers and the public about the importance of corporate governance and related investment issues. CalSTRS continues to be an active member of CII as it continues to be a leading voice for effective corporate governance and strong shareholder rights. Aeisha Mastagni, Portfolio Manager in the CalSTRS Corporate Governance Unit, serves on the CII board of directors.

ACGA

The Asian Corporate Governance Association is an independent, nonprofit membership organization dedicated to working with investors, companies and regulators in the implementation of effective corporate governance practices throughout Asia. The ACGA provides in-depth corporate governance research and advocacy for 11 Asian markets: Japan, China, Hong Kong, South Korea, Taiwan, India, Singapore, Indonesia, Malaysia, Thailand and the Philippines. CalSTRS is a long-standing member of ACGA.

ICGN
International Corporate Governance Network

The International Corporate Governance Network is a nonprofit global membership organization of about 600 leaders in corporate governance from 50 countries around the world. Its mission is to raise the standards of corporate governance worldwide to benefit the trillions of dollars in assets under management of its membership. The ICGN was established in 1995 as an offshoot of the U.S.-focused Council of Institutional Investors. The first ICGN meeting began a new era of increasingly routine communication among institutional investors around the world. CalSTRS is an active member of the ICGN, participating in the cross-border dialogue at conferences, influencing public policy through ICGN committees, and promoting best practices around the world.

Ceres

Ceres is a nonprofit organization that advocates for sustainability leadership. Ceres mobilizes investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices and solutions. Ceres helps its more than 130 member organizations to engage with corporations and help advance the goal of building a sustainable global economy. Through the various Ceres platforms, CalSTRS engages a broad spectrum of U.S. companies on their level of environmental risk management and disclosure.

3 / PARTNERSHIPS

The Investor Network on Climate Risk, a project of CERES, is a $13 trillion network of more than 100 institutional investors that promotes the better understanding of the financial risks and opportunities posed by climate change. INCR partners with investors worldwide to advance the investment opportunities and reduce the material risks posed by challenges such as global climate change and water scarcity. CalSTRS is an active member of the INCR and through this collaboration is able to help shape the strategies and policies institutional investors utilize in their efforts to mitigate the risks associated with environmental issues such as climate change.

Signatory of:

The PRI is a network of international investors working together to promote responsible investment practices. The PRI's principles were developed by the investment community and reflect the view that environmental, social and governance issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfill their fiduciary (or equivalent) duty. Signatories to the PRI believe they have a duty to act in the best long-term interests of their beneficiaries and that ESG issues can affect the performance of investment portfolios. CalSTRS shared the belief that considering ESG issues was integral to long-term value maximization and became a signatory to the PRI.

The Shareholder-Director Exchange was formed by leading governance advisors to corporations and their directors to provide for a more effective means for directors and shareholders to communicate. SDX participants came together and used their collective experience to develop the SDX Protocol, a set of guidelines to provide a framework for shareholder-director engagements. The 10-point SDX Protocol offers guidance to U.S. public company boards and shareholders on when such engagement is appropriate, and how to make these engagements valuable and effective.

CalSTRS Director of Corporate Governance Anne Sheehan is part of the SDX Working Group, which includes leading independent directors and representatives from some of the largest and most influential long-term institutional investors.

3 / PARTNERSHIPS

The Thirty Percent Coalition is a national organization consisting of more than 80 members committed to the goal of women, including women of color, holding 30 percent of board seats across public companies. Formed in 2011, the coalition currently includes public companies, private equity, institutional investors, professional service firms, national women's organizations and government officials working together to influence corporations to increase the number of women on their boards. CalSTRS is an active member of the coalition as we believe it is important to have diversity on corporate boards. Additionally, CalSTRS Director of Corporate Governance Anne Sheehan is a board member of the coalition as well as the co-chair of the coalition's Investors Subcommittee.

The Sustainability Accounting Standards Board is an independent nonprofit organization incorporated in July 2011 to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors. SASB utilizes a process that includes evidence-based research and broad, balanced stakeholder participation. SASB is developing sustainability accounting standards for approximately 80 industries in 10 sectors. CalSTRS Director of Corporate Governance Anne Sheehan was a founding member of SASB. CalSTRS CEO Jack Ehnes serves as an SASB board member.

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Executive Compensation—Say on Pay

CalSTRS continues to engage companies every year on all aspects of executive compensation. We believe it is extremely important that there be an alignment between the performance of a company and the compensation awarded its executives. While executive compensation seems to be a perennial governance issue, there have been many positive developments in this space. The say-on-pay provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act allows shareholders to consider and vote on the executive compensation at U.S. companies. Dodd-Frank and say on pay have resulted in increased engagement between companies and their investors—in our view, a very positive outcome.

Thanks to the hard work of many institutional shareholders, many of the problematic pay practices, especially tax gross-ups, excessive perquisites and employment agreements with guaranteed payments, have all but disappeared. Shareholders now must focus on confirming there is a true alignment between pay and performance. This includes ensuring companies are using the right equity vehicles, such as options, restricted stock or performance shares, and that the awards are appropriately sized. CalSTRS views the inclusion of performance-vesting equity as an encouraging development in the marketplace, but new equity vehicles can also bring increased complications. It is important companies periodically review the structure of their plan in totality. CalSTRS encourages companies to choose those equity incentives that are most appropriate for their company given their industry and business cycle. In addition, if companies choose to use performance shares, it is vital that the right metrics are used and disclosed to shareholders. Disclosure is important throughout the compensation discussion and analysis, but especially when it comes to metrics used in the compensation plan. Explaining why certain metrics were chosen and how they are structured to drive value in the business is critical to understand the link to company strategy.

CalSTRS continues to diligently review and examine pay structures at all the companies where we are investors, and we hold those individuals accountable (compensation committee members) when we find a lack of pay for performance alignment and/or problematic pay practices. CalSTRS has spent a significant amount of time during the past several years engaging companies about their pay plans. The communication between shareholders and companies can be initiated by either party. In some cases, companies have reached out to us to seek input and in other cases CalSTRS has contacted a company where we have questions about a plan or to communicate our rationale for voting against a plan.

In 2015, the market saw a number of notable companies lose their say-on-pay vote by a significant margin. The market was not focused on one particular industry as companies from across industries, and a variety of sizes, failed to garner majority support.

> Explaining why certain metrics were chosen and how they are structured to drive value in the business is critical to understand the link to company strategy.

While there were several companies with say-on-pay votes that barely passed, Qualcomm Inc. was another notable company with a say-on-pay vote that passed with only 58 percent support.

In CalSTRS' opinion, these significant "no" votes were the result of not only sheer magnitude of pay, but several structural issues that failed to align executives with the broader shareholder base. Another common trend was discretionary awards, granted outside the normal incentive plan. For CalSTRS, this was a puzzling development given the strong equity market we have experienced the last several years. There was not sufficient justification by the companies to give additional awards outside the normal plan. While it is our hope that companies view their failed say-on-pay votes as an opportunity to overhaul their compensation programs, there are several companies that failed two or more years in a row. CalSTRS

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The table below provides examples of companies whose say-on-pay proposals CalSTRS voted against and that did not obtain majority support.

Company	Industry	Annual Meeting Date	Say-on-Pay Vote
Bed Bath & Beyond Inc.	Retailing	July 2, 2015	35%
Kate Spade & Company	Consumer Durables & Apparel	May 19, 2015	38%
Natural Gas Services	Energy	June 18, 2015	48%
Oracle Corporation	Software & Services	November 18, 2015	48%
TCF Financial Corporation	Banks	April 22, 2015	31%
TiVo Inc.	Software & Services	July 22, 2015	40%

believes it is important to continue to hold the directors of these companies accountable for their poor compensation practices and lack of responsiveness to their shareholders.

CalSTRS believes that a thorough review of pay practices is an important fiduciary duty that both institutional investors and corporate boards of directors should exercise with diligence and care. The structure of a compensation program provides valuable insight into the inner workings of the board, and is one area of engagement that truly is a "board" issue. When investors have concerns about compensation, they need to hear firsthand from those individuals responsible for designing and monitoring the plan. Compensation can be a productive tool to incentivize executives, but it can also be a destructive tool that awards executives for failure or incentivizes unnecessary risks.

CalSTRS will continue to apply the same diligence and care to the proxies we vote and work with the companies in which we invest to truly align compensation with performance to enhance value for all market participants.

Majority Vote Standards

As shareholders, CalSTRS depends on corporate directors to protect the Teachers' Retirement Fund's best interests. To that end, CalSTRS believes that directors should be elected only if the majority of shareholders vote in favor of their election. While the vast majority of directors are elected with more than 90 percent of the vote, every year there are directors who receive less than 50 percent support and are still re-elected.

For many years, there has been an active effort by CalSTRS to establish majority voting as the standard in director elections. The majority voting standard requires that a sitting board member receive a majority of the shareholder votes cast in order to continue to serve as the shareholders' representative. Many companies use the plurality vote standard in which a nominee can be elected with a single affirmative vote in an uncontested election. CalSTRS believes the alignment of interest is greater between boards of directors and shareholders when directors are elected under a majority, rather than a plurality, vote standard.

In 2010, investors pushed for a majority voting standard for director elections to be part of the Dodd-Frank Act, but in a last minute compromise the provision was left out of the final legislation.

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Since then, shareholders have increased their efforts to make majority voting the standard by filing proposals one company at a time calling for such a standard.

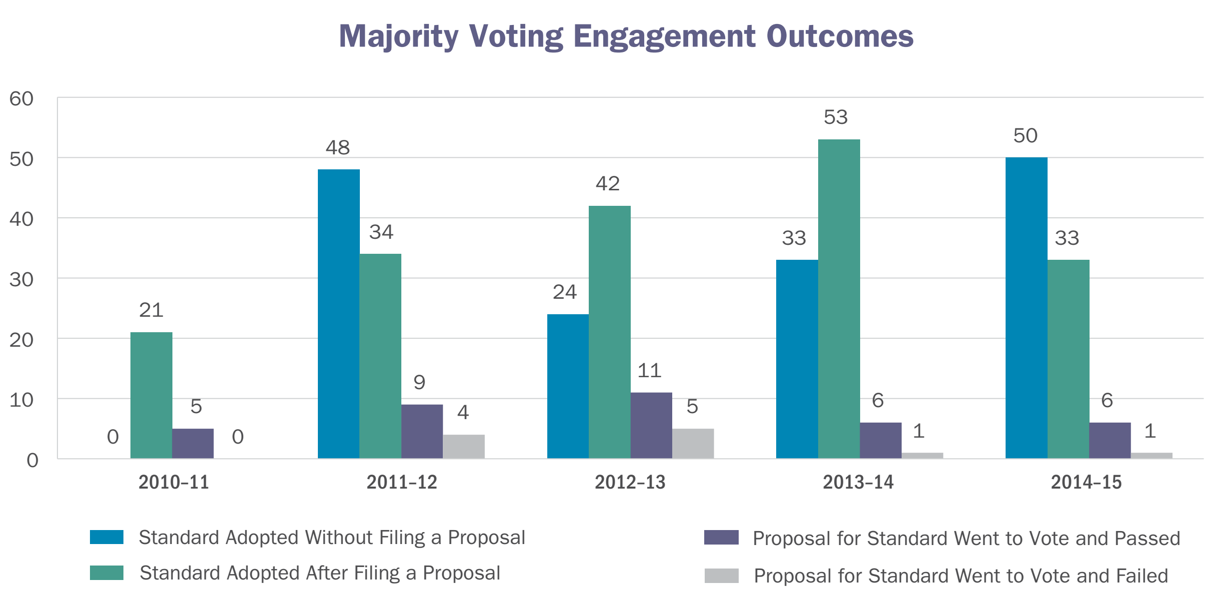
Beginning in fiscal year 2010–11, CalSTRS embarked on an ambitious engagement campaign by filing majority voting proposals at 26 companies. This effort focused on smaller cap companies because more than two-thirds of the companies in that market cap space still maintained a plurality standard. This was in stark contrast to the S&P 500 Index, consisting of the 500 largest publicly traded U.S. companies, where less than 10 percent of companies had a strict plurality standard.

Staff members were pleasantly surprised when more than 80 percent of the companies they engaged agreed to adopt a majority voting or a resignation policy—where a director who does not receive majority vote offers his or her resignation and the board or a committee of the board determines whether to accept it—without a filed shareholder proposal going to a vote. In addition, the majority vote proposals that went to a shareholder vote passed overwhelmingly.

Given the success of the 2010–11 engagement campaign, CalSTRS expanded it by attempting to engage approximately 100 companies in each of the following four fiscal years. In 2015, CalSTRS continued to see a large percentage, more than 90 percent, of the companies that staff engaged with adopt majority voting standards without the proposal having to go to a shareholder vote. Similarly, in instances where CalSTRS filed the majority voting proposal requesting the companies to adopt it, a large percentage, more than 80 percent, of the companies was very willing to negotiate with staff and eventually adopted the majority voting standard. In 2015, CalSTRS had seven majority vote proposals go to a shareholder vote, of which six passed.

Since 2010, CalSTRS has engaged 386 companies encouraging them to adopt the majority voting standard. Of the 386 companies, 155 companies, or approximately 40 percent, adopted the majority voting standard without CalSTRS having to file a majority vote proposal. CalSTRS filed the majority vote proposals at 231 companies, or approximately 60 percent

The following table shows the majority vote standard engagement outcomes for each of the last five fiscal years.



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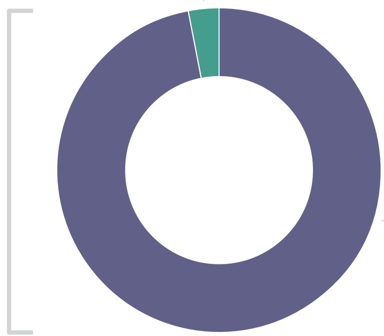
The following chart provides the volume and outcomes of the majority voting engagement campaign since inception.



of the 386 companies. After negotiating with the companies, CalSTRS withdrew 183, or approximately 79 percent, of the 231 proposals because these companies agreed to adopt the majority voting standard. Since 2010, CalSTRS had 48 filed majority vote proposals go to a shareholder vote of which 37, or approximately 77 percent, passed and 11, or approximately 23 percent, failed to pass at the annual meetings. Overall, since 2010, 375 companies, or approximately 97 percent, of the 386 companies that CalSTRS engaged on the majority voting standard have implemented it while only 11 companies, or approximately 3 percent, have not implemented it.

For 2015–16, CalSTRS will engage with more than 100 companies in the Russell 3000 Index on majority voting. The Corporate Governance staff intends to negotiate with these companies to adopt the majority voting before their 2016 annual meetings.

Diversity of Corporate Boards

According to the July 1, 2015 U.S. Census Bureau Quick Facts, women represent more than 50 percent of the U.S. population and minorities together make up more than 35 percent of our population. Those same estimates show that Blacks/African Americans number more than 40 million, Asians make up more than 15 million and Hispanics/Latinos comprise more than 50 million. Yet, those numbers are hardly reflected in the leadership of the nation's top corporations.

There is no doubt that corporations are reaping profits in part by tapping into the buying power of women and minority communities. According to the U.S. Women's Chamber of Commerce, women make 85 percent of all U.S. consumer purchases. Multicultural consumers are rapidly becoming the core of the U.S. population. As of March 2015, African-American, Asian American and Hispanic consumers account for more than 120 million people combined—38 percent of the total population (Nielsen Newswire, "The Making of a Multicultural Super Consumer," March 18, 2015). These groups are projected to increase by 2.3 million each year before becoming a numeric majority of the population by 2044, according to the U.S. Census Bureau. With expansive buying power and unique consumption habits, multicultural consumers are an emerging consumer force in the country. Given the importance of these communities to corporate profits, it is imperative that they be represented in corporate boardrooms.

Since 2008, CalSTRS has continued our long-term focus on diversity on corporate boards. Staff approaches

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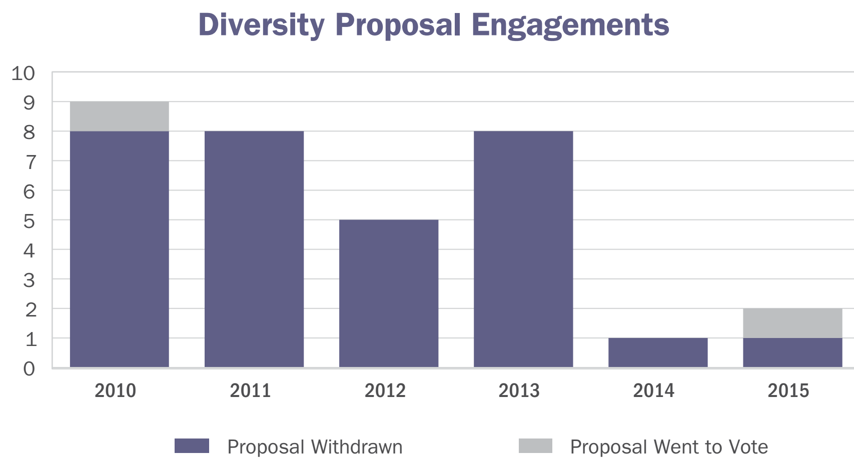
this engagement from a number of different angles, using CalSTRS' proxy power to engage companies, submitting shareholder proposals, voting according to our guidelines and advocating for best practices in the market place.

In 2015, CalSTRS introduced two diversity shareholder proposals asking that Skechers USA, Inc. and Urban Outfitters, Inc. prepare an annual report describing what steps, if any, their boards and/or nominating committees have taken or plan to take to include women and racial minority candidates in the pool from which board nominees are chosen and to expand director searches to include nominees from both corporate positions beyond the executive suite. The proposals also requested the companies to amend their relevant charter documents to include diversity as a criterion in the selection and evaluation of candidates for directorships on their boards.

After Urban Outfitters, Inc. appointed a second woman to its board, the proposal was withdrawn. Staff had dialogues with Skechers USA, Inc., but significant progress was not realized by the company and the proposal ultimately went to a shareholder vote. Though CalSTRS was able to obtain the support of leading proxy advisors, Institutional Shareholder Services and Glass Lewis, as a well as many other institutional shareholders, the proposal did not pass. The result was largely attributed to the fact that Skechers USA, Inc. has dual class shares, with the company insiders getting equivalent

The following chart shows the number of proposals that CalSTRS directly engaged on the issue of board diversity over the past six years.



to 10 times the voting power for each share that they own. While CalSTRS did not prevail, we will continue to engage with companies to increase corporate board diversity.

In 2015, the CalSTRS Corporate Governance team continued to make further progress in increasing diversity of corporate boards by inspiring other institutions to join the initiative. Staff has been proactive and inspirational by advocating for diversity of corporate boards as speakers at numerous events, including Women in the Corporate Boardroom: A Business Imperative for American Companies; Harvard Law School Women's Alliance of New York: A Shareholder Activism Program; the Sixth SAIS Global Conference on Women in the Boardroom; and the 4th Annual Insurance Diversity Summit. During these speaking engagements, staff shared the organization's own successful initiatives and challenged other institutional investors to develop their own initiatives in order to reach the common goal of increasing diversity of corporate boards.

Since 2014, CalSTRS played a leading role in the Thirty Percent Coalition's initiative calling for companies to seek and place women on their boards. CalSTRS and other institutional investors representing more than $3 trillion in assets under management, along with some of the nation's leading women's organizations, sent letters to 100 companies in the Russell 1000 Index that lack women on their boards, urging them to embrace gender diversity. The Thirty Percent Coalition sent the initial letters to 100 companies in fall 2014 and sent follow-up second letters in early 2015. CalSTRS took the lead in tracking the engagements

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and interactions of the 100 companies with the Thirty Percent Coalition's institutional investor members. The results have been very encouraging as 45 of the 100 companies responded to the letters and 33 of the 100 companies added at least one woman to their board. The Thirty Percent Coalition will be sending a third letter to the 41 companies that have neither responded to the first two letters nor placed a woman on their board.

CalSTRS believes it is important to periodically analyze the composition of boards across different markets. Staff has assessed the addition of new directors added to the companies in the S&P 500 Index and Russell 3000 Index against the percentage of new directors who are women as one measure of diversity in the top corporations in the CalSTRS portfolio. Women are generally considered a proxy for diversity as it can be difficult to reliably assess individuals' ethnicity and race.

Institutional Shareholder Services, ISS, a noted corporate governance vendor, concluded that the 2014 proxy year led to the highest percentage of new women directors. In 2014, 29 percent of new directors in the S&P 500 Index were women and 22 percent of new directors in the Russell 3000 Index were women. This dramatic change is especially noteworthy when compared to 2009. In 2009, new directors who were women represented just 14 percent of new directors in the S&P 500 Index and only 11 percent of new directors in the Russell 3000 Index. CalSTRS plans for the future include continual assessment of the diversity of corporate boards relative to new directors within the CalSTRS portfolio.

Diverse Director DataSource

CalSTRS partnered with CalPERS to create the Diverse Director DataSource, 3D, a database where corporate director candidates can self-nominate into the database at no cost to help mitigate against the exclusivity of existing network structures that impede diversity. 3D is a clearinghouse for corporate director candidates, with a special emphasis on a more diverse range of skills and experience. Shareowners, nominating committees and commercial executive/director search firms can search the 3D database of candidates as a means to expand board diversity, which has been shown to improve overall corporate performance. 3D can reduce the anecdotal nature of board appointments and broaden the pool of qualified candidates that gets presented to boards when vacancies occur. While 3D is intended to identify a robust and diverse candidate pool, it does not create any preference based on race, sex, color, ethnicity or national origin. However, it can help to reduce the homogeneity bias and works against "group think," which was so detrimental to investors in the last financial crash.

3D has been fully operational since September 2012 and currently has more than 800 qualified diverse candidates. Approximately 38 percent of the candidates have prior public or private company board experience, so they are proven, quality candidates. Companies accepting candidates to their boards will be responsible for due diligence, and each candidate for a board nomination is responsible for his or her own data.

Sustainability

Sustainability integration, often referred to as environmental, social and governance consideration, continued to be a principal focus of the CalSTRS Corporate Governance Unit during 2015. As a large, diversified global investor, CalSTRS recognizes that we need to be mindful of our exposure to a variety of sustainability-related risks. It is the job of the Corporate Governance Unit to be considering which sustainability issues are material to investment value, where these issues might impact value, and what can be done to mitigate CalSTRS' exposure to them.

At the direction of the Teachers' Retirement Board, the Corporate Governance staff has developed a sustainability risk management program that works to identify and manage sustainability-related risk within the CalSTRS portfolio. The program focuses on engaging portfolio companies, fellow investors, regulatory agencies, and government officials on the importance of integrating ESG considerations into corporate operations, regulatory actions,

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government policies, and investor evaluation and analysis.

CalSTRS mitigates sustainability-related risk through our support of organizations that promote sustainability awareness and provide platforms for investor dialogue on sustainability-related concerns. CalSTRS is a signatory to CDP (formerly the Carbon Disclosure Project) as well as to the PRI. CalSTRS also supports Ceres and the Investor Network on Climate Risk, U.S.-based organizations that facilitate environmental risk dialogue at both the company and policy levels.

CalSTRS staff also mitigates sustainability-related risk by pursuing a variety of sustainability-related engagements. These engagements can be event driven or can be geared toward promoting sustainability awareness in a specific sector or around a particular theme.

Energy Efficiency Initiative

In an effort to get more portfolio companies focused on carbon emissions management and at the same time drive cost savings to improve value, staff has been focusing on promoting energy efficiency considerations at large U.S. companies. Investments in energy efficiency are an attractive way to curb volatile energy costs, can help companies respond to potential regulations, and can enhance a company's role as a corporate citizen.

For 2015, CalSTRS partnered with ClimateWorks Australia to be the lead investor on an energy efficiency engagement tool that it was developing. This tool, the Energy Productivity Index, looked at CDP Global 500 disclosures provided by the largest 500 publicly traded companies in the world, and focused on data associated with energy use and energy efficiency efforts. ClimateWorks Australia then identified sectors where energy use was most material and the data provided on energy use was the most consistent. The following sectors were chosen: Automobiles, Aviation, Chemicals, Construction Materials, Paper and Steel.

For each sector, companies were evaluated through consideration of the materiality of energy expenditure (for example, energy use as a percentage

> "Sustainability is meeting the needs of the present without compromising the needs of the future."
>
> —Gro Harlem Brundtland 1987

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of operating expenses), the efficiency of energy use (for example, energy consumed per dollar of revenue or unit of production) and the financial benefits associated with energy use reduction (for example, energy savings per year or per unit production). This evaluation allowed ClimateWorks Australia to rank companies in each sector based on the materiality and efficiency of energy use.

ClimateWorks then used efficiency gains, and the financial benefits associated with them, that were achieved by leading companies in each sector to extrapolate potential financial benefits other companies could see were they to incorporate similar efficiency efforts. ClimateWorks then provided a general "engagement" rating for each company based on the efficiency analysis it has done and the corresponding quintile ranking.

Based on the ClimateWorks analysis, CalSTRS sent engagement letters to seven U.S. companies: Ford Motor Company, General Motors, American Airlines, Delta Airlines, Dow Chemical Company, International Paper Company and United States Steel Corporation. To date, staff has received responses from three of the seven companies and has conducted initial calls with each of these three companies. Staff's intent is to develop long-term dialogues on energy use measurement and management efforts, disclosure of energy use management, and incorporation of efficiency considerations into executive planning and board oversight.

Methane Emissions Engagement

Methane, the primary component of natural gas, is a climate pollutant 84 times more powerful than carbon dioxide over a 20 year period and, according to Environmental Defense Fund calculations, is responsible for a quarter of the warming the earth is experiencing today. Unmanaged methane emissions could undermine the value proposition of natural gas for delivering cleaner, low-cost energy through increasing scrutiny from the public, environmental and health groups, and state and federal policymakers.

Additionally, in the summer 2015, the Environmental Protection Agency released draft regulations for proposed methane emissions standards for new or modified oil and gas facilities. These draft regulations, expected to be finalized sometime in 2016, could materially impact the oil and gas companies held in the CalSTRS Investment Portfolio due to increased operational cost associated with compliance or through regulatory and reputational exposure arising from a failure to comply.

In light of the EPA's recently released draft regulations on methane emissions capture, and the environmental risks associated with oil and gas production, CalSTRS in 2015 began engaging portfolio companies involved in oil and gas production, transmission and distribution to discuss how they are approaching the issue of fugitive methane emissions. The focus of the engagement is to determine how companies are considering the draft EPA regulations, to what degree they already capture fugitive methane emissions, and whether they have analyzed the business case associated with improving methane capture.

In 2015, CalSTRS staff sent letters to 14 portfolio companies that were determined to be lacking in disclosure on how they were identifying and minimizing methane leaks throughout their facilities. Staff had several productive calls with companies that responded to the engagement request, determining that these companies were properly managing methane emissions

Methane, the primary component of natural gas, is a climate pollutant **84 times** more powerful than carbon dioxide over a **20 year period** and … is responsible for a quarter of the warming the earth is experiencing today.

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risks but were not disclosing these risk mitigation efforts.

Unfortunately, several of the targeted companies chose not to respond to CalSTRS' request for engagement on methane emissions risk management. In these instances, staff decided to file shareholder resolutions, calling on the companies to prepare reports on how they were addressing methane leaks at their facilities. Staff is hopeful that many, if not all, of these proposals can be resolved in 2016 without going to a shareholder vote.

21 Risk Factor Review Committee

CalSTRS actively works to address and minimize the geopolitical and social risk to which the fund is exposed. To further this effort, the Teachers' Retirement Board has implemented several policies, including the Investment Policy for Mitigating Environmental, Social and Governance Risks, the Responsible Contractor Policy and the Divestment Policy, which can be found at CalSTRS.com. While each asset class within CalSTRS is responsible for addressing the 21 Risk Factors as they relate to its portfolio, CalSTRS has established a cross-asset class group, the 21 Risk Factor Review Committee, to evaluate and address issues that affect the total fund and aid individual asset classes in engagement on these issues.

The 21 Risk Factor Review Committee is chaired by the Corporate Governance Unit and consists of the Chief Investment Officer, the Deputy Chief Investment Officer and at least one senior staff member from each Investments Branch unit. Additionally, the Corporate Governance staff is responsible for the research and presentation of items to the committee, as well as the reporting of activities to the board. The 21 Risk Factor Review Committee was originally created to review investments potentially meeting the criteria of legislatively mandated divestment. Since that time, the committee has expanded its scope beyond companies targeted under divestment legislation. The committee now reviews companies identified because of labor disputes, CalSTRS' tobacco divestment and CalSTRS' firearms divestment. Furthermore, the committee tracks emerging geopolitical and human rights issues identified as potential risks to the fund.

5 / PROXY VOTING

CalSTRS votes all of its U.S. and non-U.S. proxies in a manner that aligns with our interests and philosophy. CalSTRS believes that the execution of proxies is an important fundamental shareholder right, and staff always seeks to exercise CalSTRS' rights in a consistent manner that is in the best interests of our beneficiaries.

As a long-term asset owner, CalSTRS believes that we can use our proxy votes to support certain corporate directors or shareholder proposals to introduce necessary changes that will enhance the company's long-term shareholder value.

When voting proxies, CalSTRS relies on our *Corporate Governance Principles*, which can be found at CalSTRS.com. These principles serve as guidelines to be used in conjunction with analysis and judgment and consider best corporate governance practices on topics such as the board of directors, auditors, executive and director compensation, compensation plans and governance structure.

To assist staff in its proxy vote analysis, CalSTRS subscribes to proxy research from vendors such as Glass Lewis Co., Institutional Shareholder Services, Equilar, MSCI ESG Research, and Sustainable Investment Institute. Additionally, CalSTRS frequently has dialogues with corporate issuers and other relevant parties to obtain additional information or perspectives before making a proxy vote decision on key shareholder issues.

Since 2011, CalSTRS has voted both U.S. and non-U.S. proxies in-house by using the Glass Lewis proxy voting platform. Glass Lewis follows CalSTRS' proxy voting guidelines when voting proxies on the fund's behalf. CalSTRS staff cast votes on mergers, shareholder proposals, contested election meetings and extraordinary vote items. CalSTRS is also committed to disclosing our proxy votes on our website at CalSTRS.com.

CalSTRS keeps abreast of high-profile shareholder issues in the investment community by attending conferences and participating in webinars hosted by proxy advisory firms, investor activists, corporate issuers or other pension funds. In 2015, the high-profile shareholder topics included proxy access, environmental issues and executive compensation.

5 / PROXY VOTING

The following table details CalSTRS' proxy voting guidelines on major issues.

Issue	CalSTRS Proxy Voting Guidelines
Directors	CalSTRS generally votes in support of a director unless the proxy statement shows circumstances contrary to CalSTRS' policy. Some circumstances that warrant a withhold vote for a director include a potential conflict of interest due to other directorships or employment, providing legal or investment banking advice, poor board meeting attendance (less than 75 percent) or a lack of board independence.
Auditors	CalSTRS will vote to ratify the independent auditors recommended by management unless the auditor provides services that run contrary to those in the CalSTRS policy. Examples of those services include consulting, investment banking support and excessive non-audit fees (greater than 30 percent of the total fees billed).
Compensation Plans	Companies provide a variety of compensation plans, such as stock option plans, restricted stock plans or employee stock purchase plans for executives, employees and nonemployee directors. Many of these compensation plans provide for the issuance of long-term incentives to attract, reward and retain key employees. CalSTRS evaluates these compensation plans based on their design and other factors, such as the performance metrics, burn rate and dilution potential.
Say on Pay	CalSTRS refers to our Corporate Governance Principles when voting the advisory vote on executive compensation, more commonly known as say on pay. The say-on-pay vote provides shareholders the opportunity to ratify the compensation of the named executives in the proxy. CalSTRS generally supports the say-on-pay vote if the company provides a clear alignment between performance and pay in the plan and the total executive compensation is a reasonable amount.
Mergers & Acquisitions	When CalSTRS votes for a merger or acquisition, it is done on a case-by-case basis using a total portfolio view. Some considerations are given to the strategic rationale behind the transaction, the sales process, the change in control amount, the price premium or lack of it, the market reaction and the impact on the corporate governance of the surviving entity.
Other Issues	CalSTRS votes corporate actions or corporate governance issues, such as those related to spin-offs, incorporation, stock issuance, stock splits, and charter and bylaw amendments, on a case-by-case basis. Similarly, CalSTRS votes on a variety of shareholder proposals, such as sustainability, political contributions and social issues, on a case-by-case basis using our Corporate Governance Principles.

5 / PROXY VOTING

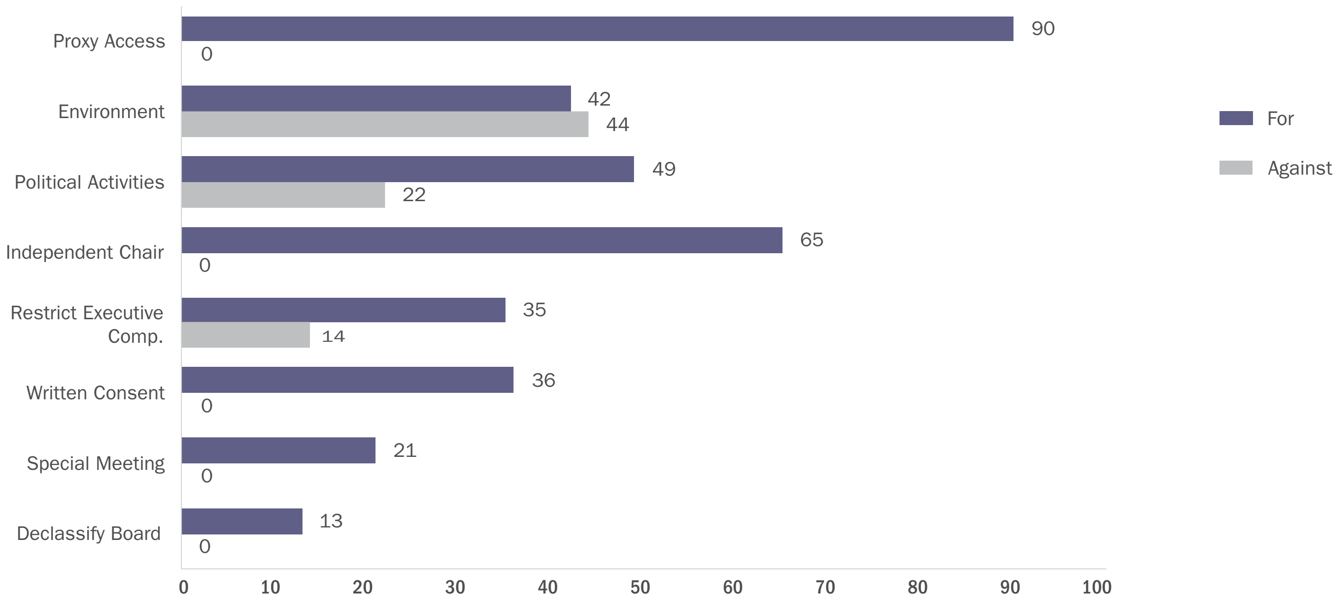
In 2015, CalSTRS voted on more than 7,900 meetings of which approximately 3,000 were from U.S. companies and approximately 4,900 were from non-U.S. companies. These meetings resulted in CalSTRS considering more than 25,000 proposals for U.S. companies and approximately 52,000 proposals for non-U.S. companies. The proposals covered a variety of topics, including the election of directors, the ratification of auditors, the ratification of compensation reports or plans, the approval of executive and director compensation plans, and the approval of mergers and acquisitions. Additional details on the voted proxies can be found at CalSTRS.com.

The following table shows the top issues voted in 2015 by volume.

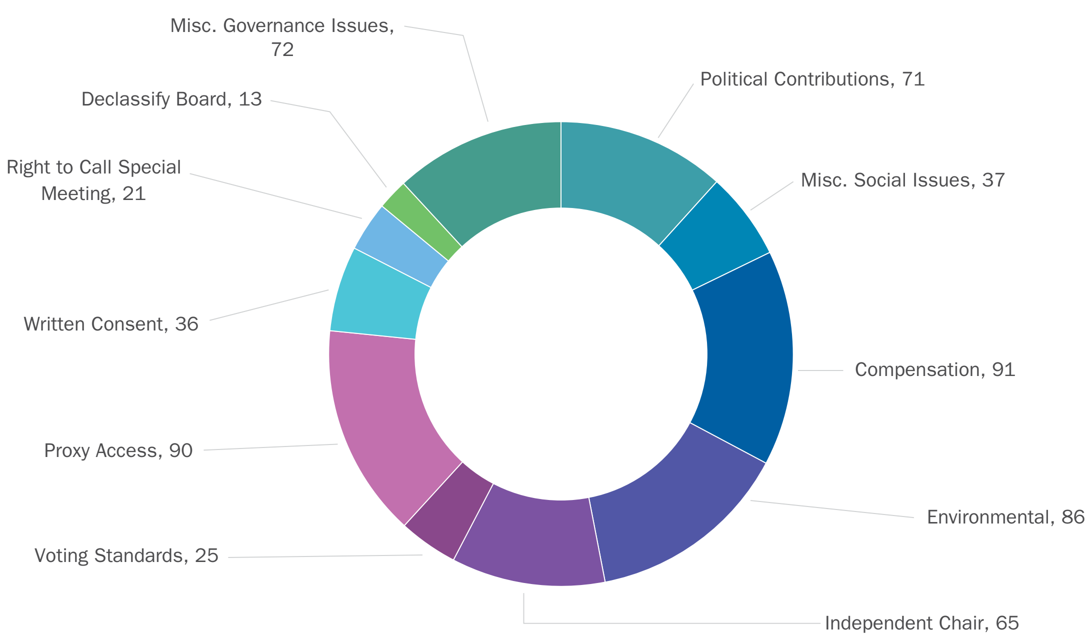
Top Issues by Volume	For	Against	Total
Election of Directors	11,855	5,606	17,460
Ratification of Auditor	2,551	232	2,783
Advisory Vote on Executive Compensation	1,806	350	2,156
Equity Compensation Plan	1,053	201	1,254
Merger/Acquisition	158	5	163
Increase in Authorized Common Stock	19	87	106
Total	**17,442**	**6,481**	**23,922**

5 / PROXY VOTING

The following chart shows how CalSTRS voted on certain issues in 2015.



The following chart illustrates the type and volume of the major shareholder proposals that staff considered in 2015.



5 / PROXY VOTING

Staff looked at the number of votes cast on major issues for U.S. proxies in 2015 compared to 2014 and found that the number of director elections, auditor ratifications and compensation plans considered remained fairly consistent year over year as the number of U.S. meetings voted on remained relatively unchanged in 2014 and 2015. However, the number of say-on-pay votes considered decreased by 15 percent, which is likely attributable to fewer U.S. companies having to provide the say-on-pay votes on an annual basis, but instead on a triennial basis.

In 2015, there was also a decrease in shareholder proposals related to political activities while there was an increase in proposals on environmental issues. The decrease in political contributions and lobbying proposals is likely due to more companies having increased their disclosure of political and lobbying expenditures over the past years since the Supreme Court decision in Citizens United v. Federal Election Commission allowing independent political expenditures by corporations. In response to that, shareholders have been requesting more information on political spending and lobbying activities from companies. As for the number of environmental proposals, it increased in 2015 as fossil fuel and sustainability risks continued to remain a high concern for shareholders.

Without a doubt, proxy access was the dominant governance issue in 2015 as there was a significant year-over-year increase, approximately 400 percent, in the number of proxy access shareholder proposals considered by staff. The significant increase in proxy access shareholder proposals was primarily due to the New York City Comptroller of New York City Pension Funds submitting 75 proxy access proposals to companies as part of its Board Accountability Project. Other investors also submitted proxy access shareholder proposals at other companies. In 2015, CalSTRS supported all proxy access shareholder proposals modeled after the Securities and Exchange Commission's original proxy access proposal, which allowed an investor or a group of investors holding an aggregate of 3 percent or more of the company's shares for three or more years, the right to nominate director candidates on the proxy.

The following table shows the number of proposals considered on major issues in 2014 and 2015 and shows the percentage change year over year.

Issue	CY 2014 Proposals Considered	CY 2015 Proposals Considered	CY 2014 to CY 2015 Change
Election of Directors	17,435	17,461	0.1%
Ratification of Auditor	2,772	2,783	0.4%
Advisory Vote on Executive Compensation	2,537	2,156	–15.0%
Equity Compensation Plan	1,233	1,254	1.7%
Proxy Access	18	90	400.0%
Political Activities	93	71	–23.7%
Environment	73	86	17.8%

6 / MANAGERS

Activist Managers

CalSTRS believes that good governance contributes to better long-term, sustainable performance. To capitalize on this outperformance, CalSTRS has allocated money to select corporate governance activist managers. The CalSTRS Corporate Governance Activist portfolios are externally managed concentrated portfolios that take large individual positions and engage boards and management to undertake value driving change. These funds have an investment strategy that relies on active intervention in a company's long-term strategy, capital structure, capital allocation plan, executive compensation and corporate governance, including takeover defenses, board structure and board composition.

Since the majority of the CalSTRS assets are indexed, the fund is always invested across much of the global equity markets. By allocating assets to corporate governance activist managers, CalSTRS gains additional alpha by making large investments in certain companies. Additionally, as managers improve the governance and performance of their holdings, CalSTRS enjoys the added benefits of holding better-performing and better-governed companies in our indexed portfolios.

CalSTRS began the Corporate Governance Activist portfolios in June 2004 by allocating $700 million to the Relational Investors Large Cap Fund. Since inception, the program has expanded and grown to more than $3.5 billion invested across 10 funds.

The following table shows the current allocations to the CalSTRS activist managers since the partnerships were initiated.

	Partnership Initiated	Market Cap	Geography	Commitments
Relational Investors	June 2004	Mid to Large Cap	North America	$1 Billion*
New Mountain Capital	December 2008	Mid to Large Cap	North America	$1 Billion
Trian Partners	April 2011	Large Cap	North America	$800 Million
GO Investment Partners	June 2008	Small to Mid Cap	Europe	$350 Million
Blue Harbour Group	November 2011	Small to Mid Cap	North America	$500 Million
Cartica	November 2013	Small Cap	Emerging Markets	$300 Million
Legion Partners	January 2014	Small Cap	North America	$200 Million
Knight Vinke	March 2010	Large Cap	Europe	€150 Million
Starboard Value	March 2013	Small Cap	North America	$100 Million
Red Mountain	February 2015	Small Cap	North America	$100 Million

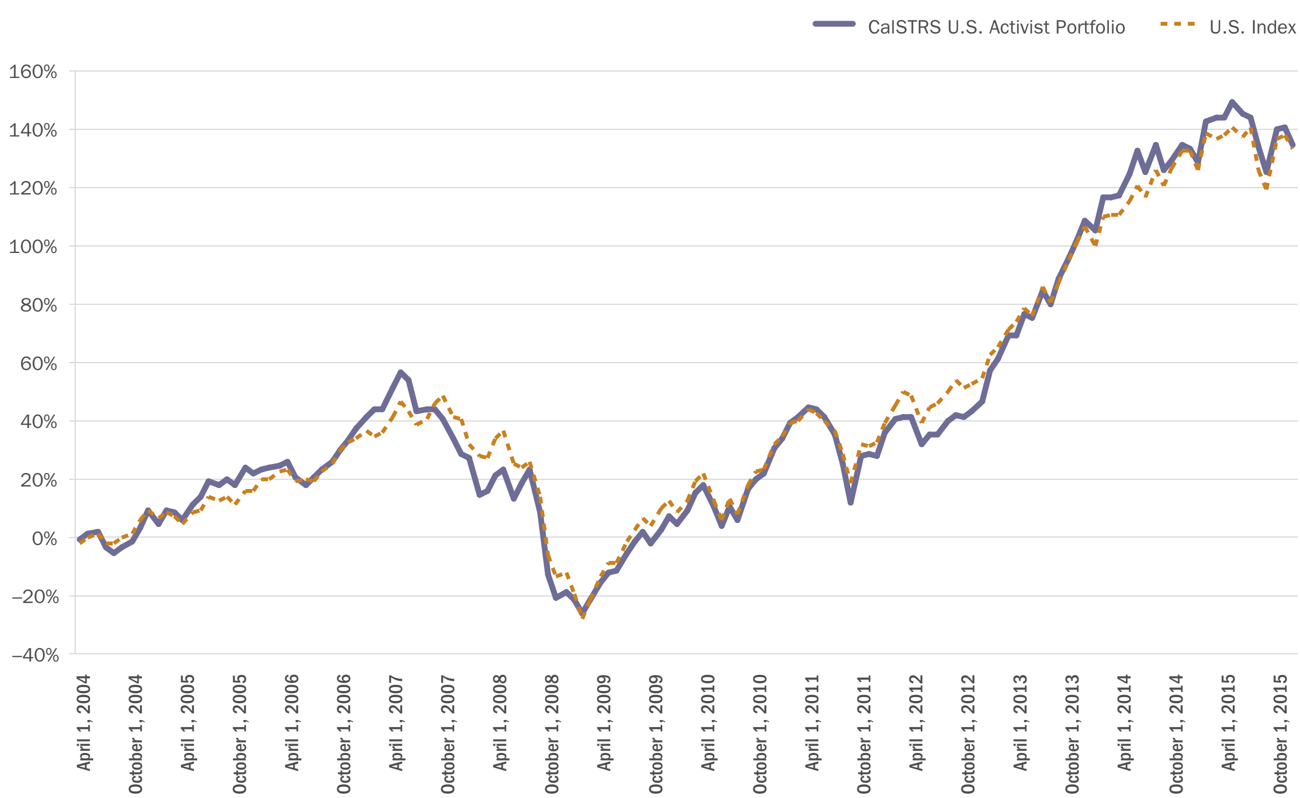
* Relational Investors completed a liquidation process on December 31, 2015.

6 / MANAGERS

The CalSTRS Corporate Governance Activist portfolios are subject to greater volatility than traditional equity portfolios. The concentrated nature and long duration of each investment contributes to this volatility. Typically, the holding period for an investment is three to five years, with a J-curve type lifecycle. A typical investment will be purchased at a relatively low or deteriorating price, then stabilize and ultimately improve as the managers' engagement efforts are recognized by the market.

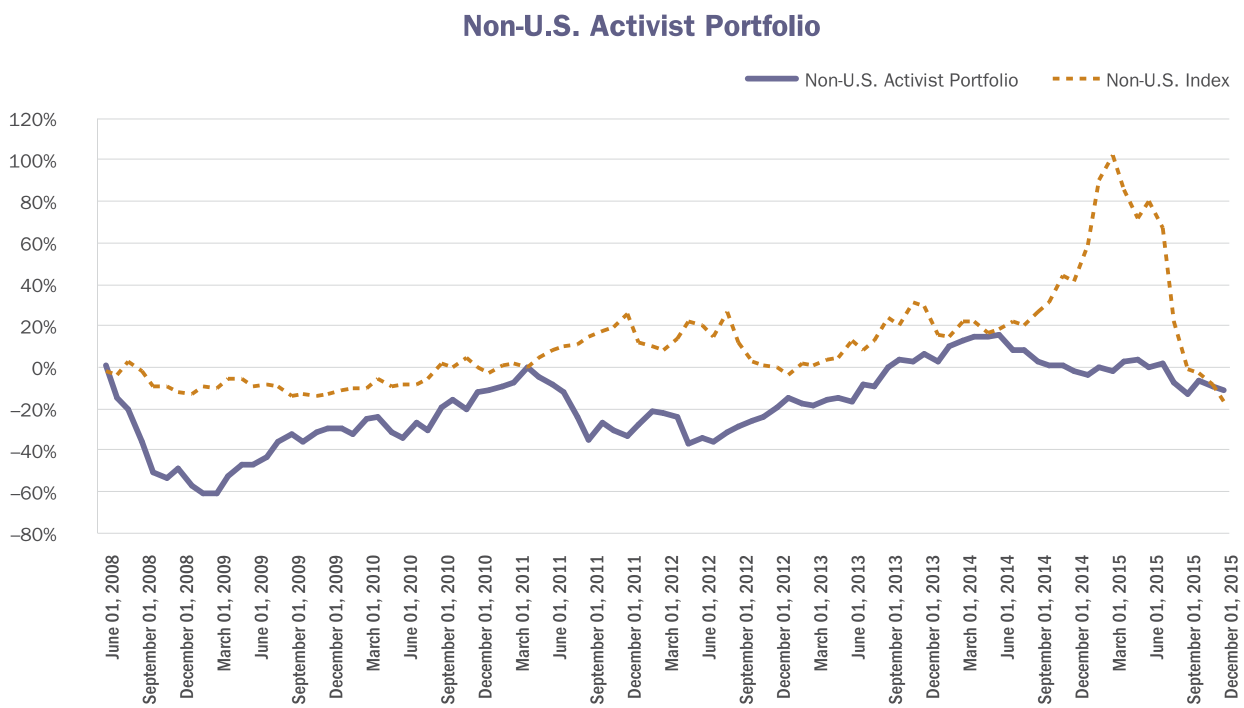
The following chart shows the since inception aggregate performance of the CalSTRS Corporate Governance U.S. Activist Portfolio relative to the U.S. public equity index.

U.S. Activist Portfolio



6 / MANAGERS

The following chart shows the since inception aggregate performance of the CalSTRS Corporate Governance Non-U.S. Activist Portfolio relative to the non-U.S. public equity index.



In addition to the CalSTRS activist manager partnerships, CalSTRS will make co-investments alongside our managers in specific companies. Co-investments allow us to increase our exposure to our manager's highest conviction investments and reduce our overall management fees. Over the past year, CalSTRS has held co-investments in Perry Ellis International, Titan International, Boulder Brands, Sysco Corporation, Ingersoll-Rand, Carrefour SA and E.ON SE.

Sustainable Managers

Starting July 1, 2015, the CalSTRS Corporate Governance Unit assumed responsibility for the Public Equity Sustainable Manager Portfolio. This investment strategy seeks external public equity managers that integrate robust environmental, social and governance criteria into their portfolio company selection process while still managing to outperform a broad market index. Corporate Governance staff assumed responsibility for this portfolio as it aligns with the broad sustainability integration efforts that staff is involved in and allows staff to leverage the expertise of these managers as they work to integrate ESG into the CalSTRS Public Equity Portfolio.

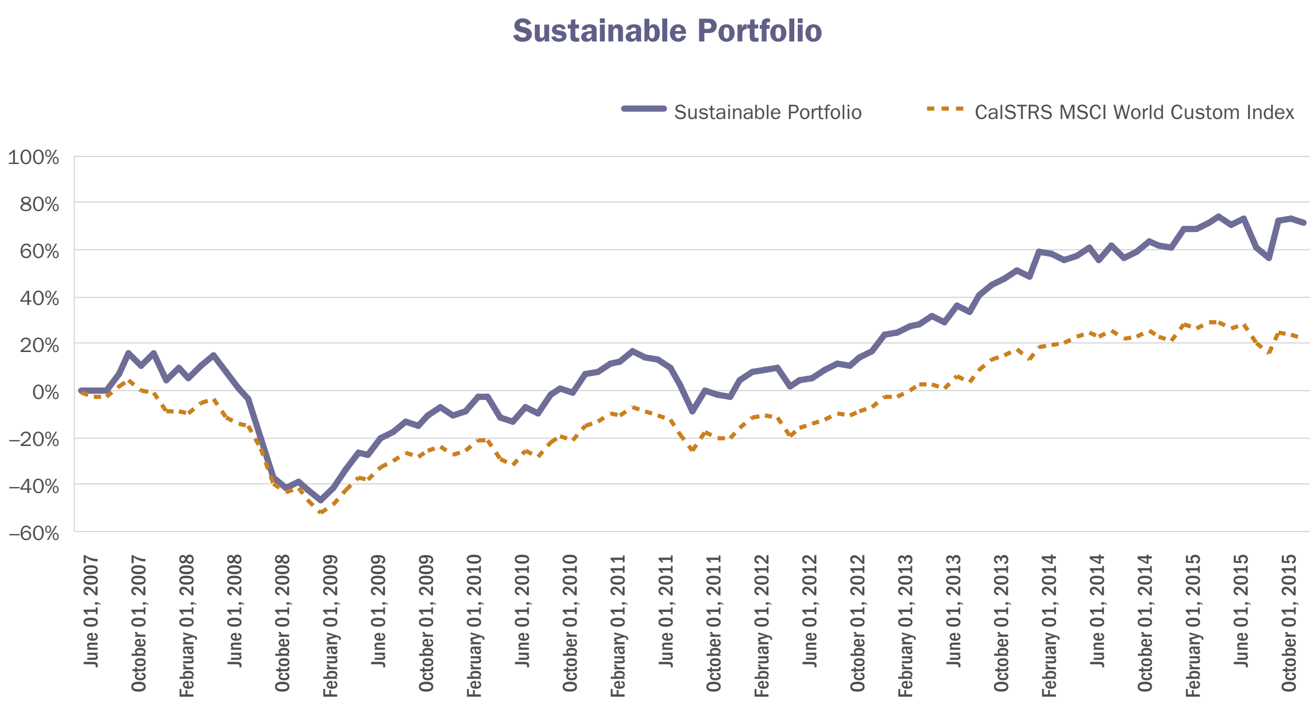
As of December 31, 2015, there were two managers in the Sustainable Portfolio: Generation Investment Management and AGF. Generation Investment Management, a London-based manager, integrates sustainability research into its long-term investment strategy to strengthen its fundamental investment analysis and deliver market outperformance. AGF, a Toronto-based global asset manager, features a sustainable growth equity strategy that focuses on investment opportunities where innovative solutions are being applied to critical environmental issues.

6 / MANAGERS

The following table shows the current allocations to the CalSTRS sustainable managers since inception.

	Account Funded	Market Cap	Geography	Market Value
Generation	June 2007	All Cap	World	$578 Million
AGF	August 2007	All Cap	World	$237 Million

The following chart shows the aggregate performance of the CalSTRS Sustainable Portfolio relative to the CalSTRS MSCI World Custom Index.



7 / LOOKING FORWARD

Mission

The CalSTRS Corporate Governance Unit will continue to be a global governance leader and remain a source of innovation and collaboration. Staff will employ a diversified engagement program to mitigate total portfolio governance risk and position our activist manager portfolios to enhance the CalSTRS Global Equity Portfolio and provide above-market investment returns.

Short-Term: Issue Focus

For 2016, the CalSTRS Corporate Governance staff expects it will continue to focus on the key issues discussed in this report.

Board accountability and succession planning are core issues for investors as the demands on directors' time on the board have increased and investors are requiring true independent oversight by a company's board. Staff will engage its portfolio companies on issues such as majority voting and proxy access to ensure boards are held accountable. Additionally, CalSTRS staff will engage with directors who sit on too many boards ("overboarded"). CalSTRS staff will also engage on issues related to board refreshment to ensure directors are dedicating sufficient time to the boards on which they serve, and that boards are continuously evaluating their directors and improving their board composition.

Executive compensation continues to be a principal issue for the CalSTRS Corporate Governance Unit as it has been over the last decade and will continue to be an issue of importance going forward. Staff will engage CalSTRS portfolio companies on how they are working to align executive compensation with corporate performance. Staff also expects to work with these companies to make the say-on-pay proposal an effective tool to help shape compensation policies that incentivize long-term value creation.

Diversity of corporate boards will also continue to be a signature focus over the next 12 months. CalSTRS staff has spent several years building support for better corporate board diversity and will continue to encourage companies to make diversity part of the director candidate consideration.

Sustainability-related engagements will focus on energy efficiency and methane emissions. Engagement efforts will also consider investment exposure to climate change risk. Collaborating with fellow investors will continue to be an important tool for achieving success, as will supporting organizations that promote sustainability awareness.

Long-Term: Building Best Practices

Looking toward 2016 and beyond, CalSTRS staff believes more institutional investor time and attention will be spent on developing and issuing best practices documents concerning issues investors and companies engage on. When engaging companies, staff is often asked to provide criteria concerning what investors feel are best practices on a variety of issues, including executive compensation, board refreshment and sustainability risk management disclosure.

CalSTRS has published best practices documents in the past and expects to continue to do so going forward. The *CalSTRS Corporate Governance Principles*, updated in 2015, and the *CalSTRS Best Practices in Board Composition*, published in 2015, are examples of staff's efforts at producing best practice guidelines.

CalSTRS believes that established best practices guidelines may help define a middle ground approach to discussions and avoid adversarial engagements. Best practices guidelines also help establish benchmarks and standardizations, and work to identify corporate and investor policies and practices that fall substantially outside the established guidelines.

Staff also believes that increased development and distribution of best practice guidelines allow corporate governance analysis to become less proprietary in nature, reduce the influence that outside firms, such as proxy advisory services, have and possibly lower the costs associated with governance analysis and engagement.

8 / FACT SHEET

Corporate Governance Investment Team

Name	Phone Number	Title	Areas of Focus	Joined CalSTRS
Anne Sheehan	916-414-7410	Director	Director	2008
Brian Rice	916-414-7413	Portfolio Manager	Sustainable Mgrs. & Sustainability	2003
Aeisha Mastagni	916-414-7418	Portfolio Manager	Activist Mgrs. & Exec. Compensation	2009
Philip Larrieu, CFA	916-414-7417	Investment Officer	Activist Mgrs. & Geo-Political Issues	2005
Ly Van	916-414-7416	Investment Officer	Proxy Voting	2007
Travis Antoniono	916-414-7421	Investment Officer	Proxy Voting	2011
Eric Kwong	916-414-7414	Investment Officer	Operations & Contracts	1989
Laurie Winston	916-414-7411	Executive Assistant	Staff Support	1998

Program Description

CalSTRS Corporate Governance Program

Activist and Sustainable Fund Managers	Legal, Regulatory and Legislative Support	Portfolio Company Engagement	Proxy Voting

- Established in 1978 to protect assets through good governance and operational accountability. The Corporate Governance Program includes proxy voting, portfolio company engagements, filing of shareholder proposal initiatives and portfolio management.

- Program benchmark: CalSTRS Custom Russell 3000 Index (U.S. Equity) and CalSTRS Custom MSCI ACWI (Non-U.S. Equity).

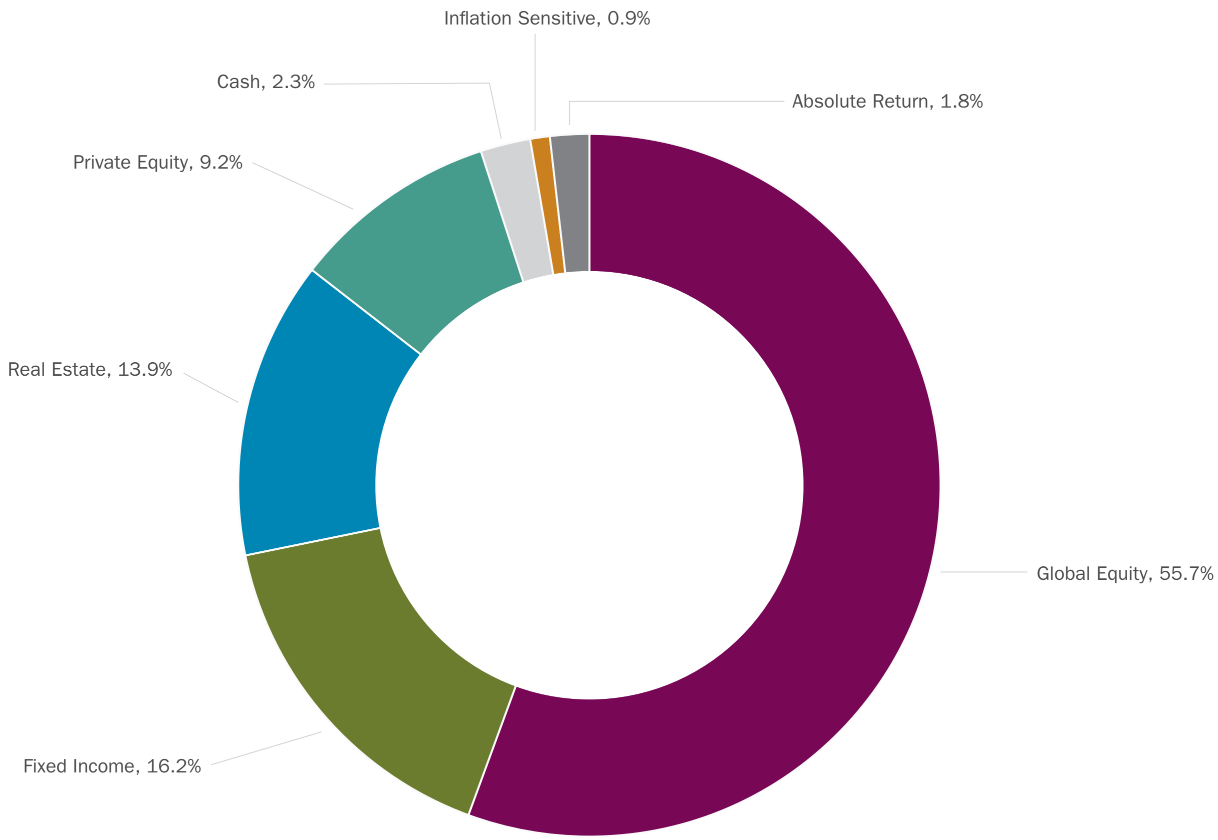
- Ten Corporate Governance external managers and multiple side-by-side co-investments. Selection is biased toward firms with experienced and stable management teams with a strong track record of engaging boards and management to undertake changes to increase long-term shareholder value.

- Two sustainable managers seeking to integrate environmental, social and governance criteria into their portfolio company selection process.

8 / FACT SHEET

CalSTRS Portfolio

Approximate value as of December 31, 2015: $186.1 billion



Transparency and Public Information Requests

CalSTRS strives to be a leader in corporate governance best practices, including transparency. For more information on the Corporate Governance Program and its managers, visit CalSTRS.com.

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