CORPORATE GOVERNANCE

2013 ANNUAL REPORT

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California State Teachers' Retirement System
100 Waterfront Place, MS-04
West Sacramento, CA 95605-2807

June 1, 2013

CalSTRS is pleased to publish our inaugural corporate governance report. This is an opportunity for us as a large, long-term shareholder to communicate to the investment community the priorities in our corporate governance program.

CalSTRS, the largest teachers' pension fund in the country, with over $160 billion of assets under management, is responsible for the retirement needs of 865,000 beneficiaries. As such, we have an obligation to be responsible stewards of the retirement funds of California's educators.

CalSTRS celebrates its 100th anniversary this year and has long been active in the corporate governance arena. We have been responsible owners for the past 100 years. We expect the companies in our portfolio to also be stewards of our capital—to make wise decisions on our behalf, to be responsible managers, and to carry out their duties.

As 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 actively engage and communicate with them to share our concerns. As long-term, universal owners, we believe we have an obligation to do this on behalf of California's educators.

This report, along with our proxy voting guidelines, our investment policies, including our 21 risk factors, and our corporate governance principles, provides the framework for all of our activities. We are happy to share our philosophy and principles here so as to continue to strengthen our stewardship rate.

Sincerely,

Anne Sheehan
Director of Corporate Governance
CalSTRS

1A / GOVERNANCE BACKGROUND

The successful public company must monitor a variety of issues in order to remain successful, among them: sales and marketing, personnel, pricing, product development, suppliers, and not least, staying a step ahead of the competition. Less obvious, but no less important for a company to monitor, is its corporate governance. Does the board act in the interest of the company's shareholders? Is the board independent, engaged and willing to remedy corporate weaknesses? Can shareholders easily express their views on the management of the company? The answers to these and other questions provide a framework for measuring the strength of a company's governance structure.

Good corporate governance will ultimately flow from a partnership among capital providers (investors), capital users (corporate management) and capital regulators (government). Achieving some degree of equilibrium among the three sides often seems to be a difficult task, owing to the often-diverging interests of the different constituencies. But it is a worthwhile task all the same, given the important role corporate governance plays in driving economic efficiency and prosperity.

It has been documented that well-governed companies significantly outperform poorly governed companies over the long term. One of the most definitive studies, carried out by economists Paul Gompers, Joy Ishii and Andrew Metrick, found that in the 1990s, companies that promoted shareholder rights outperformed those that didn't by 8.5 percentage points each year. This finding should not be a surprise: well-governed companies, with accountable management, are more likely to allocate capital efficiently and productively.

1B / GOVERNANCE PHILOSOPHY

Established in 1913 for the benefit of California's public school teachers, CalSTRS has long recognized the importance of advocating for, and engaging on, best-practice governance.

With the majority of its public equity portfolio invested in large global indexes, CalSTRS maintains the position that it owns a small part of most companies in the market and therefore needs to engage 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 long-term sustainable value. The importance of corporate governance to CalSTRS is evidenced by the Corporate Governance team's status as a distinct asset class—an organizational structure not often found in investment institutions, and one that helps to integrate its governance philosophy throughout the Investment branch.

CalSTRS has a robust group of internal programs that cover a variety of governance issues. The Corporate Governance staff focuses on executive compensation, diversity on corporate boards, board structure, director election standards, geopolitical risk issues, and sustainability risk awareness and integration. The staff is also responsible for voting over 7,000 domestic and international proxies annually, evaluating, processing and monitoring securities class action claims, and providing support to the CalSTRS legal and legislative units. Through these various programs, the CalSTRS Corporate Governance team is able to provide a layer of risk management across the fund's investment portfolio.

Additionally, the CalSTRS Corporate Governance unit is responsible for managing a public equity portfolio that features external managers who employ an activist investment philosophy. These managers work with undervalued public equity companies to improve their governance profiles and business practices. The improvements these managers engineer must be 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 investment portfolio long after the activist manager sells them.

2 / POLICIES

CalSTRS has a very large portfolio both in number of assets held and in dollar value. It is important that staff apply its actions in a consistent manner. The essential tools for such action are well-developed and thoughtfully executed policies that reflect the priorities of the Teachers' Retirement Board. CalSTRS staff has routinely reviewed its policies for relevancy and consistency with the board for over 30 years, stewarding the plan assets consistent with the highest fiduciary standards.

CalSTRS investment policies are developed by staff and brought to the Teachers' Retirement Board for approval. Board members have always taken this oversight role very seriously and have been active in giving staff direction on the policy outlines and parameters. The sitting board members do this with future board members and the beneficiaries in mind so that there is a record of their reasoning for decisions and documented processes that support the 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 its position as a long-term investor with a significant commitment to passively managed portfolios within the public markets: Global Equities and Fixed Income. The CalSTRS Corporate Governance program is designed to maximize the long-term value of the portfolio, consistent with its role as a provider of patient, significant capital to the markets and economy.

CalSTRS Corporate Governance policies include the *Corporate Governance Principles*, the *Principles for Executive Compensation*, the *Executive Compensation Model Policy Guidelines*, the *Investment Policy Regarding Geopolitical and Social Risks* and the *Responsible Contractor Policy*. All of the corporate governance policies can be found on the corporate governance section of CalSTRS.com. A detailed legend is kept for each policy, showing amendment and approval dates of the policy.

Since the Teachers' Retirement Board agenda materials are archived, the reader can understand the thinking of the board as it weighed each of these policy actions. CalSTRS believes this is the best practice for stewardship of beneficiary assets and is the appropriate response of a fiduciary to the challenges that arise in the management of such a large and complex fund.

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.

3 / PARTNERSHIPS

In order to achieve its mission of being a global governance leader, the CalSTRS Corporate Governance staff recognized the need to establish strategic relationships with collaborative partners. Staff, therefore, works closely with a variety of industry standard setters and like-minded investors. CalSTRS would like to recognize and thank those organizations that have been instrumental in helping it to become one of the leaders in the corporate governance community.

Council of Institutional Investors
The Voice of Corporate Governance

The Council of Institutional Investors (CII) 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 valuable organization since its inception in 1985.

When CII was founded, shareowners had little power to influence the companies in which they invested. Board rooms were filled with imperial CEOs and insulated boards of directors whose interests were not always aligned with the shareholders they were there to represent. The founders, a group of 21 public pension funds including CalSTRS, believed that by working together, institutional investors could use their power to hold companies accountable to their shareholders and thereby increase long-term value.

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.

ICGN
International Corporate Governance Network

The International Corporate Governance Network (ICGN) is a nonprofit global membership organization of around 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 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.

Today, CalSTRS is an active member of the ICGN, participating in the cross-border dialogue at conferences, influencing public policy though ICGN committees and promoting best practices around the world.

3 / PARTNERSHIPS

Signatory of:

PRI Principles for Responsible Investment

The Principles for Responsible Investment (PRI) is a network of international investors working together to put six Principles for Responsible Investment into practice. The six principles were developed by the investment community and reflect the view that environmental, social and corporate governance (ESG) 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.

The six principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.

Today, over 1,000 investment institutions, with assets under management of approximately $30 trillion, have become signatories to the principles.

P1	We will incorporate ESG issues into investment analysis and decision-making processes.
P2	We will be active owners and incorporate ESG issues into our ownership policies and practices.
P3	We will seek appropriate disclosure on ESG issues by the entities in which we invest.
P4	We will promote acceptance and implementation of the principles within the investment industry.
P5	We will work together to enhance our effectiveness in implementing the principles.
P6	We will each report on our activities and progress towards implementing the principles.

The PRI Initiative was created after the launch of the six principles to help investors to implement the principles. The initiative is managed by the PRI Secretariat and supports investors by sharing best practice, facilitating collaboration and managing a variety of work streams. 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 in 2007.

Through its work with the PRI, CalSTRS is able to assess the level of integration of the principles within each asset class and across its entire investment portfolio. CalSTRS staff continues to be actively involved in the many efforts and initiatives that this organization sponsors.

3 / PARTNERSHIPS

The Asian Corporate Governance Association (ACGA) 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 was founded in 1999 from a belief that corporate governance is fundamental to the long-term development of Asian economies and capital markets. CalSTRS was one of the first U.S. pension funds to endorse the ACGA.

The ACGA's scope of work covers three areas: research, advocacy and education. The ACGA holds quarterly conference call updates for its members, annual meetings and periodic study tours, where members are able to meet with regulators, government officials, trade organizations, and local investors within the markets the ACGA covers.

The ACGA provides in-depth corporate governance research and advocacy for eleven Asian markets: Japan, China, Hong Kong, South Korea, Taiwan, India, Singapore, Indonesia, Malaysia, Thailand and the Philippines. Collectively, CalSTRS owns over $7 billion in public equity in these eleven Asian markets. Therefore, the work of the ACGA provides an important layer of risk management over a significant portion of the investment portfolio.

Ceres is an advocate for sustainability leadership. Ceres mobilizes investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices and solutions. Founded by a small group of investors in 1989 in response to the Exxon Valdez oil spill, Ceres has been working for more than 20 years to weave sustainable strategies and practices into the fabric and decision-making of companies, investors and other key economic players.

Ceres works with more than 130 member organizations that make up the Ceres Coalition to engage with corporations and help advance the goal of building a sustainable global economy. Ceres works with more than 80 companies across a broad range of sectors committed to engaging with diverse stakeholders, improving their performance on social and environmental issues and disclosing strategies and progress publicly. Ceres also works with investors worldwide to improve corporate strategies and public policies on climate change and other environmental and social challenges across the global economy with the goal of increasing long-term investment value.

Through the various Ceres platforms, and in collaboration with other Ceres-led investors, CalSTRS engages U.S. companies on their level of environmental risk management and disclosure. CalSTRS engages on issues such as carbon emissions management, extractive risk management, water sourcing, sustainable land use and waste disposal risk. Working collaboratively with other investors allows CalSTRS engagement reach to extend further and allows our voice to be more powerful and more meaningful.

3 / PARTNERSHIPS

Investor Network on CLIMATE RISK a project of Ceres

The Investor Network on Climate Risk (INCR), a project of Ceres, is a $10 trillion network of over 100 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 has been an active member of the INCR for many years. Through its involvement in the INCR, CalSTRS 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. CalSTRS continues to be part of the INCR Policy Working Group and, as such, is able to help shape INCR initiatives, such as the Climate Risk Action Plan and the INCR Manager Survey.

Through the work of the INCR, CalSTRS and other investors have been able to successfully petition the U.S. and Canadian securities regulators to issue formal guidance on climate change-related disclosure, engage major oil and gas companies to strengthen risk oversight measures for deep-water oil drilling, natural gas “fracking” and oil sands production, and persuade dozens of Fortune 500 companies to improve their climate policies, practices and disclosures.

4 / ENGAGEMENTS

Executive Compensation—Say-on-Pay

CalSTRS has been actively engaging in all aspects of executive compensation for over two decades. Some of these issues include the amount of compensation awarded, the types of compensation awards given, the concentration of awards given to top-level executives, change of control agreements and severance packages.

CalSTRS has always supported market-wide governance initiatives that are expected to improve the investing landscape for shareholders. Executive compensation is one of those governance initiatives that directly influences the bottom line as compensation payments come directly out of the earnings—or lack thereof in some circumstances—a company generates.

Since it is well known that financial incentives can drive human behavior, it is extremely important to CalSTRS that there be an alignment between the performance of a company and the compensation awarded its executives. A clear misalignment between executive pay and company performance is viewed as a material risk to the viability of the company. Poorly structured pay packages harm shareholder value by unfairly enriching executives at the expense of shareholders.

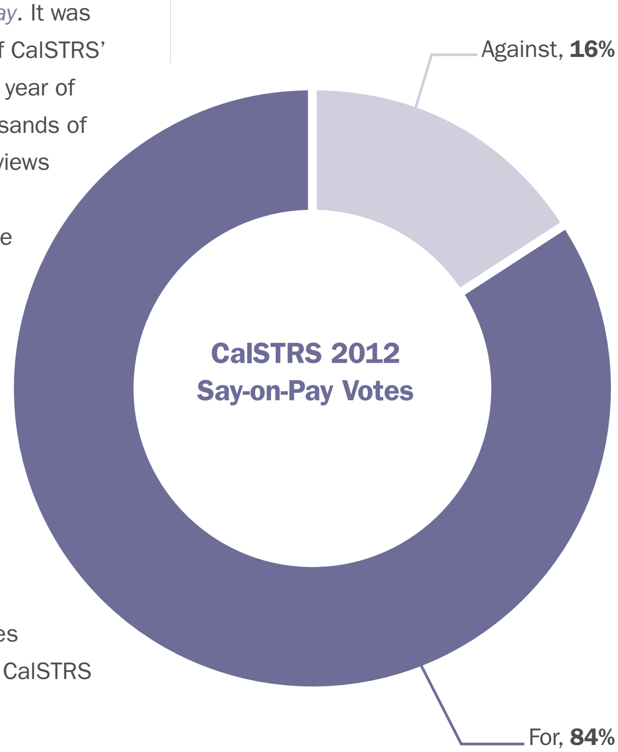
In the summer of 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into federal law by President Barack Obama. This act included a provision which required public companies to submit their executive compensation plans to a nonbinding, advisory-type, shareholder vote at least once every three years.

This requirement went into effect in January 2011. Since then, shareholders have had two years to consider and vote on the executive pay at the majority of U.S. companies. These advisory votes on compensation, otherwise known as say-on-pay, have provided a unique opportunity for CalSTRS to directly express its views on compensation plans at the companies in which it invests.

After the first year of the say-on-pay requirement, CalSTRS released a document titled *Lessons Learned: The Inaugural Year of Say on Pay*. It was a comprehensive review of CalSTRS' experience during the first year of say-on-pay. Given the thousands of pay packages CalSTRS reviews every year, the document helped communicate to the marketplace CalSTRS' process for voting these important proposals and its expectations for future years.

The second year of say-on-pay saw CalSTRS increase its engagement with portfolio companies. Several portfolio companies proactively reached out to CalSTRS to discuss their compensation policies. Others responded to CalSTRS' request for dialogue or provided supplemental materials that discussed their pay programs. This engagement also provided learning opportunities for CalSTRS, while allowing staff to provide detailed feedback to the companies.

The increased engagement also demonstrated the need for companies to "tell their story" better in the Compensation and Discussion Analysis section of the proxy. Quite frequently CalSTRS found that the supplemental materials companies provided contained valuable information that should have been included in the original proxy. In CalSTRS' view, during this second year of say on pay, companies' engagement



4 / ENGAGEMENTS

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

efforts were effective. Not surprisingly, CalSTRS saw its "against" votes on say-on-pay proposals decrease from 23 percent in 2011 to 16 percent in 2012.

Having considered the first two years of say-on-pay, CalSTRS staff has observed a number of significant changes. Shareholders have made it clear that they will no longer support compensation plans that include what CalSTRS likes to call "shareholder irritants," and companies are beginning to listen. Plan components like tax gross-ups, excessive perquisites and employment agreements with guaranteed payments are disappearing as companies no longer want to become a "target" for having included them in their compensation plans. With the elimination of these problematic pay practices, the focus turns to trying to find a true alignment between pay and performance.

All too often CalSTRS sees pay programs that consistently provide executives with large compensation awards despite shareholders' investments in these companies continuing to lose value. In the future, CalSTRS believes that these companies will receive substantial "against" votes on their say-on-pay proposals, and their compensation committees will be subject to increased scrutiny.

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. If directors can't say no to a CEO's pay package, how can shareholders trust that they will provide proper oversight of the company? 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 it votes and work with the companies in which it invests to truly align compensation with performance to enhance value for all market participants.

Majority Vote Standards

As shareowners, CalSTRS depends on corporate directors to protect the fund's best interests. To that end, CalSTRS believes that directors should only be elected 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 to the board.

For many years, there has been an active effort by shareholders 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. 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, voting 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. Since that time, shareholders have increased their efforts and have been seeking to make majority voting the standard by filing proposals calling for such a standard one company at a time.

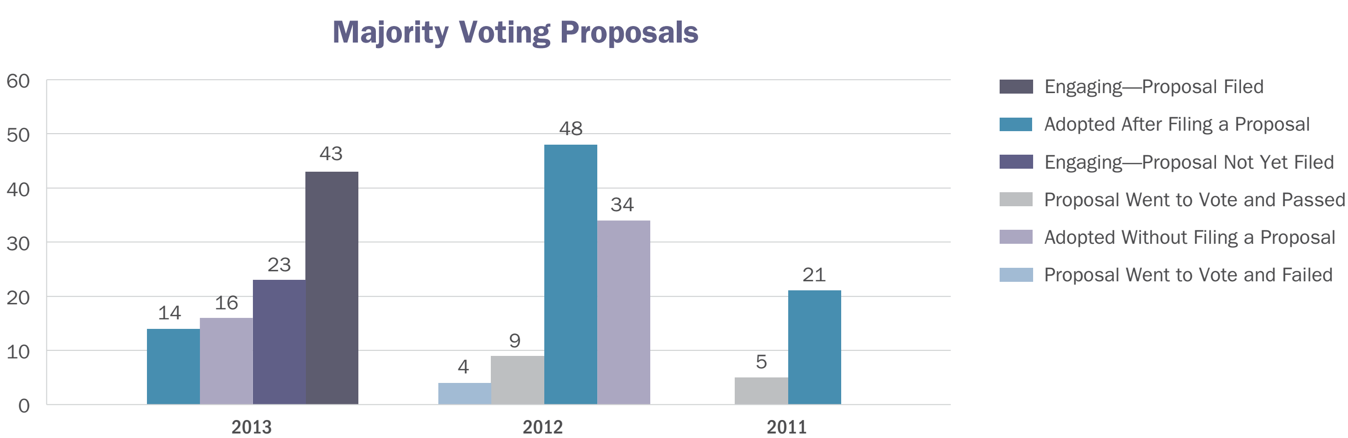
In the 2011 proxy season, CalSTRS embarked on what was an ambitious campaign by filing majority voting proposals at 26 companies. CalSTRS focused its efforts on the companies in the Russell 2000 Index, a public equity index comprised of small to mid-sized companies, because more than two-thirds of the companies in that index still maintained a plurality standard. This was in stark contrast to the Standard & Poor's (S&P) 500 Index, consisting of the 500 largest publicly traded U.S. companies, where less than 10 percent of companies still maintained a strict plurality standard.

Staff was pleasantly surprised when over 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 their resignation and the board or a committee of the board determines whether to accept) without the filed proposal going to a vote. Staff was also pleased that those majority vote proposals that did go to a vote passed overwhelmingly.

Given the success of 2011 campaign, CalSTRS expanded the program in 2012 with the goal of engaging 100 companies. Again, more than 86 percent of the companies engaged adopted majority voting without a proposal going to vote, and the majority of those proposals that did go to a vote passed. CalSTRS is again attempting to engage 100 companies during the 2013 proxy season and is actively screening the portfolio for majority vote targets for 2014.

Diversity of Corporate Boards

According to recent U.S. Census Bureau estimates, women represent more than 50 percent our population, and minorities together make up more than 35 percent of our population. Those same estimates show that Blacks/African Americans number more than 37 million, Asians make up more than 13 million and Hispanics/Latinos comprise more than 45 million. Yet, those numbers are hardly reflected in the leadership of our nation's top corporations.



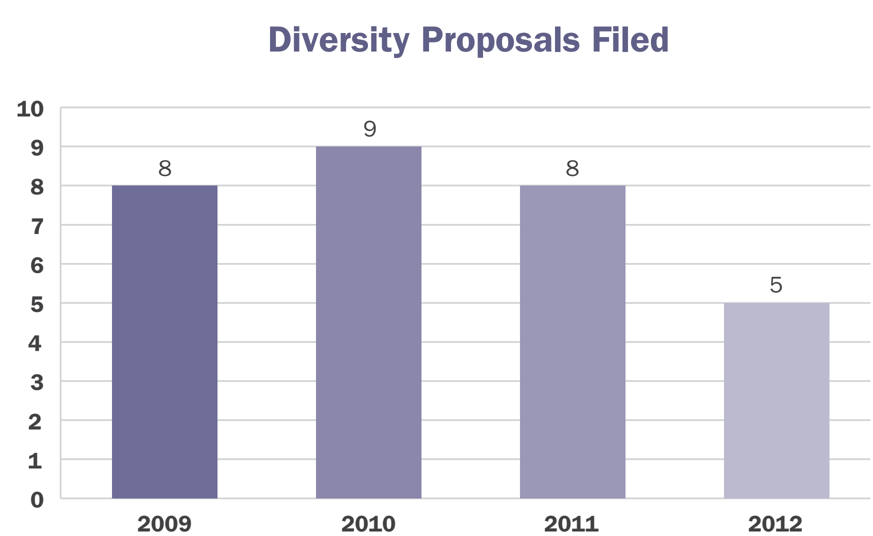
4 / ENGAGEMENTS

There is no doubt that corporations are reaping record 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 control $4.3 trillion in U.S. consumer spending. And according to the Selig Center for Economic Growth, as of 2009, the purchasing power of the Black/African-American, Hispanic/Latino and Asian communities was estimated at $910 billion, $978 billion and $508.6 billion, respectively. Given the importance of these communities to corporate profits, it is imperative that they be represented at the decision-making table of these corporations.

As in every proxy season since 2008, CalSTRS continued its long-term focus on diversity on corporate boards during 2012. Staff approaches this engagement from a number of different angles, using CalSTRS proxy power to engage, propose resolutions, vote according to our guidelines on the issue, and advocate for best practices in the market place.

During 2012, CalSTRS introduced five shareholder resolutions asking that companies amend their relevant charter documents to include diversity as a criterion in the selection and evaluation of candidates for directorships on their boards: Discovery Communications, Perry Ellis, rue21, Skechers and True Religion. After the companies commited to consider diversity, all five of these proposals were withdrawn. Staff considers this a win-win situation for both companies and shareholders, as engagement is more efficient and expeditious than traveling the timely and costly shareholder proposal route.

The following chart shows the number of diversity proposals that CalSTRS has filed between 2009 and 2012.



DIVERSE DIRECTOR DATASOURCE

Developed by CalSTRS and CalPERS and owned, operated and maintained by GMI, the Diverse Director DataSource (3D) is a clearinghouse for potential 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 potential diverse candidates and existing directors as a means to expand board diversity, which has been shown to improve overall corporate performance.

The Diverse Director DataSource is a method of identifying well-qualified individuals who may be considered for nomination to serve as board members to improve corporate performance. 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. Any applicant or potential candidate may submit his or her details to 3D.

Subscribers to 3D screen for potential director candidates who meet identified needs in experience, skills and other qualifications for optimum board composition. Companies accepting candidates to the board will be responsible for due diligence and the candidate for a board nomination is responsible for his or her own data.

4 / ENGAGEMENTS

Sustainability

Often referred to as environmental, social and governance (ESG), sustainability has been a principal focus of the CalSTRS Corporate Governance staff for many years. From a broad societal viewpoint, sustainability is considered to be meeting the needs of today without sacrificing the needs of tomorrow. From an investment perspective, sustainability can be viewed as achieving desired investment returns in the near term without sacrificing the ability to achieve needed investment returns in the longer term.

From an investment perspective, sustainability can be viewed as achieving desired investment returns in the near term without sacrificing the ability to achieve needed investment returns in the longer term.

As a large, diversified global investor, CalSTRS recognizes that it needs to be mindful of its exposure to a variety of sustainability-related risks. Carbon emissions regulations in Europe, severe weather events in the North America and workplace standards in Asia can and do present risks to the CalSTRS Investment Portfolio. 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 governance staff has developed a sustainability risk management program that works to identify and mitigate ESG risk in the CalSTRS portfolio. The program focuses on engaging portfolio companies, fellow investors, regulatory agencies and government officials on the importance of integrating sustainability considerations into corporate operations, regulatory actions, government policies and investor evaluation and analysis.

CalSTRS also supports organizations that promote sustainability awareness and facilitate dialogue on sustainability-related concerns. CalSTRS is a signatory to the Carbon Disclosure Project (CDP), a London-based organization that promotes corporate greenhouse gas emissions, corporate water use and supply chain risk disclosure. CalSTRS 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.

Additionally, CalSTRS is a signatory to the Principles for Responsible Investment, an organization that promotes awareness and integration of sustainability considerations for businesses, fund managers and investment fiduciaries.

Typically, CalSTRS staff pursues multiple sustainability-related engagements simultaneously. These engagements can be event driven. The BP Macondo oil spill lead to an extractives industry engagement that focused on companies involved in oil and gas drilling. Sustainability engagements can also be in support of efforts that promote sustainability awareness. CalSTRS routinely engages the U.S.-based companies that fail to respond to the CDP surveys on the efforts they're taking to mitigate greenhouse gas emissions and water use risks. And sustainability engagements can be issue-driven, such as the resource efficiency engagement effort that began in 2012.

Russell 1000 Efficiency Initiative

Investments in energy efficiency are an attractive way to curb volatile energy costs, can help companies respond to potential regulations, and can enhance

4 / ENGAGEMENTS

a company's role as a corporate citizen. When one considers that the energy consumed in industry and buildings represents 73 percent of all energy used in the U.S.,[1] corporate attention to efficiency can significantly reduce the levels of energy consumed in this country.

Investments in energy efficiency are typically highly profitable and low risk. In 2008, McKinsey estimated that worldwide $170 billion could be invested yearly in energy efficiency with an average annual Internal Rate of Return (IRR) of 17 percent.[2] By 2020, these investments would produce $900 billion in annual energy savings.

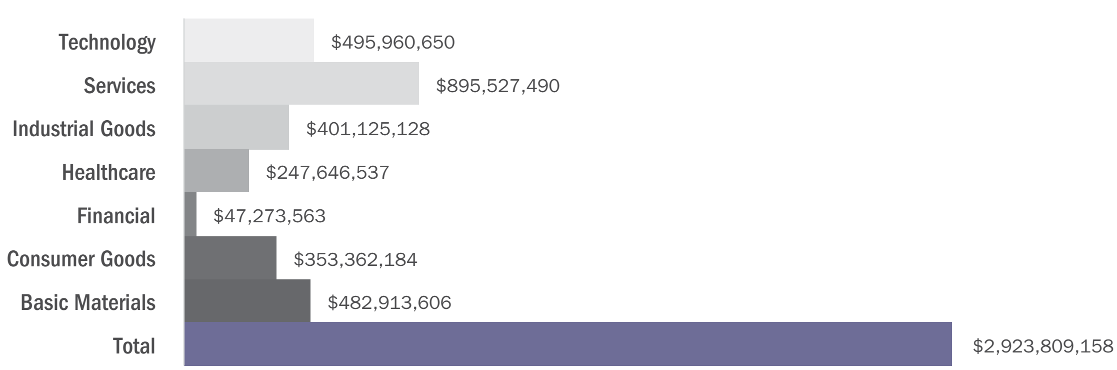
In an effort to get more CalSTRS portfolio companies focused on carbon emissions management, and at the same time drive cost savings to improve value, staff is focusing on energy and water efficiency at large U.S. companies. Using a variety of data sources, staff performed a detailed analysis of its Russell 1000 Index holdings to determine the 100 companies within the index that were most in need of engagement concerning implementing and disclosing energy and water efficiency efforts.

In August of 2012, staff sent engagement letters to the 100 companies identified through its analysis of the Russell 1000 Index. These 100 companies had a combined portfolio value of nearly $3 billion, which represents approximately 6.5 percent of CalSTRS' U.S. portfolio and 4 percent of CalSTRS' Global Equity portfolio. The letters outlined CalSTRS' belief that companies need to be cost effective, that incorporating efficiency initiatives into business plans would be beneficial from a financial and reputational perspective, and that little disclosure surrounding the company's efforts at efficiency could be found.

Staff enjoyed a very strong response to its requests for dialogues, with over 30 of the 100 companies responding. This response rate is more than double the response rate normally seen when CalSTRS requests engagement on sustainability-related issues and is likely attributable to the level of importance that companies place on efficiency. Staff was able to discuss the benefits of efficiency, from cost savings to reputational improvement, and found that many of the targeted companies were considering efficiency initiatives; they just weren't disclosing these efforts publicly.

Of the 100 targeted companies, staff developed a "short list" of 10 companies to receive shareholder proposals asking for reports on energy use management. Staff has filed six such proposals, already withdrawing two as companies agreed to improve their efficiency efforts, and anticipates filing several more during 2013.

Equity Portfolio Coverage: Efficiency Engagement



[1] *Annual Energy Review 2003*. U.S. Department of Energy, Energy Information Administration. (DOE-EIA)
[2] Farrell, Diana, and Jaana Remes. "How the World Should Invest in Energy Efficiency." Industry Today. McKinsey & Company, July 2008.

5 / PROXY VOTING

CalSTRS votes all of its domestic and non-U.S. proxies in a manner that aligns with its interests and philosophy. Not only is the voting of proxies a fiduciary duty, CalSTRS believes that the execution of proxies is an important fundamental shareholder right, and staff always seeks to exercise the fund's rights in a consistent fashion that is in the best interests of the beneficiaries.

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

When voting proxies, CalSTRS relies on its Corporate Governance Principles, which can be found on CalSTRS.com. The principles consider best practices for corporate governance on topics such as the board of directors, auditors, executive and director compensation, compensation plans and governance structure. However, these principles are not mandatory but rather serve as guidelines to be used in conjunction with analysis and judgment.

To assist staff in their proxy vote analysis, CalSTRS subscribes to and uses corporate governance research and proxy reports from vendors such as Glass Lewis & Co., Institutional Shareholder Services (ISS), GMI Ratings, Equilar, MSCI ESG Research, and the Sustainable Investment Institute (Si2). Additionally, CalSTRS frequently has dialogues with corporate issuers and other interested other parties to obtain additional information or perspectives before making an informed proxy vote decision on key shareholder issues.

Since 2011, CalSTRS has voted both domestic and non-U.S. proxies in-house by using the Glass Lewis proxy voting platform. Staff provides Glass Lewis with CalSTRS proxy voting guidelines to vote proxies and Glass Lewis votes on the fund's behalf. CalSTRS uses the same guidelines and policy when voting non-U.S. and domestic proxies. CalSTRS staff vote on mergers, shareholder proposals, contested election meetings and other extraordinary vote items. CalSTRS is also committed to disclosing its proxy votes on the CalSTRS website, as well as on the Proxy Democracy and Glass Lewis websites.

CalSTRS keeps abreast of "hot" 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. This year, these "hot" shareholder topics included proxy access, political contributions resolutions, ESG resolutions and say-on-pay.

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 our 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, employee stock purchase plans and so on, for executives, employees and non-employee 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 such factors as the performance metrics, burn rate and dilution potential.
Say on Pay	CalSTRS refers to our *Principles for Executive Compensation* 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 utilizing 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 utilizing the guidelines set by the Teachers' Retirement Board.

5 / PROXY VOTING

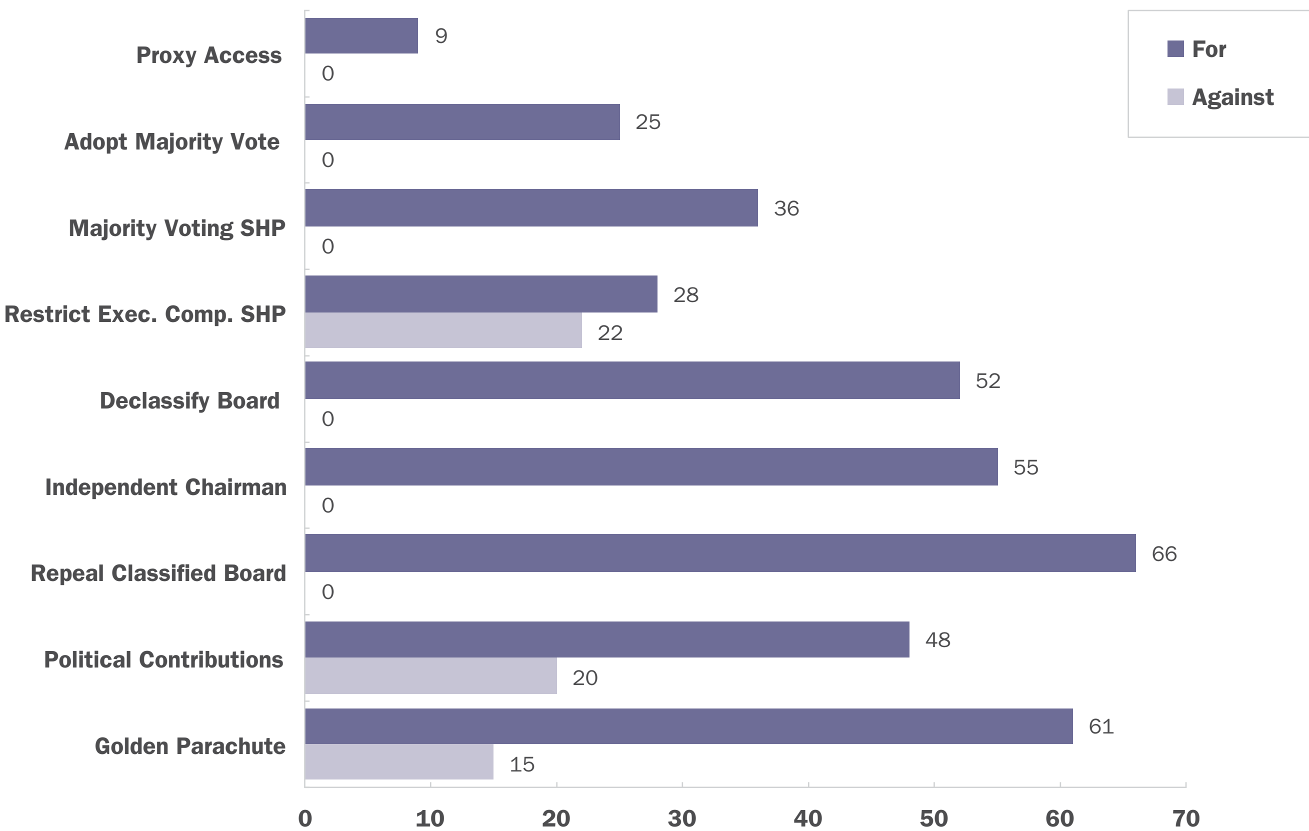
In 2012, CalSTRS voted nearly 7,000 meetings, of which approximately 3,000 were from U.S. companies and 4,000 were from non-U.S. companies. These meetings resulted in CalSTRS considering over 24,000 proposals for U.S. companies and over 49,000 proposals for non-U.S. companies. The proposals covered a variety of topics including the election of directors, the ratification of auditors, the ratification of compensation reports, the approval of executive and director compensation plans, and the approval of mergers and acquisitions. The vast majority of shareholder proposals submitted to corporations occurred in the U.S. and Canadian markets.

The following table shows the top issues voted in 2012 by volume:

Top Issues by Volume	Against	For	Total
Election of Directors	5,781	10,873	16,654
Ratification of Auditor	221	2,469	2,690
Advisory Vote on Executive Compensation	340	1,903	2,243
Equity Compensation Plan	144	598	742
Employee Stock Purchase Plan	0	104	104
Merger/Acquisition	2	99	101
Total	**6,488**	**16,046**	**22,534**

5 / PROXY VOTING

The following chart shows how CalSTRS voted on certain issues during 2012:



Staff looked at the number of votes cast on major issues in 2012 compared to 2011 and found that the number of directors, auditors and compensation plans considered remained relatively the same. Staff did see a decline in the number of proposals relating to say-on-pay and environmental issues and saw a rise in the number of shareholder proposals asking for disclosure on political contributions.

It's likely that the number of mandatory say-on-pay proposals declined as companies obtained shareholder approval to consider say-on-pay every three years. The decrease in environmental proposals is likely due to a combination of more companies integrating environmental considerations into the business practices and more companies being willing to engage shareholders on environmental concerns.

In 2012, there was also a large increase in shareholder proposal votes regarding political spending or lobbying. This is likely attributed to the U.S. Supreme court decision on the *Citizens United v. Federal Election Commission* case allowing independent political expenditures by corporations. In response to that, shareholders requested more information on political spending and lobbying activities from companies.

5 / PROXY VOTING

The following table shows the number of proposals considered on major issues in 2011 and 2012 and shows the percentage change year over year:

Issue	2011 Proposals Considered	2012 Proposals Considered	2011 to 2012 Change
Election of Directors	16274	16,660	2.4%
Ratification of Auditor	2636	2,690	2.0%
Advisory Vote on Executive Compensation	2626	2,243	–14.6%
Equity Compensation Plan	782	742	–5.1%
Majority Voting SHP	37	36	–2.7%
Political Contributions SHP	51	68	33.3%
Environmental SHP	63	47	–25.4%

6 / MANAGERS

CalSTRS believes that good governance contributes to better long-term, sustainable performance. In order to capitalize on that fact, CalSTRS has allocated money to select corporate governance activist managers. The CalSTRS Corporate Governance Activist Portfolios are concentrated portfolios with managers that take large individual positions and engage boards and management to undertake value driving change.

The CalSTRS Corporate Governance Activist Managers 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, but not limited to, takeover defenses, board structure and board composition.

Since the majority of the CalSTRS assets are indexed, the fund is always invested across the entire market. By allocating funds to corporate governance activist managers, CalSTRS gains additional market outperformance by making large investments in certain companies. Additionally, as managers improve the governance and performance of their holdings, CalSTRS enjoys the added benefits of improved performance and the long-term benefit of being a better-governed company in our indexed portfolios.

CalSTRS began the Activist portfolio in June 2004 by allocating $700 million to the Relational Investors Large Cap Fund. Since inception, the program has expanded and grown to over $3.25 billion invested across eight funds and seven managers.

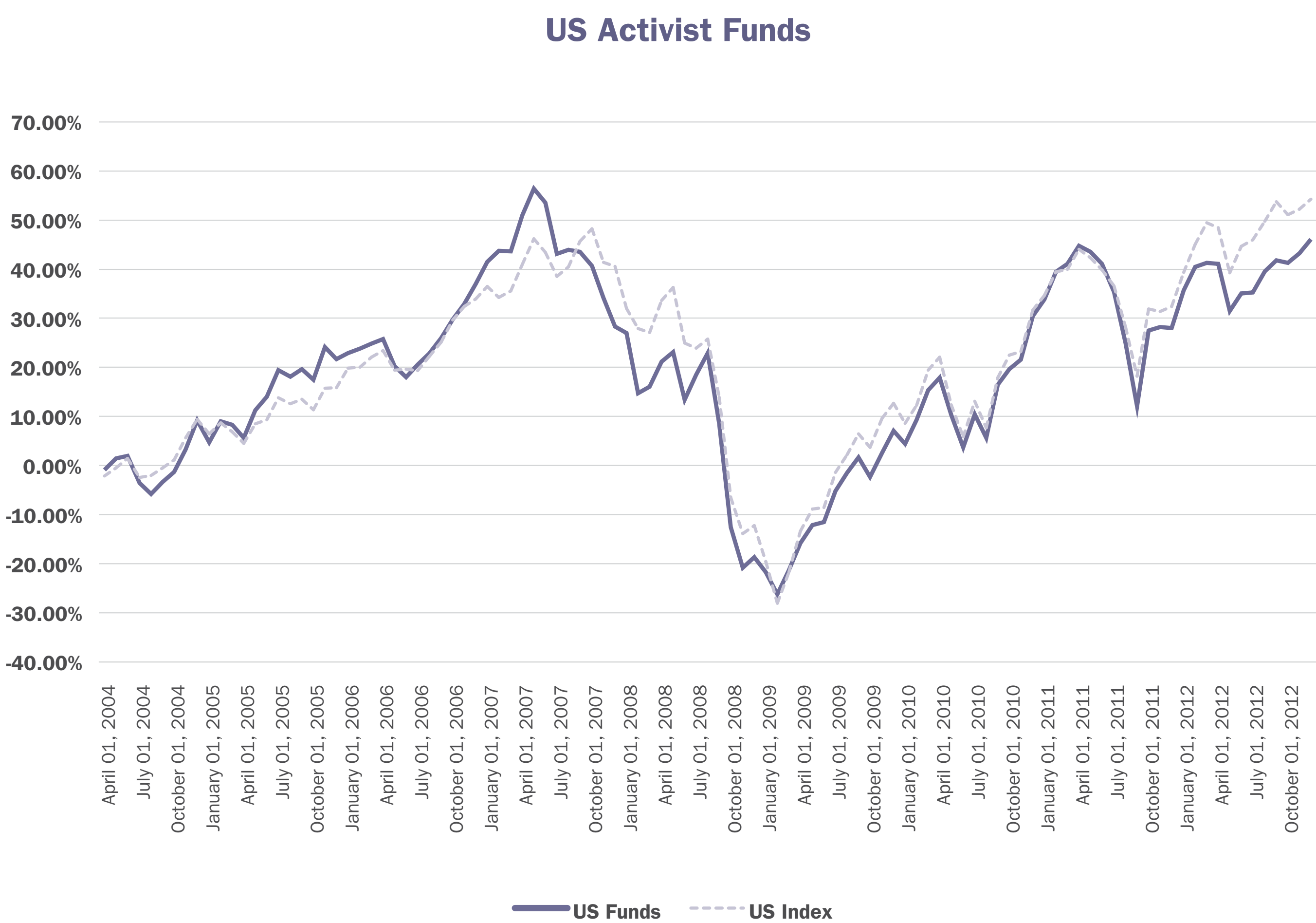
CalSTRS believes that good governance contributes to better long-term, sustainable performance.

	Partnership Initiated	Market Cap	Geography	Commitments
Relational Large Cap	June 2004	Large Cap	North America	$500 Million
Relational Mid-Cap	July 2008	Mid Cap	North America	$500 Million
New Mountain Capital	December 2008	Mid to large Cap	North America	$500 Million
Trian Partners	April 2011	Large Cap	North America	$300 Million
Blue Harbour Group	November 2011	Small to Mid Cap	North America	$200 Million
Starboard Value	March 2013	Small Cap	North America	$100 Million
Governance For Owners	June 2008	Small to Mid Cap	Developed Europe	$350 Million
Knight Vinke	March 2010	Large Cap	Developed Europe	€150 Million

6 / MANAGERS

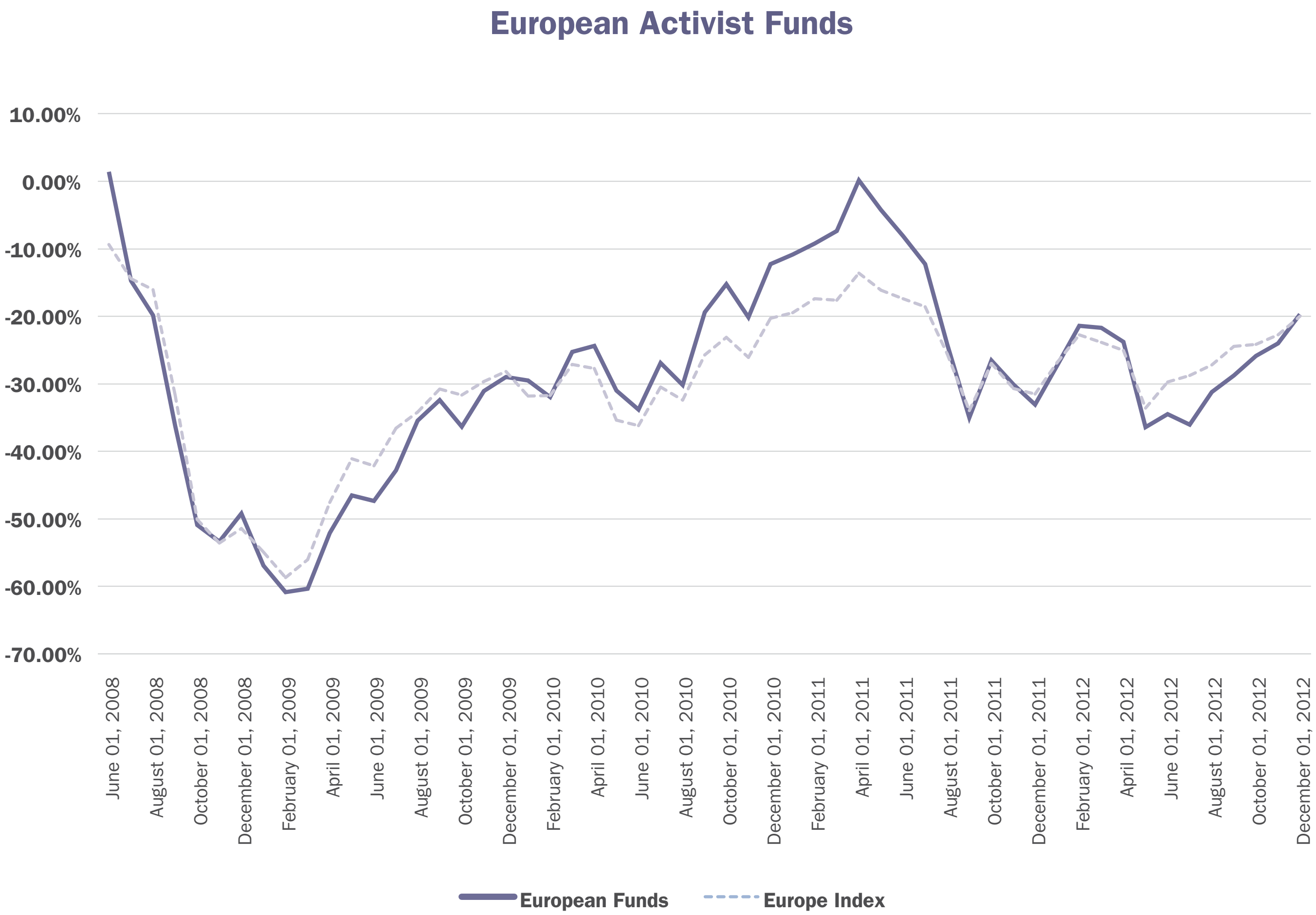
The CalSTRS Corporate Governance Activist Portfolios are subject to greater volatility than traditional equity portfolios. The concentrated nature and long duration of each investment contributes to this volatility. Typically, the holding period for an investment is three years, with a J-curve type lifecycle. 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. In addition to the money allocated to the funds, CalSTRS will make co-investments to increase its exposure to specific names in the portfolio to improve performance and lower the cost of management.

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



6 / MANAGERS

The following chart shows the aggregate performance since inception of the CalSTRS Corporate Governance European Portfolio relative to the European public equity market:



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 its activist manager portfolio to enhance the global equity portfolio and provide above-market investment returns.

Short Term: Issue Focus

For 2013, the CalSTRS Corporate Governance staff expects it will continue to focus on the key issues discussed in this report.

Executive compensation has been a principal issue for CalSTRS corporate governance over the last decade and it will continue to be an issue of importance going forward. Staff will engage its portfolio companies whenever possible 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 incentive long-term value creation.

Diversity of corporate boards continues to be a signature focus over the next twelve months. CalSTRS staff has spent several years building support for better corporate board diversity, and 2013 looks to be another strong year for this effort. The GMI Diverse Director Datasource continues to expand its applicant pool and attract corporate attention. Additionally, companies are continuing to make diversity part of the director candidate consideration.

Sustainability-related engagements will continue to focus on resource efficiency and extractives risk management. Collaborating with fellow investors will continue to be an important tool for achieving success. Support of organizations that promote sustainability awareness will be a priority again this year. Staff will strive to be forward-looking in terms of “new” sustainability risks and be proactive in engagement.

Long Term: Engagement Landscape

If any governance evolution can be gleamed from 2012, it is that the desire and willingness of institutional investors to engage their portfolio companies on how they’re being run has risen to an unprecedented level. Corporate directors and executives need to recognize that shareholders are not going to go away but rather continue to be active and be ready to hold boards accountable for fulfilling their oversight duties and managers accountable for how they spend shareholder’s money. If companies are employing policies or practices that diverge from “best practices,” they should expect to be questioned as to why and prepared to respond.

Collaboration will also evolve in the years ahead. While you will certainly see continued collaborative efforts between public pension plans and like-minded funds, the level of collaboration between “mainstream” investment banks and “traditional” equity fund managers will also certainly grow. The evolution of these relationships will result from the recognition that adding value to investments, value that is designed to last, is beneficial to all shareholders, regardless of the whether your investment horizon is short or longer term.

The CalSTRS Corporate Governance unit will continue to be a global governance leader and remain a source of innovation and collaboration.

8 / FACT SHEET

Corporate Governance Investment Team

Name	Phone Number	Title	Areas of Focus	Joined CalSTRS
Anne Sheehan	916-414-7410	Director	Director	2008
Janice Hester-Amey	916-414-7415	Portfolio Manager	Diversity & Portfolio Management	1985
Brian Rice	916-414-7413	Portfolio Manager	Activist Mgrs. & Sustainability	2003
Philip Larrieu, CFA	916-414-7417	Investment Officer	Activist Mgrs. & Geo-Political Issues	2005
Aeisha Mastagni	916-414-7418	Investment Officer	Activist Mgrs. & Exec. Compensation	2009
Eric Kwong	916-414-7414	Investment Officer	Operations & Contracts	1989
Ly Van	916-414-7416	Investment Officer	Proxy Voting	2007

Program Description

CalSTRS Corporate Governance Program

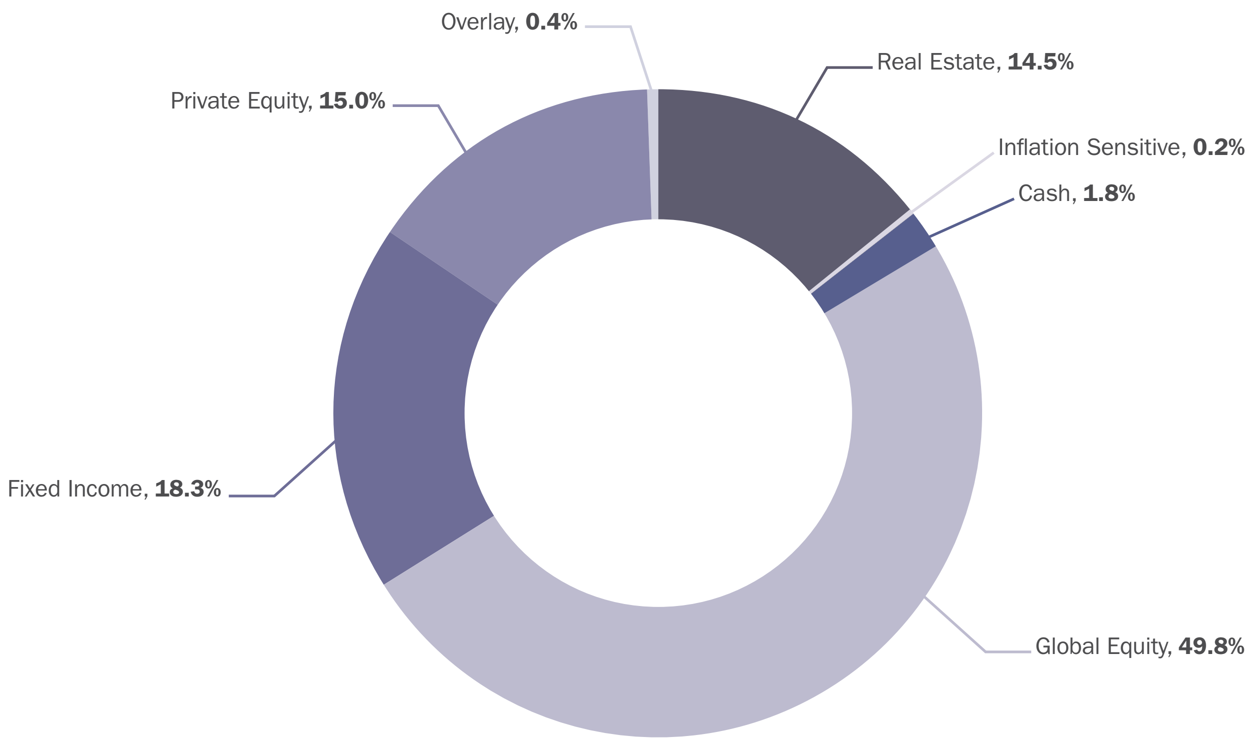
- **Activist Fund Managers**
- **Legal, Regulatory and Legislative Support**
- **Portfolio Company Engagement**
- **Proxy Voting**

- 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: Russell 3000 Index ex-Tobacco (U.S. Equity) and MSCI ACWI ex-U.S. Index ex-Tobacco (Non-U.S. Equity)
- Seven Corporate Governance external managers and multiple side-by-side co-investments. Selection is biased toward partnerships with experienced and stable management teams and strong track records in engaging boards and managements to undertake value-driving changes to increase long-term shareholder value.

8 / FACT SHEET

CalSTRS Portfolio

Approximate Value as of December 31, 2012:



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.

CALSTRS®
HOW WILL YOU SPEND YOUR FUTURE?