



Investment Committee

Item Number 3 – Open Session

Subject: Investment Policy Revision: Portfolio Restrictions Investment Policy – First Reading

Presenter(s): Christopher Ailman, Brian Bartow, and Aeisha Mastagni

Item Type: Information

Date & Time: November 1, 2023 – 30 minutes

Attachment(s): Attachment 1 – Divestment Policy – Annotated Version

Attachment 2 – Portfolio Restrictions Investment Policy – First Reading Annotated Version

Attachment 3 – Portfolio Restrictions Investment Policy – First Reading Clean Version

Attachment 4 – Meketa Concurrence Memorandum

PowerPoint(s): Portfolio Restrictions Investment Policy

Item Purpose

The purpose of this item is to present the Investment Committee with a proposed new Portfolio Restrictions Investment Policy. The new Policy on Portfolio Restrictions will replace the Divestment Policy as part of the modernization of the Investment Policy Statement (IPS).

Recommendation

Staff and the General Counsel recommend and the Board Consultant, Meketa Investment Group, concurs that the Investment Committee consider adopting the proposed Portfolio Restrictions Investment Policy (the Policy or the new Policy). This is an extension of the work being done to modernize and transition the Investment Policy Statement into a best-in-class, comprehensive set of policies. Like other initiatives affecting the Total Portfolio, the new Policy will work in coordination with the Investment Policy Statement which provides the policy structure in which other policies are linked and contingent upon.

Staff also recommends, upon adoption of the new Portfolio Restrictions Investment Policy, that the Divestment Policy be decommissioned.

Executive Summary

The California Constitution mandates the fiduciary duties of the Teachers Retirement Board, its Investment Committee, and staff. More specifically, [Article 16, Section 17\(d\) of the California Constitution](#) mandates the Investment Committee prudently diversify the assets of the fund and prioritize the minimizing of risk and maximizing of returns.

The current Divestment Policy was created 14 years ago. While it has served the fund for many years, the very nature of the title presupposes the result of any associated process for which it is intended to serve. Additionally, the Divestment Policy centers around CalSTRS engagement having a binary outcome – engagement succeeds or engagement fails – which is inconsistent with current practices. Stewardship practices, including portfolio company engagement, have evolved significantly over the past 14 years so that engagement is now used as a risk-mitigating tool that is part of the prudent and comprehensive management of the portfolio in alignment with fiduciary duties.

The new Portfolio Restrictions Investment Policy is rooted in the Board’s fiduciary duties and how active investment decisions (any portfolio restrictions) affect risk to the portfolio. Like the Divestment Policy, the new Policy recognizes the opposition to any internal or external pressures that would violate or breach the Investment Committee’s fiduciary duties, but the considerations and rationale for that opposition have been updated and enhanced to align with current practices. Moreover, the new Policy, again aligned with the outdated Divestment Policy, recognizes that there may be instances where it could be prudent to restrict, exclude, or exit certain holdings, sectors, industries, regions and/or jurisdictions, but only after appropriate diligence and consistent with the Board’s fiduciary duties. The analysis and assessment for such restrictions and/or exclusions is included in the new Policy but does not limit the processes that may be undertaken and no longer relies on a binary outcome of engagement.

Attachment 1 is the current Divestment Policy with annotations that describe the language that has been included or amended in the Portfolio Restrictions Investment Policy. Concurrently, Attachment 2 includes similar annotations, revised sections in alignment with current practices, and modernized language.

Background

The Divestment Policy has existed in its current form since March 2009. The only amendment was in April 2017 to reflect a new reporting frequency. When the Divestment Policy was established, it was a progressive policy and one of the first-of-its-kind. It helped CalSTRS navigate some of the first calls for divestment from external entities and provided a defined process for the Board and staff to follow.

Since 2009, CalSTRS has faced numerous requests from external entities to restrict certain parts of the investment portfolio. The nature of these requests has increased in frequency, complexity, and scope. The new Portfolio Restrictions Investment Policy seeks to address the drivers of these external demands, while ensuring the investment decision-making process to restrict any securities is grounded in the Investment Committee’s fiduciary duties and the California Constitution.

Over the past several years, the Office of the General Counsel has reviewed the processes of CalSTRS institutional peers, cooperated with the Investment Branch, and consulted with Meketa and fiduciary counsel to develop the new Policy. Fiduciary counsel and Meketa have advised that they agree with staff’s recommendation. The Portfolio Restrictions Investment Policy, when adopted, will work in coordination with the IPS to provide board governance and a clear structure for the Investment Committee and staff to make active investment decisions that affect the portfolio and protect the retirement security of California’s educators.

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

Board Policy Linkage: [CalSTRS Investment Policies](#)
