



Item 9. Review of ESG Engagement Practices

Regular Board Meeting

CALSTRS

Anne Sheehan, CalSTRS Director of Corporate Governance

ESG Report Shows CalSTRS Uses Its Clout to Ensure Value

The Investment Committee of the Teachers' Retirement Board continued its long-standing commitment to thoughtfully weigh environmental, social and governance factors when making investment decisions. As a result of extensive discussions over the past year, including input and feedback from stakeholders and industry experts, the board has one particular investment belief which states, "responsible corporate governance, including the management of environmental, social and governance (ESG) factors, can benefit long-term investors like CalSTRS."

At the April board meeting, CalSTRS released its [2016 Corporate Governance Annual Report](#), highlighting the organization's efforts to engage with portfolio companies, advocate for regulations favorable to investors, and vote on shareholder proposals which are consistent with established ESG principles.

CalSTRS is a passive investor but an active owner. Being passive means CalSTRS does not actively buy and trade stocks but rather owns the entire global equities market, primarily in a weighted

index. CalSTRS then uses its influence as a large institutional shareholder, as part of its ongoing commitment to ESG investing and engagement said Anne Sheehan, Director of Corporate Governance, while briefing the board on engagement efforts in the past year.

Sheehan gave examples of recent engagement successes, citing both Wells Fargo and Banc of California. Often, as in the Wells Fargo example, investors call for corporate accountability and meaningful change in the wake of a scandal. And after extensive outreach and discussions with senior-level executives, CalSTRS and other investment partners were able to successfully leverage a separation of Wells Fargo's CEO and Chairman of Board positions. CalSTRS believes those posts are inherently in conflict and should not be held by the same individual.

Diversity is a bottom line issue for CalSTRS. According to a [January 2015 research report by McKinsey & Company](#), gender and ethnic diversity on corporate boards can increase financial performance by between 15 to 35 percent. In fact, at the troubled Banc of California, a collaboration between CalSTRS and an activist investment partner resulted in the hiring of two diverse directors on its board.

CalSTRS Board Members



Dana Dillon
Board Chair

Dana Dillon is an intermediate grade school teacher from Weed. She has served on the board since her election in 2003, including stints as chair and vice chair. Ms. Dillon has been active in the California Teachers Association for more than 26 years, serving as state council representative, and was recently elected to the board of directors.

➤ An archive of the presentation is available on CalSTRS.com/board-meeting-video-archive.



Sharon Hendricks
Vice Chair

Investment Committee Chair and Board Vice-Chair Sharon Hendricks is a speech professor with the Los Angeles Community College District. She was elected to the Teachers' Retirement Board in 2011. She also serves as president of the American Federation of Teachers, local 1521 chapter at Los Angeles City College. Ms. Hendricks is active in the Community College Council of the California Federation of Teachers.

Dana Dillon
Board Chair

Sharon Hendricks
Vice Chair

John Chiang
Ex-Officio Member, State Treasurer

Michael Cohen
Ex-Officio Member, Director of Finance

Joy Higa
Public Representative

Harry M. Keiley
K-12 Classroom Teacher

Paul Rosenstiel
Public Representative

Tom Torlakson
Ex-Officio Member, State Superintendent of Public Instruction

Thomas Unterman
Public Representative

Nora E. Vargas
School Board Representative

Karen Yamamoto
Retiree Representative

Betty Yee
Ex-Officio Member, State Controller

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As an influential shareholder, CalSTRS votes more than 7,800 proxies every year. Additionally, CalSTRS maintains its steadfast focus on long-term corporate sustainability by leading campaigns on important issues like board diversity, executive pay, carbon and methane emissions reporting, majority voting standards, and sustainability.

And while proxy campaigns may not always be successful, Sheehan showed evidence that even the simple threat of an elevated discussion or proxy campaign often prompts portfolio companies to take preemptive action, especially given CalSTRS prominence across the markets. “As long-term investors for teachers’ retirement, we’re going to be invested in these companies for decades, and we’re not going away,” said Sheehan.

Actuarial Valuation Reports Funded Status and Expected Contribution Rate Changes

Despite Life Expectancy and Investment Return Assumption Changes, CalSTRS Maintains Progress Toward Long-Term Funding Goal

At its February 2017 meeting, the Teachers’ Retirement Board voted to adopt new actuarial assumptions based on the recommendations of the five-year experience study which was conducted by an independent actuarial consulting firm and validated by another. The most significant changes were adjustments to the life expectancy assumption to reflect greater improvements in member lifespans, and a reduction in the assumed rate of investment return to reflect long-term investment market expectations. Specifically, the board decreased the previous 7.5 percent investment return assumption to 7.0 percent, to be phased-in over a two-year period.

In early April, the board adopted the June 30, 2016 actuarial valuation based on the assumptions which were adopted in February. Based on this data, the

valuation indicated that the funding ratio, or the assets on hand to pay for future benefits, declined from 68.5 percent in 2015, to 63.7 percent in 2016. This decline was expected given the more conservative assumptions the board adopted. If we expect our members to live longer based on the research at-hand and with a lower investment return assumption for our portfolio, CalSTRS will need more assets to pay for future benefits. The good news, however, is that even using these new assumptions, which more accurately reflect the system’s funding situation, the funded ratio is expected to improve over time to reach close to 100 percent by 2046.

Contribution Rate Changes

2% at 60 members (no changes):

For 2% at 60 members (generally, those who were first hired prior to January 1, 2013) contributions will remain at 10.25 percent of pay.

2% at 62 members (rate change

expected in July 2018): For 2% at 62 members (generally, those who were first hired on or after January 1, 2013), contributions will remain at 9.205 percent of salary, but are expected to increase by one percent to 10.205 percent of salary beginning July 1, 2018.

Employers (Changes as scheduled in the 2014 Funding Plan legislation):

Employers will not be subject to any additional rate increases as a result of the actuarial valuation the board adopted in April 2017. The employer contribution rate will continue to increase each year in accordance to the 2014 funding plan until it reaches 19.1 percent of payroll beginning July 1, 2020.

State of California (0.5 Percent Annual Increase):

Under the 2014 funding plan, the state contribution rate can increase or decrease beginning July 1, 2017, to eliminate the unfunded liability by 2046. The state rate cannot be increased by more than 0.5 percent each year. As a result of the most recent actuarial valuation, the state contribution rate will increase to 9.328 percent of payroll beginning July 1, 2017.

CalSTRS Trustees Re-Elect Board Chair and Vice Chair For 2017-18 Term

The Teachers’ Retirement Board nominates and elects its chair and vice chair annually to provide leadership, direction and policy development for the largest educator- only pension fund in the world.

“It’s an exciting time to be in a board leadership position. CalSTRS is in the forefront of myriad investment and retirement security matters that affect the fund’s more than 914,000 members and beneficiaries,” said re-elected Board Chair Dana Dillon, an intermediate grade school teacher from Weed.

“I’m privileged to continue to serve as part of a group of individuals who are actively defining the future of institutional investing,” said Vice Chair Sharon Hendricks, a communications studies professor with the Los Angeles Community College District, first elected to the board in 2011.

ESG Risk Factors Policy Under Revision

Since 1979, CalSTRS has recognized it has a fiduciary duty to protect the assets of the system by ensuring that the companies in which we invest are adequately monitoring and mitigating environmental, social and governance risks that could affect their long-term value. In 2008, CalSTRS ESG Risk Factors were expanded from 20 to encompass 21 guidelines/parameters that CalSTRS staff and investment partners must consider before entering into an investment. The latest revision will keep the 21 risk factors in place as guidelines for investment consideration, but consistent with peers in the institutional investor community, an overarching, principles-based document will also be created. The board is expected to discuss this item in more detail at the June 7 meeting.

