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INTERVIEW WITH
CALSTRS DIRECTOR OF
CORPORATE GOVERNANCE
ANNE SHEEHAN

“Our strategy is to be active owners, to engage our portfolio companies to mitigate risk and create opportunities for improved performance.”
Corporate governance means being good stewards of our beneficiaries’ capital—protecting and growing our investments. As capital providers, we want companies to manage our beneficiaries’ capital efficiently.

How has the corporate governance arena evolved since you first became the director at CalSTRS in 2008?

CalSTRS continues our commitment to good corporate governance, going back many years, not only engaging our portfolio companies, but also being an early adopter of a portfolio-wide environmental, social and governance policy. While CalSTRS has been committed to good corporate governance since the 1970s, we’ve seen corporate governance transition into the mainstream in recent years. In large part, I think the rapid acceptance of good corporate governance practices being integrated into investment decisions is due to the aftermath of the 2008 financial crisis.

I stepped into my role at a really interesting and challenging time. I’ve witnessed this movement—this evolution—firsthand. My first day on the job was the Monday in September 2008 after the Lehman Brothers bankruptcy, right in the midst of the financial crisis. I watched the Teachers’ Retirement Fund drop in market value almost $100 billion from its peak of approximately $180 billion in October 2007. Reflecting on that crisis and trying to understand the underlying drivers, it’s important to acknowledge that the lack of good corporate governance had a role. We learned that financial companies need to be aware of risks their portfolio managers are taking and the complementary exposures that may impact assets. Post-financial crisis, we found it was an opportune time to have corporate governance fundamentally integrated into CalSTRS’ portfolio. While we are predominantly a passive equity investor, we take an active ownership role and believe that through good corporate governance, our portfolio companies can provide higher risk-adjusted returns for our beneficiaries.
What does corporate governance mean to you?

Corporate governance means being good stewards of our beneficiaries’ capital—protecting and growing our investments. As capital providers, we want companies to manage our beneficiaries’ capital efficiently. Corporate governance is the framework, the process that guides the direction of the company, and often doesn’t get much attention until the company runs into trouble. A good example is the Wells Fargo scandal, a current reminder of a failure of risk management and lack of good governance practices.

What is the corporate governance strategy here at CalSTRS?

Our strategy is to be active owners, to engage our portfolio companies to mitigate risk and create opportunities for improved performance. We accomplish this through multiple avenues, including our proxy votes, company engagements through our external activist and sustainability managers, and collaboration with other like-minded investors. We prefer to have private dialogues with our portfolio companies to understand what is occurring inside the company in order to provide feedback, without naming them in the media. We believe companies are more receptive to our recommendations when engaged privately.

Engagement is a large part of our work and much effort goes into developing these relationships. As an active owner, we first seek to understand the issue at hand. Because, as we say, “we own the market,” we oversee approximately 8,000 portfolio companies, it’s important for us to be proactive, remain vigilant and continue to engage to better understand how our capital is being put to work. We can’t do the “Wall Street Walk,” for example, sell the stock, because we are long-term shareowners and a large index investor. Since we own the market, we need to develop a relationship with our portfolio companies. Remember, CalSTRS will be a shareholder for a very long time. We are a strong believer that in order to impact and improve the market, we have to continue to be an owner. This means to not divest but to maintain a place at the table and provide an active voice. As our Chief Investment Officer Christopher J. Ailman likes to say, “As long as there are teachers in the state of California, we are going to be investors. We’ve been here in the past, we are here today, and we will continue to be here tomorrow.” We emphasize that our door is always open—we are always reachable and happy to chat with anyone.

In addition to engaging companies, we comment on regulatory policy and legislation, and even litigate our rights as shareholders. While CalSTRS is not an active litigator, we retain our rights and file lawsuits when we believe it’s necessary. I serve on the Investor Advisory Committee at the SEC, where we were strong supporters of the corporate governance provisions of Dodd-Frank. We advocate for rules and regulations promoting good governance and improving transparency and safety of the market. We advocate for state, federal and global legislation by working closely with regulatory and advisory industry bodies on updates in the governance arena to improve disclosures and raise governance standards. We also work to oppose regulation and legislation that would weaken our rights as shareholders.

“As long as there are teachers in the state of California, we are going to be investors. We’ve been here in the past, we are here today, and we will continue to be here tomorrow.”

—CalSTRS CIO Christopher J. Ailman
Since CalSTRS owns a small percentage of each portfolio company, another part of our strategy is to work with coalitions and other like-minded individuals to stretch the impact of our capital. We list our partnerships in this report, noting how these allow us to leverage our experience. For example, CalSTRS was one of the first U.S. pension funds to join the Asian Corporate Governance Association to advocate for enhanced governance in the Asian markets. Europe is more advanced in terms of corporate governance, but Asian markets like Japan, India and China have further to go—although we have seen progress over the last 15 years. Our collaborative activities include sending joint letters to Asian stock exchanges pushing for stronger listing standards, engaging Asia-listed companies and advocating together for improvement in those markets.

You mentioned the two types of managers within the CalSTRS Corporate Governance Program. Would you highlight the strategy and some successes in 2016 from these manager strategies?

Yes, Corporate Governance managers include activist and sustainability managers.

Activist managers identify underperforming and undervalued companies that we own in our passive index in order to engage with them and improve their performance for the long term. For example, if one of our managers takes a position in a company and improves the performance, like what Trian Partners did at Ingersoll Rand in 2014, we benefit both in our investment with the manager and in our passive index holding. Even when an activist manager exits a company within our activist portfolio, we will continue to own the company’s stock. CalSTRS partners with activists to increase value and improve performance, which we think is important to all shareholders and helps in terms of overall performance. Activist managers have a wide variety of tools to use. They commonly propose more efficient capital allocation processes and better balance sheet management, reducing operational costs, improving corporate governance practices and engaging companies and management to improve a company’s overall performance. In terms of our activist managers this year, we carefully considered partnership and co-investment projects with them, as we continued to develop our in-house activism. One of our major projects for the year was a search for additional sustainability managers to complement the two we currently have. ESG investing has grown successfully over the past 10 years and this tremendous momentum of improved returns contributes more stimulus to our roster of ESG managers.

Sustainability managers are the second type of asset manager in the CalSTRS Corporate Governance Portfolio. We believe that when companies are being managed in a sustainable way—by taking ESG factors into account—their long-term value improves. The environmental risks on the horizon in the next 10 to 25 years need to be considered by companies because they may have a material impact on our—and other shareholders’—long-term investment. CalSTRS is dedicated to thinking as a long-term responsible investor and this investment strategy fits our views.
How would you define success in corporate governance?

Ultimate success would be working me and my team out of our jobs! But I would also define success as when all stakeholders in a company—shareholders, employees, management, board members and others—are aligned in what is best for the company in the long run. As shareholders, we want the directors in the boardroom to act in our best interests through their fiduciary responsibility: to align the company’s interests with shareholders’ interests and ensure the company is performing at the highest caliber. I think everyone who works in corporate governance is deeply committed to ensuring that the directors in the boardroom act with integrity and share the same goals as shareholders.

As shareholders, we want the directors in the boardroom to act in our best interests through their fiduciary responsibility: to align the company’s interests with shareholders’ interests and ensure the company is performing at the highest caliber.

One of CalSTRS’ goals is to advance diversity in the boardroom. When we started in 2008, diversity was not a mainstream governance topic but we are encouraged to see that it is now an important issue for institutional investors. We believe that diversity in the boardroom is not a social issue, but is about improving company performance for shareholders by mitigating risk, improving accountability and enhancing a company’s long-term sustainable value.

In 2016, CalSTRS moved beyond diversity in the boardroom to include diversity in the workforce—the pipeline. Due to the global connectedness of our modern marketplace, people are much more aware of this issue. A number of coalitions and organizations have brought the issue to the forefront, including ethnic affinity groups such as the National Association of Securities Professionals, New America Alliance, Women Corporate Directors Foundation and the Thirty Percent Coalition, which is committed to the goal of women, including women of color, holding 30 percent of board seats across public companies.

As an asset owner, CalSTRS wants our asset managers to have a focus on diversity. We take a multipronged approach to improving board diversity and workforce diversity. We showcase how we “walk the talk” on the topic of diversity through the individuals who make up our Investments Branch staff. CalSTRS’ deputy chief investment officer is a woman, our chief operating investment officer is an African-American woman, our director of global equity is an Asian-American woman, our director of private equity is a woman, plus myself makes five out of the nine senior investment positions held by women.

CalSTRS prides ourself on the variety of initiatives that show our commitment to this issue. We provided the $250 million seed capital for the SHE Index. The SHE Index—SPDR SSGA Gender Diversity Index ETF—is a large cap U.S. stock index with a tilt toward companies that have a greater number of women in senior leadership positions. We put our capital behind our thesis, which demonstrates our commitment to diversity. This was also the impetus for spearheading the Beyond Talk workshops with State Street Global Advisors, which demonstrates our ongoing commitment to “moving the needle,” as our CIO Christopher J. Ailman often says. These workshops help advance diversity in the investments industry by putting women in contact with one another to develop a stronger network to improve C-suite representation and influence gender balance within their organizations and the financial world.
Q: What were some key trends you saw in the 2016 proxy season?

A: Proxy access was definitely a big issue in 2016. There was a continued focus on diversity both in the boardroom and company pipelines, plus we saw an uptick in support on this topic from mainstream asset managers and investors. Political contributions and lobbying disclosure continued to receive attention, calling on boards to exercise greater oversight of these activities as they can create a reputational risk for their companies.

We believe that diversity in the boardroom is not a social issue, but is about improving company performance for shareholders by mitigating risk, improving accountability and enhancing a company’s long-term sustainable value.

Enhanced disclosure remains a major issue for investors. For example, the SEC’s concept release on Regulation S-K that sought public comment on disclosure, including climate change and improved environmental disclosures. The request for comment opened the door for investors to communicate to the SEC and the financial markets why they need this information. Regardless of whether or not the SEC acts on a proposed rule, investors will still seek this information, and through engagement, we will push for greater disclosure.

Additionally, CalSTRS is a founding board member of the Sustainability Accounting Standards Board and we believe that companies should report on material ESG issues that affect their financial performance. We are a founding member of the SASB’s Investor Advisory Group, for which our CIO serves as chair. Furthermore, CalSTRS is a signatory to CDP. CDP gathers data from corporations on their greenhouse gas emissions and other environmental impacts that are material to investors’ financial decisions.

All of these efforts culminate in a strong presence on environmental concerns and the impact they have on our investments, both now and in the future.

Q: What is a governance example you would highlight from 2016?

A: One of our major priorities in 2016 was to increase our comments and filings to various regulatory and industry bodies whose rules and regulations can impact our work. As an asset owner with a large stake in the health of our capital markets, we want our voice heard as policymakers are considering regulatory changes. These entities include the SEC, Public Company Accounting Oversight Board, Taiwan Stock Exchange, Nasdaq, and German Bundestag (parliament). In all, CalSTRS filed 15 letters that advocated for issues, such as improved transparency in financial reporting and the importance of stewardship codes at both the global and local market level, and opposed legislation that would diminish shareholder rights.

A key highlight is our comment letter to the SEC regarding its concept release of Regulation S-K that would modernize certain business and financial disclosure requirements to investors. Another is our letter to the SEC supporting its proposed rule calling for universal proxy cards in contested elections because the current system of voting disenfranchises shareholders in our ability to vote in contested elections.
2016 saw several high-profile governance failures, including Wells Fargo and Mylan. How do you react from the corporate governance perspective?

Cases like Wells Fargo’s cross-selling scandal and Mylan’s EpiPen price spike really draw in the public and solidify the importance of good governance at companies. In accordance with our fundamental corporate governance principles, we actively engage and encourage companies to be proactive about improving their governance. When cases like these suddenly arise and are brought into the public dialogue, the problems of ignoring governance are highlighted and clearly show how these types of situations could be prevented by having better governance in place.

For example, with the Wells Fargo failure, we can ask: Does Wells Fargo have the right framework in place to prevent this from happening in the future? What governance processes did it have in place? Did it have the right leadership structure with its chair and CEO? How did it conduct a forensic investigation into the fake accounts? How did it end up at a point where 6,000 employees lost their jobs? At what level were management and executive staff held accountable, which caused these job losses? Was the compensation structure at fault, with metrics that ended up driving this perverse and unintended behavior?

We communicated with the company and its board on a number of these questions and requested it amend its bylaws to require an independent chair for its board of directors. To Wells Fargo’s credit, it implemented this change, which we view as beneficial. The chair of the board and the CEO are fundamentally two different roles and, when combined, can create a serious conflict for the board.

The Mylan case of the EpiPen price spike was particularly compelling because of the personal connection with California teachers and schools. California state law requires schools to have EpiPens or like products on site. Schools and teachers were severely impacted by the outrageous EpiPens price hikes. As the fiduciary of the Teachers’ Retirement Fund, it is our responsibility to engage Mylan on its actions and the potential financial and reputational risk damage resulting from their actions. Examples like these showcase the importance of governance and how it protects our investments. We take all of our engagement work very seriously to enforce our shareholder rights.

One of our major priorities in 2016 was to increase our comments and filings to various regulatory and industry bodies whose rules and regulations can impact our work. As an asset owner with a large stake in the health of our capital markets, we want our voice heard as policymakers are considering regulatory changes.
Going forward, what are your initiatives for 2017?

Our initiatives for 2017 are again multipronged and include continuing our push for universal proxy access, majority vote in director elections, improved environmental disclosures, and greater diversity in the board, executive and company staff pipelines. The SEC came out with proposed rules for universal proxy in contested elections, which would allow shareholders to vote for their preferred slate of directors, whether by proxy or in person. We will push for final adoption of this rule in 2017. We will continue to engage approximately 100 companies to adopt a majority vote standard, which we believe is a governance best practice. Directors should garner support of a majority of their company’s shareholders or resign from the board. We will also continue to ask for greater sustainability reporting due to its risk to our portfolio. We have had good success with diversity, but of course, we will continue to push for more. We are looking beyond the board level to the workforce. Human capital is one of a company’s best assets and needs to be promoted and developed.

We will also continue to focus on companies’ compensation and governance structures, as we believe improvements in both compensation and governance will augment long-term value creation for us as a long-term shareholder. In terms of governance, we are concerned with the increased use of dual class structures, where voting rights are disproportionate to economic rights. We will continue to advocate for one share-one vote structures.

Our thinking is always structured around the long term, as CalSTRS is a pension fund with liabilities that stretch over 30 years, which includes benefit payments to our beneficiaries, California’s educators. A short-term focus for us is hiring new sustainability managers.
UNIT OVERVIEW
Corporate governance is the framework that guides the direction and processes of a company, and CalSTRS considers it crucial to adding value to our investments.

Good governance adds value while poor governance detracts from a company’s returns and can actually destroy the value created. Good governance can lead to better performance, which is why corporate governance is an essential part of investments at CalSTRS. Our priority is to ensure that our public school educators and their beneficiaries are getting their maximum investment returns, and we continue to be deeply dedicated to this as seen by our progress and success in 2016.

Numerous studies have proven the importance of corporate governance time and time again, documenting 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 good governance as it improves the company’s long-term value proposition and lessens shareholders’ concerns about whether or not the company is acting in the shareholders’ best interests. With the majority of our $111 billion Public Equity Portfolio invested in large global indexes, CalSTRS maintains the position that we own a small part of most companies in the market and, therefore, we are very focused on governance issues that impact public equity security value. Specifically, the CalSTRS Corporate Governance Unit is focused on four primary areas: company engagements; proxy voting; portfolio management; and legal, regulatory and legislative support.

Corporate Governance staff engages with companies to improve on executive compensation, diversity, sustainability awareness and risk management, and other governance issues that may impact the performance of our portfolio companies. Companies are usually responsive to our concerns and often collaborate with us to improve their governance practices. However, we will escalate our engagement efforts by filing a shareholder proposal in instances where companies are not responsive to our concerns.
In addition, staff is responsible for voting more than 7,800 domestic and global proxies annually. CalSTRS believes the execution of proxies is an important fundamental shareholder right, and we always seek to exercise CalSTRS’ rights in a manner consistent with the interests of our beneficiaries.

Staff also manages an approximate $4.1 billion Corporate Governance Portfolio that includes the Corporate Governance Activist Portfolio and the Sustainable Portfolio. The Corporate Governance Activist portfolio features external managers that employ an activist investment philosophy. These activist managers work with undervalued and misunderstood public companies to improve their governance profiles and business practices to enhance long-term shareholder value, not temporary share price appreciation. The Sustainable Portfolio, managed by the Corporate Governance Unit since July 2015, is composed of sustainability managers that consider and integrate environmental, social and governance factors in their investment strategy and process to achieve financial outperformance.

In addition to providing support to the CalSTRS Legal and Legislative units, staff files and monitors securities litigation class action claims. Staff also engages with other market participants, such as regulatory organizations, government officials and fellow investors, on key regulatory issues that may impact the public equity security value because most of our investments are aligned with large global equity indexes. Staff provides comment letters on proposed rules and regulations that govern the securities markets and may impact CalSTRS’ investments.

Lastly, CalSTRS continues to provide leadership and promote certain governance best practices that may impact the financial markets and our investments.
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 Equity 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 our corporate governance policies have been adopted by the Teachers’ Retirement Board and can be found at CalSTRS.com.

The Corporate Governance Principles, adopted in 1978 and last revised in 2016, 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.
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.

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. CalSTRS CEO Jack Ehnes serves as a board member of Ceres.
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 an active 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 we continue 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.

The **International Corporate Governance Network** 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 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.

Human Capital Management Coalition, led by UAW, is a group of 25 institutional investors representing over $2.6 trillion in assets that came together to engage capital market participants and other stakeholders on the importance of investing in human capital as a driver of long-term performance. The HCM Coalition views human capital management as encompassing a broad range of corporate practices related to the development and management of a diverse workforce, employee engagement, training, compensation and a desired company culture of both diversity and inclusion. The HCM Coalition draws on well-established practices for collaborative investor engagement with corporate directors and senior executives. The overall focus of the HCM Coalition is to share the link between human capital management and increased shareholder returns. CalSTRS, as part of our involvement with diversity initiatives and the importance of human capital, joined the HCM Coalition in January 2016.

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 use in their efforts to mitigate the risks associated with environmental issues such as climate change.
The **Principles for Responsible Investment** 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 shares the belief that considering ESG issues is integral to long-term value maximization and is 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.

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 uses 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 CEO Jack Ehnes serves as a board member of SASB and CalSTRS CIO Christopher J. Alman chairs the investor working group of SASB.

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 cochair of the coalition’s Investors Subcommittee.
ENGAGEMENTS
Why Diversity Matters

Evidence and solid research confirms that companies with diversity in their management staff and on their corporate boards attain better financial results on average than companies that do not. The 2015 McKinsey & Company study, “Why Diversity Matters,” shows that gender-diverse companies and ethnically diverse companies are 15 percent and 35 percent more likely to outperform their industry median.

Additionally, there is growing evidence that diversity in the workplace and on the board are critical to an organization’s ability to innovate and adapt in a fast-changing environment. Diversity is good for business—and specifically good for CalSTRS’ investments. Diversity is not only a social issue, it is also a risk that should be mitigated and an opportunity that provides improved returns. CalSTRS supports board and staff diversity as an important business goal that can be properly addressed both in the marketplace and at the company level within our portfolio company investments.

It is vital in today’s global economy that boards and companies include diversity of thoughts and perspectives to avoid being affected by “group think.” Companies need to ensure there is depth and breadth of experience, skills, knowledge, backgrounds, age, gender, sexual orientation and identification, cultural and ethnic composition, personal qualities, and historically underrepresented groups that are most appropriate to the company’s long-term business needs and strategy.

The business case for diversity is evident in the rapidly changing demographic profile of the United States as well as the continuing rise in purchasing power of women and various ethnic and racial groups. Diversity offers companies asymmetric protection—superior upside in growth markets to allow companies to make better decisions about strategy and managing risk.

How diversity correlates with better financial performance

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<thead>
<tr>
<th>Diversity Type</th>
<th>Likelihood of Financial Performance Above Industry Median</th>
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<tbody>
<tr>
<td>Gender-diverse companies</td>
<td>15% more likely to outperform</td>
</tr>
<tr>
<td>Ethnically diverse companies</td>
<td>35% more likely to outperform</td>
</tr>
</tbody>
</table>

Source: McKinsey Diversity Database
Gender diversity on corporate boards is not a new issue. The 2014 Credit Suisse Research Institute report, “Women’s Positive Impact on Corporate Performance,” links board diversity to better stock market and financial performance—higher return on equity, lower leverage, higher price/book ratios and improved growth prospects. The report suggests several explanations for this better performance, including a stronger mix of leadership skills, improved understanding of consumer preferences, a larger candidate pool from which to pick top talent and more attention to risk. The Credit Suisse Research Institute observed similar results in its 2016 report, “The CS Gender 3000: The Reward for Change.” The 2016 report outlines the percentage of women on boards by country (see table on next page).

The graphs below demonstrate the higher return on equity when companies have at least one woman on their board and highlights the slow progress globally and the need for the United States to accelerate its push for more women on boards.
## Percentage of Women on Boards by Country

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<tbody>
<tr>
<td>Global average</td>
<td>9.6%</td>
<td>10.3%</td>
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<td>Norway</td>
<td>36.6%</td>
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<td>France</td>
<td>16.1%</td>
<td>21.6%</td>
<td>25.1%</td>
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<td>Italy</td>
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<td>Netherlands</td>
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<tr>
<td>Sweden</td>
<td>28.9%</td>
<td>27.8%</td>
<td>27.3%</td>
<td>30.3%</td>
<td>28.2%</td>
<td>33.6%</td>
</tr>
<tr>
<td>Finland</td>
<td>26.4%</td>
<td>24.5%</td>
<td>27.0%</td>
<td>29.5%</td>
<td>28.0%</td>
<td>29.2%</td>
</tr>
<tr>
<td>Denmark</td>
<td>16.9%</td>
<td>18.2%</td>
<td>20.6%</td>
<td>25.0%</td>
<td>23.5%</td>
<td>28.5%</td>
</tr>
<tr>
<td>UK</td>
<td>10.1%</td>
<td>11.9%</td>
<td>15.5%</td>
<td>17.9%</td>
<td>21.0%</td>
<td>22.8%</td>
</tr>
<tr>
<td>Canada</td>
<td>12.5%</td>
<td>13.5%</td>
<td>14.9%</td>
<td>15.9%</td>
<td>18.7%</td>
<td>20.5%</td>
</tr>
<tr>
<td>Australia</td>
<td>10.8%</td>
<td>13.7%</td>
<td>15.5%</td>
<td>17.5%</td>
<td>19.9%</td>
<td>20.1%</td>
</tr>
<tr>
<td>South Africa</td>
<td>18.1%</td>
<td>17.8%</td>
<td>18.8%</td>
<td>20.0%</td>
<td>19.2%</td>
<td>19.9%</td>
</tr>
<tr>
<td>Austria</td>
<td>11.4%</td>
<td>14.0%</td>
<td>14.4%</td>
<td>17.6%</td>
<td>17.0%</td>
<td>19.5%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>8.6%</td>
<td>8.9%</td>
<td>9.3%</td>
<td>11.3%</td>
<td>12.9%</td>
<td>14.6%</td>
</tr>
<tr>
<td>US</td>
<td>12.7%</td>
<td>12.8%</td>
<td>13.3%</td>
<td>13.7%</td>
<td>15.5%</td>
<td>16.6%</td>
</tr>
<tr>
<td>China</td>
<td>8.8%</td>
<td>9.0%</td>
<td>9.6%</td>
<td>10.7%</td>
<td>9.1%</td>
<td>9.2%</td>
</tr>
<tr>
<td>Russia</td>
<td>6.8%</td>
<td>7.1%</td>
<td>7.7%</td>
<td>8.1%</td>
<td>6.6%</td>
<td>6.5%</td>
</tr>
<tr>
<td>South Korea</td>
<td>0.7%</td>
<td>0.9%</td>
<td>0.7%</td>
<td>2.4%</td>
<td>1.6%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Japan</td>
<td>0.9%</td>
<td>1.1%</td>
<td>1.2%</td>
<td>1.6%</td>
<td>3.5%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

Source: Credit Suisse Research – sample size 27,000 directors

Credit Suisse, Research Institute, The CS Gender 3000: The Reward For Change, Sept. 2016.

[http://publications.credit-suisse.com/](http://publications.credit-suisse.com/)
Gender Parity on Fortune 500 Boards:

Despite women making up 50 percent of the workforce, earning over 10 million more college degrees than men since 1982, and accounting for more than 85 percent of all consumer purchases, the Committee for Economic Development believes it will take 75 years to reach gender parity on Fortune 500 boards.

50% of the workforce

Women have earned more than 10 million more degrees than men since 1982

Women account for more than 85% of all consumer purchases

The Committee for Economic Development believes it will take 75 years to reach gender parity on Fortune 500 boards.

http://publications.credit-suisse.com
Diversity Initiatives

CalSTRS has long focused on corporate accountability and improving long-term returns in our portfolio. Corroborative and auxiliary research studies highlight that diverse human capital in corporate boards and in corporate leadership positions can significantly increase profitability at publicly listed companies.

This, in turn, may provide a higher risk adjusted rate of return to CalSTRS as we continually uphold our promise to fulfill our mission in securing the financial future of California’s educators.

Based on this research, board and corporate leadership diversity continues to be a top priority for the CalSTRS Corporate Governance team through collaboration with like-minded institutional investors, company engagement, shareholder proposals, and advocacy through involvement as speakers and panelists. In addition, we are actively involved with affinity groups taking a leadership or board role in a number of organizations as well as encouraging different avenues to source diverse candidates for corporate boards.

CalSTRS believes a multipronged approach is the most effective method to transform the market and to improve diversity in the management of investments and within our portfolio companies. Here we summarize CalSTRS’ role, initiatives and accomplishments in 2016 in improving diversity:

1. Thirty Percent Coalition
2. California Initiative
3. Coalition of Four
4. Enhanced Diversity Initiative
5. Development of a Diverse Director Data Source

Thirty Percent Coalition

CalSTRS and 20 large institutional investors are currently engaging 81 companies to foster greater board diversity by:

- Strengthening nominating and corporate governance policies and charters by embedding a commitment to diversity inclusive of gender, race, ethnicity and more.
- Committing to include women and underrepresented minority candidates in every pool from which board nominees are chosen.
- Expanding board director searches to include nominees from both corporate positions beyond the executive suite and non-traditional environments, including government, academia and nonprofit organizations.
- Reporting on progress and any challenges experienced along the way.

CalSTRS Director of Corporate Governance Anne Sheehan is a board member and the cochair of the Investors Subcommittee of the Thirty Percent Coalition. In 2016, coalition members filed 26 shareholder proposals with companies on the topic of greater board diversity.

On a quarterly basis, staff participates in the board call of the Thirty Percent Coalition Summit, bringing together members to update its strategic plan and to discuss the activities of the various subcommittees for the upcoming year. Also, in March 2016, staff joined a Diversity Officers’ Roundtable led by the Thirty Percent Coalition with the goal of developing a Diversity Officers’ Pledge that corporations could adopt. This pledge encourages companies to thoughtfully develop a diverse pipeline of human capital as part of their executive talent management process. Corporate Governance staff will consider use of this tool in our ongoing diversity engagement of portfolio companies.

In April 2016, staff participated in a coalition meeting and presented on behalf of the Institutional Investors Committee.

In May 2016, staff participated in multiple Thirty Percent Coalition meetings to work with executive search firms. The meetings were to create an Executive Search Firm voluntary code of conduct to advance board diversity, asking the search firms to request company boards to include a diverse set of candidates in every board slate search. Then, in August 2016, CalSTRS led the Thirty Percent Coalition’s initiative to re-engage a 2015 initiative involving Russell 1000 companies with no women on their boards.
In October 2016, at the annual Thirty Percent Coalition Summit, staff proposed a number of additional companies the coalition should consider engaging to improve board gender diversity.

Our 2016 engagement efforts with the Thirty Percent Coalition have resulted in 18 companies doing one or more of the following: appointed one or more women to their board; amended the company’s corporate governance policies or charter to commit to diversity of gender, race and ethnicity; and expanded search and nominating processes to include women and underrepresented minority candidates. Following the Thirty Percent Coalition’s 5th Annual Summit in October 2016, the coalition recognized 111 public companies that added women to their boards of directors since 2012, the beginning year of the coalition’s landmark initiative, “Adopt a Company Campaign.”

**California Initiative**

The Graduate School of Management at the University of California, Davis, in partnership with Watermark, published its 11th annual study, “California Women Business Leaders: A Census of Women Directors and Highest-Paid Executives.” CalSTRS, in conjunction with the California Public Employees’ Retirement System, continues to use this study to engage California companies with no women directors.

In August 2016, Corporate Governance staff sent letters to 87 California companies to engage their companies’ Nominating and Corporate Governance Committee chairs on improving board diversity. Our 2016 engagement efforts have resulted in 12 companies doing one or more of the following: appointed one or more women to their board; amended the company’s corporate governance policies or charter to commit to diversity of gender, race and ethnicity; and expanded their search and nominating processes to include women and underrepresented minority candidates.

**Coalition of Four**

In November 2016, CalSTRS, along with two international institutional investors and a U.S.-based pension fund, with assets under management of more than $2.5 trillion, wrote letters to 61 companies to gain a better understanding of their various practices to ensure maximum board effectiveness and promote diversity. The 61 S&P 500 companies either had no women or only one woman on their board, and a significant proportion of their directors had served on the board for lengthy periods of time. The companies with no women on their board are outliers in the S&P 500, where more women are being appointed to boards on a regular basis. Staff is currently receiving responses from these companies and plans to engage them on board diversity and learn how the companies promote diversity at the senior management level and throughout their organizations. It is imperative that companies make the investment today to develop a diverse pipeline of talent to serve well into the future to enhance shareholder return.

**Enhanced Diversity Initiative**

At the Teachers’ Retirement Board April 2016 Investment Committee meeting, staff presented and received approval for an “Enhanced Diversity Initiative” to explore and engage a select number of portfolio companies to understand the board’s oversight role in their diversity programs. The goal is to have an in-depth discussion surrounding the company’s diversity program and its overall impact in developing the company’s diverse senior executive staff channel to increase the pipeline of diverse candidates who will be able to serve on corporate boards. Staff has engaged some of the companies that are currently in the SSGA Gender Diversity Index as a model of best practices of promoting diversity initiatives at their companies.
In October 2016, CalSTRS and CalPERS announced 3D is available through the Equilar Diversity Network. Launching 3D on Equilar’s Diversity Network showcases the depth and availability of qualified, diverse directors. The Equilar network is designed to connect candidates from various diversity organizations with boards.

Moving 3D to Equilar comes as CalSTRS and CalPERS continue to make strides in exercising their shareholder positions to strongly reinforce corporate board diversity across their portfolios and provide opportunities to source candidates from multiple diversity databases within the Equilar network. The use of 3D and other diversity databases may expand the depth and breadth of outreach and consideration of candidates not in current candidate slates in the board nominations and selection process.

Diversity Proposal Engagements

Over the years, our engagements and, where necessary, the filing of shareholder proposals, have increased diversity at many of our portfolio companies. CalSTRS supports engagement with companies before using the tool of filing shareholder proposals. After having ongoing dialogues with numerous companies on diversity issues, CalSTRS filed only one diversity shareholder proposal in 2016. The following chart shows the number of diversity proposal engagements over the past seven years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Proposal Withdrawn</th>
<th>Proposal Went to Vote</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2014</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td>8</td>
</tr>
</tbody>
</table>

CalSTRS and CalPERS worked with leading corporate governance experts to develop a new digital resource devoted to finding untapped diverse talent to serve on corporate boards.
CalSTRS Diversity Events

In 2016, CalSTRS hosted or sponsored diversity events to advocate and advance diversity in corporate boards and the investment industry. The following highlights these CalSTRS diversity events.

Beyond Talk
CalSTRS demonstrated our ongoing commitment to “moving the needle” on gender diversity by spearheading the “Beyond Talk: Taking Action to Achieve Gender Balance in the Financial World” networking workshop, along with State Street Global Advisors. Beyond Talk was inspired by CalSTRS’ efforts to advance diversity in the investments industry, as well as the 72 percent female composition of California’s more than 914,000 public school educators. Additionally, the event focused on establishing a firm commitment among attendees and stakeholders to pledge future dates for continued networking to build relationships and advance women in professional leadership. At the event, CalSTRS announced our initial investment of $250 million in the SSGA Gender Diversity Index, a large-cap U.S. stock index primarily tilted toward companies with a greater than usual number of women in senior leadership positions.

Emerging Managers Reception
More than 100 emerging manager firms attended CalSTRS’ first Emerging Managers Reception where managers learned more about our asset classes from key personnel. The event was supported by all asset classes in the CalSTRS Investments Branch.

Other Diversity Events
A key to staff’s multifaceted approach is advocating and sharing research to advance board and executive staff diversity in CalSTRS’ portfolio companies. Throughout 2016, staff continued to engage with and offer expertise to a variety of professional organizations on diversity through the following events.

Allianz Global Investors Center for Behavioral Finance
Allianz Global Investors Center for Behavioral Finance was founded in June 2010 with the goal of empowering people to make better financial decisions and achieve better financial outcomes. To accomplish this, the center transforms academic research into actionable ideas and practical tools for financial professionals and plan sponsors to use with their clients and employees. Behavioral finance is a relatively new field that seeks to combine behavioral and cognitive psychological theory with conventional economics and finance to provide explanations for why people make irrational financial decisions. This field deals with cognitive biases and diversity issues. Staff attended UCLA Professor Shlomo Benartzi’s presentation on behavioral finance that touched on diversity issues and cognitive biases.

Ascend Pan-Asian
Ascend is the largest, nonprofit Pan-Asian organization for business professionals in North America. Ascend has grown to serve professionals and corporations across multiple industries, offering robust career development programs designed to
cultivate Pan-Asian talent. Staff spoke at the 2016 National Ascend Convention sharing CalSTRS’ role and impact on board diversity.

**Executive Leadership Council**

The Executive Leadership Council is the preeminent membership organization committed to increasing the number of black executives in C-suites, on corporate boards and in global enterprises. Staff participated in a collective strategy session to determine how organizations could work collectively to improve board diversity.

**Hispanic Heritage Foundation’s Leaders on Fast Track**

CalSTRS is a partner with the Hispanic Heritage Foundation Leaders on Fast Track’s Finance Track. The main objective of the Finance Track is to ensure that every young Latino interested in working in the financial services industry has at least one Latino to speak to about their relevant area of interest. In addition, LOFT hosts finance boot camps and leadership trainings and facilitates internships and jobs in the industry for interested Latinos. LOFT also has an online community where active members can connect. CalSTRS was well represented at the 2016 LOFT Investors Forum.

**Johns Hopkins School of Advanced International Studies**

The 7th Annual SAIS Global Women in Leadership Conference brought together corporate executives, board chairs, institutional investors, venture capitalists, government officials, international experts and business leaders to assess the progress to promote women and minority directors to serve on publicly traded company boards. Staff participated on a panel and shared CalSTRS’ perspective on improving company board diversity. Staff also participated in a roundtable providing institutional investors’ perspective on board diversity.

**Robert Toigo Foundation**

The Robert Toigo Foundation’s mission is to foster the career advancement and increase leadership of underrepresented talent by creating mechanisms for greater inclusion from the classroom to the boardroom. The foundation hosts an annual event, “Women in Leadership: Groundbreakers,” a Toigo Institute Summit. This event provides a unique opportunity for professional women across industries to network and learn while blazing a path forward. It is the only event in the investments industry that provides such a unique forum for tomorrow’s female leaders. Staff attended this event in 2016. CalSTRS has been associated with the Robert Toigo Foundation for many years, dating back to its beginning. CalSTRS CIO Christopher J. Ailman continues to be a member of the foundation’s advisory board.

**Skytop Strategies ESG2 Summit**

Skytop Strategies provides a platform for market-moving dialogue by connecting decision makers through actionable exchange, revolutionizing the way 21st century companies create value. At the ESG2 Summit, staff moderated the “Filling the Talent Gap on Boards” panel focused on board diversity and the potential use of proxy access to increase representation of women and people with climate change related risk management experience on public company boards.

“Rewarding change in the boardroom: Progress toward greater diversity in boardrooms is being achieved with a 16 percent increase in female representation since our last survey. However, the starting point is a low one and the pattern of improvement uneven. Substantial female representation is still a mark of differentiation rather than the norm.”

—Credit Suisse Research Institute, September 2016, The CS Gender 3000: The Reward for Change Report
Human Capital Management Coalition

The Human Capital Management Coalition, led by UAW, is a cooperative effort among a diverse group of institutional investors to further elevate human capital management as a critical component in company performance. The coalition engages companies to understand and improve how human capital management contributes to the creation of long-term shareholder value. In 2016, staff attended this conference and had the opportunity to meet with other institutional investors to discuss CalSTRS’ diversity engagements and explore potential collaborations.

Vision 2020 Think Tank: Women in Corporate Governance

This 10-year non-partisan national campaign focuses on advancing American women’s economic and social equality. Delegates from all 50 states collaborate to increase the number of women in senior leadership, advance women’s economic security and pay equity, educate young people to value gender equality, shared leadership and civic engagement, and engage and educate women voters to increase women’s participation in the political process. Staff presented at the event to share CalSTRS’ perspective and innovative corporate governance leadership practices.

Watermark

Watermark is a community of executive women in the San Francisco Bay Area whose mission is to increase the representation of women at executive levels to drive innovation, human development and economic growth. Staff attended the conference and met with women from State Street Global Advisors who were also in attendance.

Women in Governance Week

The Women in Governance Week conference brought together women executives from many institutional investors to advocate for more women in the investment field and on corporate boards. Staff joined other participants in developing an action plan to improve board accountability and board diversity.

Women in Institutional Investment Network

Women in Institutional Investment Network is a Los Angeles-based forum for women in institutional investing. WIIIN strives to achieve the goal of sharing knowledge and connecting through a combination of educational and philanthropic endeavors. Corporate Governance staff is an active member of WIIIN and attended this event in 2016.

“Diversity and independence are important because the best collective decisions are the product of disagreement and contest, not consensus or compromise.”

—James Surowiecki, The New Yorker

The Financial Page
Executive compensation has long been, and will continue to be, an important corporate governance issue at CalSTRS. We view the examination of executive compensation plans at our portfolio companies as our fiduciary duty, one that we must exercise with care. We believe a well-structured executive compensation plan incentivizes executives to drive shareholder value over the long term, exhibits a strong alignment between company performance and the compensation awarded to its executives, and allows for a periodic review, by the board, of its structure to ensure this alignment.

CalSTRS engages with numerous companies every year on various aspects of executive compensation. We welcome companies to reach out to us to exchange views on the topic. In our view, increased engagement between companies and investors since the implementation of say on pay, a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act allowing shareholders to vote on the executive compensation at U.S. companies, is a positive development in the marketplace. Just as with all our other proxy voting related matters, we use our shareholder rights—with regard to executive compensation—in the best interests of our beneficiaries. CalSTRS votes on say-on-pay proposals in alignment with our Corporate Governance Principles.

The table below details how CalSTRS voted on say-on-pay proposals at U.S. companies since the Dodd-Frank Act was passed in 2010:

<table>
<thead>
<tr>
<th>Year</th>
<th>For</th>
<th>Against</th>
<th>Total</th>
<th>% For</th>
<th>% Against</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>1,952</td>
<td>580</td>
<td>2,532</td>
<td>77%</td>
<td>23%</td>
</tr>
<tr>
<td>2012</td>
<td>1,878</td>
<td>340</td>
<td>2,218</td>
<td>85%</td>
<td>15%</td>
</tr>
<tr>
<td>2013</td>
<td>1,956</td>
<td>299</td>
<td>2,255</td>
<td>87%</td>
<td>13%</td>
</tr>
<tr>
<td>2014</td>
<td>2,093</td>
<td>443</td>
<td>2,536</td>
<td>83%</td>
<td>17%</td>
</tr>
<tr>
<td>2015</td>
<td>1,806</td>
<td>350</td>
<td>2,156</td>
<td>84%</td>
<td>16%</td>
</tr>
<tr>
<td>2016</td>
<td>1,670</td>
<td>413</td>
<td>2,083</td>
<td>80%</td>
<td>20%</td>
</tr>
<tr>
<td>Total since Dodd-Frank</td>
<td>11,355</td>
<td>2,425</td>
<td>13,780</td>
<td>82%</td>
<td>18%</td>
</tr>
</tbody>
</table>

CalSTRS acknowledges that executive compensation plans are unique at every company. We encourage companies to choose a compensation structure that is most appropriate for their industry and business cycle, as long as these awards are appropriately sized and disclosed. For example, disclosure of performance-vesting equity awards should include justification for the metrics and thresholds used, and a rationale for their inclusion in the compensation structure. For instance, the rationale might detail the link between the metrics chosen and how they are structured to guide strategy and drive value in the business.

One area of executive compensation that has been a focus for CalSTRS during the past year is the use of discretionary compensation awarded outside the scope of the normal compensation structure. This is often labeled supplemental or one-off awards. We scrutinize one-off awards closely as we believe these awards suggest an improper structuring of the original plan. The factors we analyze when confronting such an award include its magnitude, vesting structure, holding requirements, rationale and overall scope. When withholding support on a company’s advisory vote on executive compensation because of a one-off award or another reason, CalSTRS typically also withholds support from all compensation committee members as we believe that the compensation committee is ultimately responsible for the design, implementation, evaluation and monitoring of the executive compensation program.
The table below lists a few examples where CalSTRS withheld support on the company’s say-on-pay proposal in 2016. While one-off awards are a common theme, our vote reflected the specific structure and rationale of the awards, in addition to what we viewed as a lack of pay-for-performance.

<table>
<thead>
<tr>
<th>Company</th>
<th>Industry</th>
<th>Annual Meeting Date</th>
<th>Say-on-Pay Vote (For/For+Against)%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allergan plc</td>
<td>Pharmaceutical</td>
<td>May 2, 2016</td>
<td>52%</td>
</tr>
<tr>
<td>Chevron Corporation</td>
<td>Energy</td>
<td>May 25, 2016</td>
<td>54%</td>
</tr>
<tr>
<td>General Motors Company</td>
<td>Automobile</td>
<td>June 7, 2016</td>
<td>62%</td>
</tr>
</tbody>
</table>

**Allergan plc**

Our objection to the say-on-pay vote at Allergan plc revolved around compensation actions it took in connection with company mergers. Specifically, the advanced payment of a portion of the “merger success” cash payouts tied to synergy from the Forest Laboratories acquisition. These payouts were originally scheduled to be paid out after three and a half years; however, they were paid out after just a year and a half. Additionally, Allergan provided excise tax gross-up provisions in new employment agreements, which provide additional payments to cover any excise taxes incurred by these executives due to a change-in-control. These actions were taken in relation to the Pfizer merger. Ultimately the merger was terminated—a result of new U.S. Treasury Department rules targeting tax inversion deals—and these gross-ups were not provided as they were contingent on the consummation of the merger. The advanced cash payouts from the merger success awards were paid out ahead of the merger.

**Chevron Corporation**

CalSTRS engaged with Chevron Corporation in 2016 ahead of its annual meeting. Chevron Corporation engaged with Chevron Corporation in 2016 ahead of its annual meeting and executive compensation was one topic of discussion. After careful consideration of Chevron’s views, CalSTRS withheld support on its say-on-pay proposal. Our primary objection was related to the misalignment of pay-for-performance, with poor relative and absolute performance not reflected in executive pay, when considering the total compensation package received. We also objected to the low target threshold for the performance shares and the high proportion of stock options. While CalSTRS is not against using stock options as an equity vehicle for executive compensation, in this particular case, we did not believe such a high proportion of an executive’s total compensation package was appropriate for a company such as Chevron, whose performance can be significantly affected by commodity prices.

Chevron also issued discretionary awards in 2015 to some executives with little accompanying rationale. Although these awards were not the primary determinant for CalSTRS withholding support, the apparent regularity of these awards was a factor.

**General Motors Company**

CalSTRS engaged with General Motors Company in 2016 ahead of its annual meeting. General Motors issued retention awards in 2015, citing new competitors in the automotive manufacturer market actively seeking to recruit its executives. “New competitors” is a reference to technology companies’ forays into the automotive market. CalSTRS believed these awards were set at a high quantum, and the two-year cliff vest too short given the lack of holding requirements. We also felt that the awards were applied too broadly in light of the short tenure and large base salary increases to some of its executive officers in 2015.
21 Risk Factor Review Committee

CalSTRS actively works to address and minimize the geopolitical and social risk to which the Teachers’ Retirement 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 (21 Risk Factor Policy), the Responsible Contractor Policy and the Divestment Policy, all of which can be found at CalSTRS.com. While staff members of each asset class within CalSTRS are responsible for addressing the 21 Risk Factors as they relate to their 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 the staff of 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 asset class within the Investments Branch. Additionally, Corporate Governance staff is responsible for researching and presenting items to the committee, as well as reporting activities to the board. The 21 Risk Factor Review Committee was originally created to review investments potentially meeting the criteria of legislatively mandated divestment relating to Sudan and Iran. Since then, the committee has expanded its scope beyond companies targeted under divestment legislation. The committee now reviews companies identified due to a variety of ESG issues, including labor disputes, CalSTRS’ divestment of tobacco, CalSTRS’ divestment of firearms and other geopolitical matters. Furthermore, the committee tracks emerging geopolitical and human rights issues identified as potential risks to the fund.

In 2016, the 21 Risk Factor Review Committee and Corporate Governance staff spent considerable time evaluating the risks of thermal coal and continued engagement on companies identified as being tied to Iran and Sudan.
Iran and Sudan

On July 14, 2015, the entity formerly known as P5+1, composed of five permanent members of the UN’s Security Council plus Germany, the European Union and Iran reached a Joint Comprehensive Plan of Action designed to ensure Iran’s nuclear development program would be exclusively peaceful. The JCPOA became effective on October 18, 2015, “Adoption Day,” and participants began preparations for implementation. On January 16, 2016, the JCPOA was implemented after the International Atomic Energy Agency verified that Iran had implemented key nuclear-related measures described in the JCPOA. While the JCPOA offers sanction relief, only sanctions imposed after the adoption of Assembly Bill 221, the 2007 California Public Divest From Iran Act, could be lifted. Accordingly, implementation did not affect the status of any of the companies CalSTRS had previously divested or restricted.

In accordance with implementation of the JCPOA, the U.S. Treasury Office of Foreign Asset Control issued general waivers for non-U.S. companies and foreign independent subsidiaries of U.S. companies conducting activities in Iran. The issuance of the waivers led to news reports and speculation that several of the largest European companies are considering doing business in or with Iran. CalSTRS was concerned that these companies, which are not currently divested or restricted, may take advantage of OFAC waivers without fully evaluating the risks. Therefore, CalSTRS staff met with many of the largest European multinationals with potential interest in doing business with Iran and discussed each company’s need to fully consider the risks, in particular the risks around the “snapback provisions” being invoked. Under the JCPOA, sanctions can be “snapped back” into place if the JCPOA is violated. OFAC has stated that contracts undertaken under OFAC waivers will not be grandfathered if snapback provisions are triggered.

Thermal Coal

In October 2015, California Gov. Edmund G. Brown, Jr. signed Senate Bill 185, which requires CalSTRS, subject to our fiduciary duties, to divest of certain thermal coal companies. Before the signing of SB 185, the board had instructed staff to review CalSTRS’ investments in thermal coal under the 21 Risk Factor and Divestment policies.

The CalSTRS 21 Risk Factor policy requires that managers and staff consider 21 Risk Factors when making investments on CalSTRS’ behalf. The policy does not systematically exclude or include any investments in companies, industries, countries or geographic areas, except in cases where one of the CalSTRS 21 Risk Factors is violated over a sustained time frame to the extent that it becomes an economic risk to the fund, a potential for material loss of revenue exists, and where it weakens the trust of a significant portion of CalSTRS members. In cases where a violation of the 21 Risk Factor policy is deemed to be sustained and an economic risk to the fund, the board may enact its Divestment policy.

Under the Divestment policy, the board requires staff to perform engagement on the issue, confirm all avenues of
influence have been exhausted, and deliver an in-depth report to the board. The board will then determine if the investment should be divested under its fiduciary duty.

In this case, staff divided the research between U.S. and non-U.S. markets due to the cost of engagement as well as differences in energy demand, public opinion, and governmental and regulatory policies between the U.S. and other countries.

Staff completed the engagement and review of U.S. thermal coal companies in 2015 and the board, at its February 3, 2016, meeting, voted to divest of U.S. thermal coal companies as they had become de minimis to the portfolio. The CalSTRS Investment Portfolio has been free of U.S. thermal coal holdings as of May 9, 2016, and the CalSTRS custom benchmarks have reflected the ex-U.S. thermal coal status since April 1, 2016.

In 2016, staff conducted the analysis of non-U.S. thermal coal. Due to the numerous challenges emerging markets face, staff believes a holistic assessment of the ESG issues is needed to evaluate whether use of thermal coal in these markets justifies divestment. Since thermal coal is more of a multifaceted social issue relating to the economic development of developing countries, staff’s analysis is focused on emerging market countries rather than specific companies. In particular, staff focused on India and China as the two largest consumers of thermal coal. Staff’s research included an extensive due diligence trip to India. During this trip, staff met with government officials, environmental groups, industry experts, Coal India (the country’s largest coal producer, which is also 80 percent state owned) and a tour of a mine in Durgapur. Staff will present our findings to the board, which will make a divestment decision on non-U.S. thermal coal in 2017.

**Divestment Cost**

In addition to research and monitoring risks, the 21 Risk Factor Review Committee tracks the estimated fiscal impact of divestment programs on the fund. As of 2016, CalSTRS had divestment mandates for tobacco, Sudan, Iran, firearms and U.S. thermal coal. Since fully divesting tobacco in 2010 and firearms in 2013, the CalSTRS Investment Portfolio, which is benchmarked against custom indexes (indexes that exclude tobacco, firearms, U.S. thermal coal and geopolitical restrictions), has underperformed the standard indexes—indexes that include securities restricted by CalSTRS—by 1.83 percent, which represents roughly $1.76 billion. Staff estimates the total compounded cost of divestments and the prior restricting of tobacco under the prior benchmark modification policy—between June 2000 and January 2010, CalSTRS divested of tobacco in passive portfolios by removing the sector from benchmarks—to be $4.8 billion.

Due to the numerous challenges emerging markets face, staff believes a holistic assessment of the ESG issues is needed to evaluate whether use of thermal coal in emerging markets justifies divestment.
Performance Differences Attributable to Divestment

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<th>Quarter</th>
<th>6-Month</th>
<th>Cumulative</th>
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<tbody>
<tr>
<td>U.S. Equity</td>
<td>0.01%</td>
<td>0.19%</td>
<td>-1.32%</td>
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<tr>
<td>Non-U.S. Equity</td>
<td>0.10%</td>
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<td>Fixed Income</td>
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<td>Total Fund²</td>
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¹CalSTRS removed tobacco companies from the index benchmark in June 2000.
²CalSTRS divested of tobacco companies in June 2009.
³CalSTRS divested of certain firearm companies in April 2013.
⁴CalSTRS has divested of certain geopolitical risky countries since 2006. However, CalSTRS began removing the identified companies from its indexes in June 2015.
⁵CalSTRS divested of U.S. thermal coal companies in February 2016.
⁶The average allocation of 50% U.S. Equity, 25% Foreign Equity and 25% Fixed Income is assumed.

Staff continues to actively monitor our portfolio for any issues related to divestment. To keep abreast of divestment issues, staff will continue to attend and participate in events and meetings hosted by various private or governmental entities. The following highlights some of those events in 2016.

**American Lung Association in California**

Staff met with members of the board and advisors to the American Lung Association in California. The American Lung Association is a voluntary health organization whose mission is to save lives by improving lung health and preventing lung disease through education, advocacy and research. Staff discussed CalSTRS’ experience in divesting tobacco, including CalSTRS’ policies, process and performance related to tobacco divestment.

**Institute for Energy Economics and Financial Analysis**

Staff participated on the Institute for Energy Economics and Financial Analysis panel. The IEEFA conducts research and analyses on financial and economic issues related to energy and the environment. Staff spoke on the CalSTRS divestment policy and the process we used to determine to divest from U.S. thermal coal.

**Office of Foreign Assets Control**

Staff attended the Office of Foreign Assets Control of the U.S. Department of the Treasury symposium. OFAC is the regulator responsible for administering and enforcing economic and trade sanctions based on U.S. foreign policy and national security goals. Staff attended the symposium to gain a better understanding of U.S. policy and requirements for compliance with certain sanctions programs. Staff will use the information gathered when engaging portfolio companies on compliance and control procedures and evaluating companies under the divestment restrictions related to Iran and Sudan.
As a long-term shareholder, CalSTRS depends on corporate directors, who serve as representatives for shareholders, to act in the best interest of the fund and help protect our investments. We believe 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 uncontested director elections. A majority vote standard requires that a director nominee receive a majority of the affirmative votes cast by shareholders 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 director election. CalSTRS believes a majority vote standard in director elections empowers shareholders with the ability to remove poorly performing directors and increase the directors’ accountability to the owners of the company—its shareholders. In addition, those directors who receive majority support from shareholders will know they have the backing of the shareholders that they represent. Most directors elected to a board receive well over 90 percent of the shareholders’ affirmative votes. However, every year a number of directors receive less than 50 percent and, under a plurality vote standard, they are re-elected. Consequently, CalSTRS and other investors have put forth an active effort to establish a majority vote standard in uncontested director elections.

In 2010, CalSTRS, along with other investors, pushed for a majority vote standard for director elections to be part of the Dodd-Frank Act. Unfortunately, in a last-minute compromise, the provision was left out of the final legislation. Since then, shareholders have increased their efforts to make majority vote the standard through private ordering by filing proposals at companies.

Beginning in fiscal year 2010–11, CalSTRS embarked on an ambitious engagement campaign by filing majority vote proposals at 26 companies. This effort focused on smaller cap companies in the Russell 2000 Index because more than two-thirds of the companies in that market cap space still maintained a plurality vote standard. This was in stark contrast to the S&P 500 Index, where less than 10 percent of companies had a plurality vote standard.

The effort paid off as 21 of the 26 (more than 80 percent) engaged companies committed to adopt either a majority vote or a resignation policy—a policy that states a director who does not receive a majority of the votes cast offers their resignation, and the board or a committee of the board determines whether or not to accept the resignation—without the filed shareholder proposals having to go to a shareholder vote. The shareholder
proposals filed on majority vote that did go to a shareholder vote, at the remaining five companies, passed overwhelmingly.

Given the success of our 2010–11 majority vote engagement campaign, CalSTRS expanded our engagement on the majority vote standard to approximately 100 companies every year for the past five years. In 2016, CalSTRS continued to see a large percentage (approximately 90 percent) of the companies we engaged adopt majority vote standard without the proposal having to go to a shareholder vote. Similarly, in instances where CalSTRS filed the majority vote proposal, approximately 80 percent of the companies were willing to negotiate and subsequently adopted a majority vote standard. In 2016, only 12 majority vote proposals went to a shareholder vote, all of which passed.

Since 2010, CalSTRS has engaged 492 companies, encouraging them to adopt the majority vote standard. Of the 492 companies, 204 companies (approximately 40 percent) adopted the majority vote standard without CalSTRS having to file majority vote proposal. CalSTRS filed majority vote proposals at the remaining 288 companies (approximately 60 percent). Of the 288 proposals filed, CalSTRS successfully negotiated with 228 companies (approximately 80 percent) prior to a vote, leading to CalSTRS’ withdrawal of the proposals. The companies agreed either to adopt the majority vote standard or to put a management-sponsored majority vote proposal on the company’s proxy statement. Over the past six years, CalSTRS had 60 filed majority vote proposals go to a shareholder vote, of which 49 (approximately 82 percent) passed, and 11 (approximately 18 percent) failed to pass at the respective company’s annual meeting.
The table below shows the majority vote standard engagement outcomes in each of the past six years.

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<td>49</td>
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Overall, since 2010, 481 of the 492 (98 percent) companies CalSTRS engaged with implemented the majority vote standard while 11 (two percent) did not. The chart below shows the volume and outcomes of the majority vote engagement campaign since its 2010 inception.

For 2017, CalSTRS continues to engage with approximately another 100 companies in the Russell 3000 Index to encourage adoption of a majority vote standard. Given our historical trend of negotiating success, we expect to successfully negotiate—instead of filing a proposal—with these companies to adopt a majority vote standard before their 2017 annual meetings.
Sustainability integration, often referred to as environmental, social and governance consideration, continued to be a principal focus of the CalSTRS Corporate Governance Unit in 2016.

As a large, diversified global investor, CalSTRS recognizes that we need to be mindful of our exposure to a variety of sustainability-related risks. The Corporate Governance Unit is responsible for considering which sustainability issues are material to investment value, where these issues might impact value and what can be done to mitigate our exposure to them.

At the direction of the board, Corporate Governance staff developed a sustainability risk management program that works to identify and manage sustainability-related risks within the CalSTRS portfolio. The sustainability risk management 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, government policies, and investor evaluation and analysis.

CalSTRS also 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 UN’s Principles for Responsible Investment. 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 pursues a variety of sustainability-related engagements. These engagements can be event driven or geared toward promoting sustainability awareness in a specific sector or around a particular theme.

When staff believes that a company is not willing to make the necessary progress toward managing environmental risks, staff will strongly consider exercising CalSTRS’ equity ownership rights by filing a shareholder proposal with the company, calling on the company to improve its environmental risk management efforts. The intent of the shareholder proposal is to bring our concerns to the company’s shareholders and generate enough support from the investor base to convince the company to commit to our recommendations. Often, the filing of a shareholder proposal will increase a company’s willingness to engage further with staff and lead to a commitment to improve risk management and disclosure.

Since 2008, CalSTRS has filed 52 environmental-related shareholder proposals that called on companies to improve their environmental risk management disclosure efforts. Of these 52 shareholder proposals, 39 were ultimately withdrawn before the company’s annual meeting as staff was able to negotiate a mutually agreeable outcome with the company. In 2016, staff filed five shareholder proposals, of which two proposals are expected to go to a shareholder vote in 2017. Since 2008, the 11 proposals voted on...
by shareholders received, on average, approximately 28 percent support.

**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 a company’s volatile energy costs. In addition, they can help companies respond to potential regulations and can enhance a company’s role as a corporate citizen.

Starting in 2015, CalSTRS partnered with ClimateWorks Australia as the lead investor on an energy-efficiency engagement tool 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 where 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 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. Next ClimateWorks provided a general “engagement” rating for each company based on the efficiency analysis it conducted and the corresponding quintile ranking.

Based on the ClimateWorks analysis, CalSTRS sent engagement letters to seven U.S. companies: Ford Motor Company, General Motors Company, American Airlines Inc, Delta Air Lines, Inc, Dow Chemical Company, International Paper Company and United States Steel Corporation. To date, staff has received responses from five of the seven companies. At the end of 2015 through the first half of 2016, staff conducted initial calls with each of these companies. The engagement proved beneficial as staff’s intent was 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.
Eco-Efficiency Initiative

During 2016, CalSTRS joined Boston Common in the development of a comprehensive eco-efficiency engagement. Five large-cap companies across energy-intensive industries were chosen to be engaged to assess and identify where these companies can save energy and water and eliminate waste. Additionally, best practices from these companies will be identified during the engagement to provide other companies and their shareholders specific areas where companies can improve.

This engagement was developed through the understanding that 50 percent or more of greenhouse gas emissions reductions can come from energy efficiency. Also key is that energy efficiency can reduce a company’s operating expenses. This can potentially improve the long-term sustainability of companies while also improving financial returns for investors. This engagement combines water efficiency and waste elimination with energy efficiency to help companies take a multidimensional approach to retooling their products, processes and policies in order to achieve sustainable profitable growth. This can be accomplished by creating desirable products that are produced in efficient ways that improve margins and support low natural resource use. In the end, these efforts create the win-win for investors and society.

This multiyear engagement began in 2016 and will continue through 2017. CalSTRS and more than 60 institutional investors globally, with more than $1 trillion assets under management, co-signed the letters to one or more companies.

Hydraulic Fracturing Engagement

CalSTRS is a signatory to the PRI and often joins PRI-led collaborative engagements that align with our long-term, value accretion philosophy. CalSTRS continued to be part of PRI-led collaborative engagement of oil and natural gas producing companies that focused on the risks associated with hydraulic fracturing. This engagement focused on 56 companies held in the Global Equity Portfolio. CalSTRS’ holdings in these companies have a combined portfolio value of more than $4 billion. Although this specific engagement concluded the fall of 2016, staff expects to continue to engage a number of these companies during 2017.
According to the PRI, the production of oil and gas via hydraulic fracturing, or “fracking,” remains important, and yet it can be viewed as a contentious method in some regions, with community controversies, bans and moratoria in different areas. Local communities and the media have brought attention to the environmental and social impacts of fracking worldwide. Complaints include traces of chemicals from fracking fluids being found in drinking water and health implications from fracking-related air pollution. Fracking risks that are of concern to investors include:

1. Operational and physical risks can increase costs and impact the value of an investment.
2. The leakage of methane and other greenhouse gas emissions contributes to climate change. Methane can also be a loss of revenue for the company.
3. Reputational risk and social license to operate. A company’s ability to adequately respond to and manage local community concerns can affect reputational risks and the social license to operate.
4. Policy and regulation. Companies need to be able to adapt to meet changing regulatory requirements, potentially raising costs.

Company disclosure of fracking practices were benchmarked before and after engagement. Eighty-seven percent of the engaged and benchmarked companies improved their disclosure of fracking-related policies, practices and management systems during the period of engagement.
Methane Emissions Engagement

Over a 20-year period, methane, the primary component of natural gas, is a climate pollutant 84 times more powerful than carbon dioxide. According to Environmental Defense Fund calculations, methane 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.

Oil and Gas Companies

In light of the U.S. Environmental Protection Agency’s 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 risk associated with methane emissions, to what degree they already capture fugitive methane emissions, and whether they have analyzed the business case associated with improving methane capture.

Companies in the oil and gas industry were targeted for engagement as the industry presents tremendous opportunities to strengthen its methane emissions risk management strategy. Engagement candidates were identified through an analysis of companies within the CalSTRS Russell 3000 Index that had a potentially material fugitive methane emissions risk. The level of disclosure of methane risk management strategy combined with an assessment of the potential leakage rate—the amount of methane leaked per unit of equivalent production—were the driving factors behind which oil and gas companies were ultimately engaged.

Beginning in 2015, staff identified 14 oil and gas companies believed to be most in need of engagement on implementing and disclosing their methane emissions risk management strategy efforts. Staff sent engagement letters to these 14 oil and gas companies which, at the time of the analysis, had a combined portfolio value of approximately $653 million. The engagement letters outlined our belief that companies need to be aware of evolving EPA regulations, that incorporating methane emissions risk management initiatives into business plans would be beneficial from a financial and reputational perspective, and that disclosure surrounding companies’ efforts at preventing fugitive methane emissions could be improved.

During 2015 and 2016, 10 of the 14 targeted oil and gas companies responded to staff’s engagement letter, and ultimately met and had a dialogue with staff. Eight of these 10 companies demonstrated a commitment to enhancing their risk management activities or at least improving their disclosure of their methane emissions risk management efforts.

The six oil and gas companies that received shareholder proposals from CalSTRS were either those that did not respond to staff’s engagement letter or those that were unwilling to enhance their risk management effort. Subsequent to receiving our shareholder proposal, two additional companies chose to engage CalSTRS and demonstrated a commitment to enhancing their risk management activities or at least improving their disclosure of their methane emissions risk management efforts. For this reason, two of the six shareholder proposals were withdrawn and four went to a vote, with two shareholder proposals receiving more than 40 percent of shareholder support.

CalSTRS continued its engagement through 2016 with four of the 14 oil and gas companies identified in 2015. CalSTRS filed shareholder proposals at three of these four companies. The proposals called on these companies to report on how they are monitoring and managing the level of methane emissions from their operations. Two out of the three shareholder proposals with oil and gas companies were ultimately withdrawn after successful negotiations.
led to companies providing valuable information on their websites regarding how they are monitoring and managing the level of methane emissions from their operations. One company agreed to include methane emissions data in a variety of ways, including in aggregate, broken down by emissions source, and in a relative method, which includes a methane intensity percentage by reporting on its methane emissions compared to its total gross operated gas production. This company also provided meaningful language on what it has currently done to mitigate methane emissions and what it plans to do to continue to reduce them.

**Gas Utility Companies**

During the summer of 2016, CalSTRS staff began researching gas utility companies for engagement. Similar to companies in the oil and gas industry, gas utility companies were targeted for engagement because the industry presents tremendous opportunities to strengthen methane emissions risk management strategy. For gas utility engagement, staff used a bottom-up approach by first assessing the underlying publicly disclosed data of all gathering, transmission and distribution utility subsidiaries. Then staff analyzed, both on a relative and absolute basis, the number of known leaks in both high consequence and non-high consequence areas, the total miles of pipeline and the rate of unaccounted for gas. After that, staff assessed the current pipeline Integrity Management Program disclosure of 35 gas utility companies and specifically evaluated disclosure of pipeline infrastructure investments, emissions rates, emission reduction targets or goals, leak detection and repair protocol, and emergency preparedness. Lastly, staff benchmarked the results across the gas utility companies in the CalSTRS Public Equity Portfolio to identify which 15 companies may be most financially exposed to the Pipeline and Hazardous Materials Safety Administration’s 2016 proposed rulings.

Nearly all 15 of the targeted gas utility companies that responded to staff’s engagement letter engaged in dialogues with staff. After an initial dialogue, the majority of the companies indicated that they were committed to enhancing their methane emissions risk management activities and making their disclosure for all their shareholders more clear. About a third of the companies required a deeper dialogue over several months before committing to more meaningful future disclosure on methane emissions. This included one gas utility company that CalSTRS ended up filing a shareholder proposal with to request a report on how it is monitoring and managing the level of methane emissions from its operations.

**Similar to companies in the oil and gas industry, gas utility companies were targeted for engagement because the industry presents tremendous opportunities to strengthen methane emissions risk management strategy.**
The Pipeline and Hazardous Materials Safety Administration, PHMSA, is the U.S. Department of Transportation agency that develops and enforces regulations for the safe, reliable and environmentally sound operation of the nation's 2.6 million mile pipeline transportation system and the nearly 1 million daily shipments of hazardous materials by land, sea and air. PHMSA comprises two safety offices: the Office of Pipeline Safety and the Office of Hazardous Materials Safety.

High Consequence Areas, HCAs, for natural gas transmission pipelines focus solely on populated areas. An equation was developed based on research and experience that estimates the distance from a potential explosion at which death, injury or significant property damage could occur. This distance is known as the potential impact radius, or PIR, and is used to depict potential impact circles. Operators must calculate the potential impact radius for all points along their pipelines and evaluate corresponding impact circles to identify the population is contained within each circle. The following are defined as HCAs: potential impact circles that contain 20 or more structures intended for human occupancy; buildings housing populations of limited mobility; buildings that would be hard to evacuate such as nursing homes and schools; and buildings and outside areas occupied by more than 20 persons on a specified minimum number of days each year.
Water Risk

For the past two years, CalSTRS has been a member of Ceres Investor Water Hub, which works to help drive greater consideration of water risk in investment decision-making. In 2015, Ceres developed the Feeding Ourselves Thirsty: How the Food Sector Is Managing Global Water Risks report, which evaluated publicly available information on the water use, stewardship and policies of 37 major food sector companies. CalSTRS was a signatory to a letter directed to many of these companies that asked for better water risk-related disclosure from their direct operations and supply chains. From this involvement, many of the companies opted to enhance their water-related disclosure during 2016.

In 2016, CalSTRS identified one specific beverage company that had yet to make any improvements to its water risk management disclosure. During the course of the year, CalSTRS engaged the company and was able to have productive meetings addressing the company’s water risk. Unfortunately, the company has refrained from adequately providing public disclosure on its risk management efforts. At the end of 2016, CalSTRS filed a shareholder proposal with the company requesting a report on its sustainability efforts, including an analysis of material water-related risks.

CalSTRS Green Initiative Task Force

Corporate Governance sustainability staff leads the CalSTRS Investments Green Initiative Task Force, or Green Team. The Green Team is a cross-asset effort focused on managing environmental risks and considering environmental-themed investment opportunities. The Green Team is composed of nearly 20 Investments staff that focus on:

1. Integration of environmental considerations into asset allocation processes.
2. Integration of environmental risk factors into manager procurement processes and ongoing due diligence efforts.
3. Improving ability to consider increased allocations to environmental-themed investments.
4. Continued education on environmental risk issues and environmental-themed investment opportunities.

In 2016, the Green Team met quarterly. Actis, a CalSTRS Infrastructure external manager, Cartica Managements, a CalSTRS public equity external manager, and water risk experts from Ceres, an environmentally focused organization, were guest speakers at 2016 Green Team meetings. These speakers provided education and guidance on how they integrate ESG factors into their investment decision-making process.

Also in 2016, Green Team members were able to participate in off-site environmental-themed events. Three members of the Green Team attended the Sustainable Innovation CDP Spring Workshop 2016 and two members attended the McKinsey & Company Sustainability & Resource Productivity Summit.

A comprehensive accounting of CalSTRS Green Team efforts during 2016 can be found in its 2016 annual report.
Peer Networking and Collaborations
CalSTRS staff continues to participate in peer networking and collaborations on sustainability issues. Below are brief descriptions of some of these opportunities.

Carbon Asset Risk Working Group
Much of CalSTRS’ work on carbon risk in 2016 was in collaboration with fellow members of the Investor Network on Climate Risk, a Ceres-led investor group that focuses on managing climate change risks. This engagement effort was on how fossil fuel producing companies were considering issues, such as expected future energy demand, anticipated future prices of oil and gas, introduction of new technologies and potential regulatory impacts, when making decisions on allocating substantial shareholder capital to new exploration projects that will take many years, if not decades, to achieve profitability. CalSTRS joined many other institutional investors in this engagement, which focused on 45 companies held in the CalSTRS Global Equity Portfolio. CalSTRS’ holdings in these companies have a combined portfolio value of approximately $4 billion. During the last year, staff led or participated in engagements with Exxon Mobil, Chevron, Apache Corporation and EOG Resources.

Ceres Investor Network on Climate Risk
Investor Network on Climate Risk Working Groups offer investors the opportunity to engage with their peers to share updates on key research, develop strategies, share best practices and advance ESG issues on a variety fronts, from corporate disclosure and performance to sustainability policy and regulations. Working groups meet monthly, bimonthly or quarterly via phone or web meeting. Staff participates extensively within Ceres INCR Working Groups.

INCR Investor Water Hub
The INCR Investor Water Hub undertakes activities that help drive greater consideration of water in investment decision-making. This group offers peer-to-peer sharing of leading ESG and water integration and engagement practices and a forum to develop more effective research methods to assess water risks and opportunities. The Investor Water Hub also explores ideas that help drive investing in solutions that support sustainable water resources. CalSTRS regularly participates on the Investor Water Hub group calls. Multiple engagements we have led or partnered with others began through the discussions and research developed within this group. Staff also invited Ceres staff that leads the INCR Investor Water Hub to provide a water risk management briefing to the CalSTRS Investments’ Green Team.

INCR Shareholder Initiative on Climate and Sustainability
The INCR Shareholder Initiative on Climate and Sustainability Working Group coordinates the efforts of investors seeking to engage investee companies on climate, clean energy and related sustainability risk and opportunity issues through corporate engagements on key ESG issues. The goal is to reduce long-term portfolio-wide risks and enhance returns. Staff members attended Ceres SICS Winter and Summer In-Person Strategy meetings where they were able to meet and strategize with more than 15 other institutional investors and provide updates and guidance on our ongoing engagements and shareholder proposals.

Sustainability Events
Corporate Governance staff attended or participated in a number of events to share CalSTRS’ perspectives on various sustainability-related risk issues with other investors, investment professionals, companies and public interest groups. Below are highlights of some of these events.

27th Annual SRI Conference
Staff represented CalSTRS at the 27th Annual Sustainable, Responsible, Impact Conference. The SRI event serves thought leaders, investors and investment professionals in the ESG, shareowner advocacy, and impact investing space. The SRI conference offered a robust agenda covering innovative financial products, emerging topics and compelling industry issues. In addition, staff had the opportunity to network with institutional and independent asset managers on strong investment or engagement strategies and partnerships.

Beverage Industry Environmental Roundtable
The Beverage Industry Environmental Roundtable is a technical coalition of leading global beverage companies that work together to advance environmental sustainability within the beverage sector. At BIER, staff spoke on a panel to more than 40 individuals representing 20-plus leading beverage companies, including The Coca-Cola Company, Anheuser-
Busch InBev and PepsiCo Inc. Staff spoke on corporate reporting, disclosure data needs and requests, context of data use, sustainable investment management and company engagements, and provided a perspective on the future of transparency and disclosure.

**CDP Spring Workshop**

Staff attended the CDP Spring Workshop 2016 along with other sustainability investors as well as government and business leaders. The workshop provided a robust conversation about pivotal obstacles and opportunities in data, disclosure, strategy and performance across a range of sectors and sustainability issues.

**Decarbonise 2016**

Staff represented CalSTRS at the Responsible Investor’s Decarbonise workshop. This event was exclusively for asset owners and a select few investment providers to discuss the opportunities available as well as the challenges institutional investors face in transitioning to low-carbon investment portfolios over the medium- to long-term.

**McKinsey & Company Sustainability and Resource Productivity 2016 Summit**

Staff attended the McKinsey & Company Sustainability and Resource Productivity 2016 Summit. During the summit, staff met with and listened to automotive, technology and utility executives speak on issues from the future of mobility to sustainability and resource productivity, including a focus on renewable energy, the use of storage and grid economics.

**The Pension Bridge Annual 2016**

Staff was on the “Environmental, Social and Governance” panel at The Pension Bridge Annual 2016 conference. The ESG panel covered various topics, including assessing ESG risks within a portfolio, ESG investment strategies, ESG integration and ESG company engagement. More than 300 people attended the event, which included CIOs, investments staff and trustees from the nation’s largest pension funds as well representatives of more than 100 investment firms.

**Society for Corporate Governance**

Staff was on the “Your Owners and Their Investment Decisions: Emerging Trends and What Analysts Want” panel at the Society for Corporate Governance Chapter Meeting. Staff spoke about how and why investors are assessing sustainability and ESG factors; the governance issues of most importance; their views on the compensation discussion and analysis; quarterly guidance and earnings; and the top things an analyst does not want to hear.

**Water & Long-Term Value 2**

Staff was on the “Institutional Investor Approaches & Needs for Water Data: Implications for Companies” panel at the Water & Long-Term Value 2 2016 conference. Staff spoke about the data that we use in assessing water-related material risks for companies in the CalSTRS portfolio.
CalSTRS believes the execution of proxies is an important fundamental shareholder right, and staff always seeks to exercise our rights in a manner consistent with the interests of our beneficiaries, California’s public educators. We believe 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. Over the course of each year, CalSTRS anticipates voting over 7,800 proxies, with more than half of them being voted during proxy season, which occurs in the months of April, May and June. Staff votes U.S. and global proxies in a manner that aligns with our interests and philosophy.

When voting proxies, CalSTRS uses analysis and judgment in conjunction with our Corporate Governance Principles, which can be found at CalSTRS.com. These principles consider corporate governance best practices on a variety of shareholder issues, including the board of directors, auditors, executive and director compensation, compensation plans and governance structure, and serve as guidelines for our proxy voting.

To assist staff in our proxy vote analysis, we subscribe to proxy research from vendors, including Glass Lewis & Co., Institutional Shareholder Services, Equilar and the 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 used the Glass Lewis proxy voting platform to vote domestic and global proxies in-house. We provide our custom proxy voting guidelines to Glass Lewis, which they follow to vote proxies on the fund’s behalf. However, Corporate Governance staff manually cast votes on S&P 500 companies as well as mergers, shareholder proposals, contested election meetings and other extraordinary vote items. Additional details on our proxy votes can be found in the Corporate Governance Summary of Proxy Votes report at CalSTRS.com. CalSTRS is committed to disclosing our proxy votes on our website.
The following table highlights CalSTRS’ proxy voting guidelines on certain issues.

<table>
<thead>
<tr>
<th>Issue</th>
<th>CalSTRS Proxy Voting Guidelines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors</td>
<td>CalSTRS generally votes in support of a director unless the proxy statement shows circumstances contrary to our Corporate Governance Principles. 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, overboarding (serving on more than four public boards), poor board meeting attendance (less than 75 percent), or a lack of board independence.</td>
</tr>
<tr>
<td>Auditors</td>
<td>CalSTRS will vote to ratify the independent auditors recommended by management unless the auditor provides services that run contrary to those in the CalSTRS principles. Examples of those services include consulting, investment banking support and excessive non-audit fees (greater than 30 percent of the total fees billed).</td>
</tr>
<tr>
<td>Compensation Plans</td>
<td>Companies provide a variety of compensation plans, such as stock option plans, restricted stock plans or employee stock purchase plans for executives, and employee 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.</td>
</tr>
<tr>
<td>Say on Pay</td>
<td>CalSTRS refers to the executive compensation sections of 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.</td>
</tr>
<tr>
<td>Diversity</td>
<td>CalSTRS believes that companies should disclose the policies or procedures used to ensure board diversity. The diversity goals should include cultural diversity in addition to gender and race diversity. We may hold members of the Nominating and Governance Committee accountable if, after engagement about the lack of board diversity, sufficient progress has not been made in this regard.</td>
</tr>
<tr>
<td>Mergers and Acquisitions</td>
<td>When CalSTRS votes for a merger or acquisition, we do so 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.</td>
</tr>
<tr>
<td>Other Issues</td>
<td>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, we vote 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.</td>
</tr>
</tbody>
</table>
In 2016, CalSTRS voted on 76,260 proposals at 7,818 meetings held by companies in our Global Equity Portfolio. The 76,260 proposals were a 1.3 percent decrease from the 77,299 proposals voted in 2015, and the 7,818 meetings considered were slightly less than the 7,950 meetings considered in 2015. Of the 76,260 proposals CalSTRS voted on, 24,818 proposals were from U.S. companies and 51,442 proposals were from global companies. As for the 7,818 meetings considered, 3,006 were U.S. meetings and 4,812 were global meetings. These meetings resulted in CalSTRS voting on proposals covering a variety of topics, including director elections, auditor ratifications, advisory vote executive compensation, compensation plans, mergers and acquisitions, and shareholder proposals.

The chart below provides a summary of the number of proposals and the number of meetings CalSTRS voted on in 2016.

**2016 Summary of Proposals Voted**

- Domestic Proposals: 24,818
- Global Proposals: 51,442

**2016 Summary of Meetings Voted**

- Domestic Votes: 3,006
- Global Votes: 4,812

The chart below is a summary of monthly proxies voted in 2016. Staff voted most of the proxies during proxy season, which occurs in the months of April, May and June.

**2016 Summary of Votes per Month**
The following chart shows the total number of proposals staff voted on over the past five years. The domestic proxy voting levels have generally remained fairly consistent since 2013. In 2010, the Dodd-Frank Act was implemented requiring all public companies to hold an advisory vote on executive compensation (say-on-pay) vote at least once every three years. However, a provision of the Dodd-Frank Act allowed a two-year exemption for smaller reporting companies, which explained why the number of proposals voted increased slightly once the two-year exemption was phased out. As for the global proxies, there was a gradual increase in the number of proposals voted on over the years, which was primarily attributed to our hiring of new non-U.S. external managers, particularly in the emerging markets, in 2013.
The aggregate amount of “For” and “Against” proxy votes for each of the past five years is depicted in the following charts. The aggregate support levels “For” domestic and global proxy votes have been fairly consistent over the past five years.

**Historical Domestic Proxy Voting**

- 2016: 72% For, 28% Against
- 2015: 72% For, 28% Against
- 2014: 71% For, 29% Against
- 2013: 73% For, 27% Against
- 2012: 71% For, 29% Against

**Historical Global Proxy Voting**

- 2016: 52% For, 48% Against
- 2015: 51% For, 49% Against
- 2014: 50% For, 50% Against
- 2013: 48% For, 52% Against
- 2012: 49% For, 51% Against

**Historical Total Domestic and Global Proxy Voting**

- 2016: 58% For, 42% Against
- 2015: 58% For, 42% Against
- 2014: 57% For, 43% Against
- 2013: 57% For, 43% Against
- 2012: 57% For, 43% Against
In 2016, staff voted on 24,818 proposals at 3,006 meetings held by companies in our domestic Public Equity Portfolio. Compared to 2015, the number of proposals and meetings was 1.7 percent and 1.8 percent lower, respectively. Staff voted on proposals covering a variety of topics, including the election of directors, the ratification of company auditors, the approval of executive and director compensation plans, and the approval of mergers and acquisitions. Staff also voted on a variety of shareholder proposals covering multiple ESG issues, such as sustainability, political contributions, majority vote standard for director elections and proxy access.

The following table shows the top issues voted in 2016 by volume.

<table>
<thead>
<tr>
<th>Top Issues by Volume</th>
<th>For</th>
<th>Against</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Election of Directors</td>
<td>11,701</td>
<td>5,498</td>
<td>17,199</td>
</tr>
<tr>
<td>Ratification of Auditor</td>
<td>2,494</td>
<td>222</td>
<td>2,716</td>
</tr>
<tr>
<td>Advisory Vote on Executive Compensation</td>
<td>1,670</td>
<td>413</td>
<td>2,083</td>
</tr>
<tr>
<td>Equity Compensation Plan</td>
<td>1,044</td>
<td>257</td>
<td>1,301</td>
</tr>
<tr>
<td>Mergers and Acquisitions</td>
<td>188</td>
<td>6</td>
<td>194</td>
</tr>
<tr>
<td>Increase in Authorized Common Stock</td>
<td>24</td>
<td>59</td>
<td>83</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17,121</strong></td>
<td><strong>6,455</strong></td>
<td><strong>23,576</strong></td>
</tr>
</tbody>
</table>

The chart below highlights how CalSTRS voted on certain major shareholder issues in 2016.

- **Proxy Access**: 81 For, 1 Against
- **Independent Chair**: 48 For, 0 Against
- **Political Activities**: 43 For, 33 Against
- **Environment**: 40 For, 47 Against
- **Restrict Executive Compensation**: 26 For, 8 Against
- **Special Meeting**: 19 For, 0 Against
- **Written Consent**: 16 For, 0 Against
- **Declassify Board**: 5 For, 0 Against
Proxy access continued to be a dominant governance issue in 2016 as it was in 2015. In 2016, staff voted 82 proxy access proposals, which accounted for approximately 32 percent of the governance shareholder proposals voted in 2016 compared to 30 percent in 2015. The significant number of proxy access shareholder proposals was primarily due to the New York City Comptroller and the New York City pension funds submitting 72 proxy access proposals to companies as part of their Boardroom Accountability Project. In 2016, CalSTRS supported all proxy access shareholder proposals modeled after the SEC’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. CalSTRS is also a strong proponent of proxy access proposals allowing the nomination of two directors or 20 to 25 percent of the board. Proxy access has gained significant momentum over the past few years, as evident by the number of proxy access proposals and the number of S&P 500 companies adopting proxy access.

The following table shows the number of proposals considered on major issues in calendar years 2015 and 2016 and the percentage change year over year. The number of director elections, auditor ratifications and compensation plans considered remained fairly consistent year over year. In 2016, the number of say-on-pay votes considered decreased slightly, which is likely attributable to fewer U.S. companies having to provide the say-on-pay votes on an annual basis instead of a triennial basis.

<table>
<thead>
<tr>
<th>Issue</th>
<th>2015 Proposals Considered</th>
<th>2016 Proposals Considered</th>
<th>2015 to 2016 Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Election of Directors</td>
<td>17,461</td>
<td>17,199</td>
<td>−1.5%</td>
</tr>
<tr>
<td>Ratification of Auditor</td>
<td>2,783</td>
<td>2,716</td>
<td>−2.4%</td>
</tr>
<tr>
<td>Advisory Vote on Executive Compensation</td>
<td>2,156</td>
<td>2,083</td>
<td>−3.4%</td>
</tr>
<tr>
<td>Equity Compensation Plan</td>
<td>1,254</td>
<td>1,301</td>
<td>3.7%</td>
</tr>
<tr>
<td>Proxy Access</td>
<td>90</td>
<td>82</td>
<td>−8.9%</td>
</tr>
<tr>
<td>Political Activities</td>
<td>71</td>
<td>76</td>
<td>7.0%</td>
</tr>
<tr>
<td>Environment</td>
<td>86</td>
<td>87</td>
<td>1.2%</td>
</tr>
</tbody>
</table>
Shareholder proposals related to political activities increased slightly while the number of environmental-related proposals remained relatively similar to the previous year. Shareholders have been requesting more information on political spending and lobbying activities from companies since the U.S. Supreme Court decision *Citizens United v. Federal Election Commission* allowed independent political expenditures by corporations. In response, more companies have increased their disclosure of political and lobbying expenditures. The number of environmental-related proposals remained relatively unchanged compared to 2015, although fossil fuel and sustainability risks continued to remain a high concern for shareholders. Shareholders also continued to maintain an interest in climate change, greenhouse gas emission reduction and reporting, energy efficiency and renewables, sustainability reporting, and the formation of an environmental or social committee.

The chart below summarizes the type and volume of the major shareholder proposals staff voted on in 2016.
In 2016, staff voted on 51,442 proposals at 4,812 meetings held by companies in our non-domestic Equity Portfolio. Compared to 2015, the number of proposals and meetings was 1.1 percent and 1.6 percent lower, respectively. The proposals covered a variety of topics, including the election of directors, appointment of company auditors, ratification of compensation reports, approval of executive and director compensation plans, mergers and acquisitions, and shareholder proposals. Shareholder proposals are not as common outside the U.S. since these proposals are mostly a North American practice, with the vast majority of shareholder proposals submitted to U.S. and Canadian corporations.

The following chart shows the number of meeting votes per region.

**Summary of Meeting Votes By Region**

**Total: 7,818**

- Canada & U.S., 3369
- Middle East & North Africa, 167
- Asia ex-Japan, 830
- Europe, 1507
- Japan, 1137
- Latin America & Caribbean, 496
- Africa, 68
- Australia, 244
The following table shows the top issues voted in 2016 by volume.

<table>
<thead>
<tr>
<th>Top Issues by Volume</th>
<th>For</th>
<th>Against</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors</td>
<td>4,834</td>
<td>17,277</td>
<td>22,111</td>
</tr>
<tr>
<td>Auditor Ratification/Audit Issues</td>
<td>2,146</td>
<td>715</td>
<td>2,861</td>
</tr>
<tr>
<td>Compensation</td>
<td>2,592</td>
<td>1,006</td>
<td>3,598</td>
</tr>
<tr>
<td>Advisory Vote on Exec. Comp./Comp. Policy</td>
<td>1,292</td>
<td>390</td>
<td>1,682</td>
</tr>
<tr>
<td>Mergers and Acquisitions</td>
<td>345</td>
<td>25</td>
<td>370</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11,209</strong></td>
<td><strong>19,413</strong></td>
<td><strong>30,622</strong></td>
</tr>
</tbody>
</table>

Two notable observations are evident between CalSTRS’ domestic and global proxy voting. First, our support level for directors in director elections between our domestic and global votes. In 2016, we had a low support level of 22 percent for directors at public companies in global markets compared to the 68 percent in domestic markets, which was primarily due to the applied director independence standards outlined in the *CalSTRS Corporate Governance Principles*. Second, in global markets, we had a lower level of support for shareholder proposals. We supported 70 percent of shareholder proposals in the U.S. compared to 14 percent in the global markets. The lower support level is primarily due to the fact that shareholder proposals in the global markets are often overly prescriptive or mandatory, rather than being advisory.
The following table shows the summary of votes versus management by major voting category.

**Table: 2016 Summary of Votes Versus Management by Category**

<table>
<thead>
<tr>
<th>Category</th>
<th>Domestic Votes Cast</th>
<th></th>
<th>Global Votes Cast</th>
<th></th>
<th>2016 Total Votes Cast</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% With Mgmt</td>
<td>% Against Mgmt</td>
<td>% With Mgmt</td>
<td>% Against Mgmt</td>
<td>% With Mgmt</td>
<td>% Against Mgmt</td>
</tr>
<tr>
<td>Audit/Financials</td>
<td>91%</td>
<td>9%</td>
<td>89%</td>
<td>11%</td>
<td>89%</td>
<td>11%</td>
</tr>
<tr>
<td>Board Related</td>
<td>67%</td>
<td>33%</td>
<td>30%</td>
<td>70%</td>
<td>44%</td>
<td>56%</td>
</tr>
<tr>
<td>Capital Management</td>
<td>53%</td>
<td>47%</td>
<td>76%</td>
<td>24%</td>
<td>75%</td>
<td>25%</td>
</tr>
<tr>
<td>Changes to Company Statutes</td>
<td>82%</td>
<td>18%</td>
<td>56%</td>
<td>44%</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>Compensation</td>
<td>80%</td>
<td>20%</td>
<td>74%</td>
<td>26%</td>
<td>76%</td>
<td>24%</td>
</tr>
<tr>
<td>Mergers and Acquisitions</td>
<td>96%</td>
<td>5%</td>
<td>94%</td>
<td>6%</td>
<td>95%</td>
<td>5%</td>
</tr>
<tr>
<td>Meeting Administration</td>
<td>0%</td>
<td>100%</td>
<td>91%</td>
<td>9%</td>
<td>78%</td>
<td>22%</td>
</tr>
<tr>
<td>Other Issues</td>
<td>0%</td>
<td>0%</td>
<td>95%</td>
<td>5%</td>
<td>95%</td>
<td>5%</td>
</tr>
<tr>
<td>Compensation SHP</td>
<td>40%</td>
<td>60%</td>
<td>50%</td>
<td>50%</td>
<td>41%</td>
<td>59%</td>
</tr>
<tr>
<td>Environment SHP</td>
<td>54%</td>
<td>46%</td>
<td>100%</td>
<td>0%</td>
<td>63%</td>
<td>37%</td>
</tr>
<tr>
<td>Governance SHP</td>
<td>7%</td>
<td>93%</td>
<td>80%</td>
<td>20%</td>
<td>38%</td>
<td>62%</td>
</tr>
<tr>
<td>Social SHP</td>
<td>55%</td>
<td>45%</td>
<td>77%</td>
<td>23%</td>
<td>59%</td>
<td>41%</td>
</tr>
<tr>
<td>Misc SHP</td>
<td>81%</td>
<td>19%</td>
<td>0%</td>
<td>0%</td>
<td>81%</td>
<td>19%</td>
</tr>
<tr>
<td>Total SHP</td>
<td>33%</td>
<td>67%</td>
<td>52%</td>
<td>48%</td>
<td>47%</td>
<td>53%</td>
</tr>
</tbody>
</table>

SHP = Shareholder proposal
Staff continues to monitor the portfolio and vote all proxies in accordance with our Corporate Governance Principles. Additionally, staff continues to keep abreast of governance, proxy voting and 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. Some of those events are highlighted below.

**Broadridge—The Independent Steering Committee**

CalSTRS has served on the Independent Steering Committee of Broadridge since its creation in 1993. The committee serves as an independent oversight body charged with monitoring the performance, voting accuracy and readiness of Broadridge and its predecessor firm in conducting the U.S. street name proxy system on behalf of the nation’s banks and brokers. The committee was organized from within the securities industry with the encouragement of the SEC and consists exclusively of persons who are neither current nor former employees of Broadridge. The members represent the four industry groups involved in the proxy process: issuers, institutional investors, brokers and custodian banks. CalSTRS represents the views of institutional investors in the proxy voting process by attending committee meetings and by meeting with the SEC and exchanges.

**Broadridge Roundtable Forum**

Staff attended the Broadridge Roundtable Forum, which provided a platform for an interactive discussion between speakers and attendees on various topics, including the upcoming proxy season, corporate governance trends, engagement between issuers and investors, a regulatory update, and board director risks and challenges.

**Equilar Compensation Forum**

Twice a year Equilar, in conjunction with the Nasdaq Entrepreneurial Center, hosts forums dedicated to discussing governance issues. Attendees of these events include corporate directors, institutional investors, corporate management and consultants. This year’s forums focused on board leadership and executive compensation. Staff participated on panels for both forums, discussing CalSTRS’ views on a variety of governance topics.

**National Association of Corporate Directors**

The National Association of Corporate Directors conducts advisory council meetings. Delegates of the advisory councils are committee chairs of publicly traded companies. This past year, staff spoke at the NACD Compensation Committee Chair Advisory Council. Staff provided CalSTRS’ perspective on compensation plans and how we, as an institutional investor, review compensation plans for proxy voting.
PORTFOLIO MANAGEMENT
CalSTRS believes that good governance contributes to better long-term, sustainable performance. To capitalize on this outperformance, CalSTRS 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, we gain additional alpha by making large investments in certain companies. Additionally, as the activist managers improve the governance and performance of their holdings, we enjoy the added benefits of holding better performing and better governed companies in our indexed portfolios.

The table below shows the CalSTRS Corporate Governance Activist Portfolio as of December 31, 2016.

<table>
<thead>
<tr>
<th>Partnership Initiated</th>
<th>Market Cap</th>
<th>Geography</th>
<th>Net Asset Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Mountain Capital</td>
<td>December 2008</td>
<td>Mid to Large Cap</td>
<td>North America</td>
</tr>
<tr>
<td>Trian Partners</td>
<td>April 2011</td>
<td>Large Cap</td>
<td>North America</td>
</tr>
<tr>
<td>Blue Harbour Group</td>
<td>November 2011</td>
<td>Small to Mid Cap</td>
<td>North America</td>
</tr>
<tr>
<td>Cartica</td>
<td>November 2013</td>
<td>Small Cap</td>
<td>Emerging Markets</td>
</tr>
<tr>
<td>Legion Partners</td>
<td>January 2014</td>
<td>Small Cap</td>
<td>North America</td>
</tr>
<tr>
<td>Knight Vinke</td>
<td>March 2010</td>
<td>Large Cap</td>
<td>Europe</td>
</tr>
<tr>
<td>Starboard Value</td>
<td>March 2013</td>
<td>Small Cap</td>
<td>North America</td>
</tr>
<tr>
<td>Red Mountain</td>
<td>February 2015</td>
<td>Small Cap</td>
<td>North America</td>
</tr>
</tbody>
</table>
We made our first investment with an activist manager in June 2004. Since then, the CalSTRS Corporate Governance activist manager program has expanded and grown to over $3.2 billion in current assets under management. Since 2004, the strategy of activist managers also evolved, and today there are many different types of activists. Some prefer quiet, behind the scenes engagement while others may escalate their engagement activities to include the use of the media or proxy contests.

Activists are sometimes criticized in the media for being short-term focused. For the CalSTRS Corporate Governance activist managers, this accusation could not be further from the truth. On average, most of our activist managers’ investments are held for three years or more. In fact, some of these holdings can extend to five or more years if the activist manager is actively engaged with the company. Before hiring a new activist manager, CalSTRS staff spends an extraordinary amount of time performing due diligence to ensure we hire activist managers that are capable of helping companies become better-performing and better-governed for the long term.

In addition to having partnerships with our activist managers, CalSTRS periodically participates in co-investments alongside them. These co-investments allow us to increase our exposure to our activist managers’ highest conviction investments and reduce our overall management fees.

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 activist managers’ engagement efforts are recognized by the market.

We made our first investment with an activist manager in June 2004. Since then, the CalSTRS Corporate Governance activist manager program has expanded and grown to over $3.2 billion in current assets under management.
The following chart shows the performance of the CalSTRS U.S. Activist Portfolio since 2008. The volatility of this portfolio is evident in the wide range of performance from year to year.

**U.S. Activist Portfolio**

![Performance Chart for U.S. Activist Portfolio]

The following chart shows the performance of the CalSTRS Non-U.S. Activist Portfolio since 2009.

**Non-U.S. Activist Portfolio**

![Performance Chart for Non-U.S. Activist Portfolio]
Corporate Governance staff has managed the Public Equity Sustainable Manager Portfolio since July 2015. This investment strategy seeks external public equity managers who 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 because it aligns with the broad sustainability integration efforts 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, 2016, there were two managers in the Sustainable Portfolio: Generation Investment Management LLP and AGF Investments America Inc.

Generation Investment Management LLP

Generation Investment Management LLP is one of CalSTRS’ non-U.S. sustainability managers. Generation was established in April 2004. Former Vice President Al Gore, co-founder and chairman, has long been a leading advocate for confronting the threat of global warming. David Blood is a senior partner and previously served as CEO of Goldman Sachs Asset Management. Mr. Blood’s current role is focused on Generation’s commitment to long-term investing and integrated sustainability research.

Generation uses a global investment strategy to identify public equity companies that fit its concept of sustainable investments. Generation believes investment results for equity strategies are maximized by taking a long-term investment horizon. Furthermore, it believes that sustainability issues can impact a company’s ability to generate returns and therefore must be fully integrated into its investment process, along with rigorous fundamental equity analysis, to achieve optimal long-term investment results. Generation uses the term “sustainability research” as the analysis of shareholder value implications of long-term environmental as well as economic, social and geopolitical challenges.

Linear Technology

Linear Technology Corporation is a Generation portfolio company. For the past three decades, Linear Technology, an S&P 500 company, has designed, manufactured and marketed a broad line of high performance analog-integrated circuits for major companies worldwide. The company’s products provide an essential bridge between analog and digital electronics in most sectors and industries.

As today’s electronic designs continue to grow in complexity, managing power consumption and optimizing overall efficiency become even more important. Accurate power supply voltage and current monitoring is crucial to conserving power and guaranteeing reliability in.
everything from industrial and telecom applications to automotive and consumer electronics.

Measuring power consumption and optimizing overall efficiency can be challenging. Linear Technology’s products provide solutions to these challenges. There is an increasing market for low-power electronic devices located in remote locations away from the power grid. Ideally, the power for these devices should be generated on-site using renewable energy sources such as solar power. Converting this solar energy into electrical energy is easily done using Linear Technology’s products, which allow for the extraction of maximum power from a solar cell under varying sunlight conditions.

During 2016, Linear Technology was a strong performer, with a positive 46 percent return.

AGF Investments America Inc.

AGF Investments America Inc., also a CalSTRS non-U.S. sustainability manager, is a global equity manager that invests in securities that fit its proprietary environmental concept of sustainable development to meet its sustainable global equity strategy. AGF believes that companies focused on innovative products and services that use resources more efficiently are being increasingly rewarded by investors. AGF’s investment strategy employs thorough due diligence on company fundamentals and emphasizes companies with viable business models derived from sustainable competitive advantages. The portfolio focuses on four themes within which market-relevant subthemes are identified. The four themes are energy and energy efficiency, water and waste water solutions, waste management and pollution control, and environmental, health and safety. The portfolio contains early-stage to mature-stage companies.

AGF is a pioneer in sustainable development investment in Canada, having launched the AGF Clean Environment Fund in 1991. Martin Grosskopf, the portfolio manager for this strategy, is responsible for sustainable investing at AGF and has more than 20 years of experience in financial and environmental analysis. His prior experience includes work as an environmental scientist at Acres International Limited.

Acuity Brands

Acuity Brands is an AGF portfolio company. It is a provider of lighting solutions for commercial, institutional, industrial, infrastructure and residential applications throughout North America and select international markets. The company’s lighting solutions include devices such as luminaires, lighting controls, power supplies, prismatic skylights, LED lamps, and integrated lighting systems for indoor and outdoor applications using a combination of

City of Elk Grove, California
software-controlled light sources. Acuity Brands has operations throughout North America, Europe and Asia.

One of Acuity Brands’ customers is Elk Grove, the second largest city in Sacramento County and located just south of CalSTRS headquarters. Elk Grove purchased more than 9,800 LED luminaires from Acuity Brands’ American Electric Lighting to replace high pressure sodium fixtures and achieve energy savings of 60 to 70 percent. The LED system is expected to operate 20 years without maintenance compared to five to seven years for the HPS units. Combined energy and maintenance savings are estimated at $400,000 annually. The city invested $3 million to purchase the LED system and an additional $500,000 to install it, which translates into a payback of approximately nine years.

Acuity Brands has enjoyed strong long-term performance. The company returned more than 109 percent over a three-year period.

The following chart shows the performance of the CalSTRS Sustainable Portfolio since 2008.

Our sustainability managers are mandated with a “double-bottom line” goal, which includes both a dedication to sustainable investing as well as competitive returns. Evaluating these managers on traditional benchmarks is problematic because these mandates intentionally overweight sustainable stocks which may face short-term headwinds. While this mismatch is noted, these managers are expected to contribute to the excess return target over the policy benchmarks in the long term.
In 2016, the Corporate Governance Unit began the search process for public equity investment managers with an environmental, social and governance focus. CalSTRS intends to award up to six new ESG investment management firms for the Sustainable Portfolio.

The deadline for investment firms to be considered was in October 2016. Corporate Governance staff will be conducting interviews with a number of investment firms during 2017. To qualify for consideration, managers must:

- Be a registered investment advisor, bank, insurance company or trust company.
- Have run an ESG or corporate governance-focused public equity trading strategy for at least two years.
- Currently have at least $100 million in managed assets in an ESG or corporate governance-focused public equity strategy.
- Currently have at least $225 million in total assets under management.
- Currently have fund information in the U.S. ESG or non-U.S. ESG universe within the eVestment database.

The following table shows the CalSTRS Sustainable Portfolio as of December 31, 2016.

<table>
<thead>
<tr>
<th>Funded</th>
<th>Market Cap</th>
<th>Geography</th>
<th>Net Asset Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Generation Investment Management</td>
<td>June 2007</td>
<td>All Cap</td>
<td>World</td>
</tr>
<tr>
<td>AGF Investments America</td>
<td>August 2007</td>
<td>All Cap</td>
<td>World</td>
</tr>
</tbody>
</table>
LEGAL, REGULATORY AND LEGISLATIVE SUPPORT
The long-term nature of CalSTRS’ liabilities, our overall stewardship of the Teachers’ Retirement Fund and the Teachers’ Retirement Board’s fiduciary responsibility to members makes us keenly interested in the rules and regulations that govern the securities markets in the U.S. and globally.

CalSTRS has a vested interest in ensuring shareholder protections are safeguarded within the rules and regulations of the U.S. and global securities markets. We believe responding to proposed legislation and regulation allows us to proactively engage policymakers and possibly provide some influence on rules and regulations that may impact our investments and, in turn, our overall assets. One of our major priorities in 2016 was to increase our activities around monitoring, reviewing and responding to various legislative, regulatory and industry bodies, including the SEC, Public Company Accounting Oversight Board, International Auditing and Assurance Standards Board, Taiwan Stock Exchange, Nasdaq, and the Bundestag, Germany’s parliament.

In 2016, we filed 15 letters with various regulatory bodies to advocate for issues, including improved transparency in financial reporting, the importance of stewardship codes both at the global and local market level, improvements to global governance codes, and opposition to federal legislation that would diminish shareholder rights. Our letters addressed various regulatory issues that impacted CalSTRS as an investor on behalf of our beneficiaries or improved market best practices. For example, we believe auditors are the gatekeepers to the integrity of financial reporting. Auditors provide an important opinion on a company’s financial statements’ reliability and a reasonable assurance that the statements are presented fairly, in all material respects, and conform with generally accepted
accounting principles. CalSTRS provided comments to the PCAOB, encouraging it to expeditiously adopt the re-proposed final standard on the expanded auditor’s report. As a long-term investor, we believe the expanded auditor’s report should focus on financial reporting risk. Most significantly, the report should focus on the extent to which improper, fraudulent or inadequate financial reporting relates to GAAP or to disclosures outside of the financial statements, as these may have played a role in the 2008 financial crisis.

A key highlight in 2016 was CalSTRS’ comment letter to the SEC regarding its concept release of Regulation S-K. Regulation S-K would modernize certain business and financial disclosure requirements to investors. Our response made it clear that we expected the SEC to continue to prioritize the needs of investors as the underlying tenant and customer of any additions or changes to business and financial disclosures. We also emphasized the need for guidance that would ensure investors’ needs are met with improved and enhanced sustainability disclosures. The disclosures must provide environmental, social and governance data that is useful to a shareholder’s informed investment and voting decisions.

The table below is a chronological summary of the 2016 comment letters CalSTRS provided to various regulatory bodies.

<table>
<thead>
<tr>
<th>Regulatory Agency</th>
<th>Regulatory Comment Letter Description</th>
<th>Submission Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taiwan Stock Exchange</td>
<td>Consultation document for Stewardship Principles for Institutional Investors.</td>
<td>February 2016</td>
</tr>
<tr>
<td>Nasdaq</td>
<td>Soliciting public comments about whether and how to update and improve its shareholder approval rules.</td>
<td>February 2016</td>
</tr>
<tr>
<td>SEC</td>
<td>Support for market alternative, establishing the Investors’ Exchange LLC (IEX).</td>
<td>March 2016</td>
</tr>
<tr>
<td>SEC</td>
<td>Proposed Rule: Transfer Agent Regulations—Proxy Tabulator, End to End Vote Confirmation, Non-Objective Beneficial Owners &amp; Objective Beneficial Owners and Bank and Broker Dealer Record keeping and Registration.</td>
<td>April 2016</td>
</tr>
<tr>
<td>Regulatory Agency</td>
<td>Regulatory Comment Letter Description</td>
<td>Submission Date</td>
</tr>
<tr>
<td>-----------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>IAASB</td>
<td>IAASB Overview Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits.</td>
<td>May 2016</td>
</tr>
<tr>
<td>House Committee on Financial Services</td>
<td>HR 5311, which aims to tighten regulation of proxy advisory firms to the detriment of investors.</td>
<td>June 2016</td>
</tr>
<tr>
<td>SEC</td>
<td>Ceres provided a sign-on letter to the SEC as it relates to climate-related disclosures required by Regulation S-K.</td>
<td>July 2016</td>
</tr>
<tr>
<td>SEC</td>
<td>Concept release to seek public comment on modernizing certain business and financial disclosure requirements in Regulation S-K. Prioritize the needs of investors, guidance that ensures investors’ needs are met with improved and enhanced sustainability disclosures that provide decision useful environmental, social and governance data that is critical to informed investment and voting decisions.</td>
<td>July 2016</td>
</tr>
<tr>
<td>PCAOB</td>
<td>The Auditor’s Report on an audit of financial statements when the auditor expresses an unqualified opinion—critical project to make the auditor’s report more relevant and informative.</td>
<td>August 2016</td>
</tr>
<tr>
<td>SEC</td>
<td>Disclosure Update and Simplification—proposing amendments to disclosure requirements that may have become redundant, duplicative, overlapping or superseded with changes in U.S. GAAP, IFRS or Commission disclosure requirements.</td>
<td>October 2016</td>
</tr>
<tr>
<td>Regierungscommission German Commission</td>
<td>Consultation regarding the proposed amendments to the German Corporate Governance Code 2017.</td>
<td>December 2016</td>
</tr>
</tbody>
</table>
Staff also continued to provide advocacy on various regulatory issues in the U.S. and global financial markets. Below are some examples that highlight CalSTRS’ advocacy on regulatory issues in 2016.

**The Conference Board Governance Center**

The Conference Board Governance Center brought together a group of leaders within the corporate governance community for a roundtable on the topic of universal proxy cards, in light of the SEC proposed rule calling for universal proxy cards in contested elections. Staff participated at the roundtable. As a result, a research paper was published that presented myriad issues surrounding universal proxy and some alternatives. CalSTRS is a strong proponent of the concept of universal proxy cards, believing the current system disenfranchises shareholders from being able to select the best candidates for board elections.

**Japanese Financial Services Agency**

In 2016, staff made a presentation to the Japanese Financial Services Agency that discussed CalSTRS’ approach to corporate governance integration and our support for the stewardship and corporate governance codes that have been introduced in that country. Following the presentation, staff answered questions from FSA and Japanese equity market participants. Questions focused on how CalSTRS considers specific elements of the stewardship and governance codes and how the codes might be improved.

**SEC Investor Advisory Committee**

The SEC Investor Advisory Committee was created pursuant to Dodd-Frank to advise the commission on regulatory priorities and initiatives to protect investor interests, and to promote investor confidence and the integrity of the securities marketplace. CalSTRS Director of Corporate Governance Anne Sheehan serves as the vice chair of the IAC. In 2016, the advisory committee issued two recommendations to the SEC:

1. The SEC should take steps to improve mutual fund costs disclosures.
2. The SEC should enhance information disclosure for bond market investors, especially retail investors.

The committee also provided a comment letter to the SEC on its Concept Release on Disclosure Effectiveness and held a session on the state of sustainability reporting.
CalSTRS can participate in class action litigation either as a lead plaintiff or as a class member through the settlement process. In most domestic cases, CalSTRS’ interests in securities class action litigation claims are adequately addressed solely through passive participation as a class member. Corporate Governance staff is responsible for ensuring that proofs of claims on securities litigation that we participate in are filed timely and damages are recovered from our claim filings. Staff uses Financial Recovery Technologies to assist with the filing and monitoring of those securities class action claims. FRT identifies and submits the securities litigation claim filings on behalf of CalSTRS and monitors those filings until the disbursed funds are received from the claims administrators.

In 2016, CalSTRS filed securities class action claims on 96 cases and recovered damages totaling more than $9.7 million from filings made in the previous years.

The chart below shows the historical damage recovery amount for the past five years.
The Legislative Analysis Team is a group of individuals from each branch within CalSTRS that meet every two weeks to discuss legislative developments in the California Legislature, analyze bills of interest, prepare board agenda items and consider sponsoring legislation on behalf of CalSTRS.

During 2016 and years prior, Corporate Governance staff represented the Investments Branch at the LAT meetings and provided initial analysis of 15 bills to determine whether the Investments Branch would be impacted if such bills were to pass. Staff initiated and led the development of comprehensive impact analysis reports in instances where it was determined the bills would impact us. These reports were then included in the CalSTRS Governmental Relations’ presentation to the Teachers’ Retirement Board.

Staff also provided additional legislative support by meeting with legislative aides to discuss potential issues surrounding certain legislation, such as Assembly Bill 2283, which would require the board to evaluate and ensure that investments in securitized home rental properties meet certain requirements and are consistent with their fiduciary duties.

In addition to monitoring state legislation, staff tracks legislation at the federal level and provides comments on legislation that would impact the Investment portfolio. During 2016, staff provided comments on two pieces of legislation. HR 5424, the Investment Advisors Modernization Act, purported to modernize certain regulatory requirements related to private equity advisors. However, the legislation actually would have rolled back the important investor protections provided to funds, in terms of transparency and oversight by the SEC.

Staff also wrote to members of the California congressional delegation expressing our opposition to HR 5983, the Financial CHOICE Act. While the legislation purported to lift the regulatory burden on financial institutions, it actually eliminated important shareholder rights, allowed for riskier public companies and decimated the SEC’s ability to protect investors.

These bills were not enacted in 2016 but staff will continue to monitor developments in Congress that could impact our rights as shareholders.
LEADERSHIP AND PROMOTING BEST PRACTICES
CalSTRS’ Corporate Governance Unit is primarily focused on mitigating governance and sustainability risk for our investments and positioning our Corporate Governance Portfolio to produce above-market investment returns. We strive to be a global governance leader and a source of innovation and collaboration on governance and sustainability issues. In 2016, Corporate Governance staff continued to provide leadership and promote best practices on the key governance and sustainability issues discussed in this report.

CalSTRS believes that established best practices guidelines may help define a middle ground approach in our discussion with companies and avoid adversarial engagements. We also believe that best practices guidelines may help establish benchmarks and standardizations, and work to identify corporate and investor policies and practices that fall substantially outside the established guidelines.

The Corporate Governance Principles, updated in 2016, and Best Practices in Board Composition, issued in 2015, represent our efforts at establishing best practices guidelines. We believe that increased development and distribution of best practices guidelines may potentially lead to corporate governance analysis becoming less proprietary in nature, reduce the influence that outside firms such as proxy advisory services have, and lower the costs associated with governance analysis and engagement.

Corporate Governance staff attended a number of events in 2016 where we provided leadership on and promoted best practices on a variety of governance and sustainability issues. Those events include:

American College of Governance Counsel

Staff participated in a session sponsored by the American College of Governance Counsel to explore the concept of tenured voting rights. Under a tenured voting system, long-term shareholders, like CalSTRS, would enjoy more voting rights due to our long tenure as a shareholder. Proponents of
the concept believe it would serve a number of purposes. First, it will help break the short termism rampant in today’s capital markets, encouraging long-term holdings. Second, it will serve as a better alternative to the growing dual class share structure adopted by some new IPOs. However, while CalSTRS is a strong and vocal opponent of dual class structure, we do not believe, as some proponents do, that tenured voting is the solution. We believe tenured voting disenfranchises certain shareholders at the expense of others. CalSTRS remains firm in our belief of a one share-one vote structure as the best governance voting structure for public companies.

**Annual Stanford Directors’ College**

Staff participated on the opening panel of the 2016 Stanford Law School’s Directors’ College, which brought together corporate directors, corporate executives, institutional investors and academics to discuss the latest topics and trends in board governance. In addition to the opening panel, staff spoke at the dinner keynote event. Staff interviewed Nelson Peltz, chief executive officer and founding partner of Trian Partners, on the Trian philosophy for investing and why Trian prefers the term “highly engaged shareholder” over “activist.”

**Boardroom Resources—Inside America’s Boardrooms**

Boardroom Resources LLC is a consulting, education and media company that works with boards of directors to improve their effectiveness and efforts to grow their corporations, enhance bottom-line performance and build positive shareholder relations. Boardroom Resources produces a board informational webshow, “Inside America’s Boardrooms,” which tackles board and governance challenges, trends and best practices. TK Kerstetter, founder of Boardroom Resources, interviewed staff and two other large institutional investors for one of its episodes that aired in October 2016.

**Ceres Conference 2016**

Staff attended Ceres Conference 2016. Ceres is a nonprofit organization advocating for sustainability leadership. Ceres mobilizes a powerful network of investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices and solutions to build a healthy global economy. CalSTRS CEO Jack Ehnes serves on the Ceres board. CalSTRS provides leadership with Ceres on engagement efforts addressing sustainability.

**Clayman Institute for Gender Research**

Clayman Institute for Gender Research at Stanford University contributes to the development of greater gender equity. CalSTRS is a member of the Corporate Program, which brings together top academics and senior executives who advance women’s opportunities within their organizations. Staff attended a quarterly meeting discussing ways to create a more level playing field where diverse talent can innovate and excel. In addition, staff participated as a panelist on the topic “Leveraging Activists & Outside Change Agents for Change” and shared our current initiatives to improve board diversity and engage companies in their efforts to ensure diversity in the C-suite and staff pipeline.

**The Conference Board Governance Center**

The Conference Board Governance Center brought together a group of leaders within the corporate governance community for a roundtable on the topic
of universal proxy cards in light of the SEC proposed rule calling for universal proxy cards in contested elections. Staff participated at the roundtable, which resulted in the publication of a research paper presenting myriad issues surrounding the universal proxy as well as some alternatives. CalSTRS is a strong proponent of the concept of universal proxy cards, believing the current system disenfranchises shareholders from being able to select the best candidates for board elections.

**Corporate Directors Forum**

Staff attended a 2016 Corporate Directors Forum event that provided a dialogue between institutional investors, directors, management and regulators. Staff participated on panels and continues to support the event by cochairing it. Keynote speakers included Ed Garden, chief investment officer and founding partner of Trian Partners; Carol B. Tome, CFO & EVP of Home Depot; and Andrew J. Ceresney, then SEC’s director of the Division of Enforcement.

**Council of Institutional Investors**

The Council of Institutional Investors holds two conferences each year for investors, public pension funds, union employee benefit funds and company representatives to come together to learn, share perspectives and advocate. The attendees heard from presenters on a range of topics, including corporate allocation strategies, role of the audit and broadening the definition of risk. CalSTRS is an active and highly engaged member of CII. Portfolio Manager Aeisha Mastagni is serving her second term on its board of directors.

**Harvard Roundtable on Corporate Governance**

Staff participated in the 2016 Harvard Roundtable on Corporate Governance. Attendees included shareholders, corporate secretaries, securities lawyers and governance consultants who discussed a number of topics in the corporate governance field. This year’s seminar included topics such as proxy access, ESG integration, proxy voting and majority voting.

**International Corporate Governance Network**

In 2016, CalSTRS co-hosted the International Corporate Governance Network Annual Conference with CalPERS. The conference brought together governance professionals and investors from across the globe and addressed topical issues such as Silicon Valley governance, accelerating board diversity and integrating ESG into investment decisions. CalSTRS CEO Jack Ehnes provided one of the opening plenary speeches discussing policy trends in California. As co-hosts of the conference, CalSTRS staff helped plan the conference program and participated as panelists.

**Society for Corporate Governance**

The Society for Corporate Governance is an organization composed of mainly corporate secretaries and business executives in governance, ethics and compliance functions at public, private and not-for-profit organizations. The society’s 2016 national conference was titled “Reaching New Heights: Looking Back, Moving Forward.” Staff participated in multiple events and panels at the national conference.

At the Society for Corporate Governance’s Northeastern Regional Fall Conference, CalSTRS staff participated in the panel, “Firsthand Discussion with an Influential Investor.” Staff interviewed Ed Garden, chief investment officer of Trian Partners and had a lively discussion about activism in today’s market and the “Trian style” of investing.
Program Description

The Corporate Governance Program:

- Was established in 1978 to protect assets through good governance and operational accountability.

- Includes portfolio company engagements, proxy voting, portfolio management, and support on legal, regulatory and legislative matters.

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

- Includes two sustainability managers that seek to integrate environmental, social and governance factors in their portfolio company selection process to achieve financial outperformance.

- Has Russell 3000 and MSCI ACWI Ex-US as the Activist Portfolio benchmark and MSCI World Custom as the Sustainable Portfolio benchmark.
2016 Statistical Summary of CalSTRS’ Governance Collaboration

Each year staff participates in a number of events to provide leadership and communicate CalSTRS’ perspectives on topics such as diversity, governance best practices, market best practices, regulatory issues and sustainability. Staff demonstrated leadership on issues related to regulatory or market best practices as a member or board member, and by attending board meetings at the Council of Institutional Investors and the SEC.

In 2016, staff represented CalSTRS at 16 events to provide leadership on pertinent issues in the governance arena and financial markets. We participated in an additional 60 events in which staff members were panelists or speakers and shared our perspective on these issues.

Corporate Governance staff stays abreast of diversity, regulatory, portfolio management and other governance issues by attending educational events, including conferences, roundtables and forums. In 2016, staff attended 22 educational events on issues pertinent to the Corporate Governance Unit.

The table below shows the many issues at the approximate 100 leadership, speaking and educational events that staff participated in or attended during 2016. Most of the issues related to governance best practices, market best practices, sustainability and diversity.
2016 Statistical Summary of Off-Site Due Diligence Activities

Corporate Governance staff periodically conducts off-site due diligence to effectively manage the Corporate Governance Portfolio. Our off-site due diligence activities include visiting and having in-depth discussions with the activist managers and sustainability managers in our Corporate Governance Activist and Sustainable portfolios regarding the firm’s fund performance, portfolio holdings, management personnel changes and other relevant issues. Staff also performs due diligence on potential governance and sustainability managers to add to the Corporate Governance Portfolio. Staff considers conducting due diligence on other investment issues that may impact CalSTRS’ investments, such as divestment, to be important and necessary. In 2016, staff performed 18 off-site due diligence activities related to our Corporate Governance Portfolio or other investment issues.

2016 Statistical Summary of On-Site Company Engagement Efforts

While at conferences or forums, staff is open to meeting and having private dialogues with our portfolio companies and others to discuss issues related to governance best practices. However, most of our private dialogues with our portfolio companies occur at our headquarters. In 2016, staff held approximately 150 in-person meetings or teleconferences with our portfolio companies to discuss compensation, sustainability, diversity, proxy or other governance issues.
## Corporate Governance Investment Team

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Areas of Focus</th>
<th>Joined CalSTRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anne Sheehan</td>
<td>Director</td>
<td>Director</td>
<td>2008</td>
</tr>
<tr>
<td>Aeisha Mastagni</td>
<td>Portfolio Manager</td>
<td>Activist Mgrs. &amp; Executive Compensation</td>
<td>2009</td>
</tr>
<tr>
<td>Brian Rice</td>
<td>Portfolio Manager</td>
<td>Sustainability Mgrs. &amp; Sustainability</td>
<td>2003</td>
</tr>
<tr>
<td>Philip Larrieu</td>
<td>Associate Portfolio Manager</td>
<td>Activist Mgrs. &amp; Geopolitical Issues</td>
<td>2005</td>
</tr>
<tr>
<td>Daniel Bain</td>
<td>Investment Officer</td>
<td>Proxy Voting</td>
<td>2016</td>
</tr>
<tr>
<td>Douglas Chen</td>
<td>Investment Officer</td>
<td>Executive Compensation</td>
<td>2016</td>
</tr>
<tr>
<td>Eric Kwong</td>
<td>Investment Officer</td>
<td>Operations &amp; Contracts</td>
<td>1989</td>
</tr>
<tr>
<td>Ly Van</td>
<td>Investment Officer</td>
<td>Proxy Voting &amp; Majority Vote</td>
<td>2007</td>
</tr>
<tr>
<td>Mary Hartman Morris</td>
<td>Investment Officer</td>
<td>Diversity &amp; Regulatory</td>
<td>2016</td>
</tr>
<tr>
<td>Travis Antoniono</td>
<td>Investment Officer</td>
<td>Sustainability</td>
<td>2011</td>
</tr>
<tr>
<td>Kathleen Hawkins</td>
<td>Executive Assistant</td>
<td>Director Support</td>
<td>2009</td>
</tr>
<tr>
<td>Laurie Winston</td>
<td>Executive Assistant</td>
<td>Director Support</td>
<td>1998</td>
</tr>
</tbody>
</table>
CalSTRS Portfolio

Approximate value as of December 31, 2016: $196.6 billion

- Global Equity, 57.2%
- Fixed Income, 15.6%
- Real Estate, 12.5%
- Private Equity, 8.1%
- Cash, 3.2%
- Inflation Sensitive, 1.0%
- Absolute Return, 2.4%

Transparency and Public Information Requests

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