

# CALSTRS

---

CALIFORNIA STATE TEACHERS'  
RETIREMENT SYSTEM

**SUSTAINABLE INVESTMENT &  
STEWARDSHIP STRATEGIES  
PROGRAM AND  
PORTFOLIO POLICY**

**INVESTMENT BRANCH**

---

**July 2020**

# C. Sustainable Investment & Stewardship Strategies Program and Portfolio Policy<sup>1</sup>

## Stewardship Program Policy

### EXECUTIVE SUMMARY

The California State Teachers' Retirement System (CalSTRS) is committed to holding and managing equity investments and to exercising the shareholder rights appurtenant to those investments, all for the benefit of its participants and beneficiaries. It is the fiduciary responsibility of the Teachers' Retirement Board (TRB) to discharge its duty in the exclusive interest of the participants and beneficiaries and for the primary purpose of providing benefits to participants and their beneficiaries. The TRB should defray the reasonable expenses of administering the Fund; the investment policy of the Fund should reflect and reinforce this purpose. The TRB views its stewardship role as that of a catalyst for enhanced management accountability, disclosure and performance at the companies it invests in. The objective of the TRB's stewardship effort is to enhance long-term shareholder returns.

CalSTRS is a long-term investor; its long-term strategy is demonstrated through its multiple long-term holdings, including its passively managed portfolios in its three largest asset categories: Domestic Equities, Fixed Income, and non-U.S. Equities. CalSTRS' involvement in stewardship activities is to maximize the longer-term value of the securities, consistent with its role as a significant capital allocator.

CalSTRS recognizes that the lending of securities, especially equity common shares is an important practice in the investment world, improving market liquidity, reducing the risk of failed trades, and adds significant incremental return to investors. As a long-term investor, CalSTRS believes that its beneficiaries' interests are more appropriately served when votes are cast by market participants who have an economic interest in the underlying company. CalSTRS will seek to coordinate the lending process with all the parties, including the investment lending officers and the custodial relationships in its effort to ensure that under-voting or voting abuse is not suffered by the fund. It is understood that this effort will result in the recall of loaned shares and the restriction of lending certain

---

<sup>1</sup> Unless otherwise indicated all further references to Sustainable Investment & Stewardship Strategies (SISS) are to the Corporate Governance program established pursuant to Education Code, Section 22354. That section requires the Board retain investment managers who are experienced and knowledgeable in corporate management issues to monitor corporations whose shares are owned by the System plan and to advise the Board on the voting of the shares owned by the plan and on all other matters pertaining to corporate governance.

shares; all of which will diminish the income received from CalSTRS' securities lending efforts; however as fiduciaries with a long-term investment horizon, CalSTRS is committed to exercising its proxy authority over portfolio investments.

**Statutory Authority:** Education Code Section 22354 requires the Board to retain investment managers who are experienced and knowledgeable in corporate management issues to monitor corporations whose shares are owned by the System plan and to advise the Board on the voting of the shares owned by the plan and on all other matters pertaining to corporate governance. While CalSTRS is not subject to the Employee Retirement Income Security Act (ERISA), applicable provisions of both the California Constitution and the Education Code make clear that CalSTRS' commitment to corporate governance is a diligent exercise of its fiduciary responsibility. As observed by the U.S. Department of Labor:

*“In general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock. ... Moreover, because voting such proxies involves plan asset management, section 403(a) requires that plan trustees have the exclusive authority and responsibility for voting these proxies...”*

Thus, CalSTRS' legal authority for corporate governance springs from its fiduciary concerns as a prudent investor and the statutory obligation imposed on it by the Legislature.

The following represent the approved policies to be used in the exercise of CalSTRS' shareholder rights and the implementation of its Stewardship Program. The policies are designed to set boundaries for the management of proxies, stewardship activities, and other corporate actions. As with all other plan assets, the Sustainable Investment and Stewardship Strategies (Corporate Governance) Program and Portfolio Policy (SISS Policy) cannot be altered without explicit direction from the TRB.

## PROGRAM OBJECTIVE

The Program shall be a catalyst in transforming the financial markets to focus on long-term value creation that fully integrates sustainability considerations and uses CalSTRS' influence as a significant global investor to promote sustainable business practices and public policies.

## PROGRAM STRUCTURE

The Program shall consist of the following components:

- a. Voting of Proxies: CalSTRS will make a best effort to vote all domestic and non-U.S. proxies; exceptions may be made based on the legal requirements or local conventions of certain markets and where practical difficulties make an informed and meaningful decision impossible. Voting of proxies shall be in conformance with all approved documents such as the California State Teachers' Retirement System Corporate Governance Principles, which can be found on the CalSTRS website.

- b. Strategic Relations Management: CalSTRS will mitigate reputational risks, including those related to environmental, social, and governance issues, by managing relationships within the Investment Branch and with external stakeholders to promote the sustainability of the portfolio.
- c. Portfolio Company Engagement: CalSTRS will engage with portfolio companies to promote long-term value creation through sustainable business practices. CalSTRS will, time and circumstances permitting, partner with other institutional investors in an effort to maximize its corporate engagement efforts. In addition, CalSTRS will continue its active participation in organizations and forums designed to have an impact on environmental, social, and governance practices.
- d. Regulatory and Legislative Advocacy: CalSTRS will, upon the completion of sound analysis, advocate for the institution or repeal of laws and regulations to improve public policies and the financial and legal marketplace, relative to the stated Investment Management Plan and the exclusive benefit of the plan beneficiaries and participants.

## RISK MANAGEMENT

The Stewardship Program for the California State Teachers' Retirement System (CalSTRS) will be managed in a prudent manner for the sole benefit of the CalSTRS participants and beneficiaries, in accordance with the Teachers' Retirement Law and other applicable State statutes.

For domestic equities, the Program will comply with the rules of the Securities and Exchange Commission (SEC), equity exchanges, and other regulatory agencies. For non-U.S. equities, the Program will comply with the appropriate regulatory body in the respective country.

### **Delegation of Authority**

The Chief Investment Officer (CIO) or designee has the authority to manage the Stewardship Program and may use other investment personnel to implement these policies.

## MONITORING AND REPORTING

Updates on the following Stewardship activities will be prepared and presented to the Board, in order to facilitate visibility of compliance monitoring and reporting according to this document:

- i. Annual Sustainable Investment and Stewardship Strategies (SISS) Business Plan – prepared by staff
- ii. Annual Stewardship Plan: In the organization, prioritization and execution of the Stewardship Plan, including its engagement activities, staff shall consider the market value of the investment, CalSTRS' ownership percentage, priorities

identified in the annual SISS business plan, the resources required, and the direct cost involved in seeking a desired result.

Furthermore, staff will consider issues, for inclusion in the Annual Stewardship Plan, based on the following:

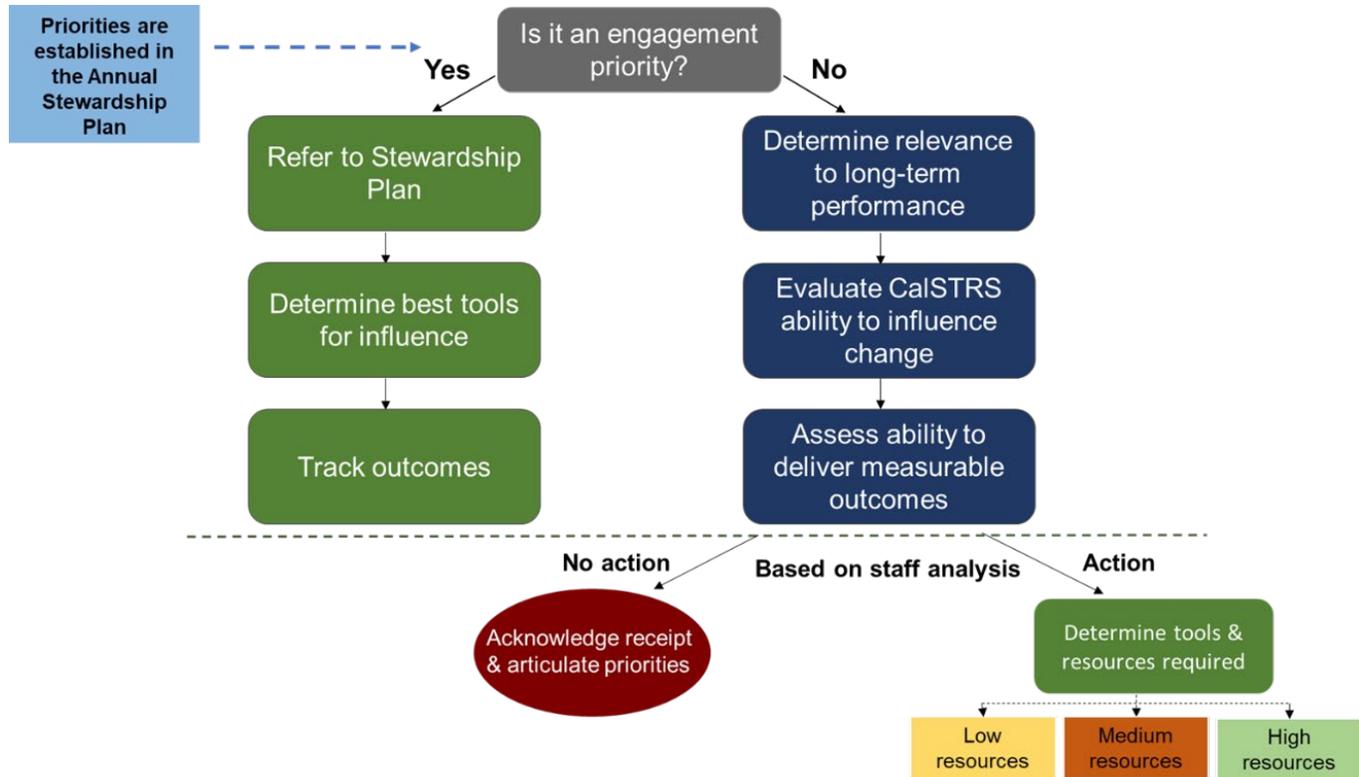
- The relevance to the long-term performance of the CalSTRS portfolio,
  - CalSTRS capacity to influence meaningful change based on the tools available to staff as shareholders and,
  - CalSTRS ability to deliver measurable outcomes.
- iii. Actions staff take as a liaison between the TRB and organizations dedicated to advancing good environmental, social and governance practices aligned with long-term value creation;
- iv. Developments in the environmental, social and governance area that may affect the value of securities held by CalSTRS;
- v. Participation by CalSTRS in securities litigation, consistent with the policy, in the event that a subject company's underperformance is related to matters that are or may become the subject of such litigation. Criteria for entering into litigation related to securities fraud and/or to accomplish the purposes of the policy, so long as these actions are consistent with the Investment Management Plan. Reports related to securities litigation will be presented to the Board on an as needed basis.
- vi. Ad Hoc/Inbound Engagement Requests: Staff will consider additional requests to engage and address specific issues that are not articulated in the Annual Stewardship Plan using the flow chart in Exhibit 1. Reports related to ad hoc and inbound engagement requests will be presented to the Board on an as needed basis.

## BOARD REVIEW

As with all other plan assets, these policies cannot be altered without explicit direction from the Board.

The Investment Committee of the Board may review this policy periodically, as deemed appropriate and in keeping with its fiduciary duties.

**EXHIBIT 1: Stewardship Program Policy – Ad Hoc/Inbound Engagement Requests Flowchart**



# **Sustainable Investment and Stewardship Strategies (SISS) Portfolio Policy**

## **EXECUTIVE SUMMARY**

In accordance with the CalSTRS Investment Policy and Management Plan, IPMP, the California State Teachers' Retirement System Board has established an allocation for global equity securities. Within this allocation, the Chief Investment Officer, or designee, has authority to authorize investment within the Sustainable Investment and Stewardship Strategies Portfolio (SISS Portfolio). CalSTRS' SISS Portfolio is to be invested, administered, and managed in a prudent manner for the sole benefit of its participants and beneficiaries, in accordance with the California Constitution, the Teachers' Retirement Law, and other applicable statutes. No investment instrument or activity prohibited by the IPMP shall be authorized for the SISS Portfolio.

This document is intended to summarize the fundamental objectives and considerations used in the investment, administration, and management of the SISS Portfolio. These policies are designed to set boundaries that will ensure prudence and care in the management of the SISS assets while allowing sufficient flexibility in the management process to capture investment opportunities.

CalSTRS believes that environmental, social, and governance, ESG, issues can affect the performance of its investments. As a result, the CalSTRS ESG Policy has been developed as a tool that both internal and external investment managers are expected to use to assess the impact of ESG risk when making an investment on behalf of CalSTRS. Detailed procedures and guidelines for each of the portfolios are maintained separately.

As with all other plan assets, these policies cannot be altered without explicit direction from the Board.

## **PROGRAM OBJECTIVES**

The SISS Portfolio shall be invested to improve the diversification of the total investment portfolio and to enhance its risk-adjusted total return. The SISS Portfolio shall be invested to provide enhanced investment returns with the ancillary benefits of improving the overall market through active engagement and integration of ESG factors.

## **PERFORMANCE OBJECTIVES**

The CalSTRS SISS Portfolio includes public equity strategies which, in aggregate, are to be structured to achieve a long-term total return in excess of the policy benchmark. Separate and distinct performance objectives and benchmarks shall be established for each equity mandate in order to determine whether each portfolio is representative of the market style adopted, and whether performance objectives have been met.

## PROGRAM BENCHMARK

The SISS Portfolio benchmark is the Custom MSCI All Country World Investable Market Index (MSCI ACWI IMI).

## PROGRAM STRUCTURE

### **Components**

#### **Public Equity**

The public equity portion of the SISS portfolio includes a range of strategies, from actively managed portfolios to passive index portfolios. All the strategies intentionally integrate environmental, social, and governance considerations into portfolio construction and may be managed by external investment managers or implemented internally by the Global Equity staff. The decision to utilize internal staff will be based on a variety of factors including, but not limited to, cost effectiveness/control, market transparency/liquidity, market efficiency, active risk, and infrastructure/resource requirements.

#### **Co-Investments**

- i. Co-investments shall be made side by side with CalSTRS external investment managers.
- ii. Due diligence process shall be thorough, consistent, and appropriate as defined in the SISS investment portfolio procedures.
- iii. Maximum amount of any single investment shall not exceed \$100 million at the time of the investment.
- iv. Co-investments will be disposed of in coordination with the CalSTRS external investment manager who recommended the co-investment.

#### **Special Situations Investments**

The Sustainable Investment and Stewardship Strategies unit may initiate or hold investments in individual global equity securities for the following reasons:

- i. Facilitate operational or legal segregation: in order to take advantage of certain legal rights, such as appraisal rights and/or legal proceedings, individual securities may be transferred to and held in a segregated account.
- ii. Facilitate trading and compliance of regulatory requirements when, acting as part of a group, there may be certain regulatory filings and/or trading restrictions determined by the group's holdings and/or changes in the amounts held by the group. In order to manage the filing process and prevent restricting CalSTRS internally and externally managed portfolios, SISS may make investments in an individual security to manage its holding level and facilitate trading among internal and external portfolios.

- iii. Funding of the accounts will be done at the determination of the Chief Investment Officer, or designee, and trading will be done by the Global Equity unit.

## RISK MANAGEMENT

The Chief Investment Officer, or designee, has authority to determine the allocation to the SISS portfolio.

Within the boundaries and ranges established by this policy, staff is responsible for the selection, allocation, and oversight of externally and internally managed portfolios. Comprehensive procedures, manager guidelines, objectives, benchmark selection, forecast tracking error, portfolio composition, including eligible securities, constraints, and trading activities are to be monitored across all SISS portfolios.

Co-investments are limited to the publicly traded stocks domiciled in markets in which the SISS Portfolio is currently invested.

A co-investment may take the form of equity, convertible preferred equity, and warrants or a comparable instrument which provides an equity type of ownership and return investment restrictions included in the IPMP are hereby incorporated by reference.

### Capital Calls

- i. Capital calls will be made in accordance with the terms stated in the executed partnerships or agreements, of the Sustainable Investment and Stewardship Strategies Portfolio.
- ii. The delegation as it relates to capital calls shall be completed following proper notification from the investment manager as described in the partnership agreement. Management of the investment will be guided by the external investment managers.

## MONITORING AND REPORTING

The following reports will be prepared and presented to the Board, unless otherwise stated, in order to facilitate visibility of compliance monitoring and reporting according to this document:

- i. **Semi-Annual Manager Report** – prepared by staff;
- ii. **Performance Report** – prepared by master custodian/consultant (semi-annually);
- iii. **Business Plan** – prepared by staff (annually);

- iv. **Co-Investments** – A report on any acquisition or disposition will be presented to the Investment Committee as soon as practical after the transaction is completed.

#### BOARD REVIEW

The Board or the Investment Committee may review this policy periodically, as deemed appropriate and in keeping with its fiduciary standards.

*Approved by the Subcommittee on Corporate Governance: October 13, 1999*  
*Adopted by the Investment Committee: October 13, 1999*  
*Amended by the Subcommittee on Corporate Governance: January 5, 2000*  
*Adopted by the Investment Committee: January 5, 2000*  
*Adopted by the Investment Committee: July 14, 2005*  
*Amended and adopted by the Teachers' Retirement Board: April 7, 2006*  
*Amended and adopted by the Teachers' Retirement Board: November 1, 2007*  
*Approved by the Subcommittee on Corporate Governance: February 7, 2008*  
*Adopted and Ratified by the Investment Committee: February 7, 2008*  
*Amended by the Board Governance Committee on November 6, 2008*  
*Amended by the Board Governance Committee on September 3, 2009*  
*Reorganized by Corporate Governance Committee on April 7, 2011*  
*Amended by the Investment Committee: February 7, 2014*  
*Revised to move Corporate Governance Portfolio Policy from Global Equity Policy to the Corporate Governance Policy November 1, 2017*  
*Revised to update the Corporate Governance Portfolio Policy on February 7, 2018*  
*Revised to reflect the new policy format and establish a CG allocation September 20, 2018*  
*Revised to make technical change to the portfolio allocation July 2019*  
*Revised to update Corporate Governance Program and remove trade/wire approval limits September 5, 2019*  
*Revised to update the Stewardship Program January 2020*  
*Revised to formally adopt the SISS name, update the public equity structure and benchmark July 2020*