CALSTRS
CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM
August 2018

The Value of CalSTRS Engagements

Corporate engagement is one of the key tools CalSTRS uses to influence change in the marketplace. Each year Corporate Governance staff, under direction from the Teachers' Retirement Board, determines key issues on which to engage portfolio companies over the next fiscal year. Each issue must be consistent with the CalSTRS Corporate Governance Program, Portfolio Policy and ESG Risk Factors for assessing environmental, social and governance risk.

CalSTRS prefers engagement over divestment as it upholds our rights as a shareholder and allows us to discuss issues with companies that impact the long-term value of the fund. The board will consider divestment as a last resort, but only after pursuing engagement and conducting careful financial analysis.

Divestment is heavily weighed and carefully considered because it could have a negative impact on the fund. To date, the estimated loss from investment restrictions and divestments to the CalSTRS fund is approximately $5.9 billion from the first restriction in 2000 through June 30, 2018.

Current Engagement Efforts:

Opioids

Staff met with McKesson, one of the big three drug distributors in the U.S., on July 5, 2018. Topics discussed included board refreshment, changes to their executive compensation structure in response to CalSTRS and other shareholder feedback, and actions the company has taken to address the opioid epidemic. McKesson has pledged $100 million to a recently formed foundation; created a Special Review Committee on the board consisting of three independent board members; released the findings and recommendations of their internal investigation; and implemented a number of oversight and compliance improvements and other company-led initiatives. McKesson highlighted their expanded misconduct clawbacks and codified the compensation committee's consideration of regulatory, compliance and legal issues when making executive compensation decisions.

Staff continues their active involvement with the Investors for Opioid Accountability as the coalition prepares their engagement agenda for next year.

Task Force on Climate-Related Financial Disclosure

In 2017, CalSTRS began a multi-year engagement effort focused on building corporate support for the Task Force on Climate-Related Financial Disclosure guidance, which details how companies can improve their climate risk management disclosures. CalSTRS committed to engaging 100 companies over the next five years around this issue. Since committing to this effort, CalSTRS has engaged more than 25 companies around TCFD-related disclosure.

Climate Action 100+

CalSTRS is actively involved in the Climate Action 100+. This global collaboration of 289 investors from 29 countries focuses on climate change risk management. The group concentrates on engaging the top global carbon emitters regarding how they align their emissions management efforts with evolving disclosure standards and existing global climate accords. Staff is the lead engager for three companies and a supporting engager for two companies. Additional information about this engagement initiative can be found on the Climate Action 100+ website.

ESG Disclosure

CalSTRS continues to engage collaboratively in support of the Sustainability Accounting Standards Board ESG disclosure standards. We are currently leading several corporate engagements designed to raise awareness of, and support for, the SASB standards.

Diversity

CalSTRS continues to engage companies on improving board diversity, refreshment and overall board composition. Staff goes beyond advocating for gender diversity and engages companies to include race and ethnicity in their Nominating and Governance Charter or Principles. Staff encourages companies to provide better disclosure on board diversity and the skillsets that tie to the company's long-term strategy.

We continue our multi-faceted approach to advancing diversity via three initiatives: collaboration with the Thirty Percent Coalition; the Coalition of 4 (APG, Legal & General Investment Management, Ohio Public Employees Retirement System, CalSTRS); and our own California Initiative. New this year is our partnership with the Office of the Chief Investment Officer of the Regents and the Los Angeles County Employees Retirement Association to engage California-headquartered companies that lack women on their boards.

Through our three initiatives, the groups involved plan to continue to engage companies previously engaged that have made no progress or commitments to improving board diversity. Where there is a lack of progress, staff will vote against Nominating and Corporate Governance Committee members.

2017–18 Diversity Initiative: Companies that appointed a woman to their board:

Diversity Initiative	Engagement Letters 2017–18	# of Companies that Appointed a Woman to Their Boards	# of Women Appointed
Thirty Percent Coalition	131	45	51
California Initiative	89	19	21
Coalition of 4	61*	29*	35*

* Represents 2016–17 figures.

CalSTRS continues its work with the Human Capital Management Coalition. The HCM Coalition is currently engaging 30 companies; CalSTRS is leading two company engagements. The engagement focuses on improving human capital management disclosures, receiving better clarification of key performance metrics and more robust disclosures in the companies' financial statements.

Private Prisons

At the July 2018 Investment Committee, Chief Investment Officer Christopher Ailman initiated the CalSTRS Divestment Policy, based on the ESG risk factor respect for human rights, in our investments in private prison companies. While Mr. Ailman noted that this particular risk factor is written to address human rights in other countries, he believed in this case it was appropriate to apply to these particular investments. The policy requires a comprehensive review of affected companies to determine potential risks they pose to the CalSTRS portfolio. Staff is developing an engagement plan with identified companies, government agencies and NGO's. During the engagement process, CalSTRS staff plans to request the management of identified companies and related entities to allow us to review their policies and procedures and visit their facilities to assess firsthand how they comply with policies, laws and standards and how oversight is conducted.

Staff anticipates providing an update regarding the divestment review at the September 2018 Investment Committee. At the November 2018 Investment Committee we expect to present the committee with our recommendation.

Staff continues to meet with stakeholders to address their concerns regarding this issue.

Iran

On May 8 2018, the United States withdrew from the Iran Nuclear Deal (JCPOA). The U.S. withdrawal and reinstatement of sanctions on Iran has created uncertainty around how companies with ties to the country will respond. Staff continues to engage companies with ties to Iran on their business strategy and sanctions compliance and controls.

Firearms

The Investment Committee approved the Assault Weapon Engagement Plan at the May 2018 meeting. In accordance with the plan, a position has been created within the Corporate Governance unit to lead engagement on firearms. At future investment committee meetings, staff will report to the board on progress made through the ongoing public engagement efforts.

Financial Markets - Regulatory

Staff continues to provide comment letter requests to fulfill the board's fiduciary responsibility to respond to rules and regulations that govern the securities market. During the past six months, six comment letters were written to a variety of regulatory agencies. In total for fiscal year 2017–18, 18 letters were submitted.