The Value of CalSTRS Engagements

Corporate engagement is a critical component used by CalSTRS Corporate Governance Program to influence change in the marketplace. Every fiscal year Corporate Governance staff, under direction from the Teachers’ Retirement Board, determines the key issues on which to engage portfolio companies. Each issue must be consistent with the CalSTRS Corporate Governance Program and Portfolio Policy, and the Investment Policy for Mitigating Environmental, Social and Governance Risks.

CalSTRS follows a set of Corporate Governance Principles based on what we believe are best practices in the marketplace, and we conduct corporate engagements in order to move the marketplace toward these best practices. Similarly, CalSTRS supports market-wide governance initiatives to improve the investing landscape for shareholders and our beneficiaries. All of CalSTRS’ engagement activities begin with private contact with the company.

CalSTRS emphasis on engagement instead of divestment is strategically important to the Teachers’ Retirement Fund. Engagement allows us to uphold our shareholder rights through proxy voting (we vote more than 8,000 domestic and global proxies every year) and to build relationships with companies and associated industries, which opens the door to discuss a myriad of issues that may impact the fund’s long-term value. The board considers divestment a last resort after all avenues of engagement are exhausted and a thorough, detailed financial analysis has been conducted. No matter the size of the divestment, there is a negative impact to the fund—we lose both investment dollars and our voice.

The estimated loss to CalSTRS to date (from 2000 to September 30, 2018) is just over $6 billion. This multi-billion dollar loss represents investment restrictions imposed by government sanctions and divestments authorized by the board. In 2000, tobacco was the first restricted investment to affect the fund. The most recent divestment—from private prison companies CoreCivic and GEO Group—was authorized by the board in November 2018. The estimated loss to the fund as a result of this divestment will be reported in a subsequent edition of this fact sheet.

Current Engagement Efforts:

Diversity & Human Capital Management

CalSTRS, in collaboration with like-minded affinity groups, continues to focus on engaging boards of directors—particularly board nominating committees—on the issue of diverse directors. While diversity engagement has focused on gender, CalSTRS Enhanced Diversity Initiative looks at the broader issue of human capital management. Our discussions include the makeup of company employees, including gender, ethnicity, race, talent and experience, in addition to a company’s succession planning efforts.

Working with three gender-focused board diversity groups, CalSTRS continues to engage companies with either no women or only one woman on their boards. Direct portfolio company engagement via engagement letters has garnered past success, as outlined in the chart below. This engagement will continue with previously engaged companies that have not made any progress or commitments to improving their boards’ diversity. In addition to verbal and written engagement, CalSTRS will vote against the companies’ Nominating and Corporate Governance Committee members and the full board if companies’ are unresponsive.

In 2018-19, the Los Angeles County Employees Retirement Association will join CalSTRS and the Office of the Chief Investment Officer of the Regents, University of California, on the work we started last fiscal year to engage with California-headquartered companies that have no women on their boards.

<table>
<thead>
<tr>
<th>Affinity Group (along with CalSTRS)</th>
<th>Engagement Letters Sent in 2017-18</th>
<th>Number of Companies that Appointed a Woman in 2017-18</th>
<th>Engagement Letters Planned for 2018-19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thirty Percent Coalition</td>
<td>131</td>
<td>45</td>
<td>157</td>
</tr>
<tr>
<td>California Initiative</td>
<td>89</td>
<td>19</td>
<td>92</td>
</tr>
<tr>
<td>Coalition of 6</td>
<td>61 (2016-17)</td>
<td>29 (2016-17)</td>
<td>To be determined</td>
</tr>
</tbody>
</table>

CalSTRS remains actively involved with the Human Capital Management (HCM) Coalition. The HCM Coalition engages with companies to elevate the issue of human capital management as a critical component of a company’s economic performance. Overall the coalition will engage 34 companies this fiscal year, and CalSTRS will lead engagements at two of the companies. In addition to its engagement efforts, the coalition is working with the Sustainability Accounting Standards Board (SASB) to develop metrics for companies to use based on sector and industry.
Private Prisons
At the July 2018 Investment Committee meeting, Chief Investment Officer Christopher Ailman initiated the CalSTRS Divestment Policy under the human rights ESG risk factor as it applied to our public investments in private prison companies. CalSTRS owned stock in our fixed income and global equities portfolios in two publicly traded private prison companies: CoreCivic and GEO Group. As noted earlier, divestment is viewed as a last resort due to its negative impact to the fund. Following the process outlined in the divestment policy, staff completed a report after conducting extensive research on the U.S. private prison industry. The report was presented to the Investment Committee in November 2018 and is available at calstrs.com. After the report was presented, the committee voted to divest of CalSTRS holdings in both companies from both portfolios. Staff estimates it will take six months to completely divest from these holdings.

Firearms
Following the school shooting in Parkland Florida, at the May 2018 Investment Committee meeting, the committee approved the Assault Weapon Engagement Plan. In accordance with the plan, Corporate Governance unit will add a position to lead all engagements with industry and stakeholder groups on firearms issues. On November 14, 2018, CalSTRS along with 12 other institutional investors signed on to the Principles for a Responsible Firearms Industry. The five principles provide a framework for institutional investors seeking to improve engagement with public and private companies globally that manufacture, distribute, sell or regulate products within the civilian firearms industry in order to address gun safety issues and reduce investment risk.

Financial Markets - Regulatory
CalSTRS has a vested interest in safeguarding shareholder protections within the rules and regulations of the U.S. and global securities markets. Thus, we respond to proposed legislation and regulations. In the first quarter of 2018-19, staff submitted a letter responding to the Public Company Accounting Oversight Board’s request for public comment on its draft Five-Year Strategic Plan for 2018-2022. CalSTRS posts these responses on our website. The Corporate Governance unit was invited to and spoke on the Shareholder Proposals -- Exploring Effective Shareholder Engagement panel at the November 2018 SEC Roundtable on the Proxy Process.

Opioids
Staff continues to be actively involved with the Investors for Opioid Accountability Coalition. During the past quarter, staff has collaborated with the coalition on six engagements with opioid distributors and manufacturers. To date, the coalition has achieved reforms and settlements with nine companies. The coalition is currently preparing and submitting shareholder resolutions for the 2019 proxy season and initiating company discussions. During the past quarter, CalSTRS filed one shareholder proposal at a drug distributor related to the company’s clawback policy. The proposal was subsequently withdrawn due to an agreed settlement with the company.

Task Force on Climate-related Financial Disclosure
In 2017, CalSTRS began a five-year commitment to engaging at least 100 companies (20 per year) focused on climate risk metrics and targets outlined in the Task Force on Climate-related Financial Disclosure (TCDF) guidance. Companies slated for engagement were screened for seven variables, including three related to carbon dioxide emissions and one on the current actions the companies are taking related to the TCFD recommendations. To date, CalSTRS has engaged more than a quarter of the 100 companies.

Climate Action 100+
CalSTRS is actively involved in the Climate Action 100+, a collaborative engagement effort of almost 300 investors, focused on engaging the largest global emitters of carbon dioxide. The five-year effort centers around actions the companies are taking or plan to take to manage and mitigate climate change risk. CalSTRS is the lead investor at six companies and a supporting investor at eight companies. Seven companies are U.S.-based, and seven are Japan-based. CalSTRS has contacted the U.S-based companies and expects to be able to meet with them by the end of the year.

ESG Disclosure
As a member of the SASB’s Investor Advisory Group, CalSTRS is taking a leading role in engaging companies on how their ESG-related disclosures align with SASB standards. During 2018-19, CalSTRS anticipates spearheading engagement at four to six companies.

Iran
In May 2018, the U.S. withdrew from the Iran Nuclear Deal (JCPOA). Then in November 2018, the U.S. reinstated sanctions on Iran, while granting limited waivers for eight countries. The U.S. withdrawal and reinstatement of sanctions has created market uncertainty, as it is not known how companies with ties to Iran will respond. CalSTRS focuses our engagement on the companies we have identified as having ties to the restricted countries. We maintain internal controls to prevent sanction violations. We file an annual report with the Legislature detailing our activities.