The Value of CalSTRS Engagements

Engagement is a critical component used by the CalSTRS Sustainable Investment and Stewardship Strategies team to influence change that supports long-term value creation. Every fiscal year, SISS 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 engagements seek to influence companies to adopt best practices in managing environmental, social and governance issues, to create sustainable businesses. Similarly, CalSTRS engages policymakers to advocate for strong governance practices that improve the investing landscape for shareholders and our beneficiaries. To facilitate better dialogue, all of CalSTRS' corporate engagement activities begin with private contact with the company.

CalSTRS emphasis on engagement instead of divestment is strategically important to the Teachers' Retirement Fund. An engagement-led strategy provides a two-fold benefit. First, we uphold our shareholder rights through proxy voting—we vote more than 8,000 domestic and global proxies every year. Second, we build relationships with companies and associated industries. These relationships open the door to discuss myriad issues that may impact the fund’s long-term value. The board considers divestment a last resort; all avenues of engagement are exhausted and a thorough, detailed financial analysis is conducted before it makes a divestment decision.

No matter the size of the divestment, we lose not only our ability to communicate with companies, we also lose our investment dollars. To date—June 4, 2000 to March 30, 2019— the estimated loss to CalSTRS related to divestment is approximately $6 billion. This loss represents investment restrictions imposed by state and federal government sanctions as well as tobacco, firearms, thermal coal, and private prisons which were initiated and approved by the board.

Current Engagement Highlights

Proxy Voting
CalSTRS has a fiduciary duty to manage its proxy voting activity with the same diligence and care as any other plan asset. The months of April, May and June are the peak of proxy voting activity as 75% of U.S. companies hold their annual meetings during these months. Staff votes upwards of 150 proxies per day consistent with The Corporate Governance Principles and votes are published daily on the CalSTRS website.

Diversity & Human Capital Management
CalSTRS continues to engage portfolio companies to promote greater diversity on corporate boards. We focus on board composition: the skill sets of directors and how members are nominated and evaluated. We believe a multi-faceted and concerted effort, with like-minded investors, increases our ability to improve long-term returns resulting from greater diversity.

CalSTRS collaborates with the Thirty Percent Coalition, the California Initiative (UCOP, LACERA, and CalPERS) and the Coalition of 6 global investors (LGIM, APG, OPERS, PGGM, RPMI) specifically to engage Nominating and Corporate Governance Committee directors. These engagements concentrate on companies— in both the S&P 500 and Russell 3000— with either no women or only one woman on their board. To date for fiscal year 2018-2019, through our coalitions, we have engaged 279 companies and 99 new women have subsequently been appointed to boards. Recently, a controlled company, headquartered in California, appointed its first ever female director—twenty years after going public.

We are also an active participant in the Human Capital Management Coalition whose goal is to elevate and emphasize human capital management as a critical component of a company’s economic performance. Through our engagement we seek to encourage better disclosure of how companies manage the demographics, composition, knowledge, motivation, skills and experience of their workforce: a company’s most valuable asset. In March, after engagement from the HCM Coalition, the Investor Advisory Committee to the Securities and Exchange Commission recommended that the SEC consider making a rule to mandate improved human capital management disclosures.

Low Carbon Transition
CalSTRS has engaged more than a quarter of the target 100 companies. Our engagement has helped drive adoption. As of January 2019, nearly 500 companies have committed to support TCFD recommendations.
**Climate Action 100+**

CalSTRS is actively involved in the Climate Action 100+, a collaborative engagement effort of more than 340 global investors—currently representing $33 trillion assets under management (AUM)—focused on 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 leading engagements with eight companies; four U.S.-based, and four Japan-based.

Staff recently led a two-day engagement meeting with Southern Company. Over the two days, in addition to meeting with the CEO for over four hours, discussions with senior executives covered a wide range of topics including: carbon pricing, nuclear energy, renewables, energy mix and generation capacity, cyber security and grid resiliency. Follow-up discussions are scheduled for later in the year as the company is expected to provide more detail on its future lower-carbon generation capacity and energy mix pathways.

A recent CA 100+-led shareholder proposal at BP received an overwhelming 99% of support (including from company management). The proposal requested that the oil and gas major provide, in its future strategic reporting, a description of how its strategy aligns with the goals of the Paris Agreement, including details on new capital expenditure, metrics and targets.

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**Environmental, Social, Governance Disclosure**

CalSTRS is a member of the Sustainability Accounting Standards Board’s Investor Advisory Group, a group of 44 global investors currently representing $32 trillion AUM. Members share a common goal: seeking consistent, comparable, and reliable disclosure of material, decision-useful sustainability-related information from the companies in which they invest to better evaluate and price ESG-related risks and opportunities. CalSTRS is taking a leading role in engaging companies to adopt the SASB standards in their reporting. Sixty-nine companies now report using the recently codified SASB standards, an 83% increase year-to-date compared to the total number reporting in 2018. Additionally, 175 companies now reference SASB in their disclosures.

**Financial Markets - Regulatory**

CalSTRS has a vested interest in safeguarding shareholder protections that exist within the rules and regulations of the U.S. and global securities markets. Thus, we respond to proposed legislation and regulations that may affect these rights. Fiscal year-to-date, we have submitted letters to the SEC on refining the proxy voting process and the Committee on Financial Services regarding H.R. 625–Promoting Transparent Standards for Corporate Insiders Act.

We have also encouraged domestic and global stock exchanges to address concerns about multi-class share structures, which limit investor influence, in their listing standards. In a related activity, Lyft conducted its initial public offering during the last quarter, with a dual-class share structure. We wrote directly to Lyft to express our disappointment about the company’s decision and to explain why we believe the principle of “one share, one vote” is central to good corporate governance. These submissions are publicly available on the CalSTRS website.

**Firearms**

In May 2019, CalSTRS hired an engagement specialist to lead our work with industry and stakeholder groups on firearms safety issues, based upon the Principles for a Responsible Civilian 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 to address gun safety issues and reduce investment risk.

**Opioids**

CalSTRS is an active participant in Investors for Opioid Accountability, a diverse coalition of institutional investors with 54 members representing $3.5 trillion in AUM. The IOA was established to engage with opioid manufacturers, distributors, treatment manufacturers, and retail pharmacies on opioid business risks that have implications for long-term shareholders, communities and the broader economy. Since 2017, the coalition has filed 33 shareholder resolutions and reached a settlement on 30 of these proposals, three of the settled proposals were filed by CalSTRS. The coalition is in active discussions with companies on shareholder resolutions filed in the 2019 proxy season. Most recently, three shareholder proposals filed by IOA members received majority support at Mallinckrodt Pharmaceuticals.

**Country-Related Activities**

**Iran**

In May 2018, the U.S. withdrew from the Iran nuclear deal (formerly known as the Joint Comprehensive Plan of Action), and later reinstated sanctions on Iran, while granting limited waivers for eight countries. In April 2019, the U.S. ended the waivers. These policy shifts have created market uncertainty as companies and countries seek to adapt and respond to them.

**Sudan**

In April 2019, after months of public protests, President Omar Al-Bashir was deposed by a military coup. The military government proposed a two-year transition to democracy but encountered further protests from civilians demanding a transitional non-military authority. The political situation remains murky; the military has made concessions but retains control. It is not clear whether these recent changes will result in a government that enables the country to be removed from the U.S. state sponsor of terrorism list and sunsets associated California divestment legislation.

CalSTRS engages companies we have identified as having ties to Iran and Sudan to ensure that we comply with our internal controls to prevent sanction violations and to file an accurate annual report with the Legislature detailing our activities.