



Investment Committee

Item Number 4b – Open Session

Subject: Revised Stewardship Priorities

Presenter(s): Aeisha Mastagni

Item Type: Action

Date & Time: January 11, 2024 – 20 minutes

Attachment(s): Attachment 1 – Meketa Concurrence Memo

Attachment 2 – 2023 Stewardship Highlights

Attachment 3 – 2024 Focus Areas – Engagement Template

Attachment 4 – CalSTRS Governance of Investment-related Sustainability Risks and Opportunities

PowerPoint(s): CalSTRS Corporate Governance Principles and Stewardship Priorities

Item Purpose

The purpose of this item is to present the revised CalSTRS Stewardship Priorities (Stewardship Priorities or Priorities), as a three-year plan, for Board approval. The Priorities are designed so staff can effectively use CalSTRS influence as a significant global investor to drive long-term value creation on behalf of California’s educators.

When the Board agreed to govern the Priorities through a three-year plan, staff committed to report regularly on the activities and tactics undertaken to implement the Stewardship Priorities. Attachment 2 details the achievements relating to the current set of Stewardship Priorities over the first three quarters of 2023. Given the early timing of the January Investment Committee, the fourth quarter’s activities are not included but will be available on the [CalSTRS website](#) in early January. Staff will continue to report quarterly through the Engagements in Action web-based publication and inform the board on significant and high-profile engagement activities, in response to emerging situations, as needed.

Recommendation

Staff recommends the Investment Committee approve the CalSTRS Stewardship Priorities for the next three years. The Stewardship Priorities and the Corporate Governance Principles (see companion agenda item 4a) are the governing documents for CalSTRS stewardship activities.

Executive Summary

The Sustainable Investment & Stewardship Strategies (SISS) unit undertakes three core pillars of activity: 1) SISS Investment Portfolio, 2) Stewardship, and 3) Stakeholder Relations Management. The purpose of this item is to approve the Stewardship Priorities that will guide staff's stewardship activities for the next three years.

CalSTRS has a long history of proactive engagement with portfolio companies on sustainability issues that impact long-term company performance and with policymakers to ensure efficient markets and proper shareholder rights. CalSTRS thoughtful, analysis-based approach to engagement is well-respected in the global marketplace. This reputation, in addition to our size, makes CalSTRS an attractive partner on a wide variety of initiatives. **This creates significant opportunities but also requires the team to be able to prioritize and allocate resources appropriately, both to align with CalSTRS goals and to affect change where we have the greatest potential for success and the largest impact.**

Stewardship Priorities

The Stewardship Priorities will guide CalSTRS in using our influence as a significant global investor to promote sustainable business practices and public policies. Staff believes the Priorities will clarify why we prioritize specific engagement issues, particularly given the increasing interest in a wide range of sustainability matters and the role of investors in addressing them.

As background, the Stewardship Priorities are determined based on three premises and are also detailed in the [Sustainable Investment & Stewardship Strategies Program and Portfolio Policy](#):

1. Relevance to the long-term performance of the Portfolio.
2. Capacity to influence meaningful change based on the tools available to staff as shareholders.
3. Ability to deliver measurable outcomes.

For 2024-2026, staff is recommending the Board approve the following three Stewardship Priorities:

Corporate and Market Accountability: Basic governance rights and well-functioning, efficient markets, including effective and diverse boards, are vital components for CalSTRS to effectively mitigate risk in the portfolio. CalSTRS is committed to influencing regulators,

standard-setters, and policymakers to promote sustainable markets, effective and diverse boards, and protect shareholder rights.

Net Zero Transition: Climate change presents a material and significant risk to society, the economy, and our portfolio. CalSTRS is committed to engaging the highest carbon-emitting companies to reduce emissions in the global economy. This is aligned with CalSTRS pledge to achieve net zero portfolio emissions by 2050, or sooner.

Workforce and Communities: A company’s workforce is an important asset for any organization. Corporate boards should play an active role in properly overseeing the management of human capital and ensuring investors have adequate disclosures to oversee workforce-related risks and opportunities. CalSTRS is committed to influencing portfolio companies to ensure a healthy and engaged workforce and to be good stewards in the communities in which they operate.

Focus Areas

The breadth of stewardship activities and the tools and tactics investors use to influence change in the financial markets have expanded dramatically over the last several years. In order to be successful and achieve meaningful outcomes aligned with CalSTRS goals, staff has developed Focus Areas within each Stewardship Priority. The Focus Areas were determined based on staff’s conviction that they are topics where CalSTRS can achieve impact with the tools available to us as investors. Staff have developed detailed Engagement Plans to achieve the goals for each Focus Area and will review them on an annual basis. The template for these Engagement Plans is included as Attachment 3.

The Focus Areas, including key areas of engagement activity, for each Stewardship Priority are described below.

Corporate and Market Accountability

- **Board Effectiveness:** Strong board leadership and oversight are key drivers of prudent risk management and value creation. Engagement will focus on:
 - **Board Diversity:** CalSTRS will continue its direct company engagement and in collaboration with the California investors, to increase diverse director representation on boards and ensure clear guidance in company policies addressing board diversity and recruitment practices.
 - **Board Competency:** Through direct company engagement and collaborative efforts, CalSTRS will encourage companies to disclose board skills, experience, background, and diversity in a matrix and explain how those attributes enhance the long-term strategy of the company.
 - **Compensation:** One of the primary responsibilities of a board of directors is overseeing executive compensation and aligning it with a company’s long-term strategy. As part of direct company engagement with high emitters in the

CalSTRS portfolio, and as part of collaborative efforts, staff will ask companies to link compensation to their net zero commitments and enhanced climate and human capital-related disclosures.

- **Sustainability Disclosures:** Consistency and transparency around sustainability-related risks and opportunities impacting companies allow investors to make better decisions. Engagement will focus on:
 - **International Sustainability Standards Board (ISSB) Standards:** Through engagement efforts with regulators and policy makers, CalSTRS will advocate for the adoption of ISSB standards as a global baseline for corporate sustainability disclosures. Staff will also encourage company adoption through direct company engagements.
 - **Human Capital Management Disclosure:** CalSTRS will continue to advocate for universal, mandatory metrics on human capital with regulators and in cooperation with the Human Capital Management Coalition (HCMC). Staff will also encourage companies to disclose the foundational metrics through direct company engagement.

- **Shareholder Rights:** *When necessary, CalSTRS will use our influence to protect shareholder rights and the long-term interests of the fund. This Focus Area is deliberately structured to allow staff to be reactive to situations where shareholder rights are compromised.*

Net Zero Transition

- **Highest Emitters:** One of the three components of CalSTRS pledge to reach net zero portfolio emissions by 2050, or sooner, is to use our influence to accelerate the transition. This Focus Area supports that component by engaging the highest carbon and methane emitters in the CalSTRS portfolio to set emissions reduction targets through three primary areas of activity:
 - **Climate Action 100+:** CalSTRS continues to be a leader in this global investor collaborative effort to engage the highest carbon emitters. Investors are influencing companies to set short-term, medium-term, and long-term goals and targets to reduce greenhouse gas emissions. In addition, investors are asking for the implementation of tangible climate transition plans.
 - **‘Priority 45’:** The Priority 45 is a subset of companies that account for approximately 7% of CalSTRS global equity emissions and are not covered through Climate Action 100+. Staff are directly engaging these 45 companies to:
 - 1) Set goals and targets to reduce emissions, 2) Obtain audit assurance for emission reporting, and 3) Link compensation to emission reductions goals.
 - **Methane Mitigation:** Through direct company engagement with companies that emit methane (one of the most potent greenhouse gases), staff are focused on companies implementing cost-effective abatement opportunities that result in

lower emissions and improving methane management and reporting in alignment with the [Oil & Gas Methane Partnership 2.0 \(OGMP 2.0\)](#).

- ***Nature-based Solutions:*** *Agriculture, forestry and land use are major contributors to global carbon emissions and species loss. There is growing recognition that nature-based solutions will play a critical role in achieving a net zero emissions economy. This Focus Area is structured to allow CalSTRS staff to build knowledge on this complex and nascent topic to evaluate the best strategies and tactics for engaging companies and policy makers.*

Workforce and Communities

- **Workforce Culture and Engagement:** Diversity at the executive level and strong operational practices to diversity, equity and inclusion at all levels of the workforce create enhanced workplace culture and improved retention, which is correlated with financial outperformance. Engagement will focus on:
 - **Workforce Composition Data:** To understand how effectively a company is managing its workforce and workforce related risks, greater disclosure of basic workforce metrics is essential, but currently lacking. CalSTRS will continue to advocate for universal and mandatory metrics with regulators and in direct company engagements.
 - **Diversity, Equity and Inclusion (DE&I):** CalSTRS will continue to advocate for greater transparency on company DE&I practices which contributes to an inclusive culture and healthy workforce. CalSTRS continues to be an active participant with the [Thirty Percent Coalition](#) that has expanded its diversity efforts beyond the Board of Directors and is encouraging greater transparency of workforce diversity.
- **Just Transition in the Utility Sector:** Transitioning the world to a low-carbon economy, will require major changes in the business models of the utility sector. CalSTRS will influence energy utility companies to provide enhanced disclosures on board-level oversight and support for workers and communities affected by the transition. Much of this engagement will be conducted in cooperation with Climate Action 100+.
- **Responsible Firearms:** CalSTRS continues to focus on reducing reputational and financial risks to the portfolio by encouraging companies involved in the civilian firearms industry to address firearms safety. Engagement will focus on:
 - **Retailers:** Engagement with retailers to establish best practices in the sale of commercial firearms, to limit the risk of firearms being purchased by individuals who are excluded from purchasing firearms.
 - **Finance:** Credit card companies, banks, and online payment services can all be involved in the purchasing of firearms. These engagements seek to understand

how companies track purchases to ensure their services are not used for illegal transactions that contribute to violence associated with the misuse of firearms.

Stewardship Tools and Tactics

CalSTRS utilizes a variety of tool and tactics to implement our Stewardship Priorities, and as described in the Focus Areas, staff often uses multiple tactics to achieve the stated objective. The four main tactics are described in greater detail below:

- 1) **Proxy Votes:** At CalSTRS, we treat proxy votes as plan assets and vote all proxies internally, both domestic and international, in alignment with CalSTRS Corporate Governance Principles (see companion item 4a). We use our proxy votes as a lever to hold directors accountable and require companies to respond to risks and opportunities. In addition to company management ballot items, we often support shareholder-submitted proposals (“shareholder proposals”) that align with our goals and call on companies to better manage risk or improve public disclosure.
- 2) **Direct Company Engagement:** Direct company engagement can be an effective tool for targeting companies that are ‘under-engaged’ by the wider marketplace or in instances where CalSTRS has a specific outcome we are trying to achieve that is directly tied to one of the Focus Areas.
- 3) **Collaborative Engagements:** Collaborative engagements allow CalSTRS to scale our influence as a global investor with other like-minded investors. Effective engagements resulting in substantive commitments from companies are time intensive and utilizing collaborative engagements provides for an effective use of resources.
- 4) **Policy Advocacy:** Like proxy voting, policy advocacy is applicable to wide-ranging aspects of CalSTRS’ portfolio. We influence regulators and policymakers to support actions that provide for well-functioning and efficient markets that support long-term value creation.

Background

For several years the Sustainable Investment & Stewardship Strategies (SISS) unit, formally named the Corporate Governance Unit, has prepared an Engagement Plan for the CalSTRS Board. Historically the purpose of the Engagement Plan had been to update the Board on environmental, social and governance engagements the team had undertaken and to inform the Board about shareholder proposals staff was considering.

Since the first Engagement Plan, the market in which we operate as institutional investors has transformed dramatically, not only in the tools we have at our disposal to influence change but

also in the number of sustainability issues that global investors focus on. While the marketplace has changed, the premise for why we engage has remained constant:

Mitigate risk in the CalSTRS portfolio, support long-term value creation, and promote practices that provide for a sustainable financial market.

Every year, SISS staff engages companies in the public equity portfolio, on a wide variety of sustainability issues consistent with our fiduciary duties to properly monitor CalSTRS investments and align with the established Stewardship Priorities. Staff developed the graphic, included as Attachment 4, to illustrate how the Stewardship Priorities and the Corporate Governance Principles (see companion agenda item 4a) fit into the CalSTRS policy hierarchy.

In years past, investors, like CalSTRS, had a limited range of tools to influence public companies: voting against management proposals at annual general meetings and/or filing shareholder proposals. Investors today have a much wider variety of tools at their disposal including face-to-face meetings with companies and policymakers and globally-coordinated collaborative engagements with like-minded peers. Staff now uses a combination of the tools described in the section above: Stewardship Tools and Tactics.

In January 2020, the Board approved the Stewardship Priorities to help prioritize and focus staff's activities on the most relevant issues for engagement that mitigate risk, support long-term value creation, and promote practices that provide for a sustainable financial market. The Stewardship Priorities also communicate to a wider audience including stakeholders, investment peers, and other market participants that have an interest in how CalSTRS uses our position as a large, long-term oriented asset owner to influence companies and policymakers.

Strategic Plan Linkage: Goal 1 of the Strategic Plan. Trusted stewards – Ensuring a well-governed, financially sound trust fund.

Board Policy Linkage: This item is covered under the CalSTRS [Sustainable Investment & Stewardship Strategies Program and Portfolio Policy](#) (Teachers' Retirement Board Policy Manual, Section 1000, C-1) and the [CalSTRS Corporate Governance Principles](#) (see companion agenda item 4a).

[Investment Beliefs](#) Linkage:

Investment Belief 7: Responsible corporate governance, including the management of environmental, social and governance (ESG) factors, can benefit long-term investors like CalSTRS.

Investment Belief 9: Investment risks associated with climate change and the related economic transition – physical and technology driven – materially impact the value of CalSTRS' investment portfolio.