POLICY

The item is covered under the CalSTRS Sustainable Investment & Stewardship Strategies Program and Portfolio Policy (Teachers’ Retirement Board Policy Manual, Section 1000, Page C-1).

HISTORY OF THE ITEM

The Sustainable Investment & Stewardship Strategies (SISS) Program and Portfolio Policy, formally called the Corporate Governance Policy, is one of CalSTRS oldest policies dating back to October 1999 and is currently divided into two parts. The first part of the Policy relates to the Stewardship Program and includes all the activities that are associated, but do not directly involve portfolio management, such as proxy voting, securities litigation, company engagement, and strategic relations management. The second part of the Policy is related to the SISS Portfolio. The SISS Portfolio Policy section was established in November 2017 when the policy language
governing SISS assets under management was removed from the Global Equity Policy creating a stand-alone policy for the SISS unit. Since that time, there have been several modifications to the SISS Portfolio section of the Policy which have focused on portfolio allocation, trade authorization and policy format. In July 2020, the SISS Portfolio Policy section was revised to include the CalSTRS Low-Carbon Index and aggregate all of SISS’ public equity strategies under one global benchmark.

At the Committee’s last meeting in January 2021, staff presented a ‘first read’ of proposed changes to the SISS Portfolio Policy to: (1) Introduce two components to the SISS Portfolio Policy consisting of the existing portfolio (with minor clarifying revisions to the current language governing what will be known as the ‘SISS Public Portfolio’) and creating a new ‘SISS Private Portfolio’; (2) Impose an aggregated allocation limit of 5% for the assets under management in the SISS Public and Private Portfolios; (3) Detail the components and planned implementation of the new SISS Private Portfolio.

**PURPOSE**

Staff requests the Committee’s approval for the proposed changes to the Sustainable Investment & Stewardship Strategies – SISS – Program and Portfolio Policy that were presented as a ‘first read’ of the policy in January 2021 as well as approval for several minor additional changes in this ‘second read’ of the policy.

**DISCUSSION**

Detailed discussion relating to the comprehensive set of changes to the SISS Portfolio Policy can be found in the Committee’s January 2021 meeting materials, [Agenda Item 7](#). Based on the Committee’s feedback in January, staff is limiting discussion in this agenda item to the following additional changes that are intended to further clarify and enhance the Policy and its implementation:

(1) **Language Clarifications**

- C-8: explanation that the Policy will be reviewed periodically by the Board or Investment Committee.
- C-9: clarification that the reference to co-investments in this section of the policy applies to publicly traded co-investments with activist managers within the SISS Public Portfolio. Additional revisions to the SISS Portfolio Policy will be presented to the Investment Committee at a later date.

(2) **Inclusion of Innovative Strategies**

As the Innovative Strategies policy covers private assets, staff believe it is appropriate for the SISS Private Portfolio to also include reference to Innovative Strategies, in addition to Private Equity, Real Estate and Inflation Sensitive. By doing so, the SISS Private Portfolio will be able to partner with Innovative Strategies to leverage their existing partnerships, as appropriate, and also develop new investment partnerships that are permitted under the Innovative Strategies policy.
In alignment with the Innovative Strategies policy, the SISS Portfolio will have the ability to develop new partnerships that will allow staff to pursue value-adding investment opportunities that may have characteristics that make them a difficult fit in other private asset classes due to benchmark or other considerations, but are still additive to the total fund and mirror the governance of Innovative Strategies’ existing due diligence and approval processes.

(3) Details of Program Benchmarks

The SISS Private Portfolio will have a blended performance benchmark comprised of the weightings for the underlying strategies, multiplied by their respective benchmarks. The SISS Portfolio will utilize the underlying Private Equity and Real Estate program benchmarks as well as components of the Inflation Sensitive and Innovative Strategies Programs. For clarity, these details have been described in the policy.

(4) Removal of Geographic Parameters for Diversification

As detailed in the SISS Private Portfolio, all investments must comply with existing limits and restrictions detailed in each private asset class policy. As such, staff and Meketa believe that it is no longer necessary to provide specific geographic parameters for the SISS Private Portfolio.

(5) Oversight and Reporting Related to the SISS Private Portfolio

Staff recognizes the Committee’s request for additional information regarding the oversight of, and reporting relating to, investments in the SISS Private Portfolio.

Meketa will address its recommendations for oversight in a separate agenda item, but reporting on investments in the SISS Private Portfolio will be included in the following, existing formats:

- Semi-annual performance report covering the SISS Public and Private Portfolios, written by the SISS team.
- Semi-annual compliance report, written by the Investments Compliance team.
- Semi-annual review, written by Meketa.
- Quarterly Substantive Investment Activities (included in the Tactical Investment Strategy report) which will include a new, specific section related to the SISS Portfolio.

Summary

The chart below illustrates what the total SISS Portfolio would look like if the proposed SISS Portfolio Policy is approved.
As a reminder, and to recap, it is important to emphasize what the proposed SISS Portfolio does and does not do.

The establishment of the SISS Private Portfolio does not create an asset class. Rather it emphasizes an investment approach across asset classes that focuses on structural shifts in the global economy linked to sustainability. The Portfolio does not seek to replicate investments that already exist in other parts of the CalSTRS portfolio. Instead it creates a systematic platform to expand these opportunities. The Portfolio also does not impact CalSTRS existing asset allocation model. The proposed SISS Private Portfolio specifies that any potential investment must consider the impacts on the underlying asset class allocation limits and cannot be made if those limits would be exceeded.

The SISS Private Portfolio will change and enhance the dynamics of internal staff governance for certain investments by enabling a collaborative approach to investment due diligence and recommendations. The Portfolio will also expand CalSTRS understanding of how specific investments demonstrate positive contributions to a more sustainable global economy. As this is an evolving, but fast-moving element of the global investment industry staff will be able to expand expertise in the intersection between risk-adjusted returns and sustainability drivers and outcomes, for the benefit of California’s educators.

**RECOMMENDATION**

Staff recommends the Committee approve the proposed revisions to the Sustainable Investment & Stewardship Strategies Program & Portfolio Policy.

Attachment 1 to this item is the existing program and portfolio policy.

Attachment 2 to this item is a red-line version of the revised policy showing the edits that have been made.

Given the extensive edits to the Sustainable Investment & Stewardship Strategies Program & Portfolio Policy, the following key will be helpful for the Committee’s review:
Attachment 3 to this item is a clean version of the revised program and portfolio policy. Meketa concurs with the changes recommended in the revised Policy and their recommendation letter is Attachment 4 to this item.
SUSTAINABLE INVESTMENT & STEWARDSHIP STRATEGIES PROGRAM AND PORTFOLIO POLICY

INVESTMENT BRANCH

July 2020
C. Sustainable Investment & Stewardship Strategies Program and Portfolio Policy

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

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1 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

Priorities are established in the Annual Stewardship Plan

Yes

Is it an engagement priority?

No

Refer to Stewardship Plan

Determine best tools for influence

Track outcomes

Determine relevance to long-term performance

Evaluate CalSTRS ability to influence change

Assess ability to deliver measurable outcomes

Acknowledge receipt & articulate priorities

No action

Based on staff analysis

Action

Determine tools & resources required

Low resources

Medium resources

High resources
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*

*Amended 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*
SUSTAINABLE INVESTMENT & STEWARDSHIP STRATEGIES PROGRAM AND PORTFOLIO POLICY
C. Sustainable Investment & Stewardship Strategies Program and Portfolio Policy

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

1 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

Priorities are established in the Annual Stewardship Plan

Is it an engagement priority?

Yes

No

Refer to Stewardship Plan

Determine best tools for influence

Track outcomes

Determine relevance to long-term performance

Evaluate CalSTRS ability to influence change

Assess ability to deliver measurable outcomes

No action

Based on staff analysis

Action

Acknowledge receipt & articulate priorities

Determine tools & resources required

Low resources

Medium resources

High resources
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 asset classes global equity securities. Within this allocation, the Chief Investment Officer (CIO), or designee, has authority to authorize investment within the Sustainable Investment and Stewardship Strategies Portfolio (SISS Portfolio). The SISS Portfolio has two components: the SISS Public Portfolio and the SISS Private Portfolio. In aggregate, the assets under management (AUM) in the SISS Public and Private Portfolios shall not exceed five percent of the CalSTRS Total Fund market value. The SISS Portfolio shall have a blended performance benchmark comprised of the weightings of the SISS Public Portfolio and the SISS Private Portfolio multiplied by their respective benchmarks. 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. This policy is 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.

RISK MANAGEMENT

In aggregate, the assets under management (AUM) in the SISS Public and Private Portfolios shall not exceed five percent of the CalSTRS Total Fund Market Value.

Delegation of Authority

The CIO or designee has the authority to manage the Sustainable Investment & Stewardship Strategies Portfolio and may use other investment personnel to implement these policies and the processes described in the procedures.
The CIO or designee has the authority to approve commitments to strategies within the boundaries established by CalSTRS investment policies.

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.

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 will review this policy periodically, as deemed appropriate and in keeping with its fiduciary standards.

**SISS Public Portfolio**

PROGRAM OBJECTIVES

The SISS Public Portfolio shall be invested to improve the diversification of the total investment portfolio and to enhance its risk-adjusted total return. The SISS Public 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 Public Portfolio includes public equity strategies (including vehicles
partnerships which primarily invest in public equities), 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 Public 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 including actively managed portfolios, partnerships which primarily invest in public securities, to and passively managed 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.

Public Co-Investments

Public co-investments are limited to the publicly traded stocks domiciled in markets in which the SISS Public 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.

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 Public 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.
SISS Private Portfolio

PROGRAM OBJECTIVES

The SISS Private Portfolio serves as a source of long-term capital appreciation for the CalSTRS Total Fund (Fund). The goal of the SISS Private Portfolio is to opportunistically improve the risk and return characteristics of the Fund. The investment scope of the SISS Private Portfolio is broad. The SISS Private Portfolio exists to leverage CalSTRS’ investment partners to source and invest in opportunities that demonstrate positive contributions to a more sustainable global economy, across private market asset classes. The portfolio does not seek to replicate investments that already exist in other parts of the CalSTRS portfolio. Instead, it creates a systematic platform to expand investment opportunities in private equity, infrastructure and real estate that are additive to the total fund.

PERFORMANCE OBJECTIVES

Over the long-term, the SISS Private Portfolio seeks to produce a positive return greater than the blended weighting of the respective private asset class benchmarks while demonstrating positive contributions towards a more sustainable global economy that benefit plan participants. Separate and distinct performance objectives and benchmarks shall be established for each investment in order to determine whether performance objectives have been met.

PROGRAM BENCHMARKS

The overall SISS Private Portfolio shall have a blended performance benchmark comprised of the weightings for each of the underlying asset classes strategies multiplied by their respective benchmarks, as detailed below:

<table>
<thead>
<tr>
<th>Private Equity</th>
<th>Private Equity Program Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate</td>
<td>Real Estate Program Benchmark</td>
</tr>
<tr>
<td>Inflation Sensitive</td>
<td>Infrastructure Program Benchmark</td>
</tr>
<tr>
<td>Innovative Strategies</td>
<td>Innovative Strategies Benchmark (as determined by the underlying individual strategy)</td>
</tr>
</tbody>
</table>

PROGRAM STRUCTURE

The SISS Private Portfolio may invest in any set of private assets that are intended to improve the risk and return characteristics of the Fund and demonstrate positive contributions to a more sustainable global economy that benefit plan participants. The SISS Private Portfolio will consist of two sub-components which are subject to appropriate due diligence as defined in the SISS Private Portfolio investment procedures and which, as appropriate, reference the Private Equity, Inflation Sensitive, and Real Estate and Innovative Strategies investment strategies.
procedures:

- Those that leverage existing CalSTRS partnerships across Private Equity, Inflation Sensitive, and Real Estate and Innovative Strategies to scale investments that will be additive to the total fund;

- Those that allow CalSTRS to develop new investment partnerships that are additive to the total fund and would otherwise have been allowed under CalSTRS Private Equity, Inflation Sensitive, and Real Estate and Innovative Strategies policies.

**Permissible Investment Types**

In compliance with CalSTRS’ existing investment policies, including the Private Equity, Inflation Sensitive, and Real Estate and Innovative Strategies policies, the SISS Private Portfolio may invest in private assets using: (1) Limited Partnerships (and other limited liability vehicles); (2) Commingled Funds; (3) Discretionary Accounts; (4) Separately Managed Accounts; (5) Co-investments; (6) Secondary Market Transactions; (7) Direct Investments; (8) Joint Ventures; (9) Debt instruments; and (10) Standard investment management agreements.

Within the limits established by CalSTRS investment policies, staff is responsible for the selection, allocation, and oversight of the investments, strategies and external managers. If prudent, CalSTRS may elect to manage a strategy internally. Any internally managed strategy must be approved by the CIO and General Consultant. Delegation limits for assets are established within CalSTRS existing policies, including Private Equity, Inflation Sensitive, and Real Estate and Innovative Strategies and are reflected in the Investment Policy and Management Plan.

All SISS Private Portfolio investments require a positive written recommendation by CalSTRS’ staff and/or a Program Advisor, an Independent Fiduciary, or Co-investment Advisor. All SISS Private Portfolio investments will comply with delegation authority limits outlined in CalSTRS existing Private Equity, Inflation Sensitive, and Real Estate and Innovative Strategies policies.

**Diversification**

Diversification within the SISS Private Portfolio is critical to control risk and maximize returns for the total fund. To provide diversification, the size of each investment shall, in aggregate, be limited to the lesser of half-a-percent (0.5%) of the CalSTRS Total Fund market value, calculated using the total commitments as of the investment decision date or existing limits and restrictions detailed in each asset class policy. This investment size limitation shall be applied to the aggregate amount of capital across multiple asset classes, as necessary, while remaining within compliance of the most restrictive investment limitation, as necessary.

The SISS Private Portfolio shall also be diversified across Private Equity, Inflation
Sensitive, and Real Estate and Innovative Strategies opportunities, and the geographic parameters to control for unintended biases.

<table>
<thead>
<tr>
<th>Geographies</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>25%</td>
<td>100%</td>
</tr>
<tr>
<td>Developed Markets (Non-United States)</td>
<td>0%</td>
<td>75%</td>
</tr>
<tr>
<td>Non-Developed Markets</td>
<td>0%</td>
<td>25%</td>
</tr>
</tbody>
</table>

**EXHIBIT 2: Policy Implementation Flowchart**

CalSTRS BOARD

Establishes Policy

CHIEF INVESTMENT OFFICER/DEPUTY CHIEF INVESTMENT OFFICER

Reviews and Advises Policy Parameters

ASSET-CLASS INVESTMENT DIRECTOR

Develops Strategy and Oversees Implementation

PORTFOLIO MANAGER/ASSOCIATE PORTFOLIO MANAGER

Develops and Implements Portfolio Strategy

INVESTMENT OFFICER

Analyses, Transacts and Monitors Portfolio Activity
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
Revised to adopt Sustainable Investment & Stewardship Strategies Portfolio January 27, 2021
Revised to adopt Sustainable Investment & Stewardship Strategies Private Portfolio March 4, 2021
SUSTAINABLE INVESTMENT & STEWARDSHIP STRATEGIES PROGRAM AND PORTFOLIO POLICY

INVESTMENT BRANCH

March 2021
C. Sustainable Investment & Stewardship Strategies Program and Portfolio Policy¹

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

¹ 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

- Priorities are established in the Annual Stewardship Plan
- Is it an engagement priority?
  - Yes: Refer to Stewardship Plan → Determine best tools for influence → Track outcomes
  - No: Determine relevance to long-term performance → Evaluate CalSTRS ability to influence change → Assess ability to deliver measurable outcomes

- Based on staff analysis
  - No action: Acknowledge receipt & articulate priorities
  - Action: Determine tools & resources required

- Low resources → Medium resources → High resources
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 asset classes. Within this allocation, the Chief Investment Officer (CIO), or designee, has authority to authorize investment within the Sustainable Investment and Stewardship Strategies Portfolio (SISS Portfolio). The SISS Portfolio has two components: the SISS Public Portfolio and the SISS Private Portfolio. In aggregate, the assets under management (AUM) in the SISS Public and Private Portfolios shall not exceed five percent of the CalSTRS Total Fund market value. The SISS Portfolio shall have a blended performance benchmark comprised of the weightings of the SISS Public Portfolio and the SISS Private Portfolio multiplied by their respective benchmarks. 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. This policy is 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.

RISK MANAGEMENT

In aggregate, the assets under management (AUM) in the SISS Public and Private Portfolios shall not exceed five percent of the CalSTRS Total Fund Market Value.

Delegation of Authority

The CIO or designee has the authority to manage the Sustainable Investment & Stewardship Strategies Portfolio and may use other investment personnel to implement these policies and the processes described in the procedures.
The CIO or designee has the authority to approve commitments to strategies within the boundaries established by CalSTRS investment policies.

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.

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 will review this policy periodically, as deemed appropriate and in keeping with its fiduciary standards.

**SISS Public Portfolio**

**PROGRAM OBJECTIVES**

The SISS Public Portfolio shall be invested to improve the diversification of the total investment portfolio and to enhance its risk-adjusted total return. The SISS Public 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 Public Portfolio includes public equity strategies (including vehicles which primarily invest in public equities), 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 Public Portfolio benchmark is the Custom MSCI All Country World Investable Market Index (MSCI ACWI IMI).

PROGRAM STRUCTURE

The public equity portion of the SISS portfolio includes a range of strategies, including actively managed portfolios, partnerships which primarily invest in public securities, and passively managed 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.

Public Co-Investments

Public co-investments are limited to the publicly traded stocks domiciled in markets in which the SISS Public 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.

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.

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 Public 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.

SISS Private Portfolio

PROGRAM OBJECTIVES

The SISS Private Portfolio serves as a source of long-term capital appreciation for the CalSTRS Total Fund (Fund). The goal of the SISS Private Portfolio is to opportunistically improve the risk and return characteristics of the Fund. The investment scope of the SISS Private Portfolio is broad. The SISS Private Portfolio exists to leverage CalSTRS’ investment partners to source and invest in opportunities that demonstrate positive contributions to a more sustainable global economy, across private market asset classes. The portfolio does not seek to replicate investments that already exist in other parts of the CalSTRS portfolio. Instead, it creates a systematic platform to expand investment opportunities in private equity, infrastructure and real estate that are additive to the total fund.

PERFORMANCE OBJECTIVES

Over the long-term, the SISS Private Portfolio seeks to produce a positive return greater than the blended weighting of the respective private asset class benchmarks while demonstrating positive contributions towards a more sustainable global economy that benefit plan participants. Separate and distinct performance objectives and benchmarks shall be established for each investment in order to determine whether performance
objectives have been met.

PROGRAM BENCHMARKS

The overall SISS Private Portfolio shall have a blended performance benchmark comprised of the weightings for each of the underlying strategies multiplied by their respective benchmarks, as detailed below:

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Program Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Equity</td>
<td>Private Equity Program Benchmark</td>
</tr>
<tr>
<td>Real Estate</td>
<td>Real Estate Program Benchmark</td>
</tr>
<tr>
<td>Inflation Sensitive</td>
<td>Infrastructure Program Benchmark</td>
</tr>
<tr>
<td>Innovative Strategies</td>
<td>Innovative Strategies Benchmark (as determined by the underlying individual strategy)</td>
</tr>
</tbody>
</table>

PROGRAM STRUCTURE

The SISS Private Portfolio may invest in any set of private assets that are intended to improve the risk and return characteristics of the Fund and demonstrate positive contributions to a more sustainable global economy that benefit plan participants. The SISS Private Portfolio will consist of two sub-components which are subject to appropriate due diligence as defined in the SISS Private Portfolio investment procedures and which, as appropriate, reference the Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies investment procedures:

- Those that leverage existing CalSTRS partnerships across Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies to scale investments that will be additive to the total fund;
- Those that allow CalSTRS to develop new investment partnerships that are additive to the total fund and would otherwise have been allowed under CalSTRS Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies policies.

Permissible Investment Types

In compliance with CalSTRS’ existing investment policies, including the Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies policies, the SISS Private Portfolio may invest in private assets using: (1) Limited Partnerships (and other limited liability vehicles); (2) Commingled Funds; (3) Discretionary Accounts; (4) Separately Managed Accounts; (5) Co-investments; (6) Secondary Market Transactions; (7) Direct Investments; (8) Joint Ventures; (9) Debt instruments; and (10) Standard investment management agreements.

Within the limits established by CalSTRS investment policies, staff is responsible for the selection, allocation, and oversight of the investments, strategies and external managers. If
prudent, CalSTRS may elect to manage a strategy internally. Any internally managed strategy must be approved by the CIO and General Consultant. Delegation limits for assets are established within CalSTRS existing policies, including Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies and are reflected in the Investment Policy and Management Plan.

All SISS Private Portfolio investments require a positive written recommendation by CalSTRS’ staff and/or a Program Advisor, an Independent Fiduciary, or Co-investment Advisor. All SISS Private Portfolio investments will comply with delegation authority limits outlined in CalSTRS existing Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies policies.

Diversification

Diversification within the SISS Private Portfolio is critical to control risk and maximize returns for the total fund. To provide diversification, the size of each investment shall, in aggregate, be limited to the lessor of half-a-percent (0.5%) of the CalSTRS Total Fund market value, calculated using the total commitments as of the investment decision date or existing limits and restrictions detailed in each asset class policy. This investment size limitation shall be applied to the aggregate amount of capital across multiple asset classes, as necessary, while remaining within compliance of the most restrictive investment limitation, as necessary.

The SISS Private Portfolio shall be diversified across Private Equity, Inflation Sensitive, Real Estate and Innovative Strategies opportunities.
EXHIBIT 2: Policy Implementation Flowchart

CalSTRS BOARD
Establishes Policy

CHIEF INVESTMENT OFFICER/DEPUTY CHIEF INVESTMENT OFFICER
Reviews and Advises Policy Parameters

INVESTMENT DIRECTOR
Develops Strategy and Oversees Implementation

PORTFOLIO MANAGER / ASSOCIATE PORTFOLIO MANAGER
Develops and Implements Portfolio Strategy

INVESTMENT OFFICER
Analyzes, Transacts and Monitors Portfolio Activity
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
Amended 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
Revised to adopt Sustainable Investment & Stewardship Strategies Private Portfolio March 4, 2021
In January, Staff provided the Investment Committee with a first reading of several changes to the Sustainable Investment & Stewardship Strategies ("SISS") Program and Portfolio Policy ("Policy").

Based on feedback from the Investment Committee, Staff has provided additional changes to the Policy in this second reading. *Meketa concurs with the changes to the Policy proposed by Staff.*

**Summary of Proposed Changes in First Reading**

The SISS Policy (formerly the Corporate Governance Policy) is one of CalSTRS' longest-standing policies. It is divided into two parts: one for the Stewardship Program that governs activities like proxy voting and company engagement and one, referred to as the Portfolio Policy, that governs the investment activities of the SISS team. The latter was amended last year to include CalSTRS' low carbon index and to modify the SISS benchmark to reflect the public equity strategies employed by the SISS team.

We summarize the proposed changes from the first reading in January below:

- Separated out the parameters and policies that govern SISS private market (i.e., Private Equity, Real Estate, Infrastructure) investments from those that govern the SISS public market (i.e., Global Equity) investments.
- Created an overall limit of 5% of the total CalSTRS portfolio invested within the SISS Program. Currently, no limit exists.
- Specified that investment decisions for SISS investments will be governed by the policies and parameters of each of the asset class policies under which each SISS asset would be categorized, subject to an overriding limit of 0.5% of the CalSTRS Total Portfolio invested in a single asset.
- Specified the benchmark for the SISS Private Portfolio will be custom benchmark that aggregates the underlying benchmarks for each asset as defined by the asset class policies that govern each SISS investment.

Importantly, the proposed policy changes clarify that the SISS portfolio is not an asset class or distinct pool of assets. Rather, it is an approach to investing that spans existing CalSTRS asset classes. This
approach allows CalSTRS to identify, diligence, and invest in strategies that are accretive to the overall expected risk-adjusted return of CalSTRS, where global trends that favor sustainable investment, such as a transition to a low-carbon future, can be taken into consideration at scale. Investments made by Staff within the SISS program will comply with all policies and parameters already in place.

**Summary of Proposed Changes in Second Reading**

Based on feedback from the Investment Committee in January, Staff has made the following additional changes to the Policy.

**Language Clarifications** – These changes clarify the Policy and do not materially impact Staff’s management of SISS.

**Inclusion of Innovative Strategies** – After the last Investment Committee meeting, Staff recognized that certain private market strategies in which CalSTRS invest reside within Innovative Strategies. These are strategies that historically have not fit neatly into the definition of private equity, real estate, or infrastructure (e.g., Private Direct Lending strategies). The modified language highlights that SISS will be able to invest in assets that would be categorized under Innovative Strategies. Like with private equity, infrastructure, and real estate, the SISS private market investment that fall under Innovation would be governed by the specific policies and parameters that apply to all Innovative Strategies assets.

**Details of Program Benchmarks** – As discussed in the First Reading, the SISS Policy will define a benchmark that aligns with the benchmarks for the various asset classes in which SISS investments are categorized. For the Second Reading, Staff added a table that specifies the benchmarks, clarifies that Inflation Sensitive SISS assets will be benchmarked to the infrastructure benchmark, and adds the benchmark for Innovative Strategies.

**Removal of Geographic Parameters for Diversification** – As the SISS investments will be governed by the parameters and constraints of the asset classes in which SISS investments are categorized, there is no need to set specific geographic constraints on the SISS program. Consequently, Staff has removed this section.

**Oversight and Reporting on the SISS Program**

At the January Investment Committee meeting, the Committee asked that Meketa work with Fiduciary Counsel to identify an appropriate mechanism for “enhanced monitoring” of the SISS program, given its novel structure with CalSTRS. After meeting with Fiduciary Counsel, and utilizing the enhanced monitoring of the RMS asset class as a model, we suggest the Committee consider the following components to enhanced monitoring.

**Quarterly Questionnaire** – On behalf of the Committee, Meketa would develop a quarterly questionnaire that SISS Staff would complete. Meketa would review the responses with Staff at regularly scheduled meetings.
Quarterly meetings with SISS Leadership – Meketa would meet with the SISS team at least quarterly to monitor developments in the Program.

SISS Scorecard for the Investment Committee – Meketa would develop a scorecard for the Investment Committee. This scorecard would rate the SISS team in its execution of the Program, and would be provided to the Investment Committee quarterly.

Enhanced Reporting to the Investment Committee – Staff and Meketa would provide separate reporting on SISS to the Committee semi-annually. The reporting would include a written status update from Staff and one from Meketa (with the Scorecard highlighted above).

This enhanced monitoring would parallel structurally the enhanced monitoring Meketa currently conducts on the RMS asset class. The Committee could evaluate the ongoing need for enhanced monitoring of SISS as the program develops.

Conclusions

The Policy changes requested by Staff are consistent with the CalSTRS Investment Beliefs and do not expand Staff's ability to invest in assets or strategies. The Policy changes do clarify the role of the SISS portfolio within the overall CalSTRS portfolio, clarify that parameters and benchmarks for individual SISS investments will be applied based on the asset class in which those investments reside, set a framework for monitoring and reporting on SISS investments going forward, and represent an extension and continuation of the collaborative model. Further, they are responsive to the requests of the Investment Committee at the January meeting.

We look forward to discussing these changes with the Investment Committee at the March meeting. If you have any questions, please feel free to contact us at (760) 795-3450.

SPM/AE/MLM/jls