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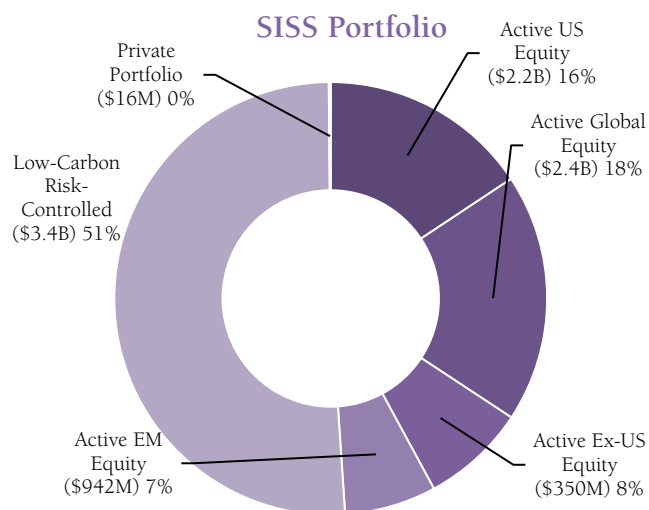
# Investment Committee Semi-Annual Activity Report

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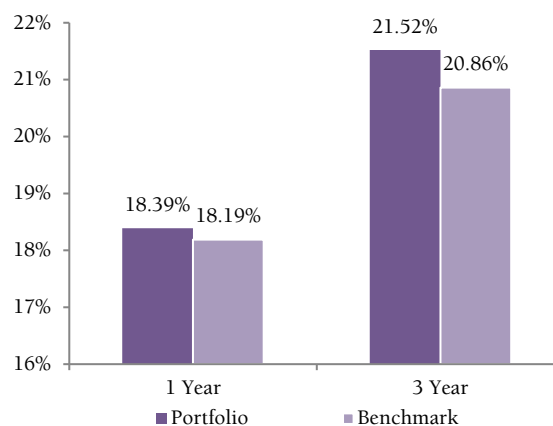
| 2. Sustainable Investment &  
Stewardship Strategies

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INVESTMENT: SISS Portfolio



Performance for Period Ending 12/31/21



INVESTMENT: SISS Portfolio Updates

During the second half of 2021, staff continued withdrawing capital from low conviction strategies or reducing exposure to higher risk strategies to manage the portfolio to the SISS risk budget. Consequently, a number of fund redemptions were received during the period, including liquidation of one fund. Redemptions were redeployed to the Low-Carbon Index, high conviction active managers, and to fund new SISS Private Portfolio investments. In addition, staff launched an Alternative Solicitation Process to expand the pool of sustainability-focused public equity managers.

The Investment Committee approved the establishment of the SISS Private Portfolio in March 2021. During the period the inaugural SISS Private Portfolio investment was funded, a low-carbon solution co-investment with Private Equity.

STEWARDSHIP: Proxy Voting

Staff continues to fulfill the Board’s fiduciary duty to treat proxy votes as plan assets. During the period, **staff voted proxies at 2,466 meetings**, consisting of 494 U.S. meetings and 1,972 international meetings.

In the U.S., staff voted on a variety of issues, in alignment with the [CalSTRS Corporate Governance Principles](#), including:

- 8,230 director votes
- 2,355 auditor ratification votes
- 2,631 compensation plan related votes
- 588 mergers/acquisitions
- 136 shareholder proposals

## STEWARDSHIP: Engagement Priorities and Highlights

### *Net Zero Transition*

Investors made considerable progress during the 2021 proxy season influencing some of the largest greenhouse gas producing companies in the United States.

Phillips 66, a CalSTRS-led Climate Action 100+ focus company, listened to the concerns of investors and committed to a 30% reduction of scope 1 and 2 emissions (those generated directly by a company's operations or to produce electricity purchased by the company), as well as a 15 % reduction of scope 3 emissions (those generated by the use of a company's products) by 2030. With the announcement the company became the first U.S.-based oil refiner to commit to lowering its scope 3 emissions.

Additionally, in October 2021, in response to a CalSTRS filed shareholder proposal, Phillips 66 released a lobbying activity report showing how the company's policy goals align with the Paris Climate Agreement. The company also explained its emerging focus on renewable fuels, batteries, carbon capture and hydrogen. The Phillips 66 case shows how CalSTRS stewardship priorities and engagement strategies are having a significant impact on companies.

Additional highlights included the following:

- In the six months since supporting Engine No. 1's activist campaign to instill three new directors on the board at ExxonMobil, CalSTRS has seen its efforts begin to pay off. In October 2021, the company announced its support for the global methane pledge supported by more than 30 nations including the U.S. In December 2021, the company announced a commitment to achieve net zero greenhouse gas emissions from operations in the U.S. Permian Basin by 2030. The plan enhances the company's commitment to reduce upstream greenhouse gas emissions intensity by 40-50% over the next decade. While these are positive announcements, CalSTRS will continue to engage and monitor the company for additional changes towards implementing a strategic plan for sustainable value creation.
- In November 2021, Southern Company announced a target for retiring more than half of the company's remaining coal-fired power generation fleet. During the company's 3<sup>rd</sup> quarter earnings call, CEO Tom Fanning highlighted the latest cuts in Mississippi and Georgia noting that by 2028, the company will have reduced its coal-fired generation capacity by 80% since 2007.

### *Board Effectiveness: Human Capital Management & Diversity*

#### **Pandemic Resilient 50**

CalSTRS led the Pandemic Resilient 50 (PR-50) a group of ten like-minded institutional investors with approximately \$4 trillion in assets under management. As a result of engagement, the PR-50 identified and pressed for a set of board best practices including: 1) A plan for crisis management including contingency planning, 2) Aligning labor rights with local and global standards, 3) Adopting worker-focused practices such as paid sick leave, fair and living wages, and training and development programs, and 4) Establishing clear and specific goals for diversity, equity and inclusion.

### **California Investors for Effective Board Diversity**

Building on the success of the California Board Diversity Initiative – initiated in 2015 and focused on increasing the board diversity of California companies – the same California-based investors (LACERA, CalPERS, CalSTRS and SFERS) expanded their focus from California headquartered companies to the S&P 500, with continued advocacy of diversity inclusive of gender, racial, ethnic diversity and LGBTQ+ identity. The California group sent 57 letters to S&P 500 companies which had not disclosed board diversity metrics or objectives, which resulted in 41 companies appointing 15 women of which 12 identified as minorities, and 7 men who identified as minorities to corporate boards.

### **Thirty Percent Coalition**

CalSTRS is a member of the [Thirty Percent Coalition](#) and was co-chair of the Institutional Investors Committee through the end of 2021. For its 2021-2022 “Adopt a Company” campaign, the Coalition identified 282 companies within the Russell 3000 Index which report having zero or one woman director on their boards. The Coalition will engage these companies to request that diversity, inclusive of gender, race, and ethnicity be considered as a priority in board composition, and to commit to including both women and people of color in applicant pools. The campaign achieved strong results: 127 companies appointed women to their boards.

### *Corporate and Market Accountability*

#### **Methane Emissions Regulation**

The Environmental Protection Agency (EPA) proposed amendments to the Clean Air Act to reduce methane emissions from the oil and natural gas industry, including--for the first time--reductions from existing sources. The proposed rule would reduce 41 million tons of methane emissions from 2023 to 2035, the equivalent of 920 million metric tons of carbon dioxide. The rule comes after years of CalSTRS’ advocacy for tighter methane regulations, including our support of a [joint investor statement for ambitious methane regulation](#). CalSTRS directly engaged the EPA in October 2021 to support stronger regulation.

#### **International Sustainability Standards Board**

CalSTRS plays a leadership role in encouraging companies to use the standards developed by the Sustainability Accounting Standards Board (SASB). As a result of global investor demand for SASB Standards, more than 50% of companies in the S&P Global 1200 use them. CalSTRS supports a single global baseline of sustainability information for investors, and over the last year, we encouraged the International Financial Reporting Standards (IFRS) Foundation to pursue sustainability standards development built on the foundation of SASB Standards. In November 2021, the IFRS Foundation announced its plans to develop sustainability standards through its new International Sustainability Standards Board. IFRS also announced its intent to acquire the parent organization of the SASB Standards.

#### **Universal Proxy Ballots**

New voting rules approved by the U.S. Securities and Exchange Commission in November 2021 will make elections for directors on company boards fairer and easier for investors. CalSTRS has advocated universal proxy for years so all shareholders can choose the combination of directors they believe will best manage the company regardless of who nominates them.

## Corporate Compensation Clawbacks

Bonus and incentive pay for top corporate leaders is often based on the financial performance of a company. After a decade of CalSTRS engagement with the SEC, a new rule will require executives to return their bonus pay if it is based on company performance that is revised downward. In October 2021, the SEC asked stock exchanges to make companies adopt a compensation clawback policy or risk delisting.

### *Responsible Firearms*

In late summer, CalSTRS responsible firearms initiative focused on the federal regulatory process. CalSTRS submitted two letters to the ATF during an open comment period. The letters were in support of two Biden Administration proposals. One to require serial numbers on, and background checks for the sale of parts used to make ghost guns, or guns assembled at home lacking commercial serial numbers. Another to restrict the use of pistols modified with stabilizing braces. The letters opined that firearm related violence is a danger which results in a direct and an indirect toll on business including lost revenue, increased costs, and unfavorable economic conditions particularly in low-income communities. Reviewing regulations to address advances in firearms technology is a responsible practice. The ATF is expected to release the new regulations in 2022.

Additionally, the Principles for a Responsible Civilian Firearms Industry continued the focus on the growing problem of ghost guns. Signatories are directly engaging with credit card companies asking the four major service providers to explain their policies regarding facilitating the sale of ghost gun kits and parts. Additionally, investors are identifying how the companies evaluate financial, legal, and reputational risk associated with the sale of firearms. These conversations will continue in 2022 year and will be strengthened by escalated engagement strategies.

### Divestment Costs (Total Fund)

CalSTRS has divested from several public equity companies, beginning in 2006, when certain companies were divested due to geopolitical risk concerns. Since 2006, CalSTRS has also divested from tobacco companies (June 2009), firearms companies (April 2013), thermal coal companies (U.S. companies, February 2016 and Non-U.S. companies, June 2017), and U.S. private prison companies (November 2018).

The following table estimates the cumulative performance impacts to identified portions of the CalSTRS investment portfolio due to company divestment.

Performance Differences Attributable to Divestment			
	Quarter	6-Month	Cumulative
U.S. Equity	0.03%	0.05%	0.06%
Non-U.S. Equity	-0.04%	-0.29%	-10.52%
Fixed Income	0.00%	0.00%	-0.09%
Total Fund	-0.00%	-0.04%	-2.13%