



# Investment Committee

## Item Number 5a – Open Session

**Subject:** Sustainable Investment & Stewardship Strategies (SISS) Program and Portfolio Policy Revision – First Reading

**Presenter(s):** Kirsty Jenkinson

**Item Type:** Action

**Date & Time:** May 4, 2023 – 10 minutes

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**ATTACHMENT(S):** Attachment 1 – Sustainable Investment & Stewardship Strategies Program and Portfolio Policy – Clean Version  
Attachment 2 – Sustainable Investment & Stewardship Strategies Program and Portfolio Policy – Redline Version  
Attachment 3 – Meketa Memo

**POWERPOINT(S):** SISS Investment Policy Revisions

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### **Item Purpose**

The Sustainable Investment & Stewardship Strategies (SISS) Policy (SISS Policy) governs the management of the SISS Portfolio (which includes the SISS Public Portfolio and the SISS Private Portfolio) to opportunistically improve the risk and return characteristics of the CalSTRS Total Fund and explicitly integrate sustainability considerations as a value driver in investment strategy. The purpose of this item is to propose revisions to the SISS Policy in order to implement the Investment Committee’s direction to allocate 20% of Public Equity to the MSCI ACWI Low Carbon Target Index (LCTI).

### **Recommendation**

Staff recommends the following two revisions to the SISS Policy for the Investment Committee’s consideration. Meketa Investment Group, the Board consultant, agrees with the changes recommended by staff, but the benchmark change is being reviewed by Meketa in the context of the Board’s broader benchmarking workstream.

The following two revisions are necessary to implement the Investment Committee’s allocation of 20% to the LCTI and ensure staff can continue to execute the objectives of the SISS Public Portfolio:

- 1) Modify the SISS Public Portfolio Policy benchmark to a blended performance benchmark comprised of a weighted blend of each underlying investment strategy.
- 2) Modify the SISS Public Portfolio active risk budget to be incorporated within the Total Public Equity Portfolio<sup>1</sup> active risk budget proposed in the Global Equity Investment Policy (refer to companion agenda item 5b).

Staff will incorporate feedback from the committee into the policy and bring it back for a second reading unless the committee decides to approve the recommended changes at this meeting.

### **Executive Summary**

The Board approved allocating 20% of Public Equity to the MSCI ACWI Low Carbon Target Index (LCTI) at the August 2022 Investment [Committee](#). Currently, CalSTRS allocation to LCTI sits within the SISS Public Portfolio. In order to streamline the management of public equity index strategies, staff believes the LCTI allocation should be wholly managed within the Global Equity portfolio. This is the most prudent and efficient way to accommodate the target 20% allocation to LCTI, as opposed to having two separate allocations in two different portfolios. The proposed SISS Policy revisions reflect the changes necessary to ensure staff can continue to execute the objectives of the SISS Public Portfolio:

- 1) Modify the SISS Public Portfolio Policy benchmark to a blended performance benchmark comprised of a weighted blend of each underlying investment strategy.
- 2) Modify the SISS Public Portfolio active risk budget to be incorporated within the Total Public Equity Portfolio active risk budget proposed in the Global Equity Investment Policy companion agenda item.

The revisions provide staff the ability to implement the Investment Committee's direction with the added benefit of simplifying the management of the public equity low-carbon index strategy under one unit. In addition, subsuming the SISS Public Portfolio active risk budget within the Total Public Equity active risk budget allows Global Equity staff to better manage active risk for the Total Public Equity Portfolio and benefits from their extensive expertise in this area.

Staff is also seeking approval for minor Policy revisions that provide policy clarity and align with Investment Branch policy specifications. The SISS Policy is divided into two parts. The recommendations and Policy edits referenced in this agenda item all relate to the second part of the SISS Policy which is focused on the SISS Portfolio. The first part of the SISS Policy is related to the Stewardship Program and includes all activities that are linked, but do not directly involve portfolio management. There are no recommended edits to the Stewardship Program part of the SISS Policy.

### **Background**

At the September 2021 Investment Committee, CalSTRS adopted a pledge to achieve a net zero investment portfolio by 2050 or sooner. Subsequently, at the August 2022 Investment [Committee](#), the Committee approved a package of four investment measures that support CalSTRS net zero portfolio emissions strategy. One of these measures was the approval to

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<sup>1</sup> The Total Public Equity Portfolio is the aggregate of the public equity holdings across the CalSTRS portfolio

allocate 20% of Public Equity to LCTI to assist in achieving the net zero portfolio emissions reduction goal. Staff has developed an implementation plan and reviewed the impacts on benchmarks and risk budgets. Staff has determined that the LCTI allocation can be implemented within the Global Equity portfolio, further detailed in the Global Equity Investment Policy companion agenda item.

To facilitate this implementation plan, the current allocation to the LCTI (approximately \$4.2 billion, as of January 31, 2023) will be transferred from the SISS Public Portfolio to the Global Equity portfolio for operational and execution efficiency. While this transfer creates benefits for the Total Fund, it has implications for the SISS Public Portfolio that need to be addressed.

### ***Current Benchmark***

The performance of the current SISS Public Portfolio is benchmarked to a global index (Custom MSCI All Country World Investable Market Index). This benchmark is appropriate for the current SISS Public Portfolio as it is currently composed of concentrated, active strategies and diversified, risk-controlled (or "passive") strategies that align with a global index.

### ***Proposed Benchmark***

The proposed SISS Public Portfolio, without a sizable allocation to an internally-managed diversified global index (currently the LCTI), presents a significant allocation mismatch relative to the current global benchmark. In other words, the old benchmark would no longer be appropriate to assess performance of the proposed SISS Public Portfolio. Staff is therefore proposing a revised benchmark that would consist of a market value weighted blend of each underlying strategy as a more appropriate benchmark to assess portfolio performance. The benchmark methodology would be consistent with the Innovative Strategies and SISS Private Portfolio benchmarks.

### ***Current Risk Budget***

The Investment Committee adopted an annualized forecast risk budget of 50 to 250 basis points for the SISS Public Portfolio in July 2021 based on the portfolio composition at that time. A separate SISS Public Portfolio risk budget was appropriate at that time as a distinct public equity portfolio with both active and "passive" (indexed and risk-controlled) strategies.

### ***Proposed Risk Budget***

In light of the proposed LCTI transition to Global Equity, the SISS Public Portfolio will no longer have an indexed component. Staff believes that a separate risk budget is no longer appropriate for the proposed, fully active, SISS Public Portfolio. Instead, staff and Meketa agree that it is best practice for the SISS Public Portfolio active risk budget to be subsumed and managed within the proposed Total Public Equity active risk budget, further detailed in the Global Equity Investment Policy companion agenda item.

The remaining changes to the SISS Policy are minor revisions that provide Policy clarity and align with Investment Branch policy specifications. Comments explaining the changes are included in the red-lined version (Attachment 2).

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Staff will incorporate feedback from the Committee into the Policy and bring it back for a second reading unless the Committee decides to approve the recommended changes at this meeting. If approved, staff will coordinate with Global Equity on the effective date of the changes.

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Strategic Plan Linkage: Goal 1 of the [CalSTRS Strategic Plan](#) - Trusted Stewards: Ensure a well-governed, financially sound trust fund

Board Policy Linkage: [Sustainable Investment & Stewardship Strategies Program and Portfolio Policy](#)

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