



# **Corporate Governance Policy**

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# I. Purpose

The Corporate Governance Policy (Policy) outlines the objectives, legal authority, and procedures guiding LACERA's corporate governance program.

# II. Strategic Objective

LACERA seeks to responsibly steward its investments in a manner that promotes and safeguards the economic interests of LACERA and its members, consistent with LACERA's mission to "produce, protect, and provide the promised benefits."

Through its corporate governance program, LACERA prudently exercises its rights as an investor to support policies and practices at portfolio companies, as well as public policies governing financial markets, that are consistent with LACERA's economic interests in order to promote sustainable, long-term value on behalf of LACERA's members and enhance LACERA's ability to fulfill its mission.

### III. Legal Authority

The LACERA Board of Investments has “the sole and exclusive fiduciary responsibility over the assets of” the system, as provided by the California Constitution (Article XVI, Section 17(a)).

LACERA exercises its legal rights on corporate governance matters in furtherance of its fiduciary duty under Article XVI, Section 17 of the California Constitution, the County Employees Retirement Law of 1937 (CERL), and other governing laws, regulations, and case authority. The Board’s fiduciary duty has two components:

#### A. Duty of Loyalty

Under the duty of loyalty, Board members have the sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. (Article XVI, Section 17(a).) Board members shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. (CERL Section 31595(a).) The Board’s duty to participants and their beneficiaries shall take precedence over any other duty. (Article XVI, Section 17(b).)

#### B. Duty of Prudence

Under the duty of prudence, Board members shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims. (Article XVI, Section 17(c); CERL Section 31595(b).) “[T]he Board may, in its discretion, invest or delegate the authority to invest, the assets of the fund through the purchase, holding, or sale of any form or type of investment, financial instrument, or financial transaction when prudent in the informed opinion of the Board.” (CERL Section 31595.) Further, the Board “[s]hall diversify the investments of the system so as to minimize risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.” (CERL Section 31595(c).)

The fiduciary obligations of prudence and loyalty to plan participants and beneficiaries compel and guide LACERA’s corporate governance activities. LACERA’s fiduciary duties extend to, but are not limited to, prudently managing its proxy votes, vigilantly monitoring and diligently mitigating risks to the value of its investments, and judiciously determining action in order to assist in the effective administration of the fund and promote the interests of members and their beneficiaries.

## IV. Program Components

LACERA's corporate governance program may include the following components and responsibilities:

### A. Proxy Voting

Proxy votes are plan assets, have value, and should be managed in a manner consistent with fiduciary duty and LACERA's interest in long-term value. LACERA exercises its voting rights for the exclusive benefit of LACERA's members and votes proxies of companies held in its global equity portfolio in accordance with its *Corporate Governance Principles*.

LACERA seeks to vote all proxies for which it has proxy voting authority. LACERA coordinates with its custodian bank and investment service vendors to maximize its opportunities to responsibly cast proxy votes in line with its fiduciary duty, while recognizing that administrative requirements and practices in certain local markets may affect LACERA's ability to cast proxy votes, such as delayed notification of proxies subsequent to vote deadlines and required powers of attorney in subcustodial chains. At meetings that require share blocking, LACERA evaluates the economic value of casting a proxy vote compared to the risk of limiting trading in the designated security and may opt to refrain from voting in order to preserve LACERA's ability to act in its best economic interests.

LACERA participates in securities lending to earn incremental income, per LACERA's Securities Lending Program Policy. In securities lending, the legal rights accorded those shares, including proxy voting, are transferred to the borrower of the securities during the period that the securities are on loan. As a result, LACERA forfeits its right to vote proxies on loaned securities unless those shares have been recalled from the borrower no later than the share's record date.

### B. Corporate Engagement

LACERA advocates its *Investment Beliefs*, *Corporate Governance Principles*, and mission through dialogue and engagement strategies with portfolio companies, which may include exercising legal rights associated with LACERA's investments, such as sponsoring shareowner resolutions.

### C. Public Policy

LACERA represents its interests to policymakers, such as legislators, regulatory agencies, and standards-setting agencies, in line with its *Corporate Governance Principles*.

### D. Investor Collaboration

LACERA collaborates with other public pension funds, asset owners and asset managers, both informally and formally through investor associations such as the Council of Institutional Investors, in order to enhance LACERA's ability to achieve its objectives and advance its *Corporate Governance Principles*.

## V. Responsibilities and Delegations

### A. The Board of Investments:

- i. Approves and promulgates policies addressing environmental, social, and governance issues, such as corporate governance and proxy voting matters and including, but not limited to, *Corporate Governance Principles* and this *Corporate Governance Policy*, as recommended by the Corporate Governance Committee of the Board.
- ii. Receives periodic reports concerning the program's progress and priorities from the Corporate Governance Committee.
- iii. Approves LACERA representatives for nomination to governing bodies of the corporate governance associations to which LACERA is affiliated, as recommended by the Corporate Governance Committee.
- iv. Approves procedures to comply with legislated or other mandated divestment or investment exclusions, such as LACERA's *Procedures for Evaluating ESG-Related Divestments* (Appendix A), as developed and recommended by the Corporate Governance Committee.

### B. The Corporate Governance Committee of the Board of Investments

- i. Recommends the *Corporate Governance Principles*, the *Corporate Governance Policy*, and other items concerning environmental, social, and governance matters to the Board of Investments for consideration and approval.
- ii. Exercises oversight and monitoring of the corporate governance program, including reviewing program priorities and progress.
- iii. Reviews reports regarding proxy voting results and trends and develops recommendations for Board approval for any policy recommendations, as appropriate.
- iv. Reviews and ensures alignment of strategic initiatives with the *Corporate Governance Principles*.
- v. Provides periodic reports on the program to the Board of Investments.
- vi. Delegates authority to the Committee Chair to determine LACERA's action on time-sensitive, investment- or financial market-related legislative or regulatory matters that are not adequately addressed in the *Corporate Governance Principles* or joint investor engagements affiliated with investor associations to which LACERA has formally affiliated.
- vii. Recommends for Board of Investments approval, LACERA representatives for nomination to governing bodies of the corporate governance associations to which LACERA is affiliated. In event the Committee is not scheduled to meet or lacks adequate time to recommend a nomination to the Board prior to a formal deadline, the Committee delegates authority to the Committee Chair to recommend consideration of the nomination by the Board.
- viii. Recommends for Board of Investments approval, time permitting, LACERA's votes in support or opposition of candidates listed on a formal member ballot and nominated to a governing board of an investor association to which LACERA has formally affiliated. In event the Committee is not scheduled to meet or lacks adequate time to agendaize under the Brown Act an informed recommendation to the Board for vote determinations prior to a formal deadline, the Committee delegates authority to the Committee Chair to recommend consideration by the Board, time permitting, of the votes in support or opposition of board candidates. In time-sensitive circumstances where vote deadlines do not permit such vote considerations by the Committee or the Board, the Committee delegates authority to the Committee Chair to consult with staff per Section V(C)(vi.) below on votes.

### C. Staff

- i. Develops and recommends *Corporate Governance Principles* and related policies for review and consideration by the Corporate Governance Committee.

- ii. Executes proxy votes in adherence to the *Corporate Governance Principles*. Staff consults with and seeks the input of the Chief Investment Officer and Chief Counsel, when applicable, to apply the *Corporate Governance Principles*, and the spirit thereof, to unique or new proxy voting items in their best judgment and interpretation of the *Corporate Governance Principles*. Staff recalls shares of loaned securities when doing so is in LACERA's economic interests, such as at portfolio companies where LACERA has sponsored a shareowner proposal.
- iii. Communicates and represents the *Corporate Governance Principles* in dialogue and communication with portfolio companies, other investors and stakeholders, related conferences, and other interested parties.
- iv. Presents any strategic plans for engagement to the Corporate Governance Committee, per the Committee's review and oversight, to promote alignment with Board-approved *Corporate Governance Principles*. In the event of time-sensitive strategic initiatives, staff consults with the Chair of the Committee, who determines action or recommends consideration of the matter by the Committee or Board, time permitting.
- v. Represents the *Corporate Governance Principles* in written communication to legislators and regulatory agencies, in consultation with the Chief Executive Officer, Chief Investment Officer, and Chief Counsel. Staff may participate in joint investor written communications that are organized as part of formal investor associations to which LACERA has formally affiliated. In event that a time-sensitive, investment- or financial market policy-related legislative or regulatory matter arises that is not adequately considered by the *Corporate Governance Principles* or being addressed by an investor association to which LACERA is affiliated, staff consults with the Chair of the Committee, who determines whether to approve action or recommend consideration of the matter by the Board, time permitting.
- vi. Represents LACERA and its *Corporate Governance Principles* at investor associations, including managing membership surveys, business meeting votes (other than selecting which candidates to a governing board to support or oppose), and other operational interactions, in adherence to the *Corporate Governance Principles* and the spirit thereof, in its best judgment and interpretation. In the event that a time-sensitive vote arises on a unique item or an issue that is not adequately considered by the *Corporate Governance Principles*, as well as for governance-related investor associations' formal business meeting ballot items pertaining to support or opposition of candidates to a governing board, and when time constraints prohibit such items from being presented to the Committee or Board for consideration, staff may determine a vote in consultation with the Chair of the Committee.

## VI. Regular Review and Reaffirmation

LACERA reviews and reaffirms this Policy at least every three years in order to ensure its alignment with LACERA's mission and objectives and in light of evolving market practices on corporate governance; environmental, social, and governance ("ESG"); and responsible investment matters.

## Appendix A: Procedures for Evaluating Prospective ESG-Related Divestments

As stated in LACERA's *Investment Beliefs*, "LACERA operates in a global financial marketplace, and as such, LACERA believes that in order to diversify its risk broadly, it is vital that LACERA possess a global perspective. Diversification across different risk factors is necessary for risk reduction."

As a diversified, global investor, LACERA is periodically requested to review its public markets investment exposures to certain issues arising from environmental, social, or governance concerns. It is generally the preference of LACERA, in order to promote diversification and minimize risk, to engage rather than divest investment holdings concerning risks to long-term value. However, in order to address prospective divestment issues and identify LACERA's exposure to exogenous risks related to environmental, social, or governance issues and not addressed elsewhere in the Investment Policy Statement, the following formal process has been adopted:

1. The issue will be directed to Committee for further direction to staff.
2. If the Committee decides to review the issue, staff will assess the potential economic and reputational impact of the issue on LACERA.
  - a. Does the issue violate LACERA's *Corporate Governance Principles*?
  - b. Determine criteria for identification of investment(s).
  - c. Preliminary identification of the investment.
  - d. Preliminary estimate on size of the investment.
  - e. Seriousness of the issue/violation and whether it impacts the economics of the investment(s).
  - f. Consultation with LACERA's CEO, CIO, and legal counsel.
3. Staff will report its findings on the potential economic and reputational impact of the issue on LACERA to the Committee.
4. The Committee may forward the issue and potential economic and reputational impact on LACERA to the Board of Investments (Board) for further direction.
5. If the Board directs staff to continue the analysis, staff will calculate the anticipated resources involved in analyzing the issue, including, but not limited to:
  - a. Estimate of staff hours required for research and analysis.
  - b. Estimate of the resource impact on current staff initiatives and projects (e.g., the delay in an RFP search).
  - c. Estimate of cost to obtain information (e.g., company list) from external service provider.
6. Staff will report back to the Committee with its resource requirements analysis.
7. Committee may make recommendation to the Board to pursue additional analysis.
8. Upon receiving direction from the Board, staff will contract with external data provider to identify investment(s) impacted by the issue.
9. Staff will identify investment exposures within the separate accounts of the public markets asset classes (equities, fixed income and commodities).
10. Staff will contact external investment managers to solicit feedback from portfolio managers on reasoning for the investment and potential return and risk trade-off of economic substitution.
11. Staff will present findings to the Board and any recommendation(s) as necessary. If further action is warranted, such as engagement with companies, staff's report to the Board will include the following:



- a. An estimate of additional staff hours needed to execute engagement.
  - b. An estimate of the impact of diverting resources from current staff initiatives and projects (e.g., the delay in an RFP search).
  - c. Cost of retaining external resources (third party consultant) to assist in the engagement process.
  - d. Feedback from portfolio managers on their investment in the company.
  - e. Discussion of criteria and terms for company engagement.
12. If further action, such as engagement, is recommended and approved by the Board, staff will seek to engage with companies on the issue. Letters will be written to the company's executive management and their boards, requesting responses within 60 days.
  13. If company response is determined to be insufficient, staff will assess the need to place the company on an economic substitution list<sup>1</sup> and present recommendation(s) to the Board for approval. Included in the recommendation(s) will be the following:
    - a. Updated company exposure within separate accounts of public markets asset classes.
    - b. Annual cost to procure company list.
    - c. Criteria by which company will be removed from the economic substitution list.
  14. Staff will continuously monitor company status relative to criteria for removal from the economic substitution list. Once criteria have been met, staff will recommend removal of the company to the Board.
  15. Staff will provide an economic substitution list update to the Board annually, which will include the following:
    - a. All companies currently on the list.
    - b. Issue for which the company was placed on the list.
    - c. Investment exposure within separate accounts of public markets asset classes.
    - d. Current status of mitigating factors.

## Document History

Revised March 13, 2019

Revised August 9, 2017

Reviewed October 12, 2016

Revised November 19, 2014

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<sup>1</sup>Companies on the list will be covered by the following investment guideline policy language: "Investment managers should refrain from purchasing securities on the economic substitution list when the same investment goals concerning risk, return, and diversification can be achieved through the purchase of another security."