UNIVERSITY of GUELPH

BOARD of GOVERNORS

To: Members of the Board of Governors

From: Gen Gauthier-Chalifour, University Secretary

Subject: 3. Strategic Discussion

Meeting: Wednesday, April 22, 2020

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a) Responsible Investing – Divestment of Fossil Fuels [Motion]

Motion for Consideration

The following motion is presented on recommendation of the Investment Subcommittee, and the Finance Committee.

The Board of Governors is asked to,

RESOLVE, that the Board of Governors approve that the University of Guelph commit to divestment from the ownership of fossil fuels within the Endowment Portfolio Investment Fund over a five-year period beginning April, 2020; and,

FURTHER RESOLVE, that ownership of fossil fuels is defined as the ownership of companies which hold fossil fuel reserves; and,

FURTHER RESOLVE, that the role of the Investment Subcommittee is acknowledged as critical in managing this transition and the Investment Subcommittee will be afforded all reasonable flexibility in managing the transition through the five-year period; and,

FURTHER RESOLVE, that the Board receive annual reporting on the implementation of the above.

Background

The University has been engaged in the realm of responsible investing since 2014. In 2015 the Board of Governors established an ad hoc Working Group on Responsible Investing, and in 2017 an ad hoc Committee on Special Action Requests was struck in response to a request for divestment of fossil fuels from within the endowment portfolio, from Fossil Free Guelph.[1]

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[1] https://www.uoguelph.ca/secretariat/menu/board-governors/board-governors-ad-hoc-committees-working-groups/ad-hoc-working-group
https://www.uoguelph.ca/secretariat/csar

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In January 2019, the University of Guelph was one of the first Canadian universities to commit to reducing the carbon footprint of its endowment fund. The University also committed to lead in advancing change in the university sector on this issue.

Since that time, the University has also become a signatory to the United Nations Principles for Responsible Investing (UN PRI) and has been engaged in sector-wide discussions to evolve considerations for responsible investing and ESG criteria.

In recent months, with the support of external investment advisors, the University has conducted careful and extensive analysis on the endowment fund to gain assurance that a shift from fossil fuels in the endowment portfolio will not impact performance, particularly if done prudently and over a period of time.

The enclosed memo further elaborates on this background, actions to date, and evolution of the University's approach to responsible investing.

Also available for information online is a briefing note from Fossil Free Guelph and a list of signatures of faculty members supporting divestment collected by Fossil Free Guelph.[2]

Committee Consideration

At recent meetings of the Investment Subcommittee (March 17) and the Finance Committee (March 31), each have considered the proposal from administration to divest from fossil fuels as part of continued discussion and oversight of the work towards the reduction of carbon footprint of the portfolio, and the evolution of the portfolio's responsible investing activities.

The Investment Subcommittee reviewed and discussed the proposal and noted the importance of clarity on the intersection of this proposal and current carbon reduction strategies, and the importance of flexibility in managing the process over the five-year period.

At its meeting of March 31, 2020, the Finance Committee discussed the alignment of divestment from fossil fuels with the University's previous commitment to take a holistic approach to responsible investing through carbon reduction. The Committee agreed that divestment could be achieved as part of this holistic approach and that it was aligned with the University's broader environmental leadership and sustainability efforts. The Finance Committee also agreed that the Investment Subcommittee would need to be provided with sufficient time and discretion to implement the divestment commitment.

[2] https://uoguelph.civicweb.net/filepro/documents/177817
https://uoguelph.civicweb.net/filepro/documents/177818

UNIVERSITY of GUELPH

OFFICE of THE VICE-PRESIDENT
FINANCE, ADMINISTRATION & RISK

To: **Board of Governors**

From: Don O'Leary, Vice President (Finance, Administration & Risk)

Date: **April 22, 2020**

Subject: **Responsible Investing: Fossil Free Initiative (ENDOWMENT)**

Background:

In January 2019, the University of Guelph was one of the first Canadian universities to commit to reducing the carbon footprint of its endowment fund. This commitment included a 10% reduction of the carbon footprint in the portfolio over a period of two years, and a further commitment to long-term carbon reduction targets. Additionally, the University committed to lead in advancing change in the university sector in the realm of responsible investing. This decision was made after research and careful consideration by the Special Action Committee. During this time all options were considered, including full divestment and carbon reduction in the portfolio.

Since that time, the University has become a signatory to the United Nations Principles for Responsible Investing (UN PRI) and has been engaged in sector-wide discussions to evolve considerations for responsible investing and environmental, social and governance criteria.

In recent months, the University has also engaged external investment advisors to review its investment strategy and conduct careful analysis on the endowment fund, and various performance scenarios. This extensive analysis, which included review of the growing number of sustainable investment products and returns, provided assurance that a shift away from fossil fuels in the endowment portfolio will not impact performance, particularly if done prudently and over a period of time.

The enclosed briefing outlines the impact of the January 2019 decision, and outlines options with respect to future fossil fuel divestment in the endowment fund.

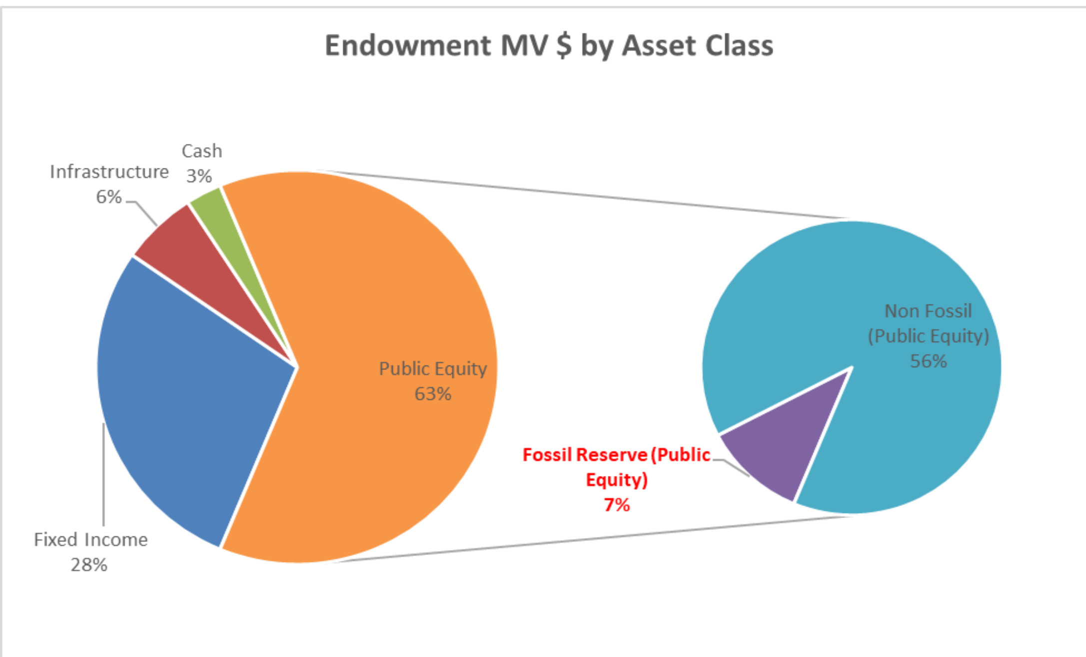
Actions to date:

1. **Since January 2019 we reduced our carbon metric by 17.5%.** As at Dec 31, 2019 our carbon metric dropped to 150.8 tonnes of carbon per USD Million invested (tCO^2/USM), down 32.1 tCO^2/USM from our initial Dec 31, 2018 metric of 182.9 tCO^2/USM. This was achieved through consultations with existing fund managers.

2. **The University of Guelph became a signatory to the UN PRI as of September 2019. As a signatory, the University has committed to implement the six principles:**
    1. We will incorporate ESG issues into investment analysis and decision-making processes.
    2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
    3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
    4. We will promote acceptance and implementation of the Principles within the investment industry.
    5. We will work together to enhance our effectiveness in implementing the Principles
    6. We will each report on our activities and progress towards implementing the Principles.

<u>Current Holdings</u>

Historically the University has reported fossil fuel holdings as being the total investment in the public equity energy sector. However, we are now able to pull more detailed reporting that identifies investments that specifically have fossil fuel reserves. Below is a detailed overview of the entire Endowment portfolio, followed by details of the fossil fuel reserve holdings, as at December 31, 2019.



Holdings with Fossil Fuel Reserves:			
Sector	Market Value (Millions)	# of Holdings	% of Public Equity portion of the Endowment Fund
Energy	$20.2	40	6.9%
Financials	$6.1	2	2.1%
Industrials	$1.9	7	0.7%
Materials	$1.8	10	0.6%
Utilities	$2.4	9	0.8%
Grand Total	**$32.4**	**68**	**11.1%**

Currently, 11.1% of the public equity portion of our portfolio contains holdings with fossil fuel reserves. These holdings equate to roughly 7% of the entire endowment portfolio. In addition to the public equity component of our portfolio, we are also in the process of reviewing our holdings with fossil fuel reserves in the fixed income pooled fund and our alternative investment (infrastructure) fund.

Definition of "Fossil Free"

The reporting that the University has shared with 'Fossil Free Guelph' to date has included all public equity holdings in the Energy Sector. The S&P/TSX 60 Fossil Fuel Free index excludes holdings that have fossil fuel reserves but does not eliminate the energy sector entirely. The original request received from Fossil Free Guelph in 2017 referenced the world's top 200 public coal, oil, and gas companies, and provided the following link the corresponding (http://fossilfreeindexes.com/research/the-carbon-underground/). This website states "The Carbon Underground 200TM identifies the top global 200 publicly-owned coal, oil, and gas reserve owners ranked by the carbon emissions embedded in their reserves.

Impact on Fixed Income, Pooled, and Alternative Investments

The University's emerging market investments is in the form of a pooled fund with a value over $23.4 million. As a pooled fund, the composition of the fund is determined independently (we do not have influence over the composition). Currently $3.3 Million of this fund includes holdings with fossil fuel reserves. If we were to commit to fossil fuel divestment, we would have to sell the entire $25 million pooled fund and transition to other investments.

The University's fixed income investments are passively managed in a pooled fund. As at Dec 31, 2019 it is estimated that this fund consists of 72% government bonds and 28% corporate bonds, some of which may include holdings in companies with fossil fuel reserves.

Evolution of the decision

Over the past few years there has been significant activity in the world of responsible investment. Our consultants, MSCI and Mercer, have provided extensive analysis and reporting that shows both a significant increase in the number of responsible investing products available (ESG, Low Carbon, and Ex-Fossil), and an increase in the quality of data (ability to measure carbon, fossil fuel reserves, etc.) See

Appendix.[1] Additionally, longer term return on investment data is now available which supports the position that return on investment can be equal to or higher in responsible investment funds as compared to core funds.

Recommendation

It is recommended that the University of Guelph commit to **full divestment of holdings with fossil fuel reserves** within the Endowment Fund. We also recommend that we adopt the definition provided above (i.e. investments that hold fossil fuel reserves) We will still continue to monitor our January 2019 commitment to carbon reduction as we continue to evolve our responsible investment goals.

[1] https://uoguelph.civicweb.net/filepro/documents/177816. Access to the Appendix is restricted to Governors as it contains proprietary information the University is contractually obligated to protect.

UNIVERSITY of GUELPH

BOARD of GOVERNORS

To: Members of the Board of Governors

From: Gen Gauthier-Chalifour, University Secretary

Subject: 5. Finance Committee Report

Meeting: Wednesday, April 22, 2020

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a) Update to Statement of Investment Beliefs for the Endowment Fund

Motion for Consideration

The following motion is presented on recommendation of the Investment Subcommittee and the Finance Committee.

The Board of Governors is asked to,

RESOLVE, that the amended Statement of Investment Beliefs for the Endowment Fund be approved, as presented.

Background

Enclosed are proposed amendments to the University's Statement of Investment Beliefs and Principles for the Endowment Fund, to reflect the evolution of the actions and beliefs of the Board of Governors with respect to responsible investing over the past five years. Also enclosed is an illustrative markup of the changes provided by Mercer, setting out additional commentary on the proposed changes.

The endowment portfolio is governed by a number of documents. Governors will be aware of annual changes to the Endowment Investment Policy, which is the primary technical document with respect to endowment investment. In addition to the Endowment Policy there is also a General Endowment Fund Management Policy, which speaks to the general objectives of the fund and spending or "pay-out" policies. The enclosed Statement of Investment Beliefs and Principles for the Endowment Fund is a higher-level principles document and provides overarching statements on the purpose of the fund, its governance, investment process and market beliefs. The Statement of Investment Beliefs was slated for review and revision due to the University's evolving stance on responsible investing over the past several years.

Mercer was engaged in the summer of 2019 to assist the University in a review of its Principles, Policies, and Guidelines pertaining to responsible investing. This process included reviewing various materials gathered over the past five years through both the Working Group on Responsible Investing and the subsequent special action request to the Ad-Hoc Committee on Special Action Requests. As a part of this review, Mercer reviewed principles and policies at other institutions and related material from UNPRI.

Committee Consideration

The proposed statement underwent thorough review by the Investment Subcommittee at their meetings of November 13, 2019, March 17, 2020 and April 9, 2020. The Investment Subcommittee reviewed the statement relative to best practices and the proposal to divest from fossil fuels. The Subcommittee recommended the proposed statement for approval by the Board, through the Finance Committee.

The Finance Committee reviewed the statement at is meeting of March 31, 2020 and is recommending it to the Board for approval.

STATEMENT OF INVESTMENTBELIEFS AND PRINCIPLES FOR THE ENDOWMENT FUND

Approved by the Board of Governors on ~~June 3, 2016~~

I. Introduction

The Endowment Investment Policy (the "Policy") reflects a number of decisions taken by the Board of Governors at the time of the policy development, and at subsequent reviews. These decisions, in turn, reflect certain beliefs held by the Board of Governors at the time the decisions were taken or approved.

To the extent these beliefs remain consistent over time, so too should those elements of the Policy that rest upon them. The purpose of this document is to set forth the Board's beliefs and principles, so that the historical context in which decisions were made will be better understood by readers and users (both current and future).

This statement shall be reviewed at least every three years to ensure that it continues to reflect the views and opinions of the Board.

II. Purpose of the Endowment Fund

- The primary purpose of the endowment portfolio is to invest capital to provide annual income that will grow with inflation.
- Endowment capital is invested for long periods, often expressed as "in perpetuity" meaning short term returns need not outweigh long term performance.
- The generation of long-term, sustainable investment returns is inextricably linked to stability in social, environmental and economic systems[1]. The United Nations Sustainable Development Goals[2] (SDGs) and the Paris Agreement on climate change are important guides for future economic development and financial systems.
- The University, through its endowment fund, should promote awareness of the importance of transitioning the economy in line with the SDGs and the Paris Agreement (the central aim of which is keeping a global temperature rise this century to well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius[3]).

[1] WGRI Final Report 2015 (page 20).

[2] https://sustainabledevelopment.un.org/?menu=1300

[3] https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

- Stewardship (which includes proxy voting, corporate engagement and policy advocacy) is an important tool for the endowment fund to influence companies and policy makers in support of a low-carbon, resilient and inclusive world.
- The University should play an active role in advancing responsible investing within the investment industry, and amongst universities in particular.
- ~~Environmental, social and corporate governance components of business practices offer insight into long term returns and investment risk. Therefore the University will have an interest in considering these factors when making long term investment decisions.~~
- ~~While the endowment portfolio has the primary purpose of providing for the real protection of designated spending, the composition of its investments should reflect the University's role in contributing to the well-being of society with a global perspective.~~
- ~~To the extent possible and prudent, the University can contribute to address global issues of economic growth, social improvement and environmental sustainability through the management of endowment investments.~~

III. Governance

- Good governance contributes to superior, timely and sustainable results. Roles and processes related to the investments should be well documented and communicated to all relevant parties;
- All parties involved in the investments will yield superior investment results if the parties' objectives are clear, the parties are empowered to act and the parties are accountable for their results;
- Transparency supports compliance with policy and allows for effective stakeholder understanding of University investment activities.

IV. Investment Process

- It is more cost-effective to hire external managers than to build in-house expertise in order to meet the various investment objectives;
- In the selection of external managers the University strives to hire the best in class who demonstrate strong ethical standards, committed professional management as well as a proven track record of performance.
- Appropriate and timely reporting of investment activities and results is required in order to monitor the investments' performance against the relevant benchmarks.
- The investments should be made and stewardship activities conducted in the context of understanding the primary objectives of the endowment fund.
- It is important to manage the cost effectiveness of the investment process including ensuring the cost of investment management is balanced in the context of returns.
- Environmental, social and corporate governance (ESG) issues can have a material impact on risk and return outcomes and these issues should be integrated into the investment process.
- Greater disclosure of climate change related risks and opportunities leads to improved transparency and helps investors make more informed investment decisions. The University encourages disclosure in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.

V. Market Beliefs

- ~~Over the longer term assets that have greater risk~~Investment risks borne by the portfolio are expected to provide ~~greater~~ commensurate returns (i.e. uncompensated risks should be avoided). Risk in this context is broader than the general measure of volatility of returns especially when measuring investment outcomes across different markets. Therefore qualitative factors in assessing risk may be considered when developing investment policy.
- To achieve the long term objectives of the endowment fund, a certain level of risk must be taken. This will involve the selection of certain asset classes with greater volatility but greater expected return over longer periods of time.
- Global sustainability challenges—such as climate change, environmental degradation and inequality—will have an impact on long-term investment risks and returns. Reducing exposure to transition risk (i.e. reducing carbon risk exposure) and gaining exposure to companies that that are positioned to support or prosper in a low-carbon, resilient and inclusive economy can improve risk adjusted returns of the portfolio.
- The majority of the variability in the investment returns, and the implied inherent risk, can be explained by the strategic asset allocation selected. As a result, the strategic asset mix decision is critical in determining the risk profile of the investments;
- The investments should be diversified across a broad range of financial assets, asset classes, geographies and management styles as portfolio diversification provides reduction in investment risk;
- Simplicity and transparency are essential attributes of any asset, asset class, or investment strategies that could be contemplated for portfolio diversification;
- The use of derivative instruments should be limited to risk mitigation purposes (e.g., limiting currency exposures) and for efficient access to certain asset classes (e.g., index replication) and not for return enhancement;
- The risk and return characteristics of specific asset classes should be reviewed periodically to evaluate if the investment strategy or the asset allocation for the Policy and its impact on specific investment risk and return metrics is still appropriate;
- Active investment management where markets can be inefficient represents an opportunity to earn higher returns thereby justifying fees. Passive investment management is not excluded when the belief is not as strong;
- Over the long term, fluctuations in currency tend to offset but over the short term, currency risk can matter when a specific exposure to an asset class is sought. Currency management (at a specific manager level or on an overall basis) in order to reduce some of the volatility that may result from interim currency fluctuations can be used if the trade-off between benefit and cost is favourable.

BELIEFS AND GUIDING PRINCIPLES

ILLUSTRATIVE MARK-UP

The following slides cover the *illustrative* mark-up on the University's Statement of Investment Beliefs and Principles (2016) to address some of the gaps identified in the Report.

- These mark-ups are illustrative; meant to promote thought and discussion.
- Mercer would be happy to assist the University of Guelph with further refinement of this Statement following discussion of this ESG Beliefs Gap Analysis report.

ILLUSTRATIVE MARK-UP
II. PURPOSE OF THE ENDOWMENT FUND

#	Provision	Mercer Commentary
1	The primary purpose of the endowment portfolio is to invest capital to provide annual income that will grow with inflation.	No change
2	Endowment capital is invested for long periods, often expressed as “in perpetuity” meaning short term returns need not outweigh long term performance.	No change
3	The generation of long-term, sustainable investment returns is inextricably linked to stability in social, environmental and economic systems. The United Nations Sustainable Development Goals (SDGs) and the Paris Agreement on climate change are important guides for future economic development and financial systems.	This statement lays the foundation of the financial relevance of ESG to financial markets, and that achieving the SDGs is important for long term stability of financial markets.
4	The University, through its endowment fund, should promote awareness of the importance of transitioning the economy in line with the SDGs and the Paris Agreement (the central aim of which is keeping a global temperature rise this century to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C).	This states that the University endowment fund has a role in being visibly supportive of the SDGs. The provision could go further and address how this impacts investment policy.
5	Stewardship (which includes proxy voting, corporate engagement and policy advocacy) is an important tool for the endowment fund to influence companies and policy makers in support of a low-carbon, resilient and inclusive world.	This states the importance of stewardship, but does not dictate any particular approach, nor minimum expectations.
6	The University should play an active role in advancing responsible investing within the investment industry, and amongst universities in particular.	This statement is as per the Ad-Hoc committee’s final report (Jan 2019); recommendation e).
7	~~Environmental, social and corporate governance components of business practices offer insight into long term returns and investment risk. Therefore the University will have an interest in considering these factors when making long term investment decisions.~~	A statement similar to this has been added to the “Investment Process” section.
8	~~While the endowment portfolio has the primary purpose of providing for the real protection of designated spending, the composition of its investments should reflect the University’s role in contributing to the well-being of society with a global perspective.~~	These statements are replaced by statements 3 and 4 above, which go further to state that achieving the SDGs and the Paris Agreement is good for long-term investors. The implications for the endowment investment policy is address in the Market Beliefs section.
9	~~To the extent possible and prudent, the University can contribute to address global issues of economic growth, social improvement and environmental sustainability through the management of endowment investments.~~	

Blue text is illustrative provisions added by Mercer.
Text struck-out is current wording in the 2016 Statement

ILLUSTRATIVE MARK-UP
IV. INVESTMENT PROCESS

#	Provision	Mercer Commentary
1	It is more cost-effective to hire external managers than to build in-house expertise in order to meet the various investment objectives.	
2	In the selection of external managers the University strives to hire the best in class who demonstrate strong ethical standards, committed professional management as well as a proven track record of performance.	
3	Appropriate and timely reporting of investment activities and results is required in order to monitor the investments' performance against the relevant benchmarks.	
4	The investments should be made and stewardship activities conducted in the context of understanding the primary objectives of the endowment fund.	This is to explicitly state the importance of stewardship in the investment process. Further details or guidance can be articulated in the investment policy and proxy voting guidelines.
5	It is important to manage the cost effectiveness of the investment process including ensuring the cost of investment management is balanced in the context of returns.	
6	Environmental, social and corporate governance (ESG) issues can have a material impact on risk and return outcomes and these issues should be integrated into the investment process.	This is a clear statement of the financial relevance of ESG and that it should be incorporated in the investment process (without dictating what specific approaches should or should not be used).
7	Greater disclosure of climate change related risks and opportunities leads to improved transparency and helps investors make more informed investment decisions. The University encourages disclosure in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.	This is a clear statement of the importance and relevance of the TCFD recommendations. It stops short of specifying any specific expectations of external managers and/or companies, nor of any commitment by the endowment fund to publicly report in line with the TCFD recommendations

Blue text is illustrative provisions added by Mercer.
Text struck-out is current wording in the 2016 Statement

ILLUSTRATIVE MARK-UP
V. MARKET BELIEFS (1 OF 2)

#	Provision	Mercer Commentary
1	~~Over the longer term assets that have greater risk~~ Investment risks borne by the portfolio are expected to provide ~~greater~~ commensurate returns (i.e. uncompensated risks should be avoided). Risk in this context is broader than the general measure of volatility of returns especially when measuring investment outcomes across different markets. Therefore qualitative factors in assessing risk may be considered when developing investment policy.	The edits are not specific to ESG, but perhaps more clearly convey the intent of the provision.
2	To achieve the long term objectives of the endowment fund, a certain level of risk must be taken. This will involve the selection of certain asset classes with greater volatility but greater expected return over longer periods of time.	No change
3	Global sustainability challenges—such as climate change, environmental degradation and inequality—will have an impact on long-term investment risks and returns. Reducing exposure to transition risk (i.e. reducing carbon risk exposure) and gaining exposure to companies that that are positioned to support or prosper in a low-carbon, resilient and inclusive economy can improve risk adjusted returns of the portfolio. Alternate statements: • Taking a broader, longer-term perspective on risk, including identifying sustainability themes and trends, is likely to lead to improved risk management and new investment opportunities. • Climate change poses a systemic risk and investors should consider the potential financial impacts of both the associated transition to a low-carbon economy and the physical impacts of different climate outcomes.	This statement (under "market beliefs") clarifies the financial relevance of climate change and sustainable trends to the endowment's portfolio, and that reducing the carbon exposure can actually reduces the portfolio's financial risk (and thereby improving risk adjusted returns).
4	The majority of the variability in the investment returns, and the implied inherent risk, can be explained by the strategic asset allocation selected. As a result, the strategic asset mix decision is critical in determining the risk profile of the investments;	No change
5	The investments should be diversified across a broad range of financial assets, asset classes, geographies and management styles as portfolio diversification provides reduction in investment risk;	No change

Blue text is illustrative provisions added by Mercer.
Text struck-out is current wording in the 2016 Statement

ILLUSTRATIVE MARK-UP
V. MARKET BELIEFS (2 OF 2)

#	Provision	Mercer Commentary
6	Simplicity and transparency are essential attributes of any asset, asset class, or investment strategies that could be contemplated for portfolio diversification;	No change
7	The use of derivative instruments should be limited to risk mitigation purposes (e.g., limiting currency exposures) and for efficient access to certain asset classes (e.g., index replication) and not for return enhancement;	No change
8	The risk and return characteristics of specific asset classes should be reviewed periodically to evaluate if the investment strategy or the asset allocation for the Policy and its impact on specific investment risk and return metrics is still appropriate;	No change
9	Active investment management where markets can be inefficient represents an opportunity to earn higher returns thereby justifying fees. Passive investment management is not excluded when the belief is not as strong;	No change
10	Over the long term, fluctuations in currency tend to offset but over the short term, currency risk can matter when a specific exposure to an asset class is sought. Currency management (at a specific manager level or on an overall basis) in order to reduce some of the volatility that may result from interim currency fluctuations can be used if the trade-off between benefit and cost is favourable.	No change

Blue text is illustrative provisions added by Mercer.
Text struck-out is current wording in the 2016 Statement

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