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| SUBJECT | TRANSFER OF TREK ENDOWMENT TO SUSTAINABLE FUTURE POOL |
| MEETING DATE | DECEMBER 5, 2019 |

Forwarded on the Recommendation of the President

**APPROVED FOR
SUBMISSION**



Santa J. Ono, President and Vice-Chancellor

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| DECISION REQUESTED | <p>IT IS HEREBY REQUESTED that the Board of Governors approve:</p> <ul style="list-style-type: none"> i. that UBC is authorized, in principle, to transfer the Trek Endowment assets, both invested capital and stabilization account, to the Sustainable Future Pool, conditional upon: <ul style="list-style-type: none"> a. UBC IMANT undertaking asset-liability studies for both the Main Endowment Pool (MEP) and Sustainable Future Pool (SFP) to be completed by March 31, 2020 which do not indicate an adverse impact to either pool as a result of a transfer, and which determine the best mix of assets for a larger SFP and a smaller MEP, b. UBC IMANT providing a recommended implementation plan that is acceptable to the Board of Governors, which will not adversely impact the Main Endowment Pool and its underlying spend rate; and c. UBC Administration confirming by February 1, 2020 the legal implications of such transfer, and ii. that the decision and timing of the transfer of all or a portion of the assets be subject to final UBC Board of Governor approval following receipt of the above advice. |
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| Report Date | November 5, 2019 |
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Presented By Peter Smalles, Vice President Finance & Operations
Yale Loh, Treasurer

EXECUTIVE SUMMARY

Overview

The Trek Endowment has a market value of \$380.5m, comprised of \$333m invested capital account and a \$47.5m stabilization account. The Trek Endowment is UBC’s own monies, made up of land lease proceeds which were endowed by the Board of Governors in the Main Endowment Pool (“MEP”). This amounts to just under 22% of the assets in the MEP.

At its September 2019 meeting, the Endowment Responsible Investment Policy Working Committee requested an explanation of the work needed to consider moving all or a portion of the Trek Endowment from the MEP to the Sustainable Future Pool (“SFP”). The work required includes an analysis of financial and legal issues related to the proposed transfer.

Background

The UBC Board of Governors approved the creation of the SFP in February 2017 with an initial contribution of \$10m from the Trek Endowment to establish the Trek Impact Endowment Fund in the SFP. The SFP builds upon progressive investment management strategies present in the MEP and has two objectives:

- (1) a financial objective to maximize the rate of return at an appropriate level of risk to honour the wishes of donors of endowed funds, to provide cash flows and capital appreciation that are sufficient to support the SFP's current spending objectives plus inflation and expenses, and to preserve the capital and purchasing power of each endowment funds with the SFP in order to provide the same level of support in perpetuity; and
- (2) a non-financial objective to materially lower carbon dioxide emissions, including the objective of reducing or excluding investments in companies that own fossil fuel reserves.

Initially the Board of Governors also committed to contributing an additional \$5m per year for three years for a total contribution of \$25m provided that the performance of the SFP is not materially adverse as compared to the MEP. In April 2019, the Board of Governors approved an additional \$25m over three years bringing the total UBC contributions to \$50m by FY2022. Currently the SFP has approximately a market value of \$31.3m.

Establishing the SFP is an important part of UBC's commitment to sustainability. The SFP pursues sustainability concepts beyond the progressive strategies already being incorporated in the MEP. The SFP currently has no fossil fuel investments and is meeting its objective to produce lower carbon emissions.

The establishment of the SFP brings together UBC's mandate of inquiry and the creation of knowledge, UBC's desire to lead from within, its academic experience, research expertise, and operations management to make the university a living lab - and to use what UBC learns to benefit the larger community.

In order for the Trek Endowment, a \$380m dollar fund (just under 22% of the assets in the MEP), to be transferred from the MEP to the SFP, there are a number of steps that need to be followed:

1. The UBC Board of Governors would need to be satisfied that the investments meet their fiduciary requirements,
2. UBC IMANT would need to analyze the impact of removing all or a portion of the Trek Endowment assets so as to avoid adverse impact on the remaining MEP assets,
3. UBC IMANT would need to undertake an asset-liability study to determine the best asset mix for the expanded SFP, and
4. The assets would likely need be transferred over time in order to avoid adverse impact on the returns of either pool.

Endowment Policy Considerations

The Board of Governors has established policy for the management of its Endowment pools.

The policy explains that the main difference between the MEP and the SFP is that the MEP must be invested strictly in the best interests of charitable purpose trusts, which is their financial interests, and the SFP must be invested in the best interests of the university, which may take some broader criteria into account. The SFP is comprised of the university's own monies and also donor monies where the donors have specifically authorized investment in the SFP.

When exercising its fiduciary responsibilities for the SFP, the University has determined that the non-financial criteria of carbon dioxide emissions is in the best interest of UBC for the following reasons:

- UBC is a place of research and will be using SFP as part of its living lab to see if a higher level of sustainability can be incorporated into its investment processes in a prudent manner;
- UBC has a long-term focus and sustainability is a core value;
- the SFP is in a separate pool so that UBC can track its results clearly;
- the SFP opens up an investment choice to donors; and
- it provides positive reputational impacts to UBC amongst its students, faculty, and donors.

Given the experimental nature of the SFP and UBC's fiduciary responsibilities, UBC must maintain the ability to adjust the investment profile of the SFP. This includes the potential to transfer SFP funds to another Endowment Pool at UBC and/or discontinue the SFP if the BOG determines that it is in the best interest of UBC.

Donor funds can be added to the SFP only where they specifically agree that their gifts will be invested in the best interests of UBC and in a manner that takes non-financial considerations into account.

UBC must also consider how a potential transfer of the Trek Endowment from the MEP to the SFP would impact the interests of the charitable purpose trusts in the MEP. UBC must consider the impact on diversification, and whether the MEP will continue to be able to access certain asset classes at a smaller size. Lastly UBC must consider how best to prudently transition the funds from the MEP to the SFP such that neither fund is adversely impacted.

Performance

Return estimates to September 30, 2019 suggest that, despite its limitations, the SFP has delivered strong relative performance versus its benchmark of 70/30 global equities and Canadian bonds and its return is comparable to the MEP.

For the past two years, the SFP has outperformed its policy benchmark by 157 basis points gaining 10.04% versus 8.47% for the benchmark, with only a slightly higher standard deviation of 7.87% versus 7.18% for the benchmark. Standard deviation is a common metric to measure portfolio riskiness. During the same two-year period, the SFP has outperformed the MEP by 293 basis points (10.04% versus 7.11%) but the MEP had a significantly lower standard deviation risk measure of 4.10%. On a risk adjusted basis, MEP produced a higher return for each unit of risk taken, that is SFP took almost double the risk, but did not generate double the return. This is because MEP is a more diversified portfolio and its return tends to be more stable.

Since the performance to date for the SFP is not significantly different from that of the MEP, we are cautiously optimistic that the additional non-financial objectives might not sacrifice portfolio returns. Although past financial performance does not predict future financial performance, the SFP's financial performance so far supports exploring transferring some or all of the Trek Endowment to the SFP.

Growing the Sustainable Future Pool

As described earlier, the formation of the SFP was intended to demonstrate UBC's commitment to sustainability and to understand how pursuing sustainability concepts of low or no fossil fuel investments and lower carbon dioxide emissions would impact performance.

While it has been demonstrated that the SFP's performance has not been adversely impacted compared to the MEP so far, the size of the SFP limits its ability to diversify investments and leads to greater exposure to public equity markets. This may lead to greater volatility of returns as witnessed over the past two years, as compared to a larger, more diversified pool.

In addition, the initial long-term return and risk assumptions (based on the 2017 Staff Pension Plan asset mix review that were the most current available to IMANT without doing an extensive and expensive full review) used in developing the original asset mix benchmark suggested that the SFP would only be expected to grow by 5.5% annually over the long term, below previous MEP return expectations and lower than the required return of 6.15%. This resulted in a spend rate of 3.75% compared to the MEP spend rate of 4.00%.

In order to truly test the performance of the fossil free, low carbon SFP against the performance of the diversified MEP, the assets of the SFP need to grow significantly. Despite UBC's commitment of a total \$50m investment by FY2022, there has been limited donor interest in the SFP. At present there are only two external donor endowment funds totalling \$125,000 within the SFP.

It would be advantageous from a portfolio construction perspective to increase the size of the SFP through additional contributions beyond the initial \$50m provided it does not adversely impact the MEP. Increasing the portfolio size would allow for more portfolio diversification, less volatile returns, and better comparison between the MEP and SFP. This in turn could result in a higher spend rate. A larger, more diversified SFP with a spending rate equivalent to the MEP may also attract additional donors.

Recommendation

Given UBC's desired commitment to sustainability and interest to further explore the impacts of additional contributions to the SFP as part of UBC's living lab, it is recommended that the Board of Governors, in principle, commit to transferring all or a portion of the Trek Endowment funds managed in the MEP to the SFP. It is intended that this transfer will also include any amounts outstanding from the amended \$50m total original commitment. This commitment to transferring all or a portion of the Trek Endowment funds is conditional upon IMANT undertaking an asset-liability study for both the MEP and the SFP to demonstrate removing all or a portion of the Trek Endowment assets from the MEP will not have an adverse impact on either pool as a result of the transfer; and that IMANT recommends an implementation plan that is acceptable to the Board of Governors and that does not adversely impact the MEP and its underlying spend rate. It is recommended that IMANT undertake an asset liability study to determine the best asset mix for an expanded SFP. In addition to presenting the results of the asset-liability studies, IMANT will need to provide a recommendation on the actual timing of the asset transfer, either in whole or in part or at once or in phases, in order to avoid negatively impacting the returns of either pool.

STRATEGIC CORE AREAS SUPPORTED

People and Places Research Excellence Transformative Learning Local / Global Engagement

BENEFITS The SFP is an important part of the University's commitment to sustainability and brings together the University's mandate of inquiry and the creation of knowledge, its desire to lead from within, its academic experience, research expertise, and operations management to make the University a living lab. Ensuring the viability and sustainability of the SFP supports the University's responsible investing framework, aligns with the overall goal to reduce the University's carbon footprint, and potentially increases donor interest.

Learning, Research,
Financial,
Sustainability &
Reputational

Increasing the SFP size allows for a more diversified portfolio and the potential for less volatility in returns. This in turn may lead to a higher spend rate. A higher spend rate has the potential to increase the impact of each donor contribution to support the charitable purpose of those donations.

RISKS Transferring the Trek Endowment from the MEP to the SFP and potentially impacting the asset mix will have potential adverse implications for the flat spend initiative and funding for the funding of strategic initiatives. While the transfer is likely to have a positive impact on the spend rate for the SFP and a neutral impact on the MEP spend rate, the possibility of a negative impact will correspondingly reduce the University's ability to fund research and support initiatives.

Financial,
Operational &
Reputational

Ongoing COSTS The cost to undertake the asset liability study will be borne by the respective pools. Costs to transition the assets between pools will be detailed by IMANT at a Future date, and before any transfer is undertaken.

Capital & Lifecycle
Operating

SCHEDULE Transfer of the funds between the MEP and the SFP would depend on the results of an asset-liability studies for both pools, legal analysis, and Board of Governor approval of an implementation plan from IMANT.

Implementation
Timeline

CONSULTATION UBC IMANT
Relevant Units, Treasury
Internal & External Office of the University Counsel
Constituencies

TRANSFER OF TREK ENDOWMENT TO THE SUSTAINABLE FUTURE POOL

November 26, 2019

Peter Smailes, VP Finance and Operations

Yale Loh, Treasurer



Introduction



- The Trek Endowment is UBC's comprised of land lease proceeds which were endowed by the Board of Governors in the Main Endowment Pool (MEP).
- The Trek Endowment has a market value of \$380.5m
- The Sustainable Future Pool (SFP) must be invested in the best interests of the university, which may take some broader criteria into account.
- The University would like to transfer all or a portion of the Trek Endowment Funds to the SFP

Rationale For The Transfer



- UBC is a place of research and will be using an expanded SFP as part of its living lab to see if a higher level of sustainability can be incorporated into its investment processes in a prudent manner;
- UBC has a long-term focus and sustainability is a core value;
- the SFP is in a separate pool so that UBC can track its results clearly;
- the SFP opens up an investment choice to donors; and
- The SFP provides reputational impacts to UBC amongst its students, faculty, and donors.

Conditions for Transfer



- UBC must consider how a potential transfer of the Trek Endowment from the MEP to the SFP would impact the interests of the charitable purpose trusts in the MEP.
- UBC must consider the impact on diversification, and whether the MEP will continue to be able to access certain asset classes at a smaller size.
- UBC must consider how best to prudently transition the funds from the MEP to the SFP such that neither fund is adversely impacted.

Proposed approach



UBC IMANT, on behalf of UBC, would:

- analyze the impact of removing all or a portion of the Trek Endowment assets through an asset-liability study so as to avoid negatively impacting the remaining MEP assets,
- undertake an asset-liability study to determine the best asset mix for the expanded SFP, and
- Transfer the assets over time in order to avoid negatively impacting the returns of either pool.

Approval Request



IT IS RECOMMENDED THAT that the Finance Committee recommend for approval by the UBC Board of Governors:

that UBC is authorized, in principle, to transfer the Trek Endowment assets, both invested capital and stabilization account, to the Sustainable Future Pool, conditional upon:

- ***UBC IMANT undertaking asset-liability studies for both the Main Endowment Pool and Sustainable Future Pool to be completed by March 31, 2020 which does not indicate an adverse impact to either pool as a result of a transfer, and which determines the best mix of assets for a larger SFP,***
- ***UBC IMANT providing a recommended implementation plan that is acceptable to the Board of Governors, which will not adversely impact the Main Endowment Pool and its underlying spend rate; and***
- ***confirming by February 1, 2020 the legal implications of such transfer, and***

that the decision and timing of the transfer of all or a portion of the assets be subject to final UBC Board of Governor approval following receipt of the above advice.