



SUBJECT	Investing Update
SUBMITTED TO	Sustainability and Climate Action Committee
MEETING DATE	September 10, 2020
SESSION CLASSIFICATION	Recommended session criteria from Board Meetings Policy: OPEN
REQUEST	For input only - No action requested

LEAD EXECUTIVE	Peter Smailes, Vice-President Finance and Operations
SUPPORTED BY	Dawn Jia, CEO of UBC IMANT Yale Loh, Treasurer

PRIOR SUBMISSIONS [Delete section that does not apply.]

The subject matter of this submission has been considered previously by the Board of Governors or Committees on the following occasions:

1. [June 2, 2020](#) (OPEN SESSION Sustainability Committee)
Action/Follow up: Divestment Plus / Responsible Investing implementation time table
2. [April 16, 2020](#) (OPEN SESSION Board of Governors)
Action/Follow up: Divestment Plus implementation plan including transition plan for divesting from fossil fuel intensive investments, nuances of measuring investment portfolio carbon emissions and overview of the United Nations Principles of Responsible Investing (“PRI”) network.
3. [February 14, 2020](#) (OPEN SESSION Board of Governors)
Action/Follow up: Report progress of financial justification to support divestment together with progress on implementing a comprehensive responsible investing framework that aligns with UBC’s sustainability priorities, incorporating climate changes beliefs into UBC’s investment policies, establishing baseline portfolio GHG emissions levels on the way to medium and long-term carbon reduction targets, becoming signatories to advocacy groups such as PRI and Climate Action 100+ at the April 2020 Board Meeting.
4. [February 6, 2020](#) (CLOSED SESSION Finance Committee)
Action/Follow up: Provide financial justification to support divestment
5. [December 5, 2019](#) (OPEN SESSION Board of Governors)
Action/Follow up: Undertake and complete by March 31, 2020 financial analysis for both Main Endowment Pool and Sustainable Future Pool to support transfer of the Trek Endowment assets to the Sustainable Future Pool. Confirm by February 1, 2020 the legal implications of such a transfer. Undertake and report the necessary legal and financial analysis to explore full divestment from fossil fuels in the Main Endowment Pool and report analysis in an expedient manner.
6. [November 22, 2019](#) (OPEN SESSION Endowment Responsible Investing Policy Committee)

Action/Follow up: Further refine UBC’s responsible investing framework and bring forward recommendations on responsible investing climate change beliefs, targets, and implementation plan.

EXECUTIVE SUMMARY

The attached PowerPoint document includes an update on the status of UBC IMANT’s Responsible Investing Strategy. Specifically, this report provides:

- An overview of UBC IMANT’s Responsible Investing Strategy
- A summary of Responsible Investing Strategy principles, goals and outcomes
- A summary of the analysis of the risks and associated costs of executing the Strategy to consider

Overview of Responsible Investing Strategy / Divestment Plus Objectives and Actions

After receiving legal and financial justification for divestment, the UBC Board of Governors approved a resolution in April that outlined UBC’s commitment to implementing a comprehensive response to the climate emergency. The purpose of divestment and the comprehensive plan is to mitigate climate change-related financial risk to the endowment assets.

Following the parameters set out in the April Resolution, UBC IMANT has drafted a Responsible Investing Strategy that will mitigate the climate change-related risk in a manner that is consistent of the fiduciary duties required of all parties responsible for the safekeeping and longevity of the endowment assets. The plan also sets out the targets for emission reduction and a timeline of events.

Summary of Responsible Investing Strategy and Goals

UBC IMANT has set the goal to reduce the portfolio’s carbon emissions by 45% by 2030, managed in a manner that is consistent with fiduciary duties. The 45% GHG reduction goal by 2030 is an ambitious goal that exceeds what other universities have committed to. However, the goal cannot be achieved using only one responsible investing tool. The goal can only be achieved by UBC IMANT using a combination of tools that are consistent with the PRI principles. The tools that UBC IMANT will employ include divestment, active ownership, leadership, disclosure, and measurements.

To align with and in support of the broader UBC climate goals, the Endowment portfolio will also achieve the following positive outcomes:

- Divestment of fossil fuel companies by 2030 (possibly earlier, pending product availability)
- Invest in companies aligned with meeting the Paris Agreement
- Enhanced community engagement
- Support UBC sustainability goals

As part of disclosure and measurement, UBC IMANT will provide quarterly updates to the UBC BoG on the progress of the Responsible Investing Strategy.

Summary of the Analysis of the Risks and Costs to Consider

While UBC IMANT is committed to advancing the Responsible Investing Strategy and achieving the 45% carbon emission reduction target, UBC IMANT is mindful of the risks and costs associated with transitioning the portfolio.

UBC IMANT used portfolio modeling to compare the risk to the portfolio returns if the top 3% of carbon emitters and the top 5% of carbon emitters were removed from the public equity portfolio. The results of the modeling were that there was a clear trade-off between the level of emission reduced and the level of risk to returns. The portfolio modelling also showed that the same reduction methods could not be uniformly applied to all markets due to the different types of companies that make up each equities market.

Another consideration for the timing of the transition is that the fossil fuel free products currently available in all public equity classes is quite limited and expensive. As such, transitioning the public equities funds in portfolio will occur as the market evolves and products that match UBC's mandate and risk profile become more available. To advance the innovation and availability of fossil fuel free products, UBC IMANT will continue to work with managers to develop products that will contribute to the reduction of emission at a cost that will maintain the Endowment Fund's spend rate. In addition to the increase in costs, there will also be an increase to the resources that UBC IMANT will need in order to effectively evaluate, monitor and report on the portfolio and investment managers.

APPENDICES (required reading for Governors)

1. Responsible Investing Strategy - PowerPoint

Responsible Investing Strategy

Reducing climate related risk to the Endowment

UBC IMANT
DRAFT FOR DISCUSSION ONLY
SEPTEMBER 2020

UBC IMANT's Responsible Investing Strategy



Align with Broader UBC Sustainability and Climate Emergency Principles



Responsible Investing Goals:

- Reduce climate change-related risk in the portfolio while meeting fiduciary duty
- 45% reduction of GHGs in the portfolio by 2030
- Advance social and governance factors



Outcomes to support UBC Climate Actions:

- Divestment of fossil fuel companies by 2030 (possibly earlier, pending product availability)
- Invest in companies aligned with meeting the Paris Agreement
- Enhanced community engagement
- Support UBC sustainability goals

What Divestment Looks Like

Reducing Exposure to Heavy Emitters



Energy



Utilities



Industrials



Materials

- As a manager of managers, we are not in a position to target any specific sector or a fixed list of companies but will divest managers
- Divestment by UBC IMANT is an ESG integrated manager selection process that will dynamically evolve with the industry
- Our initial divestment will focus on managers with exposure to heavy emitters
- We will be evaluating managers based on performance and carbon emissions
- Our portfolio will be managed by managers who are committed to Responsible Investing

The Reality of a Much Smaller Opportunity Set of Products

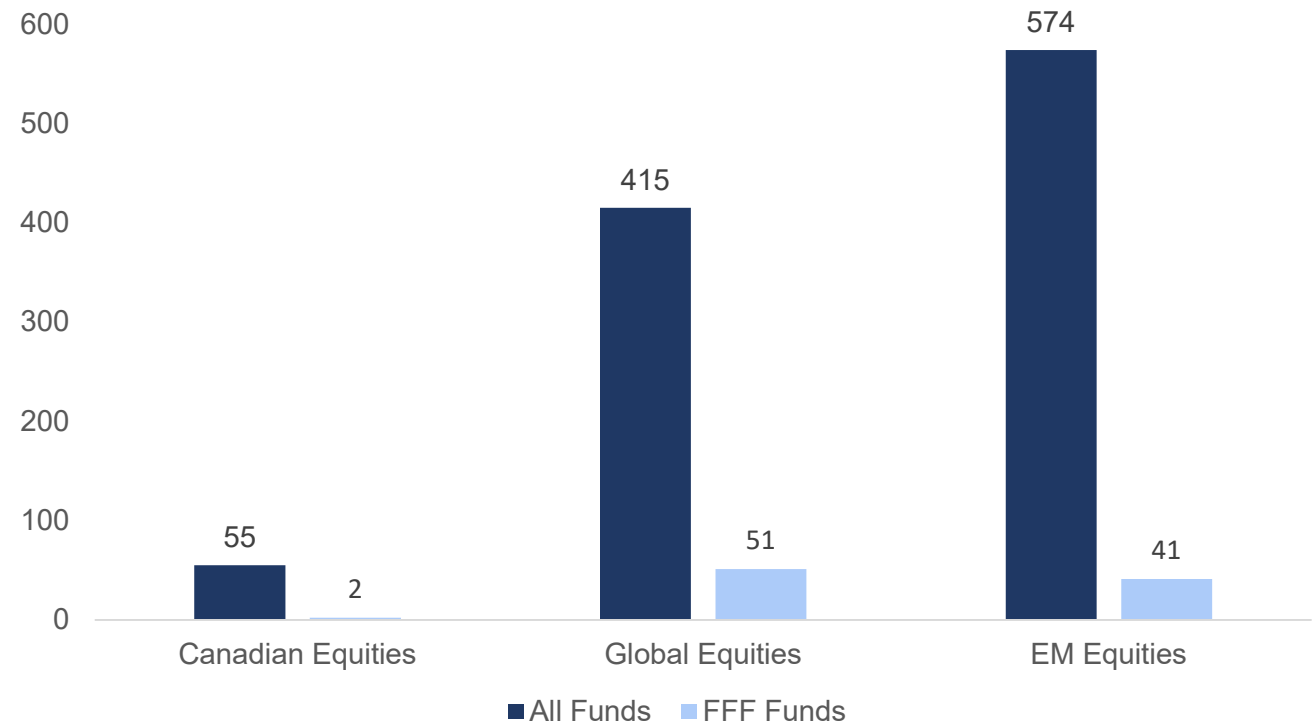
Fossil fuel-free funds are a small sub-set of available funds, and may offer lower returns. UBC IMANT expects fund availability to increase over time.

Fundamental Law of Active Management:

$$\text{Excess Return} = \text{Skill} \times \sqrt{\text{Breadth}}$$

Every 0.50% return reduction equates to \$8,500,000 less annually for the Endowment funds.

Pooled Fund Availability - Unconstrained vs. FFF



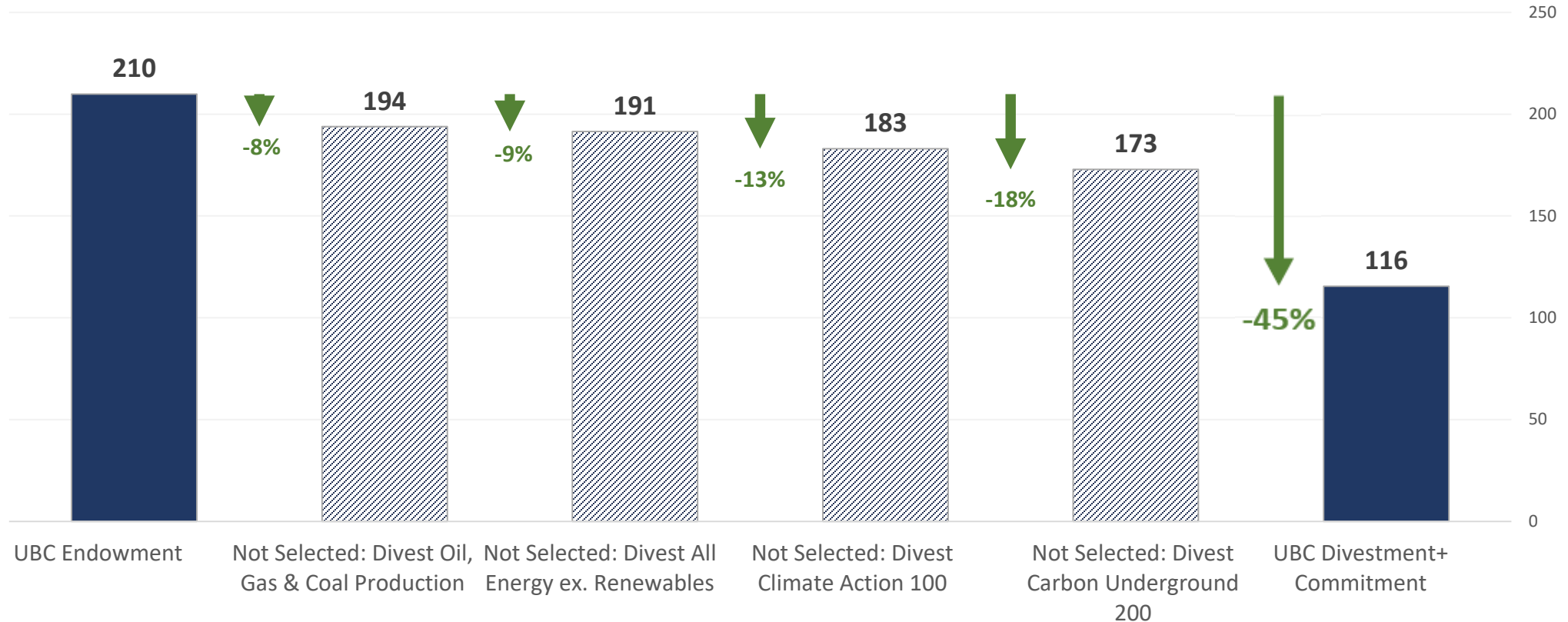
Divestment alone doesn't get us there

Pure fossil fuel divestments are estimated to reduce emissions by 8-18%.

In order to get to 45% by 2030 and net zero emission by 2050, we need to do much more.

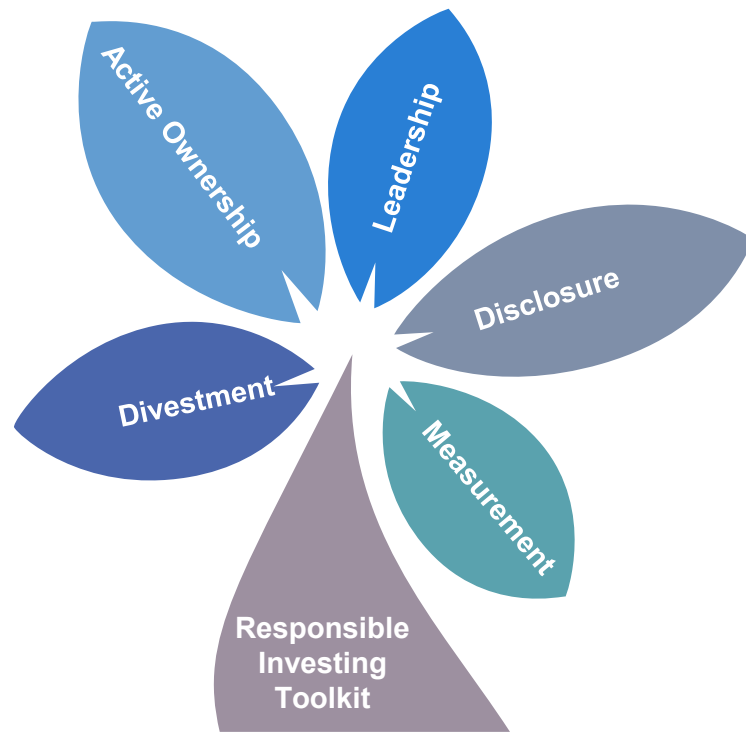
Tons CO₂e / \$M Invested

Public Equity Normalized Carbon Footprint



A Holistic Approach Positions UBC as a Leader in Responsible Investing

We will use active ownership and thought leadership to drive change, while staying on track by encouraging managers to disclose ESG and climate risk assessments and frequently measuring progress against KPIs



Divestment

Expand beyond fossil fuel energy extractors, focus on divesting from major emitters and developing a process that evolves with industry

Active Ownership

Influence managers to start to divest from major emitters

Incorporate responsible investing objectives into active ownership policies and practices

Leadership

Be a thought leader to multiply our impact

Reach a wider constituency by influencing our managers to adopt best practices

Disclosure

Encourage managers to disclose ESG facets and climate risk assessments so investors and companies are better informed of risks

Measurement

Define a balanced set of KPIs to manage the overall process, drive the right set of behaviours that all contribute to our ultimate goal

Our Goal is Achievable but Our Modelling Projects Greater Risk to Returns

At the Portfolio level, there is a clear tradeoff between the level of emissions reduction and the level of risk to returns.

The 45% emissions reduction target is achievable, but not without challenges.

A one-size-fits-all approach is not optimal for all managers and portfolios.

	Method 1		Method 2		Method 3	
	Emissions Reduction	Tracking Error	Emissions Reduction	Tracking Error	Emissions Reduction	Tracking Error
3%	50%	0.51%	40%	0.42%	39%	0.36%
5%	66%	0.77%	52%	0.41%	55%	0.40%

*Tracking Error: level of difference between the portfolio' return and the benchmark's return

Method 1: Remove the top emitters by company carbon footprint

Method 2: Remove the top emitters by company carbon intensity

Method 3: Remove worst emitters by carbon footprint and portfolio is rebalanced to ensure sector weights are maintained

New Costs to Implement the Responsible Investing Strategy

- Investing in new strategies will incur added transaction cost[^] and higher management fees*
- To effectively evaluate and report on the portfolio and managers, additional resources are required:
 - Industry data and benchmarks
 - Scenario models and measurement tools
 - IT infrastructure
 - Human capital
 - Resources to take part in peer and industry collaborations
 - Estimated annual cost for additional staff and other expenses is \$576,000
- Loss of economy of scale when managing two portfolios with different mandates

	Increase in Management Fees*	Transaction Costs [^]
Canadian Equities	0.10%	0.30%
Global Equities	0.10%	0.35%
Emerging Equities	0.15%	0.85%
Small Cap Equities	0.20%	1.10%
Estimate Costs in \$	\$2,625,000	\$11,375,000

All costs and fees are estimates only and actual numbers will vary

[^] Transaction costs are the expenses associated with buying into and selling out of an investment fund

* Management fees are annual fees charged by the investment managers

Responsible Investing Roadmap

