3 WAYS ENDOWMENTS CAN ADOPT SUSTAINABLE INVESTING

University endowments are starting to take sustainable investing seriously, not only because students are urging them to but also because we think it’s proving to be good investment practice. For endowments looking to get started — or to expand upon their sustainable practices — here are three ideas to consider.

#1 LOOK FOR DIVERSITY IN MANAGERS, NOT JUST INVESTMENTS

People of color make up a larger share of college students than ever, according to the American Council on Education. Students are looking for their universities to reflect this diversity through faculty and staff, and they want diversity and inclusion top of mind for investments as well.

We have noticed a trend of endowments incorporating diversity goals into selection for investment portfolios as well as investing with managers that represent a commitment to diversity and inclusion.

For example, one large institutional investor had been using the traditional definition of diversity by focusing on the race and gender of the investment firm owners. But the investor felt that the metrics were superficial, and it deepened the metrics to include investment team and leadership diversity, community engagement, and other parameters to capture a more holistic view of diversity and inclusion. These are metrics we discussed in our blog The Holistic Way to Invest in Diversity.
#2 RESPOND TO CLIMATE CHANGE

Endowments are feeling the pressure from students, faculty, alumna and other stakeholders to respond to climate change through their endowments. Some endowments have responded to this demand and the changing dynamics of climate risks by integrating a carbon footprint reduction into their portfolios. Stewardship activities, such as proxy voting and engagement with portfolio companies, allow endowments to use their investor voice to underscore climate risk concerns. The goal of these actions is to encourage companies to improve their reporting framework on climate risks offering more transparency and disclosure and even reduce their carbon footprint by setting greenhouse gas reduction targets.

Climate Action 100+, a collaborative engagement initiative, allows investors to increase the weight of their voice, exerting further pressure on companies to respond. This initiative, which launched in 2017, has indeed demonstrated initial success.

Certain universities have responded to climate change by taking on a fossil fuel divestment approach. More than 40 U.S. universities have committed to removing investments in companies with fossil-fuel related businesses, according to the 2018 Trends Report from the Forum for Sustainable and Responsible Investment.

According to this group, Hampshire College was the first to announce divestment of fossil fuel holdings in 2011, while a variety of other college and university endowments, including University of California, University of Massachusetts and Columbia University, have outlined and implemented approaches to fossil fuel divestment.

# 3 MAKE ESG PART OF YOUR INVESTMENT PHILOSOPHY

A growing number of endowments are including environmental, social and governance (ESG) analytics into their investment philosophies more broadly, as evidenced by North American university signatories to the Principles for Responsible Investing. According to Callan’s annual ESG survey (see Exhibit 1), over half of endowment respondents incorporate ESG into the investment process, doubling over the past five years. Investors are gaining confidence that sustainable investing strategies can perform in-line with market return expectations as the availability of robust ESG data improves and the track records of sustainable investing strategies grow.
EXHIBIT 1: AN ESG INVESTMENT PHILOSOPHY

Endowments are leaders in making environment, social and governance (ESG) investing an important part of their process.

As sustainable investing continues to trend, endowments are looking towards their peers for insights into how similar investors define language for their investment policies, educating their trustees and starting to implement. Take for example the University of California, whose framework for sustainable investing articulates eight ESG related risks and opportunities, including:

- Climate change
- Food and water security
- Inequality
- Aging population
- Diversity
- Human rights
- Circular economy
- Ethics and governance

In its investment policy statement, the university emphasized the importance of ESG integration into their investment decisions:

_We cannot best meet the needs of our current stakeholders while preserving the needs of future generations of stakeholders simply by creating exclusionary lists or applying software applications that determine “metrics” whose scientific bases are not clear or precise. Rather, we need to integrate sustainability as an integral part of our high performance culture as the best means to achieve the optimum risk-adjusted return that meets the objectives of our various portfolios._
In addition to allocating assets to sustainable investing strategies, the University of California has extended sustainability into their investment process in a variety of ways, including their stewardship activities and manager due diligence process. As endowments consider expanding on exclusions towards an ESG integration approach, case studies and examples of peer organizations have become useful tools to facilitate trustee dialogue.

GETTING STARTED

There are many entry points for endowments to include sustainable investing in their portfolios, but try these ideas to get started:

- Help stakeholders agree on common objectives such as what sustainable investing means to them and what are the return requirements for the portfolio.
- Review how current asset managers include sustainable investing into their investment processes.
- Run an audit of how managers are voting proxies on your behalf.
- Decide how to add or increase sustainable investing into your portfolios. Some endowments begin with distinct pools of funds as a first step, such as student-run portfolios. Others test out sustainable investing in one asset class and move it into other asset classes as appropriate.
- Look for available resources for support. Industry bodies such as the Principles for Responsible Investing, the National Association of College and University Business Officers (NACUBO), and the Association of Governing Boards provide materials such as webinars, panel discussions or written materials to support education. Asset managers including our own sustainable investing team can help educate and support initial dialogue as well.

We are encouraged that endowments are asking questions and encouraging productive discussion, an important step to put more endowments on the path of a holistic investment program aligned with sustainable investing principles.

Learn more about sustainable investing and our sustainable investing team at Northern Trust Asset Management.
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