

FINAL REPORT AND RECOMMENDATION

3/30/15 ver.

UNIVERSITY OF HAWAII BOARD OF REGENTS TASK GROUP ON DIVESTMENT AND SUSTAINABILITY

March 23, 2015

On January 8, 2015 the Committee on Budget & Finance met to discuss the topic of divesting the Board of Regents' endowment fund (the "endowment fund") investments from fossil fuel companies ("divestment"). Testimony in support of divestment was received from students, faculty members, alumni, legislators and other interested organizations and individuals. Hundreds of pieces of testimony were received in support of divestment and a petition supporting divestment with the names of approximately 1,330 individuals was also submitted. Additionally, the Graduate Student Organization passed a resolution in support of divestment.

The Committee noted that the Board's current policies and guidelines:

- Set forth investment guidelines and performance objectives for the endowment funds;
- Contain an Investment Responsibility section - when the Board concludes that a company's activities or policies cause substantial social injury, the board may direct its investment managers to sell the securities in question within a reasonable period of time and in a prudent manner;
- Contain a strong sustainability component in its mission statement that calls upon the university to serve as a global leader and model for sustainability.

After considering the testimony that was presented, and reviewing the current Board policies, the Committee voted unanimously to recommend that the Board appoint a task group to review the subject of both divestment and sustainability relative to current Board policies. Additionally, the Committee recommended that the task group be comprised of students, faculty, administration, as well as Board members, so that these issues would be approached in the collaborative spirit of shared governance.

The Board of Regents at its January 22, 2015 meeting approved the appointment of the Task Group. The Task Group was charged with: (i) investigating the desirability and feasibility of pursuing the divestment of the endowment fund from fossil fuel companies, and recommending policies, if appropriate; (ii) evaluating and recommending policies to address the university's sustainability goals and practices; and (iii) providing a rationale for its recommendations.

The Task Group that was approved was comprised of the following members:

Jan Gouveia, Vice President for Administration
Coralie Matayoshi, Board of Regents, Task Group Vice Chair
Joe Mobley, Faculty, School of Nursing
Randy Moore, Board of Regents Chair & Ex-Officio Member
Helen Nielsen, Board of Regents
Leilei Shih, Graduate Student, GSO
Doora Shin, Student, ASUH
Jan Sullivan, Board of Regents, Task Group Chair
Michelle Tagorda, Board of Regents
Kalbert Young, Vice President for Budget & Finance and CFO

Summary

The Task Group held its first meeting on January 28, 2015. The group agreed to split into two sub-groups – one to investigate possible divestment from fossil fuel investments and the other to investigate possible changes to the Board Policy on sustainability.

The sub-groups met on multiple occasions to discuss and review their topic areas. The full Task Group met on February 20, 2015 to provide a status update on their work to date.

Additional sub-group meetings occurred during February and March.

On March 20, 2015 the full Task Group met and voted unanimously to recommend the adoption of the following:*

- revisions to Chapter 8.207 to incorporate a policy on divestment for the endowment funds;
- new Section under Chapter 4, to be labeled Chapter 4.20, Sustainability Policy.

The recommended policy revisions are attached to this report.

*It is noted that concerns regarding the language for Chapter 4.20(a)(3) regarding LEED certification were expressed by some task group members. The group agreed that it would further investigate whether there were other equivalent certifications that could be considered. The members agreed to investigate this further.

Background Information

In 2014, the Board of Regents amended Chapter 4.201 of its policy concerning the Mission and Purpose of the University, to add a strong sustainability component to its mission:

“Within its unique geographical location, the university will serve as a leader in how it stewards the resources of the islands and the world for the benefit of all. The university shall be a global leader and model for the integration of sustainability throughout its teaching, research, operations, and public service...”

The Task Group approached its task mindful of this strong mission statement, along with the public support that was evidenced for both divestment and sustainability.

Divestment

The sub-task group worked closely with the Board’s investment manager, UBS Financial Services, Inc. (“UBS”), to evaluate potential divestment options as well as impacts to the investment goals and policies that are set forth in the Board’s current Investment policies.

All of the endowment funds are currently invested in mutual funds or exchange traded funds. This has allowed the Board to achieve a balanced portfolio while minimizing fees and costs.

The sub-task group sought to evaluate divestment options that would maintain a balanced portfolio that meets the Board’s investment criteria, while retaining the currently low fees and costs that are associated with the endowment fund.

The group evaluated the impacts of selling those funds that contain fossil fuel companies, and replacing these with funds of equivalent diversification and risk profiles (with the diversification exception being that new funds will not have a fossil fuel-producing component) of the current investment portfolio.

Current Endowment Fund Investments

UBS provided the subgroup with information on its current portfolio. As of December 31, 2014 the approximately \$66 million University endowment fund included investments in energy companies that comprised 5% to 7% of the portfolio value. This category of companies includes alternative energy producers, so it is possible that the

percentage of fossil fuel-producing companies in the University's portfolio is less than the 5-7% range stated above.

Other universities that have adopted policies divesting from fossil fuels, utilize a much narrower divestment scope. Stanford University and the University of Maine, for example, decided to adopt a narrow divestment policy to only divest from direct investments in coal companies. They are not divesting from petroleum- or natural gas-producing companies, nor are they divesting from indirect investments (mutual funds, exchange traded funds, or private equity funds) that are invested in coal, petroleum, and natural gas producing enterprises. The Rockefeller Brothers Fund (assets about \$860 million, not the Rockefeller Foundation, assets about \$4 billion) is divesting only from investments in coal and tar sands companies. The University of Hawaii, by contrast, currently has no direct investments in any fossil fuel-producing companies, because it has no direct investments in any companies.

UBS has advised that the returns available from mutual funds that do not include fossil fuel-producing companies are probably comparable to the returns from comparable mutual funds that include fossil fuel-producing companies in which the University's endowment is currently invested. At present, however, there three negative factors that argue against an immediate divestment from fossil fuel-producing companies:

- The range of investment "styles" available from fossil fuel-free mutual funds is limited. The universe of domestic mutual funds and exchange traded funds can be segregated into the following matrix:

Large cap growth	Large cap balanced	Large cap value
Mid-cap growth	Mid-cap balanced	Mid-cap value
Small cap growth	Small cap balanced	Small cap value

Similar to domestic funds with the style characteristics above, there are matrices for funds that invest in other equity asset classes: "developed" foreign markets (Western Europe, Japan, Australia, Hong Kong), major developing markets (Brazil, Russia, India, China, South Africa), smaller emerging markets (Mexico, Turkey, Indonesia) and "frontier" markets (Africa, Latin America, and elsewhere in Asia), and "world" markets (markets everywhere).

Fossil fuel-free mutual funds are not currently available in most of these investment styles and asset classes. The significance of this limitation is that an

immediate divestment from fossil fuels would result in greater portfolio volatility (greater swings in value, both positive and negative) than is likely with investments in a more diverse universe of investment styles and asset classes.

- The management costs of fossil fuel-free mutual funds are currently higher than the costs of mutual funds that include fossil fuel companies.
- There are not yet exchange traded funds that exclude fossil fuel companies, and the management costs of exchange traded funds are lower than the cost of mutual funds.

The net result of an immediate and full divestment from fossil fuel companies would be a less diversified and therefore more volatile portfolio and a decrease in the net return from the portfolio resulting from higher management fees. UBS estimates the consequence of immediate divestment would be a reduction in annual income to the University endowment of \$462,000, assuming the gross returns from fossil fuel-free investments were the same as the gross returns from investments that include fossil fuel-producing companies in the approximate proportion as these companies comprise the broad stock market.

Whether the returns from investments in fossil fuel-producing companies have historically exceeded, matched, or trailed the broad market depends on which base year is selected to make the determination. Given the current approximately 8% weighting of energy companies in the Standard & Poor's 500 stock index, and given that fossil fuel-producing companies did not exist 165 years ago, it is probable that in the very long run, returns from fossil fuel-producing companies has exceeded the returns from the broad market. What is less certain is whether the future returns from fossil fuel-producing companies will exceed, match, or trail the future returns from the broad market. An argument can be made that fossil fuel companies are currently overvalued, because a portion of their value represents the value of underground reserves that have not yet been brought to the surface and sold. Various estimates are that between 60% and 80% of current reserves cannot be exploited (and converted to greenhouse gases) if the level of greenhouse gases in the atmosphere is to be contained to a level that does not produce massive disruptions that are projected to result from global warming.

Divestment therefore would not affect the University's long-run endowment return, recognizing that there are times when fossil fuel-producing companies produce higher returns than the general market and there are also times when fossil fuel-producing companies under-perform the market. During periods when fossil fuel-producing companies outperform the market, a broadly diversified portfolio that excluded fossil fuel-producing companies would underperform the market, and during periods when fossil fuel-producing companies underperform the market, a broadly diversified portfolio that excluded fossil fuel-producing companies would outperform the market.

Rationale for Divestment

There are two broad arguments that support divestment:

First, there is a moral and leadership rationale.

There is consensus among climate scientists that the increasing concentration of carbon dioxide in the earth's atmosphere, the result of the burning of fossil fuels, is causing the temperature of the earth to rise, and that global warming will, or is already causing:

- sea levels to rise,
- changes in weather patterns, causing extended drought in some areas and excessive rainfall in others,
- higher ocean temperatures that negatively affect marine life.

In addition, many global security analysts believe that unchecked climate change will be a major destabilizing force in the world as nations and people increasingly compete for water and food resources and battle rising ocean levels.

Second, there is a long term economic argument. The long term value of fossil fuel companies may decrease because their assets (fossil fuel reserves) will not be able to be developed if the world is to avoid existential threats to human lives that will result if carbon dioxide increases are not contained.

The Task Group recognizes that the act of divestment will not directly result in the reduction of CO₂ emissions. However, the Task Group concludes that the value of divestment is to galvanize the University community as well as the greater community, to take action to invest in the production of alternative energy (such as wind and solar), to make energy-saving investments, and to change institutional as well as individual behaviors.

After discussing multiple scenarios and options for divestment, UBS has advised the Task Group that it expects to be able to execute the proposed divestment policy at no/minimal increase to the endowment fund's overall investment fees. The proposed policy sets a reasonable timeframe for divestment which recognizes that over time, an increasing number of divestment investment vehicles are being developed. As the financial community develops low-cost vehicles for fossil fuel-free investing, the fees for such vehicles are anticipated to decrease. UBS has seen an increasing number of institutional investors seeking fossil fuel-free funds, and anticipates that eventually such funds will be offered at competitive fees.

Divestment Recommendation

In summary, the Task Group concluded that divestment can and should occur, and that it can be accomplished in accordance with the proposed revisions to Chapter 8.207 in a manner that will maintain the Board's investment criteria while being maintaining reasonable fee levels.

The Task Group recommends that the Board adopt the proposed revisions to Chapter 8.207. The Task Group further notes that these revisions also require the Investment Manager to report on the progress and impact of divestment upon the endowment funds, as part of its regular quarterly reporting to the Board.

Sustainability

On January 23, 2014, the University of Hawaii's Board of Regents adopted a broad sustainability policy that recognizes Hawaii's unique geographical location and the University's leadership role in integrating sustainability throughout its teaching, research, operations, and public service. The policy delegates authority to the President to develop goals, performance metrics, and plans that include five key areas of a comprehensive sustainability program – operations, curriculum, research and scholarship, campus and community engagement, and cultural connections.

Work on this sustainability initiative began two years ago by passionate believers in the cause. A draft Executive Policy was presented at the First Annual Sustainability in Higher Education Summit on April 11, 2013 and was reviewed by approximately ninety participants from across the UH system who provided detailed input.

A broad and diverse group of stakeholders had input into further development of the policy. The draft Executive Sustainability Policy document was vetted by key staff, faculty, and student groups including the Associate Vice Chancellor for Planning & Facilities, the Student Caucus, the All Campus Council of Faculty Senate Chairs, the Council of Chancellors, the Student Sustainability Coalition of Hawaii, and others. The policy went through nineteen drafts and was finalized and signed by President David Lassner at the Third Annual Sustainability Summit on February 26, 2015.

The result is a comprehensive, well thought out sustainability plan created “by the people, for the people.”

Precedent for Higher Education Sustainability Policies

Many institutions of higher education throughout the country have adopted sustainability policies. Many Boards have adopted policies requiring their institutions to establish and meet sustainability goals.

One of the most comprehensive sustainability policies was adopted by the President of the University of California system, which, like the University of Hawaii is a ten-campus system. The University of Hawaii Executive Policies are modeled after the University of California policy, but are not quite as proscriptive, as financial constraints are being taken into account.

The Executive Policies serve as a guiding framework for each campus to utilize as they develop their own campus sustainability plans.

Sustainability Recommendation

The Task Group recommends that the Board amend Chapter 4 of its policies to reinforce the University's commitment to sustainability.

The Task Group is recommending the creation of a new Chapter 4.208 that would codify Sustainability policies at the Board level and strengthen the Executive policies that have been adopted. The proposed Chapter was drafted to include more specifics in the Board Policy and to add strength to the Sustainability movement.

The Policy requires that the University:

- 1) Establish an Office of Sustainability within the Office of the Vice President for Administration to ensure that sustainability is incorporated into planning, budgeting and decision-making throughout the institution;
- 2) Develop an energy-management plan and system with a goal of becoming carbon neutral by 2050. Goals to reduce fossil fuel-sourced energy through increased efficiency and use of renewable energy sources are set to meet or exceed the following energy reduction and renewable targets relative to a 2008 baseline: 10% by 2020; 20% by 2025; 30% by 2030; and 40% by 2035.
- 3) Develop goals, metrics, and plans that include the five key areas of our comprehensive sustainability program: Operations, Curriculum, Research and Scholarship, Campus and Community Engagement, and Cultural Connections.

In addition, the policy requires Administration to report to the Board annually on its progress towards the sustainability policies and goals.

PROPOSED REVISIONS TO CHAPTER 8 AND CHAPTER 4
BOARD OF REGENTS POLICIES

RP 8.xxx

Title

Investments

Header

Regents Policy Chapter 8, Business and Finance

Regents Policy RP 8.xxx, Divestment Policy for Investments

I. Purpose

To set forth an investment policy that is aligned with the University's sustainability goals and policies by modifying Regents Policy Chapter 8.207, Section III.C., Investment Goals and Guidelines.

II. Definitions

As used in this policy, sustainability means serving the needs of the present without jeopardizing the needs of the future.

III. Board of Regents Policy

Section C. of the Board's investment policy shall be amended to insert a new Section C.2. The amended section shall read, in its entirety, as follows:

C. Investment Goals and Guidelines

1. The board shall adopt investment goals and comprehensive guidelines to insure the preservation of capital and adequate growth and income. The long-range investment objective of the university is to achieve an optimal rate of return on assets based on the asset allocation policy to produce current income to meet spending needs of 6% while preserving the real value of the endowment principal.

2. The board also desires to align its investment goals and guidelines with Chapter 4.20, the Board's Sustainability Policy. As such, the investment manager shall hereby divest the Fund from companies that produce fossil fuels, and shall maintain a portfolio that is substantially divested of fossil fuels (0-1% holdings). While moving toward the divestment of fossil fuels, the investment manager should also include investments that will provide alternative energy substitutes, where feasible. Divestment shall occur in a responsible manner that will consider investment and management fees, while meeting the investment goals and guidelines of that are set forth in this Chapter. Divestment should begin as soon as possible, with the outside date for completion to be on or before June 30, 2018. Progress towards this objective and any monetary impacts to the Fund should be reviewed along with the investment manager's quarterly report to the Board.

IV. Delegation of Authority

The president is delegated the authority to promulgate executive policy and shall report annually to the Board of Regents on progress made.

V. Contact Information

Office of the Board of Regents, 956-8213, bor@hawaii.edu

VI. References

<http://www.hawaii.edu/offices/bor/>

VII. Exhibits and Appendices

RP 4.208

Title

Sustainability Policy

Header

Regents Policy Chapter 4, Planning

Regents Policy RP 4.20, Sustainability Policy

I. Purpose

To reflect the university's leadership role in developing goals, metrics, and plans to implement a comprehensive sustainability program.

II. Definitions

As used in this policy, sustainability means serving the needs of the present without jeopardizing the needs of the future.

III. Board of Regents Policy

Within its unique geographical location, the university will serve as a leader in how it stewards the resources of the islands and the world for the benefit of all. The university shall be a global leader and model for the integration of sustainability throughout its teaching, research, operations, and public service. The university recognizes that an important knowledge base in sustainable island systems resides in the indigenous people of Hawai'i and all those for whom Hawai'i is home. The university commits to consult with local cultural practitioners and sustainability experts on best practices in sustainable resource allocation and use for the well-being of our communities, our state, and the world. Critical resources include energy, food, water, land, sea, and space as

they are integrated with the relationships of family, culture, community, justice, work, and economy in the present and future.

The University of Hawai'i System shall develop goals, metrics, and plans that include five key areas of the comprehensive sustainability program, and shall report its progress to the Board of Regents on an annual basis:

a. Operations

The university is committed to continuous improvement in reducing its negative environmental impact and becoming ecologically restorative in buildings, climate, food systems, energy, grounds, purchasing, transportation, waste, and water. Among other things, the university shall:

- 1) Establish an Office of Sustainability within the Office of the Vice President for Administration to ensure that sustainability is incorporated into planning, budgeting, and decision-making throughout the institution.
- 2) Develop an energy-management system and commit to minimizing greenhouse emissions and becoming carbon neutral by 2050. Reduce fossil fuel-sourced energy through increased efficiency and use of renewable energy sources to meet or exceed the following energy reduction and renewable targets relative to a 2008 baseline: 10% by 2020; 20% by 2025; 30% by 2030; and 40% by 2035.
- 3) Ensure that all new construction and major renovations will achieve a minimum of LEED "Silver" designation, and will strive for LEED "Gold."
- 4) Establish metrics and reporting mechanisms to track solid waste reduction, water conservation, fuel efficiency, and sustainable food service practices.
- 5) Establish a Green Purchasing Policy, support imparting a Hawaiian Sense of Place on all campuses, and policies and programs for optional modes of transportation and bicycle and pedestrian-friendly campuses and communities.

6) Curriculum

The university will encourage, facilitate and support curriculum development that advances the principles of sustainability, and enable cross-campus

collaborations that integrate teaching and research with solutions at the campus and community levels.

7) Research & Scholarship

The university will encourage, facilitate and support basic and applied research initiatives that advance the principles of sustainability and enable cross-campus collaborations that integrate teaching and research with solutions at the campus, community and global levels.

8) Campus & Community Engagement

The university is committed to the engagement of students, faculty, staff, and the local community across disciplines to prioritize and implement sustainable practices. The classroom, the campus, and the community comprise an interconnected educational environment.

9) Cultural Connections

Recognizing the unique and respected Hawaiian host culture, the geographic remoteness of the islands, and the rich diversity of cultures in Hawai'i, the university will create a sustainable living and learning environment that honors its cultural foundation and addresses the challenges and opportunities of its location. The university will proactively form working relationships with external partners to understand community, workforce and business needs, to bring higher education, research and service outreach value to the community, and to help shape economic structures, employment opportunities and integrated, 21st Century sustainable solutions for Hawai'i, the region and beyond.

IV. Delegation of Authority

The president is delegated the authority to promulgate executive policy and shall report annually to the Board of Regents on progress made in reaching goals, metrics, and plans that include the five key areas outlined in the Board of Regents policy for a comprehensive sustainability program

V. Contact Information

Office of the Board of Regents, 956-8213, bor@hawaii.edu

VI. References

<http://www.hawaii.edu/offices/bor/>

VII. Exhibits and Appendices