Socially Responsible Investing: Lessons from the Field

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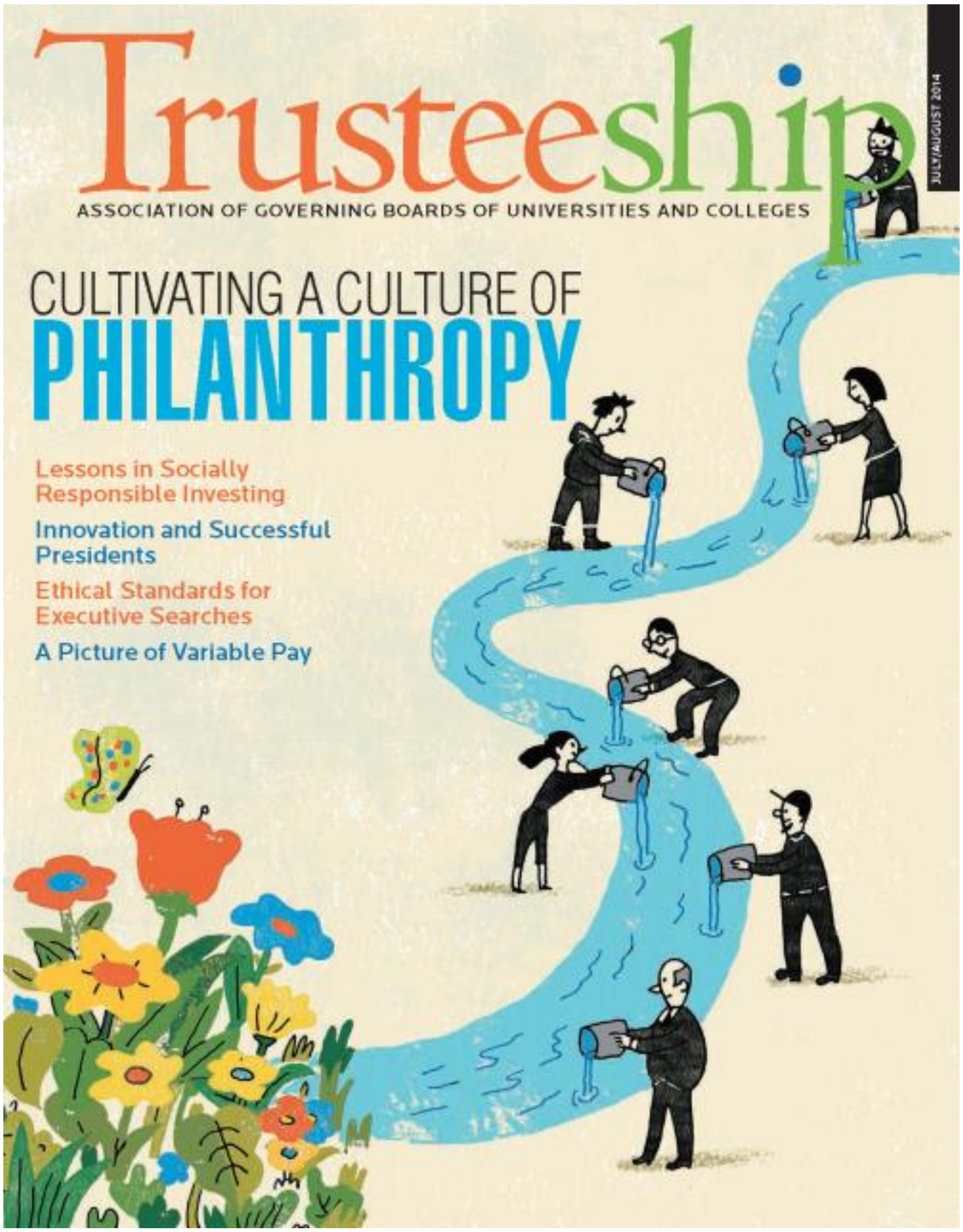

Takeaways

Across the country, students concerned about the environment and climate change are demanding that their college or university divest its investments in companies that produce fossil fuels.

The decision to engage with students in an open and respectful manner can create learning opportunities for the students, the board, and other institutional leaders.

A guiding principle for the board is to be responsive to students' concerns while balancing them with its fiduciary responsibility to ensure sound investments.

In June 2013, the San Francisco State Foundation (SF State Foundation) took a bold step by becoming the first public university in the country to limit direct investment in public companies that are fossil-fuel producers. This was a major policy decision that required extensive consultation with our board of directors, the university's academic leadership, donors, and, of course, our students. How did we arrive at this point, and how should other institutions that are thinking of doing the same thing frame the issues so as to make the best possible decision?

A new wave of student activism regarding the effects that fossil fuels and carbon-related industries are having on global temperatures is gaining momentum on many university and college campuses. Building on historical success condemning apartheid and encouraging divestment from companies doing business in South Africa, stigmatizing companies promoting tobacco products, and mobilizing against genocide in Darfur, Sudan, this new generation of students is highly energized and moving its environmental agenda forward.

The fossil-fuel divestment campaign is a growing movement across the country among college and university students concerned about the environment and climate change. The campaign resonates with students and faculty members for many reasons, but we, as foundation directors, must recognize that divestment is a viable public policy option that cannot be ignored. On many college and university campuses, this is an emerging issue that is ripe for escalating dissension and conflict among our students, administrators, and board members.

On the one hand, many of our students are justifiably concerned about the impact that fossil fuels have on the environment and on economic sustainability. On the other, foundation board members, while they might share students' environmental concerns, have the added fiduciary responsibility to invest endowment funds to maximize the return on investments and to meet commitments to the institution's donors who have dedicated their philanthropic support to building the university's future.

Like many other comprehensive institutions, San Francisco State University (SFSU), a publicly assisted state institution of 30,000 students, is still recovering from the impacts of the Great Recession and diminishing state support. In order to increase private support and augment its resource base, the university established its affiliated philanthropic foundation in 2008, made up of a 30-member board, to manage the institution's endowment and support its fundraising program.

The board’s historic decision regarding strategic divestment began with a phone call from a newly formed student organization on the campus. The students asked for information about the foundation and how its investment policy aligned with our institutional values of social justice. Historically, San Francisco State has had a strong commitment to social justice and to environmental sustainability.

In March 2013, two weeks after the first student query, we were contacted by several students requesting a meeting with the university president and board chair to learn more about the foundation, its structure, and its investments. Although our board has always included a student director, this request was a bit unusual, to say the least. Leslie E. Wong, the university president, cleared his calendar and a meeting with the students was scheduled.

The students were well prepared and had done their homework regarding environmental issues and global warming. Their opening statement was, “We do not want our money invested in fossil-fuel companies!” At that moment, we knew we were moving into uncharted territory for the foundation and university. Our first response was to explain that the money in question did not belong to the students. From that initial exchange, we were off on a fascinating and educational roller-coaster ride with our students and foundation directors. We agreed that we would continue to meet and that we would bring their request for divestment to our foundation executive committee and full board.

Over the next six weeks, the board chair and staff continued to meet with the student organization to learn more about their request and to better understand their views on climate change and the impact of fossil fuels on the environment.

We explained the role of the foundation directors, the concept of fiduciary responsibility, and that the source of our funds was third-party monies donated by alumni and friends to support students, faculty members, and other university priorities and initiatives. The process was instructive. The foundation chair agreed to bring the students’ request for divestment forward to the foundation board for discussion.

SUSTAINABLE INVESTING AND THE PRESERVATION OF INTERGENERATIONAL EQUITY: WHAT BOARDS SHOULD KNOW

While the number of campus-based movements advocating for divestment from fossil-fuel companies or in favor of other environmentally sustainable investment practices continues to grow (350.org reports over 300 active campaigns at U.S. colleges and universities), relatively few institutions have changed their endowment management practices. According to the *2013 NACUBO-Commonfund Study of Endowments*, 7 percent of the 835 participants apply some form of environmental criteria to their endowment portfolio.

Boards commonly cite a number of interrelated arguments against the application of social criteria to endowment portfolios:

1. Our mission is education, not environmental protection.

2. We have a fiduciary obligation to maximize the return on our investments and sustain the purchasing power of our endowment to support our programs, faculty, and students.
3. Divesting from fossil-fuel companies will increase the cost of managing our endowment and divert the time of the staff and investment committee.
4. A decision to avoid investments in fossil-fuel companies will exclude us from potentially lucrative investment opportunities and limit our choices of funds and managers.
5. We don't simply invest in companies. We invest with managers who employ complex alternative strategies or invest in funds of funds that don't disclose specific holdings.
6. We're making long-term decisions about a fund intended to sustain the institution in perpetuity; we can't respond to political or social movements that change each decade.
7. Our past donors would object to our using their contribution to advance an agenda not related to their intended philanthropic purpose.
8. The issue of climate change is politically divisive. A decision to divest might alienate potential donors.
9. Divestment doesn't work as a means of effecting change; if we don't invest in a given company, someone else will.
10. We could more effectively influence companies working in the fossil-fuel industries by exercising our rights as shareholders and voting proxies.

Proponents of the use of environmental, social, and governance considerations in investment decisions dispute most, if not all, of the concerns above. It may be tempting to dismiss calls for divestment from fossil fuels as the latest trend in a long history of student activism, but unlike previous divestment movements, current calls for institutions to invest in ways that advance environmental sustainability invite consideration of the larger implications of a board's obligation to maintain intergenerational equity. Investment professionals are increasingly looking at environmental, social, and governance criteria as factors that influence the long-term value and potential riskiness of specific investments. Seen through this lens, sustainable investing could contribute to the preservation of intergenerational equity as both an endowment management objective and a cultural obligation.

—David Bass, AGB director of foundations and research

THE BOARD REACTS

The university has a long history and tradition of student activism, and the administration's organizational culture and practice are to be open and responsive to students. So when the board chair first informed the board about the students' request for divestment from carbon-based investments, an animated and energetic discussion resulted. The board members appreciated the students' position and activism, but they all clearly understood that it was their principal duty as fiduciaries to invest and manage the university's endowment on behalf of its donors and designated beneficiaries. This issue presented a "teachable moment" for the board members to discuss, reflect, and reaffirm their fiduciary responsibilities in response to this request and issue.

President Wong, who was very supportive of divestment, asked the board to establish an ad hoc committee on fossil fuels, independent of the executive and investment committees, to study the issue and report back to him with the committee's recommendation of how to proceed. The committee's charge was three-fold:

1) To review and assess the foundation's current investment policy;

2) To draft proposed modifications to the social-investment section of the investment policy statement that will address investments in companies involved in fossil-fuel production or use; and

3) To develop a specific mechanism to implement this strategy and to determine if the institution's portfolio could be 100 percent free of fossil-fuel companies by 2019 and, if not, what level of fossil-fuel investment would be deemed tolerable.

The board appointed two directors to serve as co-chairs of the ad hoc committee. The first order of business was to establish a framework to better understand the policy and investment dimensions of the issue. A few of the many issues that the committee addressed included the definition of a fossil fuel, what constitutes a fossil-fuel company, and how a company comes to be included on a list of fossil-fuel producers.

The committee also reviewed the foundation's investment policy and how the endowment's assets were allocated. We determined that our exposure to fossil fuels was minimal, in the 5 to 6 percent range. In July 2013, a month after the board resolved to establish the ad hoc committee, it requested that the investment committee divest funds in its separately managed accounts (SMAs) from two companies involved in coal mining and tar sands (bitumen, to be more precise). The amounts divested in the initial phase were modest, but they helped create awareness about the issue and demonstrate the commitment and affirmative steps that the foundation board had taken.

Additional discussions were held with the foundation board about the potential impact of divestment on our investment returns. The ad hoc and investment committees reviewed a recent survey prepared by our investment advisers, UBS Institutional Consulting Group, on capital market assumptions, as well as the hypothetical implications of these assumptions for the proposed allocation of establishing an SFSU Environmental Responsibility Fund. The information helped reassure the board that we were moving in the right direction, consistent with the oversight policies of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in terms of aligning the university's core values with the foundation's fiduciary responsibilities.

The decision to engage with our students in an open and respectful manner created dialogue and learning opportunities for the students, the board, and the university. The guiding principle regarding this issue continues to be for the board to be responsive to our students' concerns about the environment while balancing the foundation board's fiduciary responsibility to ensure that we maintain sound investment policies and oversight pursuant to the standards of UPMIFA.

In March, the board took additional action to amend its investment policy to reflect that, effective July 1, 2014, the foundation would continue its divestments from direct ownership of companies with significant exposure to production or use of coal and tar sands. We are in the process of working with our investment fund manager to implement careful monitoring of comingled funds to screen and assess investments in companies with significant exposure to production of coal and tar sands. In addition, we are creating a socially responsible portfolio for donors who wish to opt in to a green investment fund.

PITZER COLLEGE DECIDES TO DIVEST

Spurred into action by students and the institution's own historical commitment to the environment, the board of Pitzer College determined this spring that it should divest the institution's endowment of nearly all holdings in the fossil-fuel industry. Of the $124-million endowment, about $5.4 million will be divested.

In addition, the college is seeking to trim its carbon footprint by 25 percent by the end of 2016. Students approached the board in spring 2013 asking for the divestment action, prompting the board to take up the issue formally at its fall meeting. It was at that point that the board decided to go even further by addressing its overall climate action plan. Options on the table include encouraging students to stay near the campus for at least one optional break each year (to save on fuel used by students traveling home and back again), limiting student cars on the campus, examining faculty and staff commuting patterns and fuel consumption for possible savings, and using electricity derived from renewable-energy sources in place of fossil-fuel-sourced energy.

"We've said over and over that the decision to divest was an act to align our actions with our mission and values," said Donald P. Gould, the head of the Pitzer board's investment committee and president of an asset-management company. "It wasn't a cultural change so much as a renewed commitment to a direction we were already heading in."

While other institutions have been approached by student groups about divesting, many have declined to consider it. For boards that are looking into it, Gould had some advice, and it all had to do with process.

"The first thing I would say is this should not be viewed as primarily an investment committee issue," he said. "We took it to the full board and asked, 'Do you think this is a good idea?' If yes, then it becomes an investment committee issue to determine the most practical way to implement it."

Secondly, Gould said, the discussion should be inclusive of all stakeholders, including students, faculty, and staff. "Although it's a board decision, it shouldn't just be a board discussion."

—Julie Bourbon, editor

LESSONS LEARNED

The foundation learned the following lessons over the last two years on the issue:

1. Engage in open dialogue with students. When the students and their respective organizations approach your foundation, be open to meeting with them to hear their

views or positions. Too often, when approached by students advocating on this issue, the university president, administration, or board leadership refuse to engage. Communicating and sharing information is a better direction than dismissing their views. The foundation and university leadership are more likely to succeed in finding common ground if students are engaged proactively and respectfully.

2. Review current investment policies. If student organizers have not already engaged your institution, there is a high probability that they will in the near future. Take proactive steps by having your governance committee discuss the issue and review current policies on socially responsible investing. Ask the investment committee to determine the endowment's current level of exposure to fossil-fuel companies.
3. Discuss with your board your institution's mission statement and core values and whether they align with the foundation board's values and investment policies.
4. Don't surprise donors. Think about how you might inform your donors about the issue to get a better sense of their views and positions. That was not an issue with our donors, based on the university's tradition of promoting social justice; however, for some institutions, consultation with donors may be helpful.
5. Be proactive with the university administration. Foundation staff should schedule a study session with the university president, vice president for student affairs, and academic leadership on the issue and have an action plan ready to respond to student requests for divestment.

Divestment from fossil-fuel companies is a complex and divisive public policy issue. Our position has been to maintain open and constructive communication with the student organization. The dialogue and process have been educational for both sides. As stewards of the university's foundation, we believe that we can achieve our investment benchmarks and align our foundation's investment policies with the university's values in promoting social justice.

A BRIEF HISTORY OF DIVESTMENT

The history of divestment is complicated, its success rate mixed—and hotly debated. The campaign against the apartheid regime of South Africa in the 1980s is usually the first example of a successful divestment campaign that springs to mind. While few would argue that the fall of that regime was not a moral and political victory, whether divestment actually led to its collapse remains a question for historians.

Ivo Welch, a professor of finance and economics at the Anderson Graduate School of Management at the University of California, Los Angeles, wrote on May 9 in the *New York Times* about the questionable impact of student divestment campaigns against fossil-fuel investments, using the apartheid case as an example. "We looked hard for evidence linking boycotts and sanctions to the value of South Africa's currency, stock market, and economy. Nothing," he wrote, referring to a study he and his colleagues conducted. But, he continued, "True, stating that the impact of economic sanctions was low is not the same as stating that the isolation of the regime had no effect. The wide ostracism may well have weighed on President F.W. de Klerk's mind. But it was not the economic effect of the boycott that forced him to the table."

Rick Cohen of the *Nonprofit Quarterly* (June 27) came to a similar conclusion, about not only apartheid but about the campaign waged against tobacco companies in the 1990s, noting that the moral argument against the former and the scientific argument against the latter eventually proved to be their undoing—not divestment. Following logically from that argument, he suggests, the weight of evidence pointing toward human behavior as the primary factor in climate change may ultimately tilt public opinion away from fossil-fuel producers in much the same way it was tilted against apartheid and big tobacco.

Welch makes the case for the futility of divestment, suggesting that colleges and universities instead consider *buying* energy stocks so as to concentrate their holdings and give them leverage against fossil-fuel companies. Alternatively, he proposes that research universities use their significant intellectual and financial resources to develop more clean-energy options.

Cohen points out that more investment firms are offering their clients options—economically viable ones—that don't include fossil-fuel producers, and that the sheer size of university endowments can help ensure the success of the funds while protecting their economic returns. Ultimately, he calls fossil-fuel divestment "a political movement, not a narrow political campaign," with "political change" its primary goal. He corrects those who mistakenly think the targets of such a movement are the fossil-fuel companies themselves. On the contrary. He writes: "The targets of divestment are Congress and the White House, both getting them to finally act on the knowledge of climate change and pushing them to put substance behind their vocal commitments to strengthening green economy investments."

—*JB*