Dalhousie University Investment Committee
Report to the Board of Governors
Interim Report on Fossil Fuel Divestment
October 2014

Summary

As outlined in its June summary report, the Investment Committee (IC) is currently conducting a review of fossil fuel divestment and will deliver a final report to the Board of Governors in November 2014. This document constitutes the interim report identified within the divestment work plan timeline of the IC's June submission.

For several years, the Investment Committee has been examining approaches and challenges to responsible investment (RI) and environmental, social and governance (ESG) investment processes as part of its ongoing mandate. The Board of Governors Investment Committee incorporated ESG principles within the investment policies in November 2013.

More recently, a group called Divest Dal is advocating for Dalhousie University to withdraw investments from fossil fuel companies. The IC has reviewed the list of 200 companies with the largest carbon reserves, as provided by Divest Dal. It was observed that a number of steel companies were included in the list of 100 companies with large coal reserves. Dalhousie's Endowment portfolio holds 10 of the coal companies with a value of $4.0 million, and 25 oil & gas companies valued at $16.3 million. This totals to 35 companies at $20.3 million, or 4.3 per cent of the total portfolio.

As highlighted in the IC's report to the Board in June of this year, the divestment movement is not unique to Dalhousie. In the Canadian context, a number of student-led divestment movements have become relatively active on university campuses at the University of Toronto, UBC, McGill, Simon Fraser University, Trent University and the University of Victoria. As of October 15, 2014, no Canadian university has undertaken divestment of its university endowment holdings in fossil fuel companies.

In the international context, including recent notable examples from the United States, a topical scan identifies a number of universities moving forward in principle with divestment from fossil fuels, while others have chosen to pursue active forms of investment engagement without endorsing divestment.

The summary below provides a brief overview of the recent divestment conversation for Dalhousie University:

- In February 2014, Dalhousie University received a proposal from a group named Divest Dal to divest any investments that the University may have in certain fossil fuel companies. (A summary of their presentation's key points was included in the report to the Board of Governors dated June 2014).
- Divest Dal proposed that Dalhousie freeze and subsequently eliminate investment in any public company that appears on a list of 100 coal companies and 100 oil and gas companies that are reported to have the largest carbon reserves.
- The Board of Governors asked the Investment Committee (IC) of the Board to consider the proposal as part of its ongoing mandate and to report back in fall 2014.
- The IC met with Divest Dal in February and July (2014) to discuss the principles, merits and effectiveness of divesting any investments in those companies with the largest carbon reserves that the University may have in order to reduce the impact on global climate change.

- The IC, in preparation for the July 2014 Divest Dal meeting, invited the group's input with a list of questions. The IC looks forward to receiving and reviewing Divest Dal's input.

Since the report to the Board in June 2014, the IC has continued to thoroughly investigate the issue of fossil fuel divestment and offers the following progress update on the committee's review and observations to date.

Considerations

As one of Canada's leading research universities, Dalhousie leads and engages in important discussions on climate change and environmentally sustainable practices. Dalhousie has been a leader in sustainability initiatives including the College of Sustainability and significant improvements in the sustainability of our buildings and campus operations.

The IC has been reviewing principles and approaches to responsible investing over the past 7-plus years. Ongoing review of the University's investment mandate is part of the IC's terms of reference, meaning this review of the divestment proposal fits within the IC's mandate.

Discussion on climate change and how to reduce our dependence on, and use of, fossil fuels is now and will continue to be part of our global conversation for some time. The same discussion and thoughtful consideration is warranted in relation to fossil fuel divestment. The topics are complex and warrant measured, balanced and thoughtful review on a number of fronts (financially and non-financial) to determine meaningful and useful approaches for Dalhousie University. Divestment, while the focus of this specific review, is a part of a larger and ongoing conversation within the University.

In its review of fossil fuel divestment the Investment Committee has considered:

- the issue of climate change and Dalhousie's sustainability commitment;
- alignment with Dalhousie's academic mission;
- the IC and Board of Governors' fiduciary responsibilities;
- stakeholder perspectives;
- the potential impact of divestment on climate change;
- an environmental scan of the current divestment conversation; and
- divestment implementation issues.

The following sections of this interim report present a high-level summary of the considerations examined thus far.

Climate change and Dalhousie's sustainability commitment

The fossil fuel divestment conversation for the IC and the Board of Governors takes place against the backdrop of Dalhousie's overall efforts in support of environmental sustainability and commitment to address climate change.

While Dalhousie has been engaged in environmental and sustainability practices in its operations, curriculum, research and student life for decades, the past several years have seen a heightening and concentrating of this activity.

In 2007-08, Dalhousie launched Canada's first College of Sustainability, bringing distinguished thinkers and problem-solvers together in a new way to examine and take action on today's most urgent global issues. That same year, the University opened its Office of Sustainability, which works to incorporate sustainability concepts and criteria into policy and planning, building and retrofit projects, and operations. The Dalhousie Student Union also opened its own Sustainability Office to help create a culture of sustainable practices within the DSU's operations and across the University. The three organizations collaborate through the President's Advisory Council on Sustainability.

Through mutual understanding and a shared sense of ownership, Dalhousie has managed to build an approach to sustainability that's unique among North American universities. The University has launched innovative new programs, won several awards and recognitions and, together with its partners, invested more than $45 million over the past five years to improve sustainability in campus operations, resulting in substantial action and positive outcomes.

Through this work, Dalhousie has demonstrated its commitment to environmental sustainability and to reducing our own dependence on and use of fossil fuels to meet our energy needs. On a societal issue, these are obviously complex topics, ones that warrant discussion on a number of fronts to determine meaningful and useful approaches to lessen our impact on climate change. The Investment Committee has examined and discussed a number of these considerations in reviewing this issue.

Alignment with Dalhousie's academic mission

Dalhousie's three-fold mission focuses on teaching and learning, research, and service to our communities. Through the delivery of this mission, the Dalhousie community is united in our quest to make a lasting positive impact on our world.

The University can only fulfil our mission by acting independently, by welcoming diverse views, and by being open to new ideas and initiatives. The IC's consideration of the divestment request is consistent with how Dalhousie approaches its mission.

While proponents see divestment as an ethical step aligned with Dalhousie's sustainability initiatives, it is also consistent with a philosophy of openness to consider opposing views. One prominent U.S. university, for instance, has rejected divestment because it would, amongst other things, position the institution as a "political actor" rather than an independent university. Others would view divestment as an act of leadership in the face of climate challenges that must be addressed, and which Dalhousie is addressing through its own sustainability initiatives.

The Investment Committee believes the University and its Board should weigh the arguments on both sides before making a decision on the divestment request.

Fiduciary responsibilities

Dalhousie has a duty to manage its investments in a manner that maximizes investment returns within a tolerable risk profile. In this context, the University and the Board must decide whether divestment of oil, gas and coal holdings would help or hinder efforts to achieve this goal. Divestment proponents argue that these holdings represent an investment in sunset carbon industries whose value will decline over time. Others argue that there is no credible evidence of declining global dependence on fossil fuels, and that the University could pay a financial price for not holding a more diversified portfolio of assets including resource or energy stocks.

Dalhousie also has an obligation to the benefactors who have made more than 1,300 gifts to the University, with a total value of close to $500 million. More than half of that money has been directed to students in the form or bursaries or scholarships. Our donors also take it on trust that Dalhousie will preserve the purchasing power of their capital, and invest it in a manner that helps achieve that end. It is a trust the University must continue to honor. The University and the Board must ask, then, whether divestiture would help or undermine its efforts to achieve those goals, knowing that so-called carbon stocks constitute 10 per cent of global markets and 25 per cent of Canadian equity markets.

Stakeholder perspectives

Dalhousie benefits from attracting students who are as serious about their studies as they are in their efforts to make a lasting impact on the world around them. It is difficult to measure the likely impact of divestiture on current students or other groups (including faculty and staff), but it would likely enhance Dalhousie's reputation with some stakeholders (including some students, faculty and staff).

At the same time, Dalhousie continues to educate students who want to work in resource-extraction industries and attend the University to be educated as geologists or engineers. This raises one key question the Board should consider: Should the University educate students to work in resource industries in which it would no longer invest? Would doing so be consistent with the University's mission?

The University and the Board must also assess the impact of divestiture on the wider University community. Would resource industries be more likely to withdraw their support for research projects or co-op programs? Would alumni be more or less engaged with their alma mater? Would donors be more or less likely to donate? Would a new class of investment stakeholders be created — individuals, organizations and foundations that would support the University because of divestiture? Dalhousie also has to assess the attitude of its primary financial supporter — government — to divestment. Would the Government of Nova Scotia support divestiture as a step that helps to brand the province "green," or question its own support for Dalhousie in light of what it might see as a risky investment strategy?

Finally, it must also be noted that Dalhousie's reputation depends more on how it acts than it does on how it invests. The University is rightly proud of the fact that it has created a College of Sustainability to educate students who will be tomorrow's leaders in building a more sustainable society. In addition, Dalhousie is taking a leadership role through its Office of Sustainability, with its mandate of ensuring the University operates as a steward of the environment in its day-to-day operations.

Potential impact of divestment on climate change

Dalhousie would have to determine if acting on its own through divestment of endowment holdings is likely to have an impact on climate change. Indeed, there is evidence to suggest that divestiture movements do not have a measurable negative impact on the financial performance of targeted corporations. One study showed that the six industries commonly targeted by divestiture proponents fared better than the market average. It concluded that 267 companies in the alcohol, tobacco, gambling, adult entertainment, weapons and biotech sectors outperformed the broad market by 11 per cent per year in 21 markets over a 38-year period.

Still, those statistics do not in themselves address the underlying ethical questions: Should Dalhousie divest its ownership position in large carbon holding companies in the oil, gas and coal companies, as divestment proponents suggests? Alternatively, Dalhousie could continue work on its own or with partners (internally or with other institutions in collective action) as engaged shareholders, with a goal of advancing Environmental, Social and Governance (ESG) goals in the management of investment funds. A key defining characteristic of ESG is to advocate shareholder engagement as a means to promote shareholder interests.

The IC decided to formally incorporate ESG in its investment policies in November 2013. This action followed substantive and ongoing discussions with the funds investment managers on the merits of ESG, as well as their capabilities and efforts in this area. The IC also believes that incorporation of ESG best embraces the United Nations' Principles for Responsible Investing (UNPRI):

1. *Incorporate ESG issues into investment analysis and decision-making processes.*
2. *Be active owners and incorporate ESG issues into our ownership policies and practices.*
3. *Seek appropriate disclosure on ESG issues by the entities in which we invest.*
4. *Promote acceptance and implementation of the principles within the investment industry.*
5. *Work together to enhance effectiveness in implementing the Principles.*
6. *Report on activities and progress towards implementing the Principles.*

Dalhousie continues to press our investment managers to build their ESG capabilities, to actively engage with these companies, and to exercise proxy votes in the best interest of Dalhousie. Annual reviews of current managers now formally incorporate an assessment of ESG capabilities and development. Managers are required to report quarterly on any company engagement activities as well as any specific ESG risk that may have arisen in the portfolio, and if so, what actions will be taken. As in the past, invested managers are, required to report on proxy voting.

Many of Dalhousie's investment managers now have dedicated resources within their firms to develop ESG capabilities, have contracted external expertise such as Sustainalytics, GMI, NEI, Bloomberg to supplement their ESG capabilities, and have become signatories to the UNPRI as well as joined organizations such as PERES and the Carbon Disclosure Project to enhance their company engagement activities. Although Dalhousie's own direct and indirect holdings are minor, they are leveraged by the holdings of other investors that are clients of the same managers.

Environmental Scan

In the Canadian context, a number of student-led divestment movements have become relatively active on university campuses at the University of Toronto, UBC, McGill, Simon Fraser University, Trent University and the University of Victoria. As of October 15, no Canadian university has undertaken divestment of its university endowment holdings in fossil fuel companies.

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Beyond the post-secondary sector, broader divestment conversations have generated media attention, including the Rockefeller Brothers Fund's announcement to proceed with a structured divestment of holdings that include fossil fuels. Additionally, notable international business leaders, including the President of the World Bank Jim Yong Kim, have highlighted that both governments and individuals should consider divestment.

The summary below (shared as illustrative examples, and not an exhaustive list) provides a snapshot of current divestment trends/discussions within the context of universities, for both Canada and the United States.

<u>Canada</u>

UBC – In April 2014, the University of British Columbia approved a new policy called the Endowment Responsible Investment Policy. The policy commits UBC to incorporate environmental, social, and governance (ESG) factors in its investment choices. This means that UBC will ensure its fund managers incorporate these factors in the management of their portfolios. The policy also outlines options to engage with companies or industries that are of concern to the UBC community, while maintaining the university's obligation to its donors.

Trent University - In June 2014, Trent University's Board began an examination of divestment. Informed by work by the Board's Investment & Pension Committee, the Board reported that it is taking a broad perspective in examining pros, cons and implications of divestment, and is also taking a multi-pronged approach in reviewing options available to meet all of its obligations: fiduciary, ethical, and sustainable.

McGill University - In June 2014, McGill University made revisions to its Committee to Advise on Matters of Social Responsibility (CAMSR). The changes now allow for a "grave environmental degradation" criteria for divestment. In addition, the CAMSR will now play a more proactive role in meeting and discussing matters such as divestment.

Simon Fraser University – In June 2014, Simon Fraser University's Board of Governors approved adoption of a responsible investment policy that includes becoming a signatory of the United Nations Principles for Responsible Investment (UN PRI).

<u>United States</u>

Harvard University – In a statement of October 2013, from Harvard University President Dr. Drew Faust, the university outlined that while it is important to address climate change, it did not feel that divestment from the fossil fuel industry is warranted or wise. In the university's statement, Faust highlights that "the university exists to serve an academic mission…we hold our endowment funds in trust to advance that mission, which is the university's distinct way of serving society. The funds in the endowment have been given to us by generous benefactors over many years to advance academic aims, not to serve other purposes, however worthy. As such, we maintain a strong presumption against divesting investment assets for reason's unrelated to the endowment's financial strength and its ability to advance our academic goals."

Stanford University – In May 2014, Stanford University outlined its decision to divest from coal mining companies. In a statement released on May 6, the university defined its position, which stated that Stanford University will not make direct investments of endowment funds in publicly traded companies whose principal business is the mining of coal for use in energy generation. The resolution's impact means that Stanford will not directly invest in approximately 100 publicly traded companies for which coal extraction is the primary business, and it will divest of any current direct holdings in such companies. Stanford also will recommend to its external investment managers, who invest in wide ranges of securities on behalf of the university, that they avoid investments in these public companies as well.

University of California – In September 2014, the University of California's Board of Regents voted to maintain its investment in fossil fuels. Media reports commenting on the decision referenced a statement from the university's Board, which stated, "…that the UC Board of Regents intended to invest US$1-billion in a plan addressing solutions for climate change. Diminishing investments in fossil fuels was an option, but divestment was not."

Divestment implementation issues

In order to identify eligible and ineligible securities for investment, segregated accounts established specifically for Dalhousie would need to be established. Approximately 78 per cent

of Dalhousie's investments are attained through institutional co-mingled funds, participating with other institutional investors where Dalhousie holds units in the funds of securities. Dalhousie does not directly hold the associated securities.
Dalhousie has utilized pooled funds to diversify its portfolio by gaining access to investment strategies that would not otherwise be available, and to adhere to its policy of investment manager diversification. Participation in institutional pooled funds also allows Dalhousie to access markets on a cost-effective basis. Transaction costs are per transaction, not by value. Consequently, participation in pooled funds allows transaction costs to be spread across larger sized transactions, resulting in lower transactional costs per security. Transaction costs are particularly high in overseas markets.

A number of firms also have minimum mandate sizes for segregated accounts that are substantially larger than what Dalhousie has to invest. As an example, Dalhousie's international managers have $100 million minimum mandates for segregated accounts. Dalhousie's largest fund is valued at $51 million, with the smallest valued at $5.4 million.

Next Steps/Conclusion

As outlined throughout this report, discussion on climate change and how to reduce our dependence on, and use of, fossil fuels is now and will continue to be part of a global conversation for some time. Like these issues, divestment is complex and warrants the same thoughtful consideration, with a measured, balanced and thoughtful review on a number of fronts (financially and non-financial) to determine meaningful and useful approaches for Dalhousie.

As the IC completes its research and due diligence in advance of its final report in November, it is important to note the broad cross-section of activity undertaken by institutions in the post-secondary sector internationally in relation to divestment. In this respect it is apparent that there is no one-size-fits–all model or approach. Quite simply, a small number of universities have moved forward with commitments to divest from fossil fuels, and many others have chosen to pursue active forms of investor engagement without endorsing divestment.

Upon submission of this interim report, the IC will continue to invite input and receive contributions from stakeholders as Dalhousie moves forward with this important discussion.

Timeline

1.	Review draft progress report at IC meeting.	Oct 2014
2.	Finalize progress report for October Board meeting	Oct 2014
3.	Invite additional input and contributions from stakeholders	Nov 7, 2014
4.	Submit final report recommendations for November BOG meeting.	Nov 2014