GU Endowment Committee report to Court on Fossil Fuel Restrictions November 2017

This report covers the experience of the endowment funds of the decision to restrict and reduce investment in companies engaged materially in the extraction of fossil fuels. This decision was taken by Court in H2 2014 and enacted from March 2015. The decision was to divest over a ten year period to zero holdings with an initial target set to be under 6.4% of the funds in fossil fuel companies by March 2019 (from an original level of c 10%) subject to a re-evaluation of the financial and other impacts of the policy.

The report covers two questions –

1) are the funds on track to meet the September 2019 target, to which the answer is yes it has already been achieved and the limits in place should ensure it is not exceeded
2) what has the impact been on investment returns to which the answer is, that for the part that is measurable (c £50m of the total of c £180m), an indicative answer of between £0.5m and £2.4m lower return has been delivered over a 27 month period. Extrapolating suggests the total effect could have been between £1.4m and £7m.

Level of Fossil Fuel Extractives Holdings

At start 2015 the endowment funds were managed by two managers – Schroders and Newton – both of whom followed active strategies which meant they may increase or reduce the levels of holdings of any asset or sector (group of similar assets). At the time Newton had a materially higher level of fossil fuel holdings than Schroders – though Schroders had at times prior to 2015 had higher levels than the level at that time. Schroders manage the funds through a combination of direct investments and investment in pooled funds they run. Newton only used direct investments.

The endowment committee decided an appropriate way to manage the reduction was to specify which companies were to be deemed to be primarily in fossil fuel extraction and then instruct Schroders not to increase the percentage of such holdings in their direct investments and to request Newton to reduce their holdings. The Schroders maximum percentage is fixed at 4.8% of their total investments (which can therefore be a higher percentage of their direct investments). No restriction has been applied on holdings of fossil fuel companies in funds / indirect investments – generally this is not possible for standard funds. The funds used by Schroders are to gain access to other asset classes such as property infrastructure and fixed interest where there the endowment committee does not consider the restriction has any application – or in specialist equity income vehicles for Asia and Global Equities. The scale of holdings of equity income funds is c 12% of the total Schroders portfolio and while there may be fossil fuel companies in those funds the impact on the overall percentage of Schroders assets is very unlikely to breach the 6.4% limit. Currently these funds do not hold any of the restricted stocks, and therefore the current total holding across the Schroders portfolio is 4.8% or less.

Subsequently, the Committee decided to change the management style applied to the portion of funds managed by Newton – following a tender process these funds have been managed by UBS since March 2017.

The mandate that UBS follows restricts the level of fossil fuel investments to 5.7% of the total plus or minus 0.5% to allow for short term market value movements. There is also a complete ban on tobacco holdings.

Impact of Restriction

Given that we have transferred assets away from Newton we are unable to get them to analyse the impact they consider the restriction had. For UBS we have agreed that they will supply regular data on the impact of the restrictions on performance. In the first three months there was a minor positive impact from the fossil fuels restriction but given the short period we have not considered this further.

Schroders have produced a report for the endowment committee which attempted to determine the impact the restriction has had on investment performance. While they do not have a direct counterfactual (ie an alternative portfolio with the exact same remit as the GU one but without the restriction) they have identified two funds that they consider reasonably similar but each different from the other. The Endowment Committee consider these to be reasonable proxies. Schroders have also pointed out that for other clients during the period in question they were holding relatively high levels of investment in fossil fuel stocks as they considered they represented good investment value. This may not always be the case.

The two proxies have both delivered higher total returns than the GU direct fund over the period in question and for much of that time held c double the amount in fossil fuel companies than our fund. (As at end June 2017 the UBS portfolio was also holding about half the level it otherwise would have held in the relevant sectors). The first proxy delivered c 0.5% pa higher return and the second 2.2% pa higher return. For the portion of the endowment funds this relates to (whose average value over the period has been c £48m) this equates to between £0.5m and £2.4m in 27 months. While both comparators are as noted reasonable proxies the first fund may be considered a slightly better proxy (because it had a specific income target as does our fund) and hence the true figure is likely to be closer to the lower end of this range. If the same effect had been the case on the Newton / UBS portfolios the total impact would have been between £1.4m and £7m. Of course it is impossible to say whether the effect would have been as much as this for Newton. It is also likely that there will be times in the future when the restriction has no effect (when the managers in the normal course of events would hold less than the limits or where they hold more but those investments underperform) and times when the effect would be above the average long term impact.

These figures compare with an indication given in the Court papers when the decision was made that the impact might be on average of the order of 0.3% pa, ie c £0.5m pa or c £1.1m over the period. It should be noted that this indication was for full divestment not the initial restriction and be over a full business cycle.

Other matters

The Schroders report also notes two other matters that are brought to Court's attention.

1) They highlight the alternative approach to dealing with fossil fuel issues which some of their clients adopt is engagement with companies to consider how they deal with carbon and climate change issues rather than divestment.
2) They also advise that if there is further restriction on fossil fuel holdings they may propose a different team deal with our direct investments than is currently the case (a team with more experience of ethical restrictions). The IAC believes the current team to be strong managers of the portfolio and therefore would note this may generate a further negative impact on returns.

Investment Advisory Committee
17 November 2017

Appendix – previous Court approval

Court approved the following recommendations:

1. that the University's direct investment in the fossil fuel extraction industry should be managed in a controlled manner such that the value of such investments does not exceed the current level of 10% of the endowment portfolio for any appreciable time period;
2. that the current level of investment should be reduced to zero over the next 10 years, subject to Recommendation 3 and biennial re-evaluation of the financial and other impacts of the divestment policy on the University along with the scope for increased investment in renewable energy sources;
3. that prior to executing Recommendation 2, a further examination of the financial impact of that Recommendation be conducted through dialogue with the Glasgow University Climate Action Society (GUCAS) and the University's Investment Committee [IAC] to provide assurance to Court as to the limited scale of the prospective financial impact.