REPORT OF THE WORKING GROUP ON INVESTMENT RESPONSIBILITY

A. INTRODUCTION AND BACKGROUND

1. In June 2008, the Council of the University approved a Statement of Investment Responsibility (SIR) for University investments[1]. Together with Charity Commission guidance, the SIR guides the work of the University's Investment Board and its Investment Office in the management of the Cambridge University Endowment Fund (CUEF). It also applies to the University's non-operational estate, holdings in spin-out companies and other investments held outside CUEF. The SIR has been amended from time to time and the current version is available publicly in the *University Reporter*[2]. The SIR is circulated to all CUEF's external investment managers.

2. The SIR records that the University's mission is "to contribute to society through the pursuit of education, learning, and research at the highest international levels of excellence". It explains that all the resources of the University are ultimately applied to this charitable purpose and that its core values include freedom of thought and expression and freedom from discrimination, as well as concern for sustainability and the relationship with the environment[3]. It makes clear that the primary fiduciary responsibility of the Council over investing, managing and being accountable for the University's endowment and other financial assets is to maximise the return on resources, consonant with the risks assumed under the University's established investment policy. As such, the SIR and investment processes might be said to describe the University's general expectations in making and accounting for its investments.

3. The SIR recognises that there are circumstances, described in Charity Commission guidance[4] and founded in judicial decisions, when University trustees may balance against their primary responsibility considerations of the ethical nature of investments. The SIR confirms that the Executive Committee of the Council - now titled the Advisory Committee on Benefactions and External and Legal Affairs (ACBELA) – is

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[1] www.admin.cam.ac.uk/reporter/2008-09/weekly/6158/4.html
[2] www.admin.cam.ac.uk/reporter/2012-13/weekly/6299/section1.shtml
[3] See also: www.cam.ac.uk/about-the-university/how-the-university-and-colleges-work/the-universitys-mission-and-core-values
[4] see CC14 – *Charities and Investment Matters: A guide for trustees* available at www.charitycommission.gov.uk/publications/cc14.aspx

responsible for reviewing the University's policy on investment responsibility and will meet at least once a year for this purpose with the University's Chief Investment Officer, its Director of Finance and the CUSU Socially Responsible Investment Officer(s). The Vice-Chancellor, to whom advice is provided by ACBELA, is also a standing member of the Investment Board. The SIR further specifies that any matter relating to the terms or application of the University's policy on investment responsibility may be addressed at any time in writing to the Registrary.

4. In May 2015, the Council endorsed the establishment of a Working Group of ACBELA with the remit "to consider whether any changes should be recommended to the current Statement of Investment Responsibility". This review was prompted by a recognition of "developments in the understanding of the integration of environmental, social, and governance aspects (including but not limited to fossil fuel investments) in investment decisions"[5].

5. The Group was asked to consider, amongst other issues, the following matters:

> "(a) how the Investment Board integrates environmental, social, and governance considerations into the University's investment practice;
> (b) the mission and core values of the University, especially its stated value of 'concern for sustainability and its relationship with the environment'; and
> (c) the relevance, performance, and scope of potential investment approaches and asset allocation strategies that would further promote the core values of the University."

6. The Group was authorised to take evidence and call upon expertise beyond its membership as necessary. Since its establishment, the Group has convened on ten occasions and members of the Group have interviewed eighteen witnesses, either in person or by teleconference. The Group has also received written evidence[6]. In addition, the Group invited individual comments from members of the University on

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[5] www.admin.cam.ac.uk/reporter/2014-15/weekly/6387/section1.shtml. A list of the members of the Group is set out in Appendix 1 of this report.

[6] A list of witnesses and parties who have submitted evidence is set out in Appendix 2 of this report, together with a non-exhaustive catalogue of documentary material which the Group has considered. Witnesses gave evidence in confidence, where requested.

matters within its remit[7] and has reviewed the submissions received. The Group has also taken advice on the legal constraints within which the University must conduct its investment policy.

7. This report draws on the evidence which the Group has received. It comprises a summary of the Group's deliberations and a series of recommendations regarding the University's policy on investment responsibility.

B. THE UNIVERSITY'S INVESTMENT PORTFOLIO

8. Within the University community, there is sometimes incomplete understanding concerning the University's investment portfolio and processes. We therefore set out here a more detailed explanation than is contained in the SIR, notwithstanding that additional information is available in the Financial Management Information published annually by the University[8].

9. In common with many other institutions in the charity and HE sectors, the University holds most of its investment portfolio indirectly. The Investment Office has a particular model under which it makes investments in, or commitments to, pooled funds and other vehicles operated by third-party managers, who in turn determine the purchase, sale and management of individual securities and other assets on a discretionary basis.

10. Only a small proportion of the University's investment portfolio[9] is therefore owned as securities and managed directly by the University. Significantly, of these directly managed securities, the Group found that at this time the University has no exposure to the most pollutive industries, such as thermal coal and tar sands, and no expectation of having any such exposure in the future. It also has negligible exposure to other fossil fuel industries. In relation to investments managed externally, there are no holdings in tar sands companies and only negligible holdings in thermal coal companies

[7] www.admin.cam.ac.uk/reporter/2014-15/weekly/6393/section1.shtml
[8] Financial Management Information for the year ended 31 July 2015 is available at www.admin.cam.ac.uk/reporter/2015-16/special/06/. Sections M, N and O contain information relating to the CUEF and the University's other investments.
[9] Currently less than 4%.

and any future holdings in such companies are expected to be negligible.

11. The Investment Office operates with a team of six investment professionals and three support members. A significant proportion of the Investment Office's execution of its responsibilities is dedicated to identifying, analysing and assessing investment processes and particular fund managers who exhibit the professional and behavioural characteristics which it seeks, subsequently recommending appointments and monitoring progress against expectations. The Office endeavours in its diligence to discover and appoint fund managers whose personal, behavioural and investment histories are consistent with the University's values. The Group considers that such alignment of values within the normal investment process has contributed, and continues to contribute, to the growth and success of CUEF and is consonant with effective and responsible investment.

12. One of the Group is a member of the Investment Board, and has knowledge of its underlying investments. She provided assurance that she is not aware of any instance of a financial asset that conflicts with the University's values. Indeed, the Group learnt of circumstances where possible investments had been rejected on ESG grounds, in line with the University's moral expectations.

13. The policy and allocation of assets within CUEF is regularly reviewed and monitored by the Investment Office and considered and agreed by the Investment Board in setting asset-allocation targets. The asset classes to which CUEF was allocated as at 31 March 2016 were:

- Public equities (59%)
- Private investments (12%)
- Absolute return (hedge funds) (13%)
- Credit (1%)
- Real assets (including property) (11%)
- Fixed interest/cash (4%)

14. The investment objective of CUEF, agreed by the Council, is to achieve or exceed a long-run average annual total rate of return equal to the retail price index for each calendar year plus 5.25%, net of costs. To date, on a cumulative basis since its inception in 2007, CUEF has exceeded this investment objective. In this context the Group notes that the principal activities of the University, through which it seeks to

contribute to the public good (scholarship, teaching and research), are in financial terms essentially and structurally loss making. Expected returns from CUEF and other capital investments are therefore critical to the success and sustainability of the University and its ability to contribute to society, and its trustees must be mindful of not doing harm to their charitable purposes in exercising their responsibility.

C. THE LAW

15. The Group has reviewed a range of sources of legal guidance[10]. The University is a charity; consequently its investment powers must be exercised in accordance with the fiduciary duties pertinent to charity trustees. The starting point in this regard is the duty to exercise investment powers in the best interests of the University and to further its charitable objectives, namely the pursuit of education, learning, and research. These charitable objectives are promoted through the operational activities of the University, which are supported by, amongst other things, returns from its investments. It is not in principle permissible for a charity such as a university to use its investment policy as a tool to adopt a particular moral stance. The primary object of the University's investment activity should accordingly be to seek the maximum financial return over the long-term, which is accountably consistent with commercial prudence.

16. There are recognised exceptions to this approach, when trustees may allow their investment strategy to be governed by considerations other than the level of investment return. Firstly, charities should not invest in activities that are illegal or contravene international conventions. In addition, charities should not invest in types of business that would create a patent or reasonably self-evident conflict with the aims of the charity. Thus, for example, trustees of temperance societies should not invest in breweries or distilleries, regardless of the financial consequences.

17. Beyond these exceptions, trustees may still take into account environmental,

[10] 2011 Charities and Investment Matters (CC14): Legal Underpinning: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/488863/Legal_underpinning_Charities_and_Investment_Matters.pdf; 2014 Law Commission Report, 'Fiduciary Duties of Investment Intermediaries: https://www.gov.uk/government/publications/fiduciary-duties-of-investment-intermediaries; an Opinion of Christopher McCall QC on Ethically Questionable Investments: http://www.bwbllp.com/file/summary-and-opinion-pdf; *Ethical Investment: a case of disjointed thinking*, Dr R. Thornton, CLJ, 2008.

social and governance (ESG) considerations, where doing so is consistent with the financial interests of the charity. Thus, charities may decide to avoid investments that are seen as having the potential to deter supporters, benefactors or beneficiaries if on balance alienating these groups would cause greater financial harm than the decision to avoid the investments in question. In addition, trustees may incorporate a broader ethical policy into their investment strategy, providing it does not entail material financial detriment.

18. In this context, it is clear that there is increasing expectation for charities to take into account ESG considerations where they coincide with responsible financial management. This includes engaging in active stewardship where charities consider such activity to be an effective means of influencing fund managers or companies to consider the environmental effects of their operations for the benefit of longer term profitability.

D. AN IMPROVED FRAMEWORK

19. In the Group's view, the University can and should ensure that ESG considerations and associated engagement inform its investment expectations in ways consistent with the underlying principle of seeking the best returns. However, at the same time the Group notes that, particularly in the context of an institution such as a university, the notion of exercising an ethical choice between investments of equivalent potential long-term value warrants considerable caution. While there may exceptionally be issues[11] that justifiably attract an overwhelming consensus, the University is a body which is proud to enjoy a wide-ranging and revolving constituency of stakeholders with an equally diverse and fluctuating compass of ethical standpoints; generally, it is not, nor should it be, the role of the Investment Office to prefer one moral position over another in the exercise of its investment function.

20. Particular current emphasis on the impact of climate change raises the challenge of identifying effective and durable methodologies that align with the CUEF's necessary and established investment objectives and its complex, and predominantly

[11] Such as those featuring in the UN Global Compact: human rights abuses, slave and child labour, environmental challenges, and extortion and bribery

indirectly-invested, portfolio across multiple asset classes, geographies and external managers. In seeking to recommend substantive means of setting and monitoring expectations of ESG performance, the Group has carefully reviewed the practicable options available to the University and the Investment Office, having due regard to applicable law, the responsibility of trustees and the views and experience of its own members, as well as evidence taken from specialists with experience of dealing with comparable questions and disclosures in other charitable institutions.

21. The Group notes that the University should be focused on sustainable long-term investment performance, and will naturally seek out investments through fund managers who act in a socially responsible way, where it is satisfied that such investments are more likely to flourish and deliver the best long term balance between risk and return. The Group observes that future action by governments, including, for example, fiscal and regulatory change concerning carbon, is likely to affect the economic attraction of particular investments for the long term.

22. The Group considers that the existing arrangements within the University provide the means for integrating ESG considerations into investment policy and setting expectations of managers on a systematic and consistent basis. There is an opportunity to enhance these arrangements to reflect a heightened awareness of ESG issues.

E. RECOMMENDATIONS

23. The Group recommends changes to the SIR to ensure that its stated expectations are more closely aligned with its values (Recommendation 1 below).

24. The Group makes further recommendations intended to support the implementation of the SIR. The Group has sought to ensure that any recommendations it makes are effective and that policies espoused by the University are grounded in authority. It appreciates that any recommended change in practice should therefore proceed from understanding the effect on the expected performance of the Investment Office, especially in its necessary and continuous engagement with advisers and fund managers. The Group also understands that, to be meaningful, this will require strong collaboration with fund managers, given the indirect nature of the majority of the University's investments in minority positions in funds.

25. The Group has noted the particular concerns of climate change, amongst other ESG matters, to investment policy. Regulatory change and public policy significantly affect the expected economic returns from carbon related industries. The Group recognises therefore that engagement with fund managers may include such considerations and involve strategies, where feasible, to divest progressively, consistent with the expected performance of the portfolio.

26. The recommendations that follow were informed by evidence from expert witnesses, investment professionals and interested members of the University consulted by the Group and are intended to expand the alignment of the University's ESG expectations and investment practices which aim to enhance the work of the Investment Office. They are grouped under three headings ("informing", "influencing" and "implementing").

27. Should any of these recommendations require material changes, including significant additional administrative cost, in the working of the Investment Office or elsewhere, they should be supported with increased resources.

28. "Informing" (see Recommendations 2 to 4 below) looks at how the existing social benefit generated by the University might be brought to greater attention and used to inform and support the work of the Investment Office. It also looks at how the University might engage with members of its community in the endowment.

29. "Influencing" (see Recommendations 5 and 6 below) looks at how the University engages with and monitors its external fund managers and investee companies on ESG considerations. The Group also recognises the direct and indirect influence that the University has on peer institutions and public discourse more generally in relation to investment responsibility.

30. "Implementing" (see Recommendations 7 to 9 below) looks at actions the University may consider to express its core values more explicitly in the management of its investments. There are actions the University could take to align investment policy more closely with expected values and are likely to evolve over time.

Recommendation 1

Specific changes should be made to the SIR as set out in Appendix 3 of this report.

Informing

Recommendation 2

The University should take steps to ensure that the existing arrangements for enabling members of the University to express views on investment practices are more prominently publicised.

Recommendation 3

The University should continue actively to promote the sustainability and environmental initiatives that it carries out through its teaching, education and research. It is of course the case that such activity is financially supported by the endowment and the efforts of the Investment Office.

Recommendation 4

The Investment Office should consider ways in which existing academic expertise within the University could be used to support its management of the endowment and other investments with respect to investment responsibility.

Influencing

Recommendation 5

The University, working through the Investment Office, under the guidance of the Investment Board, should continue to develop its own model for engaging with fund managers and investee companies on ESG issues, and for monitoring and assessing the outcomes of these processes. The model should require managers to account for any holdings in companies which give rise to concern on ESG grounds.

Recommendation 6

The University should consider exercising its voting rights as a shareholder within its strategies of engagement on ESG matters, where feasible, and reporting appropriately.

Implementing

Recommendation 7

The University should report consistently and systematically on its ESG considerations in investments and practices when it reports on CUEF and other investments.

Recommendation 8

The University should publish an open letter jointly from the Vice-Chancellor and Chief Investment Officer to its external managers describing its values and expectations in relation to ESG considerations. A draft copy of such a letter is contained in Appendix 4 of this report.

Recommendation 9

Attention should be paid to investments across asset classes that focus on ESG considerations, when financially equivalent to current holdings.

Appendix 1

Mr John Shakeshaft (Deputy Chair of the Council, in the Chair);

Professor Fiona Karet (Council member);

Mr Richard Jones (Council member);

Ms Tilly Franklin (Investment Board member);

Dr David Chambers (Academic Director of the Newton Centre for Endowment Asset Management, Judge Business School);

Dr Bhaskar Vira (Director, University of Cambridge Conservation Research Institute);

Ms Ellen Quigley (Doctoral student in the Faculty of Education and CUSU Socially Responsible Investment Officer); and

Mr Farhan Samanani (Doctoral student in the Department of Social Anthropology and CUSU Socially Responsible Investment Officer).

The Director of Finance, the Chief Investment Officer, and the Deputy Director of Legal Services were in attendance.

Appendix 2

A list of witnesses and parties who have submitted evidence

Mr James Bevan, Chief Investment Officer, CCLA

Lord Browne of Madingley, Executive Chairman of L1 Energy; Chief Executive, BP (1995-2007)

Mr Nick Cavalla, Chief Investment Officer, University of Cambridge

Ms Antonia Coad, Head of Investor Relations and External Affairs, OU Endowment Management

Professor Elroy Dimson, Emeritus Professor of Finance, London Business School

Mr Mohammed El-Erian Chief Economic Adviser, Allianz; Co-Chair, Fundraising Campaign, University of Cambridge

Mr Sean Kidney, CEO and Co-founder, Climate Bonds Initiative

Mr Rob Lake, Independent Advisor; Director of Responsible Investment, UNPRI (2011-2013)

Professor Patrick Maxwell, Regius Professor of Physic, University of Cambridge

Mr Nick Moakes, Managing Director, Investment Division, Wellcome Trust

Mr Peter Pereira Gray, Managing Director, Investment Division, Wellcome Trust

Mr David Pitt-Watson, Executive Fellow, London Business School

Mr Ross Reason, Finance Bursar, Robinson College; Member of the Investment Board

Dr Jake Reynolds, Director, Sustainable Economy, CISL

Mr David Swensen, Chief Investment Officer at Yale University

Mr Bill Trythall, Committee Member, Association of Member Nominated Trustees (AMNT); Trustee, USS

Ms Janice Turner, Founding Co-Chair, AMNT

Ms Helen Wildsmith, Stewardship Director, Climate Change, CCLA

Cambridge University Investment Board

Independent Petroleum Association of America

Cambridge University Zero Carbon Society

Catalogue of documentary material

The Value of Responsible Investment, Investment Leaders Group

The Ethical Investor, Simon/Powers/Gunnemann

Responsible Investment Quarterly Reports, Newton

David Swensen on the Fossil Fuel Divestment Debate, Financial Analysis Journal, June 2015

National status report on investments in the fossil fuel industry, NUS, January 2016

Report on student and staff attitudes towards fossil fuels and renewables, NUS, January 2016

Responsible Investing, Dimson-Marsh-Staunton

A Framework for Responsible Investing, Dimson

Responsible Investing and the Norwegian GPFG, Dimson-Kreutzer-etc

Fossil Fuel Investments in the Norwegian GPFG, Skancke-Dimson-etc

Norway's Summit on Responsible Investing, Towner

Stakeholder Perspectives on Norwegian Investment Responsibility, Takaki

Principles for Responsible Investment, UNPRI

Fiduciary Duty in the 21st Century, UNPRI

Know what you own: a toolkit for long-term, responsible and sustainable investment mandates, Cambridge Institute for Sustainability Leadership

Case study: Stanford Dumps Coal, Andrew Ang and Bruce Usher, Columbia Business School

"Is It Always About The Money?" Pension trustees' duties when setting an investment strategy: Guidance from the Law Commission, Law Commission

*Bonds and Climate Change***,** Climate Bonds Initiative

Scaling Up Green Bond Markets for Sustainable Development, Climate Bonds Initiative

Red Line Voting, Association of Member Nominated Trustees

Investors, Climate Risk and Forceful Stewardship: An Agenda For Action, Preventable Surprises

Carbon supply cost curves, Carbon Tracker Initiative

Greening the Bottom Line, Sustainable Endowments Institute

Green Revolving Funds: A Guide to Implementation & Management, Sustainable Endowments Institute and the Association for the Advancement of Sustainability in Higher Education

Investment Primer for Green Revolving Funds, Sustainable Endowments Institute

Mining Company of the Future, Kellogg Information Network

No Smoking, The Economist, June 2015

Statement from Council on representations concerning fossil fuels and the investments of The Oxford Funds, May 2015, University of Oxford

OU Endowment Management Governance Policy, University of Oxford

FRC UK Stewardship Code – response statement, Wellcome Trust

Socially Responsible Investment policies of the following institutions: Harvard, Yale, University of Texas, Stanford University, Princeton University, MIT, Texas A&M University, University of Michigan, Columbian University, Northwestern University, University of Oxford, University of London, University of Edinburgh, University of Manchester, King's College (London),and the Church of England.

Appendix 3

(Additions/alterations are marked in red and underlined)

In 2008, the Council approved a Statement of Investment Responsibility (Reporter, 6158, 2008-09, p. 1002), commended by the Executive Committee and the Investment Board. Following the annual review of the operation of the policy by the Executive Committee, the Council approved the following revised version which is now published below for the information of the University.

Background

1. The University's mission is 'to contribute to society through the pursuit of education, learning, and research at the highest international levels of excellence'. All the resources of the University are ultimately applied to this charitable purpose. Its core values include freedom of thought and expression and freedom from discrimination, as well as concern for sustainability and the relationship with the environment.

2. The University's investment assets are concentrated in the Cambridge University Endowment Fund (CUEF).

3. Council has established an Investment Board and an Investment Office. The Investment Board advises the Council through the Finance Committee on matters relating to the University's investments, working closely with the University's Investment Office. The Board proposes and agrees with the Council investment objectives and an investment strategy appropriate to those objectives, recommends for agreement asset allocation limits, and advises on the appointment of managers for these funds who operate under instruction from the Chief Investment Officer.

4. CUEF, managed by the Investment Office, primarily makes indirect investments. The investment portfolio is allocated between various asset classes (for example publicly-traded equities, bonds, real assets, absolute return (hedge funds), private equity, and bonds). Investments will be made by fund managers specializing in each asset class appointed with a discretionary mandate to outperform within that asset class.

5. Therefore, typically, securities in trading companies will not be managed or held directly by the CUEF, but indirectly through investment in other funds (index funds, exchange traded funds, hedge funds, private equity funds, and partnerships and other vehicles). Of these indirect investments, a large proportion may not be readily marketable.

6. The University holds certain non-operational assets in addition to its investments in the CUEF, including properties not in operational use let for commercial returns and investments in University spin-out companies. The majority of these investments are not held on solely financial investment grounds.

Statement of Investment Responsibility

7. The primary fiduciary responsibility of the Council in investing and managing the University's endowment and other financial investment assets is to maximize the financial return on those resources, taking into account the amount of risk within the University's established investment policy. However, there are circumstances, described in Charity Commission guidance (see CC14 – Charities and Investment Matters: A guide for trustees, available at

http://www.charitycommission.gov.uk/publications/cc14.aspx) and founded in judicial decisions, when the University may balance against its primary responsibility considerations of the ethical nature of investments.

8. When investing and managing the non-operational estate, holdings in spin-out companies and similar investments, including in circumstances where the investment cannot be entirely justified on financial investment grounds alone, the Council is responsible for ensuring that the investment is in the best interests of the University and that it too reflects its underlying values.

9. The Investment Office will take due care to ensure that its management reflects the interests and values of the University. The Office's exercise of this duty will include actively engaging with fund managers and investee companies to ensure that these interests and values are reflected in how holdings are acquired, managed and traded, insofar as such considerations are consistent with a primary mandate to generate return.

Operation

10. The University's Advisory Committee on Benefactions and External and Legal Affairs is responsible for keeping the policy on Investment Responsibility under review. Without prejudice to its power to review the policy at any time in so far as it considers it necessary to do so, the Committee will meet for this purpose with the University's Chief Investment Officer and Director of Finance at least once a year. The CUSU Socially Responsible Investment Officer(s) will be invited to attend these meetings. Any matters relating to the application of the policy should be addressed in writing to the Registrary.

Appendix 4

Draft open letter from the Vice-Chancellor and Chief Investment Officer to external managers

30 Station Road
Cambridge
CB1 2RE

Tel: +44 (0) 1223 764901

Dear Sir/Madam

The University's Statement of Investment Responsibility

In June 2008, the Council of the University approved a Statement of Investment Responsibility (SIR) for University investments. Together with Charity Commission guidance, the SIR guides the work of the University's Investment Board and its Investment Office in the management of the Cambridge University Endowment Fund (CUEF). The SIR is available publicly and circulated to all of the CUEF's external investment managers.

The University's mission is to contribute to society through the pursuit of education, learning, and research at the highest international levels of excellence. All of its resources are ultimately applied to this charitable purpose and its core values include freedom of thought and expression and freedom from discrimination, as well as concern for sustainability and the relationship with the environment.

In respect of the management of the CUEF and other financial assets, there is a primary fiduciary responsibility of the University to maximise the return on resources, consonant with the risks assumed under an established investment policy. However, the SIR also recognises that there are circumstances, described in Charity Commission guidance and founded in judicial decisions, when trustees may balance against their primary responsibility considerations of the ethical nature of investments. The University's Advisory Committee on Benefactions and External and Legal Affairs (ACBELA) is responsible for reviewing the University's policy on investment responsibility and meets at least once a year for this purpose. In May 2015, the Council endorsed the establishment of a Working Group of ACBELA with the remit to consider whether any changes should be recommended to the current SIR. This review was prompted by a recognition of developments in the understanding of the integration of environmental, social, and governance (ESG) aspects (including, but not limited to, fossil fuel investments) in investment decisions.

The report of the Working Group was received by ACBELA on 23rd May 2016 and has led to Council agreeing changes to the SIR, which is provided as an appendix to this letter.

It is clear that charities should not invest in illegal or other types of business activity that create an evident conflict with their aims. Moreover, certain charities with narrowly defined objectives may have scope to make mixed motive investments that are not selected solely on the basis of optimal financial return if they serve the wider charitable purposes of the institution. However, the Working Group noted in the context of a university endowment that the notion of exercising an ethical choice between investments of equivalent potential long-term value warrants considerable caution. While there may exceptionally be issues that justifiably command an overwhelming consensus, the University has a diverse set of stakeholders and it would be difficult for all of these to reach full agreement on the meaning of the term “ethical investment”. It should not be the role of the Investment Office to prefer one moral position over another as it exercises its investment function.

Moreover, while the University exists as a member of a global set of charitable institutions, in particular those operating in the areas of education and research, its own circumstances are unique. The activities of, and frameworks developed by, international organisations such as the CDP, IIGCC and UNPRI, in the context of investment responsibility, are of natural interest and will continue to be considered carefully by the University. However, the University’s policy in this area is a matter for its own decision and operational management and it does not expect to become a formal member of these bodies.

As is the case with many other charitable institutions, the University holds most of its investment portfolio indirectly. The overwhelming majority of investments (outside individual property assets) are managed on a discretionary basis by external investment managers selected and monitored by the University’s Investment Office, with the oversight of the Investment Board. In this context, the direct exclusion of individual investments that are otherwise legal is considered to be neither an appropriate ethical, nor indeed a practical, policy. Indeed a tokenistic approach may be counterproductive, as there is no guarantee that a desired outcome could be achieved merely by selling a particular share or other investment. Instead, the University intends where possible to pursue a constructive process of engagement and, given the Office’s intermediated investment model, reliance will be placed on working with its selected investment managers.

Climate change is the deepest environmental problem of our times. Careful consideration of both its scientific nature and the development of global agreements and associated policies to mitigate its impact should lead to a better understanding of the financial risks embedded in certain business models and facing individual companies. Policy disincentives (e.g. an increase in carbon taxation) and regulatory changes are likely to impact meaningfully on the economic returns of the least energy efficient and the most polluting industries, and these developments will affect the environmental and financial sustainability of both energy producing and consuming companies. Nevertheless, our economic wellbeing will depend on the combustion of fossil fuels for many years to come, as the world makes the transition to a lower carbon future. Hence, certain energy businesses will continue to form an essential part of the economy and by implication its investment mix. The more enlightened operators in this area are likely to have better long-term success as businesses if they anticipate policy and regulatory changes, seek to invest in research and to diversify away from the most environmentally damaging activities.

Consideration of these issues has led the Investment Office to be wary of exposure to companies that extract the most polluting fossil fuels. For example, the University has no direct or indirect holdings in tar sands companies, and negligible indirect holdings only in thermal coal companies. By contrast, after exhaustive research, the Office elected recently to invest in a build out of US solar assets that are advantaged by both the underlying economics of the solar industry and the development of US environmental policy (including subsidy arrangements that are not subject to erratic interpretation or sudden change within the life cycle of the investment). Moreover, within the natural resources area (energy and mining), the University’s investments are concentrated in companies with a low cost of production, partly on the basis that higher cost producers are likely to be less well-placed for possible future regulatory and economic changes in their industries.

While recognising that in this area inherent uncertainty, rather than calculable risk, is an analytical challenge, the University's Investment Board and Office expects its appointed investment managers to incorporate an assessment of climate change risks into their investment processes. There is a wider setting for this analysis, as thoughtful, long-term investment decisions should naturally reflect consideration of similar risks e.g. unsustainable business models, technical obsolescence, future regulatory burden, jurisdictional risk (including a weak rule of law), excessive leverage and/or financial engineering and poor corporate governance.

As a natural component of their work, the analysts within the University's Investment Office will continue to question external managers on how they have interpreted these risks and reflected broader ESG considerations into their processes. Where feasible and appropriate, the University will also consider exercising its voting rights as a shareholder to reflect these considerations.

Yours faithfully

Professor Sir Leszek Borysiewicz — Nick Cavalla

Vice-Chancellor — Chief Investment Officer