BOARD OF REGENTS MEETING

ESG Integration at UW

INFORMATION

This item is for information only.

BACKGROUND

This presentation is an introduction to ESG and UWINCO’s efforts in this area.

UWINCO is the University of Washington’s internal investment management company. It manages the Consolidated Endowment Fund and Invested Funds, which together amount to approximately $6 billion, for the benefit of the University’s teaching, research, and patient care missions. More information is available on the UWINCO website: https://www.uwinco.uw.edu. Investment policy is set by the Board of Regents, on the advice of the UWINCO Board and staff.

Attention to environmental, social, and governance (ESG) factors is of increasing importance for the investment community, including corporate executives, shareholders, and asset managers alike. For more on ESG investing and sustainable investing, see reports freely available at:


Attachment

ESG Integration at UW
ESG Integration at UW

Published by
University of Washington Investment Management Company
March 2021
Executive Summary

Section 1: Overview of ESG investing trends

Key takeaways: ESG (Environmental, Social, and Governance) issues are increasingly being included alongside financial factors in investment decision making. ESG norms and best practices are evolving. ESG integration is a popular and growing approach.

Section 2: Overview of ESG at UW

Key takeaways: UWINCO has incorporated ESG for decades. UWINCO uses ESG to support decision making in a way that does not risk financial impairment to UW. UWINCO has a strong ESG profile when compared to peers on a variety of dimensions.

UWINCO’s ESG toolkit includes, among other things:
1. Evaluating and monitoring investment opportunities and risks
2. Engaging with fund managers to encourage ESG integration
3. Exercising UW's shareholder rights (proxy voting, letter writing)
4. Leveraging peer and industry networks

Appendix
What is ESG?

MSCI ESG Research defines ESG as the consideration of Environmental, Social, and Governance factors alongside financial factors in the investment decision-making process.¹

ESG issues are broad ranging.² Examples include:

- Carbon emissions ("E")
- Labor standards ("S")
- Biodiversity impact ("E")
- Community impact ("S")
- Corruption ("G")
- Board diversity ("G")

Three common investor objectives or motivations influence the choice of ESG strategy:³

- Integration … "Incorporating ESG may improve my investment results."
- Values … "My investments should reflect my values."
- Impact … "I want my investments to make a difference in the world."

In order to achieve these objectives, investors may pursue different approaches, such as:⁴

- ESG integration
- Best-in-class selection
- Negative screening
- Thematic investing
- Impact investing
- Active ownership

ESG objectives and implementation approaches are not mutually exclusive. Many institutions adopt a blend which best suits their unique institutional characteristics.⁵

MSCI ESG 101 Primer: https://www.msci.com/what-is-esg

ESG implementation strategies

**Intentional investments**

- **ESG integration**
  Include Environmental, Social, and Governance risks and opportunities in investments

- **Thematic investing**
  Target specific themes for investment

- **Impact investing**
  Accept lower returns

- **ESG integrated thematic investing**
  Require competitive returns

- **Engagement**
  Use one’s shareholder voice to promote values and catalyze change

- **Proxy voting**

- **Shareholder networks**

**Boycotts**

- **Negative screening**, faith based, divestment, liquidation/exits

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**Section 1**

**Section 2**
Growth and scale of ESG implementation strategies

Global Trends: Growth Rates and Asset Totals

<table>
<thead>
<tr>
<th>Growth rate</th>
<th>Sustainability themed investing</th>
<th>Impact/community investing</th>
<th>ESG integration/best-in-class</th>
<th>Corporate engagement/shareholder action</th>
<th>Negative screening/norms-based screening</th>
</tr>
</thead>
</table>

$ billions

<table>
<thead>
<tr>
<th>Assets under management 2016</th>
<th>$276</th>
<th>$248</th>
<th>$11,171</th>
<th>$8,385</th>
<th>21,259</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets under management 2018</td>
<td>$1,018</td>
<td>$444</td>
<td>$19,386</td>
<td>$9,835</td>
<td>24,450</td>
</tr>
<tr>
<td>Growth 2016-2018</td>
<td>269%</td>
<td>79%</td>
<td>74%</td>
<td>17%</td>
<td>15%</td>
</tr>
</tbody>
</table>
### ESG in higher education investments

**Leading ESG Issues for Educational Institutional Assets**

<table>
<thead>
<tr>
<th>Issue</th>
<th>2020 $ Assets (billions)</th>
<th>2018 $ Assets (billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate Change/Carbon</td>
<td>$233</td>
<td>$143</td>
</tr>
<tr>
<td>Conflict Risk (Terrorist or Repressive Regimes)</td>
<td>$185</td>
<td>$287</td>
</tr>
<tr>
<td>Human Rights</td>
<td>$185</td>
<td>na</td>
</tr>
<tr>
<td>Other Products</td>
<td>$178</td>
<td>na</td>
</tr>
<tr>
<td>Sustainable Natural Resources/Agriculture</td>
<td>$176</td>
<td>na</td>
</tr>
<tr>
<td>EEO/Diversity</td>
<td>$175</td>
<td>$109</td>
</tr>
<tr>
<td>Products - Other</td>
<td>$164</td>
<td>na</td>
</tr>
<tr>
<td>Social – General</td>
<td>$143</td>
<td>$38</td>
</tr>
<tr>
<td>Community – General</td>
<td>$133</td>
<td>$37</td>
</tr>
<tr>
<td>Governance - Other</td>
<td>$133</td>
<td>na</td>
</tr>
<tr>
<td>Fossil Fuel Divestment</td>
<td>$100</td>
<td>$83</td>
</tr>
<tr>
<td>Tobacco</td>
<td>$86</td>
<td>$197</td>
</tr>
<tr>
<td>Governance – General</td>
<td>$61</td>
<td>$149</td>
</tr>
<tr>
<td>Environmental – General</td>
<td>$61</td>
<td>$40</td>
</tr>
<tr>
<td>Prison Related Issues</td>
<td>$61</td>
<td>$10</td>
</tr>
</tbody>
</table>

As of 2018, out of approximately 3,000 4-year degree granting institutions in the US, the Intentional Endowments Network finds that:

A) 3% have ESG in their investment policy statement (97 schools)

B) 1% have signed on to a major commitment on sustainable investing, with most focusing on climate action (18 schools)

C) 3% have committees on investor responsibility (95 schools)

D) 2% have partially or fully divested from fossil fuels, private prisons and other sectors (70 schools)
Section 2
## ESG roles and responsibilities at UW

<table>
<thead>
<tr>
<th>ESG area of responsibility</th>
<th>UW BoR</th>
<th>UWINCO Advisory Board</th>
<th>UWINCO CIO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Approve changes in CEF and IF Policy language related to ethical considerations</td>
<td>• Advise CIO on ESG integration plans</td>
<td>• Integrate ESG actions expected to enhance CEF and IF investment returns</td>
</tr>
<tr>
<td></td>
<td>• Evaluate ACSRI* requests</td>
<td>• Offer BoR perspective on contemplated actions (if asked)</td>
<td>• Provide financial impact assessment to UW Finance (for ACSRI) on contemplated proposals (if asked)</td>
</tr>
<tr>
<td></td>
<td>• Approve any actions expected to cause concessionary investment returns for the CEF and IF</td>
<td>• Implement any non-financial directives approved by BoR</td>
<td></td>
</tr>
</tbody>
</table>

* Advisory Committee on Socially Responsible Investing
UWINCO has a clear mission

UWINCO Mission Statement

UWINCO’s mission is to preserve and grow the University’s investments to support UW’s global leadership in research and education.
UWINCO ESG Guiding Principles

The Consolidated Endowment Fund exists to provide intergenerational financial support to the University of Washington.

UWINCO’s primary objective is to maximize risk-adjusted returns in order to preserve and grow the University’s investments.

UWINCO also recognizes that environmental, social and governance (ESG) considerations present real issues and critical challenges that impact the UW community and beyond.

1. We align all of our ESG activities with our fiduciary responsibility.
2. We integrate ESG considerations into prospective investments in a manner that reflects the unique characteristics of different asset classes.
3. We engage with fund managers, companies, peers, and UW constituents to advance ESG issues.
4. We pursue thematic investment opportunities which meet our risk and return goals.
5. We apply a growth mindset to continuously improve our ESG integration based on experience and evolving best practices.
UWINCO history of ESG action


- 1986 Exit investments in South Africa
- 2000 Exit investments in Tobacco
- 1995 Burma shareholder resolutions supported
- 2005/2006 Sudan shareholder resolutions supported, Exit investments in Sudan stocks
- 2012 First STARS survey
- 2014 Begin annual engagement with managers on ESG
- 2016 UW signs onto CDP (Carbon Disclosure Project)
- 2018 Third STARS survey; UWINCO scores in top 11% of Investment teams
- 2019 UW BoR approves Advisory Committee on Socially Responsible Investing (ACSRI)
- 2014 +
  - 5 ESG Undergraduate UWINCO research assistants
  - 60+ ESG meetings in recent years
  - Reduced energy exposure over time
- 2015
  - Exit Thermal Coal investments
  - $10m Global Environmental Opportunities investment
  - Joined US-SIF (Sustainable Investment Forum)
- 2018
  - MABA Independent Study ESG research project #2
  - Shareholder engagement consultant presents to UW BoR
- 2020+
  - Interim Special ESG UWINCO Board Meeting
  - Formalize UWINCO Guiding Principals
  - Assess manager diversity and inclusion
  - ESG industry best practices analysis
  - MABA Independent Study ESG research project #3
  - Joined Intentional Endowment Network
  - Fourth STARS survey coming in 2021
STARS survey performance
Sustainability, Tracking, Assessment, and Rating System

UW is Gold Rated in the STARS Survey
STARS evaluates 93 facets of broad UW operations

Academics

Engagement

Operations

Planning & Administration

Investment & Finance Subsection
35 questions

- Governance structure as related to sustainable investments
- Exposure to sustainable industries and investments
- Sustainable investment policies
- Proxy voting policies

- Negative screening and divestment
- Investor network participation
- Portfolio disclosure standards

UWINCO’s investment score is higher than 89% of peers.
UWINCO is ranked 39\textsuperscript{th} of 369 respondents in the Investment & Finance section of STARS.\textsuperscript{11}
# Five Point Climate Change Initiatives

Framework was initially implemented in 2013\(^{12}\) and remains the primary roadmap for climate related investment actions at UWINCO.

<table>
<thead>
<tr>
<th>Original Initiative</th>
<th>Accomplishments</th>
<th>Next Steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Create new ESG Research Assistant position</td>
<td>UWINCO has hosted 5 ESG Research Assistants</td>
<td>Continue to host ESG Research Assistants for targeted projects; leverage Investment Analysts for more sophisticated research</td>
</tr>
<tr>
<td>2. Increase Alternative Energy investments</td>
<td>UWINCO has $19 million exposure to a Global Environmental Opportunities fund and more across other managers</td>
<td>Continue looking for investments that contribute positively to CEF financial returns</td>
</tr>
<tr>
<td>3. Incorporate ESG factors into investment analysis, decisions</td>
<td>UWINCO incorporates ESG analysis into investment recommendations and assesses manager ESG policies at least annually</td>
<td>Continue requesting information from managers and prompting discussions about ESG topics of interest</td>
</tr>
<tr>
<td>4. Explore opportunities for shareholder advocacy</td>
<td>UWINCO directs managers to follow ISS Climate Policy recommendations on climate change related proxies</td>
<td>Consider other ESG themes that may warrant specific proxy treatment</td>
</tr>
<tr>
<td>5. Establish a framework for future engagement with students</td>
<td>UWINCO meets with Student Regent; UW ACSRI creates forum for divestment requests</td>
<td>Consider best interface to improve communication</td>
</tr>
</tbody>
</table>
Appendix
Appendix – Additional examples of ESG issues

<table>
<thead>
<tr>
<th>Environmental Issues</th>
<th>Social Issues</th>
<th>Governance Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate change and carbon emissions</td>
<td>Customer satisfaction</td>
<td>Board composition</td>
</tr>
<tr>
<td>Air and water pollution</td>
<td>Data protection and privacy</td>
<td>Audit committee structure</td>
</tr>
<tr>
<td>Biodiversity</td>
<td>Gender and diversity</td>
<td>Bribery and corruption</td>
</tr>
<tr>
<td>Deforestation</td>
<td>Employee engagement</td>
<td>Executive compensation</td>
</tr>
<tr>
<td>Energy efficiency</td>
<td>Community relations</td>
<td>Lobbying</td>
</tr>
<tr>
<td>Waste management</td>
<td>Human rights</td>
<td>Political contributions</td>
</tr>
<tr>
<td>Water scarcity</td>
<td>Labor standards</td>
<td>Whistleblower schemes</td>
</tr>
</tbody>
</table>
# Appendix – Definitions

## INVESTMENT APPROACHES

<table>
<thead>
<tr>
<th>Definition</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Socially Responsible Investing (SRI)</td>
<td>can use both positive and negative investment criteria to align investments with an institution’s values, but has often historically referred to negative screening (see below).</td>
</tr>
<tr>
<td>Environmental, Social, Governance Investing (ESG)</td>
<td>aims to create a more complete picture of investment risks and opportunities by factoring environmental, social, and governance criteria into investment decisions.</td>
</tr>
</tbody>
</table>

## INVESTMENT STRATEGIES

<table>
<thead>
<tr>
<th>Definition</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Best-in-class”</td>
<td>investing favors companies with better or improving ESG performance relative to sector peers. Best-in-class methodology is sometimes referred to as positive selection or positive alignment.</td>
</tr>
<tr>
<td>ESG integration</td>
<td>is the inclusion of ESG risks and opportunities in investment analysis. Unlike the best-in-class method, ESG integration does not necessarily require sector benchmarking. ESG integration also does not require any ex ante criteria for inclusion or exclusion. This strategy is relevant for most, if not all, investors.</td>
</tr>
<tr>
<td>Impact investing</td>
<td>is investing with the intention to generate measurable social and environmental benefits alongside a financial return. Returns expectations range from below market to a risk-adjusted market rate.</td>
</tr>
<tr>
<td>Thematic investing</td>
<td>is investing based on trends, such as social, industrial, and demographic trends. A number of investment themes are based on ESG issues, including clean tech, green real estate, sustainable forestry, agriculture, education, and health. Thematic investing is not confined to ESG issues.</td>
</tr>
<tr>
<td>Active ownership/engagement</td>
<td>is the practice of entering into a dialogue with companies on ESG issues. Active ownership is in sharp contrast to the idea that investors should sell off investments with questionable practices. Activism varies in terms of aggressiveness of the approach, from confrontational to more discreet.</td>
</tr>
<tr>
<td>Negative screening</td>
<td>avoids securities of companies or countries on the basis of traditional moral values and standards and norms. In values-based exclusions, the focus is on the business of the company, and entire sectors are excluded. In norms-based screening, the focus is on the company’s behavior regarding internationally accepted norms in such areas as human rights and labor standards.</td>
</tr>
</tbody>
</table>
## Appendix – ESG approaches, objectives, and critiques

<table>
<thead>
<tr>
<th>Investment approach(^{14})</th>
<th>Investor objective(^{14})</th>
<th>Common critiques</th>
</tr>
</thead>
<tbody>
<tr>
<td>• ESG integration&lt;br&gt;• Best-in-class ESG selection</td>
<td>Maximize direct innovation research funding by maximizing investment returns/endowment distributions</td>
<td>• Risk of “greenwashing” accusations(^{15,16})&lt;br&gt;• No media splash to influence social preferences and/or legislative agendas(^{17,18})</td>
</tr>
<tr>
<td>• Engagement&lt;br&gt;• Active ownership</td>
<td>Influence corporate management decisions</td>
<td>• Small shareholders may have limited impact(^{19})&lt;br&gt;• Engagement can be resource intensive(^{20})&lt;br&gt;• No media splash to influence social preferences and/or legislative agendas(^{17,18})</td>
</tr>
<tr>
<td>• Impact investing&lt;br&gt;• Thematic investing</td>
<td>Fund innovation through investments in new technologies, ESG themes</td>
<td>• Higher risk of investment return concessions/losses(^{21,22})</td>
</tr>
<tr>
<td>• Negative screening&lt;br&gt;• Socially responsible investing (“SRI”)&lt;br&gt;• Faith based investing</td>
<td>• Eschew financial gains from companies misaligned with one’s values&lt;br&gt;• Punish/stigmatize offending companies by increasing their cost of capital&lt;br&gt;• Use media splash to influence social preferences and/or legislative agendas(^{17,18})</td>
<td>• Risk of lower returns(^{23})&lt;br&gt;• Less effective than engagement at changing corporate behavior(^{24})&lt;br&gt;• Leaves equity shares in the hands of investors who are not concerned about ESG(^{25})&lt;br&gt;• Raises concerns about fiduciary duty(^{26})</td>
</tr>
</tbody>
</table>
Appendix – UWINCO’s parameters

1. **CEF and IF Investment Policies**
   Policy goals include (among others): ensuring intergenerational equity between future and current beneficiaries and providing a maximum level of return consistent with prudent risk levels.

2. **Chartered Financial Analyst (CFA) Code of Ethics**
   The CFA Code of Ethics requires prudent judgment and the prioritization of client interests.

3. **Endowment donor agreements**
   When UW accepts an endowment donation, it enters into a contract with the donor. Standard language in these contracts specify that UW will manage the donated capital in alignment with UW policies. Individual agreements may have additional legal constraints.

4. **Securities and Exchange Commission (SEC) Guidelines**
   The SEC publishes rules and guidelines for securities investors.

5. **Uniform Prudent Management of Institutional Funds Act (UPMIFA)**
   UPMIFA details how endowments should be managed. UPMIFA enumerated responsibilities for endowment managers include (among others): following the wishes of the donor, exercising prudence, and considering investment risk and return.
Appendix – Useful Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>ACSRI:</td>
<td>The UW Advisory Committee on Socially Responsible Investing</td>
</tr>
<tr>
<td>CDP:</td>
<td>Carbon Disclosure Project</td>
</tr>
<tr>
<td>CFA:</td>
<td>Chartered Financial Analyst</td>
</tr>
<tr>
<td>DEI:</td>
<td>Diversity, Equity, and Inclusion</td>
</tr>
<tr>
<td>EEO:</td>
<td>Equal Employment Opportunity</td>
</tr>
<tr>
<td>ESG:</td>
<td>Environmental, Social, and Governance issues, especially as pertaining to investment activities</td>
</tr>
<tr>
<td>ISS:</td>
<td>Institutional Shareholder Services</td>
</tr>
<tr>
<td>MSCI:</td>
<td>Morgan Stanley Capital International</td>
</tr>
<tr>
<td>SEC:</td>
<td>United States Securities and Exchange Commission</td>
</tr>
<tr>
<td>SIF/US SIF:</td>
<td>United States Sustainable Investment Forum, now known as The Forum for Sustainable and Responsible Investment</td>
</tr>
<tr>
<td>SRI:</td>
<td>Socially Responsible Investing (historically, though not always, used interchangeably with negative screening)</td>
</tr>
<tr>
<td>STARS:</td>
<td>Sustainability, Tracking, Assessment, and Rating System for Higher Education</td>
</tr>
<tr>
<td>UPMIFA:</td>
<td>Uniform Prudent Management of Institutional Funds Act, the governing regulatory code for Washington state endowment investment managers</td>
</tr>
</tbody>
</table>
Notes

1. MSCI, “ESG 101: What is ESG?” https://www.msci.com/what-is-esg. The ESG acronym is universal but more nuanced definitions for ESG investment approaches vary significantly across different sources.
2. CFA Institute, Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals” p. 4. See Appendix page 15 for more examples of ESG issues from this same source.
10. https://www.uwinco.uw.edu/
13. Intentional Endowment Network, “Intentionally Designed Endowments Primer,” Aug 2019, p. 6. Note these definitions are not standardized across the industry and may differ by institution.
14. Objectives and approaches are not mutually exclusive.
15. CFA Institute, Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals” p. 37. Specifically highlighted is the subjectivity of ESG integration and resulting credibility challenges. We use “risk of ‘greenwashing’” to summarize this challenge.
Notes (continued)

18. CFA Institute, Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals” p. 34.
19. Broccardo, Hart, and Zingales, “Exit vs. Voice,” December 2020, p. 36. Small investors may face an unacceptable amount of concentration risk in their portfolios in order to attain the scale needed to have an impact using shareholder engagement. This can be addressed by smaller investors joining together.
26. CFA Institute, Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals” p. 34.
27. https://www.uwinco.uw.edu/policies/