**TO:** Board of Governors

**FROM:** Committee to Advise on Matters of Social Responsibility (CAMSR)

**SUBJECT:** Approval of CAMSR Report Implementation Plan

**DATE:** April 23, 2020

At its meeting of April 15, 2020, CAMSR approved the submission of the CAMSR Report (GD19-50) to the Board of Governors.

CAMSR recommends that the Board of Governors approve the implementation plan contained in the CAMSR Report.

The CAMSR Report is attached as Appendix A.

Motion for approval

# COMMITTEE TO ADVISE ON MATTERS OF SOCIAL RESPONSIBILITY (CAMSR)

## REPORT TO THE BOARD OF GOVERNORS

GD19-50 APPENDIX A
APRIL 23, 2020

## Context, Process and Acknowledgement

At its meeting of December 5, 2019, the Board of Governors ("Board") approved the recommendations contained in the CAMSR Report (GD19-29), with the understanding that an implementation plan, including quantifiable targets and timelines would be developed by CAMSR, in consultation with the Investment Committee, and presented to the Board at its meeting of April 23, 2020. CAMSR's Report is available here.

Since the Board's decision, CAMSR held three meetings (January 16, March 24, and April 15, 2020) and the Investment Committee held two meetings (February 7 and March 18, 2020). In addition, the Committees held a joint working session on February 18, 2020. The Investment Committee's recommendations with respect to the operationalization of CAMSR's recommendations one through six were approved by CAMSR, along with the remaining last two recommendations (seven and eight) on March 24, 2020.

The result of this work is an im

Please see Appendix 1 for a description of the analysis that the Investment Committee and CAMSR considered in order to establish this target and timeline.

***Recommendation #2, with respect to Impact Investing:***

At its December 2019 meeting, the Board of Governors committed to:

"Invest in low-carbon funds and funds that contribute to decarbonization (impact investments) of the MIP and set global allocation objectives, which may include the following asset classes:

- Fixed income (ex: green bonds)
- Private investments (ex: new clean technologies in auto parts, solar equipment, light fixtures)
- Real assets [renewable energy infrastructure (ex: wind, solar, hydro, waste, bioenergy)]"

In response to this commitment, CAMSR recommends the following target and timeline:

CAMSR recommends, by 2025, to commit 5% of the MIP to low-carbon funds and funds that contribute to decarbonization of the MIP.

*Note:* Based on the MIP's current assets

***Recommendation #4, with respect to Engagement***

At its December 2019 meeting, the Board of Governors committed to:

> "Exercise, to the extent possible, active stewardship through investor engagement opportunities with investment managers."

In response to this commitment, CAMSR recommends the following actions:

> The Investment Committee will continue to increase the number of managers who adhere to ESG Policy and/or are signatories of the UNPRI (at 93% as at January 2020). The Investment Committee will ensure that the University follows-up with these managers on an annual basis to assure itself that they still adhere to an ESG Policy and/or that they are still signatories of the UNPRI.
>
> The University will encourage managers to monitor the carbon footprint of their portfolio using MSCI ESG research or a similar measurement tool. The University will also use the ESG Impact Monitor system of MSCI to identify, assess and question the involvement of MIP companies in practices which go against ESG and/or UNPRI norms.
>
> The Office of Investments will increase its knowledge base on socially responsible investment practices through training, attendance at conferences or other similar activities.
>
> Progress in the actions noted above will be reported to the Investment Committee on an annual basis and will form part of the Investment Committee's annual report to CAMSR and the Board of Governors.

***Recommendation #5, with respect to ESG Integration***

At its December 2019 meeting, the Board of Governors committed to:

> "Review the Statement of Investment Policy of the MIP to reflect ESG goals and objectives, including modifying the Investment Objective section to consider ESG commitments."

In response to this commitment, CAMSR is recommending the following actions:

> Following the Board's consideration of the CAMSR Report in April 2020, the Office of Investments will propose amendments to the *Statement of Investment Policy* (SIP) to the Investment Committee at its meeting in June 2020. The amendments will aim to implement the proposed CAMSR recommendations, which are presented to the Board of Governors for consideration.

## APPENDIX 1

***Analysis supporting Recommendation #1, with respect to Decarbonization:***

The analysis undertaken in respect of the decarbonization target and timeline supports the University's objective to establish meaningful and concrete actions needed to achieve the sound implementation of the recommendations approved by the Board in December 2019. With that objective in mind, the University's development of the proposed target and timeline was informed by the following considerations:

a) the University's ability to effectively implement portfolio changes required to meet different target scenarios with the current asset mix and managers;
b) the possibility that a manager's preferences (with an important underweight in carbon intense sectors) might change going forward;
c) the cost of implementation (transitional and ongoing); and
d) the long-term impact of different constraints.

The possibility that the carbon footprint of the overall equity market might reduce naturally in the future as well as the possible upward fluctuations associated with an increase of the weights of the 3 sectors (i.e. Energy, Materials and Utilities) that contribute the most to the MIP's total carbon emissions have been considered. As a result of the uncertainty related to the overall market future carbon emissions, a target measured relative to an Equity market benchmark, rather than an absolute target, is proposed.

MSCI was used to provide objective data on $CO_2$ emissions. Data, which are available for most public equity issuers, include data related to: the direct emissions from owned or controlled sources (Scope 1), the indirect emissions associated with the generation of purchased energy (Scope 2) carbon emissions, but not the data t in all 3 sectors were to be sold, the MIP would still retain a Carbon Footprint, as calculated in September 2019, of 31 tons per million invested.

**Elimination of the Carbon Underground 200 Equity Holdings**

The elimination of the Carbon Underground 200 equity holdings would reduce the Carbon Footprint from 148 to 130 – far less than would be achieved by the recommended changes. The operational impact would be almost as significant as the complete elimination of the 3 most carbon intense sectors. An investment of just one of the Carbon Underground 200 securities in a manager's fund would be problematic as all assets of the MIP would need to be redeemed from most of the current pooled fund investments, even when the portfolio carbon footprint is minimal. There would be a loss in flexibility to select the changes that achieve the largest carbon footprint reduction with the least cost and impact on returns and risk.

**Reducing Allocation to Carbon Intensive Geographic Markets (Canada and Emerging Markets (EM))**

The Canadian market index carbon emissions ($tCO_2$/$million invested) is 143; EM is 334 vs. the overall MIP benchmark emissions of 163. A reduced allocation from Canada and/or EM could conceivably reduce carbon footprint. However, McGill's managers in Canada and EM have Carbon Emissions well below the benchmarks so a reallocation away from the managers would actually have an adverse impact on the carbon footprint and require significant changes to portfolio construction. Hence, it is an inefficient solution to reduce the carbon footprint.

**More Aggressive Reduction Targets Beyond the Recommended 33% Relative to Benchmark**

At this time, the 33% reduction target relative to benchmark touches the 0.4% tracking error Materiality Threshold. Higher targets would surpass it and put at risk the capacity of the Investment Committee to adapt to a reasonable range of changes to market conditions (both the practical ability to implement changes and the impact on tracking error). Higher targets will also impose additional costs, require terminations of manager mandates and potentially impair McGill's ability to participate in important markets such as EM – which currently account for 20 % of MIP public equity allocation and could potentially continue to grow. There are very few EM managers who commit to low carbon emissions. This may change in the future but today it is a constraining factor.

The Investment Committee is confident (at an 84% confidence level) that the changes considered will not produce a negative variance from our benchmarks of more than 0.4% per annum over a five-year period. The variance could be greater over a shorter timeframe such as one quarter or one year but as an endowment fund with a long-term time horizon, the Investment Committee is less concerned about short-term fluctuations.

# APPENDIX 2

***Analysis supporting Recommendation #2, with respect to Impact Investing:***

Current allocation into renewable and clean technology private debt, low carbon real estate and listed impact equities is estimated at 2% of the total MIP assets.

Based on the MIP's current assets, the target represents an $77 million commitment, which will grow as the MIP's assets increase over time. Impact investments that will be included in this commitment will aim to generate specific beneficial environmental effects in addition to financial gains. They will take the form of numerous asset classes and will address environmental issues. Funds that incorporate sustainability principles into their value creation strategies will be considered, including real estate funds, infrastructure funds and listed impact equity funds that are highly exposed to decarbonization. Equity and Fixed Income securities could also be included if the company or the debt of the company contributes to potential climate change solutions. Lastly, this approach would include, among others, companies in alternative energy, energy efficiency, green building, pollution prevention, and sustainable water.

Taking into account the relatively limited resources in the Office of Investments, the preference will be to invest in strategies belonging to asset classes with similar risk-return characteristics as the ones already contemplated