Stanford University
Advisory Panel on Investment Responsibility (APIRL)

Review of Stanford's
Statement on Investment Responsibility
May 2018

The Stanford Board of Trustees requested that the APIRL review the current Statement on Investment Responsibility and provide feedback on updating the policies. This is the APIRL's Final Report presented to the Board's Special Committee on Investment Responsibility.

SIR Review by Advisory Panel on Investment Responsibility (APIRL)

MAY 2018

I. Introduction

Under the university's current written policy, the university considers the social and environmental impacts of its investments only when students or other members of the community affirmatively request the university to divest or take shareholder action. This policy inevitably leads students and other members of the community to believe that the university cares about the social and environmental impacts of its investments only on an exceptional basis. The policy also increases the likelihood of divestment requests, because such requests become the sole mechanism for integrating social and environmental issues into the university's investment decisions.

The university's current policy arguably leads to the worst of all worlds: rather than taking the lead in deciding how best to factor social and environmental issues into its investment decisions, the university waits for formal divestiture requests. The university reacts to student and community petitions, often in the context of heated debates, rather than being proactive. The university lags rather than leads. Consequently, students and other members of the community come to believe that the university does not care about the social and environmental impacts of its investments. Another result is often unnecessary divestment petitions.

The current process also devalues the time of the members of the Advisory Panel on Investment Responsibility (APIRL), who spend months investigating petitions without knowledge of whether the university even has an investment in the relevant companies. Occasionally, at the conclusion of the long process, the discovery is that the university has no relevant stocks.

In addition, the current policy lacks transparency. Petitioners receive little or no information while the investigation proceeds, frustrating them and the committee members. Given that Stanford is an educational institution, this is also a lost opportunity for a valuable "teaching and learning moment" for all of the participants and indeed for the larger Stanford community. The issues raised in petitions are generally worthy of consideration, deliberation, and study more campus-wide. Certainly, the non-confidential information collected as part of the investigation of the petitioners' claims deserves wider dissemination and discussion.

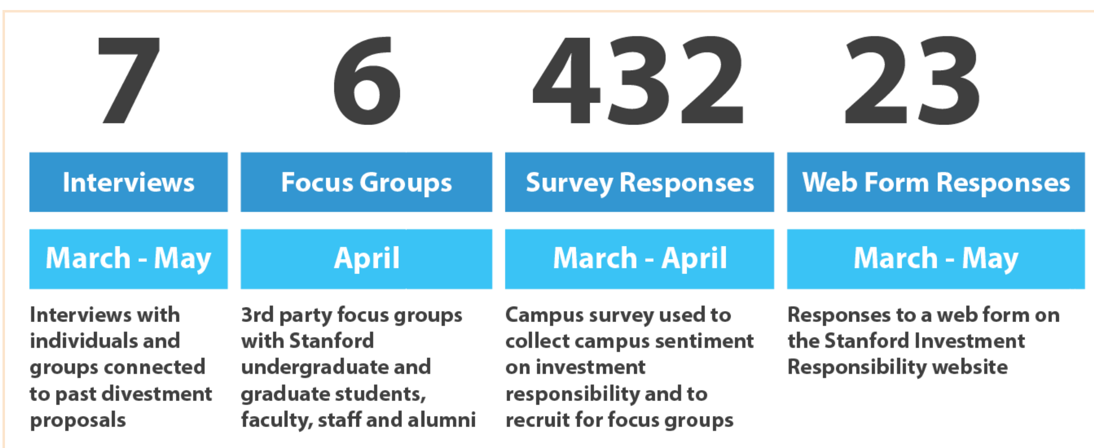
To rectify these problems, the university should begin by adopting a more proactive approach to the consideration of social and environmental issues in its investment decisions. We developed some consensus around several such approaches. Several of our committee members believe we can do even more than suggested here, and it is worth considering their arguments as well (Appendix I: Votes and statements from APIRL members).

II. Description of outreach efforts

In 2018, the APIRL, with the support of the IRSR Office, conducted a significant outreach campaign to the community to inform the review of Stanford University's investment responsibility policies. The focus of this effort was to solicit feedback from the community on the current investment responsibility practices at the institution, including related divestment standards and procedures.

The APIRL used several mechanisms to solicit community input including: retaining a third-party, Q8, to conduct focus group discussions, through which a campus-wide survey was distributed to screen potential focus group participants; inviting faculty members as guest speakers to the APIRL meetings; creating a public web feedback form posted to the IRSR website; and conducting one-on-one interviews with people who have been involved in the process.

The APIRL was then able to use the information gathered from each of the outreach efforts to inform and guide their discussions and recommendations for the final report to the SCIR.



III. APIRL recommendations

A. Standard for divestment

The current standard for divestment detailed in the Statement on Investment Responsibility (SIR) has proven difficult to use as an evaluation tool for divestment requests from the Stanford community. We present two main issues with the current standard:

1. Inevitably, any standard will rely on subjective language. The current statement includes phrases such as "social injury," "significant number of individuals," "foreseeable future," or "unusual circumstances." Confusion and misunderstanding arise because, currently, definitions of those terms inevitably vary among the community organizations that make divestment requests, the members of the APIRL and the members of the Board of Trustees. Whatever standard we use, there must be guidelines to its meaning and application. As these guidelines evolve, so must their explication in materials available to those attempting to use them.
2. Impact of divestment. Research on divestment has demonstrated that the act of divestment has almost no impact on public market valuations (i.e., share price).[1] Divestment exerts little/no direct economic pressure on a public company to change its behavior. The consequences of divestment are more indirect: 1) public shaming, with the potential for changes of consumer behavior and public policy; and 2) a domino effect on other shareholders, who might then choose to divest. Thus, mandating that the act of divestment must have direct and immediate impact on alleviating "social injury" virtually eliminates the possibility of any divestment request meeting the standard for divestment.

There are several possible standards that the Board of Trustees might adopt (see Appendix VI for list). We recommend that, whatever is adopted, should both incorporate the Stanford mission and create a high but clear bar for divestment. **The committee's preference is a commitment to implement United National Principles of Responsible Investment (PRI),[2] including the incorporation of environmental, social, and corporate governance (ESG) issues into "investment analysis and decision-making processes."**

[1] Dorsey, Ellen and Stavins, Robert. "Should Endowments Divest Their Holdings in Fossil Fuels?", *The Wall Street Journal*, November 2014, https://www.wsj.com/articles/should-endowments-divest-their-holdings-in-fossil-fuels-1416779351.
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Teoh, Welch and Wazzan, 1999. "The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott," *The Journal of Business*, Vol. 72, No. 1, pp. 35-89, https://escholarship.org/uc/item/69q4333g.
[2] See overview brochure (link)

More than 20 universities have joined the PRI and adopted a proactive standard, including a number of our peer institutions – such as Harvard, the University of California, and Northwestern.[3] As the PRI notes, investors should take ESG issues into consideration not simply because they "may better align investors with broader objectives of society," but because ESG issues "can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time)." Indeed, Harvard is explicit that it focuses only on "material" ESG factors – viz., those ESG factors that it has "determined, in [its] sole discretion, have, or have the potential to have, direct impacts on a company or asset's ability to create, preserve, or erode economic value."

Harvard seeks to integrate material ESG factors broadly into its investment decisions. As Harvard explains,

> *The Harvard Management Company (HMC)] applies its due diligence framework to its commingled funds in absolute return, private equity, and public markets. The due diligence process includes reviewing the ESG policies and governance of potential fund investments, identifying how the fund integrates ESG factors into its investment decisions, and determining how the fund communicates ESG information to its limited partners. Depending upon the nature of ESG issues identified, we may also seek to include ESG terms in the investment fund term sheet.*
>
> *Throughout the life of an investment, we monitor identified ESG risks and work with managers to ensure effective oversight. We also write letters to our team of external managers to inform them of our focus on sustainable investment and commitment to the PRI principles. The letter encourages managers to open a dialogue with HMC about their own approach to sustainable investment and how ESG factors impact its investment analysis and decision-making processes.*

Stanford need not specifically adopt the PRI principles, although the PRI principles have the advantage of being relatively clear and having been adopted by a significant number of large institutional investors. The university might decide instead to adopt a variant of the PRI principles or a custom ethical or sustainable investing framework, similar to the University of California.[4] It is important, however, that the university thinks carefully about how it should approach ESG issues in its investment decisions. Rather than a mere set of rules to inform divestiture decisions, the university's policy should constitute a broad set of principles that clearly define how the university will consider ESG factors in making investments. Like Harvard's policy, moreover, Stanford's policy should focus on the university's fiduciary responsibility over its endowment and consider how ESG issues may affect that responsibility.

[3] https://www.unpri.org/signatories/who-has-signed-the-principles
[4] https://www.ucop.edu/investment-office/_files/sustainable-investment-framework.pdf

The university's policy, in short, should not and need not conflict with the university's goal of maximizing the financial resources available for its central mission. Once the university has adopted a clear policy, the Stanford Management Company (SMC) should then apply the policy broadly rather than to only a limited class of investments.

If the university has adopted a broad and carefully considered approach to ESG issues, the university can then appropriately relegate divestment to an exceptional decision made only in the most extreme situations. This is the position that Harvard has taken. As Harvard notes in its investment policy:

the University maintains a strong presumption against divesting investment assets for reasons unrelated to the endowment's financial strength and its capacity to further Harvard's academic goals. Harvard conceives of the endowment fundamentally as an economic resource, not as a lever to advance political positions or to exert economic pressure for social purposes, which could entail serious risks to the independence of the academic enterprise and the ideal of free inquiry.

At the same time, the University recognizes that very rare occasions may arise when companies' activities are so deeply repugnant and ethically unjustifiable as to warrant the University's institutional dissociation from those activities. In recent decades, such ethical considerations have led the Harvard Corporation to instruct HMC not to own shares in certain companies involved in the perpetuation of apartheid in South Africa, in the manufacture of tobacco products, and in enabling genocide in Darfur.

As Harvard has discovered, adoption of a proactive policy on ESG factors does not guarantee insulation from heated divestment debates. Thus, Harvard has found itself criticized in the last several years for failing to divest fossil-fuel stocks. However, a proactive policy can reduce the pressure for divestment petitions on a broad set of issues, and it would help justify setting a broader bar for such petitions.

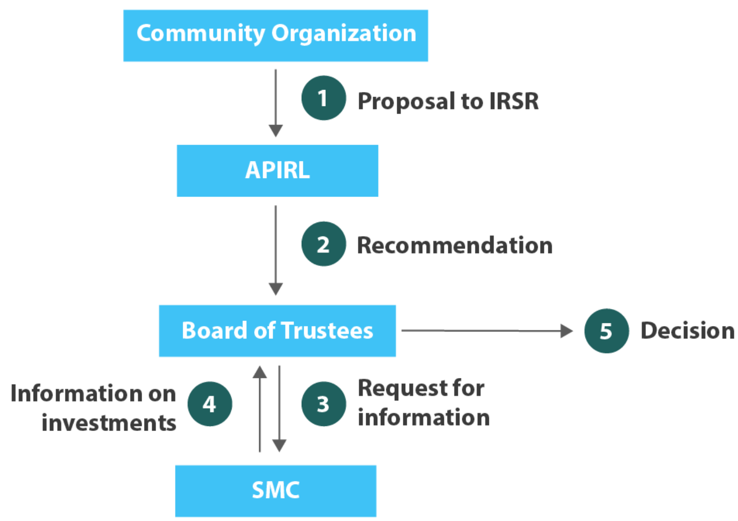
B. Making the standards for investment and divestment accessible and clear

Many Stanford community members described the Statement on Investment Responsibility (SIR) as opaque in its standards for investment as well as disinvestment. We recommend publishing and making more accessible public-facing material covering the following topics:

1. Describe why the standard for divestment is so strict. This has to do with the “primary fiduciary duty of the Trustees in managing the endowment is to maximize the risk-adjusted financial return on endowment assets” and the President’s stance that the University will not take partisan or political stances on issues that divide the campus. If the recommendations made in the previous section are pursued, an argument can be made that a high bar for divestment is appropriate in light of a proactive responsible investment strategy, rendering divestment only necessary in exceptional cases.
2. Present research on divestment that demonstrates the various consequences of divestment. For example, most companies will not be directly financially impacted. Relatedly, communicate the potential harm to the University’s resources that may result from dissociating from a fund or fund manager.
3. Make it clear in the SIR, to the extent allowed by the constraints of the privacy of the endowment, that a significant portion of Stanford endowment is not directly invested and only the small portion that is directly invested is subject to divestment proposals. The Board of Trustees needs to decide if they are open to divesting from indirect investments and communicate this in the SIR. If the Board of Trustees will consider divestment from indirect investments, they must publically communicate the timeline to implement this action (which will likely take more time than divestment from direct investments).
4. The Board of Trustees should clarify if divestment also includes preventing future investments in the companies of concern in addition to divestment of current investments.
5. Stanford Management Company (SMC) could consider releasing its internal guiding documents on responsible investing (e.g. ESG guidelines, no buy list, etc.). Per the focus groups, we understand there is a real interest in understanding how SMC makes its decisions on investments (i.e. is there anything else besides maximizing risk-adjusted returns?) SMC should also clarify that their no-buy policy only applies to direct investments.

C. Process for determining if a divestment request meets the university standard

We outline both the current process and our recommended alternative for divestment proposal consideration.



The Current Process. A proposal is submitted to the Investment Responsibility Stakeholder Relations (IRSR) office via web form or email. IRSR checks the proposal for completion before forwarding to the Advisory Panel on Investment Responsibility and Licensing (APIRL). During the evaluation process, the IRSR serves as project manager and an advisor to the APIRL and the SCIR. The APIRL evaluates the proposal against the divestment criteria described in the Statement on Investment Responsibility. The APIRL votes and makes a recommendation on divestment to the Board of Trustees, who deliberate and confer with Stanford Management Company. A decision from the Board of Trustees is returned to the original group that proposed divestment.

The current process for considering a divestment proposal requires a substantial time commitment on behalf of the APIRL to investigate the merits of a divestment request without knowledge of whether or not the Stanford endowment is directly invested in the companies relevant to the proposal. The process is frustrating for Stanford community members that bring proposals to the APIRL because their requests often require a year or more to process before the Board of Trustees makes a decision. **We recommend reforming the divestment request process.**

Recommendation for improved divestment consideration process:

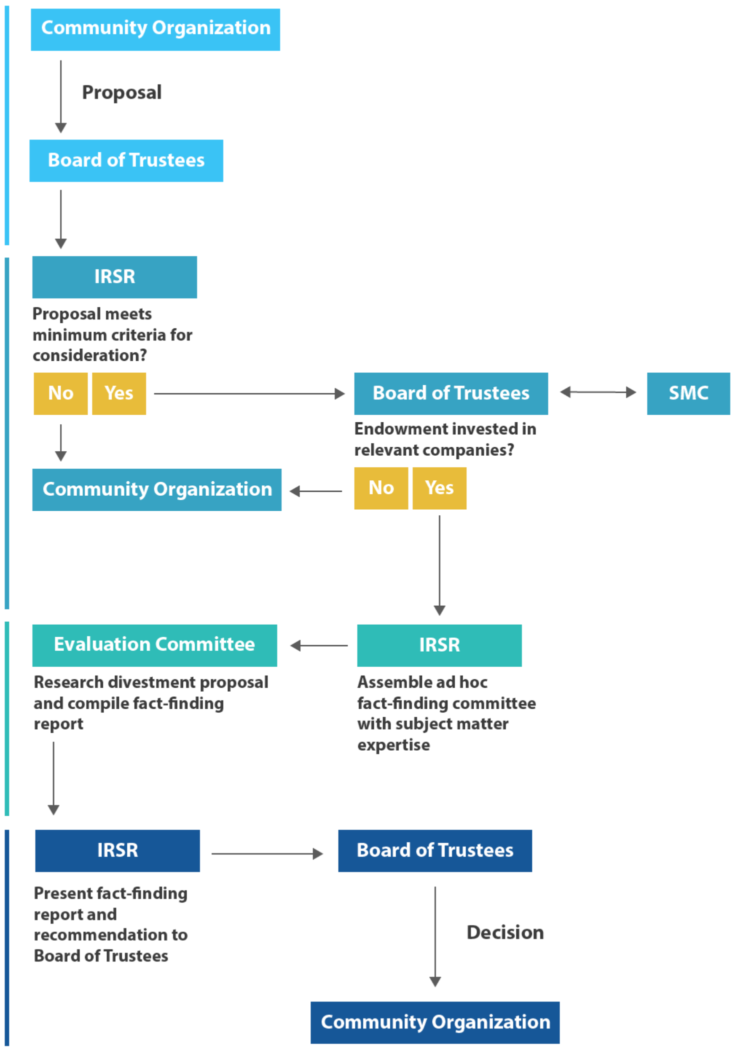
1. Community organization submits proposal for divestment request to Board of Trustees via online form. The request is passed to the Investment Responsibility and Shareholder Relations (IRSR) office.

2. IRSR evaluates proposal against minimum standards for consideration. If proposal meets minimum standards, the Board of Trustees and Stanford Management Company (SMC) are asked to provide information on whether or not the University endowment is invested in the companies of concern. If the endowment has direct investments relevant to the proposal, the IRSR is tasked with evaluating the prosal further.

   If proposal does not meet minimum standards or the Board and SMC do not find investments relevant to the propsoal, the community organization will be notified that their proposalis no longer being considered.

3. The IRSR office assembles an ad hoc committee of subject matter experts to research whether or not the proposal meets the standards for divestment articulated in the Statement on Investment Responsibility (SIR). The committee has a fixed amount of time to compile and present these findings to the IRSR office.

4. The IRSR office reviews the ad hoc committee's findings and presents the finding and a final recommendation to the Board of Trustees. The Board of Trustees reviews the findings and recommendation and makes a decision. The decision is communicated to the community organization that submitted the proposal.



Recommendation:

- **Dissolve the Advisory Panel on Investment Responsibility and Licensing (APIRL).**
- **Appoint for a faculty coordinator with IRSR for a two-year term.**
- **Task the Investment Responsibility Stakeholder Relations (IRSR) office with considering if proposals meet a minimum standard for divestment.**
- **Task the Board of Trustees and Stanford Management Company (SMC) with reporting whether or not the University holds direct investments relevant to the proposals that do meet the minimum standard for consideration.**
- **Task the IRSR office and faculty coordinator with assembling an ad hoc fact-finding committee to research any proposals that meet the minimum requirements and are relevant to current University direct investments. We recommend five (5) members of whom at least two should have subject matter expertise; the committee should include student and staff as well as faculty representation. The ad hoc fact-finding**

committee will be given three-six months to research and prepare a final report for the IRSR office.

- **Any proposal evaluated by the ad hoc fact-finding committee will be presented by the IRSR office and faculty coordinator with a recommendation to approve, deny or take no action to the Board of Trustees. It will be the responsibility of the Board of Trustees to make a final decision on the proposal and to communicate that decision formally to the community organization or individuals that originally submitted the proposal.**

In addition to the above recommendations, there are several important areas of the divestment proposal evaluation process that must be addressed:

1. Is the current divestment proposal form standardized in a way that promotes more efficient and objective evaluation of each request?
2. Can the Board of Trustees establish a “minimum standard” for consideration of divestment requests? If a divestment request passes this standard, the Board of Trustees and SMC would evaluate whether or not Stanford endowment is invested in the companies of concern. If the endowment is invested in the companies of concern, a formal proposal evaluation process will commence.
3. What types of action, besides divestment, can the Stanford community request of the Board of Trustees and SMC (e.g. shareholder engagement)? Have these been acted upon before?
4. What types of funding can be made available to assist the ad hoc committee with fact-finding missions during proposal evaluation?
5. Should the name of the APIRL be changed (if the committee is preserved)?
6. Should we create a distinct process for licensing issues?

D. Processes for providing additional input to the SCIR, Board of Trustees, and Stanford Management Company (SMC)

Our investigatory process provided a number of ideas for facilitating student engagement in the investment decisions of the University. Although outside of SCIR's direct charge to APIRL, we provide below a list of potential touchpoints for the University community to productively engage with SCIR, SMC and the Board of Trustees. This is not meant to be an exhaustive explanation or fully-developed proposal, but instead reflects our distillation of comments generated through our fact-finding process.

- Providing greater access to the Board of Trustees and/or SCIR

We received significant feedback requesting direct access to the decision makers on divestment. While that could include divestment appeals made directly to the Board or SCIR (as suggested above), it could also mean access to the Board or the SCIR by groups making divestment requests, even if a group such as APIRL first must make a recommendation to the Board. This could also include a public forum where the Board or SCIR can take public comment on a divestment request.

- Requiring more transparency from SMC

A key theme throughout the focus group sessions and our interviews is the desire for greater transparency and responsiveness to concerns about the University's investments. SMC has previously expressed reluctance to allowing greater transparency into those investments out of concern that it could put the SMC at a competitive disadvantage. Respecting that parameter, we wanted to explore, what is possible?

  - More granularity regarding industries in which investments are made?
  - Public disclosure of the composition of the SMC Board?
  - Update the SMC website to been more informative. A good example of this is Harvard Management Company[5] or Yale Investments Office[6]:
  - Allowing presentations directly to the SMC by interested groups to describe whatever undervalued externalities could be impacting investments? (e.g., fossil fuel investments).

[5] http://www.hmc.harvard.edu/
[6] http://investments.yale.edu/

E. Other means for enabling Stanford community to: a) express ethical concerns; b) turn those concerns into teaching and learning experiences for a wider sector of the community

- When an issue is raised in reference to divestment or any other major community concern about the university's responsibilities, it should become a teaching moment. This can involve teach-ins, Cardinal Conversations, expert lectures, even classes and research projects as appropriate.

- Other options to be made available to the Stanford community for those who want them:
    - Engaging with government representatives
        - Internships and Service Learning
        - lobbying activities as appropriate
    - Forms of Engagement with relevant corporations
    - Part-time student investment responsibility jobs/internships at offices like IRSR or SMC

- Courses on investment responsibility

- Creating a center for studying sustainable and responsible investment (i.e. Columbia Center on Sustainable Investment (CCSI), and Berkeley's Sustainable Investment & Finance Initiative)

- Course driven, student-run sustainable investment funds

- Supporting research: creating a sustainable and responsible investment challenge, similar to the partnership between Northwestern University's Kellogg School of Management and Morgan Stanley's Institute for Sustainable Investing [7]

[7] https://www.morganstanley.com/ideas/sustainable-investing-challenge-2018-finalists