

THE UNIVERSITY OF MICHIGAN

*Regents Communication*

**ACTION REQUEST**

Subject: Climate-Change Related Investment Impacts

Action Requested: Approve an investment strategy that increases consideration of climate-change related risks and modify the existing natural resources portfolio allocation

**Background:**

The University of Michigan seeks to play a leading role in combating climate change and pioneering scalable, transferrable, and financially responsible strategies. Climate change is an environmental and economic risk that will have an impact on the university, and specifically on its investment assets. Our economy is in the early stages of an energy transition that will lead to lower global carbon emissions resulting from diminished reliance on fossil fuels; greater energy efficiency; technologies that remove atmospheric carbon dioxide and other greenhouse gases; continued growth of renewable energy; and other innovative technologies. All of these tools are necessary to achieve the goal of keeping the global temperature rise this century well below 2°C above pre-industrial levels.

To further reduce the impact of climate change-related risk on our investment portfolio, U-M will immediately adopt the following changes:

1. The university will not directly invest in companies that are the largest contributors to greenhouse gases, currently defined as the top 100 coal and the top 100 oil and gas publicly traded reserve holders globally as compiled on the Carbon Underground 200TM list. The university does not currently hold any direct investments in such companies.
2. The university will not invest, and over the last decade has not invested, in companies that extract thermal coal or that extract oil from tar sands.
3. The university will not invest in funds whose primary focus is oil reserves, oil extraction, or thermal coal extraction.
4. The university will transition its endowment to net-zero greenhouse gas emissions by 2050 in a manner consistent with the university's fiduciary duty to manage risks and maximize risk-adjusted returns.
5. The university will shift its natural resources investment focus away from oil extraction and reserves towards renewable energy investments with an attractive risk-adjusted return profile. The university will also focus on infrastructure and services investments with an attractive risk-adjusted return profile that support more efficient resource

utilization and other emerging technologies that support the transition to a carbon-neutral economy.

To arrive at this modified investment strategy, the Board of Regents and an internal working team, including the President, the Chief Investment Officer, and others, evaluated potential changes to U-M's investment strategy to address climate-change related risk. The process included consultation with external investment experts, representatives of other institutions of higher education who have made similar commitments, and numerous faculty and student representatives of advocacy groups calling for climate action related to university investments.

### ***Natural Resources Allocation***

The university will not directly invest in companies that are the largest contributors to greenhouse gases, currently defined as the top 100 coal and the top 100 oil and gas publicly traded reserve holders globally as compiled on the Carbon Underground 200TM list. The university does not currently hold any direct investments in such companies. The university will not invest, and over the last decade has not invested, in companies that extract thermal coal or that extract oil from tar sands. The university will not invest in funds whose primary focus is oil reserves, oil extraction, or thermal coal extraction. In addition, the university will shift its natural resources investment focus away from oil extraction and reserves towards renewable energy, natural resource efficiency and other carbon mitigation strategies with an attractive risk-adjusted return profile.

Natural Resources is included in the university's investment portfolio in order to provide (a) diversification relative to investments in equity markets, which constitute the majority of the university's portfolio, and (b) protection against unanticipated inflation with an approach that adds value to the investment portfolio. The Board of Regents first approved an allocation to this segment of the portfolio, then called Oil and Gas, in 1989. The initial allocation was to investments focused on the extraction of oil reserves. This segment was renamed Energy in 2000 to reflect a growing allocation to energy service companies and subsequently Natural Resources in 2012 in recognition of the inclusion of non-oil related investments, such as renewable energy, minerals and wetland restoration.

While the composition of the investments in Natural Resources has changed over time, it continues to be the segment of the portfolio that houses the university's focused exposure to oil reserves and extraction. The university has long considered opportunities in renewable energy as well as in infrastructure and service investments to improve the efficiency of natural resource utilization. This opportunity set is expanding rapidly in response to the global need to address climate change, creating attractive investment opportunities that did not previously exist. Going forward, opportunities in renewable energy investments and infrastructure and service investments to improve the efficiency of natural resource utilization required during the energy transition are likely to offer the endowment a more attractive risk-adjusted return profile than opportunities in oil reserves and extraction. As such, the Investment Office will immediately shift its investment focus prospectively away from oil reserves and extraction toward renewable energy and resource efficiency.

The Investment Office will continue to pursue other existing strategies in the natural resources program, such as investments in wetland mitigation, agricultural products and mining. Some of

the renewable energy and resource efficiency opportunities that we are considering have an element of inflation hedging protection, such as contracts with annual price increases. However, because the opportunity set is new, we do not know what the full impact of a growing exposure to these areas would be on the portfolio's ability to hedge against unanticipated inflation. We will monitor this aspect and, as necessary seek other investments to help fulfill that role.

### ***Net-Zero Endowment Commitment***

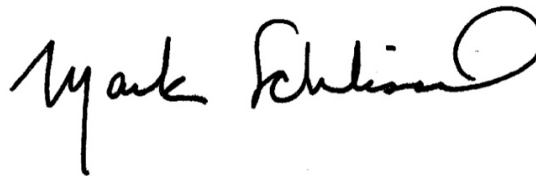
Effective immediately, the university commits to transition its endowment to net-zero greenhouse gas emissions by 2050 in a manner consistent with the university's fiduciary duty to manage risks and maximize risk-adjusted returns. Global climate change imposes significant investment risks across the full breadth of our investment portfolio, and actions that decrease greenhouse gas emissions help mitigate those risks.

To achieve the goal of the Paris Agreement and limit the increase in the global average temperature to below 2°C above pre-industrial levels, global net emissions must be reduced to zero by 2050. To that end, human-caused emissions must be balanced by actions to remove such greenhouse gases from the atmosphere. The impact of global emissions extends far beyond the energy sector's production and supply of fossil fuels. A net-zero endowment applies an economy-wide approach to address the greenhouse gas emissions across sectors and industries. This commitment (a) complements the existing analysis to reduce emissions from university activities to net-zero, as outlined in the final recommendations from the President's Commission on Carbon Neutrality, and (b) aligns with climate action standards set by the United Nations Intergovernmental Panel on Climate Change. This commitment also comes with the expectation that governments will fulfill their commitments in accordance with the Paris Agreement. The university will work with peer institutions and other aligned organizations to develop data standards and tools to implement a net-zero approach, as such methodologies for large endowments are not yet fully developed. The Investment Office will provide annual reports to the Board of Regents in public session detailing the status of progress toward this commitment.

### **Request for Action:**

I request that the Board of Regents approve the approach described in items (1) through (5) in the Background section of this action item to reduce the impact of climate change-related risk on our investment portfolio.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mark Schlissel". The signature is fluid and cursive, with a large loop at the end.

Mark S. Schlissel  
President, University of Michigan

March 2021

## **Additional Background Information**

In December 2019, the Board of Regents voted against a proposed investment in a fund focused on mature oil producing properties. At the February 2020 Board meeting, it was announced that the university would suspend making new direct investments in fossil fuel companies pending a review of the institution's approach. At the February 2021 Board meeting, it was announced that this review was underway and nearing completion. In connection with this review, the Board of Regents engaged in discussions with university faculty, students and community members, representatives from peer universities and institutions, and experts on sustainable investing.

As an investor with a perpetual investment horizon, the university's Investment Office considers numerous factors that may influence the performance of the university's investments. Climate change is an environmental and economic risk that will have an impact on university investments. The university's fiduciaries must manage university assets in a manner that mitigates the impact of climate-change related risk on its investments returns. These impacts will grow over time.

To minimize the impact of such climate-change related risks, the university will rebalance its portfolio away from investments that are carbon-intensive, and toward those demonstrating greater energy efficiency or utilizing renewable resources. The university will transition its endowment to net-zero greenhouse gas emissions (GHG) by 2050 in a manner consistent with the university's fiduciary duty to manage risks and maximize risk-adjusted returns.

The university will not directly invest in companies that are the largest contributors to greenhouse gases, currently defined as the top 100 coal and the top 100 oil and gas publicly-traded reserve holders globally. The university will not invest, and over the last decade has not, invested, in companies that extract thermal coal or that extract oil from tar sands. The university will not invest in funds whose primary focus is oil reserves, oil extraction, or thermal coal extraction.

The university's investment portfolio reflects the early-stage energy transition and increasingly includes investments in the renewable energy sector that meet the university's risk and return parameters. These varied investments include wind, solar, and energy storage projects. Additionally, the university's Investment Office will seek investments that aid in the acceleration of the energy transition while meeting required investment parameters. Examples of such potential investments include:

- Developing utility-scale wind and solar energy projects that seek to bring affordable clean energy and significant new economic opportunities to Michigan and the Midwest.
- Developing utility-scale battery storage facilities to accelerate the addition of renewable energy to the power grid.
- Developing infrastructure to support the growth of renewable energy, including electric vehicle charging infrastructure and safe hydrogen storage for industrial applications, among others.
- Developing infrastructure to sequester carbon by re-injecting it into depleted oil and gas reservoirs, mitigating the consequences of increased atmospheric carbon dioxide.
- Improving existing energy infrastructure/services to materially decrease the environmental footprint of fossil fuel production and transportation required during a transition to a net-zero emissions economy—such as decreasing methane leaks and lowering fresh water utilization.

- Producing renewable energy from agricultural waste.

The university's Investment Office will collaboratively engage with its external managers regarding their plans to address and mitigate the risks posed by climate change on university investments. The investment office will provide annual reports to the Board in public session detailing the status of progress toward the transition to net-zero greenhouse gas emissions by 2050.