

Responsible Returns: A Modern Approach to Ethical Investing for the Yale Endowment



Executive Summary - A Publication of the Responsible Endowment Project

Introduction

Over the last three decades, the Yale Investments Office has developed an innovative approach to institutional investing that has grown the endowment dramatically and materially contributed to the success of the university. Yet the Advisory Committee on Investor Responsibility (ACIR) – which was revolutionary when it was founded 37 years ago – has not been updated to meet the challenges and complexities of modern investing and is now unable to ensure that the university’s environmental and social values are reflected in today’s endowment.

The full version of this report compares the endowment in 1972 to the endowment now and examines the effects of the changes on the ACIR. Increased investment in real estate, private equity, and hedge funds has led to a significant decrease in transparency and has made the ACIR’s ethical oversight tools inadequate for today’s endowment. This executive summary explains our four proposed changes to the committee: active ownership, restored transparency, a new membership, and enhanced reporting which are designed to update the ACIR for a modern endowment.

Outdated Tools

To compare the effectiveness of the ACIR now to when it was founded, we considered the two tools it has used to respond to investments that do not reflect Yale’s values: shareholder voting and divestment. In the 1970s, shareholder voting applied to 70% of the endowment – all domestic publicly-traded companies. By 2008, due to a shift towards alternative asset classes, directly-held companies with votable shares accounted for just 0.5% of the endowment. While it may be possible for Yale to vote some of the domestic publicly-traded holdings of its investment managers, these holdings are at most 10% of the endowment (see figure 1). Furthermore, while the ACIR and Yale community have access to this 0.5-10%, they are denied any information regarding the other 90% of endowment holdings (again, see figure 1), and therefore cannot evaluate the ethics of these holdings. Such lack of transparency means that divestment is also an inadequate tool for endowment oversight. Additionally, divestment eliminates potential returns while limiting social or environmental impact as less ethical investors can easily take Yale’s place.

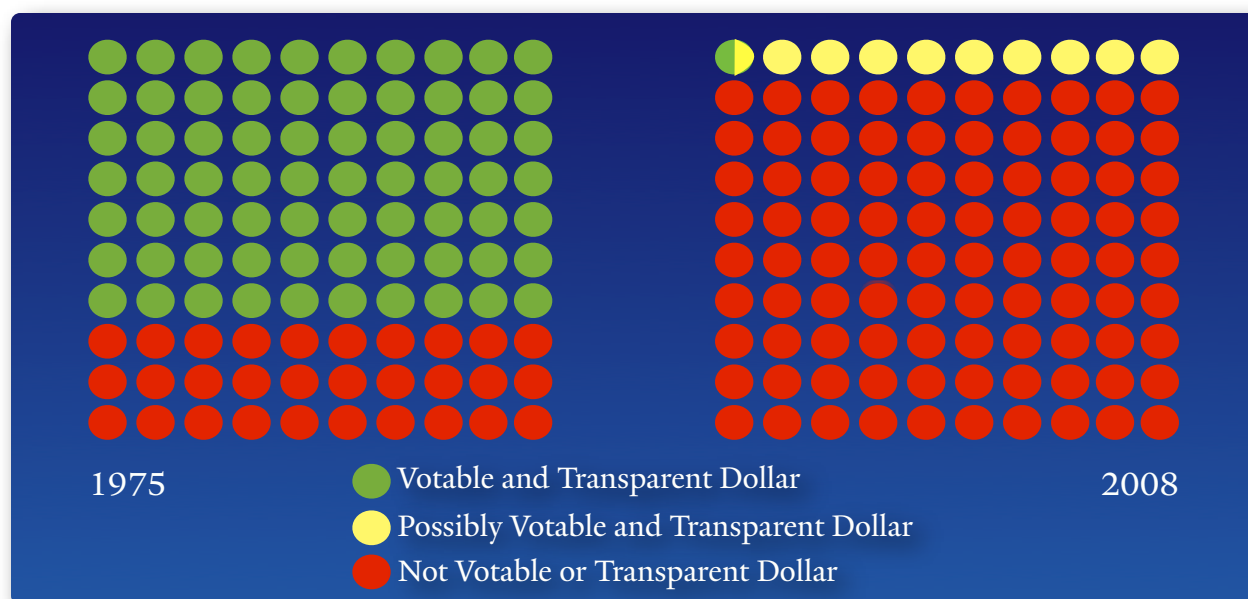






Figure 1: Voting power and transparency of a representative \$100 of the Yale Endowment in 1975 and 2008

A Modern ACIR for a A Modern Endowment

In light of the changes to the modern endowment, we have developed a four point proposal that updates the ACIR. The changes are based on the work of leading ethical institutional investors such as The Swedish National Pension Fund and other signatories of the United Nations Principles for Responsible Investment, a group whose members represent over \$14 trillion in assets under management. Our proposed changes are:

PROPOSED CHANGE	EXPLANATION	REASON FOR CHANGE
 <p>Active Ownership</p>	<p>In addition to advising on shareholder voting and divestment, the ACIR will screen the endowment annually and select five companies or assets whose activities do not meet the standards of Yale's values. With the approval of the Yale Corporation, the ACIR will then initiate dialogues with fund managers and/or company management, advising each company of actions necessary to meet Yale's ethical standards. The ACIR will continue to monitor each company's improvement and will seek the support of other investors if additional pressure is needed.</p>	<p>The ACIR's current tools (shareholder voting, negative screening, divestment) make little social impact, are not adequate for most asset classes, and can harm investments. Active ownership is the modern alternative, used by many large funds, that has none of these consequences.</p>
 <p>Restored Transparency</p>	<p>The ACIR will have full access to the latest endowment portfolio each quarter including fund manager names and holdings. Members of the council will sign nondisclosure agreements and any request to disclose information not available to the public must be approved by the Corporation. The public will have access to names of the fund managers Yale invests with subject to a one year delay in a list available on the Investments Office website. Any managers which no longer invest Yale's money will not be included.</p>	<p>The ACIR currently has access to investments representing between 0.5% and 10% of the total endowment, leaving the committee unable to keep the other 90% in alignment with Yale's values. Without transparency to the community and public, the committee loses a source of information and credibility.</p>
 <p>A New Membership</p>	<p>All members of the ACIR will be elected by their constituency (alumni will elect alumni, undergraduates will elect undergraduates, etc.). All members will serve two year terms and may run for reelection. Elections will be staggered such that senior members can pass on knowledge to junior members. The council will consist of two professors, two alumni, two staff members, two undergraduates, and two students from graduate or professional schools.</p>	<p>Members need longer terms to gain a understanding of the many complex issues and to pass on this information to their successors. Elections will make the ACIR representative of the Yale community. Additional students will allow the committee to handle more work.</p>
 <p>Enhanced Reporting</p>	<p>The ACIR will release a report at the end of each academic year detailing the actions that it took during the preceding year and the reasoning behind them. They will also publish their positions and reasoning on shareholder voting. The fund manager list from the previous year will be appended. The report will be available on the ACIR's website at the end academic year and will be accessible to the public.</p>	<p>The Yale community currently has no regular access to information regarding the actions of the ACIR. Reporting will keep the university more involved in the work of the committee that is responsible for representing their values in the Yale endowment.</p>