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NACUBO-TIAA  
Study of Endowments:  
Climate Investment Policies Report





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# Climate investment policies: How endowments can address climate risk in their portfolios

Climate change presents endowments with a particularly complicated set of choices. Should an endowment adopt an investment policy to reduce carbon emissions? If so, how can endowments balance their carbon reduction targets with their investment objectives and fiduciary responsibilities? And how should endowments best engage with their various stakeholders about steps to address climate risk within their portfolios?

With many choices to make, endowments can understandably feel overwhelmed by the complexity of carbon reduction targets like “net zero” and how to best manage progress toward them. Fortunately, many institutional investors have made significant strides in developing and implementing policies related to climate change in their portfolios. We outline some of the steps that endowments should consider when deciding how to address the issue of climate change in a thoughtful, effective manner.

This information is based on insights from Nuveen’s responsible investment team and its work with endowments and other institutional investors. Nuveen, a subsidiary of TIAA, provides access to a full range of investment capabilities through its investment specialists.

## Clarify an endowment's beliefs and objectives related to climate risk

The first step in developing an effective investment policy on climate change is to clarify the endowment's beliefs about climate risk. Climate risk refers to the potential impacts of climate change on investment performance, and includes both the physical impacts of climate change (e.g., more frequent and severe hurricanes) and the impacts of transitioning to a low carbon economy (e.g., policy, regulatory and market disruption). The following questions will play a crucial role in determining an endowment's objectives and the appropriate measures of progress:

### Will the world inevitably transition to a low carbon economy?

Many endowments believe that the transition to a low carbon economy is inevitable and that it will significantly affect companies' financial performance and their projected growth. If an endowment subscribes to these assumptions, the endowment should treat climate change as an investment risk that it must manage. This involves considering how the transition to a low carbon economy will create risks and opportunities within its portfolio. On the other hand, if an endowment believes that the global economy will not undergo a low carbon transition or that the physical effects of climate change will not directly affect its portfolio holdings, developing carbon reduction targets may not seem necessary in the near term.

### Does addressing climate risk mean sacrificing returns?

Endowments must balance their potential carbon reduction targets against their overall investment objectives and fiduciary responsibilities. To do so, endowments must determine what impact they believe potential carbon reduction targets and their time horizons will have on their portfolio. Understandably, the conclusions that endowments reach will likely vary.

Some endowments may conclude that failing to decarbonize their portfolio will pose financial risks over the long term as demand for high carbon intensity assets declines. Conversely, others may believe that decarbonizing their portfolio will negatively affect its risk-return profile, particularly in the near-term. While divesting from assets with high carbon intensity may cause tracking error—or deviation from the benchmark—there are other ways to address climate change and reduce the portfolio's carbon intensity (as discussed below). In any case, it's essential for an endowment's investment committee to determine its stance on how decarbonizing a portfolio may affect returns and then set appropriate policies based on that conclusion.

## What are the endowment's portfolio carbon and risk-return objectives?

Once an endowment has addressed the two previous questions, the endowment needs to establish clear objectives about what it hopes to achieve through its climate change investment policy. Some endowments may seek to achieve net zero carbon emissions across the entire portfolio by a certain point in time. In fact, net zero carbon goals have become increasingly popular among institutional investors because they set a clear, unified objective to work toward.

Other endowments may believe that less ambitious low carbon targets are more appropriate for their objectives. In this case, low carbon targets may center on reducing their portfolio's carbon intensity as much as possible within a certain amount of tracking error.

In other cases, an endowment may simply focus on completely divesting from certain types of high carbon intensity assets, such as fossil fuels. Fossil fuel divestment quickly reduces an investment portfolio's carbon footprint. While divestment can be an effective initial step, it may not influence the actions of the divested companies or assets and therefore may not ultimately reduce carbon emissions.

## Assess the realities and constraints of carbon data

Making decarbonization decisions depends in part on having accurate, reliable data about an asset's carbon intensity. While data providers have made significant advancements in the quality and availability of information about companies' carbon footprints, in some cases these data are not as precise and consistent as the financial data that investors typically utilize. In addition, the constant influx of data providers focused on carbon intensity or other ESG measures can be dizzying.

Currently, the quality and availability of carbon data varies significantly by asset class. While nearly all S&P 500 companies publish data about their carbon emissions, getting equivalent data regarding private assets (such as private equity or some real assets) can be extremely challenging. In some cases, endowments may choose to focus their decarbonization targets on publicly traded asset classes until better data regarding private assets become available.

Still, endowments shouldn't let "the perfect be the enemy of the good" in terms of incorporating carbon targets into their investment policies. If endowments wait until carbon data are on par with other financial data, they may miss the opportunity to set constructive decarbonization targets within a reasonable timeframe. In the interim period, endowments should lean on their asset managers, consultants, and third-party resources to determine which carbon data sources are most accurate and reliable. Estimates and proxies may also prove useful in filling data gaps in the interim.

## Determine the appropriate strategies for implementation

At the policy implementation stage, several potential strategies can help endowments work toward reducing climate risk in their portfolios. While divestment from high carbon intensity assets is one very direct and stringent approach, there are other effective ways to decarbonize an endowment's portfolio and address climate change.

Endowments can use four primary levers to drive their decarbonization efforts, each with varying levels of impact on the portfolio's composition. It is important to note that the efficacy of these levers may also vary significantly by asset class or by the endowment's size.

### Reduce exposure to high carbon intensity assets:

Endowments can reduce their portfolio's carbon exposure at both the asset class and sector level, as well as through security selection. Clearly, reallocating from asset classes or sectors with higher carbon intensity, such as energy or industrials, can have a major and immediate impact on an endowment's total carbon footprint. Still, endowments don't necessarily need to divest from these assets altogether. Rather, endowments can choose to invest in specific companies that have committed to low carbon targets themselves or that have demonstrated leadership in reducing carbon emissions within their sectors. Endowments may divest from certain fixed income investments as well, or they may simply allow specific bonds to mature and roll off their portfolio.

### Seek out low carbon and carbon negative assets:

Endowments may choose to invest in low carbon and carbon negative assets such as agriculture, timberland or bioenergy with carbon capture and storage technology. Such investments can help offset some of the financed carbon emissions within a portfolio, while also adding diversification, inflation hedging, and yield and liability matching. In addition to these benefits, investing in low carbon or carbon negative assets can help lower the cost of capital for and signal investor interest in the emerging practices and technologies that will be essential for a transition to a low-carbon economy.

In public equity and corporate fixed income, endowments may choose to invest in companies that have set their own low or net zero carbon targets, provided that the endowment believes that such companies will achieve their objectives. In fixed income, endowments may also invest in green bonds, which are bonds that finance environmentally friendly projects.

**Reduce carbon emissions of directly owned assets:**

Given endowments' long investment horizons and the nature of the gifts they receive from donors, many endowments' portfolios include directly owned assets, such as farmland, real estate properties and infrastructure. These scenarios present unique opportunities for endowments to address climate change within the operation of directly owned assets.

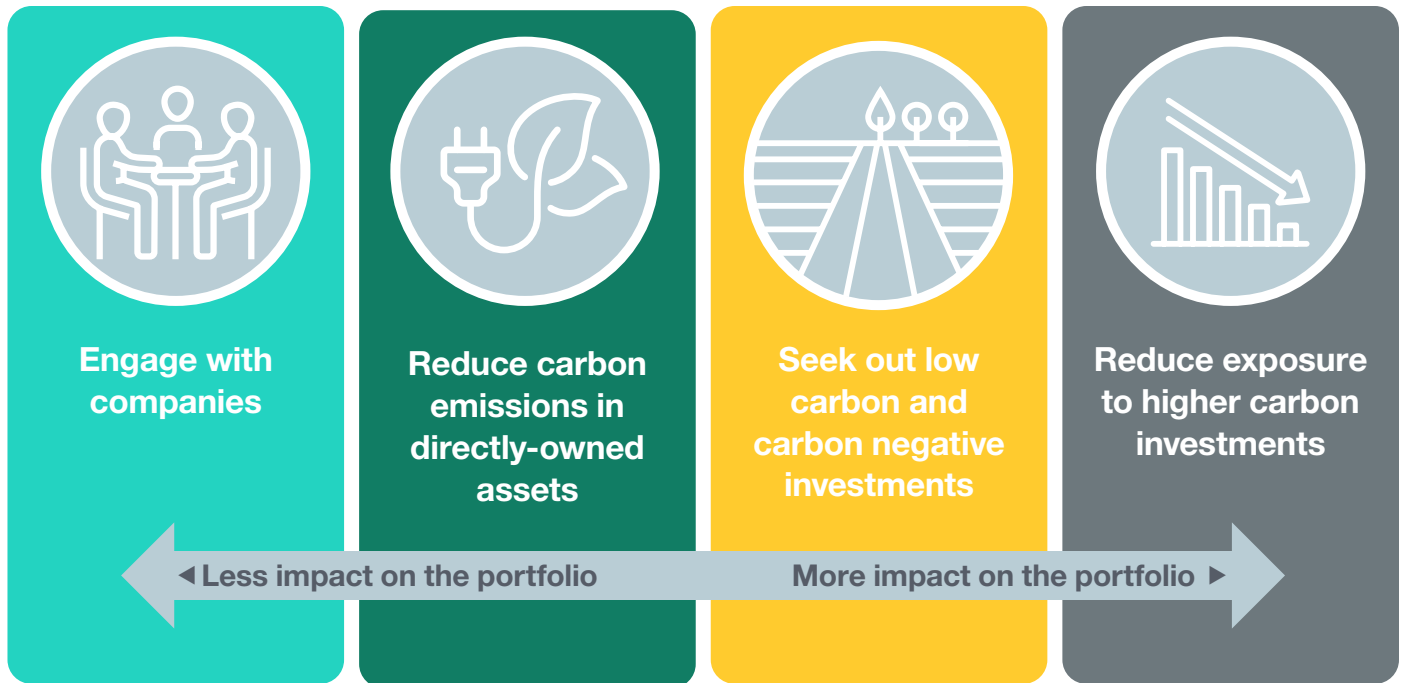
Endowments with direct equity positions in real assets can reduce these assets' carbon impact by improving their energy efficiency and by sourcing renewable energy and low carbon footprint materials. This strategy can be particularly effective in reducing carbon emissions because endowments have direct control over these assets and can potentially implement changes in their operation within a relatively short period of time. Like any other type of operational improvement, projects to reduce carbon emissions of directly owned assets should be subject to typical cost-benefit analysis.

**Engage with companies directly:**

In virtually any asset class, endowments can engage with companies and assets directly to influence climate risk management and decarbonization pathways. Endowments can vote their shares in support or opposition to a company's climate strategy (or lack thereof), or choose to support or oppose public company board members based on how well or poorly the board's climate expertise and oversight align with the endowment's objectives. Obviously, larger endowments may be more influential than smaller endowments, but smaller endowments can amplify their voices by forming coalitions, taking coordinated action and emphasizing the importance of engagement when selecting external asset managers.

While fixed income investments don't carry the power of proxy voting, there are still opportunities for direct engagement with debt issuers and even avenues for broader influence through market- and industry-based organizations and standard setters. Endowments can also effectively "vote" their support of an issuer's management of carbon emissions by deciding whether to purchase its next issuance or by allowing existing bonds to roll off a portfolio as they mature. These strategies are most effective when paired with direct meetings with the issuer to communicate the motivation behind these decisions.

## Approaches for reducing carbon risk in portfolios



### Engage with stakeholders at every step of the process:

For an endowment's climate investment policy to be effective, it must have broad support across the organization. Internally, endowments will need to engage with stakeholders such as CIOs, investment teams, risk teams, board members and, if applicable, internal ESG teams at every step of the process. Externally, endowments will also need to consider the views of constituents such as university administrators, academic faculty, donors and students.

In every case, it's essential for endowments to communicate their objectives clearly to all stakeholders and to provide transparency in the decarbonization process. Setting interim goals and showing progress toward these objectives is also critical, especially for endowments that have set net zero targets with dates far in the future.

Fortunately, endowments may have an important advantage over other institutional investors because endowments can engage members from throughout their academic and research communities in the process of setting climate targets. The input that academic researchers can offer may be an invaluable resource in helping an endowment set climate targets that will satisfy both the endowment's investment objectives and the environmental concerns of its constituents.

## Navigating a complex fiduciary challenge

Implementing a thoughtful and effective climate investment policy is not an easy task. As fiduciaries, endowments must balance potential climate targets with their return objectives and be mindful of the likely investment impacts that their climate strategy will have over time. Fortunately, endowments can follow a consistent, well-structured path to setting climate targets if they choose to do so, and the lessons learned by other institutions can help guide this process. Together, endowments can protect their investments in a changing climate while making a meaningful difference in solving the climate challenges we all face.

### Resources to help guide climate change investment policy decisions:



#### **United Nations-Convened Net-Zero Asset Owner Alliance:**

An international group of 62 institutional investors representing \$10 trillion in AUM that have committed to transitioning their investment portfolios to net-zero greenhouse gas emissions by 2050.



**CDP:** Runs the global environmental disclosure system for investors, companies, cities, states and regions and provides annual assessments of company transparency and management of climate risk.



**Science Based Targets initiative (SBTi):** Defines and promotes best practice in emissions reductions and net-zero targets and is mobilizing companies to set targets in line with a 1.5°C future.

#### **Learn more:**

Access the publicly available tables from the 2021 NACUBO-TIAA Study of Endowments and learn how to purchase the survey at: <https://www.nacubo.org/Research/2021/NACUBO-TIAA-Study-of-Endowments>

Teachers Insurance and Annuity Association of America