Excerpt from Draft Minutes of Senate
May 16, 2008

Divestment from Darfur [S.08-108]

Dean Carmichael reported that at its April meeting Senate received a notice of motion from Mr. Van Gaalen, on behalf of STAND (Students Taking Action Now: Darfur) seeking discussion at the May Senate meeting of the issue of divestment relating to Darfur with the intent of referring a recommendation to the Board of Governors. Senate's rules of order provide that notices of motion be referred to the Operations/Agenda Committee or to another appropriate committee. As the University's investment policies fall within the responsibility of the Board, not Senate, there is no Senate committee to which the motion can be referred for substantive discussion. The Operations/Agenda Committee determined that the motion should be placed on the May 16, 2008 agenda for discussion in accordance with paragraph 30(f) of The University of Western Ontario Act:

> 30(f) The Senate may pass resolutions and make recommendations to the Board with respect to any matter connected with the administration of the University and the promotion of its affairs but this clause shall not be construed to subtract from the powers and duties conferred on the Board elsewhere in this Act.

Dean Carmichael noted that the motion as submitted did not provide an explicit recommendation to the Board. Passage of the motion would simply allow Senate to discuss the issue. It was suggested, therefore, that a vote be taken on the motion immediately after it is put. He stressed that a vote for the motion would in no way pre-suppose the nature of the advice to be conveyed to the Board. Assuming the motion to permit discussion passed, the Chair would accept substantive motions with respect to Senate's advice to the Board during the course of the debate. The Secretary will provide a detailed minute of Senate's discussion to the Board.

It was moved by M. Van Gaalen, seconded by A. Awaysheh,

> That Senate discuss the issue of divestment relating to Darfur with the intent of referring a recommendation to the Board of Governors on the issue, and, that the President and Vice-Chancellor be charged with the task of presenting the opinion of the Senate to the Board of Governors at the next meeting where a discussion regarding Darfur and investment is to be held.
>
> CARRIED

Speaking in support of STAND's mission regarding divestment from Darfur, Mr. Van Gaalen noted that the proposal had significant student support - over 1,000 students had signed on a petition for divestment. He remarked that the situation in Darfur is intolerable, that the human rights violations cannot be justified by anyone, that many governments and universities have dealt with motions to divest, that the movement has significant student support and that STAND is a successful organization globally, nationally and locally. In his view, it was not appropriate to look at this from the perspective of a fear of setting a precedent. He was concerned about the type of precedent that would be set if the University did not support divestment. What would that say about the University? Would we accept these kind of atrocities if they were happening in Europe? If not, why would we accept it if they happen in Africa?

Professor Coulter pointed out that Canadian universities have a long history of deciding not to become involved at important points in history. She cited as an example the situation in the

1930's when Jewish academic scholars where not able to obtain refuge at Canadian universities - Canada accepted only six such applicants. Universities make political decisions every day in everything they do. In this case, the students have afforded the University an opportunity to take a strong ethical and moral position - at little risk, since the University has no funds invested in offending companies at the moment. She stated that not taking a stand on every issue was not a justification for not taking a stand on this issue. The situation in Darfur is dire and she would like to see her university take a stand.

Professor Dyer-Witheford noted that he too supported the proposal, both for its intrinsic merits and for the universal impact such a decision would have on the ability to have discussion of other issues of concern. Once a motion passed, the University could not then take the position that it did not have the moral authority to raise questions about corporate responsibility for other disasters around the world. He thought this proposal should be approved, and approved mindfully.

It was moved by K. Okruhlik, seconded by G. Zeni,

> That the Senate provide advice to the Board of Governors, through the President & Vice-Chancellor, that the Board issue a public statement announcing its commitment to remaining un-invested in any company on the Sudan Divestment Task Force's "Highest Offender" list.

While not disagreeing with the sentiments raised about the horrors occurring in Darfur nor with the idea that a stand needed to be taken, Dr. Hewitt questioned whether divestment is the strategy that works best, or indeed at all, and whether it caused hurt to victims in the country who might benefit by investment. He asked if there were other means that could be considered in order to take a stand and to put The University of Western Ontario on record with respect to the crimes against humanity occurring in Darfur.

On a motion duly moved and seconded, speaking privileges were accorded to Ms. Jennifer Epp, Co-VP Divestment, STAND Western. Ms. Epp stated there is evidence that divestment pressures are effective. Decisions to divest by reputable institutions draw media attention. That media attention has caused a number of companies to change their business practices in order to get off the "Highest Offenders" list. There may be many other things that universities could do to have an impact. This is just one thing that they can do.

Ms. Kulczycki noted that there was no argument that the situation in Darfur was anything but outrageous. The issue is determining the most effective way of responding to the situation in the Sudan. STAND's suggestion to divest from the worst offenders is not simple to put into operation. There are real difficulties in managing pooled investments and adding restrictions will make the investment managers' jobs more difficult. In some cases, the University does not have access to what investments a manager is holding (hedge funds, for example). The mandates given to managers are reflective of pre-set performance standards. Adding screens to those mandates will make investment more complex and more costly. It is a matter of concern as to how Western will distinguish the situation in Darfur from any number of other atrocities occurring throughout the world - how to draw the line on such requests since many groups will have views on divestment in support of a wide variety of causes.

Professor Milde asked for clarification of how the proposal would be implemented if approved by Senate and accepted by the Board. Ms. Kulczycki explained that Western would have to remove its funds from pooled investments and create segregated funds in order to ensure that the fund managers do not purchase stocks offered by the worst offender companies. Currently, only two fund managers would be affected since all of the worst offender companies are non-North American companies. However, there is no guarantee that would continue to be the case. Professor Stainton suggested adding the phrase "avoid knowingly and directly investing in" to the motion to address concerns. Ms. Kulczycki pointed out that this amendment would not resolve the problem because the University does not buy individual stocks directly.

Commenting on the letter from the President of the University of Chicago that had been provided with the background documentation, Professor Lofts noted that he was very much in favor of the decision of that institution to provide funding to support the work of faculty and students - both in terms of scholarly work and real world experiences for students - to advance human rights. He suggested that Western should do the same.

It was moved by S. Loft, seconded by A. Awaysheh,

> That the motion be amended by the addition of a recommendation that a fund, initially in the amount of $200,000 to be administered by the Provost, be established to support faculty and student work on activities to advance human rights and address other atrocities throughout the world.

A member expressed concern that the amendment was quite different from the issue that had been presented in the materials provided for meeting and suggested that more time would be needed to consider its ramifications.

It was moved by J. Toswell, seconded by R. Stainton

> That the amendment be tabled.
>
> CARRIED

Returning to discussion of the main motion, Mr. A. Awaysheh said that Western should be taking a leadership role on this issue. Implementing the proposal might not be the simplest thing to do, but it is the right thing to do. He noted that the Society of Graduate Students had passed motions in support of this move and had forwarded correspondence about its decision to the Board. Part of having the "best student experience" meant listening to students and their concerns.

The main motion was called and CARRIED.

To the Board of Governors of the University of Western Ontario;

We, the members of STAND Western, request that you implement the attached "Suggested policy relating to: provisions for how the University of Western Ontario's Operating and Endowment Fund shall address certain investments relating to Sudan." We make this request in response to the genocide and crimes against humanity occurring in Darfur, Sudan and to the University of Western Ontario's indirect, past financial contribution to these atrocities.

We are aware that UWO does not have any current investments in problematic companies operating in Sudan. We have also been informed that the fund managers of the relevant European, Asian, and Far East funds are not currently interested in obtaining such investments. For this reason, **we are asking the Board to commit to remaining un-invested in any company on the Sudan Divestment Task Force's "Highest Offender" list,** available by request at www.sudandivestment.org UWO's treasurer is currently in possession of this list. **We are also asking that the Board issue a public statement announcing this commitment.** Nothing in this request relates to pension funds of any kind.

Since UWO is not currently invested in any problematic companies, and since the relevant funds are already actively managed, **this action comes at little to no financial cost to the university** and can only enhance our reputation.

The suggested policy explicitly states that such a commitment, or similar actions to divest, should "be employed sparingly and judiciously" and only in cases that satisfy a high threshold of need. **While other socially responsible investment initiatives are controversial surely the need to preclude support for genocide is not.**

Further, all companies on the "Highest Offender" list operate in the oil and energy sectors. None of the companies on this list provide medical, educational, consumer goods, or agricultural services or commodities. Hence this action limits impact on innocent civilians in Sudan.

We have collected over 125 letters of support and over 600 signatures on petitions in support of this policy within only a few days. We will continue tirelessly to generate support for the policy and we look forward to working with you to find a mutually advantageous resolution to this issue.

Respectfully,
Jennifer Epp

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SUGGESTED POLICY relating to: provisions for how the University of Western Ontario's Operating and Endowment Fund shall address certain investments relating to Sudan.

The Board of Governors of the University of Western Ontario does enact the following policy:

Section 1: Findings

(a) Since 2003 the government of Sudan, and its proxy Jangaweed militia, has engaged in a systematic campaign of atrocities to purge civilians from the western region of Darfur. Current estimates place the death toll between 200,000 and half a million people. Two million have been displaced and tens of thousands of women and girls have been raped. Villages are being bombed and burned, wells poisoned, civilians tortured and murdered and driven into the desert without food or water.

(b)In January 2005, an International Commission of Inquiry on Darfur, authorized by UN Security Council Resolution 1564 of 2004, issued a report to the Secretary-General stating that "the crimes against humanity and war crimes that have been committed in Darfur may be no less serious and heinous than genocide."

(c) On November 29, 2006 Louise Arbour, the UN High Commissioner for Human Rights and former Supreme Court of Canada judge, declared that "The government of Sudan and militias aligned with them ... continue to be responsible for the most serious violations of human rights and humanitarian law" occurring at a "horrific" rate.

(d) On December 20, 2006, Canada's All Party Parliamentary Group for the Prevention of Genocide and other Crimes Against Humanity called on the government of Canada to increase its efforts to stop the crimes against humanity and war crimes taking place in the Darfur region of Sudan. Many parliamentarians have joined the United States in naming the crisis genocide.

(e) On December 7, 2004, the United States Congress found that "the Government of Sudan has restricted access by humanitarian and human rights workers to the Darfur area through intimidation by military and security forces, and through bureaucratic and administrative obstruction, in an attempt to inflict the most devastating harm on those individuals displaced from their villages and homes without any means of sustenance or shelter." This finding is echoed in the Amnesty International report "Sudan: Darfur - threats to humanitarian aid (AI Index: AFR 54/031/2006)".

(f) Socially Responsible Investments are widely found by analysts to perform equally well, and not to under-perform, non-socially responsible investments.

(g) The United States' Federal Government has imposed sanctions against the Government of Sudan since 1997. These sanctions are monitored through the U.S. Treasury Department's Office of Foreign Assets Control (OFAC).

(h) According to a former chair of the U.S. Securities and Exchange Commission, "the fact that a foreign company is doing material business with a country, government, or entity on OFAC's sanctions list is, in the SEC staff's view, substantially likely to be significant to a reasonable investor's decision about whether to invest in that company."

(i) A 2006 U.S. House of Representatives report states that "a company's association with sponsors of terrorism and human rights abuses, no matter how large or small, can have a materially adverse result on a public company's operations, financial condition, earnings, and stock prices, all of which can negatively affect the value of an investment."

(j) On December 31st, 2007, President George W. Bush signed the Sudan Accountability and Divestment Act (S.2271). The legislation passed the Senate and House unanimously. The law authorizes state and local governments to adopt targeted Sudan divestment policies and prohibits federal contracts with problematic companies that operate in the Sudan's oil, power, mineral and military sectors.

(k) The current Sudan divestment movement encompasses nearly 100 universities, cities, states, and private pension plans. 58 North American universities, 21 States, 10 cities, and 8 international/religious organizations have already divested.

(l) Companies facing such widespread divestment present further material risk to remaining investors.

(m) Queen's University in Canada divested from their investments in "Highest Offender" companies in Sudan in March, 2007.

(n) It is a fundamental responsibility of the Board of Governors of the University of Western Ontario to decide where, how, and by whom financial resources in its control should be invested, taking into account numerous pertinent factors.

(o) A commitment to remain un-invested in Highest Offenders, and if relevant to divest from them, is consistent with "The University of Western Ontario Operating and Endowment Fund Statement of Investment Objectives, Policies and Governance" approved by the Board of Governors Nov. 2007:

- Financial Services Division, Section 9, states that UWO "**Maintains an awareness of progressive investment management policies and practices at other Canadian and US universities.**"

(p) A commitment to remain un-invested in Highest Offenders, and if relevant to divest from them, is consistent with The University of Western Ontario's "Engaging the Future: Final Report of the Task Force on Strategic Planning" November 2006, which states that:

- "the Western environment actively fosters opportunities for personal and intellectual growth, including **the development of ethical standards and values as well as a commitment to engagement within the University community and beyond.**"

- "Our discussion will be informed by the twelve principles at the heart of our institutional self-definition" Three of these commitments are:

    - **Societal Responsibility**: through our teaching, research and service to the community, **we aspire to play a significant role in improving the quality of life** and fostering economic development in London and this region, in the Province of Ontario, in Canada, and **abroad.**

    - **Openness:** we are committed to an environment of fairness, **broad participation, and openness in which information is widely shared** and the processes for decision-making are understood and respected.

    - **Accountability**: we are accountable to our students and the general public for the quality of our teaching, research and service to the community and **for the effective use of our resources.**

(q) It is the prerogative and desire of the Board of Governors of the University of Western Ontario, with respect to investment resources, pooled and non-pooled, in its control and to the extent reasonable, with due consideration for, among other things, return on investment, on behalf of itself and its investment beneficiaries, not to participate in an ownership or capital-providing capacity with entities that provide significant practical support for genocide, including certain companies presently doing business in Sudan.

(r) It is the judgment of the Board of Governors of the University of Western Ontario that this decision should remain in effect only insofar as it continues to be consistent with, and does not unduly interfere with, the foreign policy of the Canada as determined by the Federal Government.

(s) It is the judgment of the Board of Governors of the University of Western Ontario that **mandatory divestment of university funds from certain companies and/or a commitment to remain un-invested in such companies is a measure that should be employed sparingly and judiciously.** A finding by a UN International Commission of Inquiry, authorized by a UN Security Council Resolution, that crimes against humanity are in process at the hands of a ruling government also satisfies this high threshold. Therefore, **the crimes against humanity and the atrocities occurring in Darfur, at the hand of the Sudanese government, satisfy this high threshold.**

Section 2: Identification of Companies

(a) Within 30 days following adoption of this policy, the Operating and Endowment Fund shall acquire the most current "Highest Offender" list from the Sudan Divestment Task Force (www.sudandivestment.com) and make its best efforts to identify all Highest Offenders in which the Operating and Endowment Fund has pooled or un-pooled holdings, or could possibly have such holdings in the future. **[As of January 24th, 2008 this action has already been performed.]**

(b) By the first meeting of the Investment Committee following the 30-day period described in subsection (a), the Operating and Endowment Fund shall assemble all Highest Offenders identified into a "Scrutinized Companies List." **[As of January 24th, 2008 this action has already been performed.]**

(c) The Operating and Endowment Fund shall update the Scrutinized Companies List on a quarterly basis based on evolving information in the form of quarterly updates and interim updates requested and easily available from the Sudan Divestment Taskforce.

Section 3: Required Actions

The Operating and Endowment Fund and all of its fiduciaries and trustees shall adhere to the following procedure for Companies on the Scrutinized Companies List:

(a) Engagement

(1) The Operating and Endowment Fund, through a designated trustee, shall immediately determine the Companies on the Scrutinized Companies List in which the Operating and Endowment Fund owns Direct or Indirect Holdings. **[As of January 24th, 2008 this action had already been performed and the Operating and Endowment Fund had no holdings, direct or indirect, in scrutinized companies.]**

(2) For each Company on the Scrutinized Company List the Operating and Endowment Fund shall send a written notice informing the Company of its Scrutinized Company status. The notice shall offer the Company the opportunity to change its business practices so that it is removed from the Sudan Divestment Task Force's Highest Offender list, in which case it will no longer be a scrutinized company. The letter can direct the company to the Sudan Divestment Task Force for information on the required changes.

(b) Prohibition

(1) At no time shall the Operating and Endowment Fund acquire non-pooled stock in any company on the Scrutinized Companies List.

(c) Divestment

(1) A designated trustee of the Operating and Endowment Fund shall remain apprised of all changes to all pooled holdings in said Fund. That trustee will remain aware of whether or not changes to pooled holdings result in ownership of any stock in a scrutinized company. If any pooled fund owned by the Operating and Endowment Fund acquires shares in any company on the Scrutinized Company List the Operating and Endowment Fund's designated trustee shall ensure that a segregated fund is established within 90 days to eliminate ownership in stock from said company and shall notify said company of this action.

(2) If, by the time this policy is enacted the Operating and Endowment Fund does have holdings in a scrutinized company a designated trustee of the Fund will contact the companies in question and notify them of their scrutinized status. The trustee will inform said companies that if they are not removed from the Sudan Divestment Task Force's Highest Offender list within 90 days they will be subject to divestment.

(3) After 90 days following the trustee's first engagement with a Company pursuant to subsection (b)(1), the companies in question are still listed on the Sudan Divestment Task Force's Highest Offender list, the Operating and Endowment Fund shall sell, redeem, divest, or withdraw all publicly-traded securities of those Companies.

(4) If a company that was removed from the Sudan Divestment Task Force's Highest Offender list is returned to said list, paragraph (1) shall immediately apply, and the Operating and Endowment Fund shall send a written notice to the Company. The Company shall also be immediately reintroduced onto the Scrutinized Companies List.

Section 4: Reporting

(a) A copy of this policy shall be continuously posted on the University of Western Ontario Board of Governors official website.

(b) The following shall also be posted on University of Western Ontario Board of Governors official website:

(1) A statement similar to that currently given in answer to the question "When is Western going to divest from companies supporting genocide in Sudan ?" by the Faculty/Staff version of the "Ask Western" application on the University of Western Ontario's official website.

i. Said statement will be updated from time to time for accuracy.

ii. Said statement will be altered to announce the Board's commitment to remaining un-invested in companies on the Scrutinized Companies List,

iii. and will state that information on the companies on said list can be acquired by requesting the Sudan Divestment Task Force's list of 'Highest Offenders'.

(2) A link to the Sudan Divestment Task Force (www.sudandivestment.org) to facilitate public inquiry regarding the companies on the Scrutinized Company List.

(3) If applicable, a list of any investments sold, redeemed, divested, or withdrawn in compliance with Section 3(c) sections 1-4.

Section 5: Provisions for Expiration of the Policy

This Policy shall expire upon the occurrence of any of the following:

(a) The United Nations, or the Federal government of Canada, declares that crimes against humanity in Darfur have been halted for at least 12 months; or

(b) The United Nations, or the Federal government of Canada, declares that the Government of Sudan has honored its commitments to cease attacks on civilians, demobilize and demilitarize the Janjaweed militias, grant free and unfettered access for deliveries of humanitarian assistance, and allow for the safe and voluntary return of refugees and internally displaced persons; or

(d) The Federal government of Canada, through legislation or executive order, declares that mandatory divestment of the type provided for in this policy interferes with the conduct of Canadian foreign policy.

UNIVERSITY OF CHICAGO DISCUSSION

From: Office of President Robert J. Zimmer

To: Students involved in STAND, Deans, Committee of the Council, Officers

Subject: Response to Divestment Proposal

I appreciate your willingness to engage in deliberations over the past months about the Sudan divestment proposal. I write today to review the context of those deliberations, to provide a summary of the range of views I heard on this issue, and to inform you of the decision of the Board of Trustees on the proposal.

Over the last two years, trustees, faculty, students, and administrators at campuses across the country have debated whether there is an effective stand universities can and should take with respect to the actions of the Sudanese Khartoum Regime. These deliberations have taken place in the context of a growing recognition that, despite considerable attention and effort in this area, few if any of the actions taken in the international political and economic arenas appear to have halted or even reduced the atrocities in the Darfur region of Sudan.

The campus discussions have been driven in large measure by a student movement that grew into a national network of campus-based STAND (Students Take Action Now: Darfur) chapters, each working to mobilize local resources in an effort to have an impact upon the violence in Sudan. The students involved in the University of Chicago chapter have argued that universities can play a positive role in the Sudanese conflict by divesting investment holdings in companies whose business activities are understood to be supporting the Khartoum Regime and thereby capacitating its activities in Darfur. They have also argued that, because the University has historically not acted as a corporate body on social and political issues, acting in this case would persuade other universities to look carefully at their own investment policies.

For the last forty years, the University of Chicago's response to proposals for an institutional stand on political and social issues that do not have a direct bearing in the University's mission has been informed by the work of the 1967 Kalven Committee. The report of this faculty committee, written during debate about the University's response to the Vietnam war, stated that the University "should not permit itself to be diverted from its mission into playing the role of a second-rate political force or influence." The Kalven Committee noted that "A university has a great and unique role to play in fostering the development of social and political values in a society," a role that is carried out by individual faculty and students engaged in scholarly work and any political or social activity in which they individually or in groups engage. Indeed, the work of faculty and students at the University of Chicago has been very influential in shaping public policy and national values around the world. This distinctive contribution that the University has made and continues to make is the result in large part of an institutional culture that promotes and preserves free inquiry and the expression of the fullest range of perspectives. Since the writing of the Kalven Report, the University has been steadfast in its protection of this culture, thereby preserving and extending the capacity of the University faculty and students to contribute to social and political issues over the long term.

The severity of the situation in Darfur raises reasonable questions as to whether the Sudan case is so exceptional that the University should act to divest despite its long-held adherence to the principles outlined in the Kalven Report. For even the Kalven Committee acknowledged that "In the exceptional instance.the corporate activities of the university may appear so incompatible with paramount social values as to require careful assessment of the consequences."

To understand the views of the campus on this issue, I led a number of conversations with faculty, students, administrative leaders, and trustees. These discussions took place with students leading the divestment campaign and included a face-to-face meeting with those students and the Chair of the Board of Trustees. They took place during regular sessions of the Committee of the Council, in meetings of school and divisional deans, and in many one-on-one meetings. I had the opportunity to hear from students and alumni on this topic as part of a broader set of discussions about the future of the University. The Board of Trustees, which has responsibility for the University's investment policy, considered the issue at four separate meetings, three at the Executive Committee and one involving the full Board.

These deliberations reveal a diversity of opinions about a University response to the proposed divestment strategy. On the one hand, there is some sympathy for the divestment position, although those in favor of this direction comprise a clear minority of those involved in discussions. Some argue that the divestment movement is gaining traction, and it is the most effective action a university can take in this instance. There are also those who argue that divesting is an important moral and symbolic stand, even if it would have limited practical effect on the international crisis. Others argue that precisely because divestment is likely to have little or no practical effect, especially when the University's holdings in targeted companies may on any day be nonexistent or de minimis, the University should not venture onto the slippery slope of taking institutional stands on social or political issues. Others raise serious questions about the efficacy of divestment efforts overall and of the value of economic sanctions in influencing the behavior of rogue states. The preponderant view is that the University should identify ways to contribute to this important issue only through means that comport with the mission of the University - open and free inquiry in the creation and dissemination of knowledge - which have been and will be the basis for the University's most important contributions to addressing political and social issues.

Some asked, for example, if there are research or educational programs that the University could support that might lead to a greater understanding of genocidal behavior and how to eradicate it? Would it be useful to support research on the efficacy of divestment as a lever for international political change? Would greater study of rogue states lead to new options for bringing about positive change through legal, diplomatic, economic, or military interventions? Should the University provide additional support for human rights internships to help educate and train the next generation of leaders and to broaden our understanding of global human rights initiatives? Would support for conferences, speaker series, or visiting faculty deepen knowledge on these issues and influence public policy? How do these considerations apply to Sudan?

The Board of Trustees considered these different arguments and options for moving forward. After lengthy discussions on this topic, the Board determined that it would not change its investment policy or its longstanding practice of not taking explicit positions on social and political issues that do not have a direct bearing on the University. The Board believes that the University of Chicago's distinctive profile in higher education and its greatest potential for influencing social and political issues is determined by its unyielding commitment to free inquiry and to fostering a community of scholars with a great diversity of perspectives. The Board reaffirmed the principles on taking institutional positions on social and political issues articulated in the Kalven Report that have served the University well and can be expected to do so in the decades ahead if followed assiduously.

The Board also shared the widely held view that the University should seek to identify means to contribute to greater understanding of the conflict in Sudan in ways consonant with the University's mission, with the hope of adding value to ongoing efforts to end this international crisis. The Board left it to the Administration to consider how to proceed in this regard.

It is clear that at our University programs that could be developed or enhanced to meet this goal would need to arise out of the interest and work of faculty and students. With that in mind, through University resources and the personal financial contribution of the Chair of the Board, I have established a fund initially in the amount of $200,000, to be administered by the Provost, which will support faculty and student work and activities on these issues. The Provost will develop and promulgate guidelines for the fund, which I hope will encourage creative and entrepreneurial thinking about University-based activities that will broaden knowledge and help prepare our students - through real world experiences and scholarly work - to advance human rights and the well-being of people around the world.

I understand that the decision not to divest will be a disappointment to some, especially to the students who have given great time, thought, and energy to their proposal. At the same time, the campus deliberations on this topic have reaffirmed for me the extraordinary value in our University's commitment to engaging the broadest range of perspectives. This is a commitment we must attend to and promote if the University is to maintain an environment of open discourse and extend its rich history of influencing social and political values across the globe through the work of its faculty, students, and alumni.

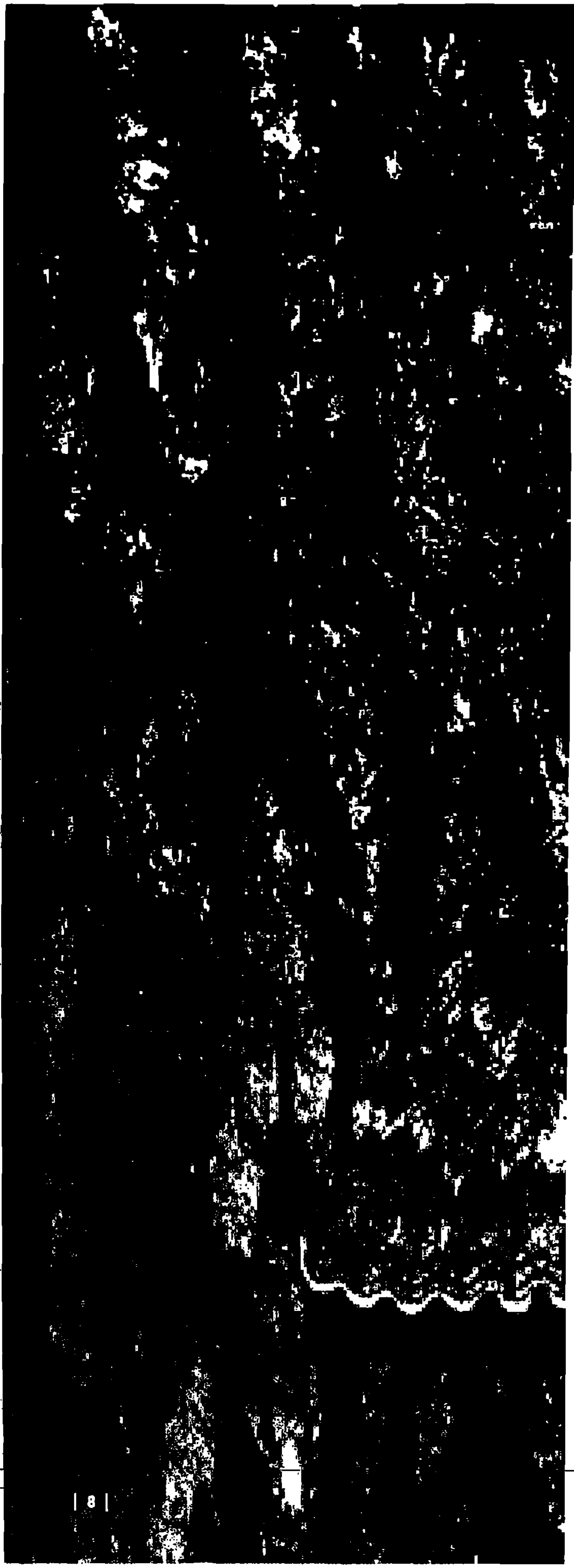
Robert J. Zimmer

President

Socially responsible investing:
More than meets the eye

Meeting long-term investment objectives is challenging, to say the least. Overlay social or environmental criteria and it becomes even more complex—often generating far more questions than there are good answers. Investing with a conscience is a laudable concept—es[illegible]ission-based nonprofit organizations. But the decision to implement an SRI po[illegible]nent policy—should be made on the basis of costs versus benefits. Besides, th[illegible]ctive means to the same end.

by Verne Sedlacek
President and CEO, Commonfund



Socially responsible investing, or SRI, is one of the most challenging and perplexing aspects of managing perpetual pools of assets that support mission-driven organizations. While the social issues are largely new, the concept and the challenges have been around for decades. The beginning of "modern SRI" was in the late 1970s and early 1980s with divestment of companies that did business in South Africa. At that time many institutions in the education, pension and nonprofit communities divested the stock of any company that had operations in South Africa. I remember with great clarity the protests by students and faculty that boiled up around campuses. For the record, I was, at the time, with Harvard Management Company. Harvard had a policy then of active engagement with companies, not divestment, which at one point resulted in our offices being taken over by student protesters. So, I have continued to watch with great interest the changing face of SRI over the last 25 years.

I have debated with myself for years as to whether I should write on this topic. It is a sensitive issue that elicits strong opinions and emotions. I am not an advocate for or against any specific issues but will attempt to lay out the process and decisions that fiduciaries need to consider as they address SRI.

What is clear to me is that, like everything else in the last two decades, the issues have become more complex. We can start with a definition of SRI: a process that makes investment decisions based on factors other than the evaluation of pure economic return of that investment. This does not automatically assume these investments are economically inferior. In fact, some argue that investing in companies that "do the right thing" will, in the long run, pay off both socially and economically. SRI is different than corporate responsible investing (CRI), which looks to invest based on factors related to governance and transparency. SRI can refer to both owning companies that the investor looks upon as socially responsible (for instance, those that reduce global warming) and not owning companies that the investor believes act in a way that conflicts with its view of social responsibility.

Two options for investors

For companies that are not acting in accordance with the institution's social mores there are two types of actions for the investor to take. The most prevalent is divestment. That means restricting ownership of (or, for that matter, any involvement with) any financial instrument of a company (or government) that engages in what the investor would consider socially irresponsible. This should theoretically include equities, debt, derivatives (convertible bonds, credit

In response to the growing complexity and demand for SRI there has also been significant growth in services supporting SRI portfolios and indices. These indices generally start with a broad market index and then "screen out" a range of companies based on the sponsoring institution's own research. Since most are commercially supported entities they screen the broadest range of companies that are determined to be in conflict with the investor's values or social norms. For instance, the KLD Research & Analytics Index screens out 950 companies from the Russell 3000 while the Calvert Social Index screens out 359 companies from the Russell 1000. The screens are very comprehensive, including not only "sin stocks" but also GE, Exxon, Mobil and Citigroup. The indices are then reweighted with the remaining stocks or lower capitalization companies to pick up the indexed industry weightings. Of course, some industry's cohorts cannot be included because all stocks from the industry are determined to be socially irresponsible. In general, SRI indices will, by definition, exhibit a lower average capitalization weight because larger multinational corporations will tend to touch more areas of SRI controversy.

Establishing policies around SRI demands a serious commitment of time, especially for monitoring and administration.

One of the key questions with SRI investing is whether an institution should delegate "social responsibility" to a third party knowing that the screen determined by the third party is likely to be much more inclusive than it would if that institution were left to its own devices. Many institutions have set up separate committees to hear petitions and to determine or make recommendations with respect to SRI. The divestment policies under good governance procedures should be approved by the investment committee and the full board of trustees, taking into account the social issues and the economic impact (if any) of the decision to divest or not hold specific investments.

Institutions that make a specific divestment decision and use separate accounts are able to inform their investment managers of the policy and have the managers sell the positions and monitor purchases to ensure that they don't end up in the portfolio.

Complexity mounts quickly

Beyond this simple approach, the issue becomes much more complex and monitoring and administration have the potential to be overwhelming. One of the things that we learned at Harvard is that establishing policies around SRI demands a serious commitment of time. Some of the things that need to be considered in establishing and executing the policy are:

- How to deal with index funds. Index funds and ETFs could own the restricted stock position.
- How to deal with commingled funds. Should an organization divest the entire commingled fund because that fund does not have a restriction against owning a specific group of financial positions? One real life case recently happened at Harvard in which it divested from two companies doing business with the Sudan. One year later, Harvard discovered that the two companies were owned in a commingled fund. What followed was a flurry of negative publicity.
- How to deal with derivative instruments. If an institution enters into a derivative contract in which the change in the value of the contract is based on an underlying cash position that has an SRI-restricted position, the institution is benefiting and somewhere down the line a counterparty must purchase the cash position to hedge exposure.
- How to deal with investments with limited transparency. Many hedge funds, as a matter of policy, do not disclose the positions they own. Therefore, it is impossible to determine if, in fact, the institution has exposure to an SRI-restricted position. There are a small number of SRI hedge funds—at least one author described these as an oxymoron—but, here again, they must take a very broad approach to SRI to deal with all of the potential constituencies that could invest.
- How to deal with long-term funds that have a lock-up. In these cases, there may be transparency but no discretion on the part of the institution. Many of these funds invest over time and when the commitment is made there is no way of knowing what the portfolio will look like over the life of the investment. If an SRI-restricted investment is made there is no way of divesting except by divesting the entire partnership. For instance at the end of April 2007, it was announced that Goldman Sachs and Whitehall Street Real Estate Funds are spending $1.3 billion to purchase several casinos from an entity owned by Carl Icahn. Clearly, SRI investors that prohibit owning gambling stocks would have to deal with a long-term investment through Whitehall or sell the partnerships.

Hundreds of companies could end up in a restricted database.

The other policy issue that must be decided is how to evaluate the investment manager operating with SRI restrictions. It can be argued that a manager that cannot own certain names cannot be evaluated against a passive index that owns divested instruments. The right approach is to create a passive index excluding those names. Of course, any index creation and compilation is a complicated matter that requires not just deciding to remove certain stocks but also how to reweight the remaining instruments and whether to include names that are not in the original index. The institution must then compute the value and the change in value, including all corporate actions and changes in the index. At Harvard we used an index we created called the Smokeless S&P 900. We engaged an outside service to compute the value and the returns—at no small cost.

As fiduciaries, trustees must consider the costs associated with decisions limiting the universe of securities that managers can use to take positions in a portfolio. There are really two factors to consider in costing-out the impact of a divestment decision. The first is the cost of making, executing and administering the investment restrictions and the second is the potential negative impact on the return of the portfolio.

Expenses need to be considered

The expense associated with SRI needs to be determined on several levels. The first is the cost of identifying the social issues that are important enough to the institution to warrant screening from the portfolio. This can be a long, drawn-out process that requires ongoing deliberations at the highest level of the governance structure. Not only do the social issues need to be debated, but questions of materiality must be determined. Should a major global company be restricted because it derives a small portion of its revenue from selling nuclear power equipment or had an environmental problem decades ago? As part of the determination process, the leadership must decide whether to divest or engage in shareholder activism. Decisions also have to be made about the policy issues described previously. While there may not be a direct out-of-pocket cost associated with these deliberations, there could be an opportunity cost as other issues may not be addressed in a timely fashion.

Screening adds to investment costs

Once the policies have been decided upon, the current portfolio must be screened for investments and SRI-restricted positions sold. There will be an execution cost associated with this process. If the policy is to include all indirect positions (those held by commingled vehicles, hedge funds, private equity and real estate funds), the cost both in terms of the discount from fair value and the time to execution could be substantial.

Once the portfolio has been scrubbed, there will be a cost of monitoring it to ensure no SRI-restricted investments find their way in. To do this, a complete database of banned companies must be maintained. This is not as easy as it sounds because it needs to include all instruments that fit under SRI restrictions worldwide. Depending on the breadth of the restrictions, this could be hundreds of companies around the world, including subsidiaries. The listing would also need to include all debt and money market issues. The institution could maintain the listing itself by performing research on all potential instruments, or it could use an outside service to keep the database up to date. Either way, there would be significant expense involved.

Third, as described earlier, to properly evaluate the performance of investment managers that are limited in terms of positions that could be owned, an index should be either purchased or created to compare performance. In addition, an institution should track the performance cost or benefit in terms of the restrictions. The institution will also need a process to continue to update the restrictions that apply as the circumstances of companies change over time.

It is no surprise that because of these additional costs, SRI mutual funds, on average, incur annual expenses that are higher by about 20 basis points when compared to funds that don't screen. (Girard, Rahman and Stone, *The Journal of Investing*, Spring 2007).

There has been much written and a significant amount of research done on the topic of return impact on portfolios of SRI investing. If one starts with the concept that underpins most modern investment theory, the Capital Asset Pricing Model (CAPM), there is no doubt that restricting the universe through noneconomic decision-making reduces the efficacy of a portfolio whose job it is to generate high risk-adjusted returns. Theoretically, it will impact expected return or risk, or both.

derivative swaps, et cetera) and short-term paper. If any of these are owned by the investor they need to be sold.

The second type of action that can be taken is shareholder activism. This involves continuing to own the financial instrument (particularly common stock) and using the ownership as a way to influence the actions of a company.

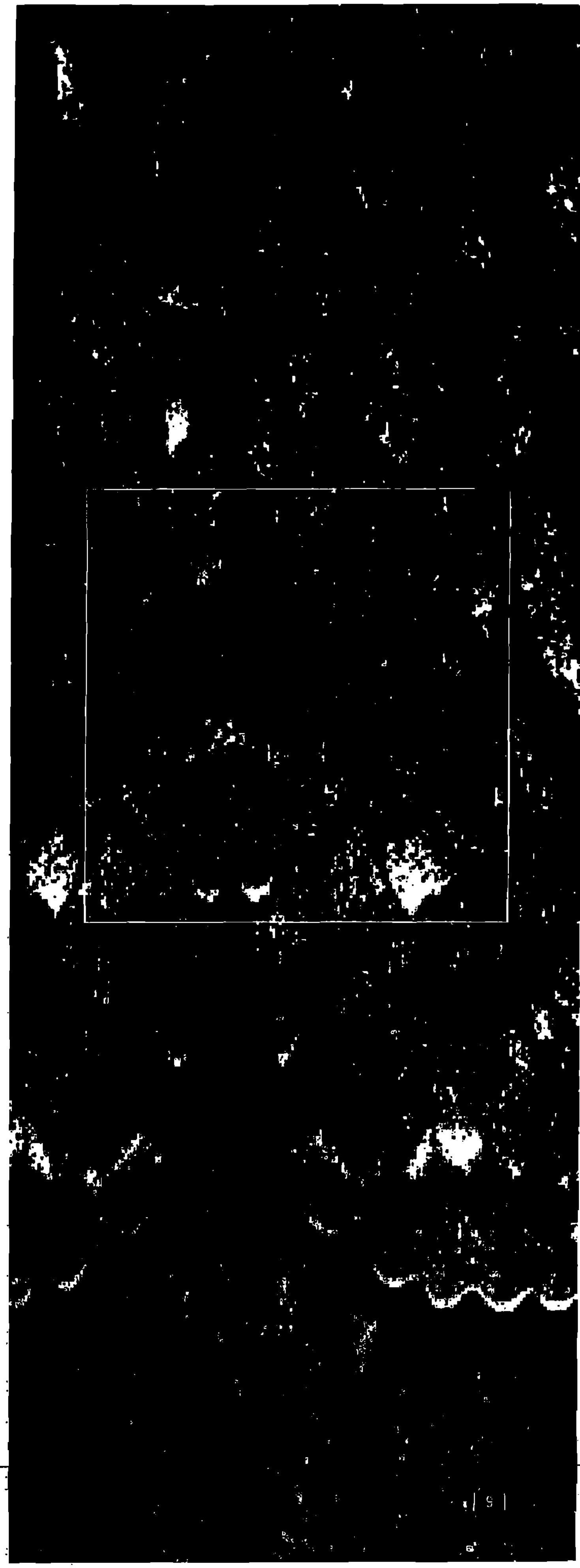
In determining which approach to take, an institution should consider its SRI objectives. There are essentially two, which are not mutually exclusive. The first is that the institution that chooses to exercise SRI does not want to benefit financially from the activities of a company that may be acting contrary to the social norms of the institution. For example, a nonprofit healthcare organization may not want to receive a financial benefit from a tobacco company.

Encouraging socially responsible behavior

The second objective of SRI is to encourage companies to engage in good socially responsible behavior. This might include influencing a corporation to change policies that are just a portion of its overall activities if, for example, it had a small operation in a country that had repressive policies against it own people. In this case the company could be influenced to change its operations because the activity had little or no impact on the enterprise value of the company.

In the first instance, divestment is the only solution to ensure that the nonprofit does not gain financially from what it sees as irresponsible activities. SRI policies related to the second reason could take either the divestment approach (to influence the company by, in effect, boycotting the stock and, thus, theoretically reducing the share price) or through shareholder activism (to influence management by putting shareholder resolutions forward or otherwise engaging with management and threatening divestment). In this case, once the position is sold leverage becomes negligible.

The number of SRI issues has grown considerably since the relatively simple days of South Africa. The issues frequently discussed today include the environment, employment policies in the U.S. and overseas, operations in countries that may have inappropriate policies, companies defined as engaging in sinful activities (alcohol, tobacco and gambling), weapons and firearms, energy (nuclear and fossil fuels), pharmaceuticals, right-to-life, pro-choice and others. There are as many flavors to SRI as there are issues that confront our world today. There are instances in which institutions have divested from companies doing business in the Sudan but have also been presented with petitions from constituencies to divest all companies doing business in Israel.



Risk: another dimension to be considered

In examining the risk side of the equation, Commonfund, using its risk analysis package, evaluated the risk of an index versus that same index excluding stocks that have been screened out due to SRI issues. For the purpose of this analysis we used the KLD Research & Analytics, Inc. Broad Market Index and compared it to the S&P 500. The KLD Index excludes companies engaged beyond specific levels of involvement in certain areas such as tobacco, firearms, alcohol, military weapons, gambling and nuclear power. For those companies that are not excluded after the initial screen, KLD uses internal ratings to rank the remaining companies based on the individual company's performance in three broad categories: environment, social and governance. Commonfund used these listings to create an index that just excluded companies from the S&P 500 and an index that excluded these companies and reweighted by industry group. We performed the analysis of the indices as of February 28, 2007, using the Bear Measurisk system.

There are two key components of risk that we examined. The first is the value at risk (VaR) on an absolute basis and the VaR relative to an index. VaR is a measure of risk that identifies how a portfolio will perform in a normal environment (i.e., not in unusual markets such as a major break in equity prices). VaR quantifies the lower limit of a portfolio's performance 95 percent of the time. Stated another way, the performance of a portfolio will be worse than the VaR 5 percent of the time (VaR does not describe how much worse). In this case, we examined VaR (amount of potential loss) over a one-month period.

In the analysis performed by Commonfund on these indices based on the S&P 500, results showed a slightly greater VaR associated with the S&P 500 excluding SRI (and not reweighted) than the unconstrained S&P 500 Index. The VaR of the unconstrained S&P on a one-month time horizon was a loss of 5.6 percent versus a 5.8 percent loss for the S&P 500 Index subject to SRI restrictions. This means that the downside risk in a normal environment is slightly higher when excluding certain stocks. When we reweight the S&P 500 by industry, the VaR is roughly the same as the base index.

When we examine relative VaR (that is, the risk of underperformance of an index based on exclusion of SRI positions relative to the unconstrained S&P), we find that relative VaR is 73 basis points and 42 basis points for the total exclusion and industry reweighted indexes, respectively. This means that if a manager is running an active portfolio versus the unconstrained S&P Index that excluded SRI-restricted positions, there is a statistical expectation that the portfolio would underperform the index by 73 basis points or more in 5 percent of the months. This level of risk is quite high on a relative basis. To put this in perspective, Commonfund's actively managed Core Equity Portfolio had a relative monthly VaR of 60 basis points versus the S&P 500 at February 28, 2007.

While VaR is a generally accepted methodology for looking at normal market environments, it does not evaluate extraordinary circumstances. How bad can things get beyond the VaR for a 5 percent level? For that we use stress testing. To stress test using Bear Measurisk, we look at some historical events and apply the impact of those events to current portfolios. Because the application of SRI principles often eliminates companies that are larger and more diverse, SRI portfolios tend to have an average lower market capitalization. As a result, those stress events that have a relatively higher negative impact on smaller stocks will result in SRI portfolios underperforming unrestricted funds. In looking at the stress of a 25 percent drop in the Nasdaq, the S&P 500 portfolio is estimated to lose 20.3 percent while the non-reweighted SRI portfolio would lose 20.8 percent. (The reverse would be true in a Nasdaq rally.) The application of the market correction associated with the Russian debt crisis of 1998 would show a loss of 17.2 percent for the S&P 500 versus a loss of 18.6 percent for the non-reweighted S&P 500 portfolio. If the portfolio is reweighted the difference in impact is not as large.

One conclusion from these relatively simple risk analyses is that, as expected, the risk of the SRI portfolio is higher than the unconstrained portfolio. In addition, another critical conclusion is that portfolio construction (or index construction) methods are very important. How one makes determinations around replacing those industries or companies that are divested will have a significant impact on the amount of incremental risk in a portfolio.

Theoretical impact on returns

The return side of the risk and return analysis is more daunting. Thinking about the issue, it stands to reason that if managers are restricted to stocks that are generally not owned by a broad group of market participants, these equities should at least theoretically be cheaper than stocks that can be owned by any investor. In that case, unconstrained investors, like hedge funds, will be able to arbitrage the position to their advantage relative to an investor abiding by noneconomic constraints.

To further examine the implications of excluding investments because of SRI policies we turn to some of the academic work that has been performed. One of the most recent pieces is a working paper authored by Harrison Hong of Princeton University and Marcin Kacperczyk of the University of British Columbia entitled

There is a belief by some nonprofits that the best way to deal with social issues is not through restrictions on the investment portfolio.

"The Price of Sin: The Effects of Social Norms on Markets" (March 2007). This paper was the winner of the Commonfund Institute Award for the best paper relevant to foundation and endowment asset management, presented at the EFA meeting, Zurich 2006.

To summarize some of the points of the paper:

- Sin stocks (alcohol, tobacco and gambling) are held in smaller proportions by institutions that are subject to social norms. These include pension funds, universities, religious organizations and insurance companies. The authors found that, during the period from 1980 to 2003, the typical firm in the broad sample had about 24 percent of its shares held by institutions while sin stocks had a 13 percent lower institutional ownership ratio than average.
- Sin stocks receive less analyst coverage than the unrestricted companies. They found that, during the period from 1976 to 2003, the total sample received coverage from about 2.5 analysts, while sin stocks had coverage of 2.1 analysts.
- Shares of sin stocks are not held in smaller proportions than average by the "natural arbitrageurs" of independent investment (hedge fund) advisers and mutual funds.
- Sin stocks are underpriced. The book-to-market ratios of sin stocks are lower than those of other companies after controlling for differences in stock characteristics.
- In terms of market returns, sin stocks outperform comparable equities by anywhere between 18 to 33 basis points per month (2 to 4 percent per year) even after accounting for well-known determinants of expected returns in cross-sectional regressions, such as market size, past return and market-to-book ratios.
- Sin stocks, as a consequence of the underpricing of their equity due to social norms, finance more of their operations from debt relative to equity. Sin companies had a 13.9 percent higher leverage ratio than the typical company.
- Sin stocks are 15 percent cheaper than the typical stock.

These findings can lead to the conclusion that the decision not to own a category of financial investments will reduce returns of the institution's portfolio and the incremental loss of return will accrue to unconstrained investors, such as hedge funds and mutual funds. These findings are consistent with CAPM and are also consistent with the lion's share of academic work done within this discipline, although much of it has been performed on mutual funds and is not directly applicable.

Where does all of this information leave us in terms of thinking about SRI? First, I am not advocating that institutions should ignore their values when thinking about their investment pools. However, they need to fully understand the impact in terms of risk, return and administration when it comes to an SRI policy.

There is a belief by some nonprofits that the best way to deal with social issues is not through restrictions on the investment portfolio—which will have little impact on the operations of offending companies and a negative impact on risk and return of the investment portfolio—but through proactive participation in solving the problem. This can be best achieved by the use of potentially higher returns on the investment fund to apply those tools of the institution that will have the greatest efficacy. If it is an educational institution, perform education and research; if a foundation, provide grants to address the problem; if a nonprofit healthcare institution, provide funding for research or patient care. In my early days at Harvard the university took this approach to investing in companies doing business in South Africa. Harvard actively engaged with companies owned by the endowment and set up scholarships for deserving black South African students. This, of course, did not quell the students, who continued to protest the ownership of companies such as IBM but, in my opinion, this approach had a greater impact on the issues associated with apartheid than if the university had simply divested itself of all U.S. companies that did business in South Africa.

The debate over divestiture

This approach is still being used by selected universities in addressing the terrible situation in the Darfur region of the Sudan. While close to 30 universities have decided to divest, at least two have taken a different approach. George Washington University plans to establish a scholarship program for Sudanese students with an expected value of more than $200,000 over four years. The institution did this in lieu of divestment. The university was quoted as moving forward with a policy that is "constructive not destructive" while stating that "embargoes don't work."

Another institution, the University of Chicago, has taken a slightly different approach. In a letter from its president, Robert J. Zimmer, to the groups petitioning for divestment, he outlined the rationale based on a discussion with the community as to why the university will not divest certain companies from the endowment. "After lengthy discussions on the topic, the Board determined that it would not change its investment policy or its long-standing practice of not taking explicit positions on social and political issues that do not have a direct bearing on the University." The university did, however, establish a fund in the amount of $200,000 "which will support the faculty and student work and activities on these issues."

Issues not easily resolved

Even the Sudan issue is complicated. Harvard University was one of the first to announce it was selling one company (PetroChina Limited) because of the company's role in supporting genocide in the Darfur region. A few weeks later, Stanford announced it was selling shares in four companies, including at least one that was still held in Harvard's endowment. Interestingly, Amherst College barred investment in 19 companies it believes benefited from activities with the Sudanese government. Initially these included some very significant multinational corporations, including ABB Ltd., Royal Dutch Shell Plc and Schlumberger Ltd. The list has since been revised (ABB and Royal Dutch were taken off) and now includes 21 names.

While Harvard was one of the first to announce a policy on divestment toward the Sudan, this hasn't relieved pressure from the Harvard Darfur Action Group, which has recently called for a targeted divestment program stating, "Harvard's current ad hoc approach to divestment leaves the University complicit in the Darfur atrocities, given that it still maintains holdings in companies as egregious as those it divested in 2005 and 2006." Says Sarah Catherine Phillips, HDAG divestment chair, "That is why we are asking Harvard to adopt the Sudan Divestment Task Force model." Needless to say, any divestment policy is very challenging and is likely to come up short in satisfying all of a nonprofit's constituencies.

To summarize, SRI is an extremely complicated matter and the adoption of policies around SRI issues should not be taken lightly. One should understand which social or political issues their institution should address and how they should be addressed. This would include the question of influence versus participation. Understand that there is a cost to restricting ownership of certain financial instruments on four levels: time for policy construction, increased risk, potential for reduced returns and administration. As fiduciaries, the decision to implement an investment policy must be made on the benefits of adopting an SRI policy versus the costs associated with a restricted portfolio. |

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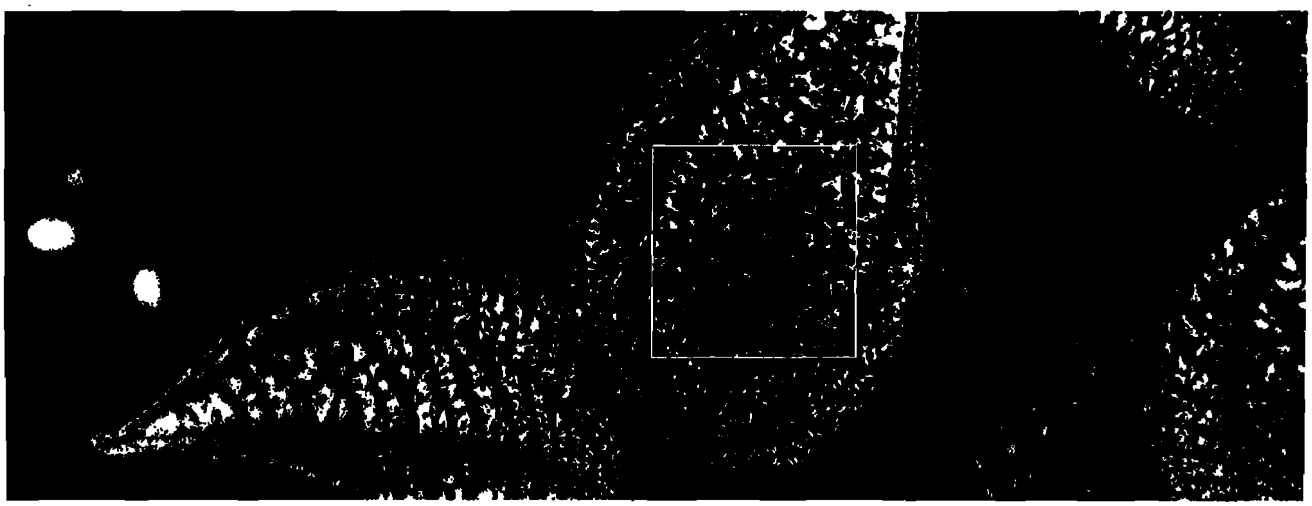

Adoption of policies around SRI issues should not be taken lightly.