Chief Investment Officer Letter to the Yale Community

April 12, 2016

To: The Yale Community

From: David F. Swensen, Chief Investment Officer

Re: Impact of Investments Office Climate Change Letter

On August 27, 2014, President Salovey announced a number of university sustainability initiatives to address the existential issue of global climate change and its consequences. The President's statement was issued following a decision by the Yale Corporation Committee on Investor Responsibility to refrain from divestment of the University's holdings in fossil fuel companies. The President's message, which emphasized Yale's role as an academic institution and a leader in sustainability, referred to a letter I would be sending to Yale's external investment managers on the issue of climate change. I am writing to let you know about the impact that letter has had on Yale's portfolio, on the University's managers and on the Investment Office's investment process.

My letter was delivered to all of Yale's active external investment managers on August 27, 2014. Over the course of the following weeks, my staff followed up with each manager to discuss the letter. In general, Yale's managers supported the approach of the letter and appreciated the admonition to consider the economic impact of climate change on investments, without placing definitive restrictions on portfolio decisions. Many expressed enthusiastic support and highlighted actions their organizations planned to undertake to support Yale's objectives. A few expressed confusion or uncertainty and the Investments Office addressed both through additional conversations and clarification of Yale's expectations.

At the time of the distribution of the letter, a few managers held positions we felt were inconsistent with our principles. Thermal coal miners and oil sands producers are two of the obvious industries that would suffer if regulation imposed the social cost of carbon emissions on producers. As of June 30, 2015, the Endowment had *de minimis* exposure to those industries. One manager held a small position in a publicly-traded company that engaged in the production and sale of coal. Another manager held interests on Yale's behalf in two publicly-traded oil sands producers. Combined, these investments represented less than $10 million of exposure to Yale. Since that time, the first manager exited its coal position. The firm's founder agreed climate change and carbon pricing represented unknowable risks and fossil fuel producers with significant carbon footprints were declining businesses, a profile the firm preferred to avoid. The second manager sold both positions and stated it would not initiate similar positions in the future. This manager had already begun to think about the impact of climate change on its portfolio when it received my letter and subsequently expressed support for the principles outlined in it.

Since the distribution of my August 27, 2014 letter, new investments made by the University's investment partners have been in keeping with the spirit of the approach outlined in the letter. We believe the lack of new investment in greenhouse gas intensive energy companies confirms a common understanding between Yale and its external managers.

In addition, the Investments Office has incorporated into its investment process pointed engagement with Yale's external managers on the topic of climate change. Although public scrutiny has focused on investments in fossil fuel producers, the Investments Office approaches the climate change issue more broadly by considering any exposure with risk related to climate change and potential regulations aimed at reducing emissions. That consideration includes, for example, asking managers about the implications of climate change when evaluating farmland acquisitions in southern locations or pushing our partners to consider the risks of owning low-lying coastal real estate.

In an example of productive engagement with our managers, my letter precipitated a significant effort by one of Yale's energy-focused private equity managers to develop a broadly applicable framework for energy investing in a carbon-constrained world. Leveraging its strong in-house research team, the firm developed a framework for assessing, reporting, and comparing the greenhouse gas ("GHG") intensity of fossil fuel operations on an apples-to-apples basis. The firm conducted carbon audits of its portfolio companies and assessed the exposure of each to more stringent emissions regulation. The firm led a symposium of investors to discuss the approach and shared a white paper with other industry participants. The firm hopes that by gathering data and modeling the GHG intensity of an operation, investors can build greater awareness of the characteristics that lead to lower GHG intensity and ultimately make better decisions on future investments, either by avoiding more challenged assets or by improving a project's design.

The Investments Office plans to continue its engagement with managers on the issue of climate change. Since the distribution of my letter in 2014, Yale initiated a number of new investment relationships with external partners and provided each of them a copy of the letter. The Investments Office engaged in conversations with each manager about the University's objectives in considering climate change. A number of managers called attention to the alignment that exists between Yale's policy and their current investment processes, highlighting specific actions their organizations had undertaken to address climate change. For example, Yale's new real estate managers noted that reduced energy consumption benefits their bottom lines as well as the environment. In one instance, Yale had traveled very far down the path of hiring a new energy manager. Discussions with the manager about the contents of the letter revealed a divergence of views and attitude between Yale and that manager towards the risk of climate change, including whether and how to incorporate those risks in its investment process. In part as a result of those conversations, the Investments Office decided not to pursue that investment relationship.

The Investments Office believes the risks of climate change, like any risks, should be incorporated in the evaluation of investment opportunities. This is not an easy, straightforward task. However, initiating and continuing a dialogue with our managers about those risks result in more thoughtful consideration of investment opportunities, higher quality and lower risk portfolios for Yale, and better environmental outcomes.