

UNIVERSITY OF SOUTHERN CALIFORNIA

Minutes of the Regular Meeting of the Advisory Committee on Investment Responsibility

January 26, 2024

The sixth meeting of the Advisory Committee on Investment Responsibility of the University of Southern California was held at 9:00 a.m. on January 26, 2024 by video conference. The following people participated in the meeting:

Committee Members Participating:

Marlon Boarnet, Faculty

Richard Sloan, Faculty

Nichelle Huizar, Staff

Kathleen Burns Campos, Alumni

Howard Kern, Alumni

Blayne Tatman, Alumni

Undergraduate Student Member #1

Undergraduate Student Member #2

Committee Members Not Present:

Stacy Giwa, Chair

University Administrators Participating:

Amy Diamond, Chief Investment Officer

Hannah Findling, Sustainability Program Administrator

Brian Johnson, Managing Director of the Investment Office

Teresa Whitehill, Senior Investment Associate of the Investment Office

ACIR Intern #1

University Administrators Not Present:

Amy Diamond, Chief Investment Office

Call to Order

Committee Chair Stacy Giwa was unable to attend this meeting. Hannah Findling called the meeting to order at 9:01 a.m. with a reading of the meeting agenda. All members participated by video or teleconference. During the meeting, all members participating could hear and be heard by one another.

Update From the Investment Office

Managing Director of the Investment Office Brian Johnson led with an update from the Investment Office. Fossil fuel exposure is \$346M as of December 2023, up from \$313M as of June 2021 due to the appreciation of fossil fuel investments. Nearly half of the endowment's fossil fuel exposure has been distributed since July 2021. The endowment realized \$143M in cumulative distributions of fossil fuel holdings since February 2021 with \$13M occurring since our last quarterly ACIR meeting in October 2023. One of the endowment's private partnerships, valued at \$95M and comprising 27% of fossil fuel exposure, is expected to be sold at nearly a 60% premium in 2024 resulting in an estimated \$200M in total gains to the endowment from fossil fuel holdings since July 2021.

A committee member requested the typical rate of return on divested assets. Brian Johnson offered to benchmark long-term horizons moving forward. Another committee member asked whether or not the Investment Office compares performance with and without fossil fuels. Brian Johnson clarified that while the Investment Office does not analyze, the portfolio returned 19% since the Board of Trustees voted to freeze fossil fuel investment in February 2021 (with the last originating in August 2018). Fossil fuel prices fluctuated following the Board's decision, indicating advantageous returns had the endowment-originated fossil fuel investments during troughs. Another committee member asked if the endowment would continue normal financial distribution. Brian Johnson confirmed. University endowments regularly issue funds to support education, research, and operational expenses into perpetuity. The Investment Office stated that the endowment is budgeted to continue normal distributions for the near future.

A committee member and Brian Johnson discussed the opportunity cost of prematurely selling existing fossil fuel holdings and agreed that while private markets often present advantageous risk-adjusted returns, low liquidity raises the appeal of exiting locked-up positions. Committee members asked if sold-off capital would be diverted into sustainable investments and requested the proportion of Environmental, Social, and Governance allocation. Brian Johnson clarified the Investment Office's current sustainable investment policy: most (if not all) cash from sold-off fossil fuel securities will be redirected into sustainable investments over a multi-year horizon. The Investment Office's flexibility is limited by related commitments outstanding and capital calls on distributed projects. ESG assets promoting resource conservation, emission reduction, and sustainable practices comprise 3.9% of the portfolio.

Evolution of ESG Investing

Committee Member Richard Sloan shared a presentation on the history and evolution of ESG investing. The term ESG was coined by the United Nations Global Compact which argued that ESG risks and opportunities affect shareholder value, linking ESG to both sustainability and financial outcomes. Neglecting ESG risks also opens up firms to legal repercussions as regulations and ESG risks typically coincide. Richard Sloan emphasized the balance between maximizing returns and impacting sustainability in portfolio management; while firms with a high ESG focus might offer superior risk-adjusted returns, enough investors purchasing these securities can drive the price upwards. This can lead to the overpricing of ESG-related assets.

Richard Sloan presented a chart containing an X-axis of Investment Approach, ranging from Traditional to Charitable, and a Y-axis of Investment Goal, ranging from Risk-Adjusted Return Maximization to Willingness to Pay for Positive Impact. Moving from the top left to the bottom right highlights the growing trade-off between financial performance and having an impact on sustainability. Fossil fuel divestment fell near the middle.

Suggesting that the Investment Office strive to maximize returns considering ESG risks and opportunities, Richard Sloan also recommended identifying businesses with significant negative impacts that are inconsistent with the values of the USC community and considering them for exclusionary screening. He encouraged the committee to engage with the community, assist the Investment Office in sourcing ESG investment opportunities, and help to identify current holdings inconsistent with USC's Investment Stewardship Policy. Committee members agreed.

Brian Johnson reinforced the ACIR's role as a liaison between the Investment Office and the broader USC community. The Investment Office encourages its Investment Managers to pursue sustainable practices due to difficulties in excluding entire asset classes or sectors. Brian Johnson asserted that utilizing privately managed accounts (PMAs) is unlikely given the endowment's moderate size, standing at approximately \$8Bn AUM, limiting control over portfolio composition.

A committee member cited the upper-right quadrant of the chart presented by Richard Sloan where Risk-adjusted Return Maximization intersects Charitability and asked the Investment Office if partnered investment managers disseminate sustainability-focused impact reports. Brian Johnson affirmed that some investment managers share sustainability content, varying in frequency and scope, and agreed to share incoming reports with the committee. A committee member suggested the Investment Office generate impact statements examining portions of the endowment, including analyses on both broader portfolio composition and particular projects or ventures.

Educational and Informational Sessions

Hannah Findling suggested multiple dates to host a joint education session between the committee and the Investment Office. More information will be provided soon.

Intern Research Update

The ACIR Intern presented an analysis of USC's upcoming Sustainability Tracking Assessment & Rating System (STARS) Report submission. The Association for the Advancement of Sustainability in Higher Education (AASHE) issues a self-reported framework on a multi-year basis, assessing universities on their sustainability performance. The presentation focused on the following subsets of the Investment & Finance category:

- PA-9 Committee on Investment Responsibility
- PA-10 Sustainable Investment
- PA-11 Investment Disclosure

The ACIR Intern acknowledged the university's strong efforts in fulfilling the criteria. The university has an Advisory Committee on Investment Responsibility consisting of students, academic staff, and non-academic staff. The university outlines a publicly available investment policy. The Investment Office actively aligns actions with university goals and criteria, conducts negative screening of assets, and publicly disseminates fossil fuel divestment efforts. All of the above contributes toward USC earning credit in the aforementioned categories.

The ACIR Intern recommended the following to improve the university's STARS rating before the next submission in 2027: sourcing and entering sustainable positions, increasing the proportion of holdings subject to negative screening, actively participating in proxy voting, and publishing more comprehensive investment snapshots, all in compliance with the criteria outlined by the Association for the Advancement of Sustainability in Higher Education (AASHE.)

STARS Rating criteria are expected to change before our next submission and will be further analyzed upon issuance.

Brian Johnson explained how larger endowments have more options to establish proxy voting guidelines than those of USC's size. A committee member asked how investors ensure voting is aligned with their unique goals as opposed to general criteria, citing Institutional Shareholder Services (ISS) guidelines as an example. The ACIR Intern elaborated that engaging peer universities often specify their conditions, tailoring votes to achieve desired outcomes.

Open Dialogue

The committee presented and discussed relevant news articles related to sustainable investment. ACIR Intern shared an article reporting billions of peer endowment funds being diverted to sustainable investment. Another article highlighted the steady increase of ESG incorporation reported by institutional investors, rising over 400% from 2005 to 2020. A committee member shared an article cautioning that sustainable investment may provide subpar risk-adjusted returns.

The committee brainstormed ways to raise awareness for future ACIR educational sessions. Partnerships with existing courses, university news outlets, and student organizations were considered. A committee member asked the Investment Office to further investigate proxy voting. Teresa Whitehill asserted that without utilizing separately managed accounts, the Investment Office may need to explore alternative measures. Brian Johnson agreed to assess the feasibility and update the committee during the next quarterly ACIR meeting.

Community Proposal Review

The committee has not received any community proposals since the previous quarterly ACIR meeting.

Adjournment

The meeting was adjourned at 10:21 a.m.

Follow-up Items

Brian Johnson plans to internally circulate partnered investment managers' sustainability progress reports and assess the feasibility and methodology of the Investment Office's proxy voting engagement.

ACIR Intern agreed to conduct research and present findings on the sourcing of proxy voting processes and services that facilitate shareholder engagement.

ACIR Intern will continue to process any community submissions received and distribute findings at the following ACIR meetings.

The committee will consider means to raise awareness for future ACIR educational sessions.

Dated: January 26, 2024