Decarbonizing Harvard's Endowment :
Reviewing Harvard Management Company's First *Climate Report*
Doug Koplow[1] – May 26, 2021

Harvard Management Company (HMC), which manages Harvard University's nearly $42 billion endowment, released its first *Climate Report* in February 2021.

As the largest university endowment in the world, decisions Harvard makes to tangibly and materially reduce the climate impact of its investments will garner significant attention around the world and provide space for many other institutions to make similar moves. Further, the school has the scale and the stature to coordinate with other institutional investors and accelerate the pace of financial innovation across asset classes to more effectively integrate climate-related criteria. The reverse is also true: when Harvard does little or nothing, it provides an excuse for other institutions to delay restructuring as well.

The issue of decarbonizing the endowment has been discussed for years, though with very little real change in investments. Perhaps as a result, Harvard Faculty of Arts and Sciences formally voted 179 to 20 to support divesting the portfolio of fossil fuel assets at their February 2020 meeting. The vote included an amendment to decarbonize the entire endowment in accord with IPCC climate projections. Thus, the FAS faculty also voted to decarbonize the endowment.

At the time, Harvard President Larry Bacow committed to bringing the faculty motion to the Harvard Corporation for consideration. Bacow summarized the Corporation's response in a June 2020 written communication. It read, in part:

> *Harvard's endowment should be a leader in shaping pathways to a sustainable future. With this in mind, the Corporation has directed the Harvard Management Company (HMC) to set itself on a path to decarbonize the overall endowment portfolio—a move in step with the final element of the resolution adopted by the Faculty in February. In particular, the Corporation has instructed HMC to develop a strategy for the endowment to achieve net-zero greenhouse gas emissions from the portfolio by 2050. This will require developing sophisticated new methods for measuring emissions associated with the investment portfolio and then for systematically reducing them across the full breadth of the portfolio. We believe that this approach, which considers the investment*

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portfolio as a whole, rather than simply targeting the suppliers and producers of fossil fuels, is the right one for the University to pursue.

The first public step along that strategic process was to be the creation of a public climate report by HMC. This is the first of what is to be an annual release; however, Harvard Magazine refers to the report as "periodic," rather than "annual". This suggests a reduced and possibly intermittent frequency on even this most basic level of reporting.

There were some positive elements to, and disclosures in, the report. However, its scope and depth were underwhelming; so too were the framing and reporting choices made by HMC. My key takeaways are below.

1) HMC acknowledges that all asset classes matter in decarbonizing the endowment

Through its frequent mentions of externally managed funds and hedge investments, HMC directly acknowledges that Harvard's private equity and hedge portfolios matter a great deal in terms of carbon impact and assessment. This is a subtle shift, but a very important one and aligned with points that I and others have been making for some time now.

The integration of all parts of the portfolio within Harvard's net zero goals also helps to highlight the stark inadequacy of HMC's current public reporting of investment holdings to the Securities and Exchange Commission. The quarterly 13F filings contain only individually held publicly-traded US stocks (or the US-traded versions of foreign companies known as "ADRs") and commingled holdings in the form of Exchange Traded Funds. This is the bare legal requirement, and clearly insufficient to provide a reasonable degree of transparency of holdings and oversight on decarbonization commitments. Indeed, the June 30, 2020 13F filing (while not the most recent filing, it is the most recent to align with the end of Harvard's fiscal year and annual report) disclosed holdings that comprised less than 1.1% of Harvard's overall portfolio.

2) Harvard's shareholder responsibility committees need restructuring if they are be relevant to the University's current portfolio structure and decarbonization effort

Harvard has two existing internal committees to address shareholder responsibility issues associated with the public firms Harvard invests in: the Advisory Committee on Shareholder Responsibility (ACSR) and the Corporation Committee on Shareholder Responsibility (CCSR). When the committees were established nearly 50 years ago, investment options and instruments were very different. The directly held publicly traded stocks on which these committees focus were a key component of the portfolio in 1972, but now comprise a tiny portion of the overall endowment.

Proxy guidelines developed by ACSR cover a variety of social and environmental issues and are quite good (general overview here). If approved by CCSR, the guidelines can direct responses on proxy battles for directly held public stocks. In addition, the guidelines are communicated to all external managers, including other asset classes – but are not binding and HMC does not disclose any information on which external managers are non-compliant.

A logical extension of HMC recognizing the climate importance of all asset classes is the restructuring of Harvard's oversight committee structure so it aligns with the current realities of their investments. Reformulated committees would have the power to review all investments within the portfolio; flag those that are potentially problematic in circumstances not limited to formal proxy balloting alone; and report in some manner to the public on the type of conflicts observed, and general patterns on the responsiveness of firms and funds to concerns raised.

3) HMC affiliations and partnerships with shareholder organizations are useful but insufficient

The *Climate Report* notes that in key data areas, including carbon measurement and corporate engagement, there are economies of scale by working jointly with other large asset managers. This is quite true, and HMC is right to engage with these efforts. However, the targets, strategy, and leverage of these organizations remain in flux and key metrics are not consistently measured across them. It can sometimes be difficult even for the member organization to evaluate the impact of these partnerships on the bottom line metric of addressing climate change. For other University constituencies and the public, it is impossible: most of the information relating to HMC's specific reporting to, and activities with, these organizations is kept confidential. HMC's current *Climate Report* lists all of the shareholder organizations it has joined to leverage its net zero by 2050 pledge. All future reports should include with each partnership a list of the data categories HMC reports to the organization, which of those it makes public, and a clear justification for each data category excluded from public disclosure on why it is remaining secret.

Further, while data on firms collected by third parties will continue to improve, sectors of the market are likely to lag appreciably and in consistent ways across all third-party data services. Data on smaller companies; non-public companies; companies based in developing countries; and state-owned enterprises that may have a large fossil fuel footprint, some traded shares or outside investors, but gaps in their financial reporting are some of the main coverage gaps expected. Carbon impacts of core supplier networks are also likely to remain opaque. In all of these areas, alternative and supplemental approaches to relying on third-party shareholder groups will be required.

4) Even with external partnerships, HMC appears under-resourced for the task of decarbonizing the endowment

The task before HMC to achieve net zero is a very large one. It is not surprising that they don't have enough capacity to meet this challenge at present. Much of the responsibility for change seems to rest with Kate Murtagh, HMC's chief compliance officer and managing director of sustainable investing. Murtagh is tasked with overseeing the integration of environmental, social, and governance assessments with investment decision-making. Other key staff includes Michael Cappucci, senior vice president for compliance and sustainable investing of Harvard Management Company (HMC). Cappucci focuses on integrating ESG factors in HMC's private fund investments.

Particularly if Harvard plans to achieve a net-zero portfolio by "developing sophisticated new methods for measuring emissions associated with the investment portfolio and then for systematically reducing them across the full breadth of the portfolio" (as President Bacow stated in 2020), a much bigger staff would be needed.

A small and static head count is one way to measure the seriousness of Harvard's commitment. Further, it is not entirely clear how much latitude HMC has to develop strategies for decarbonization, set interim milestones and targets, or boost transparency on holdings and progress. Rather, that power seems to rest entirely with the Harvard Corporation. Combining a complex problem that will require rapid innovation and change to address in the time period available with a mostly autocratic control system is unlikely to lead to success. However much the Harvard University Board of Overseers may have members interested in divestment and decarbonization (especially members voted onto the Board under the banner of "Harvard Forward"), the Overseers are not the fiduciaries of the University. The Corporation is, and the Corporation has sole control over HMC.

It needs also to be kept in mind that the Harvard Corporation, not the Overseers, and not the Harvard Management Company itself, makes decisions concerning the release of information and what is presented both to the University community and to the general public. This applies as well to the timing and contents of the *Climate Report* HMC released in February. Absent a clearer and broader mandate on reporting, disclosure, and acceptable targets, it is unlikely that HMC's small staff will be successful in moving the endowment to net-zero at the speed and scale required.

Further, HMC states that it desires not just a mode of reporting that makes net-zero decarbonization look attainable over time, but investments that actually reduce GHG emissions. However, verifying progress in that direction requires far greater accuracy *and* far more transparency in reporting; and for both to be ramped up immediately.

5) The Climate Report: too much qualitative symbolism, not enough targets and timelines

I view this *Climate Report* as primarily a marketing and parameter setting exercise by HMC, rather than the first of what should have been a more quantitative factual presentation of climate exposure within the portfolio. Maybe this is to be expected given the early stages of activities, though I feel like much of this ground was already covered in HMC's similarly short

Sustainable Investment Update from November 2019. Aspects leading me to this conclusion include:

a) It is very short. The "Report" weighs in at a mere four pages, plus appendices largely derivative of earlier announcements and the *2019 Sustainable Investment Update*.

b) It includes some key phrasing that establishes a fairly narrow domain for early actions. For example, when describing progress in decarbonizing the portfolio, they note that "HMC has no direct exposure to companies that explore for or develop further reserves of fossil fuels." They adopt this framing even while acknowledging on page 2 that this narrow definition is not aligned with what President Bacow committed the university to doing ("choosing a path of decarbonizing 'the investment portfolio as a whole, rather than simply targeting the suppliers and producers of fossil fuels'").

So, what does this narrow definition leave as an *allowable investment*, untouched and unreported? Apparently:

- These exact types of firms, if held in commingled portfolios such as mutual funds, ETFs, or more diversified private equity, venture, or hedge funds (i.e., investments not "held through dedicated externally managed funds").
- Other portions of the fuel cycle, such as pipelines, storage, refineries, compression stations, export terminals, or LNG or oil tankers.
- Fossil-intensive industries, including not just energy-intensive industries like cement, but also natural-gas and coal-fired power plants.
- And it even seems to leave in firms that are working their *existing* reserves of fossil fuels, so long as they are not developing *new* ones.

There may well be improvements in the portfolio even within this narrow definition -- for example, the decline in "companies that explore for or develop further reserves" from 11% to 2% of the portfolio is real even if Harvard's chosen framing is leaving out a bunch of other fossil-relevant holdings from both the starting and ending points. It is notable, however, that during the period of time when those holdings went from 11% to 2% of HMC's portfolio, the overall proportional market value of fossil fuel companies also declined significantly. Thus, one cannot assume that Harvard sold (net) 80% of its holdings. Further, the reduction may reverse to some degree simply as a function of rising oil prices and associated stock valuations of firms in that sector.

But the language choice to carefully craft and spin progress as broader than it really is undermines the cooperation and good faith that one would assume Harvard would desire to establish on their first formal *Climate Report*. Further, there is nothing preventing future backsliding on the share of high-carbon assets owned as long as by 2050 they are gone.

c) **The *Climate Report* makes no formal commitments to interim milestones and reporting; nor do its authors commit to establish such milestones.** All hard tasks need interim deadlines if they are to continue to move forward and allow for mid-course corrections.

d) **It posits accurate measurement of carbon emissions as the critical path item that HMC must address in order to achieve its zero carbon goals.** The *Report* argues that this will be achieved in part through HMC's relationships with third-party vendors, while at the same time noting in multiple places how hard this data will be to obtain in a timely, comprehensive, and comparable way. Further, all of these efforts will be done in partnerships with external organizations and HMC's internal team -- but they will all be done "behind the curtain" rather than in a transparent way that any person or group outside HMC can monitor, benchmark, and critique.

Yes, accurate carbon measurement is, and will continue to be, hard; and working in coordination with others will leverage the effort. Yet, we need to push back hard on the idea that this challenge is somehow a limiting factor on the timing or scope of progress. Climate intensity metrics and data should not be the sole purview of HMC, and there is much that can be deduced from the type of enterprise being funded even without being able to perfectly measure net emissions.

The need for disclosure of company-level holdings across the portfolio remains, and there is nothing in this Report indicating movement by HMC or Harvard on the issue to make that disclosure a reality.

6) HMC highlighted constraints to investment modifications in areas that don't seem particularly constrained

A few statements in the *Climate Report* didn't make much sense to me. For example, HMC argues on page 3 that Harvard's shift from internal to external managers increases HMC's challenge to measure carbon risk because the data is no longer developed by its own staff. But Harvard apparently wasn't tracking carbon impacts even for in-house managers, so any change in ease of reporting is purely theoretical.

Further, the use of external teams gives HMC the ability to select and fire managers more easily; and to establish criteria (perhaps in conjunction with other institutional investors) to control carbon risks even in diversified private equity portfolios. This should make it easier to assess what is going on over the mid-term, but only if HMC actually uses its leverage in manager selection and replacement.

They argue (page 2) that "with our increased utilization of external managers, HMC believes that the most significant way to interact with publicly listed companies is through collaborative engagements where HMC can join with other like-minded asset managers and asset owners." What exactly are they talking about? Mutual funds and ETFs? In this case, they should work with asset managers and other pension funds to develop, or select from current offerings, the best low cost, high liquidity screened funds and ETFs. That will be fast, effective, and open important opportunities for a huge range of other investors as well.

There is limited evidence that engagement works at a scale large enough or a timeline fast enough to matter. Indeed, the four examples they point to in Appendix 1 from the Climate Action 100+ are ridiculously small improvements for an initiative that controls "more than $52 trillion in assets under management" -- yes, that's "trillion." And in no reports I've seen from HMC do we see a list of *failed* engagement efforts – a pretty important metric in gauging whether the engagement approach should be relied upon or not to accelerate challenging, broad-based economic transformations. Nor do we see, even for the changes presented as successes, how much lower the agreed upon target was to what the Climate Action 100+ originally asked for. Those details also matter.

Further, from a global carbon perspective it is important to remember that it really doesn't matter whether ExxonMobil mutes its carbon footprint via new renewables investments; spins off low-carbon investments into separate companies with shares distributed to existing shareholders; or does nothing at all and regulatory constraints force it out of business in 10 years while low carbon energy services are provided by unrelated new firms. All three approaches could result in the same carbon trajectory. Where engagement is probably most useful is on the political side: if the large incumbent firms feel they will be part of the low-carbon future, maybe they will tamp down on spending to slow or block needed regulatory constraints on carbon. Indeed, ensuring key firms do not derail rational controls on emissions should be a central objective of HMC's external partnerships with shareholder groups.

If HMC is referring to hedge funds as an area of blindness to what the external managers do, engagement is irrelevant if they don't even know what firms, credits, assets, or other financial instruments were held by external hedge fund managers and for how long. Under any scenario, HMC will need to establish more transparency on what hedge fund flows and bets look like. That oversight matters not just in relation to climate, but to all sorts of problem areas of the marketplace.

7) HMC confirms it has line-level detail on all of its holdings

One notable detail on page 3 of the *Climate Report* is HMC's acknowledgement that they have details on all of the companies held within its externally managed funds. What they are lacking is reliable data on their carbon impacts ["While external managers of private assets (private equity, private real estate, etc.) provide basic portfolio holdings information, most currently do not provide data relating to the carbon footprint of their portfolio companies..."] This is a useful statement and can form a basis for establishing adequate reporting and transparency of those holdings, even with a year or two lag.

When I've asked about disclosing company-level detail on all of Harvard's investments, I've frequently been told that publishing such details on private equity or hedge fund holdings would undermine Harvard's investment strategy or competitive advantage. However, this information is *already* available in subscription databases such as those developed by PitchBook or Preqin. And while the Harvard faculty or undergrads pushing for divestment don't have the cash to buy this data, any serious investment firm seeking to study, or copy, HMC's investment strategy obviously does. To the extent these firms pull partnership data off of HMC's 990 PF tax return and then backfill partnership holdings from other sources, the data is already lagged by the time the returns are published – addressing most of the competitive risks.

Indeed, Preqin and PitchBook could likely introduce a new line of business doing climate benchmarking of the non-public equity asset classes held within key institutional portfolios. It would be a very useful addition.

8) Performance metrics calculated in the far future and at the portfolio level will drive neither critical insights nor needed change

HMC's long-term goals on portfolio exposure to carbon emissions are milquetoast -- have a look at the bottom of page 5. The metrics themselves aren't bad, but how they are being applied is problematic: all are aggregate measures at the portfolio level. This will provide some indicative trend lines, and at some point allow Harvard to say they are net zero across their entire portfolio based on whatever measurement criteria they have adopted.

However, there is a material risk that the carbon impacts of highly polluting sectors will be averaged against a massive amount of unrelated economic sectors, masking important patterns. HMC has stated that they are dedicated to an overall reduction in ghg emissions across the portfolio, but the lack of external transparency is likely to slow that process significantly. This is especially the case given HMC's own recognition that measuring the carbon footprint of particular industries and asset classes will continue to evolve for quite some time, resulting in portfolio-wide averaging that will blend emissions estimates of widely varying precision.

If HMC were to present these exact same measures also at the company level (or at the fund level if there are confidentiality constraints on some types of investments), and with interim targets, then we'd be moving forward.

The outlier companies in both directions are really important. For the most carbon-intensive firms, they signal where to accelerate divestment or intense engagement; and for the least-carbon intensive firms, the outliers can signal places to increase investment sharply. Company-level metrics also provide a resolution that external parties (such as us) can reality check. The proposed aggregate metrics are the result of a massive black box that no outsider can easily critique.

Key Changes Needed

- **Convert the *Climate Report* from an *ad hoc* policy summary to a rigorous presentation of progress and challenges.** HMC should formalize that the *Climate Report* will be an annual publication, with a specific release date. Additional changes:
    - Like a financial report, the annual Climate Report should include a standardized set of sections, including both qualitative and quantitative. This will ensure consistent and comparable reporting over time.
    - Report authors and reviewers should be listed individually all future documents. Any advance approval by parties outside of HMC and its climate team for data included in the report needs to be disclosed.
    - For each third-party organization to which HMC or Harvard has joined to leverage its decarbonization effort, the Report needs to include the data reported to that organization, which data elements are not made public, specifics on why that data has retained confidentiality restrictions, and options to address those constraints going forward.
    - The Report needs to include a section on the available financial and personnel resourced to achieve the net zero targets, an evaluation of its adequacy, and a plan to rectify shortfalls if they exist.
- **Robust interim targets.** Harvard needs to set formal interim targets and reporting milestones during CY2021 that map out its path to net zero by 2050. Milestones need to include not only emissions, but disclosure transparency on holdings and company-engagements as well.
- **Full transparency on holdings.** Company-level (not fund-level) disclosure of endowment positions across all asset classes should be implemented as soon as possible. During 2021, HMC should provide a listing of each asset class, what information is already available to others – whether released in financial filings or assembled by third-party data providers like PitchBook and Preqin, and outline a path to present investment-level holdings for all asset classes to the public via the HMC website. While there may be appropriate guardrails on when something is released or in what form, HMC needs to present a plan to go from no-release to full look-through transparency.
- **Modernize shareholder committees.** Harvard needs to update its oversight shareholder committee structure to reflect the current investment environment, and to summarize its recommendations in a publicly released white paper.