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To: Jagdeep Singh Bachher, Chief Investment Officer
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Subject: Annual UC Investment Office Sustainability Report, Fiscal Year 2015-2016 Achievements

Summary:

The UC Board of Regents approved the Framework for Sustainable Investing in September 2015. This gave the Office of the Chief Investment Officer (OCIO) the authority, and structure, to consider important additional qualitative and quantitative criteria related to sustainability in its investment evaluation and risk assessment processes. Implementation of our sustainability framework has also aligned with unique opportunities in global investing by positioning the UC endowment and pension fund as a leading institution on sustainable investment issues. The OCIO's global ranking on sustainability rose by eight spots in 2015 to be ranked 17th among all worldwide investments funds and ranked number one among university investment funds addressing climate change concerns.

The OCIO was the first U.S. based investment asset owner to sign the Japan Stewardship Code, creating unique opportunities for the UC investment office to connect with top investors in Japan. UC's visibility in energy and sustainability has helped bring to the investment office a wide array of new energy investment opportunities and partnerships that will position our portfolio for future growth, including facilitating outstanding partnerships and collaborations in clean energy such as the establishment of a non-profit Aligned Intermediary and dialogue with the Breakthrough Energy Coalition.

Our sustainability efforts first and foremost take into consideration that the OCIO is an integral part of the University of California community. The Board of Regents sets the governance structure and policies and procedures of the OCIO. The OCIO's responsibilities include ensuring that these policy and procedures are carefully and thoughtfully implemented with appropriate disclosure and transparency. **This report provides highlights on how the OCIO approaches sustainability, the governance structure of the sustainability practices at the OCIO and what has been accomplished this year in the sustainability area.**

Over the past two years, a priority of the OCIO's sustainability efforts has been to **meet with stakeholders** – students, faculty, staff, campus endowments, alumni and the public – so they could share their views on how best to manage UC investments in a manner consistent with our common goal of bettering the world while also improving financial returns. The investment office has made it a priority to be responsive to and carefully listen to stakeholders' concerns and explain the UC Regents governance structure for investments as well as the OCIO's policies and procedures. As part of my responsibilities as the senior advisor on energy and sustainability, I have facilitated this dialogue.

Where appropriate, the investment office has actively engaged with external managers to convey sustainability concerns and to keep an active dialogue with managers on alignment of policies and procedures. As part of ongoing

efforts to engage UC stakeholders on important sustainability related activities, the UC investment office has been an **energetic participant in the UC Climate Leadership Council** and hosted a reception honoring student leaders at the Carbon Neutrality Summit on October 27-28, 2015 on the UC San Diego campus. The UC investment office participated in a productive dialogue with the Black Afrikan Coalition on issues of joint concern and supported efforts to engage Wells Fargo Bank regarding its responsible banking policies and practices surrounding private prison finance. Throughout the 2015-2016 campus calendar year, OCIO leaders have also toured UC campuses to learn more about how the investment office might play a role in fashioning new solutions to student housing needs.

The investment office continues to integrate environmental sustainability, social responsibility and governance (ESG) holistically into our investment processes. **In September 2015, we began implementing a new Sustainable Investing Framework**, which was crafted to guide our philosophy for long-term investing as well as to provide a roadmap for enhancing risk evaluation. The OCIO Sustainable Investing Framework was presented to the UC Regents' Committee on Investments, to the full UC Board of Regents and to various stakeholder groups including various campus endowments, the UC faculty welfare committee and student leadership groups. The details of the framework have also been posted on the OCIO website.

The UC Board of Regents has the sole responsibility to consider and dictate divestment from any corporate security, class of assets or direct holdings in businesses for reasons related to sustainability. The UC Regents have two such exclusions in place today, one on publicly traded securities of businesses with significant interests in Sudan and a similar ban on publicly traded securities of tobacco related businesses. **To ensure compliance with these exclusions, the OCIO has created an automated monthly reporting system to make sure compliance is properly implemented.** This reporting system also covers securities selected for screening by our internal leadership committee based on long-term structural financial risks related to ESG factors.

Under proxy voting policies and procedures approved by the UC Board of Regents, the University of California votes "according to proxy voting guidelines developed by our third party advisor." The Regents have approved Institutional Shareholder Services (ISS) to manage the proxy voting process for the OCIO on the basis of socially responsible investment guidelines. As part of a full review of our policies and procedures, I have, along with our internal compliance team, **reviewed the 2016 ISS proxy voting guidelines and find them generally in alignment with the Office of the Chief Investment Officer Framework for Sustainable Investing.**

The UC Board of Regents approval of the OCIO Framework for Sustainable Investing allows the OCIO investment in-house professionals to consider important additional qualitative and quantitative criteria in their investment evaluation processes. This approach provides a structured way to think about the complex issues facing the OCIO investment team as it undertakes its duty as fiduciaries. It has also created alignment with **unique opportunities in global investing by positioning the UC pension fund and endowment as a leading institution on sustainability issues. The OCIO was the first U.S. based investment asset owner to sign the Japan Stewardship Code and to be present at the groundbreaking public launching of the code, creating unique opportunities for the UC investment office to engage with top investors in Japan.**

At the urging of our UC community, the UC investment office has paid particularly careful attention to the risks associated with investing in fossil fuels, reassessing energy holdings in our portfolio to consider changes in overall economic conditions, shifting commodity markets, climate change risk and other emerging ESG risk factors. In addition to its general ESG risk assessment processes, **the UC investment office has instituted a targeted climate change risk assessment modeling framework for use by private equity, real estate and alternatives investment opportunity assessments.** In my role as senior advisor for energy and sustainability, I have facilitated connections to the investment office professional staff and leadership with the latest academic research and commercial market analysis to inform the

process. While it takes time to implement a rebalancing in energy investments, I have assisted our leadership team in augmenting internal evaluation tools and procedures. The goal of this exercise is to assist in positioning the portfolio to be more consistent with the energy transition expected in the coming decades while still accessing today's opportunities to bring the most robust returns. In doing so, OCIO leadership have been able to **identify outstanding partnerships and collaborations in clean energy, including the establishment of a non-profit Aligned Intermediary** that will accelerate and increase the flow of private, for profit capital from long-term Investors into climate infrastructure transactions, such as clean energy, water infrastructure and waste-to-value.

The OCIO was the first and largest founder of the Aligned Intermediary and, as such, has been given the founding-chairman role within this standalone Benefit Corporation that includes six peer long-term investors, including UC Regents. **OCIO is also continuing to dialogue with the Breakthrough Energy Coalition**, a group of likeminded investors, led by Bill Gates, and focused on clean energy sustainability innovation.

Through these energy and climate change related activities, the UC investment office is able to support the University of California's leadership role in climate change innovation. **The visibility of the UC Office of the Chief Investment Officer in energy and sustainability has helped bring to the UC investment office a wide array of new energy investment opportunities and partnerships that will position our portfolio for future growth.**

As senior advisor of energy and sustainability, I also facilitate the UC Investment office's **active participation in major investor coalitions and non-governmental organizations that promote responsible investing and help magnify our collective voice and impact in the pursuit of sustainability.** We participate in a number of collaborative initiatives including the UN Principles for Responsible Investment (UNPRI), the Ceres' Investor Network on Climate Risk, the Intentional Endowments Network, CDP and the World Economic Forum (Davos). I represented the University of California as chair of the Global Agenda Council on the Future of Oil and Gas at Davos and was able to take a leading role in the World Economic Forum efforts to promote 2 degrees strategies by the world's largest fossil fuel companies. The OCIO leadership team has also taken a leading role with the UN PRI in publishing major reports on global investor statements on climate change risk, green bonds, and disclosure rules.

These many activities received international recognition, with **the UC Regents Office of the Chief Investment Officer global ranking on sustainability rising by eight spots in 2015 to be ranked 17th among all worldwide investments funds, according to an annual survey by The Asset Owners Disclosure Project (AODP)**, a non-profit organization that determines its "Global Climate 500 Index" by assessing how funds infuse climate change best practices into their investment strategies, using measures such as transparency and low-carbon investment. **The University of California ranked number one among university investment funds addressing climate change concerns, according to the AODP 2015 survey.**

Other notable sustainability achievements include the OCIO's role as a **signatory to the Paris pledge** to support the objectives of the Paris agreement to limit global temperature rise to less than 2 degrees Celsius as well as the **completion of a carbon foot-printing analysis of the UC public equities portfolio for 2015** as part of the UC investment office's commitment to the UN Montreal Pledge. The Montreal Carbon Pledge initiative asks signatories to annually measure and disclose the carbon footprint of their investment portfolios as a step toward better understanding and managing climate change-related risks and opportunities. The signatories of the Montreal Carbon Pledge hope that widespread measurement and disclosure of portfolio carbon footprints among investors will ultimately lead more publicly listed companies to disclose their emissions and carbon risk.