THE CHRONICLE INTERVIEW | **DONALD P. GOULD**

Chair of Trustees Investment Committee, Pitzer College

'In Favor of Divestment'

Pitzer College is not big, or old, or rich. But students and trustees alike want the liberal-arts college's modest endowment — $135 million — to be invested in ways that align with its long-time interests in the environment and social responsibility.

So the 54-year-old college took an unusual step that could be pivotal for other colleges and nonprofits with similar values: It pioneered a new global-equity-index fund that avoids stocks in fossil-fuel companies and chooses other investments based on how companies act toward employees, communities, the environment, and shareholders. Using sophisticated financial-engineering tools to choose stocks, the fund's managers expect it will perform as well as those that don't pay such attention to environmental and human impacts.

Donald P. Gould, vice chair of the college's Board of Trustees and chair of the investment committee, is the force behind the new fund, which he devised with help from Pitzer's investment consultant, Mercer. The investment giant BlackRock liked the idea enough to adopt it, and Pitzer became the founding investor, with a $57-million stake. Mr. Gould, who is also president and chief investment officer at Gould Asset Management, explains what led the college to create the new fund and how it works.

—LAWRENCE BIEMILLER

In 2014 students began pressing Pitzer and the other Claremont Colleges to divest from fossil-fuel companies. What was your first reaction?

I went to college in the post-Vietnam era. I graduated from Pomona College in '79, and I was not what, by today's standards, one would call an activist. Almost no one else was either. So my involvement in this is kind of unlikely, because basically I've spent my career looking at these questions the way most investment professionals do, which is with skepticism of any proposal that would reduce our latitude investing endowment assets.

But I had followed the climate-change story. I was, and remain, increasingly concerned about where it's going. And I had two kids in college — one who'd just graduated from Oberlin, and one who was still at Occidental. Both of them were much more activist than I had been. They were a sounding board.

How did the initial push at Pitzer lead to a new fund?

The conversation started in 2013, when our board formed a working group that included trustees, students, faculty, and staff. After about six months of meetings and discussions, the working group came back to the board with several recommendations, one of which was fossil-fuel divestment. There was a 25-percent reduction in the college's carbon footprint by the end of 2016, which was achieved, a campus sustainability task force, which still exists, and a subfund within the endowment for sustainability investments. We have made some small but meaningful strides there.

The college also committed to integrate so-called ESG — environmental, social, and governance factors — into investment decision making. But when we made that commitment, in 2014, we didn't know how we were going to implement it. It was, you might say, aspirational.

We initially targeted the low-hanging fruit. We went from about 94-percent fossil-fuel divested to 99-percent. We felt it really wasn't prudent to sell 100 percent of a fund to get rid of maybe a 0.3-percent allocation to fossil fuels. It's like throwing the baby out with the bathwater. We took a bit of a breather in 2015, then got back to work trying to figure out how to get rid of the rest of our fossil-fuel exposure and integrate the ESG. We sat down with Mercer with a blank sheet of paper. I sketched out, Here's what we are looking for. How do we accomplish this?

Mercer shopped the idea to different investment-management firms. BlackRock was the one that came back and said, We're excited about this. We think we can implement it, and we think there's going to be a lot of demand for it.

Is it unusual for a small college to create a custom index fund?

If you follow the whole fossil-fuel debate, the oldest, biggest, richest, most established institutions in the country have not divested. I think eventually they will. But they're never going to be the first. There are just too many institutional constraints to doing something that is so potentially provocative, at least among certain constituencies.

It takes a culture within the institution to be innovative. Pitzer's always been a bit out in left field relative to its peer group. And that's what makes it a great place. It's not for everybody, but it attracts a student body that's also very focused on a future that's different from the present. Different and better.

In layman's terms, how does the fund work?

We took the global-equity universe, all the stocks in a global-equity benchmark called the MSCI ACWI. That includes the whole gamut of U.S. publicly traded stocks, as well as foreign markets — both developed markets, like Europe and Japan, and emerging markets. We said, Now let's identify all the fossil-fuel companies, and remove those. What we have left is the benchmark, ex fossil fuels.

> **"The oldest, biggest, richest, most established institutions in the country have not divested."**

Every stock in the whole MSCI index is scored on environmental, social, and governance factors. As an investment-research company, MSCI has something like 50 different quantifiable parameters that it looks at to assign a score for E, S, and G. Does a given company have good environmental policies? Is it a good citizen in the communities where it operates? Are its labor policies friendly to the workers? How are shareholder resolutions treated? The scoring is calibrated such that the median company is a 5 on a 1-to-10 scale. We wanted to have a portfolio with an average higher than 5.

In one sense, it's not that hard to raise your ESG score. You just put your money in companies with the highest scores. But you can't do only that, because you would be violating a whole lot of other rules of prudence in terms of how you're managing the portfolio. It might have too much concentration in certain companies, or certain industries, or certain countries.

So the fund manager does something called optimization. That's a quantitative process by which you seek a particular objective, subject to constraints that you impose. The minute you try to change a characteristic in the portfolio, like the average ESG score, you introduce what's called tracking error, the degree to which your returns are going to vary from the benchmark's. In general, people want performance that's predictable relative to the benchmark, unless they're getting something for accepting less predictability.

We said, We want to tilt an ex-fossil-fuels portfolio such that we increase our ESG score as much as we can, with a tracking error of no more than 60 basis points, or 0.60 percent. That means if you had an expected return of 7 percent, there's about a two-thirds probability that the actual performance will come in between 6.4 and 7.6 percent. That was our tolerance for tracking error. With financial-engineering tools, you can run an optimization that gives you the portfolio that has the highest ESG score while not violating that constraint.

In essence, BlackRock had MSCI create a new benchmark, MSCI ACWI Ex Fossil Fuels Custom ESG Focus. We back-tested it to see how it would have performed historically, analyzed it seven ways till Sunday, and ultimately concluded, This is the way we want to go.

So how will that affect the endowment's performance?

We concluded that not having the fossil fuels would have a negligible impact. There are periods when fossil-fuel stocks outperform the averages, and there are periods when they do worse, but over time it made almost no difference. Now, there's a school of thought that you're going to do better in the future not owning fossil-fuel stocks, because climate change is going to more or less necessitate that society move away from fossil fuels. I'm not saying whether that's going to come to pass. But it's an argument a lot of people make in favor of divestment.

With ESG, again there's research that stocks of companies that pay more attention to those factors do better over time. It's probably too early to say conclusively whether that is or will be the case. But there's a real possibility that it could actually enhance performance over time. ■

This interview has been edited for length and clarity.

JENNA SCHOENEFELD FOR THE CHRONICLE