Report of the ESG Review Group

Executive Summary

- This report and its recommendations are the culmination of a long process of investigation, consultation, and deliberation. It is the product of many inputs: written submissions from students and staff; discussion from community events; the work of the Consultative Group; top scholarly research; the approaches of peer institutions, and the expertise of legal and investment professionals.

- The LSE community has a wide range of values that we respect, acknowledge, and incorporate into our recommendations. We viewed our task as trying to balance these values – some of which are in inevitable conflict – with the primary purpose of our investments, which is to enable LSE's fundamental charitable mission.

- We are in a time of uncertainty and evolution concerning the law relating to endowment governance, the investment environment; and the norms of the investment industry and higher education sector. These circumstances demand recommendations born of openness, flexibility, and caution.

- We therefore recommend a set of carefully considered and evolutionary changes to our Environmental Social and Governance (ESG) Policy to make our investment portfolio more accessible; transparent; reflective of LSE's values; and to ensure that a dynamic process is enshrined in regular reviews. In particular, we recommend the establishment of an Annual General Meeting for LSE's endowment and a review of our extant investment filters relating to fossil fuels, tobacco, armaments, and management, with a view towards further reducing our exposure to these higher-risk investments within our ESG strategy, as appropriate. We also recommend updating the list of companies banned under sanctions to incorporate the additions announced by HMG earlier this year.

- We also recommend an active strategy of engagement with other universities, as well as the Universities Superannuation Scheme and Superannuation Arrangements of the University of London to coordinate thought and action across the higher education sector on a larger scale than LSE could effect alone.

Contents

Mandate and Process

The Environmental, Social, and Governance (ESG) Policy Review was launched in October 2024, with the inauguration of a Review Group, composed of independent members of the LSE community with broad collective expertise on the subject. This Group was tasked with reviewing the School's ESG Policy and proposing potential revisions for Council to consider, after review by the Investment Sub-Committee and Finance and Estates Committee. That policy was last reviewed in 2022.

Separately, a Consultative Group composed of LSE students, faculty members, and staff was formed. This group was constituted to provide the community's input to the Review Group and advise them in their work.

Both groups' terms of reference were clear that matters decided at the June 2024 Council meeting and reported in Council's memorandum of 9 July 2024 would not be revisited.

The members of the Consultative Group were drawn randomly from a pool of self-nominations, after the anonymised nominations were treated with an algorithm, developed by LSE's Department of Statistics, to ensure that the group would be appropriately diverse across a range of variables (gender, race, Department / Division, career stage, etc.). The members – three faculty / research staff, three professional services staff, and three students – met for the first time in October 2024. Shortly thereafter, they undertook three hour-long seminars on the basics of investment management and endowment governance, led by Review Group member Caroline Butler. Subsequently, outside of prescribed meetings with the Review Group, the Consultative Group organised itself and its work product.

We must note that the precise remit for the Consultative Group was an issue of some debate, raised at various times by Review Group members, Consultative Group members, and other members of the LSE community. While the terms of reference of the Consultative Group stated that the Group should "seek input from relevant stakeholders and other appropriate sources in the course of their work, and that its members were not "advocates for a previously determined position or for any particular group or constituency," many felt that these boundaries left a lot of room for interpretation as to the duties and purpose of the Group, and particularly whether they were to devise their own proposals for the Review Group or whether they were to merely serve as spokespeople for the community. In practice, they did some of both – and admirably – but we would urge greater clarity on the role of any future Consultative Groups on School policy.

The full Review Group met ten times over the course of the Review, a tally that does not include many ad hoc meetings between members to discuss Review business. The full Review Group met with the full Consultative Group on three occasions, and members of each group met with each other on two others. The two groups also exchanged regular written communications of substance.

The Review included an extensive process of consultation with the LSE community. The main method of consultation was through five lunch-time events, each focussing on a different aspect of the ESG Policy:

- 29 January, Introduction to LSE's ESG Policy
- 25 February, Social and Governance Issues in LSE's ESG Policy – workshop and discussion
- 24 March, Net Zero Issues in LSE's ESG Policy – workshop and discussion
- 31 March, Armaments Issues in LSE's ESG Policy - workshop and discussion
- 6 May, Why Does LSE's Approach Matter – ESG Policy Roundtable

The first event was designed to ground the consultative process in a shared factual basis, with Review Group members Caroline Butler and Mike Ferguson giving attendees a condensed version of the brief education on investment management and endowment governance given to members of the Consultative Group.

The second, third, and fourth events all shared a similar format. Attendees were seated at small tables to participate in facilitated conversations on topics related to the ESG Policy.

The fifth event was meant to focus partially on the views of stakeholders beyond campus, as well as offer the Consultative Group the opportunity to summarise their activities for the community, but the programme gave way to a student protest concerning the ongoing conflict in the Middle East, following which most attendees left the room.

All events were attended by members of the Review Group, who listened to contributions but did not direct the sessions, as was the practice of the Consultative Group. The latter wrote individual reports for each event, summarising discussion. Beyond the two groups, attendance for the events ranged from approximately ten to 25 participants, mostly students, but also some faculty members, professional services staff, and staff from the LSE Students' Union.

Additionally, LSE's internal communications team provided an open channel for community members to submit written material as their contribution to the consultative process. This opportunity was publicised in staff and student news, as well as at the community events. Over approximately five months, 35 relevant submissions were made on behalf of about 40 individuals from the LSE community. Once again, the Consultative Group wrote a summary of the submissions, and the full raw text of submissions was provided to the Review Group.

Finally, there was considerable communication between the Review Group and students and student leadership. Executive Officer staffer Daniel Halem, who served as adjutant to the Review Group and its primary liaison to the LSE community, met regularly with LSESU leadership to discuss the Review's progress and how the community might contribute. He also appeared at a student town hall early in December 2024 to introduce the Review and take questions from attendees.

Before we continue, a brief word on working with the Consultative Group is in order. We have previously acknowledged the uncertainties that some parties felt concerning the Consultative Group's mandate. To a degree, some uncertainties were unavoidable, given that the formation of a Consultative Group was an innovation at LSE; in particular, the Consultative Group spent time and energy developing their own proposals earlier in the process than some Review Group members expected. As conscientious, good-faith interlocutors who engaged creatively and constructively in the Review, the Consultative Group was an invaluable addition to the process. Although some of their input reflected their own proposals and they will have their own opinions on our final recommendations, it is our sincere hope that they share this positive view of their impact and of the working relationship between the two groups.

Community Values

Over the course of the Review process, one thing became very clear: the LSE community has a wide range of strongly held values; and that the participants in the process wanted to make sure that the Review acknowledged those values and explicitly translated them into the Policy. While it is impossible to capture the range, depth, and nuance of the values presented during the consultative process, it is important that we briefly summarise what we learned about the preferences and priorities held by many in our community.

- Sustainability and Environment: participants were strongly concerned about LSE's impact on all aspects of sustainability: climate change, biodiversity, supply chains and others. In particular, some participants clearly expressed a desire for LSE to eliminate its investment exposure to fossil fuel firms.

- Human Rights: participants were strongly concerned about abuses of human rights by firms, as well as sanctions on other firms, states, or non-state actors accused of abuses of human rights. We heard many participants clearly express a desire for LSE to eliminate its investment exposure to both firms accused of such breaches as well as those operating in jurisdictions where the state or other actors are accused of such breaches

    - It must be noted that a large share of the consultation regarding the subject of human rights was situated within the context of the ongoing conflict in the Middle East and expressly motivated by concern for the treatment of Palestinians – a subject that Council explicitly placed beyond the purview of the Review. Many participants expressed the view that the ESG Review was only happening at this time due to community activism on the wider Palestinian issue (a point with which we agree), and that it was bizarre and unsatisfactory that the Review could not consider the issue.

- Armaments: most participants were strongly concerned about the worldwide proliferation of weapons. We heard many participants express a clear desire for LSE to eliminate its investment exposure to firms that make weapons, or finance or facilitate firms that make weapons or weapon-adjacent technology. Most made no real distinctions between small arms, military weapons, indiscriminate/controversial weapons (including weapons of mass destruction), and dual-use technologies that might have military application. Some participants, however, shared views that most moral questions concerning weapons lie at the point of use rather than the point of development and manufacture, and a number of comments noted that weapons are necessary and justified for defence against rogue nations and for the protection of citizens.

- Governance and Social issues: participants were concerned about many issues under the "S" and "G" umbrella: labour practices; diversity and inclusion; corporate management; transparency, and others.

- Institutional statement: participants were concerned about LSE's principle of not making public statements on political disputes not directly affecting its own operations, though in different ways. Some expressed the view that the principle was highly relevant to the ESG Policy, and that it must inform the eventual recommendations. However, others took the position that the principle was either misguided or that it had no bearing on the Review, since none of the issues under discussion dealt with political conflict.

These insights from the consultative process are extremely valuable, but they come with an important caveat: as noted above, participation in the ESG Review process by our community was relatively low. LSE educates more than 11,000 students and employs more than 3,300 full-time equivalent staff, but despite substantial publicity by LSE's internal communications division (e.g. notices in staff and student news emails; direct School-wide emails; posting on digital billboards), attendance at the five community events was generally in the teens, and never more than 25 people. Approximately 40 members of the community submitted written feedback over the course of approximately five months. With substantial overlap between the various participants' attendance and written submissions, fewer than 100 individual members of the LSE community contributed in any way to the consultative process.

While our findings must account for the passion, knowledge, and interest of those participants, we must also recognise that they only represent a small share of a much larger, much more diverse community, and our recommendations must reflect our community as a whole.

We must also note that the LSE community encompasses many stakeholders beyond those on campus in 2025. LSE has more than 200,000 alumni living all around the world; a large and diverse group of staff and investors – in a variety of ways – in the School. LSE will admit new classes of students and hire new staff every year, all of whom have a stake in the direction of the School. And the endowment itself is entirely a gift of financial benefactors, who have an important interest in how the School manages the fruits of their generosity. When considering any aspect of our investment policies, we must be mindful of the views of our current and potential donors, supporters, and partners across the globe, individual and institutional alike.

Finally, we are grateful for every contribution given during the consultative process and wish to express our deep appreciation for every input shared. Nevertheless, many of the exchanges lacked a shared basis in factual apprehension. This is completely understandable – investment management is a complex and technical subject, and mastery of that subject is in no way a prerequisite for holding and sharing valuable opinions on the Policy and Review. We have done our very best to account for the "spirit" of the community's contributions in our deliberations, whilst always bearing in mind the practical aspects of investment management. The latter contends with issues such as the need to achieve set risk and return parameters, the loss of opportunity arising from constraints on the investment universe, the practical needs of portfolio construction across the asset classes, the benefits of fund selection, financial economics, the norms and methods of the investment industry, and the trade-offs inherent in any investment portfolio, among others.

LSE is indeed "a community of like minds and different opinions," and there are deep disagreements about some of the values above and/or their applications. However, there is no question that some of these values are virtually universally held across our community, and some are ensconced in foundational documents like LSE's Articles of Association and Ethics Code which applies to individuals' conduct within the School. For example, LSE strives to conduct its own operations transparently, sustainably, inclusively, and with respect for its workforce and other stakeholders. Additionally, LSE's *raison d'être* as an institution of higher learning demands a high degree of political neutrality, preservation of academic freedom and the free exchange of ideas.

These values are crucial to LSE as an institution, and it would be folly to pretend they do not exist or should not inform our institutional policies. LSE is not separate from the society around it, free from context or value judgements, and we openly acknowledge that values are central to all of LSE's policies, including its ESG Policy.

We also acknowledge that, as the Consultative Group's work has shown, the law does permit fiduciaries some scope for incorporating non-financial considerations into their investment decisions, where those considerations – even if they conflict with financial ones – especially relate to the primary purpose of the charitable organisation in question.

Trustees may take non-financial factors into account if two conditions are met (*Harries (Bishop of Oxford) v Church Commissioners* [1993] 2 All ER 300 at [16]): first, the trust's beneficiaries must share the relevant concerns (see also *Cowan v Scargill*, [1985] 1 Ch 270, p. 288); second, there must be "no risk of significant financial detriment" (*per* Lord Carnwath, *R (on the application of Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government*, [2020] UKSC 16 paragraph 43). Trustees' duty of care in addition implies that any discretionary exclusion such as divestment or non-investment should be effective and proportionate to the non-financial goals the trustees wish to pursue. This rules out divestment that would have little effect because shares will simply change hands; or where the trustees' goals could be more effectively achieved by engagement, and such engagement has stakeholder support (see Law Commission Report 350, *Fiduciary Duties of Investment Intermediaries*, para 4.50 and 6.47 (2014).

These principles were further evolved and confirmed in *Susan Butler-Sloss & Others v Charity Commission* [2022] EWHC (Ch) and consequent guidance from the Charity Commission on 01 August 2023: trustees considering the financial effect of making or excluding certain investments can take into account the risk of losing support from donor and damage to the reputation of the charity generally or beneficiaries particularly. Where trustees are of the reasonable view that particular investments potentially conflict with the charitable purposes, they have a discretion to exclude such investments. In so doing, they should exercise their discretion by reasonably balancing all relevant factors, including particularly the likelihood and seriousness of the potential conflict and the likelihood and seriousness of any potential effect from the exclusion of such investments.

Therefore, any amendments to the ESG Policy that we propose must both reflect our community's values – bearing in mind that those values are not always clear; often in conflict with each other; and impossible to observe strictly – and also allow our investments to achieve their primary purpose. The ESG Policy does not exist in a vacuum as a pure statement of values; it only exists as a guide and enabler of our overall investment strategy, a strategy with an autonomous primary purpose to fund LSE's overarching mission of education, research, and public engagement. An investment strategy that does not accomplish this goal would be useless.

This is an extremely delicate balance to strike, and we do not pretend that our recommendations are perfect; will satisfy all members of our community; or will stand for all time. What we can say is that our recommendations are, in our judgement, the best possible balance of many competing objectives, under the present circumstances. We urge all members of our community to read this report in that spirit.

Investment Principles

As we have stated, the primary purpose of LSE's endowment is to further our charitable mission and mandate: to provide for the education of students, present and future; and to contribute to research and scholarship in the social sciences. Our investments exist for no other reasons.

One of the clearest lessons from the substantive consultation process is that this principle – and the policies that govern our investments and thus guarantee the principle – could be better understood and better emphasised among our community. Therefore, we take this opportunity to briefly restate the purpose of the endowment, the investment performance expected from the endowment, and the investment regulatory framework within which the endowment operates.

Our Funds

LSE's investments comprise funds from three main sources and used for differing purposes.

- The Endowment funds, which are given by donors, are to be used only to meet our mandated charitable objectives. For example, these endowments provide annual distributions of approximately £7.5 million for scholarships, compared with the £26.5 million in annual fee income devoted to that purpose. They also provide research grants, salaries for academics and staff, and other academic goods.

- Funds holding our loans and financings for dedicated operations, are used in the acquisition of new academic buildings and facilities, as well as the refurbishment of existing premises. Because these are borrowed funds with a dedicated purpose, they are invested extremely conservatively and deployed as space is acquired or works are undertaken.

- Reserves (held in the School Fund) repay loans and financings in due course and provide a financial buffer to deal with major crises that might affect School finances (such as future pandemics).

The Endowment funds are subject to clear legal and fiduciary constraints, and as a charity, the School is expected to optimise return based on agreed risk and return targets, set by Council. As it stands, the target for the Endowment funds is to achieve – over the long term – an average total return of Consumer Price Index (CPI) inflation +4.5% *per annum*. Detailed risk parameters have also been set which allow a majority fund allocation to equities. The purpose of each portfolio, the target net return parameters, and liquidity constraints dictate a set of asset allocations recommended by the School's investment advisers.
Further, the Charity Commission specifies the rules that charity trustees (like Council) must follow in the management of endowment monies: for example, requirements to seek professional advice; avoidance of conflict of interest; alignment with the purposes of the charity, etc. Breaching these rules could result in serious legal and reputational ramifications that could impact the future of the School as a going concern.

Our Current ESG Policy

In addition to the need to optimise investment returns to fulfil the endowment's primary purpose and the legal constraints imposed by fiduciary duties, we have grounded our current ESG Policy in our determination to motivate a change in corporate behaviour through positive investment manager engagement.

In 2015, the School became a signatory to the UN Principles of Responsible Investment (PRI) and set similar criteria for its investment managers. From that time, it began to develop a positive ESG screening approach.

For example, the School seeks to invest in those companies across the oil and gas sector who have been top-rated by LSE's Transition Pathway Initiative (TPI) Centre's company assessments for clearly transitioning towards net zero; and conversely seeks to avoid those that are the lowest-rated.

The School has also sought to work actively on the goal of achieving net zero with other universities and joined the IIGCC (the Institutional Investment Group for Climate Change).

The Policy also specifies that there should be no direct and, as far as possible, no indirect investments in companies engaged in the businesses of: Tobacco; "Controversial Weapons" (specifically landmines and cluster munitions); or the significant exploitation of Thermal Coal or Tar Sands; together referred to as TWTT. (We have also categorised the lowest rated firms on the TPI company assessments in the TWTT group.) This policy is being monitored to ensure that long term performance is not being reduced.

In general, these exclusions are made to reduce risks that could impact financial performance. Tobacco companies are highly exposed to legal and legislative risks that can arise from litigation or bans on smoking. Companies exploiting coal and tar sands – among the most polluting ways to generate energy – are highly exposed to legal and political risks that could arise from litigation or changes in public policy regarding climate change, resulting in stranded assets.

Landmines and cluster munitions are the subject of prohibitions by UK law (adapted from international conventions). Similarly, we exclude investments subject to "Magnitsky"-style sanctions, levied for human rights abuses or corruption.

The School's existing policy is based on positive screening and is dynamic. Our holdings change continually over time reflecting global investment opportunities but also the performance and management practices of our investee companies. For example, should a firm in which we hold an investment fall behind its net zero commitment or fall to a low TPI rating, we would discuss such changes with the investment manager holding the company, and if this behaviour persisted, we would consider selling the fund. Similarly, as UK law changes, our managers react.

The current (2022) TWTT exposure filters are as follows:

- Aggregated portfolios should remain under 3% (reduced from the original 5%).
- Individual funds should remain below 5% (reduced from the original 10%).
- The list of thermal coal and tar sands companies are defined as those with revenues from those sectors below 3% (reduced from the original 10%).

The School sells funds with investments that do not perform; does not purchase investments that contravene UK law; and constantly reviews and adjusts its portfolios to achieve the highest standards of corporate behaviour, climate transition policies and respect for Diversity Equity and Inclusion strategies. It is further evidence that as clear and internationally recognised net zero accounting standards are introduced in coming years, our portfolios will undergo significant reorganisation.

Our View of Divestment and Non-investment

As part of the Review, we noted several relevant aspects of both theoretical and empirical work in the academic literature regarding the investor's decision to divest and its impact on sustainability outcomes. An important immediate point was that some calls for the School to divest from the equity of certain firms seemed to confuse capital investment in a firm with stock trading. Unlike what happens in primary markets (e.g., direct lending by a bank to a firm or the purchase of shares in an initial public offering), buying or selling shares in the secondary market does not change the amount of funds available for capital expenditure in the targeted firm. If LSE were to divest its shares in a firm, the firm in question would not return money to the School. Instead, we would simply sell our stock to another buyer in the secondary market.

Therefore, divestment campaigns can have at best an *indirect* effect on firm policy through the pricing of the targeted firm's stock: if divestment lowered the firm's stock price, the company's cost of capital would be higher. That higher cost of capital could then affect the company's future real investment strategy by lowering the number of positive net present value investment opportunities, thus reducing the company's growth rate.

Of course, the sale of stock in isolation by a relatively small investor such as LSE can have no impact on the pricing of any firm's stock. The hope instead is that *collective* divestment by many like-minded investors can affect a firm's stock price. The nature and magnitude of such an effect has been studied carefully by financial economists. The Group reviewed several influential publications by highly regarded scholars that analysed these important aspects of the divestment decision.

Berk and van Binsbergen (2025) model the effects of divestiture strategies on the cost of capital of targeted firms and calibrate their model to current data. Their analysis measures a tiny effect of only 0.44 basis points (bps) per year on the cost of capital of targeted firms. Their result is based on a particular set of parameter values, but even relatively aggressive alternative parameterisations do not result in a sizeable effect. It should be obvious that such a small magnitude would have no effect at all on the capital expenditure decisions of targeted firms. Nevertheless, to put Berk and van Binsbergen's estimate of 0.44 basis points in perspective, the Group notes that Peterson (2024) argues that an increase in the cost of capital of roughly 10% - or 1,000 bps – for carbon-intensive firms would be necessary to generate the change in real activity necessary to meet a 2°C goal.

The conclusions of Berk and van Binsbergen (2025) are consistent with empirical work that directly measures the impact of sustainable investing on the cost of capital. Eskildsen, Ibert, Jensen, and Pedersen (2024) estimate differences in the cost of capital between "green" and "brown" firms to be only 25 bps per year.

Many of the arguments made during the consultation process for the potential effectiveness of LSE divestment advanced the notion that similar strategies in the 1980's eventually forced South Africa to abandon its apartheid system. However, the academic evidence does not support such claims. Teoh, Welch, and Wazzan (1999) document that the announcement of divestment from South Africa by universities and state pension funds had no measurable effect on the valuation of the targeted companies, either short-term or long-term. Indeed, the authors find that throughout the most intense period of political pressure, the Johannesburg Stock exchange reached new highs.

Based on these and other findings, researchers have turned to a natural alternative to divestment: Rather than selling their shares, sustainable investors instead exploit their control rights and engage with firm management. In an influential piece, Broccardo, Hart, and Zingales (2022) study the relative effectiveness of exit (i.e., divestment) and voice (i.e., engagement) and show that the latter is much more effective in pushing firms to act in a socially responsible manner.[1] That conclusion is consistent with recent survey evidence by Krueger, Sautner, and Starks (2020) that finds that large funds much prefer to engage rather than divest in terms of interaction with their portfolio firms on climate issues.[2]

Recognising the importance of engagement also highlights overlooked consequences of divestment campaigns. When socially responsible investors sell their shares, they force others to own the stocks they exclude, a potential ethical dilemma. Moreover, by revealed preference, these buyers are likely to care less about sustainability issues. Thus, divestment movements have the unintended consequence of increasing the likelihood that any remaining shareholders will support the very policies that the divesting shareholders are trying to stop.

We acknowledge that many in our community hold a highly expressive view of LSE's investment portfolio – that investment are a crucial component of how the institution shows and shares its values and identity. However, both theory and empirical work indicate that those investors who care about the consequences of their investment decisions should choose engagement over divestment – or voice over exit. Expression aside, holding only green assets likely has little tangible impact. Instead, it is much more likely that ownership and engagement with brown firms is what might make the world a more sustainable place. Such a concept is at the heart of the analysis that LSE's TPI produces: by developing methodologies and conducting assessments that allow investors to monitor how corporates and sovereigns progress in their transition to a low-carbon economy, TPI helps to inform engagement by investors with their investee entities and support the transition to more sustainable business and growth models.

Finally, the above discussion within the Review Group was clear that though there may be few benefits to divestment, there are certainly financial costs to LSE if it were to exclude broad swaths of stocks from its portfolio. Such exclusion strategies must naturally have a worse risk-return trade-off, as constraints can never help an investor ex ante.[3] Indeed, exclusionary strategies will not only have the lower mean and higher volatility that naturally comes from restricting one's portfolio to consider only a subset of stocks, since those investors are actively choosing to tilt towards (away from) stocks with lower (higher) expected returns, their risk-return trade-off will be further impaired.[4]

---

[1] Sir Oliver Hart, Professor in the LSE Economics Department from 1981-1985, is Professor of Economics at Harvard University and the 2016 recipient of the Nobel Memorial Prize in Economic Sciences.
[2] Professor Laura Starks was President of the American Finance Association. These findings were a centerpiece of Starks (2023), her Presidential Address on "Sustainable Finance and ESG Issues–Value versus Values."
[3] Asness (2017) strongly makes this point.
[4] See Pedersen, Fitzgibbons, and Pomorski (2020) for a formal asset-pricing model incorporating preferences for sustainability.

As we have stated throughout our report, incurring additional financial costs in the name of non-material values may be legal and possible, but as always, the decision to do so must achieve a complex and difficult balance of all the relevant factors.

Recommendations

Tying these elements – the community's values and the principles necessary to achieve the endowment's primary purpose – together is further complicated by the current state of the world. The investment environment is increasingly uncertain, as the unpredictable actions of the US government add to the list of shocks we have seen in recent years: war, pandemic, supply chain disruption, commodity shortages, price inflation, and more. UK law threatens to change rapidly in response, as legislation and lawsuits concerning sanctions wind their way through our political and judicial systems. And due to these factors, the norms of the investment industry and the higher education sector are in accompanying turbulence.

This means that in addition to maintaining that delicate balance between our community's values and the primary purpose of the endowment, our recommendations should make our ESG Policy flexible, cautious, and open to evolution as circumstances change around us. As we have written previously, we do not harbour any illusions that these recommendations are perfect; will satisfy all members of our community; or will stand for all time. But they are, in our judgement, the best balance we could achieve in this moment for the London School of Economics and Political Science's unique needs, culture, and community.

In sum, we recommend:

- **Achieving the highest possible degree of transparency and understanding about our investments and strategies:** LSE is a mature, intelligent, and knowledgeable community, and in keeping with our charitable mission, we believe that greater education and understanding is the single most important factor in enlightening and resolving debates over LSE's investments. This does not merely include transparency – though transparency is essential – but also elucidation concerning our holdings, strategies, and policies. We accept that the current website is inadequate and we accordingly recommend a thorough review and overhaul of the Endowment website. A group has already been established to undertake this work, and our hope is that a redesigned website will go live before the next academic year.

- **Distributing an "induction package" of materials to help incoming staff and students understand the endowment and ESG Policy:** In the same spirit of transparency and understanding, we propose the creation and dissemination of a small document to help incoming students and staff learn about the endowment, its purposes, and our policies.

- **Reviewing the ESG Policy on a regular schedule:** As we have acknowledged above, the unstable environment in which we find ourselves demands regular and rigorous review of our policies. This successful process of consultation should be undertaken every few years – perhaps every three, as we are now three years from the previous effort – with improvements born of multiple iterations.

- **Holding an Annual General Meeting for the endowment:** In addition to the regular review of the ESG Policy, we propose holding an AGM for the endowment, where members of the community can hear the report of the Investment Sub-committee, ask questions, and submit proposals for consideration.

- **Reviewing our extant investment filters:** We propose that ISC immediately ask our investment managers to review our extant investment filters relating to fossil fuels, tobacco, armaments, and management, with a view towards further reducing our exposure to these higher-risk investments within our ESG strategy, as appropriate. (Strictly for example, this could mean reducing the extant coal and tar sands filter from its current 3%, continuing its steady reduction from the original 10%, set in 2022.) Additionally, we propose updating our current list of companies banned due to Magnitsky-style sanctions levied against them or their controllers by incorporating the sanctions levied by HMG earlier this year; as well as proactively scanning for future shifts in this rapidly evolving landscape.

- **Providing a regular opportunity for the LSE community to share research:** LSE is one of the world's greatest producers of scholarly research on topics related to this ESG Policy – finance, economics, ethics, sustainability, and more. This research could be invaluable in the operationalisation of this Policy; for example, we are always looking for new metrics with which to evaluate our net zero commitments. While this could be folded into the proposed AGM, we propose some avenue for the community to share its research and contribute to the evolution of our ESG Policy.

- **Convening and coordinating other universities:** In relative terms, LSE's endowment is small, while its prestige and convening power is massive. We propose that Council should establish a group tasked with initiating a conversation among universities concerning the investment management of the Universities Superannuation Scheme and the Superannuation Arrangements of the University of London. As a much more collective view of funds than any single British university, USS and SAUL (with over £78 billion in assets under management between them) are the largest investment lever that any university can access. If LSE coordinates its peers to review and potentially change USS and/or SAUL investment policies, much greater positive change could be realised than any university could achieve on its own with their own portfolio.

The LSE ESG Policy Review Group

Sir David Higgins (chair)
Ms Caroline Butler
Mr Michael Ferguson
Mr Tim Frost
Professor Nicola Lacey
Dr Carmen Nuzzo
Professor Christopher Polk
Ms Sonali de Rycker

References

Asness, Cliff, 2017, "Virtue is its Own Reward: Or, One Man's Ceiling is Another Man's Floor," AQR Perspective.

Berk, Jonathan and Jules van Binsbergen, 2025, "The Impact of Impact Investing," *Journal of Financial Economics* 164.

Broccardo, Eleonora, Oliver Hart, and Luigi Zingales, 2022, "Exit versus Voice," *Journal of Political Economy* 130 3103-3145.

Eskildsen, Marc, Markus Ibert, Theis Jensen, and Lasse Pedersen, 2024, "In Search of the True Greenium," working paper.

Krueger, Philipp, Zacharias Sautner, and Laura Starks, 2020, "The Importance of Climate Risks for Institutional Investors," *Review of Financial Studies* 33 1067-1111.

Pedersen, Lasse, 2024, "Carbon Pricing versus Green Finance," working paper.

Pedersen, Lasse, Shaun Fitzgibbons, and Lukasz Pomorski, 2020, "Responsible Investing: The ESG-efficient Frontier," *Journal of Financial Economics* 142 572-597.

Starks, Laura, 2023, "Sustainable Finance and ESG Issues—Value versus Values," *Journal of Finance* 78 1833- 2411.

Teoh, Siew Hong, Ivo Welch, and C. Paul Wazzan, 1999, "The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott," *Journal of Business* 72 35-89.

ANNEXES

Annex I. Mandate from Council

In July [2024], Council agreed to move the School's scheduled review of its ESG policy forward by a year, to commence in Fall 2024. What follows is an outline for the process.

1. As was done in 2021, the process will be overseen by an ESG Review Group.

(a) The group will consist of the following members:

(1) Sir David Higgins (Chair)

(2) Ms Caroline Butler

(3) Mr Michael Ferguson

(4) Mr Tim Frost

(5) Professor Nicola Lacey

(6) Dr Carmen Nuzzo

(7) Professor Chris Polk

(8) Ms Sonali de Rycker

(b) The ESG Review Group will be staffed by Danny Hatem.

(c) Terms of reference for the Group:

(1) To review the School's ESG policy and propose revisions for Council to consider (after review by the ISC and FEC).

(2) Matters decided at the June Council meeting and reported in Council's memorandum of July 9, 2024, will not be revisited.

(3) The ESG Review Group will seek input from relevant stakeholders and other appropriate sources, as described below.

(4) It will seek to complete the process and report back to Council by the end of Spring Term, 2025.

2. As was done in 2021, the ESG Review Group will seek input from a wide range of sources and people, both inside and outside LSE. These may include:

(a) Review of the academic and financial literature, as well as of the practices of peer universities (e.g., Harvard, Yale, Cambridge, Oxford, UCL, KCL, etc.).

(b) Invitation to students and staff to offer written submissions.

(c) Workshops, roundtables, panels, and/or Town Hall meetings.

(d) Outreach will make clear that Council's responsibilities are fiduciary, meaning final decisions cannot be delegated or based on anything other than Council's considered judgment about what is best for the School in light of its mission and purpose. Input is sought for ideas and relevant considerations that might otherwise be neglected or overlooked. The review will not undertake or be based on votes or surveys unless such are needed to obtain specific factual information that cannot be obtained by other means.

3. There will also be a LSE Consultative Group comprising additional faculty, staff, and students.

(a) The purpose of the Consultative Group is to provide input from a group that reflects key stakeholders and can participate throughout the process. To play this role, members must (i) accept the above terms of reference, and (ii) be prepared to give significant time to the work, including introductory sessions on endowment management, regular meetings with the ESG Review Group, and attendance at other key events like those listed in 2-c above.

(b) The Consultative Group will include three faculty members, three students, and three members of the School's professional service staff.

(1) Student representatives will be chosen by the LSE Student Union.

(2) Academic and professional service staff will be chosen by lottery after a process of self-nomination.

(c) Representatives of the ESG Review Group will meet periodically with the Consultative Group to report on progress and obtain feedback.

(d) The Consultative Group can make recommendations to the ESG Review Group throughout the process and may also, if it chooses, submit a full report to the Group before the review process is completed.

4. The final report of the ESG Review Group will be submitted, along with other relevant materials, to the ISC, which will review it and make recommendations to the FEC, which will do the same for Council, which has final authority and responsibility to decide whether and how to revise the School's ESG policy.

Annex II. Terms of Reference for the Review Group

- The purpose of the Review Group is to review the School's Environmental, Social and Governance Policy and propose revisions for Council to consider, after review by the Investment Sub-Committee and Finance and Estates Committee.

- In so doing, the Review Group will seek input from a Consultative Group, other relevant stakeholders and other appropriate sources.

- It will complete the process and report back to Council by the end of Spring Term, 2025.

- Matters decided at the June Council meeting and reported in Council's memorandum of 9 July 2024, will not be revisited.

Annex III. Terms of Reference for the Consultative Group

- The purpose of the Consultative Group is to advise the Environmental, Social and Governance Policy Review Group on its review of the School's ESG Policy.

- In so doing, the Consultative Group will:

    - Gain substantive and technical understanding of university endowments and associated subjects such as their governance, investment, and regulation.
    - In coordination with the Review Group, seek input from relevant stakeholders and other appropriate sources from across the School community.
    - Meet with representatives of the Review Group on a regular basis, not less than termly or more than monthly, for updates and to offer input. These planned meetings may be supplemented by written submissions from the Consultative Group if it deems necessary or appropriate.

- It will complete the advisory process in time for the Review Group to report back to Council by the end of Spring Term, 2025.

- While drawn from staff and students, the Consultative Group is appointed to help inform LSE's ESG policy from a whole-School perspective: neither it nor its members are advocates for a previously determined position or for any particular group or constituency.

- Final decisions regarding LSE's ESG Policy are the sole province of Council; matters decided at the June 2024 Council meeting and reported in Council's memorandum of 9 July 2024, will not be revisited.

Annex IV. Our response concerning international law

Over the course of the Review, the Consultative Group proposed adoption of a general, overarching principle of international law or norms that should govern our investment decisions. Their thoughtful, creative, and well-researched work was the subject of significant deliberations between the Consultative and Review Groups and among the wider LSE community.

Recently, the Governing Body of King's College, Cambridge adopted a new investment policy. In particular, the policy pledges the College to exclude investments in companies that are "involved in activities generally recognised as illegal or contravening global norms, such as occupation." Given some of the similarities to the Consultative Group's proposal, this policy has stirred further debate on the idea.

For these reasons, we feel it important to explain why we are not recommending adoption of such a general principle. This decision is the outcome of much deliberation but was taken unanimously and unambiguously by the entire group. There are two linked reasons we came to this conclusion. First, despite many claims to the contrary, implementing a general principle would be inescapably and highly political. Second, implementing a general principle would be unwieldy and impractical.

We appreciate that the Consultative Group has considered many of the following critiques already. Indeed, Review Group member Mike Ferguson put many of these concerns and challenges to Consultative Group member Oliver Hailes in writing, and we read the Consultative Group's response carefully. In our judgement, the answers proffered did not dispel our many fundamental concerns. We briefly summarise them below.

First, as the House of Commons briefing on international law (which the Consultative Group provided) states in its introduction: "International law, in general, sets out the rules that apply to the relationships between states," a very common point made in many authoritative sources on the subject. Although international laws and norms have, at times, been applied or have been sought to apply to private actors like firms, there is certainly no consensus that international law governs or is meant to govern anything other than the affairs of states. It is therefore unclear how this principle could apply to a private actor's investment portfolio in the abstract.

Second, the number and breadth of international laws and norms makes the principle both overly broad in the abstract and impossible to define in practice. In only the past few years, the United States, United Kingdom, European Union, China, India, Brazil, and many other world economies have all been accused – by reputable lawyers, judges, scholars, and policymakers – of violations of international laws and norms regarding a bewildering array of issues: trade; the conduct of war; the treatment of prisoners; the treatment of asylum seekers; criminal prosecutions; grants or revocation of citizenship; greenhouse gas emissions; environmental campaigns; access to courts, and countless others. We think a broad principle of respect for international law and norms that sought to avoid investments in a country on the basis of its domestic firms' "complicity" with breaches of international laws or norms would quickly turn firms, and as mentioned above, it is not clear how else international laws and norms would consistently apply to firms.

Third, the final interpretation of international law does not enjoy universal acceptance, even among states who are party to treaties or conventions. For example, many member states of the United Nations disagree with and ignore UN interpretations of its various charters. Many states party to the Rome Statute of the International Criminal Court disagree with and ignore valid warrants issued by that body. And in another example closer to home, LSE scholars of international law – much more skilled and informed than the Review Group – have expressed widely divergent views on the legality of US and UK involvement in the Iraq War. This is before one even considers the question of enforcement of international laws and norms; a major element of the rule of law that in the case of international laws and norms is inconsistent, selective, and often lax or non-existent.

For all these reasons, international law is significantly different from domestic law, which, among other differences, plainly applies to investors like LSE and their investments; is clear, stable, and predictable; has universally accepted mechanisms for interpretation, enforcement, and the adjudication of disputes; and to which adherence is neither optional nor innovative. Deciding which international laws and norms the proposed principle should honour; at what times; in which proportions; in which applications; and through whose interpretations is both inherently political and impossible to translate into effective investment filters.

Implementing a general principle would impose upon Council, its committees, and its agents a dizzying array of subjective choices about if, when, and how to apply it, with no method of guiding decisions other than through a conflict of values and priorities (i.e. politics). It would also turbocharge formal and/or informal politically motivated debate about the endowment's management by encouraging discussion of if, when, and how the principle should apply to specific investment decisions.

We simply cannot see how a general principle could be implemented without politicising the institution and thus contravening our value of neutrality regarding political disputes to a damaging degree.

Implementing a general principle would also impose upon the endowment substantial economic costs. Those costs would be both operational – as significant new resources would be needed to apply the principle (e.g. time, manpower, attention of our advisors, etc.) – and substantive – as basic finance theory shows, exclusionary policies cannot improve returns or reduce risk in an investment portfolio and often reduce returns and raise risk.

As we have written, while there can indeed be justifications for increased costs, they must be carefully weighed in balance with competing values and the primary purpose of the endowment. It is our judgement that the costs of implementing a general principle would be prohibitive to achieving the primary purpose of our investment portfolio.

Annex V. Our response concerning armaments

Alongside international law, the most hotly debated issue during the consultation period was how the ESG Policy should treat investments in armaments. Following investigation and deliberation, we can make a number of determinations.

First, the defence sector is booming worldwide, as governments raise defence spending to deal with an increasingly uncertain and dangerous international environment. Virtually all analysts describe this increase as a secular trend, with substantial room for acceleration in the coming years. This unquestionably raises the stakes of our recommendations, as the issue is now more financially, politically, and morally salient than it has been in decades.

Second, the moral implications of the production, sale, and use of military weapons are highly contested; far more than say, those relating to tobacco or gambling. While we acknowledge that many in our community – and beyond – have a strong and principled opposition to investment in any instrument of injury and death, that is not a consensus view. Many others believe that the moral quandaries related to weapons arise principally in the use of those weapons, rather than in their production or sale, which are accordingly morally neutral in their view. Further still, many others have expressed the view that it would be morally wrong to exclude investment in the tools that allow nations and peoples to defend themselves against aggressors. We note that during the 2022 consultation leading to the creation of the ESG Policy – that is, after Russia's full-scale invasion of Ukraine but before the current iteration of the Israel/Palestine conflict – investment in armaments was a much less contentious subject in our discussions. This leads us to conclude that there is nothing approaching one universal or long-standing view on this subject in our community.

Third, the dual use of many technologies for both civilian and military purposes – and the commingling of civilian and military business lines in many firms – raises the costs of excluding investment in "armaments" dramatically. For example, among other things, our investment advisors have reported that:

- A strict filter meant to exclude investment in firms with any business lines relating to the production or sale of military weapons would preclude investment in many high-performing companies whose defence business could only be described as tangential, such as Apple.

- Virtually any meaningful filter would preclude investment in many conglomerates with robust civilian business lines, such as Rolls-Royce or Siemens. Many such firms are engaged in noncontroversial or ESG-positive sectors that we want exposure to, such as clean energy.

- The above fact would similarly complicate attempts to exclude nuclear weapons, a particular subset of controversial/indiscriminate weapons. Any meaningful filter would exclude investment in approximately 30% of the nuclear energy sector, itself a booming business with an important role to play in the net zero transition.

Similar issues present with calls to exclude investment in firms that "facilitate" the production and sale of weapons, such as banks and other financial institutions.

The Review Group discussed different classifications of weapons systems at length, but for the reasons described above, did not reach consensus on any extension to our exclusions on armaments.

Annex VI. Our response concerning King's College, Cambridge

As noted above, recently the Governing Body of King's College, Cambridge adopted a new investment policy, which some in our community have sought to compare with our own. In particular, the policy pledges the College to exclude investments in companies that:

- "Are involved in activities generally recognised as illegal or contravening global norms, such as occupation."

- "Produce military and nuclear weapons, weapons restricted by international treaty, or companies that produce key or dedicated components of such weapons."

As the annexes above have explained our concerns about incorporating international law (which is surely a rough proxy for "activities generally recognised as illegal or contravening global norms") into our policy; as well as our views on investing in "military and nuclear weapons;" we will not repeat those arguments here. Instead, we will simply restate our conclusions that:

- A similar policy would be impossible for LSE to implement.

- A similar policy would directly contravene Council's express decision against divestment for the purposes of – or with the primary effect of – expressing an institutional position on political disputes.

- Even if it could be implemented, a similar policy would impose such dramatic constraints on our investment portfolio as to make it impossible to achieve its primary purpose of funding our educational mission.

We will certainly follow King's College, Cambridge's attempts to implement their policy with great interest, and will take their experience as a valuable input to future reviews to our own policy.