In the Matter of: UNIVERSITY OF WISCONSIN FOUNDATION
a/k/a Wisconsin Foundation & Alumni Association

Earlier this year, this Department received a complaint signed by more than 200 individuals and organizations alleging that the University of Wisconsin Foundation violated the Uniform Prudent Management of Institutional Funds Act by maintaining investments in the fossil fuel industry. As explained below, this Department lacks authority to enforce the Act against the Foundation. But it does have authority to review the practices of a broad array of other financial institutions responsible for managing investment risk, from banks and credit unions to broker-dealers and investment professionals. The concerns raised in the complaint are echoed in economic and environmental reports, and they ought to be primary considerations for all prudent financial institutions—regardless of whether they are subject to the Act.

I. Investment Management Standards Under the Act

The complaint seeks relief under the Uniform Prudent Management of Institutional Funds Act, a model law drafted by the National Conference of Commissioners on Uniform State Laws in 2006 and enacted in Wisconsin in 2009. The Act establishes standards for those responsible for the management of institutional funds held exclusively for charitable purposes, including a duty of good faith, a duty of care, and a duty to “consider the charitable purposes of the institution and the purposes of the institutional fund.” The Act also identifies eight factors for consideration in managing and investing an institutional fund:

a. General economic conditions.

b. The possible effect of inflation or deflation.

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1 Wis. Stat. § 112.11.
2 The complaint is available online here.
3 See Wis. Stat. § 112.11.
4 Wis. Stat. § 112.11(3)(b).
5 Id.
6 Wis. Stat. § 112.11(3)(a).
c. The expected tax consequences, if any, of investment decisions or strategies.

d. The role that each investment or course of action plays within the overall investment portfolio of the fund.

e. The expected total return from income and the appreciation of investments.

f. Other resources of the institution.

g. The needs of the institution and the fund to make distributions and to preserve capital.

h. An asset’s special relationship or special value, if any, to the charitable purposes of the institution.\(^7\)

While the Act applies only to charitable institutions, these standards should look familiar to any financial institution serving in a trustee capacity. They were borrowed in large part from the Uniform Prudent Investor Act,\(^8\) which codifies duties owed by trustees.\(^9\)

II. The Absence of a Public Enforcement Mechanism Under the Act, and the Unique Problem It Poses Under Wisconsin Law

Though the Act specifies duties applicable to charitable institutions, it is silent on who has the right to enforce them. That fact alone does not distinguish the Act from statutes establishing the duties of fiduciaries in other contexts, such as trusteeships,\(^10\) which also set standards without detailing how they will be enforced. But in the trusteeship context, the manner of enforcement goes without saying: a trustee who violates those standards directly and uniquely injures the trust beneficiaries, who have every incentive to enforce their rights in a private cause of action in court.

In the context of charitable institutions, however, the question of enforcement by private parties is murkier. The beneficiaries of charitable institutions are often diffuse and—as the Act’s drafters noted—generally “do not have enforceable rights in the institution in the same way that beneficiaries of a private trust do.”\(^11\) The donors of a charitable institution have legal interests in ensuring that their funds are invested appropriately, of course, but they have other means of

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\(^7\) Wis. Stat. § 112.11(3)(e)1.


\(^10\) Compare Wis. Stat. § 881.01 with Wis. Stat. § 112.11.

protecting their rights without resort to legal action. Donors can express their intent in the gift instrument, which the charitable institution must normally follow, or take their donations elsewhere. Thus, while the Act establishes legal duties, it is unclear whether any private parties would possess both the legal standing and practical incentive to enforce them in court.

Recognizing these limits on private enforcement, the drafters of the Act contemplated that its legal standards would be vindicated through public enforcement by state governmental authorities. They assumed that “the state attorney general” or another state agency could “enforce the charitable interests of the public,” even if that enforcement authority was not expressly laid out in the Act.

That may be true in most states, which grant their attorneys general inherent power to initiate and prosecute litigation intended to protect the interests of the state or its residents. But that is not the case in Wisconsin. As the Wisconsin Supreme Court has explained:

> Wisconsin, unlike numerous states, has specifically circumscribed the powers and duties of the office of the attorney general. Art. V, sec. 3 of the Wisconsin Constitution limits those powers and duties to those “prescribed by law.” . . . Such power must be specifically granted by the legislature. Unless the power to prosecute a specific action is granted by law, the office of the attorney general is powerless to act.

For that reason, earlier this year the Department of Justice sent the complainants a written determination stating that it lacked legal authority to act on the complaint.

> This Department is subject to similar restrictions. It was created by the legislature, and it enjoys only those powers the legislature has bestowed upon it. While the legislature has granted this Department the authority to register and regulate certain charitable organizations pursuant to chapter 202 of the Wisconsin Statutes, it did not provide the Department carte blanche to investigate and enforce all laws applicable to charities operating in this state. Instead, this Department’s regulatory authority over charitable organizations is limited to enforcement of the provisions of chapter 202. The Act is not incorporated or referenced in chapter 202, but

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12 See Wis. Stat. § 112.11(3)(a), (4)(a), (6)(b).
13 Likely for this reason, research fails to identify any Wisconsin court decisions applying the Act.
14 National Conference of Commissioners on Uniform State Laws, Uniform Prudent Management of Institutional Funds Act (2006), § 4 cmt. See also id. § 6 cmt. (“The attorney general protects donor intent as well as the public’s interest in charitable assets.”).
15 In re Estate of Sharp, 63 Wis. 2d 254, 260-61, 217 N.W.2d 258 (1974).
16 Wis. Stat. § 15.18.
17 See, e.g., Clean Wis., Inc. v. Wis. Dep’t of Natural Res., 2021 WI 72, § 24 (published reporter cites pending).
rather appears in chapter 112 of the Wisconsin Statutes—which neither this Department nor any other government agency is expressly authorized to enforce.

Needless to say, this is a problem. Just as a right without a remedy often amounts to no right at all, a statutory duty that cannot be enforced is little more than an aspiration. The Act’s drafters certainly intended to authorize public enforcement of those duties, as noted above, but they failed to account for the special limitations on agency authority in Wisconsin.

There is a fix for this apparent flaw: amending the Act in Wisconsin to grant this Department, the Department of Justice, or another state agency the power to enforce it. This Department is willing to assist any member of the legislature who seeks to enact that change. Unless and until the legislature implements that solution, however, this Department lacks the statutory authority to enforce the Act.

III. Climate-Related Financial Risks Should Be Considerations for All Prudent Financial Institutions, Regardless of Whether They are Subject to the Act

Although the Department lacks legal authority to act in this context, the complaint raises important issues that ought to be primary considerations for all prudent financial institutions, charitable or otherwise. Among other observations, the complaint highlights several risks of investing in fossil fuel companies amidst a global transition to renewable energy:

● The “traditional value thesis” of investment in fossil fuel companies—that demand will keep growing and all reserves ultimately will be tapped—is “no longer tenable” given the immediacy of climate change and the necessary global transition to renewable energy.\(^\text{19}\)

● Fossil fuel companies face a coming “wave of litigation” related to climate change.\(^\text{20}\)

● There are many “peer institutions who, in a like position under similar circumstances, have recognized the prudence of divestment.”\(^\text{21}\) Indeed, the Governor’s Task Force on Climate Change noted in its 2020 report that “divesting from fossil fuels does not have a statistically significant impact on overall portfolio performance,”\(^\text{22}\) and several studies have found that renewable energy or other alternative investments have outperformed the fossil fuel sector over the last decade.\(^\text{23}\)

● The Task Force’s report further noted that “a growing number of financial analysts argue that fossil fuels will prove to be a bad

\(^{19}\) Complaint at 23.
\(^{20}\) Complaint at 24.
\(^{21}\) Complaint at 3, 28-33.
\(^{22}\) Complaint at 28.
\(^{23}\) Complaint at 21-23, 27-28.
investment,” and it recommended that the Wisconsin Retirement System and the UW System foundations divest from fossil fuel stocks.\textsuperscript{24}

Recent reports from central bankers and regulators echo these points. The Bank for International Settlements (BIS), an organization of central banks including the Federal Reserve, noted last year that the coming “transition from ‘brown’ to ‘green’ activities may result in a severe tightening of financial conditions for companies that rely on carbon-intensive activities, be it directly or indirectly through their value chains.”\textsuperscript{25} Last fall, New York’s Department of Financial Services cautioned financial institutions that physical and transition risks related to climate change “could send broad, intersecting and amplifying financial ripples to financial institutions with exposures to these industries.”\textsuperscript{26} In the course of making the necessary transition to a lower-carbon future, these industries’ most valuable assets—namely their proven fossil fuel reserves—may become “stranded,” an event “with potentially systemic consequences for the financial system.”\textsuperscript{27}

Traditional approaches to risk management, which rely heavily on historical data, “are largely irrelevant to assess climate-related risks.”\textsuperscript{28} As the BIS explains:

\textit{The problem is extrapolating historical trends can only lead to mispricing of climate-related risks, as these risks have barely started to materialize: physical risks will become worse as global warming goes on, and transition risks are currently low given the lack of ambitious policies on a global scale. . . . As a result, the standard approach to modeling financial risk consisting in extrapolating historical values is no longer valid in a world that is fundamentally reshaped by climate change.}\textsuperscript{29}

These risks are not limited to companies that extract fossil fuels. Given the “complex chain reactions between degraded ecological conditions and unpredictable social, economic and political responses, with the risk of triggering tipping points, climate change represents a colossal and potentially irreversible risk of staggering complexity.”\textsuperscript{30}

But this complexity is not cause for inaction. Financial regulators and institutions around the globe are fundamentally re-thinking risk management and supervisory processes to reflect the new reality of climate change. In March of this year, the Federal Reserve created two committees devoted to climate-related financial risks, including one focused on adjusting

\begin{itemize}
    \item \textsuperscript{24} \textit{Complaint} at 3.
    \item \textsuperscript{25} \textit{BANK FOR INT’L SETTLEMENTS, THE GREEN SWAN: CENTRAL BANKING AND FINANCIAL STABILITY IN THE AGE OF CLIMATE CHANGE (“BIS REPORT”) at 7 (2020).}
    \item \textsuperscript{26} \textit{Letter from the New York Department of Financial Services to New York State Regulated Financial Institutions} (Oct. 29, 2020).
    \item \textsuperscript{27} \textit{BIS REPORT, supra} note 25, at 18.
    \item \textsuperscript{28} \textit{Id.} at 10.
    \item \textsuperscript{29} \textit{Id.} at 21.
    \item \textsuperscript{30} \textit{Id.} at 6.
\end{itemize}
regulatory supervision of financial institutions to better measure and ensure their resilience against those risks.\textsuperscript{31} In May, President Biden issued an executive order warning that “[t]he failure of financial institutions to appropriately and adequately account for and measure these physical and transition risks threatens the competitiveness of U.S. companies and markets, the life savings and pensions of U.S. workers and families, and the ability of U.S. financial institutions to serve communities.”\textsuperscript{32} The order requires federal financial regulators to conduct “prudent[] fiscal management” by, among other things, evaluating, mitigating, and disclosing climate-related financial risk.

State government regulators are also shifting paradigms. New York’s chief financial regulator hired its first director of sustainability and client initiatives last year,\textsuperscript{33} and agencies in other states are raising the alarm among regulated industries about the need to incorporate climate change into their risk assessments. This October, the Secretary of this Department will speak at the La Follette Forum, a climate policy conference hosted by the La Follette School of Public Affairs at the University of Wisconsin, on the financial risks of climate change.\textsuperscript{34} As the Fed and other organizations develop methodologies to help translate “climate-related risks into measures of credit, market, liquidity, reputational, and operational risks,”\textsuperscript{35} those risks will become an increased focus of state regulatory supervision.

For all these reasons, this is a key moment for financial institutions—one marked by great rewards for institutions that are proactive in response to the climate-related financial risks, and great dangers for those that are slow to adjust. As Federal Reserve Board Governor Lael Brainard summarized earlier this year:

Financial institutions that do not put in place frameworks to measure, monitor, and manage climate-related risks could face outsized losses on climate-sensitive assets caused by environmental shifts, by a disorderly transition to a low-carbon economy, or by a combination of both. Conversely, robust risk management, scenario analysis, and forward planning can help ensure financial institutions are resilient to climate-related risks and well-positioned to support the transition to a more sustainable economy.\textsuperscript{36}

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\item \textsuperscript{31} Lael Brainard, Governor, Fed. Reserve Bd., \textit{Financial Stability Implications of Climate Change} (“Brainard Address”) (Mar. 23, 2021).
\item \textsuperscript{32} \textit{EXECUTIVE ORDER ON CLIMATE RELATED FINANCIAL RISK} (May 20, 2021).
\item \textsuperscript{33} Letter from the New York Department of Financial Services to New York State Regulated Financial Institutions (Oct. 29, 2020).
\item \textsuperscript{34} Details are available \href{https://www.newyorkfed.org/medialibrary/2021-08-24/622493-47506-52040-Final-Statement.pdf}{here}.
\item \textsuperscript{35} Brainard Address, supra note 31.
\item \textsuperscript{36} \textit{Id.}
\end{itemize}
Many financial institutions are already taking the proactive approach, “collecting data and experimenting with scenario analysis and other techniques to better understand the potential impact of climate-related risks to their balance sheets and business models.”

This Department will continue to work with state and federal regulators and provide tools, guidelines, and other updates to regulated institutions as they become available. In the meantime, there are several sources of information for institutions seeking to assess the magnitude of climate-related risks to their investments and business practices. The recent report of the UN Intergovernmental Panel on Climate Change details the potential physical effects of climate change at a global level, while its interactive atlas allows users to model regional effects under different scenarios. Information on the local impacts of climate change is available from the Wisconsin Initiative on Climate Change Impacts, a partnership of the Wisconsin Department of Natural Resources and the Nelson Institute for Environmental Studies at the University of Wisconsin. More detailed information concerning the potential financial impacts of climate change can be found in the resources footnoted in this document.

Conclusion

The Legislature has not authorized this (or any other) agency to enforce the Uniform Prudent Management of Institutional Funds Act, and therefore this Department lacks jurisdiction over the matters raised in the complaint. But those matters are of critical importance to all financial institutions, regardless of whether they are governed by the Act. Regulators and many institutions are beginning to make fundamental shifts in their assessment of risk, recognizing that processes that previously seemed prudent are wholly inadequate to capture the novel risks of climate change. The sooner Wisconsin institutions begin taking steps to measure, assess, and protect against climate-related financial risks, the better they’ll safeguard the health of their own organizations and the state’s economy against the unprecedented changes ahead.

Dated this 7th day of September, 2021.

/s/ Matthew Lynch  
Matthew Lynch  
Chief Legal Counsel  
Wisconsin Department of Financial Institutions

37 Id.
38 In addition to the resources cited above, the New York Department of Financial Services has recommended three publications that may be especially useful for financial institutions: the Climate Financial Risk Forum’s guide to climate-related financial risk management, the U.N.’s guide to climate change for asset owners, and Charting a New Climate: State-of-the-art tools and data for banks to assess credit risks and opportunities from physical climate change impacts, a publication of the U.N. Task Force for Climate-Related Financial Disclosures.