Questions and Answers about Divestment

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What is the global campaign for divestment from fossil fuels?

Since 2012 hundreds of universities, pension funds, churches and other investors have withdrawn their investments from corporations engaged in the extraction, transport and marketing of oil, gas and coal in light of the how climate change threatens life on Earth as we know it.

What are the ethical issues prompting divestment?

The primary ethical consideration is summed up in the slogan coined by the climate advocacy group 350.org: "It's wrong to profit from wrecking the climate." Archbishop emeritus Desmond Tutu compares the divestment movement to the successful campaign that persuaded many investors to withdraw for South Africa during the apartheid era:

> "The divestment movement played a key role in helping liberate South Africa. The corporations understood the logic of money even when they weren't swayed by the dictates of morality. Climate change is a deeply moral issue too. Here in Africa we see the dreadful suffering of people from worsening drought, from rising food prices, from floods even though they've done nothing to cause the situation. Once again, we can join together as a world and put pressure where it counts."[1]

What are the practical reasons for divestment?

Bank of England governor Mark Carney identifies three kinds of risks for investors in fossil fuels:

- physical risks to assets from weather events such as floods, storms or forest fires;
- liability risks if those who suffer losses or damages seek compensation from those they hold responsible;
- risks of stranded assets[i] that would result when government policies and competing technologies shift markets towards a low-carbon economy.[2]

Carney cites the Intergovernmental Panel on Climate Change's estimate for a carbon budget to limit temperature increases to 2 ^{0}C above pre-industrial levels which would allow for burning only 1/5th to 1/3rd of the world's proven fossil fuel reserves. This limited budget would "render the vast majority of reserves 'stranded" [3] resulting in a huge exposure for direct investors, insurance companies and banks.

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[i] Stranded assets may be defined as assets that lose significant economic value well ahead of their anticipated useful life due to changes in laws, regulations, markets, technological innovations, societal norms or environmental shocks.

While Carney notes that court cases initiated by those seeking compensation for losses from climate change have so far largely been unsuccessful, he draws an analogy to cases in the U.S. where claims for losses due to exposure to asbestos are expected to cost insurers US$85 billion "equivalent to almost three Superstorm Sandy-sized loss events."[4] He also notes how the issue of claims for "Loss and Damage" from climate change has become a prominent part of UN climate negotiations.

How big is the financial risk faced by fossil fuel companies?

In November, 2015, Carbon Tracker published a study entitled *The $2.2 trillion stranded assets danger zone: How fossil fuel firms risk destroying investor returns.* Carbon Tracker's news release stated "Fossil fuel companies risk wasting up to $2.2 trillion in the next decade, threatening substantially lower investor returns, by pursuing projects that could be uneconomic in the face of a perfect storm of factors including international action to limit climate change to 2˚C and rapid advances in clean technologies."

The report describes how many coal, oil and gas assets no longer constitute wise financial investments in a world that aims to keep global temperature increases below 2˚C. The report warns: "If the industry misreads future demand by underestimating technology and policy advances, this can lead to an excess of supply and create stranded assets. This is where shareholders should be concerned – if companies are committing to future production which may never generate the returns expected." [5]

According to Carbon Tracker the U.S. has the greatest financial exposure with $412 billion of unneeded fossil fuel projects at risk of becoming stranded assets by 2025, followed by Canada ($220bn), China ($179bn), Russia ($147bn) and Australia ($103bn).

Carbon Tracker estimates that about 25% of proposed capital spending on natural gas production in Canada between 2015 and 2025, mostly on LNG for export, is not needed if Canadian production is to be compatible with a 2 ^{o}C world. (Figure 5, page 13)

Similarly the report says that 35% of proposed capital spending on oil production in Canada from 2015 to 2025, almost all in the tar sands and some in the Arctic, would not be compatible with keeping temperature increases under 2 ^{o}C. (Figure 7, page 16 and Figure 8, page 17)[6]

Is assessment of risks gaining recognition from market overseers?

In 2015 G20 Finance Ministers asked the Financial Stability Board to investigate how the financial sector could take into account the risks posed by climate change. This led to the appointment of the Task Force on Climate-related Financial Disclosures under the chair of ex-New York Mayor Michael Bloomberg, with a mandate "to develop voluntary, consistent climate related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material risks." In December 2016 the Task Force recommended

widespread adoption of guidelines for disclosing comparable information that could be adopted by all organizations in their public filings with securities regulators. A key recommendation is for businesses to evaluate their risks under different scenarios, including one consistent with limiting global temperature increases to 2^{0} Celsius.[7]

Executives from major institutional investors including Black Rock (the world's largest investment firm managing US$5 trillion of assets), the Canada Pension Plan Investment Board and OP Trust, which manages public sector employees pensions in Ontario, have endorsed increasing scrutiny of climate risks for fossil fuel firms and others such as real estate and insurance companies.[8]

Timothy Lane, a deputy governor of the Bank of Canada has stated "All investors need to know whether and how companies are exposed to any risks associated with climate change, including the impact of policy changes."[9]

The Canadian Securities Administrators which co-ordinates the activities of provincial and territorial securities regulators, has announced an initiative to gather information on the current state of climate change disclosure in Canada and internationally.[10] Presumably this information gathering exercise will facilitate movement towards the harmonization of disclosure requirements.

Are corporations divulging information on risks they face from climate change?

In July 2016 Bank of England governor Mark Carney told a Toronto forum that "Only about one-third of the world's 1,000 largest companies provide effective disclosure of the risks they face due to climate change."[11] Slowly more companies are divulging more information but in different ways. Consider the contrasting approaches of three giant petroleum companies – Suncor, ExxonMobil and Chevron.

Calgary-based Suncor describes itself as Canada's leading integrated energy company, with major investments in tar sands, refining, service stations and renewable energy. In mid-April 2017 Suncor released a report on the climate-related risks it faces because it had been pushed to do so by a shareholder resolution passed at its 2016 annual general meeting. Suncor's report explores three different scenarios:

> "In one technological advances and falling costs for clean energy lead to low oil prices and declining exploration and production activity. Major new oil sands projects are unlikely to get built [although it says none of its existing operations will be stranded.]
>
> In another, improving global living standards and advanced technology fuel increased demand for energy, but carbon-intensive industries face rising costs and more stringent standards. Demand for fossil fuels remains, but alternatives take a growing share of the market.

> A third envisions more global conflict and instability as well as skittish investors and tight capital markets, with environmental concerns taking a back seat to economic woes. That would mean little change in the global energy mix."[12]

While none of these three scenarios constitutes a prediction, they provide an insight into how one corporation examines future possibilities. Suncor expects demand for oil to continue to grow until 2040 due to population growth, urbanization and higher living standards while at the same time the energy system a whole "transitions away from carbon intensive sources of energy."[13]

By way of contrast ExxonMobil and its Canadian subsidiary Imperial Oil continue to avoid public discussion of scenarios under which some of their assets could be stranded. As reported by the Canadian Press:

> Imperial Oil's 2016 shareholder circular, sent in advance of the company's April 29 annual general meeting, states that "the company's assessment is that its operations will exhibit strong performance over the long-term."
>
> It cautions that international accords and the accompanying government regulations "are evolving with uncertain timing and outcome" but states that "Imperial's estimates of potential costs related to possible public policies covering energy-related greenhouse gas emissions are consistent with those outlined in Exxon Mobil Corporation's long-term 'Outlook for Energy'...."
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> "We expect that oil, natural gas and coal — the three fuels that together built the modern economy — will continue to meet almost 80 per cent of the world's energy needs through 2040," says Exxon's 2016 energy outlook, which predicts oil demand will rise 30 per cent over the next 24 years.[14]

ExxonMobil's public position also contrasts a filing with the U.S. Securities and Exchange Commission by Chevron which acknowledged that climate change regulation "could have the impact of curtailing profitability in the oil and gas sector or rendering the extraction of the country's oil and gas resources economically infeasible." Chevron also noted the possibility of "private litigation against the company."[15]

How Do Canadian Fund Managers' Tracking of Climate Risks Compare?

A 2016 survey by British-based Asset Owners Disclosure Project found that "Canada's largest fund managers – including major pension funds – are far behind many of their global peers in managing climate-change risks within their investment portfolios."[16] The study found that Canadian fund managers had a poorer record than their counterparts in ten other countries including Sweden, Norway, the U.S., Britain, France, China, Brazil and Australia. Twelve of the 27 major Canadian funds studied "disclosed nothing about their management of climate change, giving the appearance they 'are in denial' about climate change risk."

The 2017 survey by the project found that while Canadian fund managers still trailed far behind their peers in other countries, the proportion of Canadian funds designated as "laggards", that is those showing no evidence of taking action, had fallen from 44% to 23%.[17] In global terms the 2017 report found reason for optimism with 60% of asset owners taking some kind of action with "one in five asset owners [having] staff focused on integrating carbon risk into their investments, two in five [incorporating] climate change into their policy frameworks, and 13% of asset owners now [calculating] portfolio carbon emissions."[18]

How has the campaign progressed so far?

As of December, 2016 "the value of funds divested passed US$5 trillion. Some 80% of the funds involved, spanning 688 institutions, are managed by commercial investment and pension funds."[19]

What are the results for investor portfolios?

There are some studies and anecdotal evidence indicating that those that have divested earn comparable returns to those that keep fossil fuel companies within their portfolios. An Australian consulting company surveyed 40 studies on the impact of ethical, sustainable or socially responsible investment screens and concluded there is no performance penalty. A similar study that looked specifically at carbon free investments found similar results.[20] A paper issued by Bloomberg New Energy and Finance in 2014 reports that "ex-fossil fuel portfolios have performed on par with those including oil, gas and coal producers."[21] Similarly a Canadian survey found no significant difference in returns for equity investors employing socially-responsible investment criteria and other non-SRI investments.[22]

The Responsible Investment Association published a study exploring the potential of fosil fuel free investment in Canada. It notes that divestment from all fossil fuels poses a particular challenge in Canada since fossil fuel companies account for about one quarter of the S&P/TSX composite index. The 2014 study looked at a small number of existing fossil fuel free funds and found that "The existing FFF funds have outperformed the index over the last 12 to 15 months, but slightly underperformed their benchmark on a 3, 5 and 10-year basis. Contrary to assumptions about FFF strategies, these comparable returns were also achieved with comparable risk, relative to the benchmark."[23]

Another study by "MSCI , the world's largest stock market index provider, found that portfolios with a mix of coal-, gas- and oil-producing companies returned 11.8 per cent a year. Fossil-free portfolios had an average return of 13 per cent."[24]**What alternatives do institutional investors have?**

One source for information on investment alternatives is the Responsible Investment Association of Canada www.riacanada.ca

In the U.S. a report compiled by HIP Investor, a registered investment advisor in the states of California, Washington and Illinois, contains an appendix that lists some samples of clean energy and fossil free funds for investors to consider. The authors of the report are careful to say that they are not making investment recommendations, only providing information.[25]

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[1] Cited in John Dillon. "Movement for Divesting from Fossil Fuels Gaining Strength." *KAIROS Briefing Paper* No. 38, April 2014.

[2] Mark Carney, Governor Bank of England. *Breaking the Tragedy of the Horizon – climate change and financial stability*. Speech to Lloyd's of London. September 29, 2015. http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech844.pdf

[3] Ibid. p. 10

[4] Ibid.

[5] Carbon Tracker News Release. "Fossil fuel firms risk wasting $2 trillion on uneconomic projects." London and New York. Nov. 25, 2015.

[6] The full carbon Tracker report is available for download at http://www.carbontracker.org/report/stranded-assets-danger-zone/

[7] *Recommendations of the Task Force on Climate-related Financial Disclosures*. December 14, 2016.

[8] Shawn McCarthy and Jacqueline Nelson. "New risks emerge for firms exposed to climate change." *The Globe and Mail.* April 5, 2017. B1 and B4.

[9] Cited in Keith Stewart. "Oil companies and the financial risk of climate change." *Policy Options*. March 2017.

[10] Canadian Securities Administrators News Release. "Canadian securities regulators announce climate change disclosure review project." Toronto and Calgary. March 21, 2017.

[11] Colin Perkel. "Companies need to come clean about climate change risks, Mark Carney says." *National Observer*. July 15, 2016.

[12] Jeffrey Jones. "New Suncor report signals shifting climate." *The Globe and Mail*. April 19, 2017. B1 and B8.

[13] Cited in Carl Meyer. "Suncor admits climate change will turn its business upside down." *National Observer*. April 20, 2017.

[14] Bruce Cheadle. *Some oil companies undeterred as global leaders sign on to Paris climate deal*. The Canadian Press Online Edition. April 17, 2016.

[15] Cited in Keith Stewart. "Oil companies and the financial risk of climate change." *Policy Options*. March 2017.

[16] Janet McFarland. "Canadian fund managers lag on tackling climate change risks: survey.*" The Globe and Mail*. May 2, 2016.

[17] Asset Owners Disclosure project. Global Climate Index 2017: Rating the World's Investors on Climate Related Financial Risk. April 2017. http://aodproject.net/wp-content/uploads/2017/04/AODP-GLOBAL-INDEX-REPORT-2017_FINAL_PRINT.pdf

[18] Paul Karp. "Most global investors recognize financial risk of climate change, report finds." *The Guardian*. April 25, 2017.

[19] Jeremy Leggett. "G20 Climate Risk Report is a Wake-up Call for Fossil Fuel Investors." *Jeremy Leggett blog*. January 23, 2017.

[20] Richard Dennis et al. "Climate Proofing your Investments: Moving Funds out of Fossil Fuels." The Australia Institute. March 2014. P.23.

[21] Nathaniel Bullard. "Fossil fuel divestment: a $5 trillion challenge.*" Bloomberg New Energy and Finance White Paper*. August 25, 2014. P.3.

[22] Reid Baker. "Socially-responsible funds go head to head on returns." In *Your Guide to Ethical Investing*. Toronto: Brights Roberts Inc. 2014 p.11-12.

[23] Dustyn Lanz et al. *The Climate has Changed: Exploring the Investment Potential of Fossil Fuel Free Portfolios*. Responsible Investment Association (Canada). 2014 p.3. at https://riacanada.ca/wp-content/uploads/The-Climate-has-Changed-v2.pdf

[24] "Analysis busts myth that divestment is a losing proposition." Corporate Knights. May 5, 2015.

[25] HIP Investor. Resilient Portfolios & Fossil-Free Pensions. http://hipinvestor.com/wp-content/uploads/Resilient-Portfolios-and-Fossil-Free-Pensions-ByHIPinvestor-GoFossilFree-vFinal-2014Jan21.pdf September 30, 2013.