Private Wealth

Burning Questions

Jerilyn Klein Bier | Jan. 27, 2015

Even before the energy boom became a victim of its own success as crude oil prices collapsed in November, it was facing severe headwinds from the fossil fuel divestment movement, which gained serious momentum in 2014. Initiated in 2011, when students on a half dozen campuses asked their colleges to divest endowments, and ramped up in 2012 with the launch of nonprofit 350.org's Fossil Free campaign, it has grown far more rapidly than prior divestment crusades.

As of September 19, 181 institutions and local governments and 656 individuals representing more than $50 billion in assets had pledged to divest from fossil fuels, according to a report from Arabella Advisors, a philanthropy and impact investing consulting firm headquartered in Washington, D.C.

Governments accounted for 48% of the $50 billion, followed by educational institutions (38%), philanthropic foundations (8%), faith-based organizations (2%), individuals (2%), health-care institutions (1%) and NGOs (1%).

Since January 2014, the number of commitments by campuses, churches, cities, states, hospitals, pension funds and other institutions—in the U.S. and abroad—more than doubled, noted the September report. Leaders of the movement have committed by the end of 2015 to triple the assets represented by institutions that divest, says Ryan Strode, an associate director at Arabella Advisors.

Divestment pledges vary greatly, from the portion of a portfolio that's to become fossil-fuel-free to the types of investments to be shed.
Author and environmentalist Bill McKibben, a co-founder and chairman of the board of 350.org, is pleased with the progress of the movement. "It's way ahead of our expectations," he says. "I think it's pretty remarkable given the power of the fossil fuel industry."

"When the World Council of Churches divested this summer, that was a very good sign," he adds. Another symbolic high point, he says, came in September when the Rockefeller Brothers Fund, a family foundation with $860 million in assets, announced it would begin to divest from fossil fuels. Its immediate focus is coal and tar sands. Patriarch John D. Rockefeller Sr. founded Standard Oil, now Exxon Mobil Corp.

"If the first family of fossil fuels, the descendants of the guy who started it all, have decided that it's neither wise nor moral to be invested in fossil fuels, then I think we've won the argument," says McKibben. "We just need now to win the fight."

The Fossil Free campaign is concentrating on the 200 companies with the largest carbon reserves. McKibben says there are two points for investors to bear in mind.

First, "If it's wrong to wreck the planet, then it's wrong to profit from the wreckage of the planet," he says. Second, "If the world ever begins to take seriously climate change, then those stocks are worth far less than they appear."

In his influential 2012 Rolling Stone article, "Global Warming's Terrifying New Math," McKibben shared figures crunched by the Carbon Tracker Initiative and others. He noted that keeping the rise in global temperature below 2 degrees Celsius, as scientists suggest, would require fossil fuel companies to keep 80% of their reserves locked away and, in turn, write off roughly $20 trillion in assets.

The World Bank, the International Monetary Fund and many organizations have since endorsed "the basic mathematics of climate change," he says. "It's astonishing to see it in places that are kind of at the heart of the fossil fuel beast." For example, in October, Australia's national university announced plans to divest from seven resources companies even though the country is a leading exporter and user of coal.

A small sampling of other institutions that have pledged to divest in some manner from fossil fuels includes the cities of Seattle and San Francisco, Stanford University and one of Sweden's national pension funds.

Endless Inquiries

Ben Caldecott, a program director at the University of Oxford's Smith School of Enterprise and the Environment, where he founded and directs the Stranded Assets Programme, co-authored the program's late-2013 report, Stranded Assets and the Fossil Fuel Divestment Campaign.

Caldecott says that in one sense he is not surprised by how quickly the fossil fuel campaign has spread. After all, the Internet and social media weren't available during the divestment campaigns aimed at tobacco and South African apartheid.

Even so, the pace and depth "have taken everyone by surprise, and companies and organizations have been spooked by it," he says. "It has put this on the mainstream agenda of boards and pension funds." Over the next two to three years, big pension funds will have to publish plans for their fossil fuel strategies, he says.

Presently, he is receiving endless inquiries from "big institutions to big oil majors and almost everyone in between," he says. The campaign's focus on divesting is only part of the picture. "The point is, it's raising the need for investors to think about climate change and carbon asset risk," he says. "It's opened up the space to have conversations about all these other things."

According to the Oxford report, the direct impacts of fossil fuel divestment on equity or debt are likely to be limited. Public pension funds and university endowments have just 2% to 5% of their assets invested in fossil-fuel-related public equities. Divested shares are also likely to quickly find their way to neutral investors, especially if divesting triggers any short-term discounting of stock prices.

Still, Caldecott cautions that the prices of coal stocks, which are less liquid, are more likely to be impacted than those of major oil companies. And the cost of capital could become problematic for fossil fuel companies that have small market capitalizations and are located in countries with few sizable lenders, he says. If the World Bank is a key lender and restricts lending, he says it could be difficult to secure financing.

An indirect but big threat divestment can pose, according to the Stranded Assets Programme, is stigmatization. This could impact brand value and the ability of companies to retain customers, employees and suppliers, he says. Targeted companies could also lose contracts and M&A opportunities.

Another concern, which "by far could be the biggest worry," says Caldecott, is unpredictable changes in public policy. Most divestment campaigns he and his peers reviewed—including adult services, Darfur, tobacco and South Africa—successfully lobbied for restrictive legislation.
According to the Stranded Assets Programme, anticipation of a policy can increase uncertainty surrounding a company's future cash flows and sway investors. Uncertainty can also lead to permanent compression in price-earnings ratios.

Various Approaches

Julie Gorte, senior vice president for sustainable investing at Pax World Management LLC, the Portsmouth, N.H.-based advisor to the Pax World Funds, feels positive about the fossil fuel divestment movement. "This has gotten climate change into a lot of rooms where people are talking about what to invest in," she says.

A board member of Boston-based nonprofit CERES, she says she hears fellow board members, including state treasurers and pension plans, talk a lot about carbon asset risk and stranded assets. She also receives letters from Pax shareholders, namely millennials and Gen Xers, who are interested in impact investing and concerned about fossil fuels, she says.

While many people think that energy companies are the biggest threat to climate change, she notes that the energy industry is actually the third-highest producer of carbon emissions. Utilities far outpace them, followed by materials companies—a hodgepodge of mining, metals, aluminum and steel companies, she says.

For its part, Pax World is taking a hybrid approach to fossil fuel divestment. Its Global Environmental Markets Fund and World Growth Fund are fossil-fuel-free. Its other funds may invest in fossil fuel companies but avoid investing in coal and tar sands, the biggest environmental offenders. The hybrid approach, says Gorte, enables Pax World to engage with companies to help mitigate climate change and still accommodate investors who hold different goals.

Two years ago, Gorte wrote to 42 companies in the Pax World portfolio to ask what they were doing to address carbon asset risk. More than 20% of the companies replied, which she describes as "astonishingly high" for a first-letter response.

While not all responders were taking steps to mitigate emissions or to expand their business models to include renewable energy, "The number of companies telling us to take a walk is small and dwindling on this issue," she says.

Companies she meets with are often facing regulatory, litigation and reputational risk, and many "are interested in meeting us halfway," she says. She declined to discuss ongoing engagements because, she says, "I could poison the well."

The Pax World International Fund invests in BG Group plc, a U.K.-based world leader in natural gas, which she says is diversifying into renewables. She says many major integrated energy companies are also increasing attention to renewables. "It's far from replacing their dependence on oil, but it's a start," she says. The Pax World Balanced Fund holds shares of Baker Hughes, a leading supplier of oil field services and products. The Pax Funds also invest in a number of utility companies.

Laura Berry, executive director of the Interfaith Center on Corporate Responsibility (ICCR), says there has been an enormous amount of talk about fossil fuel divestment in the faith-based investment community.

"We respect the power, wisdom and arguments of the divestment movement, but at the same time want to support deeply committed folks still in the engagement game," she says. "We need to be at the table to help companies be resilient, adaptive and innovative as we decarbonize the economy."

ICCR 326's members, who have more than $100 billion in assets under management, are taking "a continuum of approaches," she says. Some are staying invested in fossil fuel companies. Others are divesting or seeking opportunities in alternative asset classes.

"We have members who are hungry for good, viable projects to help create a new-energy economy," says Berry. "Demand is greater than supply."
Meanwhile, in November, Arjuna Capital/Baldwin Brothers Inc. and As You Sow filed a first-of-its-kind proposal with Exxon Mobil Corp., asking it to increase dividends or share buybacks rather than invest in high-cost, high-carbon projects. "Exxon Mobil should return capital to shareholders rather than gamble with investor resources," said Natasha Lamb, director of equity research and shareholder engagement at Arjuna, in a press release.

According to the August report "Fossil Fuel Divestment: A $5 Trillion Challenge" from Bloomberg New Energy Finance, it's not easy to pull money from oil and gas equities and plunk it into clean energy, because clean energy lacks the scale of other sectors, its equities are volatile, and its yield instruments are still very small.

“Fossil fuel divestment is neither imminent nor inevitable,” concludes the report. “But, neither is it impossible for motivated investors.”

The Stranded Assets Programme encourages investors to closely monitor their fossil fuel exposure, stress-test their portfolios for potential environmental risks, be explicit about strategy on fossil fuel investment, understand the costs of divestment and engage with the management of companies targeted by divestment.

Investors and financial advisors seeking to stay informed about issues concerning fossil fuels can turn to the Carbon Disclosure Project, the United Nations-supported Principles for Responsible Investment (PRI), groups within the Global Investor Coalition on Climate Change and GoFossilFree.org, says Caldecott.

McKibben doubts shareholder engagement will influence fossil fuel companies to significantly change their business models. After all, the Rockefeller family’s efforts with executives at Exxon Mobil Corp. were unsuccessful, he says.

“If you’re invested in this stuff [fossil fuels], you’re making a bet that the planet is never going to do anything about climate change,” he says. “It’s an immoral bet, but I think it’s probably a stupid one too because Mother Nature is reminding us, with frequency, the depth of our folly.”

http://www.fa-mag.com/news/burning-questions-20573.html