

# The Case for Fossil Fuel Divestment: City Hall and the LPFA



Briefing for the London Assembly Labour Group

January 2015

## **Divest City Hall and the LPFA of its fossil fuel investments**

We request that City Hall commit not to invest in fossil fuel companies and that it apply pressure to the London Pensions Fund Authority (LPFA) to divest its fossil fuel holdings.

Our request comes as citizens around the world ask their public and private institutions to recognize the financial and environmental risks posed by fossil fuel investments.

More than 800 global institutions – including the World Council of Churches, the British Medical Association, Glasgow University, Stanford University, and the Rockefeller Brothers Fund, heirs to the greatest oil fortune in history – have so far pledged to withdraw a cumulative asset base of \$50 billion from fossil fuel investments over the next 3-5 years. Other city councils, including San Francisco, Seattle and Oxford, have also committed to divest.

The Fossil Free campaign is now the fastest growing divestment movement of all time.

### **The Climate science: 25 years to limit temperature increases to 2°C warming**

Human-induced climate change is the greatest threat facing human civilisation. The actions we take in the next two decades will define the conditions in which we and future generations live.

The Intergovernmental Panel on Climate Change (IPCC) released its fifth report in September 2013 – ‘arguably the most audited scientific document in history’.<sup>1</sup> In its Summary for Policymakers it states: ‘Warming of the climate system is unequivocal’ and it is ‘*extremely likely*’ (95-100% certainty) that the observed increase in global temperature ‘was caused by the anthropogenic increase in greenhouse gas concentrations.’<sup>2</sup>

‘Continued emission of greenhouse gases will cause further warming and long-lasting changes in all components of the climate system, increasing the likelihood of severe, pervasive and irreversible impacts for people and ecosystems.’<sup>3</sup>

At the 2009 Copenhagen summit, attendee nations pledged to limit global warming to 2°C above pre-industrial era temperatures, beyond which humanity risks ‘dangerous interference with the climate system’.<sup>4</sup> In order to stay below the 2°C guardrail, the IPCC has calculated that humans can emit a maximum cumulative amount of 1000 gigatons of carbon (GtC) up until the year 2050.<sup>5</sup> There are currently 565 GtC left in this ‘carbon budget’. This year we will emit greater than 10 GtC globally and this amount increases by 2 to 3 percent each year as global consumption of fossil fuels continues to grow. Staying on this business-as-usual

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<sup>1</sup> Chris Rapley, professor of climate science at University College London, (<http://www.theguardian.com/science/2014/nov/22/-sp-climate-change-special-report>).

<sup>2</sup> IPCC Fifth Assessment Synthesis Report, ([http://www.ipcc.ch/pdf/assessment-report/ar5/syr/SYR\\_AR5\\_SPMcorr1.pdf](http://www.ipcc.ch/pdf/assessment-report/ar5/syr/SYR_AR5_SPMcorr1.pdf)). p. 1, p.5.

<sup>3</sup> Ibid, p. 8.

<sup>4</sup> Copenhagen Accord, ([http://unfccc.int/files/meetings/cop\\_15/application/pdf/cop15\\_cph\\_auv.pdf](http://unfccc.int/files/meetings/cop_15/application/pdf/cop15_cph_auv.pdf)). p.1.

<sup>5</sup> IPCC Fifth Assessment Synthesis Report, p. 10.

trajectory will exhaust our remaining carbon budget by the year 2040 and likely commit us to a 4°C+ rise by the end of the century.<sup>6</sup>

The 4°C scenarios are devastating: the inundation of coastal cities; increasing risks for food production... unprecedented heat waves in many regions, especially in the tropics; substantially exacerbated water scarcity in many regions; increased frequency of high-intensity tropical cyclones; and irreversible loss of biodiversity... most importantly, a 4°C world is so different from the current one that it comes with high uncertainty and new risks that threaten our ability to anticipate and plan for future adaptation needs. The lack of action on climate change not only risks putting prosperity out of reach of millions of people in the developing world, it threatens to roll back decades of sustainable development.<sup>7</sup>

### **The ‘Carbon Bubble’ and its associated risks for the London and UK economies**

In 2013, a landmark study by financial analysts at the Carbon Tracker Initiative, in collaboration with Professor Lord Stern and the Grantham Institute, identified ‘a gross inconsistency between current valuations of fossil fuel assets and the path governments have committed to take in order to manage the huge risks of climate change’.<sup>8</sup>

The modelling used in previous analyses by Carbon Tracker and the International Energy Agency showed that the carbon budget for a 2°C scenario would be around 565 – 886 billion tonnes (Gt) of carbon dioxide (CO<sub>2</sub>) to 2050. This budget, however, is only a fraction of the carbon embedded in the world’s indicated fossil fuel reserves, which amount to 2,860GtCO<sub>2</sub>. A precautionary approach means only 20% of total fossil fuel reserves can be burnt to 2050. As a result the global economy already faces the prospect of assets becoming stranded, with the problem only likely to get worse if current investment trends continue - in effect, a carbon bubble...

If listed fossil fuel companies have a pro-rata allocation of the global carbon budget, this would amount to around 125 - 275GtCO<sub>2</sub>, or 20 - 40% of the 762GtCO<sub>2</sub> currently booked as reserves. The scale of this carbon budget deficit poses a major risk for investors. They need to understand that 60 - 80% of coal, oil and gas reserves of listed firms are unburnable.

The report identifies highly significant implications for London.

... the CO<sub>2</sub> potential of the reserves listed in London alone account for 18.7 per cent of the remaining global carbon budget... With approximately one third of the total value of the FTSE 100 being represented by resource and mining companies, London’s role as a global financial centre is at stake if these assets become unburnable en route to a low carbon economy.<sup>9</sup>

### **Concern at the highest levels**

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<sup>6</sup> Ibid, p. 18.

<sup>7</sup> *Turn Down the Heat*, A Report for the World Bank by the Potsdam Institute for Climate Impact Research and Climate Analytics, (<https://www.thepmr.org/system/files/documents/turn%20down%20the%20heat.pdf>). p.ix.

<sup>8</sup> Carbon Tracker Initiative, *Unburnable Carbon 2013*, (<http://carbontracker.org/wp-content/uploads/2014/09/Unburnable-Carbon-2-Web-Version.pdf>) p. 8.

<sup>9</sup> Ibid, p. 4.

The London Assembly has recognised the Carbon Bubble in a recent Economy Committee report as one of the major climate change risks facing the city.<sup>10</sup>

This echoes the warning raised by the House of Commons Environment Audit Committee that ‘stock markets are currently over-valuing companies that produce and use carbon.’<sup>11</sup> Chair and Labour MP Joan Walley further cautioned: ‘The UK Government and Bank of England must not be complacent about the risks of carbon exposure in the world economy.’<sup>12</sup>

In response, Mark Carney has warned of ‘unburnable carbon’ at the World Bank, and the Bank of England has committed to widen and deepen its enquiry into stranded fossil fuel assets, with its Financial Policy Committee investigating the risks these pose to economic security.<sup>13</sup>

Meanwhile, Secretary of State for Energy and Climate Change Ed Davey has called for more stringent transparency from financial groups about the size of their fossil fuel investments. Highlighting particular concern for pensioners, he warned that fossil fuel holdings could be the ‘sub-prime assets of the future’.<sup>14</sup> In fact, stranded carbon assets may be worth as much as \$28 trillion, dwarfing the size of the sub-prime bubble.<sup>15</sup>

### **The economic arguments for divestment**

With fossil fuel investments looking increasingly risky, there is mounting evidence that divestment is a prudent financial decision and that the ‘smart money’ is beginning to move.

Examples include: the US\$74 billion Scandinavian asset manager, Storebrand, which divested from coal and oil sand businesses on the basis that ‘these resources are worthless financially’;<sup>16</sup> Tom Steyer, US billionaire and founder of Farallon, one of the world’s most successful hedge funds, who has divested in part because he believes a fossil-free portfolio ‘will outperform the market’;<sup>17</sup> and the Rockefeller Brothers Fund, whose President stated that ‘if John D Rockefeller’, the founder of Standard Oil, ‘were alive today, as an astute

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<sup>10</sup> *The Impact of Climate Change on London’s Economy*, London Assembly, ([https://www.london.gov.uk/sites/default/files/FINAL%20climate%20change%20summary%20views\\_0.pdf](https://www.london.gov.uk/sites/default/files/FINAL%20climate%20change%20summary%20views_0.pdf)). p. 11.

<sup>11</sup> *Green Finance*, House of Commons Environmental Audit Committee, (<http://www.publications.parliament.uk/pa/cm201314/cmselect/cmenvaud/191/191.pdf>). p. 3.

<sup>12</sup> Chair’s comments, <http://www.parliament.uk/business/committees/committees-a-z/commons-select/environmental-audit-committee/news/green-finance-por-substantive/>

<sup>13</sup> Letter from Mark Carney, Governor of the Bank of England to House of Commons Environmental Audit Committee, 30 October 2014, (<http://www.parliament.uk/documents/commons-committees/environmental-audit/Letter-from-Mark-Carney-on-Stranded-Assets.pdf>).

<sup>14</sup> (<http://www.telegraph.co.uk/finance/newsbysector/energy/11277546/Fossil-fuel-investing-a-risk-to-pension-funds-says-Ed-Davey.html>).

<sup>15</sup> Divest-Invest, *The \$28 Trillion Carbon Bubble*, ([http://www.academia.edu/8381776/The\\_28\\_Trillion\\_Carbon\\_Bubble\\_Chapter\\_2\\_of\\_Divest-Invest\\_The\\_Beginning\\_of\\_a\\_New\\_Movement\\_and\\_the\\_End\\_of\\_the\\_Fossil\\_Fuel\\_Era](http://www.academia.edu/8381776/The_28_Trillion_Carbon_Bubble_Chapter_2_of_Divest-Invest_The_Beginning_of_a_New_Movement_and_the_End_of_the_Fossil_Fuel_Era)). p. 4.

<sup>16</sup> (<http://blueandgreentomorrow.com/2013/07/05/norwegian-pension-fund-divests-from-financially-worthless-fossil-fuels/>).

<sup>17</sup> Tom Steyer, *Statement to the Middlebury College Board of Trustees*, 22<sup>nd</sup> Jan 2013, (<http://middleburycampus.com/wp-content/uploads/2013/01/SteyerLetter.pdf>).

businessman looking to the future, he would be moving out of fossil fuels and investing in clean, renewable energy.’<sup>18</sup>

In response to growing interest, BlackRock, the world’s largest fund manager, has teamed up with FTSE Group to provide a fossil-free index for investors.

Research shows that investment in a fossil-free portfolio is unlikely to be financially injurious in the short to medium term. The U.N. Environment Program Finance Initiative’s meta-analysis of twenty academic studies on the effect of incorporating ESG factors in the investment management process found no evidence of a resulting performance penalty. The two reviewed studies that focused specifically on environmental factors found a positive relationship between consideration of those factors and performance.<sup>19</sup>

Furthermore, asset management firm Impax published a report in 2013 comparing a portfolio consisting of the MSCI World Index with another in which fossil fuel stocks were excluded. They determined that the portfolio excluding fossil fuel investments would have seen improved returns of 0.5 percentage points annually over the period 2008-2013.<sup>20</sup> These conclusions are echoed in recent analysis from MCSI ESG Research, which found close tracking between their standard index and an ‘ex Carbon list’.<sup>21</sup>

In the long term, these investments will become increasingly risky as the cost of extraction increases and international treaties restrict the use of fossil fuels. President Jim Yong Kim of the World Bank and Christiana Figueres, UN Climate Chief, have warned institutional investors and pension fund managers to rethink their fiduciary responsibilities in the light of stranded asset risks.<sup>22</sup>

### **The political challenges of climate change**

The last twenty years of international negotiations on implementing a global climate treaty have not resulted in a binding multilateral commitment to address climate change.

Meanwhile, rather than facilitating the transition to a low-carbon economy, fossil fuel companies are fully committed to utilising all of their known reserves, as well as devoting significant capital to developing new methods and sources of extraction.

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<sup>18</sup> (<http://www.telegraph.co.uk/finance/newsbysector/energy/oilandgas/11114591/Rockefeller-family-sells-out-of-fossil-fuels-and-into-clean-energy.html>).

<sup>19</sup> *Demystifying Responsible Investment Performance*, UNEPFI and Mercer, ([http://www.unepfi.org/fileadmin/documents/Demystifying\\_Responsible\\_Investment\\_Performance\\_01.pdf](http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf)).

<sup>20</sup> *Beyond Fossil Fuels: The Investment Case for Fossil Fuel Divestment*, Impax Asset Management, (<http://www.impaxam.com/media-centre/white-papers/beyond-fossil-fuels-investment-case-fossil-fuel-divestment>).

<sup>21</sup> MSCI ESG Research, *Responding to the Call for Fossil-fuel Free Portfolios*, ([http://www.msci.com/resources/factsheets/MSCI\\_ESG\\_Research\\_FAQ\\_on\\_Fossil-Free\\_Investing.pdf](http://www.msci.com/resources/factsheets/MSCI_ESG_Research_FAQ_on_Fossil-Free_Investing.pdf)), p. 5.

<sup>22</sup> UN Press Release, *Safeguarding Future Retirement Funds – Time for Investors to Move Out of High-Carbon Assets Says UN’s Top Climate Official*, ([http://unfccc.int/files/press/press\\_releases\\_advisories/application/pdf/pr20140115\\_ceres\\_final1.pdf](http://unfccc.int/files/press/press_releases_advisories/application/pdf/pr20140115_ceres_final1.pdf)).

The Carbon Tracker report found that in 2012 the top 200 fossil fuel companies allocated up to US\$647 billion for exploring new reserves.<sup>23</sup> The London stock market has continued to invest, increasing its exposure to carbon (particularly coal) by seven per cent between 2011 and 2013.<sup>24</sup>

In response to the Carbon Bubble issue, major fossil fuel companies argue that long-term energy demand ensures a long-term market for their products. In a recent statement to its shareholders, Royal Dutch Shell wrote:

...because of the long-lived nature of the infrastructure and many assets in the energy system, any transformation will inevitably take decades. This is in addition to the growth in energy demand that will continue until mid-century, and possibly beyond... As such, we do not believe that any of our proven reserves will become “stranded”.<sup>25</sup>

Similarly, Exxon Mobil reported to shareholders:

ExxonMobil believes that although there is always the possibility that government action may impact the company, the scenario where governments restrict hydrocarbon production in a way to reduce GHG emissions 80 percent during the Outlook period is highly unlikely.<sup>26</sup>

Their conclusions rest on the assumption that governments will not follow through on their emissions pledges. However, after the US and China’s landmark joint announcement of far-reaching plans to cap GHG emissions, Lord Browne, former BP chief executive, has accused the fossil fuel industry of ignoring the ensuing energy regulation that poses ‘an existential threat to their business’.<sup>27</sup>

China’s commitment to cap their coal use makes investment in coal companies such as Rio Tinto and BHP Billiton, both of which the LPFA invests in, particularly risky. Secretary Ed Davey has singled out coal as ‘the short-term biggest worry by a long way’.

### **Why City Hall needs to act**

The investments we make as individuals and institutions reflect what we expect the future to be.

The Mayor and the London Assembly have committed both to reducing London’s contribution to climate change as well as safeguarding the city against its impacts. In

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<sup>23</sup> ‘There is no good reason for this vast expenditure of stockholder wealth’. Bevis Longstreth, Former Commissioner, US Securities and Exchange Commission, *The Financial Case for Divestment of Fossil Fuel Companies by Endowment Fiduciaries*, Huffington Post, ([http://www.huffingtonpost.com/bevis-longstreth/the-financial-case-for-di\\_b\\_4203910.html](http://www.huffingtonpost.com/bevis-longstreth/the-financial-case-for-di_b_4203910.html)).

<sup>24</sup> *Unburnable Carbon* 2013, p. 4. Also quoted in the London Assembly Economy report, p. 12.

<sup>25</sup> Royal Dutch Shell plc, Letter from Dr JJ Traynor, Executive Vice President, 16 May 2014, (<http://s02.static-shell.com/content/dam/shell-new/local/corporate/corporate/downloads/pdf/investor/presentations/2014/sri-web-response-climate-change-may14.pdf>). p. 1.

<sup>26</sup> Exxon Mobil, *Energy and Carbon – Managing the Risks*, (<http://cdn.exxonmobil.com/~media/Files/Other/2014/Report%20-%20Energy%20and%20Carbon%20-%20Managing%20the%20Risks.pdf>). p.12.

<sup>27</sup> Financial Times, *Energy Groups face ‘existential’ climate threat, says ex-BP chief*, (<http://www.ft.com/cms/s/0/697dc8de-7016-11e4-bc6a-00144feabdc0.html#axzz3QK7odJhl>).

particular, they have developed an energy policy to cut London's carbon emission levels by 60% by 2025.<sup>28</sup>

The LPFA manages the pensions of City Hall employees (including the Mayor of London and the London Assembly) as well as many other local authorities. It handles £4.8 billion worth of assets, millions of which are direct investments in fossil fuel companies such as BHP Billiton, Rio Tinto and Shell.<sup>29</sup> Indirect investments are likely to exceed £100 million.

Continuing to invest in the fossil fuel industry contradicts the commitment to ensure 'London is a city that becomes a world leader in tackling climate change'.<sup>30</sup> The Mayor and Assembly's targets for emissions reduction are undermined by their investment in companies whose business models explicitly rely on those targets not being met.

A recent study by the Oxford University Smith School of Economics has demonstrated that, throughout history, divestment has successfully instigated robust political action: 'In almost every divestment campaign we reviewed from adult services to Darfur, from tobacco to South Africa, divestment campaigns were successful in lobbying for restrictive legislation affecting stigmatised firms.'<sup>31</sup> Divestment could create the context in which widely called for policy measures – such as effective carbon pricing<sup>32</sup> and redirection of subsidies<sup>33</sup> – may be enacted.

The Oxford study also finds that 'the direct impacts of fossil fuel divestment on equity or debt are likely to be limited. The maximum possible capital that might be divested by university endowments and public pension funds from the fossil fuel companies represents a relatively small pool of funds.'<sup>34</sup> In other words, there is no danger of LPFA divestment bankrupting the companies in question and 'causing huge disruption to the world economy', as Matthew Pencharz, Senior Adviser, Environment and Energy, expressed great concern about in a recent email exchange with our campaign.

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<sup>28</sup> Greater London Authority, *Delivering London's Energy Future*, (<http://www.london.gov.uk/sites/default/files/Energy-future-oct11-exec-summ.pdf>). p. x.

<sup>29</sup> LPFA, *Breakdown of Portfolio Holdings as at 31 March 2014*, (<file:///Users/latty637/Downloads/Breakdown+of+Holdings+31+03+14+v1.pdf>).

<sup>30</sup> Mayor of London, *London's Response to Climate Change*, (<https://www.london.gov.uk/sites/default/files/LP2011%20Chapter%205.pdf>). p. 138.

<sup>31</sup> A. Ansar, B. Caldote & J. Tilbury, *Stranded Assets and the Fossil Fuel Divestment Campaign: What does Divestment Mean for Stranded Assets?* (<http://www.smithschool.ox.ac.uk/research/stranded-assets/index.html?content=publications>).

<sup>32</sup> The International Monetary Fund, the World Bank and the OECD have endorsed carbon pricing as the most cost effective way of cutting emissions. See OECD, *Effective Carbon Prices*, ([http://www.keepeek.com/Digital-Asset-Management/oecd/environment/effective-carbon-prices/executive-summary\\_9789264196964-2-en#page1](http://www.keepeek.com/Digital-Asset-Management/oecd/environment/effective-carbon-prices/executive-summary_9789264196964-2-en#page1))

<sup>33</sup> 'Removing energy subsidies helps prolong the availability of non-renewable energy resources over the long term and strengthens incentives for research and development in energy-saving and alternative technologies.' International Monetary Fund, *Energy Subsidy Reform: Lessons and Implications*, (<https://www.imf.org/external/np/pp/eng/2013/012813.pdf>). p. 16.

See also House of Commons Environmental Audit Committee, *Energy Subsidies*. 'Energy subsidies in the UK are running at about £12bn a year; much directed at fossil fuels... the Government needs to demonstrate leadership in increasing the deployment of renewables and in promoting energy efficiency through the careful and targeted use of subsidies and levies'.

(<http://www.publications.parliament.uk/pa/cm201314/cmselect/cmenvaud/61/61.pdf>). pp. 3-4.

<sup>34</sup> Oxford Smith School, p. 12.

Beyond arguments of leadership and integrity, there is a strong moral case in favour of divestment. Archbishop Desmond Tutu has pointed out that those least to blame for the climate crisis – the world’s poor – are worst affected. ‘Nobody should profit’, he argues, ‘from the rising temperatures, seas and human suffering caused by the burning of fossil fuels... Reducing our carbon footprint is not just a technical scientific necessity; it has also emerged as the human rights challenge of our time.’<sup>35</sup>

### **Conclusions: The 'win-win' reasons for a carbon-sensitive investment policy**

Fossil fuel divestment can be a 'win-win' strategy for City Hall.

The Mayor would align the investments made by and on behalf of City Hall with its intentions to reduce London's greenhouse gas emissions and to protect the citizens of London from climate change.

Furthermore, given the medium to long-term risks of carbon intensive investment, such a move ensures the ability of City Hall to protect the prosperity of its employees and constituents into the future.

So we ask:

1. The Mayor to make a public statement supporting the principle of divestment and committing to avoid investment in any bonds, stock or shares connected with fossil fuel extraction.
2. The Chair of the London Pensions Fund Authority to:

*-Immediately freeze any new investment in fossil fuel companies, including those made by externally managed and pooled funds;*

*-Offer a fossil free pension option to members;*

*-Draw up a plan for a managed divestment from the top 200 companies with the largest known carbon reserves (oil, gas and coal), and shift these funds to lower risk, ethical investments within 5 years.*

3. The Mayor must be transparent about his relationship with the fossil fuel industry:

*-Publishing full details of GLA group’s financial and other ties to the fossil fuel industry in an easily accessible manner;*

*-Not accepting sponsorship and advertising from fossil fuel companies in any part of the GLA group.*

4. The Mayor must do the above in a timely manner:

*-By setting up a working group to report back on a strategy within three months.*

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<sup>35</sup> Desmond Tutu, *We fought apartheid, now climate change is our global enemy* (<http://www.theguardian.com/commentisfree/2014/sep/21/desmond-tutu-climate-change-is-the-global-enemy>).



### Key Reports Cited:

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A. Ansar, B. Caldote & J. Tilbury, *Stranded Assets and the Fossil Fuel Divestment Campaign: What does Divestment Mean for Stranded Assets?* (<http://www.smithschool.ox.ac.uk/research/stranded-assets/index.html?content=publications>).