# DIVESTING THE TOWER HAMLETS PENSION FUND: THE FINANCIAL CASE

*Submitted by Divest Tower Hamlets, a group of Tower Hamlets-based citizen volunteers*
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## 1. EXECUTIVE SUMMARY

Divestment from fossil fuels is part of a growing global movement, supported by a range of respected financial actors. While there are strong ethical and environmental arguments for divestment, this briefing focuses on the financial case against fossil fuels. Divest Tower Hamlets believes fossil fuels are a risky and outmoded investment class, ownership of which is not in the best financial interest of stakeholders in the Tower Hamlets Pension Fund. Continued investment in fossil fuels therefore contradicts the primary investment objective of the Pension Fund, as set out in the Pension Fund's Statement of Investment Principles[1]. According to data compiled from Freedom Of Information requests, the Pension Fund owns more than £91 million in fossil fuel securities, with a strong likelihood of significantly greater exposure through exotic investments and multi-asset funds[2].

Divest Tower Hamlets strongly recommends, for the sake of pension members, the climate and Tower Hamlets taxpayers, that the Pension Fund divest in full, or at least to the level consistent with keeping below 2 degrees of warning. The Environment Agency have pursued this latter approach, divesting 50% of their oil and gas stocks and 90% of their coal stocks in October 2015[3].

## 2. THE SCIENTIFIC CONTEXT

Before turning to the financial risks associated with investment in fossil fuels, it is important to note, at least briefly, the scientific context of climate change and its environmental consequences. The overwhelming scientific consensus is that climate change is a real phenomenon and that it is anthropogenic, that is, the product of human activity. The environmental consequences of unchecked climate change are difficult to predict and vary with the extent of global warming, but an increase in the average global temperature of even 2 degrees would have dramatic consequences and an increase of 3 degrees or above could make large parts of the earth uninhabitable. A more detailed discussion of climate change science and possible future scenarios is set out in the Annex at the end of this briefing.

## 3. RECENT DEVELOPMENTS ON CLIMATE CHANGE AND CARBON BUDGETS

The global deal reached on climate change in Paris on 12th December 2015 binds signatories to take action to stay within 2 degrees of global warming, and commits them to "pursuing efforts to limit the temperature increase to 1.5 degrees"[4]. As it stands now, the world has already warmed at least 1 degree Celsius since pre-industrial times[5]. To stay within 2 degrees, there is a limited carbon "budget" of gigatonnes of $CO_2$ the world can emit before breaching this upper warming limit. Award-winning research by one of the world's leading carbon accounting NGOs, Carbon Tracker, has shown through rigorous quantitative analysis that we can only emit a further 565 gigatonnes of $CO_2$ if we are to stay within the 2 degree limit[6]. Carbon Tracker also found that proven fossil fuel reserves owned by private and public companies, and governments, are equivalent to 2,795 gigatonnes of $CO_2$, of which 745 gigatonnes are owned by the top 200 listed oil, gas and coal companies. Unabated burning of all these proven reserves would blow the global carbon budget by a factor of five, taking us far above 2 degrees of warming[7]. Clearly, the

market value of these listed fossil fuel companies will be severely impaired if their proven reserves are unburnable and therefore become "stranded assets".

## 4. WHO HAS DIVESTED SO FAR?

As of 1st January 2016, various hedge funds, sovereign wealth funds, councils and universities comprising almost 500 institutions have committed to divest $3.4 trillion worth of assets between them[8]. Key divested institutions include the Rockefeller Brothers Fund, the Norwegian Sovereign Wealth Fund, The Environment Agency of the UK, the British Medical Association, the South Yorkshire Pension Fund, The Joseph Rowntree Trust, the cities of Berlin and Stockholm and many more. For the latest list of divested institutions, go to www.gofossilfree.org.

## 5. WHAT DO WE MEAN BY "FOSSIL FUEL DIVESTMENT"?

Fossil fuel divestment means avoiding direct ownership of, or commingled funds that include, shares, bonds or other securities of fossil fuel companies. The vast majority of the global coal, oil and gas reserves of publicly traded companies are held by just 200 firms[9].

The Environment Agency chose to go further, reinvesting 15% of their holdings into low-carbon solutions[10]. Divest Tower Hamlets believes it is key for the Pension Committee to also consider this option as part of their approach to divestment.

## 6. WHY NOT ENGAGE FOSSIL FUEL COMPANIES ON ISSUES OF CLIMATE CHANGE?

The "ask" for avoiding dangerous global warming is for fossil fuel companies to become integrated energy companies, rapidly moving away from extracting fossil fuels. Conservative estimates state that to stay within 2 degrees of warming, the world must rapidly decarbonise at a rate of 6.2% per year[11]. The world has missed this decarbonisation target for six years in a row, demonstrating the urgent action needed. Despite huge pressure from some of the most prominent stakeholders in the world to undertake such a transition, we are unaware of any fossil fuel company that has done this to date. On the contrary, the majority have sold off their renewable divisions and spent millions of pounds lobbying governments to maintain the status quo[12], whilst doubling down on 'core businesses' of oil, coal and gas:

| Company | Renewable Energy Division | Date sold off or shut down |
|---|---|---|
| **BP**[13] | Solar | 2011 |
| **BP**[14] | Wind | 2013 |
| **Chevron**[15] | Biofuels | 2010 |
| **Chevron**[16] | Renewables & Energy Efficiency Technology | 2014 |
| **Shell**[17] | Wind, Solar & Hydrogen | 2009 |

Another oil major, ExxonMobil, has no renewable energy assets within wind, solar or geothermal. When shareholders attempted to engage CEO Rex Tillerson on this issue at the ExxonMobil AGM in 2015, he mocked renewable energy, and a subsequent motion to install a climate change expert to the company's Board of Directors was rejected[18]. At its

most recent meeting in May of this year, ExxonMobil again rejected shareholder proposals to take action on climate change[19].

Other key financial actors and think tanks conclude that:

*"Measures of operational performance indicate [the fossil fuel] sector is largely unresponsive to expectations for leadership in addressing environmental impacts."*

**- CERES, a leading sustainability think tank[20]**

*"In regards to fossil fuel companies directly engaged in extractive activities, it is unrealistic to imagine them being swayed by shareholder arguments to get out of their core business of exploring for, extracting and selling carbon-emitting fuel."*

**- Bevis Longstreth, Former SEC Commissioner[21]**

*"We came to the conclusion that it was impossible for today's oil and gas majors to adapt in a timely and intelligent way to the imperative of radical decarbonisation. We felt we had no option but to end our longstanding partnerships with [them]."*

**- Jonathan Porritt, Founder of Forum for the Future[22]**

*"We tried engagement, and frankly got nowhere."*

**- Stephen Heintz, President, Rockefeller Brothers Fund[23]**

This last example is particularly poignant as the Rockefeller family laid the foundations for ExxonMobil, and their fund therefore had considerable influence over the company and its board of directors. In addition, at the time of divesting in June 2014, they had $45 million invested in various fossil fuel companies[24]. Yet engagement was still an unsuccessful strategy. In fact, far from convincing ExxonMobil to change course, it now appears that ExxonMobil may have been doing the exact opposite by actively misleading the public about the risks of climate change, as alleged in an investigation opened by the New York Attorney General last year[25].

We also do not see a credible comparison between, for example, the Local Authority Pension Fund Forum (LAPFF) lobbying the companies its members invest in on the London Living Wage or executive pay and convincing large multinational corporations with thousands of employees to abandon their core business. The fact that no institutional investor or government – globally – has achieved this to date is a strong indication that Tower Hamlets and the LAPFF are unlikely to succeed at this.

For all of the above reasons, Divest Tower Hamlets does not believe the Pension Committee can successfully persuade multinational fossil fuel companies to abandon their core business model within a realistic time frame, without being exposed to significant financial risk.

In addition, should the Pension Committee wish to participate in the annual shareholders' meeting of any particular fossil fuel company in order to make known its views on climate change, it would be sufficient to own a single share. There is no need for £91 million of exposure to implement engagement.

Moreover, it is the belief of Divest Tower Hamlets that engagement without a time limit is a hollow threat. It would only have influence if backed up by a commitment to divest along the lines of, "We, the Tower Hamlets Council Pension Committee, would like to see [Fossil Fuel Company A] become an integrated energy company within 5 years, or else we will divest". Other forms of engagement, when considering the urgency of climate change, are unlikely to have a timely or meaningful effect.

## 7. LONG-TERM RISK OF FOSSIL FUEL INVESTMENTS

The fossil fuel industry and the commodity markets that heavily influence its performance are inherently volatile, particularly when coupled with unforeseeable geopolitical factors[26]. As stated by the International Institute for Sustainable Development:

> *"Commodity price volatility has been tremendously problematic in the past. When revenues are high they tend to distort fiscal responsibility and encourage corruption. When revenues slump they slash government revenues, drive unemployment, increase national debt, and undermine health and education spending."* [27]

Higher risk in the form of elevated volatility has not in recent years meant higher returns for investments in the fossil fuel sector. For example, the market value of the US coal industry declined 94% between 2011 and early 2016[28], while the largest coal miner in the US, Peabody, recently declared bankruptcy[29]. A similar pattern is apparent internationally, and Bloomberg reports that "Coal is an industry in terminal decline"[30] as global coal consumption falls[31].

The oil industry appears to be following the trajectory of coal. A recent report from Chatham House argues that the major international oil companies face a choice between slow decline and rapid collapse[32]. If only a fraction of total global oil reserves are burnable without exceeding the 2 degree threshold, sovereigns like Saudi Arabia and Kuwait, which can produce oil at less than $10 per barrel[33], are more likely to be the ones producing that fraction than major oil firms in the private sector operating in some of the most inhospitable, and expensive, locations on the planet, like the Arctic seabed. In the absence of a radical change in direction by international oil firms, the Chatham House report's final assessment is that "what remains of their existence will be nasty, brutish and short" [34].

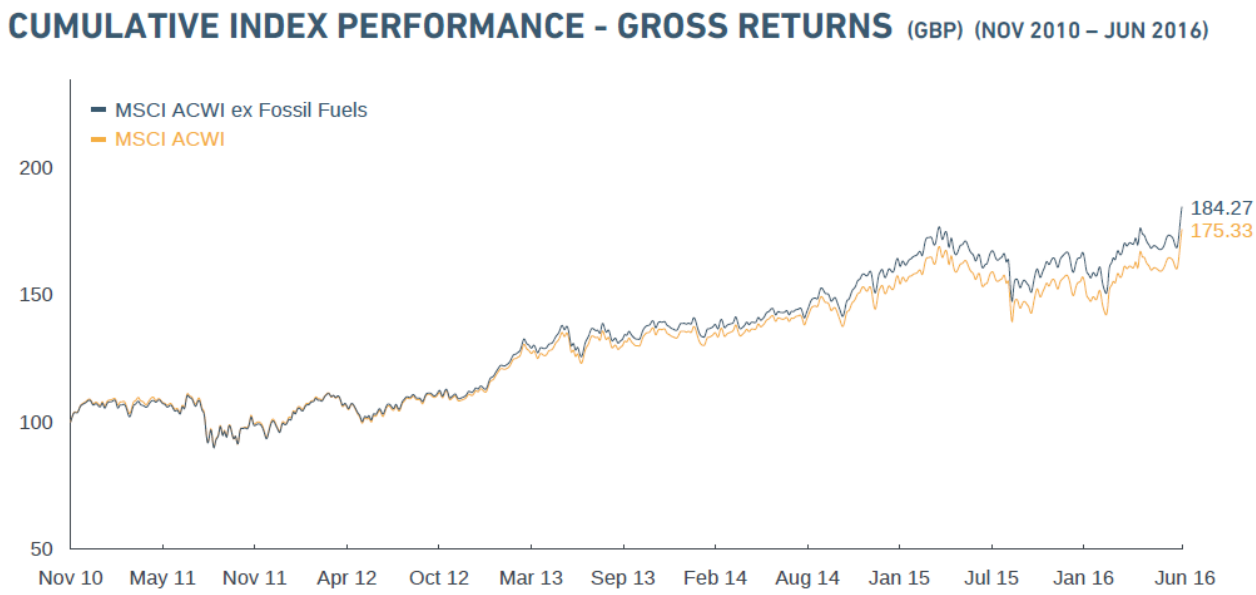
For these reasons, Divest Tower Hamlets does not believe that investments in fossil fuel companies are in the best financial interests of stakeholders in the Pension Fund.

## 8. THE FINANCIAL UPSIDE TO NON-FOSSIL FUEL COMPANIES

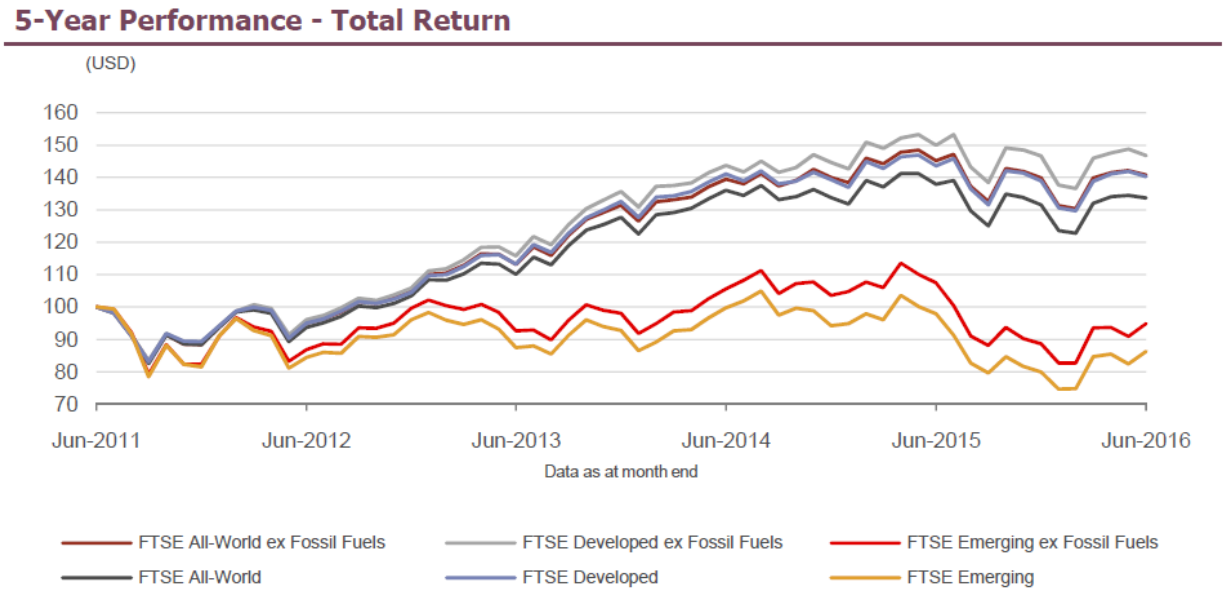
There is a growing body of evidence that companies that take environmental, social and governance (ESG) factors into account in their management consistently outperform the market. Deutsche Bank carried out a major review of this trend in 2012, concluding that 89 percent of the studies they observed showed that companies with a high ESG rating also exhibit market-based outperformance[35]:

| *ESG* Academic Studies and Meta Studies Disaggregated & Aggregated | Correlation to Higher Market-Based Performance (Returns) | Correlation to Higher Accounting-Based Performance | No. of Studies | Date Range of Studies | Date Range of Samples |
|---|---|---|---|---|---|
| Governance | Positive | ----- | 7[101] | 2003-2011 | 1990-2008 |
| Governance | Neutral | ----- | 1[102] | 2008 | 1997-2004 |
| Governance | ----- | Positive | 6 | 2006-2010 | 1990-2007 |
| Governance | ----- | Negative | 1[103] | 2003 | 1997-2002 |
| Environmental | Positive | ----- | 3[104] | 2003-2008 | 1994-2006 |
| Environmental | Neutral | ----- | 1 | 2010 | 1996-2007 |
| Environmental | ----- | Positive | 2[105] | 2001-2010 | 1989-2007 |
| Environmental | ----- | Mixed | 1[106] | 2008 | 2003-2004 |
| Social (Meta-Study) | Positive | | 1[107] | 2011 | 1991-2009 |
| Social | Positive | ----- | 4[108] | 1995-2010 | 1984-2009 |
| Social | Mixed | ----- | 1 | 2011 | 1992-2008 |
| Social | ----- | Positive | 2[109] | 1995-2006 | N.A |
| Aggregate | Positive | ----- | 1 | 2009 | 1999-2009 |

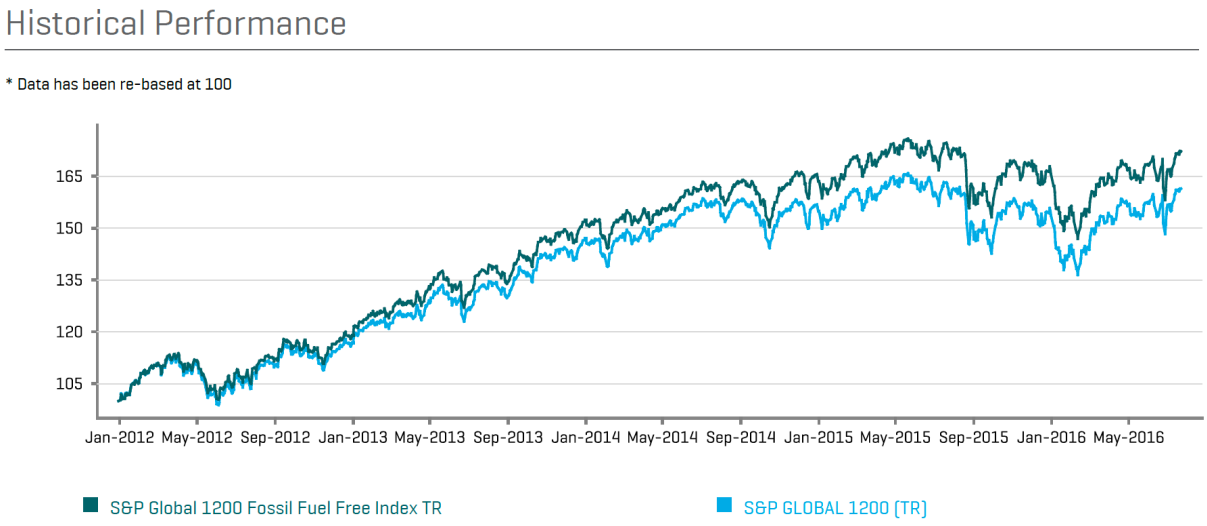
A number of global benchmark indices show the same thing. For example, MSCI's ACWI index without fossil fuels had higher absolute and risk-adjusted returns for the three- and five-year periods ending 30 June 2016[36]:




FTSE's indices with and without fossil fuels tell a similar story. Over recent three- and five-year time periods, ex-fossil fuel indices outperformed their corresponding conventional indices for developed, emerging and global markets[37]:




Similarly, the S&P Global 1200 Fossil Fuel Free Index has performed significantly better than the conventional S&P Global 1200, which includes fossil fuel companies[38]:




For these reasons, Divest Tower Hamlets believes that the Pension Committee should consider fossil-fuel free investment indices and products as a means to implement divestment in line with the investment objectives of the Pension Fund.

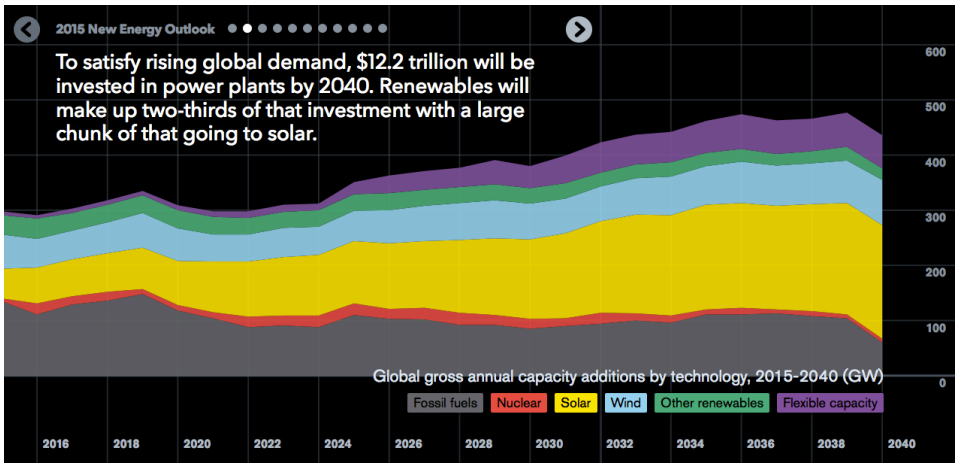
## 9. THE MARKETS ARE LISTENING

The above is also consistent with a number of key trends for ex-fossil fuel products entering the market in the near future. For example, Blackrock, one of the world's major asset managers, is considering launching a fossil fuel free fund in 2016[39]. At the recent UN Principles for Responsible Investment Conference in September 2015, the CEO of PIMCO, a major asset manager, additionally stated that:

*"It is in our interests to analyse ESG risk, it is no longer just for the do-gooders"*

- Douglas Hodge, CEO, PIMCO[40]

Other major institutional investors are taking note, with players like Allianz choosing to dump €4 billion of coal stocks in November 2015[41]. Analysis by Bloomberg New Energy Finance similarly predicts that the majority of all added capacity of energy from now until 2040 will be from renewables, dramatically reshaping the market, keeping spot prices for renewables low, and increasingly on par with conventional generation methods[42]:




## 10. KEY RECOMMENDATIONS

For the sake of the climate and Tower Hamlets taxpayers and to fulfill its obligation to pursue the best financial interests of all stakeholders in the Pension Fund, Divest Tower Hamlets would like to see the Pension Fund commit to:

- Divesting the £91 million (or current sum) in full, or at least to the level adopted by the Environment Agency in October 2015, that is, to a level consistent with staying below 2 degrees of global warming.
- A time frame to complete the divestment process (e.g. within five years).
- Refraining from making any new investments into fossil fuel companies.
- Reinvesting a proportion of the fund in low carbon solutions.

# ANNEX

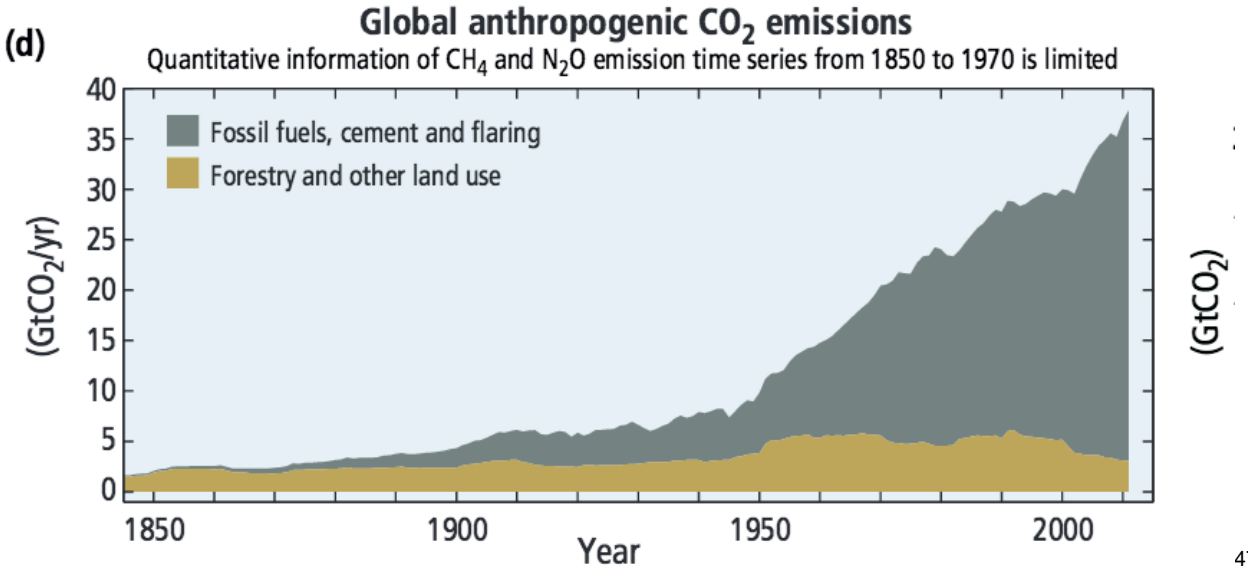
## THE SCIENCE AND CONSEQUENCES OF BREACHING 2 DEGREES OF GLOBAL WARMING

The UN's Intergovernmental Panel on Climate Change (IPCC), the leading global authority on climate science, have produced five major reports since 1988[43]. These form the basis of what we know and don't know about climate change science. Their work is a compilation of thousands of peer-reviewed reports from leading climate scientists from around the world. 97% of scientists concur that climate change is real, that it is caused predominantly by human activity, and that the major problematic greenhouse gases are $CO_2$, methane and others[44] [45].

The IPCC's latest conclusions (2013) on the consequences of going above 2 degrees of global warming include, amongst others:

*"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"* [46].

As the chart below indicates, the IPCC also conclude that the use of fossil fuels constitutes the biggest factor in anthropogenic climate change since 1850:




[47]

Another key report on the financial impact of climate change is Lord Nicholas Stern's report[48] from 2006, which is based on the IPCC's work. This, amongst others, formed the basis for the Government's Climate Change Act of 2008 and much of the analysis undertaken in the run-up to COP21 in Paris[49].

In Chapter 3, "*Impacts of Climate Change on Growth & Development",* Stern sets out several possible scenarios resulting from different levels of warming[50].

***A scenario of 2 degrees warming would:***

- Potentially cause a 20-30% decrease in water availability in vulnerable regions (e.g. Southern Africa and the Mediterranean)
- Lead to sharp declines in crop yields in tropical regions (5-10% in Africa)
- Expose 40-60 million more people to malaria in Africa, due to an increase in vector-borne diseases from changes to humidity levels and rainfall
- Leave 10 million more people vulnerable to coastal flooding each year
- Drive 15-40% of species toward extinction

***A scenario of 3 degrees warming would:***

- Produce serious droughts in Southern Europe once every 10 years
- Cause 1-4 billion more people to suffer from water shortages, while conversely exposing a further 1.5 billion to flooding
- Put 150-550 additional millions of people at risk of hunger with a peaking of high-latitude agricultural yields
- Lead 1-3 million more deaths from malnutrition (assuming carbon fertilisation is weak)
- Cause 100-170 million more people to be affected by coastal flooding each year
- Drive 20-50% of species toward extinction, including 25-60% of mammals, 30-40% of birds, and 15-70% of butterflies in Southern Africa
- Cause, according to some models, the collapse of Amazon rainforest

***Both scenarios of 2 and 3 degrees warming would:***

- Potentially cause the Greenland ice sheet to begin melting and collapsing irreversibly, leading to a 7m rise in sea levels
- Increase the risk of abrupt or irreversible changes to monsoons, the collapse of the West Antarctic Ice Sheet, and the collapse of the Atlantic Thermohaline Circulation

***A scenario above 3 degrees warming would:***

- Produce effects that are hard to predict, but which would possibly be far worse than the above, with major regions of the earth becoming uninhabitable (potentially resulting in mass refugee displacement, country-scale starvation and water shortages)

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