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WMPF Fossil Fuel Divestment

Frequently Asked Questions

This briefing addresses concerns raised by councillors concerning fossil fuel divestment. It tackles four main areas of concern which have been raised:

- Concern A - What is the purpose of divestment?
- Concern B - Do the risks of fossil fuel investment outweigh the rewards?
- Concern C - Why should the fund strategy change from engagement to divestment?
- Concern D - Who is responsible for divestment policy?

It is formed of a brief FAQ and an appendix which develops the arguments.

Concern A - What is the purpose of divestment?

Divestment means moving money out of unethical companies. This strategy is famously linked to the dismantling of apartheid by putting moral pressure on the regime in South Africa.[1] Fossil fuel divestment aims to stigmatise companies responsible for fueling the climate crisis and for lobbying against government action[2]. Since the start of the fossil fuel divestment movement a decade ago, £10 trillion[3] of investments have divested while the fossil fuel industry has been in steady, now possibly terminal decline.[4] By divesting from fossil fuels, the pension fund can reinvest in socially beneficial investments while protecting returns.

Have any West Midlands councils passed motions supporting divestment and climate action?

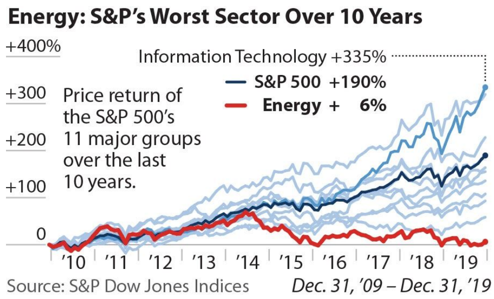
Yes, Solihull, Birmingham, Coventry, Wolverhampton and the West Midlands Combined Authority (WMCA) have all declared climate emergencies.

In October 2019 Dudley Council passed a fossil fuel divestment motion with unanimous, cross party support. In July 2017 Birmingham City Council passed a cross-party motion calling on WMPF to divest from fossil fuels.

Wolverhampton Council, with the majority of councillors on the pension committee, is beginning to take a closer look at investments in fossil fuels. It has requested that

WMPF report on levels of investment in fossil fuels and review strategy to give due consideration to climate change impacts in the investment portfolio.
The WMCA Climate change Green Paper included a commitment to work towards divestment of the West Midlands Pension Fund (WMPF) from fossil fuels.

Concern B - Do the risks of fossil fuel investment outweigh the rewards?



In the past, fossil fuel companies would reliably produce regular returns for pensions funds, and could be expected to be strong growth assets. In the last ten years, however, the industry has performed terribly, with the sector placing last in the S&P 500 for the last three years. In August 2020, ExxonMobil was dropped from the Dow Jones after 100 years.[5] Meanwhile this year, the industry has been downgrading it's assets,[6] cutting shareholder payouts and funding profits from borrowing.[7]

Against the diminishing rewards from fossil fuel investments, what are the risks? Fund managers surveyed[8] in 2018 believed oil industry valuations would be affected by:

1. Reputational damage because of their role in causing climate change;
2. Litigation for losses from climate change;
3. and Regulation to curtail fossil fuel pollution.

In addition, other risks include failure to transition to the low carbon economy, and peak demand passing.

All of these risks are now impacting the industry:

- The new BP boss has acknowledged he is unable to hire the best people due to the company's poor reputation.[9]
- There is a slew of climate litigation in progress[10] In the USA seven states and three large cities have filed suits against companies including BP, ExxonMobil, Chevron and Royal Dutch Shell plc. They are suing them for the part they have played in causing climate change. If any of these suits prove successful they could be liable for massive compensation payments.
- In September 2020, the EU has announced a plan for 55% cut in emissions by 2030[11]

Concern C - Why should the fund strategy change from engagement to divestment?

WMPF's Climate Change Framework and Strategy 2019-2023 acknowledges that climate change is a material risk to the fund and it's beneficiaries.

The fund has a policy of engagement with the fossil fuel companies in the short to medium term to change their business models. There is a growing realisation that since the 2015 Paris Agreement, engagement has **not been successful** in changing the core business models of the fossil fuel companies. WMPF engagement has no quantitative targets for success, timescales or escalation strategy, and the results have not come close to the scale of change required. Globally, shareholders have filed more than 100 climate-related resolutions with fossil fuel companies since 1990, and despite these efforts, none have directly reduced production of fossil fuels.[12]

The fund acknowledges that engagement is a "long term project",[13] but only ten years now remain to decarbonise most of the economy to prevent catastrophic global heating. The clock is ticking, and WMPF must stop wasting time engaging with oil companies and refocus engagement on other industries with a better chance of success.

> If you're Apple, we want you to produce your computers in ways that are good. But we like computers. The fossil fuel industry, though – its existence is fundamentally against our existence. We can't change them by investing in them, because they're not going to write off reserves. There's no way they can be made sustainable, in the same way tobacco can't be made healthy.
>
> **Dan Apfel** [21]

Friends of the Earth's excellent engagement briefing has more information.[14]

Does Fiduciary Duty prevent divestment?

From the Pension Committee meeting of December 2017, "According to the regulations and statutory guidance within which the Fund operates, investment decisions may only be made for non-financial reasons (i.e. for ethical reasons) where two conditions are satisfied: (a) that there is no significant financial detriment and (b) where scheme members are likely to agree with the ethical position adopted." Given (a) the sustained underperformance of the fossil fuel industry and (b) the wide public support for strong climate action[15], it is clear that divestment is justified.

It's not the job of the investment specialists to determine the Investment Strategy, only make recommendations. It is the responsibility of the committee to set out the Investment Strategy.

This report shows that divestment has no material financial detriment. Therefore, fundamental questions like the response to climate change are the responsibility of elected representatives.

Concern D - Who is responsible for divestment policy?

The Pensions Committee, which includes representatives from each of the seven West Midlands councils, are responsible[22] for making decisions about investment strategy under advice from the Fund and their advisers.

Responsibilities of the Pensions Committee include:

- “To review and agree the Investment Strategy Statement” and
- “To monitor investment activity and the performance of the Fund's investments”.

This puts strategy of investment sectors within the remit of the committee members and therefore the council they represent. The managers are responsible for implementing the investment strategy which the Pensions Committee have agreed.

The scale of the action required demands that all politicians show common sense leadership in this area.

Conclusion

By divesting from fossil investments, WMPF would be joining major global financial institutions including Axa, Citi, Lloyds, RBS and Zurich, who have also deemed the risk of these investments unacceptably high. The centre of gravity in this argument has now shifted from justifying divestment to justifying why investment should be maintained in fossil industries. It is clear fossil investments **no longer deliver from either an ethical or financial perspective**, putting the Pension Committee in contravention of their fiduciary duty.

Now more than ever, West Midlands local authorities are in serious need of additional investment in social housing, green infrastructure and other projects that will stimulate recovery. WMPF is in a position to reinvest to benefit both members and residents in the region.

The current WMPF climate policy does not adequately address the urgency and scale of the climate crisis. This policy needs to change as it puts the future wellbeing and financial security of fund members at risk. Divestment from fossil fuel companies, will both protect fund members and send a clear signal to the financial markets to take climate change seriously.

Appendix

Why should WMPF divest from fossil fuels?

Climate change is putting members futures at risk.
There is a growing awareness that climate change poses an existential threat to human civilisation. Scientists' warnings are becoming more evident to the public as increasingly frequent extreme events driven by climate change hit the headlines, both globally and in the UK. Not only will climate change hit fund members' future wellbeing, but also it puts the value of the fund at risk. WMPF acknowledge the devastating effects of unabated climate change on our way of life, the economic cost of inaction, and the material impact to all asset classes in the fund.

Divestment protects members pensions from the financial risks of holding these investments.
There is not only a strong ethical case, but importantly there is also a strong financial case for shifting investments from fossil fuels to fossil free alternatives. This is discussed later in the Concern B section.

WMPF's fossil fuel investments contribute to climate change.
The fund invests in fossil fuel producing companies like BP and Shell which extract oil, gas and coal, contributing directly to climate change. It is widely accepted, even by the industry itself that 80% of the existing reserves are unburnable and need to stay in the ground to prevent runaway climate change. Technological solutions like Carbon Capture and Storage are necessary and so is reducing greenhouse gas emissions.

Fossil fuel divestment is a crucial tool in the fight against climate change.
The global energy market needs to shift rapidly to renewables and clean energy technologies. Divestment is helping to create the conditions for the rapid changes needed to tackle climate change.

Divestment has a good track record of changing markets.
Divestment against South Africa during Apartheid helped to increase political pressure for action. This is now happening on fossil fuels with more institutions joining each month.

Divestment erodes the fossil fuel industry's social license and weakens its political power. This helps create conditions that are more amenable to the introduction of legislation to restrict fossil fuels and accelerate the transition to renewable energy. Divestment now presents a material risk to the fossil fuel industry and is making it more difficult for companies to raise capital for new fossil fuel projects. Divestment is having real impact and driving change.

What questions should councillors be asking the fund?

Here are some suggested questions for councillors to ask the fund managers:

1. Exactly how much is invested in fossil fuels and why is this not being regularly reported? Wolverhampton Climate Emergency motion requested this information. It is not sufficient to provide a list of individual investments because of the many indirect funds that do not publish investment data.
2. What are the targets for successful engagement, the timescales, and what is your planned response if they are not met?
3. Have you modelled the financial impact of divestment on the fund?
4. Past performance is no indicator of future performance, but what has been the relative performance of fossil fuel investments over the last five years compared to other sectors?
5. Has the fund conducted analysis of where it can most effectively use its limited capacity for engagement on climate change issues?
6. Are you in breach of your fiduciary duties if you hold fossil fuels stock knowing the financial risks?
7. Given the recent downgrading of fossil fuel assets by several majors, has the fund assessed whether the fossil fuel majors' demand forecasts for future fossil fuel demand are accurate?
8. What is the fund's view on these companies' consistent under-forecasting over the last decade of renewable energy growth?

What is climate risk? And how does it affect the fund?

Above 2 degrees warming, the damage to the global economy from climate impacts will be increasingly unmanageable, and will damage the majority of the assets in the portfolio. The fund claims to take this climate risk seriously but with current policies projected to result in a devastating 3-4C of global heating in 30 years - by the time many members will be collecting their pensions - the risk to fund value is not being taken seriously enough. This is not consistent with the council's statutory obligation to keep temperatures below 2 degrees and reduce carbon emissions to net zero by 2050, as outlined by the climate change act.

Climate change is *already* having a significant effect on fund performance. The WMPF 2018 annual report points to the insurance sector "which was hit by a series of natural disasters in terms of the hurricane season and also Californian wildfires" leading to the fund delivering only 3% instead of the benchmark 4% target.

Business-as-usual is a highly damaging and risky scenario for WMPF.

How do WMPF consult with pensioners?

WMPF usually engages with customers to keep them informed about the scheme, the performance of the Fund in the delivery of its services. They do not usually consult with customers regarding investment strategy. However in an FAQ the Fund does recognise that UK law gives trustees discretion to consider member feedback regarding exclusion of investments.

As we will see later there is precedent for the Fund divesting following campaigning from members.

The scale of the action required demands that all politicians show common sense leadership in this area.

How can councillors be sure they are acting in the interests of fund members?

Individual fund members have already expressed their wishes for divestment and there is a growing public awareness of the need for rapid action to tackle climate breakdown. A recent survey found 69% of 2000 UK respondents wanted to see urgent political action on climate change. This widespread support is more than sufficient for councillors to be sure they are acting in members interest.

Decisions made at council affect the lives of constituents all the time with councillors weighing up differing viewpoints, seeking advice and considering the pros and cons and seeking to act in the interest of their constituents.

The information below about financial impacts will reassure you that you are not putting members' pensions at risk; and that the moral impetus to stop funding companies who are putting fund members' futures at risk is clear.

Though not how the fund usually makes decisions, it is perfectly possible for members to be consulted about a divestment decision. Indeed, the Conservative amendment to the Birmingham divestment motion called for just that (outlined later).

Another approach to considering if the decision is in members interests is to look to other funds which have taken this decision . Also, based on the Fund's previous divestment, the Fund may consider that since strong action is supported by international agreements, members' consent can be presumed.

Have any other West Midlands councils passed climate motions?

Yes. In October 2019 Dudley Council passed a fossil fuel divestment motion with unanimous, cross party support.[16] In July 2017 Birmingham City Council passed a cross-party motion calling on WMPF to divest from fossil fuels. The original motion contained two Conservative amendments:

1. Focus additional future investments, where possible, on local and regional opportunities including (but not limited to) green technology and

infrastructure such as decentralised energy solutions, energy storage, and electric vehicles.
2. Decisions on disinvestment strategies by the West Midlands Pension Fund should be put to Members of the Fund before implementation.

In June 2019, Birmingham City Council voted to declare a climate emergency in a cross party motion, committing the council to “To aspire for the City to be net zero carbon by 2030 or as soon after as a just transition permits”

In June 2019, Coventry City Council declared a climate emergency with unanimous cross party support.

In June 2019, the West Midlands Combined Authority (WMCA) declared a Climate Emergency. Andy Street, Mayor of the West Midlands, said: “The West Midlands has a moral responsibility to tackle climate change, and that is why it is so important the WMCA Board has agreed to declare a climate emergency.” WMCA followed this on 26 July by setting a target for net zero emissions by 2041

In July 2019 Wolverhampton City Council declared a Climate Emergency, committing to reduce CO2 levels to zero by 2028. The declaration included "Report on the level of investment in the fossil fuel industry that the West Midlands pension fund has, and request a review of the investment strategy to give due consideration to climate change impacts in the investment portfolio”.

In October 2019 Members of Solihull Metropolitan Borough Council unanimously Declared a climate emergency.[17]

The tide is turning away from fossil fuels in the West Midlands.

What percentage of WMPF investments are in fossil fuel companies?

In 2017 a percentage of total investments fossil fuels were a small part of the fund at 3% of the total. This means divestment will only affect a small part of the portfolio while sending a very strong signal that the Fund is committed to protecting its members and future investments.

What are the non-financial risks of continued fossil investment?

Stranded Assets
Analysis by Carbon Tracker in 2015 found that investors were investing excess capital in legacy fossil fuel infrastructure, assets which would become ‘stranded’ when policymakers, technology and geography rendered them unusable or uncompetitive. Coal assets have already started to become stranded as the price of renewables and government policy are increasingly leaving coal power stations idle, not giving expected returns to investors.

Risk of litigation
A legal opinion for ClientEarth by two leading UK barristers has found that pension fund trustees (the pension committee while not legally a trustee, fulfils a similar role) who fail to consider climate risk could be exposing themselves to legal challenge.

Echoing the litigation against the tobacco industry in the 1990s which culminated in $209bn settlement payments, climate change court cases are active in 28 countries. These are being brought by investors, individuals, cities and states against governments and fossil fuel companies.

Where could the investments be moved to and give a similar return?

Fund members are missing out of greater exposure to growing markets. For example, global investment in renewables in 2018 was $298bn compared with $132bn for fossil fuels.

For indirect investments, in March 2019, WMPF appointed a panel of investment managers to run a "global sustainable equity mandate". Fossil fuel heavy funds such as BlackRock could be reallocated under this scheme.

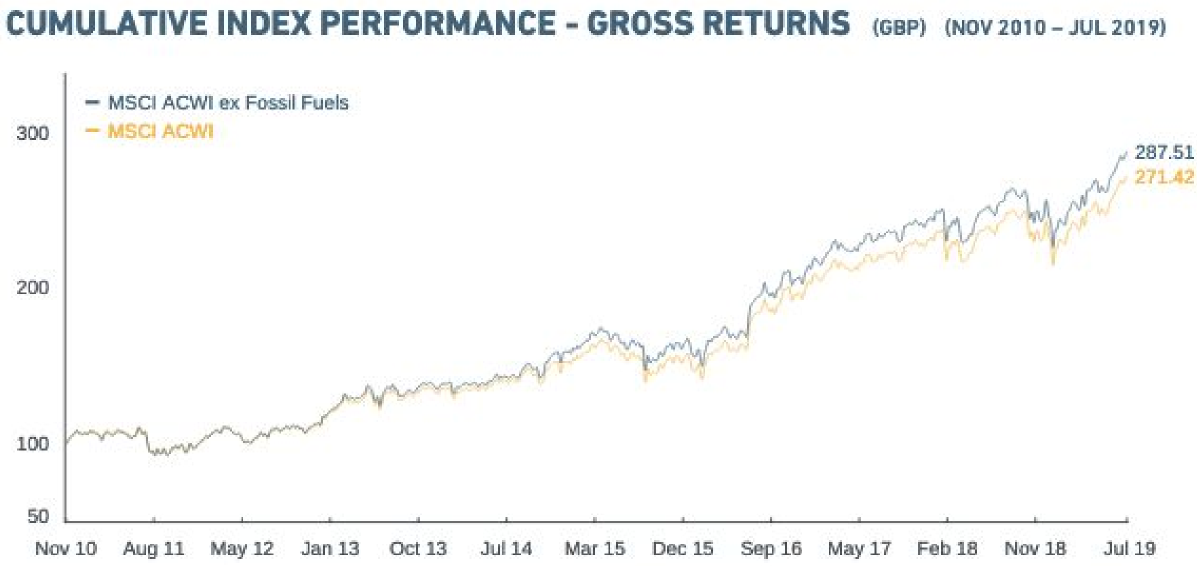
For direct investments, the fund would carefully move its holdings over the next four years to non-fossil fuel companies that perform at least equally (councillors should bear in mind the declining performance of fossil fuel companies). There are signs that this is already happening. The latest fund climate policy shifts asset allocations, with 10-15% to be invested in renewables by 2023 and only 1% thermal coal by 2023.

Reallocations to consider could be green investment bonds, renewables, or local clean infrastructure projects.

Months prior to a previous divestment decision related to cluster munitions, WMPF ran an adjusted shadow portfolio which showed that the tracking error was not material. A similar exercise could be performed for the fossil fuel divestment.

How well do fossil-free indexes perform?

Fossil free indexes outperform indexes which include fossil fuel companies. Since 2010, the MSCI-ex global index (excluding fossil fuels) has outperformed the MSCI global index which includes fossil fuel companies. Institutional investors investing trillions of pounds of investments are guided by the MSCI index. The superior performance of the ex-fossil fuel fund undermines arguments that it is not possible to construct a portfolio which excludes fossil fuel companies.



Indexes that exclude fossil fuels outperform the stock market

Will managers be able to hit their investment targets without fossil fuels?

Yes. A recent study by Mercer Associates with the support of 16 large institutional investors presents both a strong case for divestment and the construction of investment products that can achieve investment targets.

Are there better ways to invest funds?

Yes. WMPF could move capital wasted on fossil fuel industries to other sectors that are growing: information technology, discretionary consumer, financials, health care, industrials, utilities, and real estate. Within the energy sector, funds could be redirected to energy-efficiency technologies, renewable energy, and electric vehicles are producing solid returns and offering growth opportunities now.

What is the fund's current climate change policy?

WMPF's Climate Change Framework and Strategy 2019-2023 acknowledges that climate change is a material risk to the fund and it's beneficiaries[18].

How does the Fund address climate change?

The current Investment Strategy seeks to address this risk via "engagement" with fossil fuel companies not exclusion ("divestment"), the aim being to help companies change their business models. They argue that this is more effective than divestment, since a less responsible investor would buy the shares.

The fund has a policy of engagement with the fossil fuel companies in the short to medium term to change their business models.

What is the problem with the engagement policy?

There is a growing realisation that since the 2015 Paris Agreement, engagement has **not been successful** in changing the core business models of the fossil fuel companies. WMPF engagement has no quantitative targets for success[19], deadlines or escalation strategy, and the results have not come close to the scale of change required. Globally, shareholders have filed more than 100 climate-related resolutions with fossil fuel companies since 1990, and despite these efforts, none have directly reduced production of fossil fuels.[20]

How does the fiduciary duty affect divestment?

Pension fund boards have a "fiduciary duty" to act in the "best interests" of their funds beneficiaries.

From the Pension Committee meeting of December 2017, "According to the regulations and statutory guidance within which the Fund operates, investment decisions may only be made for non-financial reasons (i.e. for ethical reasons) where two conditions are satisfied: (a) that there is no significant financial detriment and (b) where scheme members are likely to agree with the ethical position adopted." Given (a) the sustained underperformance of the fossil fuel industry and (b) the wide public support for strong climate action, divestment is justified.

Has WMPF ever divested before?

In December 2017 following ethical concerns from fund members, and after years of engagement with the company, WMPF decided to divest from Hanwha, a Korean arms manufacturer of cluster munitions. At WMPF's meeting, Michael Marshall, then responsible investment officer, listed a number of arguments in favour of divestment from Hanwha, stating that "the deselection of this particular stock at this particular time is not expected to cause significant financial detriment."

Shouldn't investment strategy be left to the fund investment specialists?

It's not the job of the investment specialists to determine the Investment Strategy, only make recommendations. It is the responsibility of the committee to set out the Investment Strategy. This includes the Responsible Investment strategy, and the benchmarks for performance. Pensions Committee members have fiduciary responsibility to their stakeholders, and should be exercising their leadership to change the Investment Strategy when it is manifestly not succeeding in serving fund members.

Simon Jones, head of responsible investment, WMPF advisors Hymans Robertson says:

> "Unless managers are challenged, and called out for their actions or inactions, nothing will change. Managers need to be held to account and asked to explain. Stewardship needs to become more forceful because, until the behaviours of all parties in the investment chain change, we will be left with the status quo."

If WMPF divests, won't it lose its ability to influence corporations?

An argument frequently put forward by the WMPF managers is that once divestment has taken place, the fund will lose its ability to influence corporations, or that a less ethical investor will buy the shares. Councillors should question whether this is a responsible justification for continuing to risk pension funds by investing in a declining industry. Since the start of the divestment movement in 2012 this argument has been made by many funds, and greenhouse gas emissions have continued to rise unabated.

What might motivate administrators to advise against divestment?

Given the poor performance of the fossil fuel industry, it is hard to understand why administrators are advising against divestment. It is important to remember that administrators are not legally responsible to the members, the Pension Committee are!

The membership of groups such as LAPFF, can be effective in engaging with companies regarding climate risk but is flawed regarding companies whose primary business is fossil fuels. Engagement is literally their purpose; they are unlikely to recommend divesting. Councillors may ask what evidence the fund managers are receiving from these groups about the effectiveness of engagement to change fundamental business models. Councillors may ask if engagement spending may be better focussed on issues with more chance of reducing emissions and improving social conditions.

The question is no longer 'Why divest in fossil fuels?' It is 'Why invest in them?'

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Document History

1.0 - 26 Sept 2020 - Initial version, for Pensions Committee and other councillors