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Fossil engagement: if you won't divest, at least do this...

DR QUINTIN RAYER
Head of research and ethical investing, P1 Investment Management

Many investors are acutely aware of the risks generated by global warming, including rising sea levels, storm surges, droughts, wildfires, extreme heat and other extreme weather events.

As a result, many ethical and sustainably orientated investors have focused on the reduction of industrial carbon emissions, among other measures, to hasten progress to a carbon-neutral economy. Fossil divestment is one approach, although some investors argue that engagement with fossil companies is more effective in promoting essential change.

So what form should engagement with fossil firms take and for how long should you keep talking with companies if there are no meaningful signs of progress?

What is fossil divestment?

Fossil divestment involves severing ties with firms that extract fossil fuel reserves and selling or refusing to own stock in fossil extractors and producers. Divestment was backed by the UNFCCC in 2015.

Estimates in 2012 suggested that to keep global warming below 2°C, no more than around 565 gigatons of additional carbon dioxide could be released by mid-century, but proven underground coal, oil and gas reserves amount to 2,795 gigatons.

This is far more than the climate can tolerate to stay below 2°C warming. More recent estimates indicate that at least two thirds of known fossil fuel reserves must remain unburned. The logic is simple – the vast majority of this carbon needs to stay in unused fossil reserves underground.

At the 2018 Intergovernmental Panel on Climate Change (IPCC) meeting in South Korea, the world's scientific community re-emphasised the need to keep global warming contained, making it clear that to avoid the worst consequences it must be kept below 1.5°C above pre-industrial levels. Current warming is estimated at 1.069 and on track for 3.3°C or more by 2100.

Why not divest?

Some investors fear that restricting investment may reduce diversification and impact performance, although many ethical investors disagree.

However, others accept the need to reduce CO_2 emissions but feel engagement with fossil extractors and producers is more likely to achieve that goal. They point out that a shareholding is needed to influence a firm, so divestment removes the possibility of company engagement to encourage movement away from fossil fuels to renewables.

Critics suggest that engagement is most effective when backed up with a credible threat to divest. These investors have the same goal – a low carbon or carbon-neutral future – but differ whether engagement or divestment is a more effective tool.

What should engagement look like?

Given the carbon emissions risks that fossil fuels pose, engagement must be robust. It could lack teeth unless backed by a realistic likelihood of divestment if targets are not met. An end is required to deliberate climate science obstructionism and continued fossil expansion. Resulting minimum engagement criteria might include a commitment to divest if minimum engagement targets are not met within defined timescales, perhaps two or five years.

Major oil and gas companies must cease funding trade associations or activities that lobby against climate action. If membership of trade associations is to continue, the companies must ensure those bodies do not work to obstruct climate action.

At the same time, executive remuneration packages and bonuses must no longer be based on fossil production volumes. Ideally, they should be based around increases in renewable energy volumes or emissions reduction.

Royal Dutch Shell has recently agreed to set carbon emissions intensity targets, tying them to executive pay, although this permits them to expand fossil production providing renewables are increased more.

Additionally, exploration for new fossil fuel reserves should be stopped with no further capital allocated.

Other engagement measures are possible, but these seem a useful starting point. The fossil companies' most perverse actions – to invest in renewable energy and headline 'green' initiatives while still financially supporting global warming deniers or other activities that obstruct climate action appears deeply hypocritical and cynical, and needs to be addressed.

What can investors do?

Ethical and sustainable fund managers can either divest or ensure their engagement policies are as robust as possible. By taking early action, they can show leadership and enhance their reputation with their clients.

Advisers and fund selectors can identify those managers taking active steps in this area and guide their clients accordingly. The science is clear, strong action to prevent dangerous climate change needs to be taken quickly.

Media commentary shows that many sections of the public understand this message, even if the finance sector has been slower to adjust. Perhaps fund managers should listen – early movement could reap significant reputational benefits. •