

# Fossil fuels: divest or engage?

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## Biography

Quintin has worked for actuarial and investment consultancy firms and a multi-national European bank, including wide experience in quantitative fund and risk analysis. He is a Fellow of the Institute of Physics, a Chartered Fellow of the CISI and a Chartered Wealth Manager. Quintin has applied skills gained from his Oxford University Physics Doctorate and while working in engineering to finance. He is the second UK graduate from the Sustainable Investment Professional Certification (SIPC) programme and joined [PI Investment Management](#) in January 2017, founding their ethical and sustainable investing proposition.

## Introduction

Many investors are acutely aware of the risks from global warming [1], [2] including sea-level rise, storm surges, droughts, wildfires, extreme heat, and extreme weather events [3], [4], [5]. Consequently, many ethical and sustainable investors have focused on reduction in industrial carbon emissions among other measures to hasten progress to a carbon-neutral economy. Fossil divestment is one approach [6]. However, some investors argue that engagement with fossil companies is more effective in promoting essential change.

Investor motivations can include risk management or a moral position. Exposure to climate risks could undermine company valuations. On the moral question, it became clear in the 1960s that continuing CO<sub>2</sub> emissions would progressively damage the climate. At this point, the major carbon producers could see that they were marketing harmful products. The philosopher Henry Shue [7] argued that by failing to address these harms over the subsequent half-century, fossil fuel firms have additional responsibility to correct the damage done.

This article outlines divestment and explores what engagement with fossil firms should involve. It suggests limits to the length of time spent 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, selling or refusing to own stock in fossil extractors and producers, and was backed by the UNFCCC in 2015 [8]. The focus may be on all fossil fuels (coal, oil, and gas), or else on only the most damaging, coal and oil from tar sands.

Estimates from 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. Yet proven underground coal, oil and gas reserves amount to 2,795 gigatons [6]. Far more than the climate can tolerate to remain below 2°C warming. More recent estimates indicate that at least two-thirds of known fossil fuel reserves must remain unburned [9]. The logic is simple – the vast majority of this carbon needs to stay locked and unused in fossil reserves underground.

At the 2018 IPCC meeting in South Korea, the world's scientific community re-emphasised the need to keep global warming contained. The IPCC made it clear that to avoid the worst consequences; warming must be kept below 1.5°C above pre-industrial levels [10]. Current warming is currently estimated at 1.17°C [11] and on track for 3°C or more by 2100 [12].



## Why might Investors Engage?

Some investors fear that restricting investment choices may reduce diversification and impact performance, although many ethical investors disagree (see, e.g. [13], [14], [15]). However, others accept the need to reduce CO<sub>2</sub> emissions but feel engagement with fossil extractors and producers is more likely to achieve that goal [16]. They point out that a shareholding is needed to influence a firm, so divestment removes the possibility of company engagement [17]. Critics suggest that engagement is most effective when backed up with a credible threat to divest [18]. Both groups of investors have the same goal – a low carbon or carbon-neutral future – but differ whether engagement or divestment is the more effective tool.

## Robust Engagement

Given the climate 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 [18]. An end is required to deliberate climate science obstructionism and continued fossil expansion.

The resulting minimum engagement criteria might include:

- 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 [18]. If membership of trade associations is to continue, companies must ensure those bodies do not work to obstruct climate action.
- Executive remuneration packages and bonuses must no longer be based on fossil production volumes. Ideally, they should be based around increases in renewable energy output [18], or emissions reduction. In 2018 Royal Dutch Shell agreed to set carbon emissions intensity targets, tying them to executive pay [19]. More recent bonus schemes [20] include a 10% climate risk measure, but overall, still, reward executives for higher fossil fuel output. At BP, the remuneration scheme lacks transparency over whether it extends to include emissions from customers' use of oil and

gas [20].

- Exploration for new fossil fuel reserves should be stopped with no additional capital allocated [17].

Other engagement measures are possible, but the points above would seem a good start.

The second point addresses one of the fossil companies' most perverse actions. By investing in renewable energy and headline 'green' initiatives while still financially supporting global warming deniers or other activities that obstruct climate action, firms appear deeply hypocritical and cynical.

### How this helps Investors

Ethical and sustainable investors can either divest or ensure their engagement policies are as robust as possible. If using funds, they can check investment policies to ensure the approach the manager is taking accords with their personal views. The science is clear, decisive 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. Clients increasingly wish to invest ethically; the Investment Association reports £40.0 billion assets in the UK responsible funds sector in September 2020, a yearly increase of £15.4 billion [21]. By addressing issues of divestment and engagement, either directly, by careful fund selection, or raising with their advisers; investors can help ensure their views are implemented as fully as possible.

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