Local Authority Pension Fund Forum

Pension Fund Investments in Fossil Fuels: Guidance for Members for stranded asset divestment enquiries

Summary

The Forum recognises the issue of stranded assets and continued fossil fuel extraction as a collective investment risk for all asset owners and as an engagement and policy priority.

For companies engaged in fossil fuel extraction, LAPFF's approach is to undertake robust engagement on aligning their business models with a 2°C scenario and to push for an orderly low carbon transition.

For oil and gas companies, an important engagement focus is the restriction of capital expenditure (capex) on high cost resource extraction and promotion of the return of any additional cash generated to shareholders. For companies with coal operations, no new resources should be exploited.

LAPFF engages by meeting with companies and participating in collaborative investor initiatives including filing and supporting relevant shareholder resolutions to companies.

Monitoring of progress and outcomes includes LAPFF's participation in the Transition Pathway Initiative, which aids understanding of where companies are placed in the transition to a low carbon economy and their competence to manage this transition.

Forum members are interested in investment opportunities afforded by a low-carbon future which increase asset diversification and provide long-term returns.

LAPFF does not give investment advice or promote placing restrictions on particular types of investment as it is not authorised by the Financial Conduct Authority.

Engagement Strategy

The Forum's engagement strategy with oil, gas and coal companies has been developed with Carbon Tracker Initiative (CTI) and is set out in the report 'Engaging for a Low Carbon Transition'.

The report looks at stranded assets under different demand trends, noting that companies can face both physical and financial stranding. The implication of demand trends is such that, should the fossil fuel industry continue with a business-as-usual approach, supplies of oil and gas could outpace demand. Companies will then face the choice between shutting in capacity and starting a price war to force others to do so. Both of these choices lead to stranded assets: the first leads to physically stranded assets, the latter to financially stranded assets.

It is estimated that the fossil fuel industry could waste investments of $2 trillion by 2035 if it continues to invest under a growth model. It is already too late for coal, no new projects are needed under a two-degree demand scenario. Thus the oil and gas industry has time to avoid the massive value destruction seen in the coal industry but only by curtailing capex and returning any additional cash generated to shareholders.

Therefore LAPFF's engagement focus for oil and gas companies is the value at risk, particularly from high cost projects, and instead asks for companies to consider where they can support returning capital to investors. For coal companies, this would mean no new projects should be developed that continue 'business as usual'.

LAPFF has promoted this strategy in practice through LAPFF Alert voting advice provided on shareholder resolutions to Chevron in 2015 and 2016 supporting the request that the board adopt a dividend policy increasing the amount authorised for capital distribution to shareholder in light of the risk of the Company having stranded assets in the future.

LAPFF Engagement

Since 2011, as part of a core UK investor group engaging with resource and utility companies, LAPFF has encouraged company disclosure on the strategic resilience of their business models, by means of supportive shareholder strategic resilience resolutions.

LAPFF member funds co-filed resolutions to the BP and Shell 2015 AGMs and the Rio Tinto, Glencore and Anglo American 2016 AGMs on strategic resilience for 2035 and beyond as a key component of the collaborative engagement strategy. The resolutions include asking companies to report on asset portfolio resilience to the International Energy Agency (IEA)'s scenarios as well as other elements including low-carbon energy research and development and investment strategies and public policy positions relating to climate change.

The resolutions aim to be supportive but also to be stretching. The 'stretching' element for most fossil-fuel companies is to set out their business strategy in alignment with a two degree increase in global temperature, relating to the IEA 450 ppm scenario.

Filing of the strategic resilience resolutions at the above-named companies followed a long process of engagement with all the companies on climate risks, stranded assets and reporting this information in the context of their business models. Each resolution to date has been supported by the board and has prompted other resolutions such as to Statoil. They have all been carried by a record margin.

Of course resolutions of themselves do not provide evidence of meaningful changes in impact or strategy and LAPFF and other investors continue to engage with company representatives to provide substantive disclosure demonstrative of progress. Examples of progress in 2016 include BP setting out a 'faster transition' scenario and Total publicly aligning their strategy with a two degree scenario including moving 20% of its portfolio to renewable energy over the next twenty years. To support effective engagement, LAPFF has joined the Transition Pathway Initiative which aims to provide a transparent framework to track engagement and analyse company responses to climate and carbon risk.

Encouraging appropriate regulatory frameworks is also crucial. An example of this has been LAPFF's participation in collaborative engagement with other investors with the Financial Reporting Council (FRC) on long-term investors' expectations that fossil fuel dependent companies should address climate-related risks in the viability statements in their annual reports. LAPFF is also promoting relevant disclosure by responding to the Task Force on Climate Disclosure's consultations.

LAPFF supports member pension funds addressing concerns around climate and carbon intensive investments through a combination of individual engagements at corporate level, working with investor coalitions, contributing to the regulatory and policy debate and adding to institutional investor voices engaging with international forums.