DIVESTMENT

Beyond coal? The outlook for divestment

Jennifer Johnson looks at why some of the world's biggest investors have yet to turn their back on coal – and what this means for the growing divestment movement.

In the past decade, some of the world's wealthiest pension funds, insurance firms and educational institutions have vowed to limit their financial support for fossil fuels. The divestment movement began in 2011, with students at a handful of US universities calling on administrators to stop investing institutional endowments in coal, oil and natural gas. As of December 2018, more than 1,000 global organisations with a combined total of $8tn in assets had made divestment pledges of their own.

Many institutional investment funds are large enough to own significant parts of publicly-listed fossil fuel companies. This has made them a focus for concerned citizens – such as students, savers and pension payers – whose own money is pooled and invested by organisations to generate income. Pressure from these individuals has led some institutions to shrink or eliminate their fossil fuel holdings, while others have chosen to divest because they feel there's an ethical imperative to do so.

The Church of England, for instance, has promised to sell its shares in companies that are slow to tackle global warming, beginning in 2023. With a £12bn endowment behind it, the Church has stated that it feels compelled to 'exercise moral leadership on the urgent issue of climate change'.

However, there is also a sound financial case to be made for divestment. Assets such as oil fields and coal mines could be drastically devalued – or 'stranded' – if governments begin imposing strict limits on fossil fuel use, or if renewables become cheap enough to drive down fossil fuel demand.

According to a 2015 study published in *Nature*, around one third of oil reserves, half of gas reserves and 80% of known coal reserves must never be extracted if the world is to align with the temperature targets set out in the Paris Agreement. Coal is the most carbon-intensive fossil fuel, therefore phasing it out is an obvious short-term target for both policymakers and divestment campaigners. So why are some major investors increasing their thermal coal holdings?

Passive approach

A new report from InfluenceMap, a UK non-profit that tracks corporate influence on climate policy, has found that the world's 15 largest asset management groups have upped their holdings of thermal coal reserves by 20% since the Paris Agreement was signed. These firms manage investments on behalf of

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Laurence Watson, Carbon Tracker

clients – known as 'asset owners' – such as insurance companies, pension funds and wealthy individuals. While some asset owners also manage their own investments, others entrust part, or all, of the job to asset management companies.

In its latest report, the UN's Intergovernmental Panel on Climate Change (IPCC) estimated that the world has a remaining carbon budget of 420 gigatonnes (Gt) of carbon dioxide emissions to maintain a 66% chance of meeting the 1.5°C global warming target. InfluenceMap reports that the current thermal coal holdings of the 15 largest asset management groups account for over 3% of this carbon budget.

While the report admits that this is not a significant proportion, it emphasises that the actions of large asset managers are 'hugely influential to the overall financial market and, importantly, to the overall economy.'

The motivations behind this 20% increase are somewhat unclear, but part of it has to do with the way that investment products known as 'listed funds' are structured. Institutional or individual investors can buy shares in a listed fund, which is a collective pool of money used to purchase tradable financial assets, such as stocks and bonds.

Some funds are actively managed, meaning that there is a team of investors making decisions about which assets are included in a portfolio based on market trends and geopolitical shifts. Others are 'passively' managed, which means they're structured to mimic the contents of a given market index, such as the S&P 500.

In recent years, many investors have come to favour passively-managed funds because the management fees associated with them tend to be lower. However, asset managers and their clients don't get a say in which companies are included in an index – this is the role of an index provider – and this partially helps to explain the presence of coal in the portfolios of major asset managers.

'The amount of thermal coal in the listed company universe has increased by 6% in the last two years as the result of two bankrupt US coal companies, Peabody Energy and Arch Coal, coming back into the market,' explains Dylan Tanner, Co-Founder and Executive Director of InfluenceMap. 'They have naturally been acquired by a lot of the funds after being included in the major indexes.'

According to the report, BlackRock, the world's largest asset management firm, also has the largest holdings in thermal coal. When questioned by the *Financial Times*, the company said that much of its exposure to coal comes from its passive funds, therefore it could not divest and would instead engage with companies to understand how they're managing climate concerns.

Transparent trading

In the last 10 years, major asset managers have begun offering environmentally-sensitive funds to clients concerned about the climate impact of their investments. To create these products, many managers rely on external index providers to develop 'green' indices. For instance, S&P has created an index that measures the performance of companies in the S&P 500 that don't own any fossil fuel reserves.

However, the contents of many 'fossil fuel free' funds and indices are not publicly available, making it difficult to verify whether they're as climate-friendly as they say.

In its research, InfluenceMap was also able to identify 13 funds marketed with 'climate related' language whose constituent companies have thermal coal holdings. Some of these funds don't wholly follow green indices and the contents of the portfolios may have been optimised – or tweaked – by fund managers. Consequently, the report says, it's difficult to determine whether the index provider or the fund manager have included fossil fuel holdings.

'There has been a tendency for asset managers to say they're responding to passive trading, and the index providers to say they're responding to demand from their clients,' Tanner says. 'Everyone's pointing the finger at everyone else. Ultimately, demand for clean funds will be driven by asset owners who want to express their values in terms of their investments. The people who will have to act will be the large fund managers like BlackRock and Vanguard because they're so powerful in the marketplace.'

'No brainer' closures

While it's not clear when – or how – asset managers will go about cutting coal from their portfolios, the risks of not doing so are increasing. In many developed economies, such as the US and Europe, coal-fired power stations are already massive lossmakers.

Two years ago, analysis by the climate think tank Carbon Tracker revealed that 54% of the European Union's coal plants were losing money. In a new report, *Powering Down Coal*, the group predicted that 72% of the global coal fleet will be cashflow negative by 2040. While there has been a resurgence in political support for coal in the US, this is unlikely to keep the industry afloat for long.

'In any region, there is little you can do to stop renewables costs coming down in the long term,' says Laurence Watson, Data Scientist at Carbon Tracker. 'President Trump has said that he's pulling out of the Paris Agreement, and yet he can't undo the fall of coal power in the United States, where more plants are closing than ever. If investors are counting on a strong leader to protect their fossil fuel assets, then they should be wary.'

Carbon Tracker has identified three 'inflection points' that investors and policymakers should be aware of when trying to limit their stranded asset risk. The first is when new renewables and gas outcompete *new* coal; the second is when new renewables and gas outcompete operating *existing* coal; and the third is when new *dispatchable* renewables and gas outcompete existing coal. Carbon Tracker believes that the first inflection point will be reached by 2025 at the latest – and the second won't be far behind.

'Coal is already more expensive on a levelised cost of energy basis in almost all markets,' Watson explains. 'For a lot of places, new renewables will be cheaper than running existing coal within the next 10 years, and this second point is crucial in terms of phase out. Closing coal becomes a no-brainer at that point.'

Powering Down Coal argues that coal is going to become an increasingly high-cost form of power generation in the coming years – with or without climate policies that would restrict its use. While the International Energy Agency (IEA) has predicted that global coal demand will remain stable until 2023, its long-term decline is now all but certain.

Timelines for coal closures vary, but the economic case for divestment is getting stronger all the time. This means that investors who have thus far been able to ignore ethical arguments may soon have to acknowledge the financial necessity of divestment. It's a matter of choosing the right moment to sell up and move on. ●