Briefing: What councillors need to know about the Fossil Free Greater Manchester campaign for fossil fuel divestment.

Contents

1) Executive summary

Over 350,000 Greater Manchester pension fund holders' retirement funds are at risk because of their exposure to risky fossil fuel investments. These pension fund holders – members of UK local authority pension fund GMPF (the Greater Manchester Pension Fund) – are faced with the prospect of a diminished pension pot because of their pension fund's continued policy of investing in carbon-intensive firms such as Shell and BP. These companies, and the pension funds that invest in them, are at risk of serious financial losses because governments and markets are acting to prevent climate change, which involves keeping these companies' carbon assets in the ground. This phenomenon is known as the Carbon Bubble. Fossil Free Greater Manchester is committed to highlighting this risk to GMPF pension fund members and pension fund managers. It is encouraging them to mitigate this risk by disinvesting from fossil fuels.

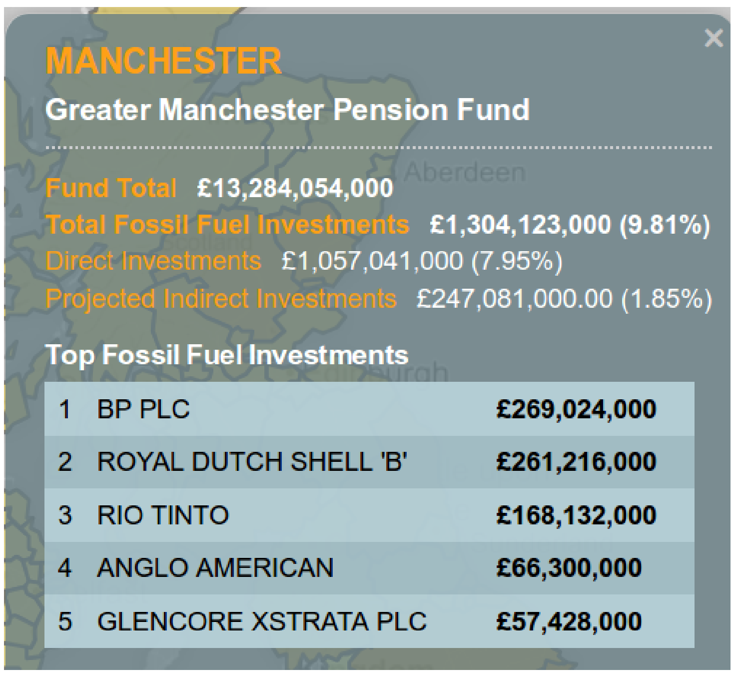
Over 150 countries committed themselves to tackling climate change at the 2015 United Nations conference on climate change. This historic agreement signalled the end of the fossil fuel era. Since this agreement means at least 80% of known fossil fuel reserves cannot be burned[1], fossil fuel companies have considerable "stranded assets", in effect a Carbon Bubble. The Greater Manchester Pension Fund (GMPF) is neglecting its duty to protect its pension fund holders from the long term threat of a Carbon Bubble which has increased as a result of this agreement. GMPF has the most invested in such companies of any local authority pension scheme – a position which leaves pension fund holders at risk of an economic shock once government and market pressures are exerted on fossil fuel companies' valuations.

1The 80% figure refers to the 2 degree C threshold. However the aspiration of the Paris agreement is for 1.5 degrees maximum. Moreover, the carbon budgets which correspond to these figures are uncertain: the 80% figure, only relates to a 60% chance of avoiding a 2 degree increase - not very good odds. For more discussion see Anderson, K. and Peters, G. (2016) The trouble with negative emissions.
Science 354 (6309), (October 13, 2016) 182-183. [doi: 10.1126/science.aah4567]

2) How much does the Greater Manchester Pension Fund have invested in fossil fuels?

As of September, 2015, the Greater Manchester Pension Fund (GMPF) had over £1.3 billion invested in fossil fuels[2], which equates to over £500 per Greater Manchester resident. This includes both direct investments in fossil fuel extraction companies and indirect investments in companies (banks, for instance) that themselves have holdings in fossil fuel companies.

At 9.81%, GMPF has one of the largest proportional holdings of the UK's local authority pension funds - the Lancashire Pension Fund, in comparison, only has 1.89% of its investments in fossil fuels.



3) What is Fossil Free Greater Manchester (FFGM) asking for?

FFGM is calling upon the GMPF to:

- Immediately freeze any new investments in fossil fuel companies
- Divest from companies involved in the exploitation of coal and unconventional oil or gas within two years and all fossil fuel companies within 5 years
- Work with the Greater Manchester Combined Authority to develop and fund a low-carbon investment programme for Greater Manchester

We recognise that moving up to £1.3bn of assets cannot be done overnight, hence this proposal for a phased, responsibly managed approach.

[2] Figures from a study published in 2015 see http://gofossilfree.org/uk/pensions/. From consideration of more recent lists of holdings (published at http://www.gmpf.org.uk/investments/holdings.htm), we believe the situation is still substantially the same, as of October, 2016.

4) Which councils have divested so far?

A number of councils and pension funds have committed to either partial or full divestment. These are great examples of how councils, with similar responsibilities to Greater Manchester, have taken all of the arguments on board and have concluded that divestment is the correct course of action. Below is a list of some of those councils who have made such commitments:

Full divestment:

- Waltham Forest Pension Fund (£735 million)[3]
- Bristol City Council[4]

Partial divestment:

- The South Yorkshire Pension Fund committed to divest from **coal and tar sands**, November 2015[5]
- Oxford City Council[6]
- Hastings Borough Council[7]
- Haringey Council and Pension Fund (coal)[8]
- Cambridge City Council[9]
- Kirklees Council[10]
- The Environment Agency Pension Fund (also an LGPS fund) committed to **divest 90% of coal assets and 50% of oil and gas stocks by 2020** in October 2015.[11]

We would encourage the GMPF to consult with the above funds (especially Waltham Forest, Haringey and the Environment Agency) about their methodology, decision making processes, and how they assessed the risk to their portfolio presented by climate change.

The amount divested from fossil fuels continues to grow. There are now over 50 local government pension fund divestment campaigns in the UK, and further, the UNISON North West regional council recently voted to support[12] the fossil-free divestment campaign. In May 2016, 152 local election candidates supported the principle of Greater Manchester Pension Fund divesting from fossil fuels[13].

For a complete list of divestment commitments, visit: http://gofossilfree.org/commitments/

3 http://www.localgov.co.uk/London-council-to-divest-pension-from-fossil-fuels/41712
4 http://gofossilfree.org/uk/press-release/bristol-mayor-commits-to-keeping-city-money-out-of-deadly-fossil-fuels/
5 http://www.pensionsage.com/pa/south-yorkshire-pension-fund-divests-from-pure-coal.php
6 http://gofossilfree.org/uk/press-release/oxford-council-first-uk-authority-to-pass-divestment-motion/
7 http://gofossilfree.org/uk/press-release/hastings-council-passes-unanimous-fossil-fuels-divestment-vote/
8 http://www.pensionfundsonline.co.uk/content/pension-funds-insider/investment/haringey-to-invest-200m-in-green-fund/2038
9 http://gofossilfree.org/uk/press-release/cambridge-city-council-backs-the-move-towards-a-fossil-fuel-free-future/
10 http://gofossilfree.org/uk/press-release/kirklees-council-calls-on-west-yorkshire-pension-fund-to-divest/
11 https://www.theguardian.com/environment/2015/oct/19/uk-environment-agency-divests-landmark-move-help-meet-2c-limit
12 http://www.manchesterfoe.org.uk/unison-nw-regional-council-votes-to-support-the-fossil-free-divestment-campaign/
13 http://www.manchesterfoe.org.uk/election-survey-2016-local-parties/

5) Who else has voiced concerns about the Carbon Bubble?

Globally, institutions with assets worth over $3.4 trillion have made divestment commitments because of the risk of the Carbon Bubble and this growth is exponential. Stranded asset risk assessments are now mandatory for all EU pensions[14], which paves the way for fossil fuel divestment of those funds comprising of 75 million members. Here in the UK, institutions including 20 universities, the British Medical Association and the Church of England and scores of large private pension and wealth funds have made divestment commitments.

The financial risks of fossil fuel investments are increasingly widely-recognised. The Governor of The Bank of England Mark Carney stressed the risks in a speech in 2015[15]:

> *"Take, for example, the IPCC's estimate of a carbon budget that would likely limit global temperature rises to 2 degrees above pre-industrial levels. That budget amounts to between one fifth and one third of the world's proven reserves of oil, gas and coal. If that estimate is even approximately correct, it would render the vast majority of reserves "stranded" – oil, gas and coal that will be literally unburnable."*

6) Risks of fossil fuel stocks in the future

The risks of climate change to human health and the environment are indisputable; the link between greenhouse gases and rising temperatures is supported by an overwhelming body of evidence[16] and is widely accepted by governments and policy makers[17]. If we are to avoid serious interference with global climate systems and prevent irreversible changes to weather systems we must keep global temperatures to at least 1.5 degrees C below pre industrial levels[18]. With global temperatures already 1 degree C above levels, immediate and sustained action is needed to make the transition away from fossil fuels, and in fact there is now only 4.5 years left on the global carbon budget. In the absence of efforts to stabilise the atmospheric concentration of Greenhouse Gases, the average global temperature rise is projected to reach almost 5.5°C above preindustrial levels in the long term and almost 4°C by the end of this century (OECD, 2016). A 4 degree scenario threatens to create an entirely different world than the one we recognise today; setting off a cascade of disastrous changes including extreme heatwaves, drought, sea level rise with severe consequences on agricultural production, water resources, ecosystem services, populations is coastal areas[19].

> *A 4 degree warmer world can, and must be, avoided – we need to hold warming below 2 degrees,"* said World Bank Group President Jim Yong Kim. *"Lack of action on climate change threatens to make the world our children inherit a completely different world than*

14 http://gofossilfree.org/stranded-assets-risk-assessment-now-mandatory-for-eu-pensions/

15 http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx

16 See IPCC 5th assessment report, 2013, http://www.ipcc.ch/report/ar5/wg1/

17 For example, the Global Covenant of Mayors for Climate & Energy, https://www.compactofmayors.org/globalcovenantofmayors/

18 https://newrepublic.com/article/136987/recalculating-climate-math

19 World Bank Group. (2014) Turn Down the Heat : Confronting the New Climate Normal. Washington, DC: World Bank. https://openknowledge.worldbank.org/handle/10986/20595

we are living in today. Climate change is one of the single biggest challenges facing development, and we need to assume the moral responsibility to take action on behalf of future generations, especially the poorest[20].

We at Fossil Free Greater Manchester believe that investing in fossil fuel companies and thus promoting the ongoing exploitation of fossil fuel reserves is unethical. The Pension Fund has already divested from tobacco shares on the grounds of public health: climate change poses an even greater threat to public health with long lasting consequences for both present and future generations[21].

7) Comparison of fossil fuel stocks compared with other investments

A growing concern that fossil fuels are indeed stranded assets, if we are to meet climate change targets, has prompted a number of finance houses to explore the possibility of indexes that exclude fossil fuels. The research that followed has included comparisons the performance of these indices with comparable indices that include fossil fuels. This has led to some very interesting conclusions.

The Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) and the MSCI ACWI excluding Fossil Fuel are broad global indices which include large and mid-cap stocks and the developed and emerging markets of the world. The MSCI ACWI excluding Fossil Fuel represents the performance of the broad market while excluding companies that own oil, gas and coal reserves. It is an index that can be used by investors who aim to eliminate fossil fuel reserves exposure from their portfolio.

Analysis of the two indices over the period of November 2010 to June 2016 shows there was a return of 10.57% in the MSCI ACWI, while in the MSCI ACWI ex Fossil Fuels there was a return of 11.56%[22]. Furthermore the MSCI ACWI ex Fossil Fuel has a slightly lower volatility rating than the MSCI ACWI with a volatility beta of 0.98 compared to the 1.00 of the MSCI ACWI. **So performance was better for fossil-free stocks while volatility was lower**. This is contrary to a popular understanding that moving out of fossil fuels leads to a less diverse and thus less stable portfolio.

This is further supported by the S&P Dow Jones equivalents, namely the S&P Dow Jones Global 1200[23] and the S&P Dow Jones Global 1200 Fossil Fuel Free[24]. Comparing the two as of 31st August 2016 based on their Total Return Index for the past 3 years we see that the

20 http://www.worldbank.org/en/news/press-release/2012/11/18/new-report-examines-risks-of-degree-hotter-world-by-end-of-century

21 Costello, A., Abbas, M., Allen, A., Ball, S., Bell, S., Bellamy, R., … Patterson, C. (2009). Managing the health effects of climate change. *The Lancet*, *373*(9676), 1693–1733. https://doi.org/10.1016/S0140-6736(09)60935-1
Editorial (2016). The perfect storm: climate change and its health consequences. *The Lancet*, *387*(10026), 1348. https://doi.org/10.1016/S0140-6736(16)30117-9

22 Source https://www.msci.com/resources/factsheets/index_fact_sheet/msci-acwi-ex-fossil-fuels-index-gbp-gross.pdf

23 http://us.spindices.com/indices/equity/sp-global-1200

24 http://us.spindices.com/indices/equity/sp-global-1200-fossil-fuel-free-index-usd

standard index had a return of 7.93% while the Fossil Fuel Free index had a return of 9.24% (Figure A). **Again the Fossil Fuel Free index has a slightly lower risk**, with the Global 1200 showing an Annualised Risk Standard Deviation over the past 3 years of 11.41%, while the Global 1200 Fossil Fuel Free shows an Annualised Risk Standard Deviation over the past 3 years of 11.34%.

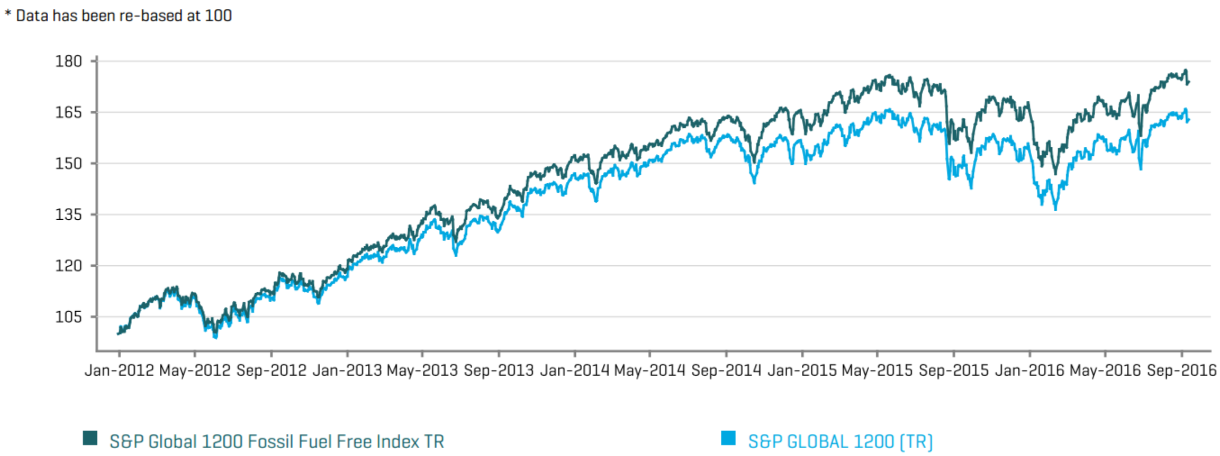


Figure A[25]

These two analyses of similar time periods show us that divestment is likely to not only increase expected total returns, but also reduce the volatility of a portfolio.

This is further supported by similar analysis done by FTSE Russell from June 2006 until January 2014, taking into account the financial crisis in 2008[26], and an independent US based investment management company that looked at the period from January 2014 to December 2014 for both a US based index, the S&P 500 Index, and a global index, excluding the US, called the MSCI EAFE[27], using their own equivalent indices.

From the latter analysis, they comment that "In examining the historical data, we find that divestment can be achieved with minimal impact on portfolio return or volatility over the long-run. **In other words, an investor can track a standard broad market index reasonably well even while excluding fossil fuel related securities**." [our emphasis].

If we consider these findings together, we can see that the implications are that **a portfolio that has divested from fossil fuels is expected to at least follow the trends of the original portfolio and may actually be expected to lead to a greater return, all with a lower volatility and risk**. **As we begin to see an increased instability in oil barrel prices, the risk of leaving our money in fossil fuels is only increasing. It is therefore plausible to conclude that the best course of action is early divestment, to reduce the risk posed by**

25 In the downloadable factsheet, http://us.spindices.com/indices/equity/sp-global-1200-fossil-fuel-free-index-usd
26 Source: http://www.ftse.com/products/downloads/FTSE_Stranded_Assets.pdf
27 Source: https://www.parametricportfolio.com/insights-research/paper/fossil-free-investing

leaving money in fossil fuels. While the above analysis focusses on market value (where gains and losses are realised on sale of the shares), the profitability of companies and hence income from share dividends (of interest to Pension Funds as the income on which pension payments are based) largely follows this.

8) Possible objections and concerns

A number of objections to and reasonable concerns about divestment have been raised. The following considers the most common ones.

Isn't engagement with fossil fuel companies better?

There has been little evidence to suggest this is the case. FFGM has asked GMPF to provide us with a breakdown of how they measure the success of their engagement. We have yet to be sent anything confirming their success[28]. In FFGM's opinion, while there is scope for engagement with secondary investors (such as banks, for whom fossil fuel stocks comprise part of their portfolios), it is futile to be engaging with a gas, oil or coal company to convince them to reduce their fossil fuel extraction when that is their sole output.

Won't we lose money by divesting?

Recent research by investment companies and internal analysis of their indexes has shown that a fossil free portfolio will not only perform in a similar way to a non-divested portfolio, but may also lead to increased profit margins while decreasing the risk. More information can be found in section 7.

Isn't divestment against the pension fund's fiduciary duty?

The fiduciary duty is a legal obligation that requires trustees to act in the best interest of their members. "These duties, however, aren't clearly defined in law and has led to some pension funds interpreting their duties in a very restrictive way, focussing often on short term profits rather than longer term considerations such as how climate change will impact members' retirements."[29] It is indeed arguable that divestment is one way of complying with the fiduciary duty to take account of members' financial and other interests (see Law Commission guidance[30] that institutional investors 'fiduciary duty' should consider the environmental and social impacts of their investments), and new (2016) guidance from the DCLG is consistent with this view[31].

We should wait for a while before making such decisions

A fossil fuel free portfolio is a less volatile portfolio (see section 7), and further, is no longer exposed to an increasingly unstable oil market. With at least 80% of carbon assets considered

28 Our correspondence with the Chair of the Fund can be found here: http://fossilfreegm.org.uk/index.php/2016/10/18/our-correspondence-with-greater-manchester-pension-fund/

29 http://communityreinvest.org.uk/wp-content/uploads/2016/03/Reinvesting-Pensions.pdf

30 http://gofossilfree.org/uk/wp-content/uploads/sites/3/2015/05/Law-commission-guidance-for-trustees-is-it-all-about-the-money.pdf

31 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/553342/LGPS_Guidance_on_Preparing_and_Maintaining_an_Investment_Strategy_Statement.pdf

stranded, it is only a matter of time before actual losses on fossil fuel investments become a reality. The earlier divestment is made, the earlier GMPF can reduce the risk of its investments.

Is this really beneficial for the environment?
Divestment itself can lead to a positive environmental impact. By pulling money out of fossil fuels it sends a message to the fossil fuel companies, to other peer organisations and to the GMPF members that there is no longer viability in keeping money in fossil fuels. This will add to a global movement and increase the pressure on fossil fuel companies as more and more money leaves their industry. Without money in this industry there will be a decline in fossil fuel extraction which will help us meet the globally agreed 1.5C target. Further, there can be more benefits if the divested money is invested in green industry and energy, which will help to increase their output and help that industry to grow.

Won't others just buy the stocks?
In the short term this is so, but a snowballing divestment campaign is helping reduce the value of these stocks with the result that they are less attractive to investors who won't gamble on a recovery when the only way is down. As noted in the previous paragraph, this sends a signal to the industry to abandon further exploration, hence meeting the aim of leaving fossil fuels under the ground.

9) Opportunities following divestment

Divestment is only the first part of the story. Where should the monies released be reinvested? Fossil Free Greater Manchester recognises that it may not be possible to invest the large sums involved entirely in assets that positively promote a low carbon future. We also recognise that reinvesting such a large sum needs to take place in a managed way, over time, and this is why we have called for a five year programme of divestment and reinvestment, beginning by withdrawing investment from the most damaging equities. We are not investment advisors so we do not pretend to offer investment advice. Instead we can suggest some guiding principles which actually build on the current best practices of GMPF.

1. Consider opportunities to positively invest in low carbon energy, especially in truly renewable energy, including wind, tidal, solar, geothermal and biomass (where it is not dependent on imports of timber).

2. Consider opportunities to invest in energy demand reduction, including insulation, manufacture of energy efficient equipment, and energy management systems.

3. Consider opportunities to invest in the local economy, especially in affordable and social housing, in low carbon businesses, in social enterprises and SME's that source and supply locally, so building economic and social prosperity and resilience in Greater Manchester.

Taking the above three points together, we believe that a particularly beneficial opportunity exists at present, for the fund to work in concert with the Greater Manchester Combined Authority, in developing a long term investment strategy, aimed at boosting the Region's expanding Low Carbon Industries. GMPF already have a sound track record of investment in the local economy and we believe that targeting this sector would have several specific advantages.

- It would support Greater Manchester in its ambition to become a global leader in the development of green and sustainable technologies[32] and in the establishment of companies to develop these technologies commercially.

- It would also have the opportunity to invest in 21st century technologies with a long term sustainable future, bringing high quality jobs to the region, as a result of which it would be popular with Civic Leaders, Fund Members, Trades Unions and the general public at large.

- It could build on and support the agreement reached in September, 2016 that the Greater Manchester Combined Authority invests in local businesses.

- It would also assist in providing the right sort of environmental and technology based platform, to assist the city region in a variety of competitive bids.

4. Where the above are not possible, invest in stocks that are not implicated in fossil fuel extraction.

A report from Trade Unions for Energy Democracy, One Million Climate Jobs, Campaign Against Climate Change (Trade Union Group) and Platform gives quantified estimates of the potential benefits in terms of renewable generating capacity, house-building, and public transport were pension funds to switch their investments from fossil fuels to these areas.[33]:

By divesting from fossil fuels and reinvesting in environmentally and socially positive and benign vehicles, GMPF can make a vital contribution to the welfare of its members, their dependents, and the wider population, in Greater Manchester and far beyond, both today and tomorrow[34].

10) What can councillors do?

There are several things you can do if you would like to advocate for divestment of fossil fuels from GMPF as a councillor. The options you have include:

- Gathering information - read the Fund's Responsible Investment Guidelines and other relevant policies held by the Fund and council ;

32 See draft GM Strategy: https://www.greatermanchester-ca.gov.uk/download/meetings/id/1149/9_gm_strategy_annual_report
33 http://platformlondon.org/wp-content/uploads/2015/11/Trade-Unions-Divest-Reinvest1.pdf
34 Further resources on reinvestment can be found here: http://www.asyousow.org/divest-invest/#Divest

- Using your position as a councillor to -
    1. Discuss fossil fuel investments and risk with the council's Chief Financial Officer - get their opinion and present them with the financial case: do they realise that investing in fossil fuels is not as financially sound as it once was?
    2. Engage with the pension fund Management and advisory committee - assess how likely they are to support divestment and which argument might be most persuasive to different members.
    3. Work to set up a meeting with the pensions committee, local divestment campaigners, interested fund members and experts on climate risk.
    4. Put in a divestment motion to the full council, calling on the council to immediately freeze any new investment in fossil fuels, divest from companies involved in the exploitation of coal and unconventional oil or gas within two years and all fossil fuel companies within 5 years.
    5. Push to update the council's ethical investment policy to include fossil fuels.
    6. Get in touch with Fossil Free Greater Manchester to let us know your progress! We can help you celebrate and publicise wins, as well as give advice on next steps.

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