MANAGING FOR FOSSIL FUEL RISKS

A 6-POINT PLAN FOR AUSTRALIAN SUPERANNUATION FUNDS.

INTRODUCTION

The vast majority of fossil fuel reserves (equivalent to a net present value of $US22 trillion) must not be burnt if we are to avoid warming in excess of 2 degrees Celsius – the safe upper limit agreed to by climate scientists and governments internationally.[1] Given this physical reality, it is clear that capital markets have financed future fossil fuel development based on the false assumption that what the corporate sector has asked investors to finance can safely be burnt. Consequently, leading international authorities are increasingly highlighting the major risks that this overcapitalisation of fossil fuel assets poses to capital markets and investors globally.[2]

With the fourth largest coal reserves and an estimated 20% to 30% of market capitalization connected to fossil fuels, Australia is particularly exposed to these risks.[3] As public awareness of fossil fuel risks grows, investors will face increasing pressure from their members, shareholders, peers and regulators to respond. This document proposes a five-year staged process for super funds to respond to and manage the risks that fossil fuels pose. It is open to the individual fund to interpret this framework as they see fit.

[1] Meinhausen et al (2009), "Greenhouse gas emission targets for limiting global warming to 2°C", Nature, 458: 1158-1163.
[2] Carbon Tracker (2013), op cit.; Mercer (2011), "Climate Change Scenarios – Implications for Strategic Asset Allocation"; HSBC; Citi; Climate Institute (2013), "Unburnable Carbon: Australia's Carbon Bubble"
[3] Carbon Tracker (2013), op.cit. p.2

THE PLAN

phase 1: years 1-2

Step 1: A fund-wide climate risk management plan

This would manifest as:

- Formal recognition, within the Fund's Trust Deed and Constitution, that the Board's Fiduciary Duty to their members entails managing for the risks that fossil fuels pose the fund and its beneficiaries and conversely that the Board has a duty to minimise the fund's contribution to climate change via its investments, both long and short term, and
- a portfolio-wide, ideally publicly available, plan to mitigate the risks that climate change poses the fund and that the funds investments pose to the climate.

All of the ensuing five steps could fall within the scope of this plan.

Step 2: Creation of a "fossil free" investment option for members[4]

"Fossil free" is defined as a portfolio that excludes:

- all ASX listed companies with a significant upstream and downstream exposure to fossil fuels – as defined in **Tiers 1 and 2 of Appendix 1** and
- all of the largest 200 largest coal, oil and gas companies by proven reserves, as defined in Fossil Free Indexes' Carbon Underground list.[5]

Step 3: Full coal divestment

An increasing number of funds are shedding coal companies across their portfolios in reaction to the structural decline in the coal market. This step would see the fund make a commitment to divest from companies in **Tiers 1 and 2 of Appendix 1** that derive significant profits from coal, and make a commitment not to re-invest in these companies because of their contribution to climate change.[6]

[4] For example, UniSuper's SRI options which now exclude fossil fuel companies. See here: http://www.unisuper.com.au/investments/investment-approach/responsible-investing
[5] See here to see the full list and methodology: http://fossilfreeindexes.com/research/the-carbon-underground/
[6] For example, see Local Government Super's approach. See here: http://www.lgsuper.com.au/documents/media/LGS%20Press%20Release%20on%20negative%20screens%2020141007.pdf

Step 4: Engagement with companies for whom fossil fuels are not their core business

The Fund commits to increase its active engagement of companies with indirect exposure to fossil fuels (as defined in **Tier 3 of Appendix 1**), setting clear deadlines for companies to implement requested changes and an understanding that divestment may be pursued if requests are not met within a suggested deadline of 2 years. Our recommendation is that engagement focus upon eliciting company responses, to the questions set out by Columbia University's Jeffrey Sachs, specifically:

- Has the company publicly and clearly subscribed to the internationally agreed goal of limiting global warming to 2° Celsius above pre-industrial levels, and to the limits on global carbon-dioxide emissions needed to meet that goal?

- Will the company pledge to leave business groups that lobby against effective climate policies to achieve the 2° limit?

- Will the company agree to end any exploration and development of unconventional reserves (for example, in the Arctic and much of the Canadian oil sands) that science has shown to be inconsistent with the 2° limit?

- Can the company demonstrate that it remains a good investment, despite the transition to low-carbon energy sources and technologies (for example, by demonstrating its own plans to make such a transition)?

Step 5: Increased investment in low-carbon sectors

A commitment to increase investments in **low-carbon** 'industries of the future' to promote sustainable new jobs in the clean-tech sector and facilitate 'a just transition'.

Low-carbon excludes all gas and low-emissions coal technologies. Ideally, the Fund's investments in low-carbon sectors would be increased to 5% by Year 5 of this plan.

phase 2: years 3-5

Continuation of steps 1-5, plus:

Step 6: Fund-wide divestment

Staged divestment across all portfolios of:

- all ASX listed companies with a significant upstream and downstream exposure to fossil fuels – as defined in **Tiers 1 and 2 of Appendix 1** and
- all of the largest 200 largest coal, oil and gas companies by proven reserves, as defined in Fossil Free Indexes' Carbon Underground list, as mentioned in Step 2.

appendix 1

CATEGORY	SUGGESTED RESPONSE	COMPANIES
TIER 1: Companies that derive all or most of their revenue from fossil fuel extraction, transport or generation.	Divestment candidates.	WOODSIDE PETROLEUM, ORIGIN ENERGY, SANTOS, CALTEX, OIL SEARCH, BEACH ENERGY, AURORA OIL & GAS, WHITEHAVEN COAL, KAROON GAS, AWE, SENEX ENERGY, DRILLSEARCH, LINC, AQUILA RESOURCES, HORIZON, BURU ENERGY, COALSPUR
TIER 2: Companies with large fossil fuel reserves but a smaller amount of their revenue is sourced from fossil fuel extraction, transport or generation.	Divestment candidates.	ENVESTRA, APA GROUP, AGL ENERGY, ENERGY WORLD, BHP BILLITON, RIO TINTO, WESFARMERS
TIER 3: indirect fossil fuel exposure.	Initial engagement; divestment if outcome of engagement not satisfactory	ASCIANO, ANZ, AURIZON, AUSDRILL, BOART, CARDNO, COMMONWEALTH BANK, DECMIL GROUP, DOWNER EDI, INCITEC PIVOT, LEIGHTON HOLDINGS, LEND LEASE, MACQUARIE GROUP, MINERAL RESOURCES, MONADELPHOUS, NATIONAL AUSTRALIA BANK, NRW HOLDINGS, ORICA LIMITED, QBE INSURANCE, QUBE HOLDINGS, SUNCORP, TOLL HOLDINGS, TRANSFIELD SERVICES, TRANSPACIFIC INDUSTRIES, UGL,WESTPAC, WORLEY PARSONS