Weekly Briefing

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Stranded:
UK Pension Funds May Get Green Light to Divest

- *Early this week, the UK government issued a report seeking comment on discussion to allow UK government pension funds to divest of fossil fuel related financial assets.*
- *This effort is not new, but the UK government may be ahead of other countries in their call to allow portfolio managers to consider this as a criteria for asset allocation.*
- *Investors with an eye toward long-run climate risks, social, and corporate governance outcomes keep pushing for such considerations.*

On June 18th, the UK government issued a report seeking comment on a recommendation to allow pension fund managers to consider moving away from their investments in fossil fuels. Currently, these managers are bound by "fiduciary duties," which means that they must seek out the highest financial investment returns for the fund participants, in this case, UK employees at companies and government.

According to Willis Towers Watson's Thinking Ahead Institute, the UK had an estimated $3.1 trillion of pension assets at yearend 2017. To put this in context, there are an estimated $131 trillion of assets under management worldwide, including $45 trillion of pension funds (top chart). The UK has the second largest, after the U.S., in pension assets as a % of GDP (2nd chart).

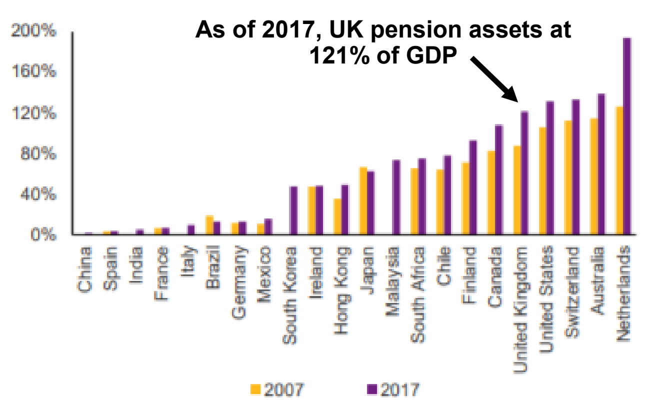
The UK government's report and call for comments could potentially give way to a substantial shift in pension fund investment away from equity and debt products tied to carbon-emitting fossil fuels.

- There is an "if" in this policy directive. The fund managers would need to assess that these fossil fuel investments could become stranded, i.e., not productive and yielding subpar returns in future. Indeed, many energy analysts have begun to mark down the value of future oil on the basis that it may never be "lifted" from the ground. Alternatively, in the longer run if this oil is lifted, its value will be diminished because technology and economics have yielded alternative energy sources with a much cleaner profile for the environment.
- While the report does not indicate that it will regulate such changes, it is promoting an approach that allows pension fund managers to identify an asset allocation excluding fossil fuel investments as part of its Statement of Principles (SIP). The SIP could very well be the basis for articulating the long-run risk associated with such investments due to their links to harmful climate change.
- Norway's pension schemes already divested in late 2017 because of the risk assessment associated with these financial assets.

Asset owners globally control USD 131 trillion

Source: The asset owner of tomorrow: Thinking Ahead Institute. Various original sources. Projections used to derive end 2017 estimates

Pension assets as % of GDP



Environment, Social, and Corporate Governance (ESG) Factors
"A generic term used in capital markets and used by investors to evaluate corporate behaviour and to determine the future financial performance of companies."
Source: Financial Times Lexicon

Social Impact Investing
"The provision of finance to organisations addressing social needs with the explicit expectation of a measurable social, as well as financial, return."
Source: OECD