



# Divestment and Stranded Assets in the Low-carbon Transition

32<sup>nd</sup> Round Table on Sustainable Development  
held on 28 October 2015  
OECD Headquarters, Paris

## Chair's Summary

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## **Divestment and Stranded Assets in the Low-carbon Transition**

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#### **Chair's Summary**

##### **Key take-away points from the meeting**

- Stranded assets are highly likely to emerge as the world moves to decarbonisation. At present, this risk is mispriced, if priced at all. Divestment from fossil fuel is motivated by either ethics or the perception that fossil fuel companies may be stranded by climate policy. Such risks could extend beyond coal, oil, gas or fossil-fuelled electricity to carbon-intensive industries.
- Climate-related risks are perceived differently by stakeholders depending on where they sit in the investment value chain, the nature of their investment and their relevant time horizon. A prime concern is the speed of the energy transition.
- Clearer policy signals and enhanced corporate disclosures on climate-related risks are prerequisites for an orderly transition, to avoid surprises and run-away stranding. National and regional governments should pay close attention to communities that could be 'stranded' and face job losses, which would seriously undermine political conditions for the transition.
- Divestment, which can take different forms, sends a strong signal to targeted companies and others in the same sectors. Alternatively, engagement is meant to encourage a company to take action, and can help to generate information on its exposure to climate-related risks. Divestment can be seen as the last resort, when engagement and active ownership fail.
- A corporate climate disclosure framework that is consistent, comparable, reliable, clear and efficient, and integrates material risks into investment decisions, is necessary and should become mandatory. Beyond the carbon footprint, such disclosure could include the corporation's strategy with respect to global climate change goals (e.g. a 2°C-compatible scenario) and indications of progress towards its implementation.
- Stress-testing of asset portfolios against defined benchmarks is also envisioned in some jurisdictions to expose vulnerabilities to climate-related risks.

##### **The Round Table Chair's suggestions for future work of the OECD in this area**

The Chair suggests that the OECD could usefully investigate the following issues:

- Public policy to minimise the impacts of the low-carbon transition on capital value and jobs.
- The explicit inclusion of corporate disclosures on climate in the OECD Guidelines for Multinational Enterprises.
- The role of breakthrough technologies in the minimisation of stranded assets.
- The identification of channels of financial stability risks due to stranding and divestment.
- The risk of stranded assets in heavy industry, as well as maritime transport or aviation.
- How the implementation of the Sustainable Development Goals and the Paris Agreement could combine to increase the likelihood of stranded assets.

## Full Summary

On 28 October 2015, the OECD Round Table on Sustainable Development brought together representatives from treasuries, central banks and supervisory authorities, banks and institutional investors, asset managers, energy companies, business and labour associations, academia and NGOs as well as OECD and IEA experts to discuss the issue of divestment from fossil fuel companies and stranded assets in the low-carbon transition.

Keeping global average temperature increase to 2°C requires structural changes to reduce our reliance on fossil fuels and CO<sub>2</sub> emissions. Energy-using equipment and other economic activities will have to be retired at an accelerated pace to make space for less carbon-intensive technologies and practices. As this transition proceeds, some fossil fuel assets will become ‘stranded’, i.e. unable to recover their investment cost, with a loss of value for investors. A range of individuals and investors are divesting assets in fossil fuel activities in anticipation of this risk. Other stakeholders are divesting on the ground that if fossil fuel use threatens the planet, earning profits from such activities is unethical. Assets under management (AUM) of actors who are undertaking some form of divestment from fossil fuel companies grew fifty-fold from USD 50 billion in 2014 to USD 2.6 trillion in 2015.<sup>1</sup>

Participants were asked to focus on four questions:

1. As the world looks to stepping up climate action in Paris, what practical concerns do divestment and the risk of stranded assets raise among policymakers and private sector stakeholders?
2. How are various stakeholders such as civil society organisations and institutional investors pursuing divestment? Could engagement be more effective than divestment?
3. What gets measured gets managed. What form of corporate disclosures and other indicators could help investors understand climate change-related risks?
4. How can public policy minimise the occurrence of assets stranding and value destruction while not compromising the low-carbon objective?

A background document ([Baron and Fischer, 2015](#)) was provided as basis for the discussion.

### **1. What practical concerns do divestment and the risk of stranded assets raise among policymakers and private sector stakeholders?**

Participants pointed out that the concerns around divestment and the risk of stranded assets result from the lack of integration of climate-related risks into decision-making. While asset managers are starting to integrate climate-related risks, banks react still mostly with incomprehension. Further, these risks are understood and priced differently depending on where stakeholders sit in the investment value chain, the nature of their investment and relevant time horizon. Asset owners may price the risk in relation to the sovereign wealth income generation from the resources a country owns and assess the impact on trade flows and currency valuation if these resources get stranded. Investment

*“Every way you look at it there will be stranded assets and the exposure is very significant because actors misprice the risks”*

<sup>1</sup> All references can be found in Baron and Fischer (2015), *Divestment and Stranded Assets in the Low-carbon Transition*, Paris: OECD Roundtable on Sustainable Development, available [here](#).

managers in a European equity portfolio, on the other hand, may want to exclude oil and gas companies to mitigate the risk. Banks have a completely different time horizon – between one to three, and five to ten years – for their loan books which also implies a different risk profile.

Whatever the perspective, participants acknowledged the risk of assets stranding due to the physical impacts of climate change and the policy and broader society’s response to climate risks. At the same time, the risk on companies’ value does not seem to be appropriately priced by the market at present, with a risk of abrupt adjustments down the line. Many participants agreed that the financial sector does not yet "know what to do with this".

There is limited quantified information on the materiality of the stranded assets risk, so concerns about climate change currently create mostly a risk to firms’ reputation. The insurance industry has a more sophisticated approach to the problem, as it will be first in line in the financial sector to withstand systemic risks due to climate change impacts. Assets stranded by climate policy itself depend on the speed of the transition and the resulting loss of value. It was reported that more than twenty power plants could be stranded in Italy under current EU climate policy plans. Some participants indicated that assets could also be stranded in carbon-intensive sectors outside the fossil fuel industry. It was also noted that fossil fuel companies could also suffer from a failure to attract a competent work force, as their reputation is tarnished by the lack of response to climate change.

***“The extent to which we consider our assets as stranded depends on the speed at which countries decarbonise”***

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### ***Decision Horizon and Incentives***

The question of what may be a feasible ethical investment in fossil fuel companies was raised. Oil and gas companies are the biggest actors in the energy sector and the climate constraint needs to be reconciled with the projected growing demand for energy services. The challenge is in the balance between necessary investments in fossil energy to support existing end-uses, the limited carbon budget, and the dynamics of new low-carbon technology that can substitute fossil fuels. Some questioned the role of divestment in that picture –it could make it more difficult for companies to engage in the transition, through higher capital costs and less access to finance – while others considered it useful to create pressure for action.

Incentives and signals – including but not limited to carbon pricing – were repeatedly mentioned by a majority of participants. Incentives are needed to encourage long-term thinking and the appropriate management of risks that are beyond the traditional time horizon of financial actors; but also incentives for companies to disclose what they are already doing without violating client confidentiality. Different signals are needed for investors to accompany the low-carbon transition. Several participants pointed out that there may be a gap between governments’ stated goals (e.g. the 2°C objective) and implementation, for example the absence of a meaningful price on carbon. On the issue of ensuring a proper allocation of investment, improved transparency via better corporate disclosures was stressed as an essential step, also to allow an informed public debate.

***“There is nothing more powerful than markets – we need the right incentives for the market to be working”***

### ***Orderly versus Disorderly Transition***

The distinction between an orderly and a disorderly transition to low carbon was an important theme. A disorderly transition could lead to a runaway stranding of assets and most concurred that

governments at national, regional and local levels should set clear terms for an orderly, gradual and controllable transition. This may facilitate a fossil fuel company's decision to invest of fossil-fuel revenues in the development of low-carbon solutions.

It was asked whether cash flow from ring-fenced polluting assets planned to be phased out over x years could be turned into a financial product, given clear policy signals. An important question in that respect is whether policy makers can provide clear timelines for private sector action, but also whether the transition can be controlled once incentives and new markets have been created.

Stranded assets may also represent a risk for financial stability. A systemic risk could emerge if it is not easily insurable and if mispricing of assets leads to a significant misallocation of capital. The presence of these factors in the case of stranded assets may justify government intervention.

The importance of the stranded assets risk to the public budget was also mentioned repeatedly, noting that state-owned companies control 50% of power plants and more than 90% of fossil fuel reserves. Whenever policymakers are also shareholders in fossil fuel assets, they ought to pay closer attention to this emerging risk, even if the idea of divesting national fossil fuel activities may not be easy to 'sell' to citizens, the ultimate shareholders of these companies. It was suggested that state-owned companies should start investing based on a merit order of projects because not all reserves will ultimately be produced. It was noted, though, that private companies own more high-carbon and high-cost reserves and would therefore be more exposed to lower demand and lower prices.

Participants also discussed the link that is sometimes made between expectations of stranded assets and the achievement of the 2°C objective. Stranding is likely to occur even if policies are not in line with 2°C, and there is already a debate on whether current low fossil fuel prices result from a cyclical or structural phenomenon, some participants stressing that structural factors would be reinforced as countries implement their national contributions to emission reductions. The ensuing lower demand and energy prices would precipitate stranding, even more so if high capital expenditures in new fields are continued.

## **2. How are various stakeholders such as civil society organisations and institutional investors pursuing divestment? Could engagement be more effective than divestment?**

### ***Divestment***

Divestment from fossil fuel and power generation assets ranges from full divestment of all fossil fuel assets to partial divestment based on well-identified thresholds, or a worst-in-class approach based on companies' carbon-intensity. Several participants agreed that divestment is already delivering an important signal to companies and sectors, increasing the pressure to change business conduct. Some argued that divestment can be undertaken as part of fiduciary duty, e.g. to mitigate financial losses in companies that are not adequately responding to their climate policy risks. The focus of divestment activities on whole sectors could be improved by a focus on individual projects or companies – especially when it comes to fixed income divestment (debt, bonds).

The best-in-class approach and ranking of companies according to their carbon intensity and future investment plans can also indicate where engagement would be most useful, and where divestment should occur. Some investors have decided on thresholds above which divestment occurs, e.g. the share of revenues drawn from fossil fuels (coal, oil or gas) – the Norwegian Sovereign Wealth Fund is following this strategy from 2016 onwards. It was mentioned that these thresholds remain discretionary at the moment.

Some participants objected to divestment, pointing out that it may lead to: shares being acquired by less socially responsible investors; less private research and development on low-carbon technologies like CCS; and the lock-in of capital into high-carbon assets. Another issue is the extent to which divested resources can be allocated to assets with significantly better carbon performance.

A counter-argument was that the fossil fuel divestment movement aims to “break the political power” of fossil fuel companies, seen as the greatest obstacle to the change towards a low-carbon economy. The capacity of engagement had been overstated in the past 25 years, as illustrated by the Rockefeller Foundation’s unsuccessful engagement with ExxonMobil, which eventually led to divestment; engagement could become an excuse for inaction. Others cautioned that resources for engagement are limited: it requires a detailed analysis of the targeted companies. Divestment is often simpler, less time-consuming and sends a more visible signal to the market. Some argued nonetheless that companies with relatively poor carbon performance could improve significantly and may be worth the effort of engagement, or to be exposed to ranking in best-in-class indices.

One participant pointed out that large listed fossil fuel companies may not be threatened by divestment due to benchmark investment – i.e. investment tracking a prominent index from which investors are unlikely to move away. Fossil-free indices are now on offer, however. One obstacle for institutional investors mentioned in this context is that they can invest their own assets as they see fit, but can only propose, not impose the use of fossil-free indices for assets that they manage for third parties.

***“Engagement and divestment are options on a continuum. Divestment is the escalation strategy”***

### ***Engagement***

Participants also emphasized the central role of engagement and defined it as their primary aim. Most stressed that engagement and divestment are part of a continuum. Divestment could deliver pressure and signal to other companies in the same sector – as well as internally to the investor’s employees – the seriousness of an investor’s concerns about climate-related risks. Engagement, on the other hand, could function also as a signal to the engaged company but it is equally about getting companies to generate information about its climate vulnerability, to act on it, and to inform financial analysts about this dimension which has largely been ignored so far. Active ownership and dialogue are seen as an integral part of responsible investment. Engagement without the threat of divestment would be rather ineffective, some participants pointed out. The current cancellation of high-cost, high-carbon capital expenditure by oil and gas companies was presented as an example of successful engagement. Moreover, some participants suggested that divestment may be more feasible for smaller, non-mainstream funds, while larger asset managers could employ their weight for effective engagement.

***“Active ownership and dialogue must remain key tools to address climate issues”***

Participants addressed the content of engagement in the context of climate change. It was suggested that engagement has to address the incompatibility of fossil fuel companies’ business models with the transition to a 2°C world. Effective engagement would imply obtaining a credible road-map for the company’s transition to low carbon. Fossil fuel companies could be asked if they can formulate a purpose that is consistent with a zero-carbon future, which does not require carve-up or bad bank scenarios, with parts of companies being split off and phased out.

Some argued that engagement can improve business conduct but questioned its ability to change the business model of oil and gas companies. It may be more effective for utilities or car companies due to more regular investment decisions and alternative business options. Overall, more work is necessary to articulate engagement and divestment strategies, together with transparent and robust climate policy tools for an effective and orderly transition. But an acceleration of market dynamics in favour of low-carbon technologies and a strong signal at COP 21 could lead to faster divestment and stranded assets before the elements of an orderly transition are in place.

### **3. What gets measured gets managed. What form of corporate disclosures and other indicators could help investors understand climate change-related risks?**

Consistent, comparable, reliable, clear and efficient disclosure by companies and investors is essential to integrate climate-related risks into investment decisions. Investors need to be able to understand what risks companies face with regards to physical impacts from climate change, liability claims and the low-carbon transition. Financial regulators also need to be informed about these risks, meaning an improved understanding of the transmission channels through which mispriced information flows, and how adjustments would take place.

One issue with disclosure seems to be the lack of attention to the already published information. The lack of scrutiny by stakeholders is evidenced by the fact that reporting corporations are very rarely questioned on their climate disclosures. This in turn does not encourage the generation of better disclosures, or their verification. The multiplicity of different voluntary and mandatory disclosure schemes was considered unhelpful by participants. The convergence of these into one comparable and mandatory framework would be preferable, and could reduce the reporting burden on business. Further, making board members liable for the information published could draw greater attention to the integration of climate-related risks in business decisions.

Article 173 of the French Energy Transition Law was mentioned as a positive example in this context. It requires listed companies to disclose risks related to climate change and scope 3 emissions (all indirect emissions that occur in the value chain), while institutional investors are obliged to disclose their exposure to climate-related risks and their contribution to the low-carbon transition. For banks, a stress-testing approach will be proposed soon. More recently, the Climate Disclosure Task Force (CDTF) proposed by Mark Carney, Governor of the Bank of England, was seen as a step in the right direction to harmonise disclosure frameworks. Some hoped that the CDTF would produce guidelines for regulators to formulate mandatory disclosure schemes.

***“To go wholesale and mainstream, legislation is the way forward”***

Various speakers urged looking beyond carbon footprints and carbon intensity. While measuring a company’s carbon footprint is a useful instrument to trigger emissions savings, it does not indicate a company’s exposure to risks related to technological change, let alone actual climate and weather-related risks. Some companies have relatively low carbon footprints but sell products relying on fossil fuels and could have much at stake as climate mitigation policy is ramped up. Other quantitative indicators and narrative reporting are needed.

Disclosure frameworks for carbon-intensive companies should include their status quo (i.e. carbon footprint, project-level information with regards to, for example, geography and energy mix), their 2°C-compatible strategy (i.e. targets, timeframe, scenarios used) and the implementation plan (i.e. changes in capital expenditures, structural changes, responsibility of implementation within the

company). It is also essential to set an appropriately long time frame for the reporting of climate-related risks, and to disclose discount factors that are applied to any measurement of risk. It was also pointed out that companies should disclose how they want to reach net zero CO<sub>2</sub> emissions and by which year, in relation to the international community's objective for climate stabilisation.

Several participants called for a standardised and enforceable approach to climate disclosures, enabling actors to reflect on their involvement in making the transition permanent and substantive. A number of issues remain nonetheless:

- What data should be published, looking beyond companies' extended carbon footprints?
- What data is required by policymakers and by different market participants?
- Where are the data quality issues and how can they be resolved?

#### **4. How can public policy minimise the occurrence of assets stranding and value destruction while not compromising the low-carbon objective?**

##### ***Stress-testing and litigation***

As part of the France's Energy Transition bill, the stress-testing of institutional investors' portfolios has been put forward as a tool that its financial supervisory authority could use to assess climate vulnerability. This would require providing institutional investors with assumptions on time horizon, the policy scenario, and the transmission channel of any climate shock. It was noted that regulators are still in a learning process regarding stress-testing. As a way to increase the importance of climate change disclosure schemes and portfolio stress-testing, some suggested that rating and auditing companies should include climate-related risks in their guidelines.

Litigation was also mentioned as another lever to draw attention to these risks. Climate risk-related litigation cases have started to appear – prompted not by regulators but by shareholders affected by decreasing coal companies' share prices. It was suggested that regulators should provide more particular guidance on climate-related risks in order for companies and investors to give a more useful response as to what represents a material risk.

Moreover, regulators were urged to take action against companies failing to disclose material risks from climate change or relying on assumptions that are incompatible with a 2°C scenario – e.g. the fact that fossil fuel companies have more reserves than they can burn and yet do not systematically report on their plans to address this contradiction. On that topic, the US Securities and Exchange Commission (SEC) published interpretive guidance on climate disclosure but did not enforce its implementation, and most companies have failed to report meaningful information.

***“There is no enforcement action for failure to report material climate change risk”***

##### ***Transparent and robust national climate change plans to minimise stranded assets***

Credible national climate change plans such as the UK Climate Change Act were seen as an important part of risk minimisation. As some assets will be stranded, it is essential that a multi-stakeholder dialogue takes place, where the abovementioned issues would be addressed (disclosures, risks, etc.) as well as fiduciary responsibilities in the context of climate risk.

It was argued that national and regional governments should pay close attention to communities that could be ‘stranded’ and face job losses during the low-carbon transition – stranding which could negatively impact the political feasibility of the transition, as some said. Transition funds could be

***“Stranded assets,  
stranded labour”***

created to mitigate the social and economic impact on vulnerable communities. Re-skilling was also seen as an important part of the response.

Regarding national climate plans and implications for financial supervision, Sweden has introduced legislation through its 2015 budget bill that obliges the country to reach net zero emissions by 2050. Moreover, a sustainability target has been imposed for the financial sector but not operationalised yet. Scoping work is underway by its financial stability authority on the impacts of stranded assets as well as on tools to benchmark credit according to sustainability targets. A report on this subject matter is due to be published in late February 2016.

### **Ways forward?**

The following points were made by participants about ways to minimise the stranding of assets and promote the integration of climate-related risks into decision-making:

- Need for incentives and clear policy signals – not limited to carbon pricing – to change decision horizon of financiers, and to make material climate-related risks visible.
- Government focus on ensuring an orderly transition so as to avoid runaway stranding of assets and value destruction.
- Introduction of mandatory, standardised disclosure frameworks for companies and investors which could come through the Climate Disclosure Task Force established by the Financial Stability Board, also with a view to minimising reporting costs to companies.
- Stress-testing of portfolios against climate-related risks.
- The need for companies to generate carbon plans, in line with globally-agreed climate goals.
- The need to take full account of communities and labour force that could be stranded in the transition to low carbon.