Brought to you by J O Hambro Capital Management

The divestment dilemma

November 2020

Investors often consider ‘divesting’ their portfolios of fossil fuel companies, as a way to address climate change.

How should they approach this decision?

Authored by:

Susheela Peres da Costa
Head of Advisory, Regnan

Blurred lines

A first step is to decide what types of firms qualify for divestment. Should divestment focus on those that *produce* fossil fuels? Or firms that burn them, releasing global warming gases into the atmosphere? Are firms that support the fossil fuel supply chain in or out? Coal ports? Gas pipelines? Roadside retailers of petrol (“gas”)?

Burning fossil fuels is a major part of industries as diverse as energy generation, steelmaking and aviation. Are these all candidates for divestment too? Many of the largest organizations involved in fossil fuels are governments; should countries be divested too?

Are fossil fuels equal? Is coal burnt to make steel for wind turbines worse than lower-carbon oil to air freight fresh tropical fruit to temperate markets? Is it worse than food firms’ destruction of carbon sinks like The Amazon, for agricultural expansion? Is it worse for a firm to undermine climate action with propaganda? If so, some media companies are higher priorities for divestment than coal.

The good news is that a well-canvassed consensus on such questions is developing, as a result of the new EU taxonomy for “environmentally sustainable activities”. After long and fiercely contested debate, the EU converged on a sensibly functional framework: with a top-line focus on *activities* rather than *industries*, and clear guidance on which activities these count as “climate-mitigating”. A framework for activities that *harm* climate mitigation is still underway.

Digging deeper

To avoid being paralyzed by the possibilities, I recommend that clients stay focused on their rationale.

A well-founded rationale for considering divestment makes many of the confounding complexities recede and is a ready-reckoner for whether (and which) divestments would deliver the desired result.

For some investors, divestment is about wielding capital responsibly; they see withholding capital from fossil fuel businesses as a way to deny them support. However for mature, publicly traded companies; divestment involves one investor selling shares to another, and these transactions are dwarfed by the volumes of shares that trade on any day. The financial position of a fossil fuel company may be unaffected by divestment decisions made by equity investors.

For others, divestment is more akin to a boycott; a protest expressed through refusal of fossil fuel-based returns. This has historical precedents, for instance the “disinvestment” of companies operating in South Africa in protest of Apartheid, as part of a sustained global campaign that also included a UN resolution, trade sanctions, and boycotts of the country by consumer, sporting, academic and cultural groups. Isolation of fossil fuels, in contrast, is nearly impossible as they are entangled in everything from agricultural production to defense. Even most climate-action oriented investors would struggle to back their divestment with a boycott of fossil fuel *use*.

Hammer and nails

Systemic problems like climate change require system interventions. Focusing on a single investment portfolio could be viewed as myopic in this context; perhaps a case of “when all you have is a hammer, everything looks like a nail”.

In fact, the divestment ‘hammer’ is far from the only tool in the kit. Investors who prioritize *climate* (versus portfolio) objectives often use other, more powerful tools.

Stewardship initiatives – in which investors use influence for climate action – have gained momentum, and are getting results. Examples include victories claimed by the Climate Action 100+ coalition which co-ordinates many institutional investors to secure climate commitments from the world’s largest corporate emitters; including fossil fuel companies.

Investor stewardship at times goes further; electing directors, putting resolutions forward, or stipulating conditions to be met before agreeing to roll over debt. Reining in fossil fuel company influence on government carbon policy or appointing corporate leaders committed to decarbonization are among the ambitious climate outcomes investors have pursued.

Direct advocacy with regulators, industry bodies and governments, is a further avenue that should not be neglected. Pricing carbon pollution, removing fossil fuel subsidies, and supporting institutional R&D are all in the interests of diversified investors. Investors can at a minimum check that they don’t support climate *inaction*, directly or through third parties, for example via support of business groups, political parties, or public communication platforms that obstruct, diminish or delay climate action.

Also effective is well-targeted catalytic investment. Early investors (for instance in energy storage technology) helped spawn whole industries (like electric vehicles) now transforming the world’s reliance on burning fossil fuels.

Know when to hold them, (know when to fold them)

None of the above means divestment should not be considered; indeed many investors divest when they believe that markets have failed. This includes investors who believe many fossil fuel assets are ‘stranded’, and think this is not well reflected in their price. It also includes those who think fossil fuel liability risks are not worth taking. Or those simply seeing more attractive opportunities elsewhere.

This last of these highlights the unspoken assumption that investors default to holding all available shares. For active investors, ‘divestment’ is superfluous: they hold only the assets they have *explicitly chosen* to own.

These investors are also better placed to pursue climate action through stewardship, without this being compromised by their continuing interest in good returns from fossil fuels. Indeed this may be one of the better reasons for investors to divest: to free them from ambivalence about the fortunes of fossil fuels, and thus empower them to be more assertive in global decarbonization to protect their broader more enduring investments.

Regnan

Disclaimer

THIS DOCUMENT IS FOR PROFESSIONAL INVESTORS ONLY.

Regnan is a standalone responsible investment business division of Pendal Group Limited (Pendal). Pendal is an Australian-listed investment manager and owner of the J O Hambro Capital Management Group. Regnan's focus is on delivering innovative solutions for sustainable and impact investment, leaning on over 20 years of experience at the frontier of responsible investment. "Regnan" is a registered trademark of Pendal.

The Regnan business consists of two distinct business lines. The investment management business is based in the United Kingdom and sits within J O Hambro Capital Management Limited, which is authorized and regulated by the Financial Conduct Authority and is registered as an investment adviser with the SEC. "Regnan" is a registered as a trading name of J O Hambro Capital Management Limited.

In addition to Regnan Investment teams is the Regnan Insight and Advisory Centre of Pendal Institutional Limited in Australia, which has a long history of providing engagement and advisory services on environmental, social and governance issues. While the Regnan investment management teams will often draw on services from and collaborate with the Regnan Insight and Advisory Centre, they remain independent of the Regnan Insight and Advisory Centre and are solely responsible for the investment management of their strategies.

Issued and approved in the UK by J O Hambro Capital Management Limited ("JOHCML") which is authorized and regulated by the Financial Conduct Authority. Registered office: Level 3, 1 St James's Market, London SW1Y 4AH. J O Hambro Capital Management Limited. Registered in England No:2176004.

Issued in the European Union by JOHCM Funds (Ireland) Limited ("JOHCMI") which is authorized by the Central Bank of Ireland. Registered office: Riverside One, Sir John Rogerson's Quay, Dublin 2, Ireland.

Regnan is a trading name of J O Hambro Capital Management Limited.

The registered mark J O Hambro® is owned by Barnham Broom Holdings Limited and is used under license. JOHCM® is a registered trademark of J O Hambro Capital Management Limited.

The information in this document does not constitute, or form part of, any offer to sell or issue, or any solicitation of an offer to purchase or subscribe for Funds described in this document; nor shall this document, or any part of it, or the fact of its distribution form the basis of, or be relied on, in connection with any contract.

Recipients of this document who intend to subscribe to any of the Funds are reminded that any such purchase may only be made solely on the basis of the information contained in the final prospectus, which may be different from the information contained in this document. No reliance may be placed for any purpose whatsoever on the information contained in this document or on the completeness, accuracy or fairness thereof.

No representation or warranty, express or implied, is made or given by or on behalf of the Firm or its partners or any other person as to the accuracy, completeness or fairness of the information or opinions contained in this document, and no responsibility or liability is accepted for any such information or opinions (but so that nothing in this paragraph shall exclude liability for any representation or warranty made fraudulently).

The distribution of this document in certain jurisdictions may be restricted by law; therefore, persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any such distribution could result in a violation of the law of such jurisdictions.

The information contained in this presentation has been verified by the firm. It is possible that, from time to time, the fund manager may choose to vary self imposed guidelines contained in this presentation in which case some statements may no longer remain valid. We recommend that prospective investors request confirmation of such changes prior to investment. Notwithstanding, all investment restrictions contained in specific fund documentation such as prospectuses, supplements or placement memoranda or addenda thereto may be relied upon.

Investments fluctuate in value and may fall as well as rise and that investors may not get back the value of their original investment.

Past performance is not necessarily a guide to future performance.

Investors should note that there may be no recognized market for investments selected by the Investment Manager and it may, therefore, be difficult to deal in the investments or to obtain reliable information about their value or the extent of the risks to which they are exposed.

The Investment Manager may undertake investments on behalf of the Fund in countries other than the investors' own domicile. Investors should also note that changes in rates of exchange may cause the value of investments to go up or down.

The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation.

Information on how JOHCM handles personal data which it receives can be found in the JOHCM Privacy Statement on our website: www.johcm.com