48. Climate change and fossil fuels: an update

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1. Summary

This paper reports on the progress the Joint Advisory Committee on the Ethics of Investment (JACEI) has made in responding to the following memorials to the 2017 Conference.

M32 Investment in fossil fuels

The Central Scotland (31/9) Circuit Meeting (Present: 12; Voting: 10 for, 0 against) requests that the Methodist Council oversees a process with a view to issuing advice that the Methodist Church divests all of its investments in fossil fuel industries (coal, gas, oil) by the 2022 Conference and seeks to invest a significant and growing proportion of its overall investment portfolio in renewable energy and infrastructure investments that will reduce greenhouse gas emissions.

Reply

The Conference thanks the Central Scotland Circuit Meeting for its memorial.

The Conference has examined the question of Methodist investment in fossil fuels over a number of years, most recently in 2014 and 2015.

The Conference Statement, Hope in God's Future (2009), was not specific on the question of disinvestment from fossil fuels, but the increasing urgency of the situation in recent years has made the ethical questions raised by different fuels more critical. The Conference has acknowledged that a need for a radical change in our reliance on fossil fuels is increasingly urgent. If we are to limit warming to well below 2°C, nations need to reduce emissions dramatically.

In 2014, the Conference directed the Methodist Council through JACEI to undertake a review of the Central Finance Board (CFB)'s climate change policy with specific reference to the oil, gas and coal extraction sectors but stated that this should be "without prejudice to a specific commitment to disinvest". The report to the Methodist Conference of 2015 stated: "The JACEI advice on specific fuels should be regularly reviewed against internationally agreed action that is considered necessary to limit global warming to two degrees and in due course prioritise other fossil fuels as necessary."

48. Climate change and fossil fuels: an update

In 2015 the Conference rejected the request in a memorial which called for total disinvestment from oil and gas companies by the end of 2018. The CFB continues to evaluate companies for investment on a case-by-case basis using the guidance of JACEI and CFB policies.

The CFB invests Methodist money in accordance with ethical investment policies, whilst seeking to achieve above average returns for the Church and other clients. Following advice from JACEI, the CFB implements its investment approach to climate change according to three policies, which are available on the CFB website: Climate Change (2009), Implications for the Electricity Generation Industry (2013) and Implications for different fuels (2015). Together these policies set a framework for lowering the carbon footprint of CFB's portfolio, focusing engagement on companies with the greatest intensity of carbon emissions, and considering whether companies' business models imply a low probability of meeting emission reduction targets. CFB policies on climate change have also led to almost twenty companies in the coal, oil and gas, and electricity sectors being excluded from investment, including disinvestment from six shareholdings.

The CFB reports that, as an investor, it is in a position to engage on both the investment and ethical imperative for action on climate change. Working with the Church Investors Group it has encouraged companies to provide a more comprehensive disclosure of their carbon emissions and it takes emissions disclosure into account when it votes at company AGMs. As a founder member of the 'Aiming for A' investor coalition, the CFB co-filed shareholder resolutions at the AGMs of BP, Shell, Anglo American, and Rio Tinto, which were overwhelmingly passed. The resolutions required companies to show how they will transition to a low carbon world and investors are now engaging with the results.

The CFB is also a founder member of the Transition Pathway Initiative (TPI), which helps asset owners assess companies' own emissions, including how expected future performance compares to targets and pledges made as part of the Paris Agreement. This additional tool will better enable the CFB to determine how quickly companies are transitioning and which companies merit further intensive engagement, or even disinvestment or exclusion.

Oil and gas companies, particularly those focused on gas which is an important fuel needed for a realistic transition to a low carbon world, merit different treatment to coal companies. CFB policies recognise the differences and also distinguish between companies which align their business investment plans to be consistent with a scenario of well below 2°C and those many which do not.

Investor engagement with oil and gas companies has helped bring about some changes in behaviour but many investment plans are still predicated on average temperatures *rising above 2°C. Given the urgency of action required for transition to low carbon economies confirmed by the Paris COP21, pressure to set a timescale for successful engagement or even disinvestment is understandable.*

The Conference acknowledges that CFB retains responsibility for investment decisions, including on the merits of renewable or infrastructure investments, with implications for portfolio risk and return. Ethical choices need to be made in the context of the fiduciary responsibilities of the underlying Methodist investing organisations, including the pension schemes for ministers and lay employees. For example, the exclusion of all oil and gas companies would lead to total ethical exclusions forming 27% of the FTSE All Share index, compared to the current 15%. The removal of fossil fuel companies from a portfolio by a specific date raises questions of investment risk on which key stakeholders (such as the pension fund trustees) would need to be consulted.

The Conference therefore affirms the ethical basis of this memorial, which is that if engagement with companies that are heavily dependent on the extraction of fossil fuels does not lead to business models compatible with the ambition of the Paris agreement, disinvestment will ultimately be the response.

However, the Conference does not at this time accept the specific request in the memorial as it could be argued that there is further work to do on the ethical and investment questions related to fossil fuels before final decisions can be taken on disinvestment.

Therefore, the Conference asks the Methodist Council to request JACEI to:

a) examine the pace of change in the extractive industries sector;
b) in the light of the increasing urgency for more global action, continue actively to consider disinvestment criteria, timescales, and consultation processes required to disinvest from oil and gas companies that fail to comply with the ethical basis outlined above;
c) report to the Conference in 2018, with the expectation that if any such company in which the Church invests has not aligned their business investment plans with the Paris Agreement target of a global temperature rise well below 2 degrees, there would be a recommendation that the Church disinvest from such a company by the 2020 Conference.

M33 The Scotland District Synod, Representative Session (Present: 56; Voting: 45 for, 3 against)

This memorial was received with the same text as M32, with the exception of replacing "(coal, gas, oil)" with "(coal, gas, oil, industrial peat)". The Conference adopted the same reply.

M34 Investment in fossil fuels

The Bristol District Synod, Representative Session (Present: 72; Voting: 67 for, 0 against)

requests that the Methodist Conference instructs the Methodist Council to ensure that the Methodist Church entirely divests from fossil fuel industries (coal, gas and oil) by the 2022 Conference, and seeks to invest a significant and growing proportion of its portfolio in renewable energy and infrastructure investments that will urgently reduce greenhouse gas emissions.

Reply

The Conference adopted the same reply as to M32.

M35 Investment in fossil fuels

The Stratford and Evesham (5/15) Circuit Meeting (Present: 24; Voting: 23 for, 1 against) welcomes the Transition Pathway Initiative on global warming supported, among others, by the Methodist Finance Board and the Church of England, but fears that its targets in relation to timing and holding temperature increase to 1.5 degrees are seriously insufficient. It further fears that fossil fuel companies are an increasingly risky investment. It therefore requests that the Methodist Council oversees a process, in company with the Joint Advisory Committee on the Ethics of Investment (JACEI), with a view to issuing robust advice that the Methodist Church entirely divest from fossil fuel industries (coal, gas and oil) by the 2020 Conference, and seeks to invest a significant and growing proportion of its portfolio in renewable energy and infrastructure investments that will urgently reduce greenhouse gas emissions.

Reply

The Conference adopted the same reply as to M32.

M36 The Birmingham District Synod, Representative Session (Present: 114; Voting: 73 for, 23 against)

This memorial was received with the same text as M35. The Conference adopted the same reply as to M32.

The Committee and the Central Finance Board (CFB) have reviewed the outlook for the fossil fuel sector. They have developed a methodology for assessing companies in the light of a future where temperature rises are limited to “well below 2°C”. The next steps are to test and implement this methodology, engaging with companies as this is done, to assess the extent to which company investment plans are aligned with this objective.

2. Response to Memorial 32 (2017)

As set out above, the 2017 Conference considered five Memorials expressing deepening concern about climate change and the role of the fossil fuel industry. It acknowledged that considerable work had been done by JACEI and the CFB over many years to address this important issue. It recognised the CFB's responsibility to make investment decisions. The Conference asked the Committee to accelerate the pace of further work analysing the fossil fuel sector.

The Conference affirmed that "*if engagement with companies that are heavily dependent on the extraction of fossil fuels does not lead to business models compatible with the ambition of the Paris agreement, disinvestment will ultimately be the response*."

The Conference stated that there was further work to be undertaken on the ethical and investment questions before further disinvestments could be considered.

3. Climate change and investment

For over ten years the Committee has advised the CFB on climate change and investment, and has been encouraged by the urgent priority which CFB has given to this work.

Three ethical policies have shaped CFB's ethical investment activity over the issue:

- The first, adopted in 2009, was based around the Conference Statement, *Hope in God's Future* and commits the CFB to targeting a below average carbon footprint in its portfolios.
- *Implications for the Electricity Generation Industry*, was adopted in 2013 and led to companies being excluded from investment.
- *Implications for different fuels*, was adopted in 2015 and focused on companies producing fuels that were significant emitters or which were solely focused on finding new carbon assets.

The Committee reviews and encourages the CFB's engagement with companies on climate change issues, which includes extensive interaction and, at times, the co-filing of shareholder resolutions pressing companies for more action, (only possible when the CFB holds shares in the relevant companies). CFB voting at company Annual General Meetings is also influenced by a company's disclosure of carbon emissions and progress, or otherwise, in transitioning to a low carbon world.

The CFB also works with other investor groups on this issue, including the Church Investors Group, the Institutional Investors Group on Climate Change, and the Transition Pathway Initiative.

The Committee has advised the CFB on the exclusion of almost twenty companies as a result of its climate change policies, including a number of disinvestments. It continues to monitor the application of these policies to CFB-managed investments.

4. Scenarios

One of the challenges arising from the Conference's direction has been to understand what it means in practice to achieve the Paris Agreement objective of a world where temperature rises are limited to "*well below 2°C*". There is no consensus understanding of what a "*well below 2°C*" world will look like; let alone what a transition to this world would mean for the future of various extractive industries. This understanding is vital if JACEI is to advise the CFB on whether business investment plans are aligned with the Paris Agreement objective or not, but unfortunately no detailed blueprint exists.

Therefore, the Committee examined the limited available research into scenarios which could help it understand a "*well below 2°C*" future. It should be noted that scenarios give only a picture of what the future *may* be like and are highly sensitive to the assumptions underpinning them.

The Committee has identified a small number of scenarios which are most relevant. It has found particularly useful a report by the International Energy Agency (IEA) and the International Renewable Energy Agency (IRENA) which outlines scenarios where there is a 66% probability that the average temperature rise will be limited to +2°C. The IEA/IRENA projections are not necessarily reliant on extensive adoption of commercially unproven technology such as Carbon Capture and Storage or on technology which extracts carbon from the atmosphere.

The report recognises that there would have to be an energy transition to low carbon energy sources "*of exceptional scope, depth, and speed*" with increasing energy efficiency too. Fossil fuels remain "*an important part of the energy system*" but coal use would decline rapidly, natural gas "*would continue to play an important role in the energy transition*", and oil use would fall as it was replaced by other energy sources "*but its substitution is challenging in several sectors, such as petrochemicals*". IRENA believes that in 2050 "*oil demand would be at 45% of today's* level". Of note is that the IEA believes that "*Investment in new oil supply will be needed as the decline in currently producing fields is greater than the* [projected] *decline in demand.*"

5. A methodology for assessing fossil fuel companies

The CFB has developed a methodology for assessing the extent to which fossil fuel companies' business investment plans are aligned with the Paris Agreement objective.

The first step was to construct a timeline to 2100, using relevant scenarios to determine what developments in energy production will need to take place by certain times. The aim was to see company investment plans within this context. It is acknowledged that in a dynamic market economy it is possible that some more efficient companies could be expanding production of fossil fuels even while the global level of production is falling, consistent with a "*well below 2°C*" scenario.

The CFB and the Committee will examine fossil fuel companies on the following basis:

- Current asset mix – the mix between different types of fuel.
- Capital expenditure on exploration, development, and production – estimates of what capital expenditure sits inside and outside a '+2°C budget' and company spending on specific projects.
- Climate strategy and governance – management's commitment to addressing climate change, including public statements and representations to governments.
- Positive transition steps – investment in projects likely to facilitate the transition to a low carbon economy, including renewable energy investment.
- Decreasing direct emissions – a fossil fuel company which takes climate change seriously will also be taking action to reduce its own emissions.

The Committee has advised the CFB that it should apply its methodology initially to fossil fuel companies in which CFB funds directly hold shares. These will be held within UK equity portfolios and the European portion of the Overseas Fund. Later, other companies across global markets can be considered. An initial assessment of companies will be followed by engagement and re-evaluation. The Committee will be fully involved. The Committee has kept in mind the statements in the Conference direction that "*Ethical choices need to be made in the context of the fiduciary responsibilities of the underlying Methodist investing organisations*", which include the Ministers and Lay Employees pension schemes and TMCP. The Conference also stated that "*the removal of fossil fuel companies from a portfolio by a specific date raises questions of investment risk on which key stakeholders (such as pension fund trustees) would need to be consulted.*"

6. Implications for the wider Methodist Church

The research around scenarios highlights the need for energy efficiency and reduced reliance on gas for heating. There are potential implications for management of the operational property assets of the Church.

7. Implications for JACEI and the CFB

The Committee believes it is important to highlight that undertaking this work at an accelerated pace, as requested by the Conference, has had the following implications for ethical investment work:

- **Resources**
  The CFB has diverted significant resources to this project, at the expense of other activities including ethical investment research in other areas. It should also be noted that the CFB undertook this work during an operations review, and while preparing for new financial regulations. The Committee commends to the Conference the extensive work of the CFB investment team on this project during this short time frame.

- **Focus**
  This project has required the Committee to focus further on the supply of fossil fuels. It has been unable therefore to devote as much attention as it would have on companies with significant consumption of fossil fuels. Without more action in this area, the outlook for climate change is grim.

8. Conclusion

The Committee notes that the debate around climate change is evolving with new data, new projections, actions by government and companies, and new technological developments and innovations. A major event will be the publication of the IPCC's *Special report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways.* This will prompt a new range of projections. The Committee and the CFB will continue to keep up to date with developments as they assess fossil fuel companies.

The task given to the Committee and CFB by the Conference is a significant one, but so is the urgency and scale of the challenge confronting our world. Both the Committee and the CFB are committed to using ethical investment to help the transition to a low carbon future. As is stated in *Hope in God's Future:*

> *"We cannot, therefore, countenance a future in which God has abandoned the project of creation and redemption, in which climate change destroys all that God has established or in which human irresponsibility overwhelms God's ability to bring redemption to creation. The basis for Christian responses to climate change is hope in the realisation of the reign of God over a renewed creation."*

*****RESOLUTIONS**

48/1. The Conference receives the Report.

48/2. The Conferences directs the Methodist Council to request that the Joint Advisory Committee on the Ethics of Investment provides a report to the Conference in 2020 on the progress made in implementing the methodology described.