Divestment Concerns Creep In for More Industries

Although engagement is the top priority, investors are increasingly pulling out of companies

by Lindsay Frost

Stakeholders are increasingly pressuring institutional investors to divest from companies — particularly in the fossil fuel, private prison and tobacco industries — due to predicted long-term impacts of environmental, social and governance issues.

For most companies in these and other industries, investor sources tell Agenda that they still think engagement is more effective in terms of having companies address their concerns. But for those companies that may not survive the next 10 years, some sources say divestment is the only option.

For boards, the climate crisis and increasing focus by investors on ESG issues not only brings pressure to disclose or engage, but threats to divest that could ultimately result in changes to the composition of their investor base.

"We are looking very closely at how boards of directors are tackling this real challenge and we are expecting them to exercise oversight of climate risk," said **Liz Gordon**, executive director of corporate governance at the **New York State Common Retirement Fund**. "I want to see [boards] giving it some real thought and developing their own strategies that work to make money for them and us over the long haul."

NYSCRF, under the direction of New York State Comptroller **Thomas DiNapoli**, restricted investments in five coal producers earlier this year. In total, the pension has divested from 22 companies in 2020 and 2021. It initially sent letters to 27 coal companies to let them know about risk assessments the fund had completed, asking the companies to respond and give more information. Ultimately, the fund found that 22 of the 27 companies "didn't have a path forward given their current levels of capital expenditures and their current disclosures didn't meet a, frankly, low bar," said Gordon.

The fund continues to stay in touch with these companies to see if there is a change in approach, and the companies could become available for investment again if they took steps to address risks, Gordon said.

NYSCRF is not alone. According to a July survey from Investopedia and Treehugger, 29% of more than 700 investors who include ESG criteria in their decision-making said they've divested or sold shares for ESG reasons. Many other pension funds, endowments and other investors are considering divestment campaigns after coming under pressure from their own stakeholders. For example, Baltimore, Maryland, this month directed its pension funds to divest from fossil fuels. The city joins **BlackRock**, **BNP Paribas**, **Harvard University**, the **MacArthur Foundation** and New York in pulling money out of coal and fossil fuel producers as the climate crisis becomes more urgent.

Similarly, the Maine state legislature passed a statute in June requiring the $17 billion **Maine Public Employees Retirement System** to divest $1.3 billion from fossil fuels within five years and the state treasury to do the same with other state funds.

"What we are doing now is studying how to implement the statute consistent with our fiduciary duty," said **Michael Colleran**, COO and general counsel at MainePERS. "We are examining our current fossil fuel exospore in our portfolio and looking to see what alternatives there are available with comparable risk-return profiles and costs."

He continued: "Fossil fuels have, over time, become a smaller part of our portfolio and in all likelihood will continue to do so as people move away from fossil fuel and towards renewable energy."

At the **California State Teachers' Retirement System**, divestment is reserved for "the most extreme cases," when the fund objects to the core business of the company, the company declines to change or adapt and the money-making situation for the fund is "unsustainable," according to **Chris Ailman**, chief investment officer at Calstrs. This includes the coal industry and the firearm industry, he said.

"This is when the risk is too great and will overcome the return opportunity," Ailman said. The firm has made six divestments, four of which "lost us a lot of money," Ailman said. The most expensive divestment was tobacco, he added.

The private prison industry is also under pressure. Calstrs divested from **CoreCivic** and the **GEO Group** in 2018, and pension funds in New York and Rhode Island pledged to divest as well.

But the fossil fuel industry may be generating the most divestment campaigns these days. Investors pulled an estimated $14 trillion out of fossil fuel companies as of last year.

"There are major pension funds committed to divest, cities that have divested those [fossil fuel] assets, philanthropies, universities — it has spread all over the world," said **Ellen Dorsey**, executive director of the **Wallace Global Fund** and president of the DivestInvest global network, which encourages divestment from fossil fuels. "This is coming after a decade of activism. You are seeing the elite institutions within their sectors now committing. This is going to go fast into the mainstream — the floodgates are open."

Meanwhile, NYSCRF is currently evaluating 42 publicly traded shale oil and gas companies that derive more than 10% of revenue from crude oil and gas production from shale, including **Marathon Oil Corp.**, **ConocoPhillips** and **Hess Corp.**

"Divestment is a last resort — only to use when we see a risk can't be addressed through engagement," Gordon said. "It's a very high bar. We also take the process around it very seriously. We develop policies to articulate why a particular risk rises to that level where we would even consider divestment."

New York City's portfolios experienced no negative financial impacts from divesting fossil fuels, according to research that BlackRock conducted for the **Teachers' Retirement System of the City of New York**. In future divestment considerations, the fund should keep in mind that "the fossil-fuel-linked securities of each divestment option have underperformed the broader investment market over the last five years," the report said. As a result, two of New York City's pension funds voted to divest an estimated $4 billion from fossil fuel securities.

BlackRock itself announced last year that it would remove any companies that generate "more than 25% of their revenues from thermal coal production" from their active portfolios, impacting roughly 0.007% of its total holdings.

Indeed, Dorsey said portfolios that divest from fossil fuels tend to outperform those that do not. For example, at Wallace, which divested from fossil fuels in 2014, the firm is "crushing all of our benchmarks." Indeed, the fossil-free funds project from **As You Sow** reports that both **State Street Global Advisors**' and **Parnassus Investments**' fossil fuel-free indexes have posted higher annualized returns than BlackRock's core S&P 500 ETF on a three-year and five-year basis as of Aug. 31.

Still, even as some pensions, endowments and others divest from certain industries, others are still buying up those shares. For example, the Financial Times recently reported that hedge funds are buying shares in oil and gas companies other investors divested and posting large gains in doing so.

Engagement

Investors say they generally prefer engagement to divestment. For the NYSCRF, it has "long been committed to engagements. We want our companies to succeed," Gordon said. "We want to be invested in them for the long haul, which requires a frank discussion about the risks we perceive and how to address those risks."

This active engagement includes direct meetings with company management and board members, letter-writing campaigns and filing shareholder resolutions, Gordon said.

Similarly, at Calstrs, Ailman said that when dealing with an issue that an industry or company faces that presents an outsize risk, the first thing the firm does is engage, including traveling to the company to meet with management and have a dialogue.

The pension wrote last year that divesting from fossil fuels "fails to address the myriad issues that contribute to climate change."

"While the major oils are seen as the evil empire, they may be the groups that have the solutions," Ailman said. "We are a friend, not a foe." But directors can't have their heads in the sand when it comes to innovation and adapting to change, he continued. Otherwise, the company will be "like a BlackBerry or Kodak" that won't withstand the test of time and will lose investors in the process.

But to Dorsey, the divestment activist, engagement in some industries just hasn't worked. She said investors have engaged companies in the fossil fuels sector "for decades, and it has failed. They haven't moved the needle at all and are moving against science. The time for engagement is absolutely over." ■

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