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# Climate-related investor engagement in the oil and gas sector - how to have the greatest impact

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## Abstract

The energy transition from a fossil fuel-based economy to an economy based on renewables is necessary to limit the impacts from climate change. The transition poses a risk to the fossil fuel sector, the fossil fuel-dependent sectors and their investors. While activists and NGOs promote divestment from fossil fuels, international organisations and industry coalitions urge investors to use their influence as owners to change the behaviour of portfolio companies exposed to risk from the transition. However, there is a lack of research on whether investor engagement actually changes the behaviour of companies, and what type of engagement is most effective. Zooming in on the oil and gas sector, this thesis will answer the question:

How can institutional investors best influence oil and gas companies in their portfolio to include climate change considerations in their business?

An analysis of the top 15 listed oil and gas companies showed that their efforts to mitigate the risks they face from an energy transition are very limited. However, a survey of European investors' climate-related engagement with oil and gas companies showed that engagement is widespread. The essence of the respondents' view of impact was that the sum of efforts is what drives change, but that it also takes cooperation by the target company. Four semi-structured interviews provided a deeper insight into the current quality of engagement. The analysis exposed how climate-related investor engagement in the oil and gas sector looks better than it performs.

Five steps for effective investor engagement were identified. 1. The investor needs to position itself as powerful and legit, e.g. by cooperating with other investors to aggregate their share. 2. The investor needs to identify the companies which are subject to the transition risk 3. The method choice depends on the target company, but should include informal engagement, potentially backed up by shareholder resolutions or pressure through the media. 4. Divest if unsuccessful 5. Follow up with the target company to hold it accountable. The five steps provide a structure of engagement, but the process will be different for every company.

Good-quality engagement will be difficult to introduce without a change in the financial system from profiting of transactions to the ownership of the underlying assets. Furthermore, investors need political pressure and thereby increased legitimacy to push for climate mitigating initiatives in the oil and gas sector.

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# 1 Introduction

Post-industrial human activity has caused greenhouse gas (GHG) levels in the atmosphere to be at their highest for 800,000 years, leading to a global average temperature increase of 0.85°C from 1880 to 2012 (IPCC 2014b). Further warming will have immense consequences for natural and human systems all over the world, including rising sea levels, changing weather patterns, reductions in quantity and quality of water resources and loss of biodiversity. Reaching a temperature increase of more than 2°C would bring intensified effects and lead to a point of no return (UNFCCC 2014; IPCC 2014b). To limit the temperature increase to 2°C, society needs to develop sustainably, i.e. *"development that meets the needs of the present without compromising the ability of future generations to meet their own needs"* (Brundtland 1987, p 41). As GHG emissions are the cause of climate change, a reduction in GHG emissions is crucial to mitigate climate change (IPCC 2014a).

In December 2015, a milestone was reached when 186 governments signed the Paris Agreement, pledging to limit the global temperature increase to well below 2°C, aiming for 1.5°C (COP21 2015). To achieve this goal, a transition from a fossil fuel-based economy to alternative, renewable energy sources is necessary (International Energy Agency 2015). Researchers have shown that up to 80% of the known fossil fuel reserves need to stay in the ground to reach the target towards 2050 if the consequences of climate change are to be limited, i.e. 80% of the known fossil fuel reserves are unburnable (McGlade & Ekins 2015; Carbon Tracker 2011).

However, these unburnable reserves are still adding to the value of fossil fuel companies (Carbon Tracker 2011). This happens for two reasons; market inefficiency and market failure (Waygood 2011). Market inefficiencies occur when investors fail to punish short-termism or fail to reward businesses who consider the long-term sustainability of the company, and market failure occurs when negative externalities of a company are not included in the value of the firm, i.e. the costs are transferred to society instead of being internalised (Waygood 2011). The climate-specific externalities of e.g. GHG emissions can potentially be internalised by introducing a price on carbon dioxide (CO2), either through a tax or a cap-and-trade scheme (Carl & Fedor 2016; Van Der Ploeg & Rezai n.d.), whereas market inefficiencies need to be solved through a change of the investors themselves.

The stakes are high, as the value at risk from climate change is estimated at USD 4.2 trillion towards 2100, using a private-sector discount rate, in a pre-Paris business-as-usual scenario (The Economist Intelligence Unit 2015). In the worst-case scenario, using a temperature increase of 6°C and a public-sector discount rate, 30% of the global assets' value are at risk (The Economist Intelligence Unit 2015). Climate change will have such vast impact on the economy that it poses a systemic risk (e.g. Waygood 2011; Carbon Tracker 2011; The Economist Intelligence Unit 2015). If governments decide to take action through policies mitigating climate change, e.g. a carbon tax, it will affect the profits of high-carbon assets such as the fossil fuel sector and the infrastructure built around it. Some of the key industries affected would be industrials, cement, utilities, aviation and road transportation (Fulton & Weber 2015; FSB TCFD 2016a). To put it in perspective, coal, oil and gas, make up 20-30% of the value of the stock exchanges in Australia, London, Moscow, Toronto and Sao Paulo (Carbon Tracker 2011). This is why Carbon Tracker has introduced the concept of a carbon bubble in the economy, which when it bursts will create financial instability (Carbon Tracker 2011).

The climate-related financial risks are divided into physical and transition risk (Fulton & Weber 2015; Chenet et al. 2015; FSB TCFD 2016a; Silver 2016). Physical risk is the risk of physical impact caused by climate change, e.g. a change in the availability of water. It can be both acute and chronic. Transition risk includes the financial risk from the transition to a low-carbon economy, i.e. policy/legal risks, technological risks, market risks and reputational risk (FSB TCFD 2016a). However, not only do investors need to consider climate-related issues due to financial risk. Many institutional investors are also obliged, or under pressure from their beneficiaries or other stakeholders, to actively invest in a climate friendly way (Thomä et al. 2015). This implies that some investors see themselves as future makers, i.e. changing the market and pushing forward a specific agenda, in contrast to climate-aware future takers, who do not view themselves as able to change the market, but see a mispricing of risk due to climate change (Mercer 2015).

Although climate-aware future takers and future makers differ in motivation, both investor types see an inefficiency in the market. For climate-related issues, and environmental, social and governance (ESG) risks in general, the two options are to divest or to engage with the portfolio

companies at risk (Waygood 2011; Atif et al. 2013). The international community has adopted investor engagement as the primary tool to change the behaviour of fossil fuel companies and companies in the dependent sectors (e.g. PRI 2016; ICGN 2013; IIGCC 2017; Waygood 2011). However, although most large investors, organisations and researchers advise investor engagement, they rarely go into depth with how engagement should be conducted or what kind of impact it has. Therefore, this thesis will answer the question:

# How can institutional investors best influence oil and gas companies in their portfolio to include climate change considerations in their business?

To answer this, the thesis first needs to investigate which climate change considerations are important for oil and gas companies to consider, how institutional investors currently engage, what asset classes they engage in and whether it has an impact. The different types of engagements need to be analysed in order to figure out how investors can influence their portfolio oil and gas companies in the best way. To do this, different methods have been applied. A survey of European institutional investors, both asset owners and asset managers, with more than EUR 20 billion in assets under management was conducted to find their approach to investor engagement and their assessment of impact, specifically on climate-related engagement in the oil and gas sector. European investors were chosen as they investors are under-researched compared to their US peers. Furthermore, fixing the location can improve the generalisation factor of the analysis. The limit of EUR 20 billion was chosen to gain diversity in investor size, while still only including institutional investors large enough to be universal owners. Of the 95 investors contacted, 28 responded to the survey. A statistical analysis of the responses was conducted to find correlations between investor attributes and behaviour. Apart from the survey, four interviews with investors and experts were conducted to get a more in-depth view of the state of engagement, what impact it has and how to optimise engagement efforts. To link the investor action to the oil and gas sector, an analysis of the 15 largest listed oil and gas companies based on CO2 in their reserves, globally, with dispersed ownership, i.e. no majority owner, was conducted. The analysis was done using data from Bloomberg Professional and provided descriptive statistics of the development of the companies from 2010 to 2016, using some key indicators on their policies, governance and GHG emissions. The mix of methods enables a deeper understanding of the issues and barriers to solve them. Furthermore, it provides a more complete picture of the situation, in which climate change considerations in the oil and gas sector are highlighted from the sector itself and from the investor perspective and their role in preparing the sector for change. To present these analyses and answer the research question, the thesis is structured as follows.

Chapter 2 will provide a literature review of the research done on investor engagement and active ownership, followed by a presentation of the methodology used to answer the research question and conduct the analyses in chapter 3. Chapter 4 consists of an analysis of the climate-related risks faced by the financial sector, in general, and specifically for the oil and gas sector, as well as an analysis of the development of the 15 oil and gas companies chosen for this analysis. This will be followed by an analysis of how investors engage, i.e. the engagement methods they use and how it is explained by the traits of the investor itself, e.g. geography, investor type or size in chapter 5. Chapter 6 will show the impact of the different investor engagement strategies and an assessment of the approaches will result in a set of recommendations for institutional investors. Chapter 7 will discuss the results of the thesis in relation to a wider discussion of the financial sector, both related to its structure and the recent work on the effects of climate change. Last, chapter 8 will provide a conclusion to the thesis and re-cap the findings.

### 2 Literature review

This review will create an overview of the literature concerning active ownership. There are two strands of literature in the field of active ownership; shareholder activism and shareholder engagement. The first is primarily concerned with investors seeking changes in the corporate governance structure of target companies, while the latter includes social and environmental engagements. This literature review will highlight which themes the literature on shareholder activism and engagement cover and what they are missing.

#### 2.1 Background

Shareholder activism is primarily focused on governance measures, e.g. diversity on boards and profit maximisation (Carleton et al. 1998; Hamilton & Eriksson 2011; Appel et al. 2016), whereas investor engagement is concerned with a broader set of stakeholders and topics (Dimson et al. 2015). In practice, shareholder engagement started with religious and ethically driven funds exiting their investments from South African companies to protest against apartheid in the 1980s (Atif et al. 2013). The divestment movement led to negative screening based on ethics and later spilled over to ESG issues and stewardship, which was picked up by more mainstream investors, such as pension funds (Allen et al. 2012). From negative screening, a movement of engagement rose. Investors started to promote dialogue with companies regarding their ESG practice, tapping into the methods of the shareholder activism movement. The shareholder activism literature is focused on activism regarding governance structures and optimising the value of the company, not environmental or social considerations (Denes et al. 2016). It started in the 1980s, coinciding with a rise in institutional shareholding focused on index-mimicking funds. Because institutional investors could not divest from poorly managed companies due to diversification considerations, they started acting as activist owners (Denes et al. 2016). Although they are fairly different in motives and processes, especially in the beginning of both movements, they overlap in terminology. The engagement strand was started by activist funds and the research on shareholder activism primarily focus on engagement as a tool.

However, literature on both activism and engagement focus on institutional investors, especially pension funds, although activist literature also includes much research on hedge funds (e.g.

Greenwood et al. 2007; Greenwood & Schor 2009; del Guercio & Hawkins 1999; Hu & Black 2007; Clifford 2008; Stowell 2010). One of the key reasons for the rise of institutional investor activism/engagement is that they are universal owners, i.e. they own shares in companies from every sector. Universal owners worsen their risk profile by divesting, but at the same time, externalities in one sector will influence other companies and sectors in the portfolio, i.e. worsen the risk profile of the portfolio. These externalities are in the form of environmental, social and governance issues, which is the reason why ESG issues are not only a concern for ethical investors, but pose a financial risk to all universal owners (Carleton et al. 1998; Allen et al. 2012; Dimson et al. 2015). Theoretically, the financial ESG risk should be enough to start engagements, but reputational risk, public opinion and media coverage are equally – if not more – important factors to spark action and engagement (Allen et al. 2012; Dimson et al. 2015). Both shareholder activism and engagement departed from increased institutional ownership, specifically institutional investors with a passive investment strategy.

Although shareholder activism and engagement do not mix, this thesis will draw from both strands of literature. Both movements have tried to investigate the effectiveness of active ownership and the degree of impact. Therefore, they are both relevant to look at to find the optimal way of engaging. In this thesis, active ownership will be referred to as investor engagement. This is because engagement/activism will be explored wider than just for equity.

The effect of institutional ownership on a company spreads wide. A survey from 2008 to 2014 showed that a higher share of large passive institutional investors increased the long-term value of the company as well as enhancing the company's focus on governance issues (Appel et al. 2016). Rees and Rodionova (2013) showed that dispersed ownership with a large share of institutional owners has a positive impact on the firm's focus on ESG issues, especially within climate change, environmental management, business ethics and human rights (Rees & Rodionova 2013). Apart from their presence, institutional investors are also successful in obtaining the objective when they themselves engage (del Guercio & Hawkins 1999; Aggarwal & Starks 2014). This aligns with the fact that activist investors, in the sense of ESG, target companies with a high degree of institutional ownership (González & Calluzzo 2016). However, the positive impact of institutional ownership is

not universal, as institutional investors' business ties either to the target company or companies in general are less engaged than investors without business ties (Cornett et al. 2007; Davis & Kim 2007). The focus on institutional investors in this thesis is based on these features, as they have a distinctly different impact on company behaviour than other investor types.

#### 2.2 The process of engagement

Allen et al. (2012) set out three stages of a successful engagement process; getting issues on the agenda, affecting corporate policies and affecting the situation on the ground. To obtain success, there are different methods of investor engagement; shareholder resolutions and proxy voting at annual general meetings (AGMs), informal dialogue, public shaming and active monitoring (Allen et al. 2012). Of these, proxy voting and shareholder proposals are the most researched engagement type (e.g. Gillan & Starks 2000; Gray 2011; del Guercio & Hawkins 1999; Morgan & Wolf 2007; Denes et al. 2016). To back up the engagement efforts, divestments can be used as the consequence of unsuccessful engagement. This section will provide an overview of the research done on investor engagement and its effects.

The key theme in proxy voting research is voting for shareholder resolutions which change the company's approach to corporate governance or environmental and social issues. Shareholder resolutions are not binding, even if a majority votes in favour but it is best practice to adopt them, and this is why investors use shareholder resolutions to try to change companies' strategies or disclosure (Carleton et al. 1998). But they can also be used to promote a specific social political agenda which can create spill-over effects (Cook 2012). During the past 30 years, proxy advisory firms have become more positive towards shareholder resolutions and institutional investors have increasingly adopted independent voting policies (Aggarwal & Starks 2014). Public pressure is crucial and impacts both proxy voting recommendations and the investors' voting decisions by pressuring stakeholders as well as legitimising engagement on ESG issues. Public scrutiny has gained strength after investors have begun disclosing voting records and the development has led to increased support for shareholder proposals at AGMs (Aggarwal & Starks 2014). A different approach to engagement through proxy voting is withholding votes for directors at AGMs. This is used as a tool to show concerns with e.g. the board's actions or specific governance issues (Del Guercio et al.

2008). Even though many directors run unopposed, the hypothesis is that the negative publicity from a campaign against a director will push the company in the intended direction. Del Guercio et al. (2008) found that the "just vote no" campaigns did indeed alter the target company's behaviour.

In spite of the large amount of research on shareholder proposals and proxy voting, other types of engagement have not received much attention. This is due to the private nature of informal engagement and the difficulty of tracking qualitative data (Becht et al. 2010). One of the only, but very important studies on private negotiations is Becht et al. (2010). They received access to Hermes UK Focus Fund's engagement records, including meeting schedules, agendas, emails and phone recordings. Hermes is an investment manager that also provides engagement services for clients for whom they do not manage assets (Hermes Investment Management 2016). The case study showed that Hermes was able to significantly change the companies', with which they engaged, focus, both the ones who had a collaborative response and the ones working against Hermes (Becht et al. 2010). Furthermore, the study showed that the fund performed significantly better than their benchmark. Carleton et al. (1998) made a similar study and found that many companies introduced new governance initiatives after informal engagement public to enhance the pressure on the target company (Carleton et al. 1998). This makes the monitoring easier, although no research on this basis has been found.

One of the key elements of active ownership is cooperation. Dimson et al. (2015) found that investors increasingly cooperate with each other when engaging, as it reduces the costs. This is consistent with the findings of González and Calluzzo (2016) stating that investors prefer to target companies in which other investors are already engaged. The current research finds that cooperation between investors increase the success rate of the engagement and increases the shareholder value of the engagement (Brav et al. 2015; Becht et al. 2015; Dimson et al. 2015; González & Calluzzo 2016). The problem with cooperation is that when the ownership of a company is very dispersed it requires many shareholders. A dispersed ownership increases an already-existing problem of free riding, as shareholders do not want to pay for the engagement effort which other shareholders would do anyway (Kruitwagen et al. 2016). Consequently, large mainstream investors

should be sought included to the engagement coalition so they can pressure other mainstream investors to co-engage and thereby reduce the problem of free riding (Cook 2012).

No matter the method, there are still some company-features that enhance the chances of success. Investors are more likely to succeed in engaging with companies with poor financial performance, which are subject to reputational risk and have a culture which welcomes the change (Dimson et al. 2015; Renneboog & Szilagyi 2011; Allen et al. 2012). Furthermore, companies need capacity to implement the desired changes (Dimson et al. 2015). For the investors' part, power, legitimacy and urgency are key elements in succeeding (Allen et al. 2012). Both Dimson et al. (2015) and Denes et al. (2016) find a correlation between size of ownership share and engagement success, while Allen et al. (2012) find that legitimacy is the most important factor. The legitimacy is affected by the political context and public attention (Aggarwal & Starks 2014; Allen et al. 2012).

This section has provided an overview of the research in the different methods of investor engagement and what criteria increase the rate of success. The next section will provide an overview of what is missing.

#### 2.3 Gaps in the literature

The literature on active ownership is generally very focused on corporate governance. It is harder to engage on environmental and social issues than governance, as environmental and social issues require substantial changes on the ground, do not necessarily improve financial returns on the short term and are more complex than governance issues, and consequently require more in-depth expertise (Allen et al. 2012). Therefore, more research on environmental and social engagement is needed in order to find the effect of the initiatives and what strategies work best. Currently, engagement based on environmental and social issues is a very niche topic, and only one of the identified journal articles concerned with ESG engagement was not published in the Journal of Sustainable Finance & Investment.

This is also shown by Denes et al. (2016) whose survey of research on 30 years of shareholder activism did not include any reference to environmental or social issues. However, it shows which

engagement methods within corporate governance are under-researched. Their review includes a summary of 56 studies (table 1). The studies are divided into panels and what method they fully or partly research. As seen, the studies done on shareholder resolutions, and partly for negotiated settlements and non-proposals, have given ambiguous results on effectiveness.

Table 1: A summary of studies on active ownership

Criteria emphasized as measures of shareholder activism success:	Panel A: Authors drawing conclusions primarily from empirical findings regarding shareholder proposals	Panel B: Authors drawing conclusions primarily from empirical findings regarding negotiated settlements and non-proposals	Panel C: Authors drawing conclusions primarily from empirical findings regarding hedge fund activism
Increase in shareholder value	++++	+++++++++	+ + + + + + + + + + + + +
Increase in accounting measures of performance	+	++	++++++
Change in target firm's operations or management	+ -	+	+ + + + + + + +
Specific actions sought by activists adopted by target firm	++++	-	+++
Some actions by target firm attributed to activism	++	+ + + +	
Percent of votes cast in favour of shareholder proposals	++++	+	

(Summary of 56 studies of the effects of shareholder activism on target companies. A plus sign (+) indicates that the authors interpret their findings as indicating that shareholder activism has substantial impact on target companies. A minus sign (-) indicates that the authors interpret their findings as indicating that shareholder activism has negligible or negative impact on target companies. Source: A resume of table 4 in Denes et al. (2016)

As this thesis does not consider hedge funds, shareholder resolutions, negotiated settlements and non-proposals are the most interesting columns. The fields highlighted in orange represent the type of literature which relates to these areas and can help answer the research question of this thesis. There is a significant lack of literature in regards to these themes, especially on informal engagement. Furthermore, most of the literature included in panel A and B are from before the global financial crisis (Denes et al. 2016). The ESG literature did not have its break-through until the Journal of Sustainable Finance and Investment was published for the first time in 2011. Also, just as mostly focused on governance, the asset class in focus is almost by definition equity. Since the investor engagement literature is based on the notion of active ownership, and shareholders are the owners of the company, the lack of investigation in bond engagement is not unexplainable. However, this thesis will show that there is a need for research in the area of bond engagement.

A key issue is that much of the literature is unclear on what type of engagement they have researched. Often they refer to number of engagements (e.g. Dimson et al. 2015), but do not state whether it is meetings, emails, shareholder proposals or other engagement types. This makes it hard to apply for investors as well as to assess for other researchers.

The geographic focus of most published articles is on the US or Canada. This is problematic, as there are some distinct differences in the governance systems across the world, which means that US-focused research is not necessarily applicable to Europe or other regions. In the UK, for example, directors can be voted out, even if they run un-opposed, shareholders can change the basic governance contract without board approval and if 10% of shareholders approve, they can call for an extraordinary general meeting (Becht et al. 2010). Neither of these things are possible in the US. Furthermore, UK institutional investors are much more organised and can act collectively with associations for e.g. insurance funds or pension funds (Becht et al. 2010). In Sweden, there is also much of a culture of investor cooperation, especially when doing engagements with foreign companies (Hamilton & Eriksson 2011). In Japan, institutional investors only play a small role in engaging with their portfolio companies, although it is increasing in the sphere of governance issues. Environmental and social shareholder proposals are still only for small activists (Saito 2012).

#### 2.4 Sub-conclusion

This chapter has provided an overview of the literature on investor engagement. In general, the research has mostly been focused on the US formal engagement in the form of shareholder resolutions and proxy voting. Furthermore, the focus is on governance issues, while environmental and social issues have stayed a niche topic for researchers. The narrow focus of the literature leaves many themes open and un-researched. This thesis will seek to close some of the gaps by analysing European investor engagement on climate-related issues, both formal and informal and including a perspective on bond engagement as well. The next section will go through the methodology to conduct such an analysis.

# 3 Methodology

This chapter will introduce the philosophy of science used to understand and analyse the data and research gathered, as well as set out the research design. The different methodological components will be critically assessed in relation to their usefulness and limits.

# 3.1 Philosophy of science

This thesis will take the position of critical realism, also called social realism, in social sciences. Critical realists see a stratified world, i.e. a world made of layers of obtainable knowledge. The goal of critical realist research is "not to identify generalizable laws (positivism) or to identify the lived experience or beliefs of social actors (interpretivism); it is to develop deeper levels of explanation and understanding" (McEvoy & Richards 2006, p. 69). It takes from both the naturalist and constructivist world views as it recognises the naturalist method of explaining phenomena through experiments and causation, whereas it also recognises the interpretive dimension of science which dominates constructivism (Moses & Knutsen 2012). Roy Bhaskar founded critical realism with his PhD thesis, A Realist Theory of Science, and still the most significant contributor (Benton & Craib 2011).

### 3.1.1 Ontology

Critical realism acknowledges the existence of a real world, independent of our understanding of it, i.e. a mind independent world (Benton & Craib 2011). However, humans live and see a world dependent on their mind in which they seek to reach insight into mind independent world. This means, humans are partly able to change the mind independent world through advances of knowledge in the mind dependent world. However, the independent world cannot be assumed to be in a certain way just on the basis of our knowledge of it (Sayer 2000). Critical realism explains the world as stratified. Bhaskar sets out three layers; the real, actual and empirical world (Benton & Craib 2011). The real world consists of everything natural and social that exists, independent of whether humans have an understanding of it and how deep the understanding is. The actual world consists of every flow or sequence of events that can be produced through experiments or happen in less predictable and more complex circumstances. The empirical world is comprised only of observed events, which are only a small part of the actual world (Benton & Craib 2011).

Depending on the subject of investigation, there are open and closed systems. Some phenomena exist in closed systems and can be isolated in order to find causation, whereas many other concepts exist in open systems making it impossible to find a cause or a defined truth (Benton & Craib 2011). Most subjects of interest in social science exist in open systems, e.g. capitalism or the economy and are impossible to isolate in order to investigate them. In relation to this thesis, the financial system, in which institutional investors work to influence their portfolio companies, do not work in isolation. There are many factors and stakeholders affecting the behaviour of both investors and companies, implying an open system.

#### 3.1.2 Epistemology

Critical realists see science as a process, in which knowledge is cumulative but not linear, i.e. causation is not a necessity from repetitive events (Benton & Craib 2011). They share with natural scientists that they see scientific methods as the tool to grasp the true character of the world in the best possible way (Moses & Knutsen 2012). However, critical realists question the objectivity of everything, even the objective scientist, i.e. they focus on "necessity and contingency rather than regularity, on open rather than closed systems, on the ways in which causal processes could produce quite different results in different contexts" (Sayer 2000, p. 5). Critical realists seek to find a deeper level of knowledge by identifying tendencies that are caused by underlying mechanisms rather than making empirical generalisations (McEvoy & Richards 2006). They use retroduction, "a mode of analysis in which events are studied with respect to what may have, must have, or could have caused them. In short it means asking why events have happened in the way they did" (Olsen and Morgan 2004, p. 25 in McEvoy & Richards 2006, p. 71).

In this thesis, the research question is *"how can institutional investors best influence oil and gas companies to include climate change considerations?"*. Although a set of general recommendations will be presented, they are not a universal set of rules, but rather context-dependent. The development of the recommendations will happen on the basis of tendencies in investor engagement as well as an analysis of the change in oil and gas companies over the past five years.

Combined, they will provide a basis on which recommendations can be built on, not as a guarantee for an effect, but to optimise the probability of success.

#### 3.1.3 Methodology

Critical realism embraces a wide range of methodologies. However, the choice of method depends on the object in question and what knowledge the researcher wants to obtain (Sayer 2000). The most important methodological feature of critical realism is that they "*reject cookbook prescriptions of method which allow one to imagine that one can do research by simply applying them without having a scholarly knowledge of the object of study in question*" (Sayer 2000, p. 19). It works against over-conceptualisation, where e.g. the service sector is categorised as one sector even though in includes different sub-sectors with very different drivers and stakeholders, in which case generalisations rarely work (Sayer 2000). Therefore, this thesis' focus is climate-related issues in the oil and gas sector. Although there are differences within the industry, the overall drivers and risk exposure is similar and therefore, investors need to consider the same factors in their investment and engagement activities. The focus on climate-related issues in the oil and gas sector allows for fixing one of the few variables that can be fixed and thereby for a better understanding of investor behaviour and the potential effect it has on portfolio companies.

Methodologically, critical realists use either an intensive or extensive approach (Sayer 2000). Extensive research primarily shows the extent of a phenomena or pattern, while intensive research is mainly concerned with causation or the discourse in a particular situation. This thesis will be based on intensive research. The research question cannot be answered without identifying substantial relations of connection and causal explanations. Corroborating evidence will be sought out to answer the questions set out in the introduction, while still critically looking at the objectivity or subjectivity of the data. Intensive research has its force in finding causality and meaning in contexts. The limitation of intensive research is that the in-depth nature makes it difficult to generate a study which is generalizable. However, it can to some degree provide causality for other situations in which the conditions are similar (Sayer 2000).

The research methods used in intensive research is mostly qualitative, but not limited to case studies. This thesis will take a methodological pragmatist approach, i.e. use a mix of methods in order to obtain the best results. Quantitative methods have been used to find reliable descriptions in order to make comparisons. It can be used to identify associations which could have been hidden in the initial phase of the research (McEvoy & Richards 2006). Qualitative methods have also been used due to their strength of being open-ended and allowing for new themes to emerge while conducting the research. It can be used to shed light on complex concepts which cannot be standardised or put into strict categories (McEvoy & Richards 2006). The practice of mixed-methods for this thesis is founded in the purpose of completeness, i.e. the quantitative and qualitative methods complement each other (McEvoy & Richards 2006). This enables a more comprehensive analysis than any method could provide alone.

#### 3.2 Research design

This thesis is seeking to answer the question: *How can institutional investors best influence oil and gas companies in their portfolio to include climate change considerations in their business?* To answer the research question, some sub-questions need to be answered first. What are climate change considerations for the investment community and in the oil and gas sector? How do investors currently engage with their portfolio companies and in what asset classes? Has the oil and gas sector improved in relation to climate change considerations? Does engagement have an impact? As the purpose is to find a meaningful result which can be used by investors, several methods have been used.

First, academic and grey literature, i.e. research done by non-governmental organisations, government bodies, international organisations and industry coalitions will be used to contextualise the issue of climate change-related considerations in the investment process, specifically in the oil and gas sector. Furthermore, literature on corporate governance and active ownership will be used as a foundation for the analysis of the results and contribute to the final recommendations. Much of the literature on climate-related financial risk and the inclusion of it in the investment process is grey literature, as the field is very new, as most of the reports are from 2014 or thereafter. However,

even though the literature has not been peer-reviewed, most of it has been written by either longterm practitioners or professional researchers, i.e. PhDs and professors.

Apart from using secondary data, primary data has been gathered in different forms. The research mixes quantitative and qualitative methods to find the tendencies and an optimal strategy for being an engaged investor. First, a survey of asset owners and managers in Europe was conducted. This is accompanied by a review of climate-relevant factors from 2010 to 2016 for the 15 largest listed oil and gas companies in the world with diversified ownership, based on the amount of CO2 embedded in their reserves. Finally, four in-depth interviews were conducted with targeted actors relevant to the research.

#### 3.2.1 The survey

The survey questions are included in Appendix A and is built in three sections. The first section has introductory questions to type of investor, location, whether the company has policies for engagement and voting at AGMs, whether climate change considerations are included in the policies and whether they outsource any of the activities. The second part seeks information on what asset classes the investors engage in, specifically on climate-related issues in the oil and gas sector, and how they engage with each asset class. In the third section, the investors answered whether they see their engagement activities having an impact, an evaluation of what works best and whether they track changes. Finally, there is a comment field for the method of tracking performance and general comments on their engagement activities. The comments by investors has been included in Appendix B. The questions allow for a comparison of the different investors and an interpretation of tendencies in the investor community.

The survey of asset owners and asset managers was conducted among European investors. All sovereign pension funds in Europe with assets under management (AuM) of more than EUR 20 billion as of end 2014, which were found in a Towers Watson analysis from September 2015 (Towers Watson 2015), were included on the list of potential survey participants. PwC published an overview of top 10 asset owners in Europe in the categories; pension funds, insurance companies and funds of funds (PwC 2016). All 30 investors were listed as target investors, including BlackRock and

Prudential, which are both based in the US. Furthermore, Investment & Pensions Europe made a list of the top 400 asset managers in Europe (Investment & Pensions Europe 2015). The ones with AuM of more than EUR 20 billion were included. When the chance to include Nykredit Asset Management with EUR 19 billion in AuM arose, they were included as well. Some AuM values were in US dollars, but were converted on oanda.com on December 23, 2016. This resulted in a group of 185 European investors, including two global asset manager with dual headquarters in the US and the UK. Emails for specific people or sustainability/corporate governance departments were publically available for 95 investors. The contacted people were in positions such as managers, directors and "chief" positions within investments (e.g. Chief Investment Officer), equities, corporate governance, sustainability, active ownership, ESG or climate. Of the 95 investors, 37 responded to the email. Seven of them declined to participate in the survey. Of these, two do not invest in fossil fuels at all, two were reviewing their ESG and engagement strategy, one did not have an engagement policy because they mostly invest in fixed income and two did not have time. Two investors responded that they would participate, but have not done so. In total, 28 survey responses were gathered. Several investors had difficulties opening the survey in Google Docs as their security systems blocked it. A Word file was therefore made and sent out to the investors mentioning technical problems, as well as when sending a reminder to the investors who had not responded. This unforeseen challenge is likely to have reduced the number of respondents.

Figure 1: Geographical distribution of participants



Of the 28 respondents, the geographical diversity is as seen in figure 1. The survey sample has a fair diversity in geographical terms. A geographical distribution of the contacted investors is shown in

figure 2. As seen, the response rates for Denmark and the Netherlands were very good, whereas the UK and Swedish took the third and fourth place. Apart from the Netherlands, Continental European investors have not been very responsive. However, three geographical categories have been established; Scandinavian, including Danish, Swedish and Norwegian investors; Continental Europe, including German and Dutch investors; and UK, including UK and Global investors.

Figure 2: Geographical distribution of contacted investors



The sample consists of different types of investors distributed in categories of asset owners, asset managers, combined asset owners and managers, and then two respondents have categorised themselves as insurance companies. For the analysis, the insurance companies have been included in the asset owner and manager category. The distribution can be seen in figure 3A. Figure 3B shows the size of the respondents in four size categories (two responses were anonymous and AuM is therefore unavailable). In the analysis, the natural logarithm of the values was used as the sample spans from EUR 19 billion to EUR 4,398 billion in AuM.

Figure 3A: Investor type, 3B: Assets under management



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The distribution and variety based on both investor type and geographical location as well as size makes the sample fairly representative of the European institutional investor community, especially with regards to the UK, Scandinavian and Dutch investor communities. However, the different attributes are not distributed evenly among the investors. As seen in table 2, six of the 11 Scandinavian investors are also asset owners, whereas Continental Europe and the UK only have one asset owner each.

	Asset managers	Asset owners	Asset owners and managers
Continental Europe	5	1	2
Scandinavia	2	6	3
UK	5	1	3

Table 2 The geographical distribution of investor types

Linking the size of the investor to either location or investor type also shows biases, as seen in figure 4A-B. It is clear that both Scandinavian investors and asset owners are smaller. Furthermore, there is a clear outlier in the survey. This is the largest of the asset managers. In a larger sample, it would have been excluded, but due to only having 28 responses, it has been included.

Figure 4A: Assets under management distributed on location, Figure 4B Assets under management distributed on investor type



Even though the sample is not completely random, it has a good distribution between investor type, location and size. However, the participating investors are likely to be more interested in the topic and more active in investor engagement than their non-participating peers, indicating a bias in the sample. The assumption is that the investors generally do not want to risk bad publicity and therefore do not participate if they do not engage in climate-related active ownership activities. Furthermore, the responding investors all showed interest in the findings of the research, which indicates that they have an interest in the topic.

Although there were only 28 participants, it is enough to find statistically significant correlations, but the small sample meant that only one independent variable was applied in each run. The dependent variables are all binary, i.e. the variable either equals 0 or 1. A linear regression could be used to find statistical correlations. In a linear regression, the ordinary least square estimator is the function in which the coefficients minimise the sum of squares (Stock & Watson 2012). However, as the dependent variable can only take the values 0 and 1, it makes more sense to use a non-linear model, which is limited to finding the probability of the dependent variable equalling 1. Probit or logit models can both be applied in such a case. The probit model uses the cumulative probability distribution function, whereas the logit model uses the logistic cumulative distribution function (Stock & Watson 2012). The results are similar enough for the models to be interchangeable (Stock & Watson 2012). The logit model was chosen as it is easier to use in the statistics programme R. Since the logit model is used to predict the value of a binary variable, the assumptions of a linear regression are not applicable. Therefore, the logit regression uses a maximum likelihood estimation, i.e. it estimates the coefficients given the observations by finding the coefficients which maximise the likelihood of the function being significant (Stock & Watson 2012). The coefficients can be interpreted as the change in z-value, i.e. if a coefficient is positive, an increase will lead to a larger probability of the dependent variable equalling 1 (Stock & Watson 2012). The coefficients can also be used to calculate the predicted probability of the dependent variable being 1, but as the survey is only used to analyse investor engagement, not predict it, the predicted probabilities will not be calculated. The p-value shows the probability of the coefficient being 0, i.e. if the p-value is 5%, there is a 95% probability that the coefficient is not 0 and the variable explains the dependent variable at a statistical significance of 95%.

In a linear model, R<sup>2</sup> is the fraction of the dependent variable explained by the model. However, in a non-linear model, the model fit can be found by using the null deviance and residual deviance (model deviance) to estimate the pseudo R<sup>2</sup> and the p-value of the model (Stock & Watson 2012). The pseudo R<sup>2</sup> can be calculated as the likelihood ratio between the model and no model (Stock & Watson 2012). If the residual deviance is significantly smaller than the null deviance, the independent variable(s) has improved the model fit. 68 different models were run, and five were found to include statistically significant correlation at 5%.

The survey's main objective is to answer the question of how investors engage. Furthermore, it provides a picture of the perceived effect of investor engagement and what works best. The survey shows tendencies in European investor engagement, although the sample is most likely more representative of climate-aware investors rather than all investors. It is difficult to compare the depth of the sample's engagement efforts, as the investors' responses are from their own subjective point of view. The depth will be further explored through semi-structured interviews. The methodology for interviews will be introduced in section 3.2.3, but first, the method of comparing oil and gas companies will be introduced.

#### 3.2.2 A comparative analysis of oil and gas companies

To find out whether the perceived effect of investor engagement on positive change in the inclusion of climate-related issues in the oil and gas sector is fictional rather than actual effort, a comparative analysis is conducted of the 15 largest listed oil and gas companies with diversified ownership, based on the CO2 in their reserves from 2010 to 2016. The data is included on a USB stick. A list of the largest 100 companies was provided by the Fossil Free Index, and ownership data was then found on Bloomberg Professional (Fossil Free Index 2016). As the potential GHG emissions of these companies are the basis of their impact on climate change, the GHG, measured in CO2 equivalent, in reserves is relevant to focus on. This resulted in a sample of seven US companies, two Canadian, one Japanese and five European oil and gas companies as seen in table 3.

	Country of	Market cap	Oil	Gas
Company	origin	(USD billions)	(Gt CO2)	(Gt CO2)
ExxonMobil	US	363.3	4.678	3.281
BP	UK	99.0	3.979	2.409
Royal Dutch Shell	Netherlands	210.0	2.346	2.649
Chevron Corporation	US	192.3	2.441	1.604
Total SA	France	121.9	2.077	1.755
ENI	Italy	57.7	1.507	0.997
ConocoPhillips	US	59.0	1.522	0.937
Canadian Natural Resources	Canada	33.5	0.828	0.297
Inpex	Japan	12.3	0.514	0.358
Occidental	US	57.9	0.658	0.184
Repsol	Spain	18.4	0.315	0.719
EOG Resources	US	44.5	0.579	0.209
Suncor Energy	Canada	45.2	0.773	0.002
Anadarko Petroleum	US	27.1	0.400	0.328
Antero Resources <sup>1</sup>	US	8.0	0.178	0.520

Table 3: Top 15 oil and gas companies with dispersed ownership

Source: (Fossil Free Index 2016; Forbes 2016; Yahoo Finance 2017)

The sample was kept at 15, as the companies smaller than this were mostly US-based and therefore assumed fairly similar to e.g. Anadarko Petroleum or Antero Resources. In the sample, there is a geographical diversity as well as a diversity in the level of recognition in the public. The majors, i.e. ExxonMobil, BP, Royal Dutch Shell, Chevron Corporation and Total SA have significantly larger market capitalisation (market cap) than any of the following nine companies, which means that there is also diversity in size.

The 15 companies have been analysed on the basis of change in key factors relevant to climate change. The information was found on Bloomberg Professional and although it is limited by the availability of factors and information found there, it provides comparability of the data across the firms. A further explanation of the importance of the factors is given in chapter 4, but a quick introduction is provided here. The factors considered are:

<sup>&</sup>lt;sup>1</sup> Market cap for Antero was not included in Forbes' World's 2000 largest public companies, so the market cap was found on Yahoo Finance

#### - Environmental

- o Total GHG emissions
- Total GHG/BOE<sup>2</sup>
- o Environmental disclosure level

#### - Policy

- o Emissions reduction initiatives
- o Climate change opportunities discussed
- o Risks of climate change discussed
- Climate change policy
- New products climate change [friendly]
- GRI<sup>3</sup> Criteria Compliance
- GRI checked [whether the GRI reporting has been verified]
- Assured ESG data [by a third party]
- Employee Corporate Social Responsibility (CSR) Training
- o CSR/Sustainability Committee
- o Non-executive director with responsibility for CSR
- o Executive director with responsibility for CSR
- o ESG-linked compensation for the Board
- Executive compensation linked to ESG

The rationale for choosing these factors is a mix of what effect the oil and gas companies will have on the climate and what risks oil and gas companies are exposed to from climate change. The environmental factors are mainly related to the effect of the oil and gas companies on climate change, as well as the exposure to a potential carbon tax. The environmental disclosure level is measured by Bloomberg themselves and is therefore not primary data, but is practical to detect improvements. The policy variables are all binary. Therefore, the improvement will be the

<sup>&</sup>lt;sup>2</sup> Barrel of oil equivalent

<sup>&</sup>lt;sup>3</sup> Global reporting initiative https://www.globalreporting.org/

introduction of a policy. Both the policy and disclosure variables are an indication of the organisational efforts to mitigate climate change.

The change for each company will be analysed together with the climate-related resolutions from the companies' AGMs. Descriptive statistics on the development of the companies and tendencies in the group will be provided, but there is not enough data to make statistically significant correlations. The analysis will help answer the question of whether the oil and gas companies are improving on climate-related parameters.

#### 3.2.3 Semi-structured interviews

To take the analysis to the next level and understand the "why"s and the "to what extent"s, qualitative method is deployed through in-depth semi-structural interviews. This thesis contains four such interviews. Semi-structured interviews are used to find more complex explanations for a problem than quantitative methods are able to provide (Arksey & Knight 1999). The purpose of the interviews is to gain insight from the participants in a way that can only be found in a semispontaneous discussion (FAO 2016). The four interviewees were chosen due to their different positions, which gives a wider representation. Transcriptions of all four interviews are found in Appendix C. The first interview was with Pelle Pedersen, ESG Analyst and responsible for the ESG activities at PKA, a Danish pension fund with approximately EUR 34 billion in AuM (PKA 2016). This makes PKA a relatively small institutional investor in the sample. The reason for choosing Pedersen is that PKA has positioned itself as an active owner and a responsible investor who ranks high on e.g. the Asset Owners Disclosure Project - an NGO ranking asset owners based on their responsibility (Asset Owners Disclosure Project 2016). The second interview was with Sophie Rahm, Responsible Investment Analyst specialising in oil and gas at Standard Life Investments with more than 10 years of experience with the sphere between sustainability and the financial system. Standard Life Investments a UK-based asset manager with approximately EUR 344 billion in assets under management (Investment & Pensions Europe 2015). These two interviews provided an opportunity to get an insight into how two very different types of investors act and why. One is a very large asset manager, while the other is a significantly smaller asset owner. Furthermore, as PKA

outsources its engagement activities and Standard Life Investments do engagement themselves, different opinions and observations are expected from the two participants.

The third and fourth interviews are conducted with two professionals from advisory services. Courteney Keatinge is the Director of ESG at Glass Lewis, a proxy research and voting provider with assets under advice of USD 25 trillion (Glass Lewis 2016). She provided an insight into the world of shareholder resolutions and voting at AGMs. Colin Melvin is the founder and former CEO of Hermes Engagement and Ownership Services (Hermes EOS), which now has GBP 237 billion in assets under advice. Furthermore, he was a Director and board member at the UN Principles for Responsible Investments (UN PRI) and is the current Chairman of the Social Stock Exchange. He is an expert in the field of investor engagement and active ownership and can bring insights from a long career in the leading provider of engagement services.

The combination of interviews provides the opportunity to get a deep insight into the mechanisms of investor engagement, both from engagement professionals, including a specialist in shareholder resolutions, as well as from the point of view of the investors. Adding to the quantitative analyses, the research design is built in the best possible way in order to provide a complete analysis of the effect of investor engagement related to climate issues in the oil and gas sector. Next chapter will show what climate-related risks are, how they affect investors and the oil and gas sector as well as how the oil and gas sector has developed over the past five years.

# 4 Oil and gas vs. climate change

Since the climate-related engagement efforts in the oil and gas industry are either based on climate risk assessments or goals of climate friendliness, it is crucial for investors to understand the climate-related risks they are facing, both in their portfolio overall, and specifically for the oil and gas sector. This chapter will answer the question of why investors should engage with oil and gas companies and how the sector has developed since 2010. Section 4.1 will present climate-related financial risks and opportunities as well as methods to assess these risks and relate it to the oil and gas sector. Following a general presentation of the risks, opportunities and assessment methods, the future energy mix is analysed in section 4.2 to show the potential changes in demand for fossil fuels towards 2050. Section 4.3 will analyse the development of the chosen oil and gas companies within climate-related factors. This will be used to check whether the postulated impact of investor engagement holds water.

#### 4.1 Climate considerations in the financial system

#### 4.1.1 Climate-related financial risks and opportunities

As mentioned, there are two types of investors who engage; climate-aware future takers and future makers. They engage to either mitigate climate risk or promote climate friendliness, respectively. One investor commented *"investors should approach climate change from a risk perspective stressing how climate change will affect portfolio companies and their future business"* (investor 1). Although the climate friendliness approach is commonly known with ethical funds and non-governmental organisations promoting such a strategy, climate risk is still a niche topic, slowly gaining grounds in the academic literature and in practice. Leading up to COP21, France introduced a law, Article 173, on investor reporting on their exposure to climate change and the energy transition (2D ii 2015). At the same time, the G20 gave the Financial Stability Board the mandate to set down a Task Force on Climate-related Financial Disclosure (FSB TCFD) to systematise the research on the topic and gather the experience from the industry, in order to create a voluntary reporting framework (FSB TCFD 2016b). The voluntary reporting framework is directed at both financial and non-financial companies and the idea is to provide the information necessary to calculate the exposure to climate-related risks. In order to do so, they first had to set out the climate-

related risks faced by all sectors as well as sector-specific risks. This thesis will draw on FSB TCFD and France's definitions of climate-related risks and opportunities and show examples.

The risks are divided into the physical risks and transition risks. France's Article 173 defines physical risk as "exposure to physical impacts directly induced by climate change" (2D ii 2015) and transition risk as "the exposure to changes caused by the transition to a low-carbon economy" (2D ii 2015). Physical risk can be systemic, industry-specific as well as company-specific (Chenet et al. 2015). An example is water shortage, which will hit an entire geographic location whereas supply chain disruption might be company-specific. It is a risk to businesses because it changes the dynamics of supply and demand and has directly damaging effects on assets (Chenet et al. 2015; Fulton & Weber 2015). Although this is most severe on the long term, weather patterns are already changing, having an effect on assets (Mercer 2015). The main focus of this thesis, however, is on transition risk.

Transition risk is a relatively new term. It is a concept covering risks related to the transition to a low-carbon economy, such as political risk as well as carbon asset risk or stranded asset risk. Carbon asset- and stranded asset risk research focuses on the fossil fuel sector, looking at what reserves need to stay in the ground to keep the temperature rise at 2°C. Financially it is a risk, as the portfolio companies' assets, i.e. their reserves, will potentially become stranded (Atif et al. 2013; Carbon Tracker 2011; Chenet et al. 2015; Cleveland et al. 2015). The energy transition has many drivers and the following will present the four strings of transition risk; reputational risk, technological risk, market risk and policy/liability risk.

Reputational risk is the brand damage which can occur if a company or an investor does not live up to societal expectations (Fulton & Weber 2015; FSB TCFD 2016a). One example is the partnership between Lego and Shell which ended when Greenpeace began shaming Lego (The Economist 2014). The reputational risk and the speed of public shaming has increased much since the rise and spread of social media (Ristuccia & Rossen 2014). This reputational risk exposure is very difficult to measure, as it is hard to predict and quantify (Fulton & Weber 2015; FSB TCFD 2016a). However, it is often mentioned as a driver for including climate risk and making climate friendly investment decisions as well as in investor engagement (see chapter 2).

Technological risk factors are core risks and more predictable than reputational risk, although disruption can occur very abruptly. Technological risks include innovation of low-carbon alternatives to e.g. fossil fuels as well as increased energy efficiency, which can drive down demand for e.g. oil (Fulton & Weber 2015; FSB TCFD 2016a). The energy transition cannot be reached without technological innovation. This means that technological risk is more a concern of timing than occurrence. Key sectors at risk are transport, energy, telecommunications, hardware and software.

Market risk includes the risk of price changes, e.g. oil price, due to a change in the demand structure (Fulton & Weber 2015). For example, the CFO of Shell has stated that the demand for oil might already peak in five years (Katakey 2016). Accordingly, the market risk can hit companies, which either lose revenue or have sudden increased costs. But it can also affect investors who have missed significant risks in their assessments and therefore have a higher portfolio risk exposure than planned (AODP 2016). Although some investors are afraid to lose short-term profits by being a first mover within climate risk (Pedersen 2016), being a first mover can also provide the investor with expertise to get ahead of the investing game (AODP 2016).

The last part of transition risk is the political/liability risk. This mainly includes potential regulation that favours a low-carbon economy. Examples of potential political action is a tax on CO2 or policies like the recent ban on drilling in the Arctic (FSB TCFD 2016a; Bloomberg 2016a). However, there is also an increasing risk of law suits against companies on liability of environmental damage or climate change (Fulton & Weber 2015; AODP 2016). It is not a large factor yet and not an area of focus, but recently, the Commission on Human Rights of the Philippines has begun an investigation of how 47 of the most CO2-emitting companies have breached the human rights of the Philippines' population through their pollution, which has caused impacts from climate change, including a series of deathly cyclones (Vidal 2016). Furthermore, Exxon is currently being sued because they withheld information about the effects of climate change for 30 years (Bloomberg 2016b).

Climate change poses widespread risk to companies in all sectors, at different levels. But from highrisk situations, opportunities arise. To transition into a low-carbon economy, the carbon-intense industries need to either change or be substituted along with an adoption of a wider approach to investing. The FSB TCFD has identified five categories of opportunities; resource efficiency, energy source, products and services, markets as well as resilience. The main theme of these five factors is to tap into the technological development which needs to happen in order to reach a low-carbon economy. Opportunities within resource efficiency arise from optimising existing technologies, whereas energy source opportunities focus on substitution of fossil fuels. Products and services as well as resilience include both optimisation and substitution, but target different types of companies, e.g. changing energy demand by producing electrical cars instead of petroleum cars, or diversification of energy sources. The market opportunities are presented by entering into new sectors, but also partnering with the public sector or developmental organisations. The opportunities are not limited to new disruptive companies, but can also be utilised by existing companies, e.g. fossil fuel companies diversifying into renewables.

#### 4.1.2 Climate risk assessment

In most of the existing research, the focus of risks and opportunities are on the fossil fuel industry and the energy transition. Although climate change is more than just GHG emissions, emissions are the main cause for climate change. This means that GHG-intense sectors, both for fossil fuel extraction, utilities or the industries which are dependent on fossil fuels, e.g. oil infrastructure and the transport sector, are the main focus of climate- and transition risk research (e.g. Fulton & Weber 2015; Carbon Tracker 2011; Thomä et al. 2015). If investors ignore the risks of climate change, they can end up over-exposed to high-risk companies, sectors or geographical locations and underexposed to the winners of transition (AODP 2016). This section will go through different methods of climate risk assessments and explain why they are useful in the process of engagement.

To calculate the risk, several methods have been developed. The United Nations Environmental Programme Finance Initiative (UNEP-FI) and the World Resource Institute have developed a bottomup methodology to assess carbon risk, i.e. transition risk. The framework is built on the International Energy Agency (IEA)'s scenarios, which will be presented in section 4.2, and focus on four sectors; fossil-fuel assets, fossil-fuel-dependent assets, high-carbon assets facing shift to low-carbon technologies as well as high-carbon assets without low-carbon competitors; see table 4. Their risk assessment is based on a sector- or company-level analysis of the sectors included in table 4 (Fulton & Weber 2015). As only a handful of sectors are included, a portfolio risk cannot be computed. 2° Investing Initiative and The University of Oxford have developed an open-source Sustainable Energy Investment (SEI) Metrics, which allows investors to measure how their portfolio is aligned with a 2°C scenario (Thomä et al. 2015). Currently SEI only includes equity in the US, Europe and Developed Markets and only within coal mining, utilities, automotive and oil & gas. It measures the exposure to an energy mix compatible with the IEA's 2°C scenario and is planning on widening the scope to other asset classes and sectors (Thomä et al. 2015). It uses firm-level data and creates the possibility to aggregate on portfolio level. However, it only analyses the assets in a 2°C scenario and cannot be used for other projections.

Category	Example sectors	Principal types of risk facing the category	Typical financial asset classes
1. Fossil-fuel assets	Coal mining, oil and gas production	Policy; technology market and economic; reputational	Equities; bonds; corporate lending
2. Fossil-fuel dependent infrastructure	Oil and gas pipelines; rail lines (e.g. those shipping coal)	Policy; market and economic; reputational	Bonds; project finance
3. High-carbon assets facing shift to low-carbon technologies	Fossil fuel-fired power plants	Policy; technology market and economic	Equities; bonds; corporate lending
4. High-carbon assets without low-carbon competitors	Cement; steel; glass	Policy; technology market and economic	Equities; bonds; corporate lending

Table 4: Summary of typical risk types and asset classes associated with each category of assets

Recreated from Fulton & Weber (2015) p. 23

Apart from the two bottom-up approaches introduced above, two top-down methods have been identified (Covington & Thamotheram 2015; Mercer 2015). Mercer (2015)'s TRIP (technology, resource availability, impact of physical damage and policy) is the oldest and a widely used methods for calculating climate-related portfolio risk. Both top-down methods generalise based on geographical location, which is key in the impact of physical damage, and use general sector-level or economic data, which means that the risk assessment will be very general and cannot be used to identify high-risk portfolio companies.

The models for assessing the climate-related financial risks are still on a very early stage and they need further development to be of widespread use (Bartholdy 2016). While the bottom-up models still need to be developed, they can be used to identify specific companies in the included sectors, which are more exposed to climate risks than others. Engagement provides the investor with a tool that can mitigate the potential excess risk they face by investing in exposed companies. As seen in table 4, the fossil fuels sector is very exposed to climate risks and Fulton and Weber (2015) note that the key asset types invested in these companies are equities, bonds and project lending.

Section 4.1.1 showed how climate change poses a risk to companies and investors in all sectors. However, most research and industry initiatives are focused on investors' equity portfolios. But it is not only the equity markets which are exposed. Climate risk can increase or decrease companies' or even countries' credit risk (AODP 2016; Fulton & Weber 2015). This is confirmed by the work of Moody's and Standard and Poor's, who have started researching the impact of climate change on corporate bonds and sovereign risk (Kraemer & Negrila 2014; Serov et al. 2016). This emphasises the importance of an analysis based on a wider view of investor engagement than just equity engagement.

The companies need to get ready for an energy transition and investors need to manage their risk. Therefore, it is beneficial to widen the concept of investor engagement to also include corporate bonds. The next section will analyse the proposed energy mix in future scenarios made by the IEA in order to illustrate the risk the oil and gas sector faces from a transition to a low-carbon society.

#### 4.2 Future energy mix

As seen in the introduction, COP21 ended up with 186 committing to limit the temperature increase to well below 2°C, which limits the amount of oil and gas which can be extracted. Every year, the IEA estimates the future energy mix under different scenarios. Their base case is a business as usual path with no change in energy mix and constant growth (Fulton & Weber 2015). Then they have a New Policy Scenario, which limits the temperature increase to 3°C through the implementation of the pledged policies from the Paris Agreement (Fulton & Weber 2015). IEA's last two scenarios aim at limiting the temperature increase to 2°C, either by limiting the the GHG emission to 450 parts per million of CO2 (the 450 scenario) or by cutting the GHG emissions in half by 2050 (the  $2^{\circ}$ C Scenario – 2DS) (Fulton & Weber 2015). The two last scenarios have different probabilities of success, as the 2DS is more ambitious than the 450 scenario.

The scenarios are built up around different energy mixes in which oil and gas keep being a major part, also in the low emissions scenarios (Fulton & Weber 2015). However, in the 2016 report, changes have been made. Until now, carbon capture and storage (CCS) technology has been a major part of IEA's scenarios on reducing emissions. The focus on CCS is very risky as BP, for example, has stopped doing research in CCS because they could not find a way to make it useful at a scale which makes sense (BP PLC 2015). Shell focuses a lot on CCS in their sustainability report, but they still only use it at a trial basis (Royal Dutch Shell Plc 2015). No company has been able to scale up CCS, so it is interesting that it is still seen as a major part of the future energy mix. IEA has partly taken the consequence and reduced its estimates for CCS, which has pushed down the share of fossil fuels and increased the estimated share of renewables.



Figure 5: Fossil fuel demand 2000-2040 (Carbon Tracker 2016)

Source: IEA in Carbon Tracker (2016) p. 6

Carbon Tracker has illustrated the NPS and 450 Scenarios graphically, depicted in figure 5. The 450 Scenario shows a decrease in demand for fossil fuels, which would likely be caused by a carbon tax and thereby decreased demand (Carbon Tracker 2016). The decreased demand would bring lower fuel prices, further decreasing the profitability of fossil fuel companies.
McGlade & Ekins (2015) have estimated what regions must leave what amount of fossil fuels in the ground, based on the cost of exploration and proximity to usage, to get the optimal total economic benefits. They use the IEA scenarios to look at the future energy mix and geographical locations of the fossil fuels to find which fossil fuels need to stay in the ground to keep the temperature increase at 2°C. McGlade and Ekins (2015) make scenarios both with CCS and without it. Among other things, they estimate that all Arctic resources should be classified as unburnable towards 2050 (McGlade & Ekins 2015). Apart from that, they have estimated where the most economic reserves are and thereby which regions need to leave their reserves in the ground. However, for oil and gas, the majority of reserves are owned by national oil companies. OPEC is estimated to own 70% of oil and 50% of gas reserves although the listed oil and gas companies' reserves have shorter life times, meaning that their proportion of oil and gas production over the next 15 years is far greater than 30% and 50% respectively (Carbon Tracker 2016). Carbon Tracker estimates that private oil companies will be responsible for 44% of production and 55% of capex in oil projects over the next 20 years. These factors are likely to change which regions will actually leave their oil in the ground, as undiversified economies with large national oil reserves are likely to keep extracting.

This section has shown part of the risk oil and gas companies face from the energy transition. CCS has been used to postpone change in oil and gas companies for many years, as it has been a believable solution to mitigate GHG emissions. However, with the new IEA report, it is clear that major reductions in fossil fuel extraction is needed to keep the GHG emissions down. Furthermore, it was shown that the decision on which reserves to explore is not only a matter of costs, but also relates to international politics, which increases the uncertainty. The next section will analyse the development of the 15 oil and gas companies chosen for this thesis.

### 4.3 The oil and gas sector and climate change

The fossil fuel sector is often the centre of the discussion when it comes to implementing a 2°C direction. As seen in section 4.2 on the future energy mix, the extraction of oil, gas and coal needs to decrease to get to the target. However, most forecasts say that the demand for oil and gas will grow until 2020, even under a 2°C scenario (Fulton & Weber 2015). After this, policies and

substitution technologies will drive the demand down. Table 5 shows an overview of the key factors which are important to assess the climate-related risk performance of an oil and gas company.

Risk type	Historical factors	Forward-looking factors
Operational	<ul> <li>Fuel mix</li> <li>Types of assets</li> <li>Location</li> <li>Expected life time</li> </ul>	<ul> <li>Corporate strategy, policies and management capacity</li> <li>Specific operational management approaches (e.g. methane capture, flaring)</li> <li>Strategy for diversification of operations</li> </ul>
Financial	<ul> <li>Cost of production</li> <li>Earnings before interests and tax (EBIT) margin</li> <li>Capital structure</li> <li>Capital expenditure (CAPEX)</li> <li>Break-even prices</li> </ul>	<ul> <li>Strategy for effectively assessing and managing key risks, including climate risk</li> <li>Strategy for managing CAPEX and development plans in relation to climate risk factors</li> <li>Net present value or internal rates of return for future projects</li> <li>Sensitivity to commodity price changes</li> </ul>
Climate-related	<ul> <li>Scope 1, 2 and 3 GHG emissions profile (absolute and/or relative)</li> <li>Energy efficiency</li> <li>Climate-related risk disclosure</li> </ul>	<ul> <li>Scenario analysis of future climate scenarios</li> <li>Planning of new disclosure</li> </ul>
Governance	<ul> <li>Corporate governance structure</li> <li>Transparency and level of disclosure</li> <li>Board involvement in climate-related risks and opportunities</li> </ul>	<ul> <li>Management structure and independence from board</li> <li>Efforts to engage with investors (on climate- related risks)</li> <li>Changes in organisational structure to focus on climate-related risks</li> </ul>

### Table 5: Factors needed to assess climate risk in fossil fuel companies

Source: FSB TCDF (2016) and Fulton & Weber (2015)

The factors shown in Table 5 represent the information which is needed to be able to assess the oil and gas companies' approach to climate change and an energy transition. By looking at the companies' disclosure a lot of the historical data can partially be gathered. However, companies differ in the level of reporting. To get a good overview of the future implications, break-even prices and expected life time are needed on sight level (Fulton & Weber 2015; Carbon Tracker Initiative 2015). Furthermore, the quantitative figures like GHG emissions, financial disclosure and operational information are needed over enough time for trends to emerge. There is not enough data to determine whether potential GHG emissions reductions are intentionally or will last, as it could be the existing projects which are energy efficient, but future projects are more energy intensive. This is part of the reason why it is difficult to assess the companies only on the basis of

their disclosure. The forward-looking data is the determinant of the intention of a historical trend, but forward-looking data is harder to find in public disclosure.

5	Potential 2014-2025 production (%) requiring market prices:			
Company	USD 75/bbl+	USD 95/bbl+		
ConocoPhillips	56%	36%		
Royal Dutch Shell	45%	30%		
Total	44%	29%		
ExxonMobil	44%	29%		
Chevron Corporation	46%	26%		
BP	40%	21%		
ENI	30%	15%		

Table 6: Oil majors ranked by capex risk





Source: Carbon Tracker Initiative (2014) p. 4

A key risk indicator is the capex of new projects and these future projects' required break-even prices. Table 6 shows the seven largest public oil and gas companies ranked by their risk in relation to capex strategy. As seen, 36% of ConocoPhillips' oil reserves under development require an oil price of at least USD 95 per barrel. Although the crude oil price stayed around that level for three years, it is clearly seen in figure 6 that this is not a viable assumption. With a current oil price of USD 51.80 per barrel, which is the highest for more than a year, a market price of USD +95 over a 10- or 20-year period looks like questionable risk management. The sample for table 6 only includes undeveloped reserves, which means that they can be abandoned. Therefore, the strategy, especially regarding future capex and fuel mix, as well as preparedness to include climate risk in corporate planning are very important.

Table 7 on the following page shows an overview of the case companies, which are the 15 largest listed oil and gas companies with dispersed ownership, based on GHG in their reserves, and their climate-related policies in 2015. Although it does not necessarily say much about the quality of

company's approach, the disclosure of a policy is an indication of what strategic considerations the company has. Most of the case companies have emissions reduction initiatives and link executive compensation to ESG factors. The latter is not necessarily revealing their climate strategy, as ESG also covers environmental, social and governance issues, e.g. health and safety. The key elements lacking in the whole sample are climate change opportunities discussed, new climate friendly/mitigating products, verification of GRI reporting, CSR training of employees as well as executive or non-executive directors with responsibility for CSR. BP is the only one discussing opportunities from climate change in 2015.

The analysis shows that overall, the industry is not looking into opportunities created by the energy transition. It also indicates that the companies might not take the risk very seriously, as no directors have responsibility over CSR and only two companies are engaged with training their staff. Interestingly, the European companies disclose more policies directed at ESG and climate change than their US counterparts, with BP, Shell, Total, ENI and Repsol all disclosing at least seven of the 14 possible policies. Only Exxon is at eight, whereas the rest of the North American companies are at six or less. For the North American companies, it also seems like the ones smaller than the majors have significantly less focus on climate change and ESG issues, e.g. Canadian Natural Resources and Antero Resources. This could potentially be linked to less publicity and public pressure.

Antero Resources													×	
Anadarko Petroleum	×		×	×									×	
Suncor Energy	×			×		×		×		×			×	
EOG Resources	×		×	×					×				×	
Repsol	×		×	×		×		×		×			×	
Occidental	×		×	×						×			×	
Inpex			ı			1			1				1	
Canadian Natural Resources	×					×				×			×	
Conoco- Phillips	×		×	×		×				×			×	
ENI	×		×	×		×		×		×			×	
Total	×		×	×		×		×		×			×	
Chevron Corporation	×		×	×				×		×			×	
Royal Dutch Shell	×		×	×		×	×	×		×			×	
BP	×	×	×	×		×		×	×	×			×	
ExxonMobil	×		×	×	×	×		×		×			×	
Policy	Emissions reduction initiatives	Climate change opportunities discussed	Risks of climate change discussed	Climate change policy	New products climate change	GRI Criteria compliance	GRI verified	Assured ESG data	Employee CSR training	CSR/Sustainability Committee	Executive director with responsibility for CSR	Non-executive director with responsibility for CSR	Executive compensation linked to ESG	ESG-linked compensation for Board

### Table 7: Top 15 oil and gas companies' policies in 2015

Source: Bloomberg Professional

Table 8: Changes in policies in 2010-2015 source

Company	Positive policy development	Negative policy development	Company	Positive policy development	Negative policy development	Company	Positive policy development	Negative policy development
ExxonMobil	0	0	ENI	2	1	Repsol	1	2
BP	2	1	Conoco- Phillips	1	0	EOG Resources	4	1
Royal Dutch Shell	1	1	Canadian Natural Resources	3	2	Suncor Energy	1	1
Chevron Corporation	0	1	Inpex	-	-	Anadarko Petroleum	0	0
Total	1	1	Occidental	0	1	Antero Resources	1	1

Source: Bloomberg Professional

Table 8 shows the amount of policies and disclosures which have either been introduced or removed from company disclosure in the period 2010 to 2015. Interestingly, most of the companies have removed policies from their reporting in the time period. Antero Resources removed their emissions reduction initiatives from 2013 to 2014, whereas Suncor Energy removed their climate change policy in the same period. Repsol had a non-executive director with responsibility for CSR until 2012. Several companies have stopped getting either their ESG data or GRI reporting verified by external providers, e.g. Repsol in 2011, ENI in 2012, Chevron in 2013 and Occidental in 2014. Canadian Natural Resources had their GRI reporting verified until 2012, ended, and then started again in 2014. Some of the changes occur in the same category. Shell, for example, introduced new products to combat climate change in 2011, whereas 2013 saw a decrease in new products. This could be explained by the implementation of the product and thereby rather a lack of new products rather than abandoning existing ones. Canadian Natural Resources started discussing opportunities arising from climate change in 2011 but stopped the year after. EOG Resources had a climate change policy in 2010, removed it in 2011 after which it was returned in 2012. Suncor did the opposite, introducing a policy in 2011 and then removing it in 2014. Interestingly, EOG Resources is the company which has introduced the most new policies and measures in the past five years, but is still one of the worst performers when counting the amount of policies as seen in table 7. The findings show that very few new policies have been introduced in the past five years. This may indicate that the oil and gas companies are not improving their risk management towards climate change. It also shows that, although European companies are ahead of North American companies, all of them still lack key governance measures to implement real climate change mitigation.

One indicator which can provide depth of the disclosure is Bloomberg Professional's "environmental disclosure level" score, which ranges from 0 to 100. In figure 7, the development of the 15 companies' disclosure score is seen. Repsol is a clear best performer with no ranking under 70 points. BP, ENI, ConocoPhillips, Total and ExxonMobil have fairly stable scores over the six-year period. However, changes have happened in the rest of the sample. Suncor has improved significantly over the period, just like Shell. Chevron increased its score until 2013 after which it has worsened quite significantly. Occidental and Anadarko have both seen large decreases in their scores, whereas Antero has not been scored at all, and EOG Resources and Inpex receive very low and interrupted scores. Canadian Natural Resources has a stable, although low score. The key trends from Table 7 reoccur in figure 7, as the five European companies are among the seven best performers on disclosure both in the first and the last year. Furthermore, the North American companies not included in the majors are performing significantly worse than the rest of the group, except for Suncor Energy, which was also the case in table 7.





#### Source: Bloomberg Professional

Of the 15 companies, 13 had a policy to reduce GHG emissions. Only Inpex and Antero did not have such a policy. Therefore, it is relevant to look at the development of GHG emissions, both in total and per barrel of oil equivalent (BOE). Especially as all the companies have had such a policy since 2010, except for EOG Resources, which introduced it in 2011. However, the GHG emissions data is not available for EOG, Inpex or Antero. For the remaining companies, the relative GHG emissions are presented in figure 8 and the total emissions indexed in figure 9. Figure 8 shows that there are large differences in the GHG efficiency of the different companies. From BP at 49 tonnes CO2 per BOE to Suncor Energy at 97. However, Repsol, the best performer in the disclosure assessments, has by far the lowest GHG efficiency with 109 tonnes of CO2 per BOE. Although this is much higher than the others, it is relevant to notice the improvement in efficiency. Repsol and ConocoPhillips are by far the companies that have improved the most. The others have been constant at their energy efficiency. This contradicts their policy on reducing GHG emission.



Figure 8, GHG emissions in tonnes per BOE, 2010-2015

Figure 9 presents approximately the same story, although here, Shell, Chevron, Suncor Energy and Canadian Natural Resources are the only ones that do not follow a downwards trend throughout the past six years. The most significant reduction in GHG emissions is accomplished by ConocoPhillips. Repsol followed until 2014 after which it increased again. The fact that these two companies have reduced their emissions so drastically, especially ConocoPhillips, and improved efficiency indicates that they have followed a strategy of reducing emissions. ENI, however, has

Source: Bloomberg Professional

performed well in all categories. It implemented many policies and measures, scored consistently high (in comparison to the group), improved GHG efficiency from 90 to 60 tonnes GHG per BOE and has managed to reduce its total GHG emissions significantly. Furthermore, it has the least projects requiring a market price of USD +95 and USD +75 as seen in table 6.

Figure 9 Direct and indirect GHG emissions indexed, 2010-2015



Direct and indirect GHG emissions indexed

Although data was available on capex, reserve replacement and dividend pay-out ratio, these figures did not show any trends. Project-level data is necessary for capex and the other two indicators need a longer timeframe and policies to provide context for any trends. Furthermore, much data is still missing from the companies' disclosure. It is also clear from this analysis that even though a company has a stated mission to e.g. reduce GHG emissions, this is not necessarily happening.

The analysis of the 15 oil and gas companies shows that there are some improvements and that there is a difference between European and North American companies. Furthermore, it is clear that there is a gap between disclosure of policies or strategies and action. This should be taken into consideration when investors engage with oil and gas companies, as well as their portfolio companies in general. The next chapter will look at how the investors say they engage.

Source: Bloomberg Professional

# 5 Investor engagement

This chapter will present how investors do engagement. To analyse the impact of investor engagement, it is necessary to understand how investors engage. This chapter will begin with an analysis of the decision between divesting and engaging and how the fossil fuel divestment movement has enabled the engagement activities in section 5.1. In section 5.2, a presentation of what asset classes, investors engage in will be provided. Section 5.3 shows the results of the survey and what investor attributes explain the engagement approaches. This is followed by an analysis of the geographical differences between investor engagement in Europe and the US in section 5.4. The last three sections will analyse investor activity within three engagement methods; voting at AGMs and proposing shareholder resolutions in section 5.5, informal engagement in 5.6 and finally, cooperation and aggregation in section 5.7.

### 5.1 Divestment or engagement

To manage the financial risk related to climate change, there are two options; divest from the highrisk companies or engage to make them mitigate the risk. Divestment is often used as a tool for ethical screening and dates back to the anti-Apartheid divestment campaigns in the late twentieth century, where investors divested to promote social justice (Hunt et al. 2016). Furthermore, many investors avoid investments for ethical reasons in e.g. gambling and tobacco or specific types of weapons (Atif et al. 2013). The ethical 'divestors' are part of the same movement as the responsible investors introduced in chapter 2. To understand the role of investor engagement in more depth, the fossil fuel divestment campaign will be presented with the arguments for and against it, as well as an overview of how much support it has received.

The divestment movement from fossil fuels, i.e. the fossil free movement, has gained a lot of attention in the public. It was started by students, urging university endowment funds to divest from fossil fuels, which has then spilled over to public pension funds and other long-term investors (Grady-Benson & Sarathy 2015; Atif et al. 2013; Hunt et al. 2016). As of December 2016, 689 institutions, with USD 5.44 trillion in AuM, have divested or committed to divest from fossil fuels, either partly, e.g. divesting from coal, or fully (GoFossilFree 2016). Two of the investors contacted for this thesis' survey also declined to reply due to having divested from fossil fuels. The strength of

the divestment campaign is the public pressure, which has increased the reputational risk for both fossil fuel companies to diversify their operations and for institutional investors (Hunt et al. 2016). This has spilled over to other investors who have then reconsidered their investment approach. Many have refused to divest because of the decreased diversification and thereby increased risk, but they have had to take a stance. The University of Edinburgh is an example. They created a review group to investigate their position in fossil fuels and set out a strategy going forward, taking climate risk into account (University of Edinburgh 2015).

Previous divestment campaigns have shown that in order to have an impact on the valuation of the underlying assets, they need to be originated in either changing market norms or constrained debt markets (Atif et al. 2013). Endowment funds and public pension funds, the primary 'divestors', only represent a small part of the equity holders in fossil fuel companies, decreasing their impact on share price when divesting. However, although the divestment campaign might not have much direct impact on the fossil fuel industry, it has triggered a stigmatisation of the sector, which can have great impact (Atif et al. 2013). First, stigmatisation can potentially create a momentum for pushing ambitious legislation through (Atif et al. 2013), e.g. banning fossil fuel companies from drilling in the Arctic like Canada and the US have just done (Bloomberg 2016a). Second, it can cause a large increase in reputational risk, which increases public pressure and can pave the way for investor engagement, as seen in chapter 2 of this thesis.

As mentioned in the introduction, investor engagement has, to a large extent, been adopted by the international community as being the solution to change the business models of fossil fuel companies in a more climate-aware direction. The UN-backed Principles for Responsible Investments' (PRI) second principle is *"We will be active owners and incorporate ESG issues into our ownership policies and practices"* (PRI 2016a) and the International Corporate Governance Network promotes engagement as part of a stewardship strategy (ICGN 2013). Furthermore, national committees, such as the UK Financial Reporting Council, have developed stewardship codes, which highlight responsible ownership (Financial Reporting Council 2016). The logic is that investors need to use the influence they have over portfolio companies instead of losing it by divesting (Melvin 2016; Pedersen 2016).

Although the engagement movement, especially on fossil fuels, has been set up as a contrast to divestment, it is clear that engagement will not work without investors ultimately divesting in case of unsuccessful engagement (Carbon Tracker Initiative 2014; Pedersen 2016). One survey participant commented "some clients may monitor progress  $O\&G^4$  companies make on climate risks and over time could choose to divest where they do not see meaningful progress and are concerned about financial impacts to long term investment objectives" (investor 22). Another respondent also mentioned divestment as a last resort; "disinvesting removes much of our right to be heard and we would only do so if we believed there was simply no progress being made and that the company showed no appetite to consider the concerns of its shareholders" (investor 25).

However, investors who have divested, are of the conviction that engagement moves too little and too slowly (e.g. Green Century Funds 2016). This thesis focuses on how investors do engagement and what impact it has. Therefore, it will explore whether it is worth engaging on climate-related risks in the oil and gas sector or whether investors should choose to stay passively invested or divest, without the engagement process, depending on their analysis of the risk and ethics. Chapter 6 will look further into the impact of investor engagement and what works best in terms of preparing oil and gas companies for an energy transition. Before making recommendations for the best strategy, however, an analysis of what European investors are actually doing will be provided.

### 5.2 Investor engagement vs active ownership

The literature on investor engagement follows the rhetoric of active ownership. Equity investors hold the ownership of a company and have ownership rights such as voting at annual general meetings and proposing resolutions (Fulton & Weber 2015). They have the least seniority of the capital stack, meaning that if a company goes bankrupt, they will get paid last – after creditors and bond holders. In return of the increased risk, equity is much more liquid and comes with ownership rights (Berk & DeMarzo 2014). This is part of the reason, why the focus of active engagement is on equity holders. The other reason is that if a company does well, the value of the equity rises and shareholders will get increased returns, either through a higher value of their share or through

<sup>&</sup>lt;sup>4</sup> Oil and gas

dividends (Berk & DeMarzo 2014). This gives shareholders an incentive to push for improved performance by the company. When bonds are created, the payments are fixed, and, unless the company goes bankrupt, there is no change in the cash flows made to the creditors (Berk & DeMarzo 2014). If an investor holds bonds, and not equity, in a company, it is therefore financially only in their interest to engage if they see a large risk.

Following the same discourse, when gathering responses for the survey, several investors answered that they would not reply to the survey because they only held fixed income and therefore had no influence. However, one survey respondent commented that *"bond holders are not owners of the company so we cannot vote at AGMs, but we do still have some influence over time as they need to come to the public debt market to raise debt"* (investor 28). Investor 28 is not the only one. As seen in figure 10, bond engagement is not as rare as the lack of research suggests. The respondents are not only engaged with their equity portfolio, but also their corporate bond holdings, and to a smaller degree project lending and private equity. While 96%, i.e. 27 of 28 respondents, said they were doing climate-related engagement activities with their equity holdings in oil and gas companies, 64%, i.e. 18 investors, said they engage with their bond holdings. This result is surprising, as literature on corporate bond engagement does not exist.



Figure 10 Engagement per asset type

Figure 11 shows the break-down of engagement in equity and bonds. It shows that 20 respondents stated that they do informal engagement with their bond holdings, 16 send letters and/or emails

and 7 do other types of engagement. One asset owner responded that their engagement in bonds were *"typically an overlap between equity and corporate bond holdings – the corporate bonds are hence indirectly part of the engagement programme"* (investor 1). This is partly backed up by the survey as only one investor engaged with bond holdings even though they did not hold equity. However, Sophie Rahm from Standard Life Investments said that they sometimes combine equity and bond engagement, but that it is not always so straight forward to match them to each other (Rahm 2016).

Figure 11 holds another interesting point. Several investors do 'other engagement', both for bonds and equity. The responses have mostly emphasised collaborative engagement between several investors and/or through a third party company hired to do engagement. One investor commented that *"sometimes we will use press commentary on engagement and shareholder resolutions and speak at AGMs"* (investor 27).





The responses to the survey expose a gap in the literature on investor engagement. Most of the academic research is focused on equity and voting at AGMs. However, as seen, bond engagement is also very common. Looking at the equity engagement, 22 of the respondents vote at AGMs, 24

meet with the companies informally and 24 send letters and/or emails on their equity holdings. This indicates a much broader approach to investor engagement than the academic literature suggests. A possible explanation for this gap in the literature, is that most research is from North America and the survey only includes European investors (further explored in section 5.4). Furthermore, informal engagement is harder to document and often happens in confidence and less systematically than voting. The next section will analyse correlations between investor attributes and their engagement efforts.

### 5.3 Survey results

With 28 responses, it has been possible to look at correlations in the sample. Due to the restricted sample size it is difficult to generalise, but a couple of statistically significant correlations have been identified to understand the behaviour of investors better. The models have sought to find correlations between investor attributes and engagement behaviour. The significant models with significant coefficients are shown in table 9A-E.

Table 9A shows that being an asset owner is negatively correlated with being engaged with both equity and bond holdings rather than just equity, i.e. asset owners are less likely to be engaged with both bonds and equity than asset managers. The coefficient's and the model's p-values are less than 0.05 which means that they are both significant at 5%. A model p-value of less than 0.05 means that the model explains the variable "asset type" better than no model. This could indicate that asset managers, who already have a more direct line to the companies than asset owners, who might outsource their asset management activities, use this to engage with both equity and bond holdings. Table 9B, shows that a higher value of assets under management increases the likelihood of being engaged in both equity and bond holdings compared to only equity engagement. The size of an investor is undoubtedly linked to its capacity and resources to engage, explaining their increased likelihood of engaging with bonds and equity. However, as seen in section 3.2.1, there seems to be a correlation between size of the investor and investor type. This could change the explanatory effect of one of the attributes.

Table 9A-9E: Statistically significant correlations between investor attributes and behaviour

R

A					
	Asset type				
Investor type	Coefficient	p-value			
Intercept	0.9808	0.1474			
Asset owner	-2.0794	0.0499			
Asset owner and					
manager	0.9651	0.4457			
Pseudo R^2		0.2157			
Degrees of freedom		24			
P-value of model		0.0215			

Assets under	Asset type			
management	Coefficient	p-value		
Intercept	-16.1368	0.0299		
InAUM	1.4918	0.0290		
Pseudo R^2		0.2640		
Degrees of freedom		23		
P-value of model		0.0029		

C .			
	Climate vote		
Location	Coefficient	p-value	
Intercept	1.946	0.0687	
Scandinavia	-2.927	0.0207	
UK	-3.199	0.0167	
Pseudo R^2		0.2560	
Degrees of freedom		25	
P-value of model		0.0075	

E					
Outsourcing	Equity resolutions				
engagement	Coefficient	p-value			
Intercept	-1.6094	0.0109			
Outsourcing					
engagement	1.8326	0.0468			
Pseudo R^2		0.1289			
Degrees of freedom		25			
P-value of model		0.0397			

D					
	Climate engage				
Location	Coefficient	p-value			
Intercept	1.9459	0.0687			
Scandinavia	0.3567	0.8817			
UK	-2.6391	0.0395			
Pseudo R^2		0.2780			
Degrees of freedom		25			
P-value of model		0.0095			

Table 9C and 9D show that location is correlated with both having a climate-specific sub-strategy for voting and engagement. For voting, it is shown that both Scandinavian and UK investors are negatively correlated with having a climate-specific voting policy, i.e. they are less likely than Continental investors to have a climate-related sub-strategy. On the engagement side in table 9D, the coefficient for Scandinavian investors is no longer significant, but it is shown that UK investors are less likely to have a climate-related sub-strategy in their engagement policy. This indicates that the Continental investors have a more systematic approach to climate-related voting and engagement.

Interestingly, there is a strong statistically significant correlation between outsourcing engagement efforts and proposing shareholder resolutions as a part of the engagement strategy, as seen in table 9E. One investor comments that they co-author resolutions through their engagement service company, which could explain this correlation.

When looking at the comments made in the survey on how the investors track progress the answers are very different (Appendix C). However, some consistencies have been identified. The most common way of tracking change is through a system of key performance indicators or milestones, either internally or through an engagement provider. Of the 13 investors indicating the use of milestones, nine stated that they have their own system of tracking the change in a company. Six investors state that they have follow-up meetings or informal check-ups with the target company, indicating a more qualitative approach to engaging. Four investors look at rating agencies and four look at company reporting. Only looking at company reporting indicates that the engagement focus is more on company reporting than strategic change, which might not be reported, but can be obtained in more informal discussions. Two investors replied that they measure engagement on a case-by-case basis and three did not state any method even though two of them replied yes to the question "Do you track the change in company behaviour after engagement?".

The analysis of how European investors engage reveals the level they begin at. The small number of statistical correlations point towards investor engagement being fairly similar across location, size and investor type within the sample. This is interesting, as the literature, for example, says pension funds are under more pressure from their beneficiaries to act responsibly, and hypothetically would be more engaged or have more specific policies. Both the lack of correlations and the significant correlations found can be used to understand the level of investor engagement, which can then be used to understand the impact or lack thereof.

### 5.4 Geographical differences

The inter-European differences were limited, indicating a similar approach to investor engagement across the region. This section will compare European investor engagement to other regions. Since the thesis is focused on the 15 largest listed oil and gas companies, of which only one is neither European nor North American (table 3), and USD 55.7 trillion of the global USD 71.4 trillion in AuM are sourced from these two regions (Shub et al. 2016), the focus will be on the differences between Europe and North America, specifically the US. The two regions have very different approaches to

corporate governance, which can lead to clashes when European investors try to engage with US companies.

The US market is distinct by being very compliance-oriented with the consequence that there is a lawyer at every stage and informal meetings are difficult to both get and if held, the value added is limited (Rahm 2016; Melvin 2016). The corporate governance system in the US is very focused at shareholder resolutions and it is very easy for investors to file them (Keatinge 2016). Colin Melvin said that *"you are much more likely, as a US shareholder, to file a resolution than to actually talk to the board"* (Melvin 2016 line 306). Shareholder resolutions are used to start an engagement dialogue rather than as a last resort, which is the case in Europe (Covington & Thamotheram 2015).

This is backed up by the statements from the AGMs by the US oil companies, analysed in this thesis. Exxon, for example, had six shareholder resolutions on climate-related issues in 2016 alone, including a report of the impacts of climate change, inclusion of a climate expert on the Board and a policy to limit global warming to 2°C (see USB drive). Chevron's shareholders proposed targets for reducing GHG emissions and a policy to return capital to investors instead of investing in new projects (reducing capex). Most of the resolutions are related to increased disclosure, but some do target the company's strategy or operations. However, none of the resolutions on climate-related issues found for the seven US oil and gas companies received a majority vote at the AGM. This reduces their effect considerably. Furthermore, several of the resolutions have been proposed several years, e.g. hiring an independent director with environmental expertise at Chevron, which has been proposed every year since 2010. The continuous proposal of certain shareholder resolutions and the small support indicates lack of action by the companies. Many US institutional investors do not vote against the management's recommendations, especially in the US, due to tight relations to the industry (Melvin 2016). BlackRock, for example, only voted for the Shell and BP resolutions because the management backed them, whereas they voted against the exact same resolutions with Chevron (Melvin 2016). As mentioned in chapter 2, a tight relation to the industry decreases the quality of engagement. This is confirmed by the US investors voting with management, reducing their role as a monitor of the company.

Whereas US investors are more likely to put forward a shareholder resolution, European investors use informal engagement to a higher degree (Rahm 2016). Especially in the UK, this is driven by the Stewardship code, as the general ideology among asset managers is that they need to engage with their portfolio companies (Rahm 2016; Melvin 2016). This is made easier by European companies being less compliance-driven and more open to informal meetings with investors. In relation to shareholder resolutions, there are harsher requirements to the shareholder before they can propose one (Keatinge 2016), but it is also viewed more like a last resort if informal engagement does not work (Covington & Thamotheram 2015). However, informal engagement is harder to track and hold investors accountable for. This reduces the transparency, enabling investors to report action without taking action.

The difference in engagement traditions across regions is crucial for investors to be aware of when they set out an engagement strategy. Chapter 6 will look more into the impact of European investors in both European and US companies. But first, the different engagement strategies will be analysed.

### 5.5 Voting at AGMs and shareholder resolutions

Shareholder resolutions and voting at AGMs make up the key privileges of shareholders. Most of the literature on investor engagement is on shareholders using their ownership rights (see chapter 2). Topic-wise, the shareholder proposals stick to either increased transparency or governance measures, e.g. appointing a climate expert to the board, which are all easily trackable.

The key characteristic of using the right to vote and propose shareholder resolutions is that many investors hire proxy advisors, i.e. separate companies to conduct the research on proposals, both management-proposed and shareholder-proposed, and conduct the actual voting (Melvin 2016). In the survey, 43% say they outsource some or all of their voting activities, and there is a possibility that more of them buy proxy research. The market is incredibly concentrated with a duopoly consisting of Glass Lewis and ISS (Keatinge 2016; Melvin 2016). Glass Lewis, has 1200+ investors as clients, holding assets of more than USD 25 trillion (Glass Lewis 2016), i.e. more than a third of the global assets under management (Shub et al. 2016). Courteney Keatinge, Director of ESG at Glass Lewis, explained that the company does research and makes recommendations on what to vote,

based on the quality of the resolution. The clients either use the research or the recommendation. When voting on behalf of clients, Glass Lewis follows their clients' voting policies (Keatinge 2016).

The large-scale outsourcing underlines the importance of a good-quality voting policy, and a voting policy which specifically outlines the investor's interests regarding climate change. Especially for large investors who hold shares from several thousand companies, as this indicates a decreased likelihood of going through all the recommendations. It also shows that most investors get their information from very few service providers, giving these providers much power. Next, the paths of informal engagement are analysed.

### 5.6 Informal engagement

Informal engagement includes meetings, calls, letters and emails from an investor to a target company. From figure 11, it is clear that informal meetings and sending emails/letters to equity portfolio companies' management are the two most popular types of engagement, and doing the same with companies in the bond portfolio are the third and fourth most popular types of engagement. This is backed up by the interviewees, who said that informal engagement is preferred in Europe (Pedersen 2016; Rahm 2016; Melvin 2016). The purpose of engagement within ESG is *"making sure that the companies are aware of their risks and that they take them seriously"* (Rahm 2016 line 193). This means that informal engagement can be used to address deeper topics than shareholder resolutions, e.g. strategic, operational and structural topics.

Both Rahm and Pedersen emphasised how informal engagement is about asking the right questions in order to nudge companies into acting on all available information (Pedersen 2016; Rahm 2016). An example could be asking a company how its resilience to a carbon tax is. It can, however, be difficult to measure the impact of raising awareness or changing the strategy. One investor put it like this: *"in other cases, the nature of the engagement is more to make them aware that we are concerned - and in these cases there are no sure clear indicator present on whether they in fact change behaviour"* (investor 11). Some of the survey participants have mentioned follow-up meetings as keeping track of the behaviour and this is also in line with Rahm and Pedersen's arguments (Rahm 2016; Pedersen 2016). Even though informal engagement is more difficult to approach, it theoretically allows for deeper and more drastic topics. The actual impact will be analysed in chapter 6. Next, the aggregation of investor power and cooperation will be under scrutiny.

## 5.7 Cooperation and aggregation

One of the statements observed several times in the comment section of the survey is the emphasis on cooperation between investors when engaging. The Aiming for A coalition<sup>5</sup> is an example of cooperating on shareholder resolutions, but it can also be through PRI (Rahm 2016). Aiming for A is involved in investor engagement on climate change issues and pushing for an agenda of strategic resilience for 2035 and beyond (Investors on Climate Change 2016). The PRI and Aiming for A resolutions are often fuelled both by the amount of investors and public pressure (Rahm 2016). Another strategy is to outsource engagement activities to an external service provider, who aggregates the clients' shares in order to engage. In the sample, 36% responded that they outsource their engagement efforts. Hermes EOS is a leading engagement provider (Melvin 2016; Pedersen 2016) and they currently have GBP 237 billion in assets under advice (Hermes Investment Management 2016). PKA is an example of an asset owner using Hermes EOS as their engagement provider. Pedersen from PKA emphasised the need for aggregation, especially for smaller institutional investors, who do not own a significant amount of shares in companies (Pedersen 2016). The results of the survey showed that larger investors are more likely to be engaged with both equity and bond holdings. Furthermore, it was shown, in chapter 2, that the power of the investor is a significant success factor in the engagement process. These hypotheses will be further explored in chapter 6.

This chapter has provided an insight into the state of investor engagement and the actions taken by European investors. The next chapter will dig deeper and analyse what impact the engagement efforts have had on oil and gas companies regarding climate-related issues.

<sup>&</sup>lt;sup>5</sup> A coalition of investors started in 2011/12 by CCLA Investment Managers, a charity fund investment management company, and now also includes local public pension funds, church funds, Hermes EOS' stewardship clients and other "sustainable" investors (Investors on Climate Change 2016)

# 6 The impact of investor engagement

The previous chapter has analysed what kind of engagement, European investors are involved in. The amount of engagement is large, when measuring the number of investors involved, but the analysis has not yet shown what impact the engagement activities has on oil and gas companies. This chapter will investigate whether, and to what degree, engagement has an effect. In the survey, 23 of 28 respondents said that investor engagement has an impact on company behaviour. Four investors stated some version of "it depends", either of the individual company or the topic of the engagement, and one did not answer. When asked what type of engagement works best, the response was fairly consistent, see figure 12 below.



Figure 12: Best engagement strategy

Figure 12 shows that conducting informal meetings is the most popular way of engaging. Furthermore, almost half of the respondents stated more than one factor and several made comments about how *"it is the sum of efforts that is most effective"* (investor 8). As mentioned in section 2.2., there are three steps of a successful engagement process; getting issues on the agenda, affecting corporate policies and affecting the situation on the ground (Allen et al. 2012). This will be the success criteria for this analysis of engagement impact.

The analysis will look at three topics of engagement; disclosure, policies/governance and strategy/operations. Disclosure includes the enhanced transparency and public reporting, as

recommended by the FSB TCFD, policies/governance includes organisational structures or company policies on e.g. climate change, whereas strategy/operations includes measures to decrease GHG emissions and the implementation of them or a new capex or dividend strategy. The three topics have different levels of interference with the company and differ in ease of implementation, which are the reasons for the differentiation.

This chapter will start by introducing the company-specific features that will increase the likelihood of success. An analysis of the different engagement methods will then be presented to find how investors may position themselves optimally. Hereafter, an analysis of the impact of aggregation and engagement with different asset classes will be made. Based on these considerations, the chapter will end with a set of recommendations for climate-related investor engagement in the oil and gas sector.

### 6.1 Company features

Even though the engagement process affects the outcome of the investment, the target company's features are also important. The literature analysed in chapter 2 showed that poor financial performance, reputational risk, a change welcoming culture and capacity to implement change are important factors in gaining engagement success.

Low oil prices within the past two years, as shown in figure 6 in chapter 4, have undoubtedly reduced the profitability of oil activities, increasing the legitimacy of the engagement efforts. This is especially true for companies investing in high-break-even projects, even though actions succeeding in reducing high-cost projects are yet to be seen. Reputational risk is the second factor, and this disproportionally hits consumer-facing companies (Poulsen et al. 2016). The companies suffering the most from reputational risk are the best-known oil and gas companies. Shell is an example, which is often the 'victim' of bad publicity, even though it remains unknown whether they are actually worse than their less known peers (e.g. The Economist 2014). This might be a part of the explanation why Shell's management has been supportive of the 2015 shareholder resolutions on climate resilience reporting. However, Exxon has also been through much bad publicity, with the newest being the campaign #exxonknew, which was started when it was revealed that Exxon's scientists have known about climate change and its affects for 30 years (#exxonknew 2016). Instead of trying to meet investors, Exxon have recommended against any climate change initiatives at AGMs ever. This is likely due to a completely different company culture from Shell as well as the lower perceived legitimacy of climate change engagement.

The importance of culture is backed up by both Rahm and Keatinge emphasising how the success of engagement was dependent on the target company's willingness to change (Rahm 2016; Keatinge 2016). When asked whether there was a difference in willingness between different sectors, Keatinge stated that *"there are very responsive companies in every sector and very unresponsive companies"* (Keatinge 2016 line 76). In the survey an investor responded that "[...] *some willingness from company management is necessary"* (investor 15), when asked whether investor engagement has an impact. These statements underline the importance of cooperation by the target company to get a successful engagement process.

The last factor mentioned is the capacity to incorporate change. Rahm explained how engagement can be more difficult with the smaller oil and gas companies, i.e. non-majors as they do not have the same organisational size or skills to implement new initiatives (Rahm 2016). This was particularly clear for disclosure and data gathering, where the majors have more resources to deal with potential change. However, it does not stop the effort to strive for best practice, it just slows the process down (Rahm 2016).

Features of the target company itself is very important. As shown here, the impact depends on the status of the company, its receptiveness to investors and its capacity to change. However, these factors alone do not guarantee a positive engagement process. The engagement method also has an impact together with the investor's features. However, this section also showed that the right process cannot guarantee an effect, as success also depends on the individual company. The next section will go through voting and proposing shareholder resolutions at AGMs as a method for engaging.

### 6.2 Voting at AGMs and resolutions

Voting at AGMs and proposing shareholder resolutions are the two main ownership rights of a shareholder (Melvin 2016). These rights have historically been the reason why equity holders are seen as the owners and therefore responsible for the companies. However, only 32% of the survey respondents viewed voting at AGMs as the, or part of the most effective engagement method and only 18% chose the initiation of shareholder proposals (figure 12).

From the survey respondents' perspective, the ownership rights do not present the most efficient way of engaging with a company. When looking at the oil and gas companies, very few shareholder resolutions received a majority vote. Only at BP, Shell and Statoil (the latter is not included in this analysis) experienced success in 2015's shareholder proposals on increased climate-related disclosure (Melvin 2016). Their common denominator was that management backed the resolution, which led to an overwhelming majority for increased reporting on climate-related risk (Melvin 2016; Rahm 2016; Keatinge 2016). Furthermore, they were all proposed by the Aiming for A coalition. However, even though the resolution on climate resilience reporting by e.g. Shell was passed at the 2015 AGM, investors still needed to address the incompleteness of the task at the 2016 AGM (IIGCC 2016). This indicates that monitoring and follow-ups are necessary to get the resolutions implemented, even if they have been adopted formally. This is difficult to imagine without either public pressure through the media or informal engagement.

Keatinge said that the climate-related resolutions are receiving increased support, and in 2016, Occidental saw a 42% support for a proposal of assessing the effects of carbon policies without management support (Keatinge 2016). Although very few shareholder resolutions are adopted, they do raise awareness in the public and increase societal pressure on companies (e.g. Reuters 2015; Wall Street Journal 2016). Importantly, it also increases the pressure on investors, and institutional investors. Especially pension funds and sovereign wealth funds, are increasingly backing up climate initiatives, which increases the likelihood of getting the resolutions through (Keatinge 2016). If this is successful, shareholders can have impact on the disclosure of companies and partly the governance structure. In spite of the room for improvement, Shell and BP have both improved their disclosure of climate-related risks and opportunities (e.g. Royal Dutch Shell Plc 2015; Royal Dutch Shell Plc 2014).

The paradox is that shareholder resolutions are used as the main engagement tool in the US, and are initiated largely without prior discussions with management (Keatinge 2016; Rahm 2016; Melvin 2016), which means that the management has not been involved and may be caught off guard, i.e. management will not recommend voting for the resolution. This will then lead to the majority of shareholders voting against the resolution. With the large share of US investors in both US and European companies, it is then difficult to see how true progress can be made without the US investors changing their approach. Therefore, it is worth looking into the effects of informal engagement, which could theoretically replace or complement the incomplete formal engagement efforts. The next section will analyse the impact of informal engagement.

### 6.3 Informal engagement

With informal engagement being under-researched, it is interesting to observe that 82% of the surveyed investors believe that conducting informal meetings with the target company's management or board is the, or part of the best way to engage. Sending letters and/or emails got 14% of the survey participants' support and a combination of several strategies 43% (figure 12). As mentioned in the previous chapter (section 5.6), informal engagement can be used to get a dialogue started about a company's strategy, operations and structure, which cannot fully be done through initiatives such as shareholder proposals. It can also be used to raise awareness of certain risks, which the investor believes underestimated. Rahm explained the informal engagement process as being the sum of marginal effects, i.e. to change a company's behaviour, the investors will need to be persistent and "engage and engage" (Rahm 2016 line 185) and potentially then gain better receptiveness from the target company. She said that there is an effect from investor engagement, but only because of repetition. To have a larger impact, investors need more data and more frequent meetings with companies to push them in a certain direction.

Looking at the development of oil and gas companies, however, they show limited improvement on climate-related measures. As shown in chapter 4, very few new policies or standards were

introduced in the 15 oil and gas companies over the past six years. Two companies introduced CSR training, two introduced a sustainability committee and four introduced ESG-linked payment structures for their executives. The topics indicate improved governance of ESG/CSR risk, rather than what public pressure usually aims for, e.g. large investments in renewables, or GHG emissions reduction targets. Furthermore, BP and Shell's management supported the shareholder resolutions on climate resilience reporting, which is likely to be the result of pre-proposal engagement by investors, as the geographical distribution of adopting the proposals matches the European engagement tradition. Since informal engagement is, by definition, informal, it can be hard to trace action by a company back to a specific meeting or one specific investor (Melvin 2016; Rahm 2016). However, the development in the oil and gas sector of measures, which are more in the interest of investors than public pressure agendas, suggests that investor pressure is the cause of development.

The question is whether informal engagement has a real impact on oil and gas companies in making them reduce their impact on and resilience to climate change. The improvements in the policies have happened over the past five years, and even though most of the analysed companies do have climate change policies, they are still developing projects demanding very high break-even prices planned (table 6 in chapter 4). Furthermore, none of them seem to be backing out or making any fundamental strategic changes to accommodate for climate-related risks. There are cases, where most of these companies say that they include a carbon tax in their financial scenario tests of their projects, but this seems far-fetched when investing in USD +100 break-even projects. In their sustainability reports, several of the oil and gas companies emphasise the problem of climate change and how coal should be phased out, while oil and especially natural gas should take its place (e.g. Royal Dutch Shell Plc 2015; ExxonMobil 2015). The sustainability reports are very long, but do not have a lot of content, which indicates that much of what they say is window dressing with little actual action behind. The lack of action shows the uncertainty of the impact of investors. The question is whether the hard part was to make them realise and admit that climate change is a problem concerning the fossil fuel industry, which has been accomplished, or whether it is to make them change their behaviour.

The improvements that have happened in the oil and gas sector are difficult to trace back to investor engagement. However, these companies have shown such resistance to change that it is difficult to imagine them changing their behaviour or getting them to admit climate change issues, if they were not afraid it would impact their access to capital or share price. Although the change is very slow and the extent very limited, it seems that informal engagement does have an impact and does change the behaviour of oil and gas companies regarding climate change. When relating the impact to Allen's (2012) three stages of success, investor engagement has, with some companies, succeeded in getting issues on the agenda and affecting corporate policies, but not affecting the situation on the ground. However, there are ways of improving the chances of success. The next section will show how and why different investor features affect the engagement success.

#### 6.4 Investor features

Even though the target company has the features mentioned in section 6.1, there is no guarantee for successful engagement. The engaging investor also needs to be in a position to engage. Allen et al. (2012) found that power, legitimacy and urgency increase the probability of successful engagement. As mentioned in chapter 2 legitimacy was found to be the most important by Allen et al. (2012), whereas other researchers have only researched the correlation between power, i.e. ownership share and effect (Dimson et al. 2015; Denes et al. 2016).

Power is the size and importance of the investor in relation to the company. For equity, it is the ownership share, whereas bond holders gain power from the share of the debt. Increasing the power of the investor can be done through cooperation between investors, either by themselves or by outsourcing to an external engagement service provider, who aggregates their clients' stakes.

Table 10 shows the top six owners by investor and by country of five of the oil and gas companies analysed in this thesis. Exxon and Occidental are representative of the US companies in the sample, whereas the European companies vary more in their ownership structure. None of the US companies had more than 17% foreign ownership, whereas US investors dominate the European companies' ownership. One of the key findings is how dispersed the ownership is. Apart from the Italian government owning 26.37% of ENI, the largest ownership share is BlackRock's 7.70% in

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Occidental. The shares drop quickly, when going to the sixth largest investor. For Exxon and Shell, they are at less than 2%, and these stakes are still held by some of the world's largest investors. This gives a hint of how much it takes to represent a large share of a large listed company, and underlines how cooperation could improve an investor's position.

	Country		Investor		
	Name	Share	Name	Share	
	US	83.53%	Vanguard Group	6.80%	
bil	UK	4.20%	BlackRock	5.94%	
٩	Japan	3.04%	State Street Corp	3.43%	
(ou	Switzerland	1.78%	BNY Mellon	1.40%	
EX	Canada	1.68%	Capital Group	1.32%	
	Norway	1.62%	Northern Trust	1.31%	
	US	83.76%	BlackRock	7.70%	
_	UK	4.94%	Vanguard Group	6.73%	
Ital	Japan	2.16%	JP Morgan Chase	3.99%	
der	Canada	1.95%	State Street Corp	3.87%	
Occi	Switzerland	1.35%	Bank of America	3.32%	
0		,	Barrow Hanley Mewhinney		
	France	1.17%	and Straus	2.51%	
_	US	48.27%	BlackRock	6.20%	
hel	UK	11.80%	Norges Bank	3.87%	
ih Sl			Manufacturers Hanover		
utc	Norway	8.44%	Invest	2.94%	
alD	Luxembourg	8.44%	Banguard Group	2.38%	
i o A	China	4.58%	Capital Group	1.96%	
æ	Ireland	3.10%	Safe Investment	1.59%	
	US	35.34%	Credit Agricole	7.53%	
	France	29.24%	BlackRock	5.00%	
tal	Luxembourg	12.83%	Total SA	4.72%	
Lo Lo	Belgium	5.32%	JP Morgan Chase	4.11%	
	Norway	2.94%	Vanguard Group	2.79%	
	UK	2.83%	Groupe Bruxelles	2.45%	
	Italy	62.12%	Cassa Depositi e Prestiti	26.37%	
			Ministero Dell 'Economia e		
	US	14.44%	Delle	3.93%	
ENI	Luxembourg	6.33%	BlackRock	2.20%	
	France	3.11%	Vanguard	1.68%	
	Norway	2.92%	Norges Bank	1.46%	
	Ireland	2.02%	Franklun Resources	1.06%	

#### Table 10 Ownership shares by country of investor origin and investor

Source: Bloomberg Professional

Apart from power, legitimacy is a key factor in engagement success. Allen et al. (2012) focus on legitimacy in the eyes of the public and the political context. This is a key piece in understanding why European companies have, in general, been more receptive to investor engagement in comparison to their US peers. Although the European countries as well as the US signed the Paris Agreement, there is still a significant difference in the political context. In spite of the oil companies having stated that climate change is real and caused by humans, they have funded lobby organisations that deny climate change for decades (The Guardian 2015b). In the US, these lobby organisations have successfully limited the climate policies in the Obama administration, with Congress blocking any attempt of a federal climate policy (Ohlinger 2015). Furthermore, with the upcoming Trump administration including several climate change deniers, regulations to mitigate climate change seem far away (New York Times 2016). The European countries and EU as an institution have a more progressive agenda on climate change regulations with EU emissions targets and promotion of member state action (European Environment Agency 2016). A key strategy is to strengthen the emissions trading scheme, i.e. carbon pricing (European Environment Agency 2016). In the Netherlands, citizens sued the state for not having a progressive enough climate change policy, and won in court (The Guardian 2015a). France hosted the COP21 meeting, resulting in the Paris Agreement, which is a diplomatic victory. At the same time they implemented new disclosure policies on the energy transition in the form of Article 173 (Chenet 2015). The contrasting conditions in the US and Europe is likely to add to the explanation for why European companies seem more cooperative and willing to change than the US companies.

Even with the political pressure being different, the public pressure on oil and gas companies has been very outspoken in both regions, with e.g. the divestment campaign gaining much support, as shown in section 5.1 and even starting in the US. However, the public pressure has not, to a large extent, translated into political action. With limited substitutes to oil and gas, the pressure has not been felt in the monetary value of the oil and gas companies. This is linked to the urgency of the matter. As mentioned in the introduction and chapter 4, climate change is urgent and is a financial risk of systemic levels. However, it will not necessarily affect short-term profits of the companies. Therefore, the urgency factor is not pushing the oil and gas sector. To sum up, the process is not easy, and many factors and stakeholders affect the success of an engagement process. Two respondents' comments sum up the points this way: *"It can be a very slow process and we believe that it is the united voice of the fund management industry as a whole speaking on behalf of its customers that will slowly make a difference"* (investor 25) and *"regulation is necessary and the Paris agreement is already a game changer but needs to be followed through"* (investor 3). In the next section, the power of investors and how to gain more, will be the focus.

### 6.5 Aggregation and cooperation in informal engagement

As shown above, power, i.e. the size of the investor's share or bond holding in the target company is a significant factor in a successful engagement process. Many of the investors in the survey are nowhere near the size of the top-six, or even top-ten investors in these companies and often only own a fraction of a percent share or very little debt. To enhance the power of an investor, cooperation is an option, either with other investors or by outsourcing the engagement activities to a service provider who will aggregate the investors' shares in companies and engage on their behalf (Pedersen 2016). This is similar to the proxy research done on AGMs, but on in-depth informal engagement.

When knowing that the size of the investor's share or bond holdings in a company is important, if they want to have access to management, it is interesting that there is no correlation between the size of the investor and whether they outsource their engagement<sup>6</sup>. 57% of the respondents do informal engagement without outsourcing its activities, and there is also no correlation between that and the size of the investor. Figure 13A and B show the lack of correlations graphically. This means that several of the respondents say they do informal engagement in the oil and gas sector on their own, even though an investor such as Standard Life with EUR 344 billion in AuM has a hard time getting meetings with management of US oil and gas companies. Although non-US oil and gas companies exist, it is assumed that the respondents generalised across all geographies, indicating that they also say they do informal engagement with US companies.

<sup>&</sup>lt;sup>6</sup> The assumption that an investors size is approximately proportional to its share in oil and gas companies has been applied



Figure 13A: outsourcing engagement per AuM, 13B: Informal engagement without outsourcing the activities per AuM

In figure 14A, 1 is outsourcing and 0 is no outsourcing; In figure 14B 1 is informal engagement in either equity or bonds without outsourcing engagement efforts and 0 is outsourcing the engagement

As mentioned, PKA has hired Hermes EOS to conduct engagement activities on their behalf, which has given PKA access to dialogues with some of the largest companies in the world in spite of their size as an investor (Pedersen 2016). The benefit of an external engagement service provider is that they can divide the costs between the investors, giving the individual investor more engagement and man power for smaller costs, and at the same time be represented as part of a larger coalition (Melvin 2016). Hermes EOS' size and resources enables them to engage on behalf of what is a much larger share of a company than any of the individual investors. But with GBP 237 billion under advice, Hermes EOS still only represent maybe 0.5% or 0.25% of the ownership of target companies (Melvin 2016). According to Melvin, they do manage to move things with their targets through a thorough dialogue due to their large team of 27 professionals, but the relatively small size affects them negatively.

The experience by Hermes EOS shows that large investors could also benefit from aggregation. Even the top-ten investors invested in an oil and gas company, who have the size to have an impact without aggregation. Both Rahm and Pedersen emphasised the importance in repetition of the engagement topic, i.e. the more time and effort, an investor puts into engagement, the better it works, depending on the company, they engage with (Rahm 2016; Pedersen 2016). According to Melvin, BlackRock, with EUR 4.4 trillion in AuM, has approximately 15 employees, and investors the size of Hermes' assets under advice have teams of five, if they have large teams (Melvin 2016). If the investors shared the costs instead, an engagement provider could hire more people to cover

the engagement effort as well as represent larger shares of the companies, increasing their impact (Melvin 2016; Pedersen 2016; Dimson et al. 2015). The next section will investigate the notion that engagement only includes equity.

### 6.6 Asset classes

The traditional view of investor engagement is that shareholders need to be responsible for their portfolio companies and therefore, investors are only focused on engaging with their equity portfolio. However, as shown in chapter 5, investors are not only subject to climate-related risks on their equity portfolios but across all asset classes. Furthermore, 82% of investors ticked informal meetings as one of the most or the most effective way to engage and 43% said that it was a combination of things, or the sum of the efforts (figure 12). Informal meetings and sending letters and/or emails is not conditioned on ownership rights. Rather the access is determined by some of the same factors that determine the success of engagement, i.e. power, legitimacy and urgency. During the interviews, Melvin, Rahm and Pedersen all mentioned having good experience with engaging in bond holdings (Melvin 2016; Rahm 2016; Pedersen 2016). Although stating that the focus of investor engagement is on equity, Melvin said that *"the experience of engaging on behalf of corporate bond holders is actually quite a good one. You can get change that way, companies do listen and they are interested in listening to the views of the people who are providing and lending to them, so it does actually work in practice"* (Melvin 2016 line 324).

In the end, whether the investor really implements either a climate-related risk management or climate friendliness strategy is what matters. Rahm put it this way: *"if you hold the bonds in a company, you are ultimately looking at the risk of that company so why would you not have ESG in the engagement with the bond issuer"* (Rahm 2016 line 71). This also seems to be the case for the investors included in the survey. 20 of the respondents stated that they engaged informally with bond holdings and 16 sent letters and/or emails (figure 11 in chapter 5). As the investors engaging with their bond holdings find it successful, there is nothing in the way of implementing it in international recommendations and academic research.

### 6.7 Recommendations for engagement

To sum up this chapter, a summary of best-practice methods and assumptions will be given to guide investors in future engagement processes. The strategy will be divided into five steps; 1. Find the motivation and position yourself as a legit and powerful investor, 2. Identify target companies, 3. Choose methods, 4. Be serious about the consequences of failed engagement and 5. Follow up.

When investors want to start engaging with their portfolio companies, they need to first figure out why they want to engage; climate risk considerations or climate friendliness. To have the largest impact, investors need urgency, legitimacy and power. The matter of climate change and the energy transition provides urgency in the sense, that companies need to act now to prevent losses on a longer term, although this is not currently translated onto their balance sheets. The legitimacy comes from the public pressure and political agenda, and with the Paris Agreement there is a momentum for creating change, although the pressure varies for every region. Power comes from the size of the share, and here, it is clear that investors can get most impact in relation to costs if they either cooperate or outsource their activities. By sharing the costs of engagement, investors can get a much larger team for lower costs than they could on their own, and thereby more time dedicated to each target company. Apart from lowering the cost, it increases the share of equity or bonds represented during the engagement, which increases the power of the engaged.

When the investor has decided on an approach to engage, the first step in the process is to identify companies in which the investor has a chance to make an impact. This is an important step as it will set the foundation of the entire process. When engaging on climate-related risk in the oil and gas sector, the first step is to find out in which companies the investor perceives the highest risk. When these companies have been identified, they need to be screened for the factors shown in section 6.1, i.e. financial performance, reputational risk, willingness and capacity to change. For financial performance, it is beneficial to look at the companies with high-capex projects which are very sensitive to climate regulation. Furthermore, the more known companies have higher reputational risk, so choosing a company which has been or is being scrutinised publicly by e.g. NGOs or the press improves the chances of getting the company's attention. The company's willingness to change is

based on the level of cooperation by management and will be crucial to the engagement process. The lower the willingness, the harder and less impactful, the engagement will be.

Method-wise the best option seems to be as many and as intense as possible. Furthermore, the right choice of the engagement method is highly dependent on the target company, so a standardised engagement is simply not possible. "*My experience is that the impact of different strategies depends mostly on the companies and the specific question at hand*" (investor 11).

Informal meetings, where investors start a dialogue is the most efficient type of engagement, according to the survey respondents and interviewees. However, it is a process and takes time. Therefore, the amount of information from the target company and the number of meetings, where the investor can ask the right questions and work on increasing the company's awareness of certain risks, is crucial. The informal style of engagement allows investors and companies to discuss more in-depth topics, such as strategy and organisational structure. Furthermore, it allows the investor to leverage both its equity and bond holdings. It can be combined with shareholder resolutions, which gain better resonance if they are proposed by a coalition of shareholder. Resolutions are good for specific disclosure or governance measures, which are easily monitored, and resolutions also have the potential to increase publicity on the company and the engagement topic, as AGMs are public. The success of a resolution depends on management support, so it is important to include management, i.e. communicate why the specific resolution is important and seek to get management to cooperate. This process can also lead to the shareholder resolution being obsolete, if the company decides to implement the changes without the demand of a vote. The most important thing in the engagement process seems to be persistence and patience.

However, no matter the quality of the engagement, its effect will decrease if there is no consequence of not complying. Divestment should be the last resort of failed engagement, as the investor would otherwise not take the investor's demands seriously. Although it might not have a future impact on the company itself, depending on the size of the investor pulling out, it will send a message saying that the investor is serious about the engagement, also for future target companies. Furthermore, the inclusion of climate-related risks would seem more genuine, if the investor acts

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on a rejection to mitigate the risk. This is particularly important in such a high-climate-risk sector as the oil and gas sector, which will be affected profoundly by the energy transition.

If the target company accepts the investors' requests to disclosure, policies or strategy, the investor needs to keep monitoring the company. Publicly announced engagement processes can increase the help to monitor, as NGOs or the media will help keep an eye on progress, but investors should still keep track of their target companies. Furthermore, several survey respondents emphasised the importance of follow-up meetings and keeping track of the disclosure and publicity of the company.

Successful engagement is not an easy task. To get things through, especially if the company needs persuasion, investors need to be persistent (Rahm 2016). As so much of the impact is generated by dialogue and continuous informal pressure, either by public shaming or private conversations, it is difficult to have a standardised strategy. This chapter has given its recommendations on how to approach engagement and what to consider. Even without a standardised approach, there are still certain features of a process which determine the success or failure of the process, and the investor can optimise its probability of success by following these steps. The next chapter is a discussion of the findings of the analysis in a context of the current state of the financial system.
### 7 Discussion

The above analysis provided recommendations for investors to pursue investor engagement in an optimised fashion, to obtain the best possible result. It was also shown that there is a lack of goodquality engagement and a lot of window dressing. Melvin said "we have a situation of absent ownership" (Melvin 2016, line 100). Pedersen argued that PKA's motivation to conduct engagement was two-fold; they have to seem socially responsible, i.e. reputational risks; and they believe their engagement actually has a positive impact on companies' risk management (Pedersen 2016). PKA's motivations seem to be quite an accurate description of the financial industry's take on investor engagement. A lot of communication is involved in the engagement process, and all the investors participating in the survey engage in some way. Furthermore, the investors, who said no to participating in the survey all explained why (except for one), which indicates that there is a societal pressure to do engagement. However, the more in-depth analysis show that the effect is limited and depends on the target companies. The investors believe that it is the sum of efforts, but many of them do not cooperate or aggregate their voices and allocate very few people to do engagement on a portfolio of thousands of companies. These insights points towards that investor engagement still being a concept in its early phase and an industry which has not yet decided whether it will be a communications exercise or a method to actually do in-depth risk management. This is problematic, as the evidence points towards the fact that the larger the pressure, the better the results of engagement turn out.

The motivation for engagement is different for different investors. Nonetheless, two main directions exist. Investors either engage to reduce risk from climate change, or they engage as activists to reduce the company's negative externalities on society. In their report "Investing in a Time of Climate Change", Mercer (2015) divides investors into three different categories; climate-unaware future takers, climate-aware future takers and future makers, as mentioned in the introduction. Pedersen emphasised PKA's responsibility to deliver the best possible return to their beneficiaries as the key reason to their engagement activities. They believe it has a positive effect on the target companies' risk management, and thereby on PKA's portfolio (Pedersen 2016). Their job is to invest in order to get the best possible return with the lowest risk and use engagement as a risk management tool. Whether the temperature increases 2°C or 4°C, they believe the energy

transformation will happen at some point and they need to include that in their investment strategy (Pedersen 2016). However, engagement can also be used for a more activist purpose in line with the idea of future makers. They target oil and gas companies due to the externalities from their business models, i.e. GHG emissions causing climate change, environmental damage from oil spills, human rights cases, etc. These are the same types of funds that are active in the divestment movement, but have chosen the engagement path rather than fully divesting. These include religious funds, endowment funds and some public pension funds.

Although the two different movements might not aim for the same goal, they do support each other. The increased number of activist investors, and 'divestors', have put climate change issues on the agenda and are very active in the media. This increases the legitimacy of mainstream investors who find climate risks urgent and important. Rahm said that the response they often get from US companies, when they ask for meetings on climate-related risks is *"none of my other investors are asking me that, so why would I give you some time?"* (Rahm 2016 line 255). The public presence of the activist funds and their efforts can thereby increase the reputational risk of the oil and gas companies and pave the way for mainstream investors, who want to engage on the motivation of risk management.

However, a main obstacle for investor engagement is that the benefits are a public good among shareholders. If engagement improves a company's climate risk management, all shareholders benefit; not only the investor who engaged. This makes the benefit of investor engagement a common good for shareholders. As shown in the analysis, proper engagement takes effort and time, which means that only investors who really believe it will make a difference and think it is important will commit. Although some investors are engaging in spite of the private costs and public benefits, the increased publicity and legitimacy of engagement has not resulted in large enough engagement efforts to actually make a difference.

Apart from the private costs vs. public benefits, the major reason for the lack of investor engagement is *"traditions and cultures within the financial services industry, whereby the intermediaries make money through trade and activities of derivatives of trading"* (Melvin 2016 line

101). When investors profit from trade rather than ownership of the underlying assets, it distorts the incentive to be an active owner, who engages with its portfolio companies. This mind set of trading is linked to the short-termism and financialisation of the global financial markets. Financialisation has meant that the financial system has moved further away from the underlying assets and investors are *"making money from money"* (Perez 2002, p. 1) instead of from owning companies (Azkunaga et al. 2013). This automatically breeds a focus on short-term profits and undermining long-term value.

Short-termism arises from a longer distance from investor to company. This has been enabled by longer investment chains with more intermediaries, increasingly international ownership and larger institutional investors, who hold thousands of companies (Curran & Chapple 2011). All of this is possible due to technological innovation that has decreased the transactional costs and enabled extreme short-termism. Companies are willing to sacrifice future economic value for short-term profits, which satisfy shareholders (Curran & Chapple 2011). This is deeply rooted in the financial system and to change it, financial companies need to change their mind set. They *"need a change in the business models of financial companies whereby they see themselves not as traders but as owners on behalf of their clients, where they shift their focus from a short-term transactional perspective to longer-term relational one, where they recognize their interdependence with their clients and the entities in which they invest" (Melvin 2016 line 123).* 

They need to get away from a way of thinking investments in single companies and look at their investments from a portfolio perspective. As mentioned in chapter 2, institutional investors are universal owners, i.e. they have investments in many companies in order to diversify their company-specific risk away. If institutional investors looked at their portfolio instead of individual companies and recognised the interdependence, they would have an incentive to engage with e.g. oil and gas companies to reduce the negative externalities, which affect the environment and society, and thereby other companies in their portfolio (Melvin 2016). If the institutional investors take a longer-term relational approach where interdependence is recognized, the assumption is that they would naturally incorporate ESG considerations in their decision-making process, because it would make

sense in their business model. This would also increase their incentive to engage with their portfolio companies (Melvin 2016).

The risk of a relational approach is that the necessary space between the investor and company will be limited, which can hinder the investor in making proper engagement. The relation to the industry, in general, correlates with less effective engagement, as shown in chapter 2, and is a key reason why the largest, especially US, asset managers do not vote against management of a target company's management on shareholder resolutions (Melvin 2016). However, the downsides need to be weighed against the upsides of longer-term investment strategies and better inclusion of externalities. Furthermore, increased transparency and accountability could help align interests (Holland 2011), both by the public and regulators.

In recent years, there has been a shift in the financial markets. Investors are increasingly moving from active to passive investment strategies, and some of the large investors, e.g. CalPERS, have started to internalise asset management (Melvin 2016; Shub et al. 2016). This shift represents a disruption in the asset management industry and could be an indication that there is an existential crisis in the financial market, as the financial crisis has left asset owners with weakened trust towards active strategies and asset managers (Melvin 2016). Although the switch to passive asset management will not change investors' view from a transactional one to an approach of good ownership, the internalisation of asset management is a set in the right direction. One of the key obstacles for implementing climate risks in the investment process, of which engagement is a method for mitigation, is the difference in incentives in the investment chain (Bartholdy 2016). The internalisation indicates that investors wants to shorten the investment chain to regain control.

Nevertheless, the financial system will not be changed overnight. There are several initiatives pushing the agenda of a more inclusive financial system, e.g. UNEP's "The financial system we need" (UNEP 2015), PRI (PRI 2016b), Financial Stability Board's Task Force on Climate-related Financial Reporting (FSB TCFD 2016a) and Institutional Investor Group on Climate Change (IIGCC 2017), but the transition will take time. The energy transition is no longer in question, the question is how much and how fast. This leads to the question of whether investor engagement can influence the

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oil and gas sector to change its strategy quick enough to avoid losses an excess risk exposure during the transition.

The current form of engagement has not shown much influence, and especially not in the pace necessary to mitigate climate risk. However, things are moving. The FSB TCFD is ground-breaking as it speaks the language of investors and has emphasised the risk aspect of climate change. The legitimacy is strong with the Financial Stability Boards as the messenger. Furthermore, the tendency to internalise asset management will hopefully reduce the amount of intermediaries, which enables a better alignment of long-term interests from the long-term asset owner to the company. Last, the focus on climate risk and risk mitigation will, at some point, lead to oil and gas companies not being able to hide behind increased disclosure, but nudge them to take action. The same goes for investors, who need to start doing high-quality engagement, instead of window dressing.

### 8 Conclusion

This thesis has sought to answer the research question:

How can institutional investors best influence oil and gas companies in their portfolio to include climate change considerations in their business?

To answer the question, a mix of methods has been deployed. First, a literature review of the research on investor engagement was conducted. Then, and overview of the climate-related risks and risk assessment tools was presented, followed by an analysis of the development of the 15 largest listed oil and gas companies worldwide, with dispersed ownership. To get an overview of whether and how investors currently engage with their oil and gas investments on climate-related issues, a survey of European institutional investors was conducted. A more in-depth understanding of the quality of the engagement was obtained through four semi-structured interviews with two investors and two experts from the engagement and proxy research fields.

Chapter 4-6 analysed different aspects of investor engagement. Chapter 4 consisted of the analysis of climate risks in general and the assessment of the 15 oil and gas companies. It was concluded that although the companies face great risks from an energy transition, they have not significantly started to manage these risks. Although many of them have policies on climate change and have introduced either executive compensation linked to ESG or CSR training, oil and gas companies still invest in high-break-even projects.

Chapter 5 showed that investors do engage on climate-related issues with their oil and gas investments. All the respondents, except the one with no equity holdings, do equity engagement and 20 out of 28 do informal engagement with their bond holdings. This indicates that investors try to engage with their portfolio companies, but in contrary to what the research limits itself to, investors engage with both equity and bonds. European governance is more focused on informal engagement with the portfolio than in the US, and this is also clear from the respondents. More than 80% of the participants listed informal meetings with a target's management or board as the most effective way of creating change, and 43% stated that a combination of efforts is the most optimal. Many investors added that there is no guarantee for impact. According to the investors, it takes repetition, persistence and patience and in the end, it is the sum of efforts that matters.

Chapter 6 assessed whether investor engagement has an impact and what kind of engagement works best to influence oil and gas companies on climate-related issues. The conclusion is that investor engagement currently looks better than it performs. Engagement can have an impact, but so far, the climate-related change in the oil and gas sector has been limited to getting issues on the agenda and for some companies changing governance policies. However, getting the oil and gas companies to publicly admit that climate change is real and that fossil fuels are a cause of it, is a large step in the right direction. The next step must be to change their behaviour on the ground. Five steps for effective investor engagement were identified. 1. The investor needs to position itself as powerful and legit, e.g. by cooperating with other investors to aggregate their share. 2. The investor needs to identify the companies which are subject to the transition risk. 3. The method choice depends on the target company, but should include informal engagement, potentially backed up by shareholder resolutions or pressure through the media. 4. Divest if unsuccessful 5. Follow up with the target company to hold it accountable. The five steps provide a structure of engagement, but the process will be different for every company. A major step to enable better engagement is the aggregation of size, either through cooperation or outsourcing to an external engagement service provider. This would provide a lower-cost solution with more resources to engage, thereby getting better results.

The major obstacle to good investor engagement is the absence of engagement. This is partly caused by the fact that positive results benefit all investors, whereas the costs are privatised to the engaging investor(s) alone. This leaves room for free riders and reduces the incentive for the individual investor to do in-depth engagement, which demands many resources. This difference in public benefits and private costs are enhanced by a financial system profiting from trading rather than owning the underlying assets. Nonetheless, there are signs of change. Large long-term asset owners are starting to internalise asset management, shortening the investment chain and making it easier to align the interests of the portfolio companies with a goal of long-term value creation.

However, investor engagement cannot stand alone. From the analysis conducted, it is clear that the companies most welcoming to change are the European oil and gas companies, which operate in a political context of much more ambitious climate mitigation than US companies. Politically

ambitious countries are thereby enabling and helping companies and the investor community to get ready for the energy transition.

As a conclusion, engagement can have an impact. But to optimise the influence on oil and gas companies regarding climate change considerations, investors need to keep engaging, i.e. repeat the demands, be persistent and patient, but also recognise defeat by divesting. The larger the investor, and more climate change-mitigating political context, the more effective the engagement. The easiest way to grow is by cooperating or outsourcing.

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# Appendix A – Survey questions

Thank you for participating in this survey. It will help me map how the institutional investor community engages in portfolio investments in the oil and gas sector. If you want to be anonymous, you can leave the company name questions blank.

What type of company do you represent?		
	Asset owner	
	Asset manager	
	Asset owner and manager	
	Consultancy	
	Other:	

In which country is your company based?

Country:

What is the name of your company?

Name:

Do you have a specific voting policy?

Yes	
Yes	

No

Always vote with management

Do you have a specific engagement policy?

Yes

No

Do a	ny of the policies include sub-strategies on climate change?	
	Yes to voting	
	Yes to engagement	
	Yes to voting and engagement	
	No	

Do you outsource voting or engagement activities?		
	Yes to voting	
	Yes to engagement	
	Yes to voting and engagement	
	No	

If you outsource, do you have a policy on voting and engagement they need to follow?

Yes to voting	
Yes to engagement	
Yes to voting and engagement	
No	

Do you monitor the external manager's activities?		
	Yes	
	No	

# Who do you outsource to? Name:

# Active ownership in the oil and gas sector

What asset classes do you consider when actively engaging in oil and gas companies in relation to their impact on climate change and climate risk?

_		
	Equity	
	Corporate bonds	
	Project lending	
	Private equity	
	None	
	Other:	

How do you engage with equity holdings in relation to their impact on		
climate change?		
	Voting at AGMs	
	Making shareholder resolutions at AGMs	
	Informal meetings with company management and/or board	
	Emails and/or letters to the company	
	Other:	

How do you engage with corporate bond holdings in relation to their impact		
on climate change?		
	Informal meetings with company management and/or board	
	Emails and/or letters to the company	
	Other:	

How do you engage with project lendings in relation to their impact on climate change? Informal meetings with company management and/or board Emails and/or letters to the company

Other:

How do you engage with private equity holdings in relation to their impact on climate change? Informal meetings with company management and/or board

Emails and/or letters to the company

Other:

# The effect of investor engagement

Does engagement have an impact on increasing corporate focus and action			
on mitigating their impact on climate change?			
	Yes		
	No		
	Other:		

Wha	What type of engagement is most effective?	
	Voting at AGMs	
	Initiating shareholder resolutions	
	Informal meetings with management/board	
	Emails and/or letters to the company	
	Other:	

Do yo	ou track the change in company behaviour after engagement?	
	Yes	
	No	

### If yes, how?

Additional comments on how to make oil and gas companies in your portfolio consider and act to reduce their impact on climate change

Investor	Engaging with	Most effective type	Comments on how to measure	Comments on how to make portfolio companies consider and act to reduce their impact on climate
number	equity holdings	of engagement	engagement	change
1		Informal meeting	Hermes, they have a milestone	Investors should approach climate change from a
		with	programme that tracks the	risk perspective stressing how climate change will
		management/board	different steps in the process e.g.	affect portfolio companies and their future
			the outcome.	business.
2	Making	Informal meeting	Our engagment provider tracks	We look at more how they are mitigating risk.
	resolutions	with	all engagements in a milestone	
	through our	management/board	system so they can report on	
	voting provider		engagement Progress.	
ω	Through pooled	We have not made	It depends. For some	Regulation is necessary and the Paris agreement is
	engagement	the comparison, but	engagements we track progress	already a game changer but needs to be followed
	with other	we believe that a	through KPI:s that are measured	through. Investors need to make sure that
	investors	combination of	before the engagement starts	businesses align their business to a 2 degree target,
	through GES	engagement	and then followed-up. Successful	and do not obstruct the process of implementing
	and Ethix	through different	shareholder resolutions, such as	regulation through obstructive corporate lobbying.
		channels and by	the "aiming for A" resolutions	This can be done through different measures and
		different owners	will have to be followed-up on in	tools. AP7 use all tools we have available to do this.
		and other	order to make sure they are	We invest in solutions, we vote at all AGMs of all
		stakeholders will	followed through	the companies we own, we file shareholder
		have most impact		resolutions, we engage with companies, we issue
				securities class action lawsuits against companies
				such as VW. And we are currently looking into how
				to incorporate the Paris agreement into our public

# Appendix B – Comments from survey respondents

∞	7	б 	<b>Б</b>	4	
Subject whenever we meet with IR or other representatives	Ad hoc requests	Collaborative engagement			
Voting at AGMs, Informal meeting with management/board, Emails and/or	all of them can be, I think timing is the most relevant	Voting at AGMs, Initiating shareholder resolutions, Informal meeting with management/board	Informal meeting with management/board		
We follow a milestone evaluation towards the goals of the engagement.	our engagement is usually aimed at getting a public commitment, which is easily trackable which is easily trackable	regular reviews where need for change identified, identifying milestones			
	I think the more effective engagement strategy is not on "stopping" something, but how a financial service provider can be of assistance to make the transition to a low-carbon economy happen. The company has the advantage to be able to pro- actively leverage institutional assets for this and financial institution can show that it proactively allocates capital for low-carbon purposes.	our role is to encourage the strategic consideration of climate change, i.e. make sure it is treated as a material business risk and needs to be addressed at the board level. For example, we are asking that companies test the resilience of their product portfolio to climate change.			blacklisting tool, where we blacklist companies for norm-breaches in order to put pressure on them to change.

11	10	Q	
			from the company.
My experience is that the impact of different strategies depends mostly on the companies and the specific question at hand	Initiating shareholder resolutions, Informal meeting with with management/board	Informal meeting with management/board, Emails and/or letters to the company	letters to the company, It the sum of efforts that is most effective.
It depends on the style of engagement and the nature of the engagement - if we ask them by mail to comply with for example reporting standards, we of course monitor if they change behaviour - it other cases the nature of the engagement is more to make them aware that	By formulating clear and smart demands, it is possible to track developments at the companies and compare them actual progress	Monitoring sevice conducted by EIRIS	

16	15	14	13	12	
Informal meeting with management/board	Voting at AGMs, Informal meeting with management/board	Informal meeting with management/board	Informal meeting with management/board	Informal meeting with management/board	
By keeping in touch with the company and following their ESG profile development	Our climate related engagement/proxy voting is very limited. We track it on a case by case basis	Sustainalytics		Annual reporting by the company	we are concerned - and in these cases there are no sure clear indicator present on whether they in fact change behaviour.
	Open dialogue is one possible option - but in some cases it is also hihgly unlikely. One of the most effective tools may turn out to be disclosure of fund used by companies to lobby politicians since that will increase transparency regarding how company spending matches long term trends. However, that will probably require political changes before that becomes a given.		It is difficult to measure the effect of a single engagement by one investor as you cannot isolate the effect		

20       Informal meeting with management/board       We have an internal stewardship committee and sustainability review committee. The committees often review engagement outcomes and also discuss the broader policy agenda. We would examine the       Engagement on strate	19     Voting at AGMs, Informal meeting with management/board     On a case by case basis	18 Informal meeting Internal tools Societal pressure with management/board	17       Voting at AGMs,       We have follow up meetings to       To make them aware c         Informal meeting       follow through the engagement       consider which forces ·         with       management/board       management/board       impact for their busine
dship Engagement on strategy is key. Y		Societal pressure	to To make them aware of the challenges they need to consider which forces them to consider them. Make them understand how these issues have material impact for their business model.

		24				23							22									21			
such as IPIECA	organisations	Through sector																							
	Initiating	Voting at AGMs,		management/board	Intormal meeting with	Voting at AGMs,					management/board	with	Informal meeting							management/board	with	Informal meeting			
system	through our own milestone	We track engagement progress		on specific issues	Ubjectives with milestones during the engagement process	ESG Ratings,		over time	allows us to monitor progress	outcomes in a database which	capture this information and	objectives at the start, we	We determine engagement							also note progress over time.	our internal database where we	We keep track of engagements in	managers.	engagement with portfolio	discuss the progress of
sector representatives such as IPIECA; companies	supranational institutions such as the Arctic Council;	We try to address all "layers": government and	Globally we have partially outsourced engagement activities, Domestically we do the engagement	initiative. F.eks reporting to CDP, if relevant.	change, strategies, actions.   Request for participating and reporting on relevant	Requirements regarding reporting on climate	than pooled account.	possible for clients that hold a segregated rather	term investment objectives. This is really only	and are concerned about financial impacts to long	divest where they do not see meaningful progress	make on climate risks and over time could choose to	Some clients may monitor progress O&G companies	about carbon reduction targets and strategies.	many will be in oil&gas and utilities industries)	engaging with carbon intensive companies (of which	In order to meet this target, we will be actively	25% to address climate change in our investments.	of the equity portfolio between 2015-2020 with	One of the targets is to reduce the carbon footprint	2015 including concrete targets for its investments.	Our biggest client has launched a new RI policy in			

	etc. + Through public statements	shareholder resolutions		themselves; consumers of the oil and other investors. Only by addr chain we can change we system.
25		All of them are important	We expect the managers of our mandated funds to report to us regularly on what impact they can see such engagement having. It can be a very slow process and we believe that it is the united voice of the fund management industry as a whole speaking on behalf of its customers that will slowly make a difference.	We believe that eng companies that hav investment risks tha Disinvesting remove and we would only o simply no progress t company showed no concerns of its share
26		Informal meeting with management/board	Milestones	We support the Ain
27	Sometimes we will use press commentary on engagement and shareholder resolutions and speak at AGMs	Informal meeting with management/board	We meet up with approximately 400 companies a year and set engagement targets with each. Climate change is a key theme on which we engage	The Taskforce on ( Disclosures, which should improve th corporate and inve related risks and p

28	Collaborative	Voting at AGMs,	Informally, in terms of their	We are fixed income specialists with minimal eq
	investor/multi	Initiating	public positioning and reporting,	exposure. Engagement with corporate issuers or
	stakeholder	shareholder	in update meetings etc.	ESG issues like climate change in energy sector i:
	initiatives	resolutions,		less extensive/advance vs equity investing. Bonc
		Informal meeting		holders are not owners of the company so we
		with		cannot vote at AGMs, but we do still have some
		management/board,		influence over time as they need to come to the
		Emails and/or		public debt market to raise debt.
		letters to the		
		company,		
		Collaborative		
		investor/multi		
		stakeholder		
		initiatives		

# Appendix C Interviews

## Pelle Pedersen, PKA – December 2, 2016

### 1 [meeting in person, so we sit down]

- Pelle: Ja, jeg har den her, din lange liste [af spørgsmål]. Men altså, bare fyr løs og bed mig om at
  holde min kæft når jeg skal holde min kæft. Jeg kan snakke om det her rigtig lang tid, og snakke
  uden om det rigtig lang tid også
- 5 6

2

Sofia: Jep, men jeg tænkte måske sådan mere at starte med hvad i laver inden for engagement og
hvad motivationen er, og hvor meget i er involveret i det som Hermes laver

9 10 Pelle: Ja. Altså, vi har jo været hos dem siden 07, så vi er jo en af de tidlige klienter, hvad var der 11 tilbage der, jeg tror kun der var 10, hvilket gjorde at de virkelig kunne være fleksible i forhold til 12 vores ønkser, hvis der var et eller andet selskab, der i en dansk kontekst var vigtig, så kunne de 13 hurtigt finde på et eller andet. Og nu har de jo nogen og 40 klienter eller sådan noget, så nu, selv 14 om de kender os rigtig godt, så er det jo klart at vi kan ikke bare få alt vi ønsker i dag. Men hvad kan 15 man sige, dengang, og jeg ser det jo stadig som social responsible investment, at lave screeninger 16 og engagement, det skal du ligesom have med. Og argumentationen har jo hele tiden været, vi tror 17 på det kan betale sig at have en dialog, som det jo så fancy lyder, ikke. Problemet er jo bare at det 18 er svært at sætte facit under og sige, og det kan jeg se i dag når jeg snakker med Hermes, så har jeg 19 meget sådan, og det har de faktisk været meget villige til at imødekomme, at jeg har sagt, "i jeres 20 kommunikation, kig nu på hvad var problemet, hvad har i gjort, og hvad var outcome". Det gør det 21 meget nemmere for jer selv at kommunikere og det er hele deres måde at gøre det på nu.

- 22
- 23 Sofia: Ja okay

24

25 Pelle: Så når de kommer ud og laver en blog eller de laver sådan nogle client alerts, fx VW eller 26 Vestas og Siemens med de her ting der nu har været, så kommer de: problemet, det var det, vi har 27 gjort det og det, outcome't var det. Men det er selvfølgelig klart at Hermes er jo ikke de eneste der 28 har haft dialog med VW eller med Vestas, så jeg har jo svært ved at sidde fuldstændig og sige det 29 var pga. PKA og pga. Hermes, så igen, der må vi bare sige at det er en del af et større spil, og vi tror 30 på at det faktisk betyder noget, på den ansvarlige side, at få dem til at indordne sig. Nu kan du se 31 de sager der har været den her uge med palmeolie, vi har faktisk som de eneste i Danmark, 32 ekskluderet palmeolieselskaber fordi de ikke rapporterer i forhold til de her RSPO. Men det er for 33 os på den ene side sådan en need to have factor, hvor at det er vigtigt for os at vi kan sige til 34 omverdenen at vi har taget den her dialog, og så tror vi faktisk også på at på den lange bane, uanset 35 om det er mig der siger det eller vores CEO der siger det, at det har en betydning på selskabernes 36 performance, har du styr på din supply chain, hvor er det du sourcer dine ting fra? Nogen, der 37 konsekvent stiller dem de her spørgsmål, for er der ikke det, så som du ved, så kan man hurtigt blive 38 comfortable med den måde man arbejder på. Vi må være med til at stille de spørgsmål, der er svære 39 at stille, men at back-trace det til at sige, det var fordi PKA eller det var fordi Pelle var med til det 40 møde, hvor han sagde det, det er derfor de har gjort det, det er ekstremt svært. Så der er lige som 41 to, igen, det ene er rent kommunikativt og ansvarligt at vi bør gøre det her, på den anden side, rent 42 performance-mæssigt at sikre at, jeg vil ikke sige går dydens smalle sti, men holder sig on track i 43 forhold til de politikker og de retningslinier de egentlig har.

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- 45 Sofia: Ja. Hvor stor en investor skal man egentlig være for at man har adgang?
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47 Pelle: Til Hermes?

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49 Sofia: Til selskaberne, altså fx Exxon. Hvor mange aktier skal man have for at kunne ringe deres chef 50 op og sige, hey, vi skal have et møde?

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52 Pelle: Mange. Jeg sagde det faktisk til det her oplæg jeg holdt, jeg var ude til Social business 53 company, der talte jeg med en fra Dell og sagde, "med vi med vores 0.00001%, nu er de så ikke 54 børsnoterede mere, men hvis de var, med vores andel, hvis vi så ringede til Louise og sagde 'skulle 55 vi ikke lige snakke om de problemer i har haft med jeres fabrikker?". Chancen for at hun har tid er 56 relativt lille. Selv hvis det var – det kommer også meget an på hvilken kontekst det er, hvis det fx er 57 Mærsk, selv om vi ikke ejer særlig meget af Mærsk, de ville nok stadig være villige til at tage en 58 samtale med PKA i dag fordi vi operere i en dansk kontekst, vi har en indflydelse i Danmark. Men 59 snakker du bare, syd for den tyske grænse, kommer vi alene med vores begrænsede ejerandel, det 60 tager de jo ikke, det gør de jo ikke, det er ekstremt svært. Og jeg tror man skal højere op, rent 61 volumen-mæssigt eller ejerandelsmæssigt end folk forventer før man faktisk har indflydelse, før 62 man faktisk får adgang til bestyrelseslokalet, ledelsen osv. Så jeg vil sige, vi ser eksempler på danske 63 pensionskasser, også der er meget mindre end os, der selv foretager engagement i en dansk 64 kontekst, og der tror jeg de kan gøre noget fordi at de længe har gjort det her, de kender 65 selskaberne, de har også en mere koncentreret portefølje end vi har, de har større ejerandele i de 66 her selskaber. Hvis de med fx DKK 100 milliarder opererer et hvilket som helst andet sted i Danmark, 67 de kommer ikke igennem. Så jeg tror man skal op, nu har vi FLC, vi har Ethix, vi har GES og vi har 68 Hermes, og jeg vil sige, kigger jeg på dem jeg kender, der har de andre end Hermes, de har ikke den 69 samme adgang. Hermes repræsenterer, hvad er det, 2300ish milliarder kr. Og da jeg var nede i 70 Bangladesh, hvilket jeg var meget overrasket over at se, Target, Wallmart, Marks and Spencer, der 71 repræsenterede vi jo mellem en og 1,5% af aktiekapitalen. Det betyder noget. Så jeg tror det er 72 rigtig svært at sætte to streger under og sige, du skal have X amount, men du må bare acceptere 73 alene i dag, medmindre du er the PGGMs, the APGs, eller den norske, CalPERS, CalSTRS, alle de her

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75 Sofia: Men jeg synes det er svært, fordi alle siger, at du skal engage i stedet for at diveste, men hvis 76 du sidder med en ejerandel på 0,0001%, så er det jo begrænset hvor meget du kan engage. Altså, 77 så er det jo bare kommunikation.

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79 Pelle: Helt enig. Og det er jo derfor at hvis du ikke gør brug af engagement via sådan en partner som 80 Hermes, der er jeg overbevist om at du ikke får særlig mange ændringer igennem. Så det kan godt 81 være du siger det er en del af din politik, og du vil forsøge, og det synes jeg er nobelt at forsøge 82 stadig, selv om man ikke har så meget at skulle have sagt, men kigger du igen, der kunne du så godt 83 sætte noget facit under, mener jeg, og sige det kommer ikke til at ske. Det er i hvert fald min 84 holdning til det. Så det er simpelthen bare anderkendelsen af at vi er ikke store nok selv. Det er vi 85 simpelthen bare ikke. Og dem der tror de er det uden at være det kommer bare ikke langt. Så de

86 eneste der for eksempel kan gøre det, jamen det er PGGM og APG, men selv de overvejer at leverage 87 deres indflydelse, fx at lave nogle separate engagements fx på klima eller et eller andet, hvis man 88 kan have noget shared mindset omkring det her, så giver det mening. Men derudover, der er det 89 simpelthen umuligt og du kan se, vi har også nogle asset managers, som siger at de er active 90 managers og på ESG-siden, og så forvalter de for 2,5 milliarder [kr.] og selv forsøger det her. Det er 91 umuligt. Jeg ville ikke smide mine egne penge i deres engagement strategi. Så kan vi se, der er nogle 92 af dem der har prøvet at koble sig lidt på Hermes nogle gange, og det er super fornuftigt, men det 93 er også en anderkendelse af at det er 2,5 milliarder. De kan slet ikke, når vi ikke kan med 250 94 [milliarder].

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Sofia: Ja, det giver meget god mening. Så tænkte jeg også på, i forhold til, nu har jeg kigget lidt på
olie/gas-sektoren, og som jeg forstår den, så er de nationale olie/gas-selskaber, det var
overraskende svært at finde tal på, men nationale olieselskaber, de står for sådan 75% af reserverne,
og Exxon, som er sådan den helt store har 2%. Kommer det til at gøre en forskel at engage med
Exxon. Giver det overhovedet mening at engage på supply side i stedet for bare at engage voldsomt
på VW og sige "i skal bare lave elektriske biler"?

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103 Pelle: Jamen for vores udgangspunkt, at engage på supply side handler ikke så meget om, hvad kan 104 man sige, vi tager det jo fra et risikoperspektiv, så sige, jamen vi ser hvordan verden forandrer sig, 105 vi ser der kommer flere elektriske biler, vi ser at renewables slår nye highs hvert år. Det er et scenario 106 vi bliver nødt til at accepterer, uanset om du tror på ansvarlighed eller ikke tror på ansvarlighed, det 107 er sådan verden ser ud nu. Og derfor mener vi det stadig er ekstremt relevant at stille de her 108 spørgsmål til de her selskaber. Exxon, har i overhovedet overvejet hvordan i performer i en 109 anderledes verden? Fordi vi kan se at de er ekstremt rigide og ekstremt langsomme med at ændre 110 deres perception af hvordan verden egentlig ser ud og hvordan verden vil forandre sig, hvilket er 111 paradoksalt når man tænker på at Exxon og Chevron jo kommer ud af en energitransformation med 112 Standard oil, du går fra hesten til benzin, og med Ford, der kom og lavede bilen, det var deres 113 business, så de var jo ved at blive fuldstændig smadrede fordi de lavede jo petroleum til 114 petroleumslamper. Så kommer Tesla og opfinder vekselstrømmen, det tror jeg det hedder, så 115 bruger du elektricitet i stedet for petroleum. Hvad er business casen? Jamen benzin er så et 116 restprodukt af det, så kommer Ford med bilen, boom, der er en kæmpe business case der, så deres 117 vækst blev skabt ud af en energitransformation. Og trods alt det, så er de i dag ikke klar til at 118 embrace en ny transformation. Så for os handler det kun om risiko. Er i klar over det her? Så kan det 119 godt være, hvis man kigger på klimaforandringerne som helhed, at det måske ikke har den store 120 effekt, men ultimativt, så er vores ansvar jo i forhold til vores medlemmer at sikre det bedst mulige 121 afkast. Men det er helt klart, den store påvirkning, nu er Dong så godt nok blevet børsnoteret, men 122 det er de her selskaber man skal sætte ind. Vi har bare ikke noget indflydelse. Og specielt hvis vi 123 kigger på nogle af de asiatiske aktører. Det er jo lukket land.

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- Sofia: Men nu har jeg jo kigget på jeres aktieliste. Og i har shares i sådan noget Gazprom fx
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127 Pelle: Jaja, og Lukoil

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129 Sofia: Ja. De er jo statskontrollerede.

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- 131 Pelle: Ja
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133 Sofia: Hvordan har man indflydelse på dem, når den russiske stat har +50%?

134 135 Pelle: You don't. Det har du i ikke særlig høj grad. Jeg kan jo også se at de opdateringer jeg får fra 136 Hermes, når vi snakker med de her selskaber, det er jo ikke sådan, du bliver ikke mødt med åbne 137 arme. Det gør man bare ikke. Men det er jo også derfor, vi må sige, fint nok, de tror supermeget på 138 gas. Og det kan godt være at gas er et middel til at force den her transformation. Men her må vi 139 bare sige, at når vi kigger på verden og ser hvad det er der sker pt. Når løsningen er der på 140 transportsektoren, som står for 55% af olien, og det kan godt være at gas bliver brugt i produktion 141 af elektricitet. Jamen når alternativet er her, så er det her, så alle tror at det her det kommer til at 142 tage lang tid indtil det faktisk sker. Det er jo det disruption det er. At man tror det går meget 143 langsomt indtil man finder ud af at det går meget hurtigt. Det er klart, at jeg skal ikke sidde her og 144 være super naiv, og det sker ikke i morgen, men der må vi bare kigge på de her selskaber fra et 145 risikoperspektiv og sige hvordan passer de ind, tror vi i et scenarie, ikke fordi det skal være to grader, 146 man kunne faktisk helt lade være med at snakke om de her 2-graders scenarier, fordi om det er to 147 grader eller fire grader vi ender ude i, det ændrer ikke vores syn på verden at vi går mod en 148 transformation, så kan det godt være at vi ender på fire grader fordi det spinder ud af kontrol, men 149 det tror vi ikke har så meget at gøre med om der kommer flere elbiler på gaden eller man bygger 150 sol off grid i Bangladesh i stedet for at bygge kæmpe kulkraftværker som har en tilbagebetalingstid 151 på 30 år eller hvor meget det nu er. Så det er selvfølgelig risikoperspektivet, det er også derfor vi er 152 i det projekt med Carbon Tracker at vi vil sige, eller vores udgangspunkt vil være, så har du en række 153 selskaber, der er nogle selskaber, hvor vi kan se at der er rigtig meget risiko når du kigger på deres 154 forretningsstrategi og interne mindset, har de stress-tested deres portefølje, hvad er det for nogle 155 reserver de ligger inde med, hvad er deres gennemsnit break-even-pris i deres operations. Så vil vi 156 nok tage en dialog med dem for at finde ud af, specielt de amerikanske, hvordan håndterer i det 157 her. Gør de ikke det, så ryger de ud, selv om det er Exxon, selv om det er Conoco, Chevron er så ude 158 i forvejen. Og så vil der være et segment hvor vi siger, det er nok the BPs, det er nok Totals, Shell, 159 osv., de har gjort noget, de har ført de her resolutioner igennem, stadig sådan yet to see hvad det 160 konkret betyder med de her resolutioner. Det er jo meget fint og masser af support osv.

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162 Sofia: Jeg synes også det virker, nu er jeg ikke nået så langt med de her resolutioner men...

Pelle: Der har jeg noget jeg kan sende. Der er lidt os, men også de her der hedder Shareaction, de
laver nogle papirer, hvor de angriber hvordan Shell, BP, osv. Har reageret på de her resolutioner.
Har de faktisk stress-tested, har de faktisk oplyst investorerne om det de bad om?

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Sofia: Ja, for jeg synes det er svært, for med Exxon er det sindssygt nemt at finde ud af hvad der erblevet stemt om, BP, ikke så nemt.

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171 Pelle: Er det ikke det?

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Sofia: De har en liste, men de har kun en liste over de forslag de slev lægger frem. Og jeg ved jo, at der har været shareholder resolutions hos BP, så det. Men jeg kan ikke finde dem. Kun nyhedsartikler om at det gik igennem. Men jeg synes primært de går på rapportering. Det er selvfølgelig også det man skal bruge for at beregne risiko, men stadig, det er meget mererapportering end det er

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179 Pelle: Stress-tests

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181 Sofia: Ja, og strategi.

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183 Pelle: Men ja, jeg tror bare lidt, de troede at de var home safe, fordi de støttede de her forslag og 184 så gik det igennem osv. Det er de bare ikke. Jeg forestiller mig en proces igen hvor vi har en dialog 185 med de her selskaber. Har de en tilfredsstillende plan for hvordan de vil tage del i den her 186 transformation, eller er de bare ude på at italesætte det. Ikke totalt sådan "i er totalt ødelagte i 187 morgen, jeres business case er væk", men hvorfor har du ikke lyst til, du skal sidde og kigge på sådan 188 et kæmpe forretningspotentiale, hvorfor har de ikke lyst til at være en del af det? Kan vi se at de 189 tilfredsstillende kan svare på de her spørgsmål, jamen så tror vi på at vi kan investere i, altså 190 fortsætte med at investere i dem. Og så vil der være nogle selskaber, der ligger med en break-even 191 pris på 40 dollars, er meget omstillingsparate, har ikke alle mulige, som Exxon, rafinaderier, som de 192 skal ende med at nedskrive, de kan stadig godt ende med at operere tror jeg.

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194 Sofia: Ja, hvorfor investerer olieselskaber i nye explorations med en break-even-pris på 90 dollars?

196 Pelle: Don't ask me. Jeg ved det simpelthen ikke, for det gør de stadig. Men det er fordi, de har jo 197 sådan en perception, du kan jo se hvad Exxons CEO sagde så sent som for et år siden, han sagde at 198 væksten har været drevet af fossile brændstoffer de sidste 100 år og vil også blive drevet af fossile 199 brændstoffer de næste 100 år. Nej det var Chevrons der sagde det, og Exxons sagde, da han blev 200 spurgt om hvorfor de ikke investerer i renewables, "we choose not to lose money on purpose". Hvis 201 det er det mindset du opererer din virksomhed med, og du tænker, det skift der har været i 202 olieprisen, det handler ikke om at der sker noget ude i verden, det er ikke en transformation, et 203 generelt skift, det er bare cyklisk olieprisen går jo op og ned osv osv.

- 205 Sofia: Jo men har olieprisen nogensinde været over 90 dollars 20 år i træk?
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207 Pelle: Nej

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209 Sofia: Fordi det er jo 20-årsproekter.

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Pelle: Men det er jo fordi de laver bare et projekt, der kommer befolkningstilvækst, vi tror på at olien stadig vil fylde præcis det samme fremadrettet, det kan du se på EIA stadig, når de kigger på hvad de tror fossile brændstoffer vil fylde. Men selv når du kigger på hvordan de ser hvad der vil fylde i fremtiden. Det svære er at de er jo bare benchmarket. Det er jo deres scenarier du bruger i alle henseende, når du snakker to-graders scenarier, er det jo deres scenarier du snakker. Og de undervurderer bare altid renewables. Altså jeg synes det er ginagtigt at folk stadig vil bruge den her kilde og vi bliver også nødt til at gøre det for der er ikke noget alternativ.

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219 Sofia: Ja, for det jeg har hørt er at de lægger meget vægt på Carbon Storage.

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- 221 Pelle: Ja, og det er totalt dumt.
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- 223 Sofia: BP er gået væk fra at researche i det, for de kan ikke finde ud af det.

225 Pelle: Ja. Det er helt blæst med carbon storage, regeringerne vil ikke betale for det, det er pissedyrt, 226 specielt ovre i UK har der været rigtig meget omkring det her. De vil ikke betale for det, det er 227 pissedyrt, teknologien er ikke klar til det og man vil stadig bet på det her. Igen i stedet for bare at 228 sige, jamen er der noget alternativ? I stedet for bare at have et mindset, hvor du siger, jamen vi 229 bliver ved med at udvide vores forretninger, så laver vi bare carbon storage. Retningen er bare en 230 helt anden, altså.

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232 Sofia: Jeg forstår det ikke. Især når, i Shells rapportering skriver de rigtig meget om carbon storage, 233 og hvis man prøver at grave lidt i det, så er det jo sådan 0.01% af det de udelader.

235 Pelle: Jamen, det er helt tosset. Så jeg er overbevist om, at alle de her projections, og selvfølgelig vil 236 de aldrig være 100% spot-on, men de er virkelig virkelig, altså de er virkelig afvigende i forhold til 237 virkeligheden. Det sjoveste er jo at se tilbage fra 04 eller 02 og så bare se hvordan de har taget fejl 238 hele vejen igennem, og så reviderer de en lille smule op, og så kommer actual kurven, de er totalt 239 bagud hele tiden. Så det er jo lidt mærkeligt at Pelle fra PKA med en juridisk baggrund der ved lidt 240 om det her, who am I to say at de er galt på den. Historien viser bare at de er galt på den. Og når 241 the notion omkring stranded assets bliver accepteret generelt, og det er den ved at blive i den grad. 242 Jeg tror der kommer til at ske et abnormt kapitalflygt fra de her selskaber. Fordi igen, du må bare 243 stille dig selv spørgsmålet, har du lyst til at tage risikoen. Du ved det her kommer til at ske, du ved 244 at uanset hvad, så kommer de her selskaber med deres nuværende måde, selv om det er BP og 245 Shell, vil de altid være unsustainable fordi de er afhængige af et produkt der ikke er, det er ikke 246 uudtømmeligt. Så det ved du. Og så må du bare sige at det, sker transformationen så hurtigt at du 247 har lyst til at sige, jamen vi tror stadig på sådan the value proposition, BP kommer med når de siger, 248 vi satser på at hive olie op de næste 50 år og vi investerer i projekter, som har en løbetid på 50, 60, 249 80 år, et eller andet. Tænker de ligesom, jeg kan ikke huske hvem der snakkede om 2050, hvem var 250 det der snakkede om det, jeg tror en inde fra oliesektoren også, hvor de også havde lavet et 251 projection på 2050, tror du virkelig med alt det der sker nu, at du er i stand til at lave projections 252 der ligger inden for en margin på 20% af hvordan tingene faktisk kommer til at forholde sig. 253 Selvfølgelig kan du ikke det. Men det sidder de faktisk og tror. Så det er noget af en udfordring. Og 254 det der med at sige, for vi ved heller ikke lige som hvor kagen skal skæres, vi ved heller ikke om det 255 kommer til at være 15% sol, 20% sol eller 2% sol, jeg vil bare ikke. Kul er et godt eksempel, skal 256 sygeplejerskerne investere i kul, altså kommer der en 25-årig sygeplejerske, giver det mening for 257 hende over hendes levetid på 50 år er hun nok på arbejdsmarkedet, lad os sige det, at være investor 258 i kul? Selvfølgelig gør det ikke det, og på et eller andet tidspunkt kommer det til at være det samme 259 der kommer til at ske for olie-gas-sektoren. Spørgsmålet er bare hvornår, og det ved vi ikke, og 260 derfor laver vi ikke projections på hvornår det kommer til at ske, vi vil bare gerne positionere os i 261 forhold til engagement, vedvarende energiinvesteringer, måske noget divestment, sådan så vi 262 faktisk er klar til det scenarie. Ikke fordi vi kommer til at gøre det perfekt.

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- 264 Sofia: Prøver i at engage på at de skal rykke sig over mod renewables?
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266 Pelle: Ja, big time. Lige som med BP har lavet, og Total er jo faktisk en af de største udviklere af 267 solcelleprojekter, det går bare ikke særlig godt. Fordi det Kina jo gør er at marginerne på solprojekter 268 er jo bare fuldstændig smadret. Fordi kineserne altid gør det med deres 5-årsplaner, så kører de jo 269 bare derudaf og kommer med et kæmpe over-supply, som bare driver priserne fuldstændig ned så 270 du får sådan et boom and bust, så nu kan alle de her solcelleselskaber, de kan ikke tjene penge jo 271 fordi prisen er blevet drevet så meget ned og alle underbyder hinanden og så kommer der det her 272 bust, som er det der sker nu, hvor der er nogle der går konkurs, og så begynder man at finde ud af 273 hvem det er der overlever det her, og så kommer business casen igen. Men Kina gør det altid, de 274 gjorde det på vind og de gør det også på sol nu her, ikke. Altid. De rykker derudaf. Det er jo godt for 275 prisen. Men for business casen er det ikke særlig godt. Men det er helt klart at det er noget, som 276 Hermes har fokus på, at, og som jeg har fortalt dem, at de skal have fokus på, men vi må stadig sige 277 at de beløb de investerer, der var nogle der lavede et JV for et par måneder siden, hvor de lavede 278 en energy division renewable ting, men det var sådan noget 20 eller 25 millioner pund, eller sådan 279 noget, der var i det her, som skulle investeres i projekter, så det er jo stadig ekstremt begrænset. 280 Og så tror jeg, at problemet er, at de her mennesker, de ved jo ikke særlig meget om renewables. 281 Vi har set tidligere, det er faktisk paradoksalt, på kulsektoren, at kulselskaber, der har prøvet at 282 diversificere sig ind i andre områder har faktisk endt med at destroy shareholder value, fordi de 283 vidste kun noget om at hive kul op, de vidste ikke noget om metaller, de vidste ikke noget om alt 284 muligt andet. Og så prøver de at lave de her JVs, hvilket er fint, men hvis du ikke giver dem den 285 funding, der er nødvendig for virkelig at rykke på det her, og så tror jeg også ærligt, fx her med Total, 286 de her purchase, de her solcelleselskaber osv, de tror jeg også lidt er et politisk instrument. Der er 287 jo meget run på det er i Frankrig pt. Så det er helt klart en del af det, hvordan diversificerer de deres 288 portefølje, men faktisk ikke engang kun på olie/gas, også på mineselskaber. Det er hele tiden at tale 289 til strategien og mulighederne, i stedet for at sige, vi skal redde verden for det her går ikke.

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Sofia: Hvordan, nu når man taler om Shell, BP og Exxon, det er selskaber alle kender og der er også
en form for reputational risk. Men det er der mange selskaber der ikke rigtig har. Altså hvis du er et
eller andet ukendt olie/gas-selskab. Er det sværere at få dem til at ændre sig?

Pelle: Selvfølgelig. Det er meget sværere. Specielt osgå fordi at de større institutionelle investorer har jo samlet set en større ejerandel i de store, som BP, Shell osv frem for et eller andet lille amerikansk pure-play upstream-selskab. Selv når vi snakker Conoco og Anadarko og hvad de nu hedder, som er meget mindre. Indflydelsen kommer ikke til at være lige så stor som den er på de her store selskaber. Total er jo Frankrigs Mærsk. Og det er jo klart, at vi har også nogle nationalfølelser omkring Mærsk hvis de var nogle banditter, så ville vi jo også have et problem med det.

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303 Sofia: Ja, og Shell er den evige skurk

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Pelle: Ja, præcis. Selv når de har et samarbejde med Lego. Men igen, vores udgangspunkt, og det
tror jeg er vigtigt lige at vende tilbage til, det er bare risiko. Så uanset om du er et lille selskab og du
indgår i vores portefølje fordi, jeg vil ikke sige jeg er i en utaknemmelig position men den strategi vi
har er meget alternativ i forhold til de andre investorer, så vi kan sagtens have kun 80 millioner [kr]
i Shell, men også 80 millioner i Conoco eller Occidental, det kan vi sagtens have selv om de selskaber
er meget mindre forrdi vores strategi bare er meget alternativ. Hvor jeg tror du ville typisk se inden

for de andre, jamen så har de Exxon, BP, Total osv de har en større eksponering, sådan fungerer verden bare. Og det gør bare at jeg også bliver nødt til at tage højde for de her selskaber. Og det er også derfor vi i vores projekt har valgt at sige, vi kunne godt bare vælge at tage de 15 største integrerede olie/gas-selskaber, så ville alle kende dem her. Men der er altså bare et undersegment, som er ekstremt relevant og stadig ekstremt værdifuldt. Fylder stadig meget af benchmarket. De bør altså også være med.

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Sofia: Men man skal heller ikke så langt ned. Nu kigger jeg, jeg kigger på de største 15 med
diversificeret ejerskab, fordi jeg synes det er irrelevant at kigge på Gazprom fx, men der kommer
rigtig mange af dem med, der kommer Antero og Anadarko, de ligger i top 15.

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322 Pelle: Men det er det. Og jeg tror vores, eller mit udgangspunkt, altså min anbefaling, så kommer 323 PKA til at være, når vi laver den her øvelse på olie/gas nu her. Så bliver vi simpelthen nødt til at kigge 324 på, hvad er så step 3. Nu har vi kørt kul, olie/gas, og hvad er så step 3. Er det at kigge på hele 325 undersegmentet inden fro olie/gas-sektoren, fordi der er jo sådan en kæmpe industri, som vi ikke 326 rigtig tænker så meget over. Og der tror jeg vi kunne begynde at fokusere. Vi kunne også begynde 327 at fokusere på alternative sektorer, begynde at være lidt mere aktive, det kunne for eksempel være 328 aviation. Jamen, hvad gør de her selskaber. Ren business strategi, men også på prisen på carbon. 329 Hvad betyder det at der kommer et market stability reserve i '18 begynder at kick'e ind. Der bliver 330 fjernet 12% af de her allowances [EU Emissions Trading Scheme] fremadrettet. Der hvor den ligger 331 nu på lige under 6 EUR/ton, jamen der kommer den ikke til at ligge. Hvad gør SAS vs Norwegian, hvis 332 SAS' flåde er virkelig gammel og du ved de udleder 1,5 gang så meget CO2 som Norwegian, det gør 333 de ikke, men hvis de gjorde. Det bonger ud fra day 1 jo. Altså prisen har jo været 35 EUR/ton, det 334 kan den sagtens ende op med at være igen. Det pudsige er at CO2-markedet er det eneste marked 335 i verden, hvor du ved, altså det er bygget på at der over tid skal være et mindre udbud. Det ved du 336 bare. Og du ved at der er nogle mekanismer, som gør at prisen bliver tvunget, jeg vil ikke sige 337 kunstigt op, men bliver tvunget op. Og den eneste grund til at det her ikke kan ske er hvis landene, 338 og det tror jeg ikke på med det der sker i EU, alle sammen bliver enige om at gå ind og ændre 339 konventionen og gå ind og ændre det her regelsæt bagved. Og det tror jeg ikke de gør. Der skal nok 340 være en eller anden der er uenig i det her, om det så er Danmark, Frankrig 100% ville være uenig i 341 det her, så du ved det her kommer til at ske inden for en årrække der hedder frem mod 2020, og vi 342 har alle sammen 2020-strategier og i 2020 kan prisen easy ligge på 30 [EUR/ton]. Jeg tror den 343 kommer til at ligge mellem 16 og 30 EUR'ish. Det er sådan noget med fuel switch, det er faktisk en 344 super spændende diskussion omkring at gå ind og kigge på, hvad er marginalomkostningerne for 345 kul og gas, og jo mere renewables der kommer ind, jo mere presser det kulsektoren, jo mere presser 346 det gassektoren, faktisk superspændende, vi sidder faktisk og kigger på om vi kan lave nogle trades 347 baseret på det i CO2 markedet, det er faktisk ret spændende. Men det er ikke noget der sker i 348 morgen, men det sker altså inden for 3 år, og hvis du er en langsigtet investor, og det er det der er 349 et problem, i det hele finansielle marked, synes jeg, og det er også virkelig nemt for mig at sige, men 350 folk agerer bare ikke langsigtet. Jeg forstår det ikke, for du har mandatet for lovgivningen, du skal 351 gøre det her, men hvor langsigtet agerer du, jeg sad og snakkede med min CEO for et par timer 352 siden, hvor han sagde, han havde læst noget i the Economist, hvor han sagde at de havde et kæmpe 353 section om præcis alt det her, i den forrige udgave, hvor han sagde at når the Economist, som er 354 sådan et ret liberalt magasin begynder at kigge på det her og snakke om Stranded Assets, og siger 355 at det giver så meget mening for investorerne at kigge på det her, så er der altså ved at ske et skift,
som altså sker hurtigere end vi går og forventer. Og du kan se, bare før COP21 da vi gik ud af kul,
der var der jo nogle af vores kollegaer der sagde, det er foolish, det var dumt at gøre det, og syntes
nærmest vi var nogle idioter, fordi så skulle de jo selv stå til ansvar for deres strategier. Så det er
bare generelt, om det så er inden for olie/gas-sektoren eller om det er inden for the financial
community, folk agerer altså ikke særlig langsigtet.

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Sofia: Nej, men jeg forstår ikke hvorfor de ikke gør det, eller jeg forstår det godt, men altså hvordan
ændrer man det?

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Pelle: Det er nogle store spørgsmål du kommer med. Det ærlige svar er at det ved jeg ikke, men det
kræver ekstremt meget lederskab.

Sofia: Men jeg synes, nu kigger jeg jo på de der mange olie/gas-selskaber, og jeg vil jo gerne se en
ændring, men den sker jo ikke i løbet af de sidste fem år. Altså der kommer måske et punkt, hvor så
skal alle ændre sig sindssygt meget. Men udover det, hvis du skal agere langsigtet, så kræver det
også at du har data på lang sigt.

372

Pelle: Men igen hvis de prøver at give data, som måske passer med det som the International Energy
Association siger, "jamen i 2050, det er kun 5% mindre supply, der kommer der. Ingen problemer.
Det kan vi sagtens forholde os til". Hvis det ligesom er det du benchmarker dig imod, selvfølgelig
laver du investeringer hvor du tænker at 90 dollars, det skal vi nok komme op på igen. Så det er jo
hele det der mindset og den ramme hele branchen opererer inden under. Og jeg forstår det ikke.
Jeg forstår ikke hvordan du kan sidde og overse hvad det er der sker rundt omkring i verden.

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Sofia: Men jeg kan så heller ikke helt forstå at, altså nogle af de jeg nåede igennem, da jeg stadig
selv læste alle sustainability-rapporterne, inden jeg begyndte bare at finde Bloomberg data, at *"jamen vi opererer selv med en intern carbon tax på 40 dollars", så i går ind i projekter med en*break-even pris på 90 + 40 dollars, så i skal have en break-even pris på 130?! Really?! Altså, det giver
jo ikke nogen mening.

386 Pelle: Nej. Og det gør de. Problemet er jo at prisen er så kunstigt presset ned nu på. Det er faktisk 387 en megaspændende diskussion nu om det her CO2 marked, hvorfor den er så kunstigt lav, for når 388 den er så kunstigt lav som den er nu, så går man ud og tænker, jamen så kan du gå ud og afdække 389 dig lang tid frem. Så er du good, altså. Og når du ligger på de på bøgerne her, når du så får, om det 390 er olie/gas-selskaber eller industriselskaber, du får kæmpe surplus på dine allowances fordi 391 systemet blev lavet før 07, før krisen. Så ligger du bare og har dem på bøgerne, dem holder du jo 392 bare. Så har du bare kæmpe allowance, som ligger på bøgerne, som du ikke bruger. Så stiger de i 393 pris tjener du penge, og du skal ikke gå ud og købe nye, for så kan du bare bruge dem på det ekstra 394 du udleder. Så hvad er dit incentive til at, når du ser dine udledninger så at gå over i noget nyt osv. 395 osv. Jeg forstår det ikke, er der en dag. Altså hvis ikke du forstår forretningsmulighederne, hvis du 396 ikke forstår solbranchen, at folk siger, jamen der er ikke penge at tjene. Og det er der ikke, netop 397 fordi Kina bare går amok og bare køre, som de jo er rigtig gode til at få omkostningerne ned, kæmpe 398 produktion, så prisen du tjener pr solcelle-unit er bare ingenting. Hvad skal man så gøre. Man kan 399 bare se på vind nu også med den her, var det Krias [?], den nye vindmøllepark, som Vattenfall bød 400 på, hvad var det den lå på, de snakkede om 35 øre/kWh de producerer. Vi får over 1 kr. for Anholt.

401 Den lavede vi i '11. Den tidligere rekord blev sat af Dong i Holland tidligere på året i juli på 0,70
402 kr/kWh. På under 4-5 måneder bliver der givet et bud, der ligger på halvdelen af det. Så hurtigt går
403 det. Og de laver stadig et afkast på 3-4%, Vattenfall. Fixed over de næste 15 år.

Sofia: Så er det så noget helt andet, men i forhold til den der private information. Når man engager,
og virkelig engagerer sig i deres strategi, så ender man vel med noget information, som gør en til en
insider?

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409 Pelle: Nej. Fordi vi beder altid om ikke at blive gjort til insidere. Så selv hvis Hermes er insidere, det 410 er meget sjældent, vi har nemlig snakket om det her, du vil typisk ikke få noget information som, 411 det er sådan insiderinformation er defineret, at hvis det blev kendt til offentligheden, så ville det 412 være kurspåvirkende. Og fordi vi har en bedre forståelse af fx BP's investeringsplan vil som sådan 413 ikke påvirke kursen. Vi har bare en bedre forståelse for hvordan vi ser på BP givet den information 414 vi får. Så jeg vil ikke, det er meget sjældent Hermes bliver insidere, og de vil helst ikke være det. Og 415 vi har aldrig oplevet at være insidere. Ikke mens jeg har været her i hvert fald, og grunden til at de 416 foretrækker det er, at de har over 40 klienter. Skal vi så alle sammen være insidere?! Det bliver 417 noget rod.

- 418
- 419 Sofia: Ja, for så er det lidt svært at agere, hvis man er utilfreds.
- 420

Pelle: Ja præcis. Og man må bare sige at jo større din andel er, jo mere access har du. Og det der
med at så siger du, altså alle har ikke adgang til den samme information. Det har de bare ikke. Og
that's just the name of the game. Men det gør os ikke til insidere som sådan. Men det er da klart at
sådan rent, jeg vil ikke sige etisk, men det er da klart at hvis vi har mere information end alle andre,
så kan vi basere vores beslutninger mere sagligt end andre kan. Det er jo kun godt for os.

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- 427 Sofia: Men det er jo også hvem der har ressourcerne til at lave mere research.
- 429 Pelle: Ja, netop, for det er jo hvem der har penge har flere muligheder, og dem der har ressourcer...
- 430
  431 Sofia: I forhold til om der er noget spill-over, altså hvis i engager med Shell, og de pludselig bliver
  432 sådan "okay, vi bliver nødt til at gøre noget ved det her, vi bliver nødt til at investere i renewables".
  433 Ser man så en effekt på andre olieselskaber eller er de ligeglade?
- Pelle: Det ser du i den grad; i en europæisk kontekst. Fordi det er sådan lidt, det er jo blevet lidt
  moderne at fokusere på de her ting. Problemet er bare at den spill-over effekt. Specielt med de her
  klimaresolutioner, så har det mere været en kamp om at se god ud meget hurtigt op til COP21, alle
  de her ting, frem for konkret action. Og jeg håber så at step 2 bliver at spill-over effekten bliver at
  de faktisk tager det her mere alvorligt. Men du ser helt klart blandt BP, Total, Shell
- 440

441 Sofia: Repsol måske?

442

Pelle: Ja præcis, ENI, RVE i Tyskland, som jo drev rigtig mange kulminer, er også begyndt at sælge
ud af det. Det er sådan en hel politisk diskussion som er med til at præge det her og præge
selskaberne i stor grad. Men problemet er, at hvis udgangspunktet er at diskussionen handler mere

446 om se godt ud og vise noget action, selv om der ikke er så meget bag ved det, og du kan se du kan 447 slippe afsted med det, og du ikke bliver kaldt på dit bullshit, så er det bare business as usual.

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449 Sofia: Jamen, der er bare så meget bullshit. Det er jo svært at kalde det hele.

451 Pelle: Ja, selv for os. Apropos de der rapporter, det er jo derfor at når fx ShareAction sender mig 452 rapporter om deres syn på det ene og det andet. Så kan jeg læse 7-8 sider i stedet for at skulle læse 453 100 sider fra Shell. Min ambition med det projekt om olie/gas-selskaberne er at gå til fx BP og sige, 454 fint nok at i har fået en masse støtte fra investorerne og i rapporterer i nogen grad. Denne her 455 rapport siger, den nuværende strategi i har, den nuværende måde i investerer. Den siger at i har 456 20% af den nuværende markedsværdi at stake i 2030. Hvad gør i ved det? Så kan i sidde og 457 offentligøre nok så meget information, men det betyder jo ikke at i foretager jer noget konkret 458 action. Så jeg vil bruge det i første omgang som et engagement tool og prøve at løfte den her 459 rapport, selv om det stadig er assumptions, og løfte den lidt op og sige "nu kan i sidde her og lave 460 alle jeres egne projections osv." men igen stille dem spørgsmålet "tror i på den elektriske bil kommer 461 til at fylde mindre, tror i på at renewables kommer til at fylde mindre, eller bare det samme som i 462 dag?". Det tror de selvfølgelig ikke på, men okay, "hvorfor gør i så som i gør?". Når vi har fået den 463 rapport, kan jeg sagtens forestille mig at vi vil være mere aktive i dialogen med de her selskaber 464 sammen med Hermes, fordi der er selskaber, der er særligt interessante for os, igen noget politisk 465 og hvis de opererer i Danmark, hvor vi selv stiller spørgsmålene, men er der sammen med Hermes. 466 Men det er dem der er eksperterne, det er klart, og det bliver man slet ikke i tvivl om når man er på 467 engagement ture hvor man kan se, så sidder der en er kan sproget uanset om det er i Bangladesh 468 eller Sydkorea, og som kender kulturen. De er sindssygt gode til at worke rummet. Det er derfor vi 469 betaler en del penge, det er det de gør samt at opbygge relationerne. Men jeg kunne sagtens 470 forestille mig at vi kommer til at tage meget mere del i den her dialog med de her selskaber sammen 471 med Hermes. Selv stille de her spørgsmål. Så vi vil gerne udfordre dem på deres strategier, har de 472 et tilfredsstillende svar på hvordan de rent faktisk tager opportunities og mitigere risici. Det er det 473 der er så mærkeligt, alle taler om effektive markeder, og at det er inkluderet i prisen, men det er 474 bare bullshit, hold nu op. Hvis du ikke engang ved hvordan du kvantificerer klimarisikoen, hvordan 475 kan du så vide at den er indregnet? Divestment skal ikke være et politisk tool, du skal ikke diveste 476 for at diveste. Du skal diveste fordi du tror på at der er en ukompenseret risiko i de her selskaber, 477 at du ikke er comfortable med at tage risikoen, hvis du ikke forstår risikoen, det er i hvert fald vores 478 udgangspunkt. Så er der nogen der tager sådan en meget politisk tilgang til hvad divestment er. Men 479 med divestment policies, hvad er baggrunden for at de har divested? I de her pressemeddelelser, 480 der kommer ud, hvad er baggrunden? Det var kun PKA og en anden en der havde sagt financial risk. 481 Alle andre har sagt miljøet og det er det rigtige at gøre. Det er fint nok, men lovgivningen siger at vi 482 skal sikre det bedst mulige afkast, så det er derfor vi kigger på det.

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- 484 Sofia: Men jeg havde to der svarede på min survey, fordi de slet ikke havde olie/gas.

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- 486 Pelle: Det er egentlig meget progressivt. Carnegie har jo heller ikke olie/gas overhovedet.
- 487

488 [small talk]

489

490 Pelle: Pelle: Vi havde en stor passiv eksponering på mange af de her index. Og tidligere, så har 491 branchen bare lavet, du ved, index, det findes ikke. Det er bare et derivat, det findes ikke. Card 492 blanche. Og så har jeg sagt, selv om du har en ETS på 20 milliarder kroner på MSCI World, hvad er 493 den tidligere største, historisk? Det er Exxon, fordi den har haft den største markedsværdi. Så kan 494 det godt være du har en passiv eksponering, men det er jo stadig en direkte eksponering når Exxon 495 fylder 1,3% af det index, når der er 1400 selskaber, og kun et selskab fylder 1,3%, det er ret meget. 496 Så har fx Trucost sagt tidligere, fordi vi er nemlig gået fra at være mere aktive til at være mere 497 passive, så hvis jeg bare valgte at være en kommunikations-guy, så kunne jeg sige "prøv at se, vi har 498 reduceret vores CO2 med X amount siden '11", jamen det var fordi der kom en ny strategi som 499 gjorde at vi var mere passive. Så jeg lavede en screening både af vores aktive portefølje, 500 sammenlignet den med den tidligere portefølje, men lavede en screening også hvor jeg sagde "okay, 501 hvis vores fx 20 milliarder på MSCI World, hvad er min indirekte eksponering til Exxon?" Den er så 502 1,3% af 20 milliarder, og det samme for alle de andre. Hvad svarer den ejerandel til når vi snakker 503 på udledning af CO2. Fuldstændig det samme som tidligere. Men der er mange der bruger den slags 504 argumentation.

505

506 [saying goodbye]

## Sophie Rahm - Standard Life Investments – December 2, 2016

The recording of the first 15 minutes of the interview has not been saved properly, so the
 transcribing starts in the middle of a sentence:

- Sophie: Capital expenditure is going to be one percent so there is a, there is that discrepancy on what they say they do and what they do, again. So, maybe carbon capture and storage is part of the solution, I don't argue with that, but the oil majors will always say, before they can do anything further, they need support from the government, so it's a catch 22 in a way
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Sofia: yeah, because I find it strange how a lot of the criticism of renewables is that it's too expensive
and that it's being criticized that they need government support

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12 Sophie: Yeah, but you'd be surprised, I mean it has changed considerably over the past years. You 13 know it makes economic sense to generate electricity using solar and wind without much subsidies 14 by governments. Now, you, of course, you probably Germany and Denmark and maybe even 15 Sweden have heavily subsidized renewable energy generation, but now we come at a point where 16 it's actually economical to generate of these. That's why it's such a danger to the majors and that's 17 why we keep highlighting the fact that, you know if a megawatt hour of electricity from wind is 18 costing, at the moment, 40 dollars, why would you want to go deep water at, you know when the 19 cost curve is so much higher, it costs you 90 dollars to extract to start with, so you know, they need 20 to realize that.

21

Sofia: It's just that, these companies, how do you think, because they will probably have to get smaller, unless they diversify and go into renewables or something else completely, but do you see like, would investors start fleeing? It seems like everyone needs to keep growing just for growth's sake and if you don't grow then it's not good, but these companies can't keep growing, so at some point...

27

28 Sophie: And you're exactly right, I think, you know for a responsive investor, and if you speak to 29 investors outside the ESG community, a lot of them are still very growth focused. They want the 30 cash, they want to generate money for their clients and, you know it goes back to the time horizon 31 and the tragedy of the whatever horizon that Mark Carney and the Bank of England describe. We're 32 in for the long term. These are long-term issues, of course oil and gas companies will not become 33 obsolete in the next three years, but, on the longer term we need to ask ourselves about the point 34 of return, whereas these guys here that I work with, you know they look at quarterly earnings 35 reports. They want to see the dividends, they want to see cash flows, etc. etc. They ask about capex, 36 how capex is reduced, how operations are optimized and that kind of stuff, so it's very difficult for 37 us and it's a struggle that we have eternally to make them realise that, or make them anticipate the 38 risk. But in all honesty, it makes economic sense and it starts to make economic sense I think they 39 will get on to the point by themselves, you know. These guys work with money metrics and financials 40 so it's sad to say but it's what motivates them, and if they can see it, they will realise that perhaps 41 oil and gas is not as cash generative as it once was and the market is not properly pricing the risk 42 into these stocks. So that's why as an informed asset manager, perhaps they will do something else. Again, for me, it's taken way too long, but you know. 43

44

Sofia: Do you think, because when I looked at it, it looked like most of the oil reserves is state-owned
and it's national oil companies, and it just seems...

- 47 48 Sophie: Yeah, that's a big issue because, you know, there are two angles for this, but as investors, 49 what we're trying to do is increasingly looking at, so we're not only equity-focused. Equity focus, 50 you go and have chats with companies, etc., but we also have a bit of credit and we also have a bit 51 of sovereign debt, so if you do a bit of ESG stuff on sovereign debt and on country risk, you know, 52 what is the country doing on things like education level, for gini index, for living wage, all that kind 53 of stuff, then you can get a better sense of the motivation and what's driving the growth in those 54 countries and perhaps you can tackle some of the problems that way. But the oil and gas majors, 55 despite having a small share of the reserves, they're still in touch with these countries and, again, 56 Shell would say something like "we're really heavy on natural gas these days because the Indonesian 57 government has made it clear to us that gas is really the way they want to go, etc.", so it goes back 58 to, it goes way beyond the limits of environmental engagement, it goes back to corruption, bribery, 59 community engagement, all that kind of stuff, and honestly, if we look at the Paris agreement, and 60 countries have agreed to their national targets, perhaps things will change, but it is true that as 61 investors we're a lot more removed from that level, because we invest in companies. But these 62 companies have invested interest in governments and governments trust releasing more land for 63 them to explore so then you have companies going in and, Shell, BP, going into Nigeria or Brazil or 64 Mozambique and starting a conversation about, how you want us to help you with forest areas, so 65 the interface is quite tricky, but it is true that as investors we're quite removed, and a bit more 66 removed from countries and country risk.
- 67

69

68 Sofia: Okay. Do you engage with your bond holdings as well, or is it only equity?

Sophie: Yeah yeah, so at my former job, they did not engage with bonds because they could not
vote, but here, if you hold the bonds in a company, you're ultimately looking at the risk of that
company so why wouldn't you have ESG in the engagement with the bond issuer

- 73
  74 Sofia: Yeah, because it also seems that most of the people who replied to the survey say that the
  75 most efficient way of engaging is through meetings and letters, so the AGM, I mean it has an effect,
  76 but that's not where the change is happening anyway.
- 77

78 Sophie: No, that's true, but again, it really depends on the asset manager, we have "XX" and "XX" 79 who go out and say they screen out some stocks and we collect positive stocks so if you want to be 80 able to advertise that, then of course you an ESG layer to that, so yeah we, sometimes we hold 81 equity stocks and we have positions on that company's bonds, so it makes sense. Not always, but I 82 think credit is very much involved here as well. The difficulty sometimes, it is a bit technical, but the 83 difficulty is to map, sometimes it's really tricky to match bonds to equity because the ESG world is 84 still very much driven by equity so, you know, mapping of corporate issuers with certain bonds and 85 you have time line issues and you know, certain companies don't exist anymore, but they still owe 86 us money on the bond, so how do you reconcile that. So, it's tricky, but it can be done.

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88 Sofia: Yeah, okay.

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Sophie: So yeah, I would say both, even though the focus is still very much on equity, but creditdefinitely as well.

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Sofia: Do you see a spill-over effect? Like if you engage heavily in one of the large oil companies, do
the smaller ones start implementing the same kind of policies? Or is it like, you have to go through
every single company?

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97 Sophie: It's a very good question. I would say that, it's not black and white, so even though there 98 are sector issues, you recognize that each company operates under different conditions in different 99 countries, and of course, the large caps, or the oil majors, they will be so much better at IR, at 100 sustainability reports, at annual reports, at getting representation, etc. etc. But, if we do engage 101 with a smaller player, we still ask those questions, because there are some things, we consider best 102 practice. And people will recognize that there are challenges of perhaps operating a small, e.g. 103 exploration and production company of the, I don't know, the shore of Senegal, or something like 104 that, if you don't have the same challenges. It's a balancing act between what is reasonable to ask, 105 because a smaller organisation perhaps has less resources, but also we want to push for best 106 practice. So this is probably the same for emerging markets as well, which are perhaps less 107 developed and less mature in their thinking, and of course then they have the entire issue of 108 contractors and how you deal with contracting staff. You know, the majors, maybe they are better 109 at reporting on their operated JVs [joint ventures]. Some are very good at that, but what happens 110 to not-operated JVs like with Conoco and things, like, you know so there are lots of issues. I think 111 we often underestimate the amount of contractors that these guys, the majors and other oil and 112 gas players employ, and so some of these companies, again, some of these are human rights and 113 social movement issues, but whatever we do, we try and push for best-practice, keeping in mind 114 that conditions may differ. And that's the trouble, so it's not black and white, and there can be 115 differences in observations, and it is analyses and analyses, as you know can be subjective.

116

Sofia: Yeah, because I did a masters in Ecological Economics at Edinburgh University as well and I did my thesis on investor reporting on climate risk, and I found it so, partly frustrating, and also how hard all the ESG factors are to report on, because they're so hard to measure, with the whole, you have to disclose your carbon footprint, which might not make sense but it's something where you can get a number so everyone wants to do that...

122

123 Sophie: Yep, and you know, you're exactly right, one of my jobs early next year is to look at carbon 124 footprinting, there's a lot of pressure from NGOs and people like you, you know students, people in 125 the civil society, customers, clients, you know, we get a bit of heat from the EU on non-financial 126 reporting, it's so massive and so, what is a company doing to align its strategy to a 2degree world. I 127 think, honestly we're only scratching the surface, we don't realise how important it's become, but 128 it's a first step. We may be behind on some of our peers on that one, but we now need to think 129 about carbon footprinting and think about beyond carbon footprinting, about climate change and 130 what do they need from our portfolios. Can we craft change, or modify or optimize our portfolios 131 so that we can still have returns but we're climate aware at the same time. So, the first, and I'm sure 132 you know this, but what gets measure gets managed, so we're looking at carbon footprinting and 133 thinking about how we perhaps can include that in all our client communication. You know, usually

134 you'd get a quarterly results report from your client manager saying the performance, 1 yr, 3 yr, 5 135 yr, and the top holdings of your fund, etc., but perhaps we can have extensions including reports on 136 climate change or climate risk profile to your fund. And I think there might be an opportunity 137 because, again, it makes investment sense to look at these things and hopefully we can justify and 138 showcase better returns, and then also demonstrate to clients that we take this seriously, but I do 139 think it's a huge job for us, you know there's a lot of funds, that's a lot of funds. Like what do you 140 do about reporting, you have different teams who have to come together about this, clients and 141 marketing e.g., you don't have, it's not an easy thing to integrate into business as usual.

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Sofia: It's very interesting. But, do you think that the supply side of oil, like, do you match your engagement in the oil sector with engagement in other sectors which are dependent on oil, like the car industry or something?

147 Sophie: Probably not as thoroughly as you're thinking about it. We deal with this, very much sector-148 oriented, so it's not like we have a map, say a mind map of oil and gas companies and we sort of 149 know who the big clients are and where the production goes and ways of transit, etc. but that would 150 be really cool, actually, but I don't think anyone's done that. But it would be useful for us to have. 151 But we do, sort of, when we have a sector that sort of highlights where we think the most mature 152 risks are and climate change risk, you would see it highlighted of course high impact for the minors 153 of oil and gas but also for perhaps, on the top of my head, for industrials, consumer goods, 154 petrochemicals, chemistry, automobiles etc. etc., so you have some idea and you have to expand it, 155 so who has the mandate in oil and natural gas, and you have some competition as well, you know, 156 some of these guys in the automobile sector are in the same situation, you know, unless they come 157 up with hybrid models or start diversifying their own, you know at one point in time, no one will 158 drive petrol fuel cars, you know, they need to come up with a strategy about this, and it's very, and 159 especially in the auto sector, this is highly problematic, because as much as VW and others are very 160 good at making fuel engines, they don't have expertise on electric engines, and so it's like the 161 manufacturing companies that come in and manufacture the motors for the cars, this is very 162 disruptive for a basic car industry, so the potential for disruption is, I think in the auto sector, is even 163 greater because the business model in itself, their changability and their expertise is really at stake. 164 I don't think it's such a stretch for an oil and gas company for instance to move into solar or carbon 165 capture or whatever. I think their level of expertise allows that, but for an auto manufacturer, this 166 disruption is so big that I think they will have to either just rethink what they do or perhaps just 167 absorb these players or something. So yeah, I think also related to carbon footprinting, scope three 168 emissions, no one really knows how to account for those and you know, a product in use vs. a 169 product in operation, things like that, so yeah, we do talk about climate change and climate risk with 170 other sectors as well, that's for sure.

171

Sofia: Yeah, because I was thinking, if 75% of the oil reserves are national oil companies, then supplyside ...

174

Sophie: I think, maybe, I have seen this map of the oil flows between sectors and all of those talks about fossil fuels and removing that from the equation, that's super disruptive. When, and this is going to be at a longer term horizon, but to question companies like BASF for instance, or even pharma companies or industrial goods, you know all these people are really pushing a trolley, and you know, what is it they're going to do, are they going to go for bio feedstocks vs petroleumfeedstocks and things like that, so we do have these conversations, especially with chemicals.

- 181
- 182 Sofia: It's really cool. Ehm, do you think engagement works?
- 183

184 Sophie: I think it works, but I think it works because it's a persistence, you know, you show your 185 face, you engage and engage and engage, and maybe will increase presence from investors and 186 companies will sort of be a bit more receptive, but I don't think an investor can go in and say "look, 187 tomorrow, I want you to change your strategy because it makes sense financially". I think that's a 188 big stretch. But I think we have a marginal effect on things like, we need more data, we need more 189 interaction with management, that kind of stuff. That works, but it really works because they are 190 required, and because, the reason we do engagement and the reason UK asset management 191 especially do engagement is because they're so hot on stewardship and making sure that the capital 192 invested is invested reasonably, so this is the purpose of engagement. For ESG, it's about, again, it's 193 about making sure that the companies are aware of their risks and that they take them seriously. 194 And again, it works because it is being repeated, so I have engaged with companies for a number of 195 years and even if something minor happens, you're so gratified because in the end, in three years 196 or four years, change has happened, so it is mixed. Sometimes it works, sometimes it doesn't, it's a 197 cultural thing as well, why not, you know. If it brings however marginal the benefits are, you know, 198 we might as well do it, again probably all UK asset managers will say that because that's how they 199 see the world. It's all about meetings, it's all about showing your face and establishing a good 200 relationship, etc. But the information you get out is marginal. Companies are getting good at saying 201 what we want to hear, and that's why the job [in ESG] is getting increasingly difficult, because what 202 you really want to know is, how does it work on site, again, do you really do what you say you do, 203 or are you just showing me nice slides that showcase some stuff and I can go away with a good 204 feeling, so that's difficult about the job. But it's also very exciting.

205

Sofia: It's the same for the investors, I can see in my survey, I'm a bit surprised about how much it looks like they are engaging, and I don't think I have enough qualitative questions, because it was hard to do something where you measure the quality of engagement. Because I feel like some investors engage and some say that they engage, but it's really hard to find out what they're actually doing.

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212 Sophie: Because, for instance here, the systems are even less mature, but for instance at my old job, 213 we used to measure engagement success, so we would say "okay, we engage with this company 214 because we want to find out more and we're not really clear on certain things, so we'll engage just 215 purely for informational purposes". And then we're engaged on that company "because we think 216 that this, this and this should change", so one year later we would have a reminder automatically in 217 the system that's telling you "look Sophie, a year ago, you engaged with this company, what's the 218 status now. Can you find new stuff in their annual disclosure, can you talk to the company to get an 219 update or has any of these things been implemented?" And then you start to track progress and 220 then you go to the market and say "out of the 100 engagements we had in 2015, 60% we asked 221 companies to change and 10% of them, a year on, has changed". So yeah you get a start of that, but 222 it's true that each asset manager does it differently which makes it very difficult to compare. But it's 223 very difficult as well because, who knows if the company changed because of our engagement. It

might have been because of totally different reasons, so you don't really know. So, who are you to brag, in a way, that "I'm the one who achieved this amazing engagement result because we have spoken to this company for four or five years and it's finally done what we asked it to do". It's 15 investors that have done that but we don't know about we have done that exact thing, but of course, the company has changed, but there is no way we can know that. So, there are reasons why companies do things differently but it's not entirely down to engagement. That's the difficulty.

230

Sofia: How do you see, because it seems like most of the oil companies are American, like if you're
a listed oil company, you're probably American, and then there are a few Europeans, and I am
looking at European investors, but if you look at the ownership of these companies, the US investors
own +80% of all of these things but it seems to be a very European phenomenon?

235

236 Sophie: That's true, I mean, you'd be surprised, even for us to have conversations with US 237 companies, you know US companies it's very very difficult, they're so behind Europe in terms of 238 engagement, in terms of having chats with companies, just because, I think the reason for that is 239 liability, you know the US is a very compliance-driven country. So companies, when you meet US 240 companies, you would be, there's a head of Compliance that's sitting with everybody here, you 241 know with investor relations, and everybody's checking sort of what they can't say, what they want 242 to say, what's going to get them in trouble or not, so it's very very tight and nothing really filters, so 243 usually they will say what they have in the 10-K, go back to our SEC filing and that's all you're going 244 to get, because they're always afraid of being sued. So if you look at Exxon, for instance, I mean 245 Exxon is a case in point, so for them to have known about climate change risks and possible impacts 246 on the valuation of their assets for about 30 years, and they haven't disclosed that to the market, 247 so liability risks are huge, and they're in a lot of trouble, but it is true that the culture in the US and 248 of US investment managers is definitely not about engagement, and ESG-wise, fairly speaking, they 249 are way behind.

- 250251 Sofia: It's a bit sad.
- 252

253 Sophie: It is. It's very sad. It makes our jobs even more difficult because if you want to speak to 254 Dominion Resources or the company that's looking after the XX pipeline and things like that, they 255 will say like "well, none of my other investors are asking me that, so why would I give you some 256 time?". So it can be very frustrating. It can be, but having said that, well I'm not sure that the things 257 will change in the US so that's another issue, but it's true that investors who are engagement-258 focused, for us it's hard to go to the US, so we look a lot more for controversies, newspapers, 259 headlines and things like that, because we know that we're not going to get anything from 260 companies themselves.

- 261
- 262 Sofia: Yeah
- 263

Sophie: But yeah, that's the way that, and Shell is disrupting everything in the US, so the risks, water risks, methane pollution and people not being able to consume their usable water because of, you know, so it's very difficult for us to have this conversations, because they don't want to say anything to us. Again, that's a liability-driven culture. But, you know, we're working on it, we have people in

- the US, we have a US energy team, so they do meet companies, but they don't press them on thingslike we do here.
- 270
- 271 Sofia: No, but that's quite interesting to hear as well.
- 272273 Sophie: Hopefully it will change, but I think I'm being kicked out of the room, someone's trying to274 get in
- 275
- 276 [saying goodbye]

Courteney Keatinge – Glass Lewis – December 6, 2016

1 2	Sofia: Hi, this is Sofia, can you hear me?
2 3 4	Courteney: Hi Sofia, how are you?
5	Sofia: I'm good, how are you?
7 8	Courteney: Good thank you, sorry about the delay
9 10	Sofia: No worries. So, I can introduce myself, if you'd like?
10 11 12	Courteney: Yeah
13 14 15 16	Sofia: I'm Sofia and I study at Copenhagen Business School where I'm doing a masters in Applied Economics and Finance and I'm currently doing my master thesis on institutional investor engagement in oil and gas companies within climate risk and climate change issues and focusing on European investors
17 18 19	Courteney: Sorry, you keep cutting out
20 21 22 23	Sofia: Sorry, so yeah, I'm looking at European investors but global oil and gas companies. So I'm trying to figure out how they engage and partly why or whether it works for them and what works best of the different strategies; like is it informal meetings, is it voting or something else, so yeah.
24 25	Courteney: Great
26 27	Sofia: Do you want to just quickly introduce yourself and what you and Glass Lewis do?
28 29 30 31 32 33 34 35 36 37	Courteney: Sure, so my name is Courteney Keatinge. I am the director of environmental social and governance research here at Glass Lewis. We are a proxy advisory service, so we help our clients who are generally large institutional investors, we help them vote. So I specifically provide research, so I am kind of on the research team. And we will look at generally shareholder resolutions, which are primarily in the US, wherever they come up as kind of environmental and social in nature. But I would say that Europe is kind of the least active market with respect to this issue. The US is obviously very very active. Canada has, you know, several shareholder proposals, not as many as the US and Japan also has quite a bit of activity. And in Europe it's not as prevalent, but a lot of that is because of the engagement that you are referencing.
38 39 40	Sofia: Yeah, is it like? It seems like a shareholder resolution is the last resort if it doesn't work to talk to the company?
41 42	Courteney: Yeah, I think that's a fairly common sentiment kind of in most markets, particularly with respect to Europe. It's much harder to get a resolution on the ballot in Europe. That kind of explains

43 some of why there is that discrepancy there. And the ones that we have seen, the ones that have

done really well, which I'm sure you're aware of, are the Aiming for A coalition shareholder
resolutions which were management supported. So those are really the kind of the ones of note
that we've seen over there in recent years. You know, some of the ones that we've seen at Shell
have been a bit more mmh interesting, I guess, not quite as well-received and not quite as well
crafted.

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50 Sofia: How, because it has been quite easy to find shareholder resolutions on, because I am looking 51 at the top-15 oil and gas companies, based on embedded CO2 reserves and who have a diversified 52 ownership, so I'm not looking at Gazprom or anything, so it's mainly US companies. And it seems 53 like they keep being voted down, at least the climate ones.

54

Courteney: Yeah, that's really common, very few resolutions in the US, particularly with respect to
environmental and social issues, receive majority shareholder support. You know, two years ago I
don't think there weren't any and last year I think there were maybe four or so, and none of those,
I believe were climate-related. You know, some of the ones that we have seen, like the Occidental
Petroleum, that one got like 49.5% support, which is really really high for these types of resolutions,

60

yeah.

61
62 Sofia: Ehm, do you think that it works to do shareholder resolutions, even though it doesn't get
63 through, like, does it change the behaviour of the company?

64

65 Courteney: I think it depends on the company itself and its responsiveness to their shareholders, so 66 I would say a lot of companies will make changes, you know, and a lot of them don't even need a 67 shareholder proposal, and some others might be incentivized to move by other resolutions, whereas 68 others will receive resolutions year after year and the won't really do anything about it so I think it 69 really depends on management and the board and kind of other companies' general response to 70 shareholders.

71

Sofia: Is the oil and gas sector like, does it have any specific things compared to other sectors, likeis it more responsive?

74

Courteney: I don't think I would make that generalization. Again, I think it really depends on the
 company. There are very responsive companies in every sector and very unresponsive companies.

78 Sofia: I've looked at the report which you have on your website on how to do shareholder proposals.

79

80 Courteney: On our proxy voting guidelines?

81

Sofia: Yeah, and it's very focused on reporting and GHG emissions and that's what I see in the shareholder resolutions as well. So the climate ones are mostly GHG emissions and I have included reporting of lobbying activities and then increased disclosure. Do you think that can change company behaviour by increasing transparency?

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Courteney: I think what you're referencing are our house guidelines, so our proxy voting guidelines,
so that's kind of how we approach things and not generally speaking how other people approach

things, so that's kind of our house policy. That's just an important distinction. We're reticent to ask companies make significant operational changes without credible evidence that there's some sort of issue or they have acted in an illegal fashion, so we generally support well-crafted proposals asking for disclosure on certain issues as opposed to specific actions. So like reporting reducing GHG emissions for example, however we do look at all of these proposals on a case-by-case basis. So it really kind of depends on what issue is.

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Sofia: Do you see an increased interest in trying to influence companies by making shareholderresolutions?

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99 Courteney: There has been a focus on shareholder resolutions for quite a while and I would say that 100 they are gaining a popularity as far as shareholders support is concerned, but as far as amount, it 101 has remained fairly steady for a number of years and I think it has always been an ebony by which 102 more active shareholders have tried to influence companies.

Sofia: I looked at different, maybe it was one of your reports as well, but sometimes the resolutions are withdrawn before the AGM because the company has decided to include it so there is no need for voting on it. Is that a good sign or is it more like "okay we will try and do this at a minimum" or is it "okay, we can see that this is a good thing"?

- 108 109 Courteney: I mean, I would say that it's a good thing for shareholders because the company is clearly 110 in some kind of concession that led the shareholders to feel comfortable with withdrawing those 111 proposals. We don't generally track withdrawn proposals unless they're actually on the ballot in 112 which case we will see them, but in a lot of cases, they are not visible to other shareholders.
- 114 Sofia: Ah okay. Do you help companies, or investors, make shareholder proposals?
- 115

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116 Courteney: No, absolutely not. We only analyse them, it presents significant conflict of interest if 117 we were to do that, so that's something that we are very aware of. So we will not help with that.

- Sofia: Yeah, I think I found something on your website about engagement services as well, but now
  I cannot find it, when I tried to look again. Do you do others things than proxy research?
- 122 Courteney: No, we do do engagement with companies on our own behalf, but you know we have 123 not been authorized to do engagement by our clients, so we do not offer engagement services, but 124 we engage with companies, kind of during the – you know at any point after the solicitation period, 125 which is after they filed their proxy statement.
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- 127 Sofia: Okay. How do you engage with them?
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129 Courteney: It's really just kind of starting a dialogue if there is misunderstandings on our part, you 130 know, we will meet with companies that have complex business structures or want more 131 perspective on our policies and our thoughts, so it's really just kind of a dialogue. We don't actually

- 132 engage to make changes like a more active investor would.
- 133

134 Sofia: Yeah, I could see that, I think it says more than 20 trillion dollars under advice, or something 135 136 Courteney: That's our clients. We don't hold any shares. 137 138 Sofia: No no, but, I googled the entire assets under management globally and I found a number at 139 approximately 70 trillion. Are you actually doing proxy research for a third of the global financial 140 market? 141 142 Courteney: Probably yeah 143 144 Sofia: That's really cool. 145 146 Courteney: Well, most large institutional investors use us to, and our competitor, it's kind of a 147 duopoly, to help them vote, so our policies are, so the way we recommend on things, are not 148 necessarily what they do. A lot of clients just use our research for their own purpose, so you know 149 a lot of them, more active investors will say we want to vote on, you know we want to support all 150 climate change proposals and that's something we will do for them, even if our own policies will not 151 support them. 152 153 Sofia: Because then I thought that if you represent so many people you have a lot of market power, 154 I don't know if you can call it that because I know that they decide for themselves, but you can still, 155 like you have quite significant influence 156 157 Courteney: Yeah, I mean, we are really a research provider, so that's kind of how I view a lot of our 158 role is to help them make informed decisions based on their own feelings and thoughts and kind of 159 their own voting policies and priorities. 160 161 Sofia: Do they look at, you know if it's an investor who holds shares from like 4000 different 162 companies, do they look through your recommendations for each company or do they just do what 163 you say? 164 165 Courteney: I think it depends on the investor. So a lot of them, if they own that many shares, then 166 they're likely kind of a larger investor and they will generally have their own voting policies, so that's 167 something that will kind of set their votes to be cast a certain way, based on their voting policy so it 168 should really not, so we will kind of just look at what they say. And then they'll generally kind of do 169 their thing 170 171 Sofia: Yeah, but when you do recommendations for a company, is it then, you say that "this 172 shareholder resolution on increased GHG emissions disclosure improve shareholder value"? Could 173 that be like a recommendation? Or is it more like "this does this" and then you have to take your 174 own view on it? 175 176 Courteney: We do make recommendations based on our house policies. So we will, you know we 177 have a lot of sass and many houses don't have as much sass as we do, so we will provide 178 recommendations, however, a lot of, we're also providing a lot of research behind those

- recommendations so a lot of our clients will just use that research and kind of not pay attention to
  our recommendation or will only pay attention to our recommendation, in which case they will read
  through it and make their own recommendation, so it really depends on the client.
- 182

Sofia: Yeah, because I was just thinking that one of the issues of trying to include ESG considerations in the strategy is that it's very long term compared to other things, which are very short term. And you can improve shareholder value both short term and long term and I was wondering whether you have, like as a company, do you have a policy saying "we have to look at, we have to weigh long term shareholder value higher"?

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189 Courteney: It's a good question. We usually, I mean I think long term is a very subjective term, you 190 know long term for some investors is two years, long term for some investors is an indefinite 191 horizon. So it really depends on the investor. But when we support a shareholder proposal, it's 192 usually, you know, we would like to see kind of compelling evidence from the shareholder 193 proponent that the requested disclosure or action will kind of increase shareholder value or mitigate 194 risk, you know, either that or the company is lacking behind its peers with respect to that issue, so 195 since we're reporting that the company doesn't provide all that its peers provide, you know, that's 196 a consideration that we take into account. So we factor in a lot of things like as far as time horizon 197 is concerned, a lot of our biggest clients are pension plans which kind of have an indefinite holding 198 policy so I think that is a consideration but it's definitely not something that we're a bit fuzzy on, 199 and I think a lot of people can be a bit fuzzy on what exactly long-term shareholder value means as 200 far as time-line is, you know

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Sofia: Yeah, do you see like, do you think that shareholder resolutions can change the course of
 companies, like if you at it from an environmental or climate change perspective, where maybe it's
 not going in the right direction, or at least not in a climate mitigating direction?

206 Courteney: Yeah, I mean I think they have, I think that they can, you know I think engagement also 207 plays a big part, and I think that making sure that the resolutions are well crafted and are asking for 208 the right things. I think that shareholders only have a role to play in this, but again, I think it kind of 209 depends on the company itself and whether or not they are responsive to those sorts of pressure. 210

- Sofia: Yeah. Do you think, you said that it's very common in the US but not very common in Europe,
  that it has a bigger part to play in the US? Or is it something that should gain grounds in Europe
- 213 214 Courteney: I don't really know, like I said the holding requirements are, you know the submission 215 requirements are different, so that kind of plays a big part in why there are more shareholder 216 proposals in one market than another. So I think you have to own 5% for one year, or something, to 217 submit a shareholder resolution in the UK, or you have to have like 100 shareholders, you know, it's 218 something along those lines, whereas in the US you only need to hold 2500 dollars in a company's 219 shares for one year to submit a resolution so because of that we get a lot of kind of religious groups 220 and sisters and nuns and kind of activist organizations and PETA who can kind of, want to an issue 221 at a company whenever they feel like it, because the bar is so low. You know, I think that that is 222 another big reason why it's more of an issue here in the US than it is in other markets. 223

- 224 Sofia: Do you know how companies decide which ones should be voted for? Because as far as I 225 understand they can say that this proposal is too stupid or something.
- Courteney: So all proposals go through the SEC, so in the US the SEC can issue a no-action letter, so
  essentially they can bring it to the SEC and they will say that on x grounds, like a number of different
  reasons why a company doesn't have to put a proposal in its proxy statement. So if the SEC
  determines that they do have to then they will.
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- 232 Sofia: Yeah okay. Because I saw some of the Exxon ones were a bit interesting. Is it a very 233 concentrated market with proxy voting?
- Courteney: Yeah, there are really kind of two main players, that's ourselves and ISS that kind of
  make up a lot of the market. There are also some other players but those are kind of the main proxy
  advisors.
- 239 Sofia: Yeah. I don't think I have anymore.
- 241 Courteney: Great, well if you have any more questions, please feel free to email me.
- 243 Sofia: Okay. Thank you very much
- 245 Courteney: Absolutely, good luck.
- 247 Sofia: Thank you, have a good day.
- 248
- 249 Courteney: Thank you, you too. Goodbye
- 250251 Sofia: Goodbye

Colin Melvin – Former CEO for Hermes EOS and board member at PRI – December 9, 2016

1	Colin: Colin Melvin
2 3 4	Sofia: Hello, this is Sofia Bartholdy
5 6 7	Hello Sofia, thank you for calling, I'm driving at the moment so I hope you can hear me fine, but normally it's fine
, 8 9	Ah okay, I can call you later if that's better?
10 11	No no, it's fine for me, I'm on hands free so it's quite safe, so it's not a problem
12 13	Okay, well, I could start by introducing myself and what I'm doing
14 15	Yeah, that'd be fine
16 17	[talk about my educational background]
18 19 20 21	So, I'm doing this master thesis on investor engagement in the oil and gas sector from the institutional investor perspective. So my aim is to find out whether investors engage, how they do and whether it works.
22 23 24	I'm very happy to help with that and have you talked to my colleague [explaining colleague that works with oil and gas]. So what I can do is to provide the overall background, the reason why all of this is happening, the quality of the work, that sort of thing.
25 26 27 28 29	That would be amazing. So what I thought you might be an expert in is e.g. the difference between actively managed investments or passively managed investments, whether it even makes a difference
30 31 32	So, just to make sure I understand the question, does the investment strategy make a difference in the investor's reporting or behaviour or both?
33 34 35	Maybe, because I heard from another interviewee that it's mostly active investors who engage with their holdings?
36 37 38 39 40 41 42 43	I see, okay we'll talk about active and passive a little bit. I'm sure you fully understand the difference, so If you're a passive investor, you invest in a little bit of every company assuming it's a standard passive strategy. Now the reason why passive investment strategy works as a business model is because they take a free ride on price discovery and stewardship done elsewhere, so it's a commoditized sort of business and requires them to not spend a lot of money on stewardship. That said, the very largest passive houses have allocated some resources towards it because their clients are interested. The other reason they tend not to do it is because it doesn't really make sense in the context of their business model, either they're paid, passive investors and fund managers, they're

44 paid to track the index and so there's no specific private benefit to them in engaging with companies 45 to improve the companies', even if that improvement leads to an improvement in financial 46 performance which I would hope it would, because I think a lot of these issues are connected to 47 financial performance, because that's not how they're paid. So that combination of a commoditized 48 business model and one which is focused on tracking the value of the index suggests that they're 49 not going to do it. That said, BlackRock has allocated some resource to this and the team is led by 50 Michelle Atkins, a former colleague of mine, and they have, I can't remember the recent numbers, 51 but let's say 15 people or so, globally, doing engagement. There is a third problem though and that 52 is that these big financial groups like BlackRock have a lot of business relationships and those 53 relationships and the cultures which they operate in militate against effective engagement as well. 54 So, to give you an example from BlackRock, you might have seen that although they were able to 55 support the Aiming for A resolutions in Europe with BP and Shell, they were not able to do so in the 56 US. And the reason for that, they were very heavily criticized for that recently, and you'll find some 57 press coverage on that, it's quite an interesting difference. So I think it was Chevron where basically 58 the same resolution was put by shareholders and because it wasn't supported by management, 59 whereas in the UK and in Norway with Statoil, the resolutions were supported by management, they 60 received 95%. In the US, they weren't and BlackRock has a policy of only voting for shareholder 61 resolutions where they're supported by management. So, you see that there's kind of a cultural 62 issue that gets in the way and there are other ones, they would always vote in favour of a combined 63 chair and chief executive at an election, which is a standard governance problem, where you'd 64 expect them to vote against, and they would always support political donations by companies. So, 65 those are all the reasons why passive investors find it difficult to engage effectively.

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But if investors like BlackRock, and I assume it's similar for Vanguard or State Street, if they don'tdo anything, can you even have an impact, because they sit with so many shares?

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70 Yes, so that takes us to the state of stewardship itself. There's no good-quality engagement 71 happening anywhere in the world, partly because there is a dysfunction in the heart of the financial 72 system. Because a lot of the same objections I have given you as the reasons why passive investors 73 don't do engagement effectively also apply to large active investors. Because of the nature of active 74 investments. The active investment managers tend to have business models which focus on short-75 term performance and their analyses of companies then tend to be of short-term nature. Therefore, 76 it is not in their interests to engage with companies to get change unless there's a client that tells 77 them to do so. Now they may find it possible to allocate a bit more resource and combine it with 78 resource for fund management purposes, but they have a lot of the same problems and so, we have 79 a capitalist system where the people, whose job it is to allocate the capital, the fund managers and 80 the City and Wall Street, have business models which do not support them undertaking good 81 ownership activities on behalf of the providers of capital, and so you have a system which is focused 82 on trading and transacting around the shares rather than the ownership of the underlying 83 companies, which is very bad and leads to a lot of the problems that we know about and that you're 84 interested in. So why, when we all know that climate change is a problem, are we not able to solve 85 it? Why is it that our big investors are invested in companies that are involved in bribery, corruption, 86 child labour? Why are they invested in tobacco companies whose purpose seems to be to get people 87 addicted to some kind of poison, which then kills them? None of this is okay, but it's happening 88 because of the way this system is organized. So it's not a very happy story, I'm afraid. And that's the

89 reason that I set up Hermes EOS [engagement and ownership services], was because I realized 14 90 years ago that the fund managers weren't going to do this job. And so I got together a group of 91 pension funds supported by the BT pension scheme to share the costs of a stewardship service and 92 aggregate their equity together so they could have more of an influence. And that service now, 93 although I'm not running it anymore, that service has 42 clients and 250 billion dollars in assets 94 under advice and engages companies around the world, about 450 a year, and you know about this 95 already, I expect. Now that sounds great, but normally we're speaking on behalf of a fraction of one 96 percent of the equity at the company. So a typical shareholding outside the UK would be round 97 about the half of one percent of a medium to large company. We still get change through the 98 engagement, but you could imagine then the opportunity of say a greater aggregation of pension 99 fund assets or getting the big passive houses doing this properly. And that's the situation at the 100 moment. We have a situation of absent ownership which is the detriment of the economy, society 101 and environment and the providers of capital. And the reasons that happens is because of traditions 102 and cultures within the financial services industry, whereby the intermediaries make money 103 through trade and activities of derivatives of trading.

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Yeah, do you think, like what do you think the minimum of active owners should be to start makinga real difference and start to change the system?

Yeah, so there's an interest in change. So you look at the United Nations Principles for Responsible Investments Initiative, PRI, where I was on the board until last week, when I resigned because I left Hermes, but I was also involved there as chair and first chair and co-drafter of the principles. Now the principles of PRI have 60 trillion dollars signed up. 1500 large investors or intermediaries and it's nice to see that those Danish funds are going back, I don't know if you saw that news yesterday...

- 113
- 114 Yeah, I saw it

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116 ... but, it's very encouraging, so that's a great statement to the intent. So the most important of the 117 six principles are the first two, which is "we will incorporate ESG into our decision-making and we 118 will be good owners of the underlying assets". That says to me "we know we need to change". If 119 you talk, as I have done, to Larry Fink, who runs BlackRock, he will tell you that all this is very important. So there's a sense for a need to change, but a kind of, I call it a hegemonic shift a need 120 121 for change, a shift in the language and understanding that we apply to our jobs in the investment 122 industry, but it's as if we're forced to keep behaving the way we are, and I think that's the culture 123 and tradition I was talking about earlier. So to your question, what do we need to happen, we need 124 a change in the business models of financial companies whereby they see themselves not as traders 125 but as owners on behalf of their clients, where they shift their focus from a short-term transactional 126 perspective to longer-term relational one, where they recognize their interdependence with their 127 clients and the entities in which they invest. That's a different world view, it's a different way of 128 seeing the world. I think it's starting to happen, but it needs people like you to get involved and to 129 help the change along and I'm very pleased and excited that you and other students at their 130 beginnings of their career are interested in understanding these issues and what needs to be done.

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132 Do you think it can change gradually, or do you think there needs to be, to use a fancy word, 133 disruption in the financial system?

## 134

135 It's a great word. And I don't think it's a fancy word. The disruption, yeah, I think it does, Hermes 136 EOS is a sort of disrupter. I think we're going to see some, you know the flight to passive investment, 137 particularly in the US is interesting. The fact that large pension funds are doing, well, two things; 1 138 they are allocating away from active fund management to passive and 2 they're bringing fund 139 management in-house. CalPERS is doing that at the moment, so, they've gone from 200 external 140 managers in public markets to 50 and they've taken 300 million dollars out of their cost base for 141 investment by bringing it in-house. It's very exciting. You might think that that's a terrible thing to 142 active fund management, and it is to some extent, but what is also suggests is that there is a kind of 143 existential crisis and within crises, there are opportunities. And I think that there is an opportunity 144 for a different sort of fund management to emerge, whereby the fund manager builds strong 145 relationships to the underlying clients, recognizes the interdependence that I mentioned earlier that 146 enables them to lengthen time frames, naturally incorporate ESG into their decision-making 147 because that's what happens when you take a longer-term perspective and then do some 148 engagement because it's now making sense in the context of the business model. I still think there 149 will be a need for aggregation of pension fund interests and fund managers as well because I still 150 think it would work to get towards the longer-term issues, but I think it would certainly take us a 151 step in the right direction, so I think that's an opportunity to change the way active fund 152 management works and indeed I'm looking at that at the moment...

153 [talking about plans for future job]

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How do you, so I spoke to Standard Life, and they seem to do engagement internally. And I spoke to Steve Waygood from Aviva, but they both have, Aviva has like 260 billion dollars which is approximately the same as Hermes under advice, but would they benefit from aggregating their votes with for example Hermes, because it seems like the large ones do it themselves, but they still only have like half a percent ownership or a quarter of a percent ownership...

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161 Exactly, and far less resource as well, so whereas Hermes EOS has managed to create a sustainable 162 model for delivering stewardship, which is profitable, not very profitable, but a little bit, has 27 163 people full time on this, including 15 front-line engagers, I'm not sure about Aviva, I would think 164 they have maybe 5 maybe, maybe a few more, so you see that there is a problem there still, because 165 Aviva, and I have a lot of respect for Steve, he does brilliant work, particularly on policy and 166 regulation, they have the same constraints as any fund management business. This is not how fund 167 management companies make money. Anything they spend on it comes out of their bottom-line 168 and they just cannot get their heads around allocating more resource to it, and so, the model I 169 created was one, where the costs were shared by interested underlying asset owners, pension 170 funds, and that works. And it's unique in the world now, in working the way that it does and doing 171 the quality of work that it does. So these big financial groups have a problem, they need, because 172 of their size and client relationships to seem to be doing this themselves, yet they cannot get enough 173 resource to it. So yeah, it's a really interesting problem. I think, at some point they will need to 174 aggregate. One of Hermes EOS' clients, is a large US investing institution. It's an 800 billion dollar 175 fund management company amongst other things and Hermes EOS does some work for them, not 176 across the whole 800 billion, I was still working on that when I left, but on a couple of, I think there 177 are maybe five funds now, that they manage in Europe, which are available to particularly Dutch 178 investors to invest in. And they found that they couldn't sell these, largely passive ESG-filtered

products without engagement, and they decided after a lot of consideration to hire us to do the engagement rather than to do it themselves and I think there's going to be a bit more of that. But it's also a tradition of some pride within some of these groups, you know, they like their jobs a lot, they're doing some good work and that professional pride also stops them from collaborating from time to time. And that can be frustrating as well. They do some good work, it's not like it's all bad,

- 184 it's just not getting us where we need to get to.
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- 186 Yeah, because I'm trying to find the best strategy. So there can still be good strategies.
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188 Yeah. I think it will need some collaboration. Or as I said a different business model for active fund 189 management, but even then, I feel collaboration will be necessary. And maybe that is then 190 consistent with what we were discussing earlier. If the world is moving, if the financial world is 191 moving from a transactional perspective to a relational one, from a short to a long term, from the 192 recognition of interdependence from independence, then that suggests a different model for 193 competition as well amongst fund managers, so they would start as some of the better companies 194 like BT or Unilever, they would start working with their competitors, sharing information to create 195 a larger sum of wealth and knowledge, because that's a different model of the firm. The 196 transactional perspective supposes that we live in a world of scarcity, a kind of zero sum transacting 197 game where your skill relative to mine as trader determines the outcome, and if you're better than 198 me you win, I lose, but everyone loses really, because we're focused on the transaction, not the 199 relationship and that transaction mentality, yeah, so you contract that to the relational model where 200 you see the firm you invest in or work within, as not a transacting engine, but as a set of stakeholder 201 relationships, and if you can understand the quality of those relationships and do something about 202 them, and improve them, then you understand something more about the value of the company 203 and you can improve that. And that supposes an expanding wealth environment where you're 204 increasing the total sum of wealth by improving the relationships between companies, one company 205 to another, and suppliers, customers, and so on, but also with shareholders. That's a different world 206 view, as I mentioned earlier, and I think if fund management can go that way as well, and then we 207 start to get interested in the purpose of the fund management companies and then the impact that 208 they have and these ideas of corporate purpose and impact are starting to enter the investment 209 discussion. Apply that then to fund management and perhaps we can get different sort of fund 210 management and that leads then to a more collaborative perspective and better stewardship as a 211 result.

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Yeah. How do you see, because some companies need to become smaller if we need to get to a
2degree scenario, because they're too polluting or too damaging to the environment? How do you
see that in a financial market which might be a bit more focused on ownership rather than trading?
Is it still, because it can be quite bad for a company, or?

217

It's really hard, and even people who are more enlightened in this area still find it difficult to get away from the idea that they're investing in single companies. And to forget that companies interact with each other and with the environment and the economy. So universal owners recognize that large investors, invest not in a single company, but in lots of companies in lots of markets. And that those companies interact with each other and with the economy and the environment and society, and that suggests that you should then take a full portfolio view of your investments and not be 224 obsessed about an individual company's success, but rather recognize how one company affects the 225 other and now if you really implement that, you would be much more involved as an investor, in 226 policy and best-practice and regulation, which is why I think the work Steve does at Aviva is so good. 227 But also, you would be more interested in minimizing the externality costs by the companies that 228 you invest in and also in the portfolios, because those externalized costs would be picked up 229 elsewhere in the portfolio, with damages to the environment and for example pollution to climate 230 and carbon. And that would suggest that large investors have a legitimate interest in winding down 231 the activities of highly polluting companies. Because of these mega effects they have elsewhere. 232 You cannot really achieve that by simply selling the company's shares, so the argument goes, you 233 need to stay invested in order to have the influence to wind them down. And there's an interesting 234 project called "Forceful stewardship" run by Raj Thamotheram, an old friend of mine, which is 235 proposing this at the moment, and that would then lead to resolutions going to the, for example, 236 the annual meetings of oil companies, proposing higher dividends, because the company should be 237 paying back their profits rather than re-deploy them in further exploitation natural carbon 238 resources, and I did a resolution like that last year, I think at Chevron's meeting, but it didn't get 239 much support. And Hermes didn't support it either, by the way.

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It's very interesting. Do you see a difference between the US and Europe, and other countries?

243 Yeah yeah, there's a big difference internationally. In relation to stewardship, there are different 244 traditions on different markets. Some are better than others, necessarily, I mean the UK is often 245 held up as a great example of stewardship, but if you look at the actual implementation of the 246 stewardship code, it's not very impressive, for the reasons given already. In some other markets, 247 there's a lot of advance or interest, so we'll take one or two others. Japan is fascinating, you got 248 prime minister Abe, with his Abenomics program which is now well established, making a clearer 249 link between the quality of corporate governance and stewardship and the economic success. 250 Investors are lately under a lot of pressure to do more stewardship, and there's a new stewardship 251 code, based on the UK and there's a corporate governance code and Hero, that's his nickname, who 252 runs the Japanese government pension fund, he is just joining the board of the PRI as I come off it. 253 But I've had a couple of meetings with him, just one to one, well three actually in the last year in 254 Tokyo, and he is really interested in this agenda. The Japanese government pension fund is the 255 biggest pension fund in the world with 1.3 trillion dollars, and, he's not able to engage directly with 256 Japanese companies at the moment because of regulation in Japan which stops that happening, but 257 he's putting a lot of pressure on the fund management companies in Japan to do the engagement 258 for him. And that's really interesting, and they're all panicking about this at the moment. They don't 259 know how to do it, they have very little resource, they have a lot of the problems that we already 260 discussed, that fund management companies have, so a really interesting set of circumstances. I 261 think the Japanese government pension fund is going to get involved with engagement 262 internationally first directly, and I was trying to position Hermes EOS to provide that engagement 263 service. Throughout Asia, there is more interesting engagement and stewardship, and there are 264 stewardship codes arising in different markets. There's one in Malaysia there is one on the way in, 265 I think Singapore, and also in Korea, so a growth in interest but from a low base of understanding 266 and experience in Asia. In the US, there's a long tradition of what they would call corporate governance work with very long standing staff. You'd find people who in the US who's been doing 267 268 corporate governance as long as I have, which is a long time, so 22 years in my case, or even longer.

269 But these jobs are not very good, not so much well paid, well they're not well paid, but I meant 270 more in terms of influence. They tend to be very much compliance-oriented jobs, simply involved 271 in ticking the boxes in proxy voting forms, very strange phrase, proxy voting means voting by proxy, 272 you know, at a distance, getting someone to cast the vote for you. And there's a whole industry 273 around this with ISS and Glass Lewis as the main providers of research and agency. And that's highly 274 commoditized and a lot of the research is done by people who really don't understand how the 275 companies work, that they're researching. So that's the tradition in the US and more recently 276 they've woken up to the fact that there's something else to do and they're trying to make sense of 277 moving from their traditional cheap compliance-oriented approach to corporate governance to 278 something which is far more value-added and that transit is happening right now. And I think, I'm 279 quite cautiously optimistic, I think the US is a very interesting and innovative market, and once they 280 try to do something, they often come up with interesting and innovative solutions, so it's worth 281 keeping an eye on that and I've spent quite a lot of time in the US for the past couple of years for 282 that reason. I mean you look at initiatives, which is not fully US, like focusing capital on the long 283 term, which is started by the Canada pension plan investment board, you familiar with FCLT? If you 284 google FCLT and the Canada pension plan, so CPPIB, Canada pension plan investment board, and 285 McKinsey, they were both involved initially. Very interesting project because of that corporateinvestor combination. A lot of the most interesting work done by companies and investors together. 286 287 The papers for FCLT are fantastic. What they wrote to get it going is such a great survey of all the 288 problems a bit like John "Caine's" work in the UK, and they proposed some solutions, but they found 289 it very hard to implement them. And they just appointed a chief executive or managing director, 290 Serio Williams, formerly of Wellington, I'm hoping she's going to do a bit more with that. One of the 291 things they proposed was to set up an international platform for stewardship, and I went to see 292 Mark Wiseman who was then head of CPP, at the time, and said, well I got one of those, why don't 293 you just use Hermes EOS and he said he wanted to do it himself, and then they didn't do it, and then 294 they ended up hiring us, but just for Canada pension plan. So I think there's something worth 295 watching there and BlackRock's now involved in that group, the FCLT group, which is interesting as 296 well.

I spoke to a woman from Glass Lewis on Monday and she said that it was interesting how shareholder resolutions were then much more present in the US market than in the European market, because it's so much harder to get shareholder resolutions on the agenda in Europe than it is in the US, whereas the woman from Standard Life said that it is way easier to engage with European companies, way easier to get meetings with them.

Yep, so both of those things are true. There's a transition, remember we were talking about transactions earlier, the US market is very transactional and litigious, and involves lawyers on virtually every stage, and it's still the case, I think, that you're much more likely as a US shareholder to file a resolution than to actually talk to the board. So it's sort of a means of communication, which is, yes it's a very different market. So, we don't put resolutions to meetings so frequently in Europe. Is it because we don't need to? Possibly, there isn't a tradition to do so, and the corporate law doesn't.

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Okay. So, I did my survey, and it's very clear that, well I probably have quite a biased sample, because I think it's only the people who are interested in this who answered my survey, but they all say that they engage and they're very much on equity, they all engage on equity, but then they say that the most efficient way of engaging is by doing informal meetings and emails, and I find it interesting that; I mean from my sample, a lot of them engage in bond holdings, but I don't think that's necessarily a general thing for the market, but if the informal meetings are the most efficient way of engaging, then I don't see the barrier from engaging with bond holdings.

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320 Yeah, so, what's engagement about? Engagement has to do with exercising your right as an owner 321 of the company, and the traditional view is that the owners of the company are the equity 322 shareholders, not the bond holders, so bond holders are lending to a company, but they're not 323 exercising ownership. And I think that that's the main reason why there's that bit of confusion and 324 lack of understanding. So, that said, the experience of engaging on behalf of corporate bond holders 325 is actually quite a good one. You can get change that way, companies do listen and they are 326 interested in listening to the views of the people who are providing and lending to them, so it does 327 actually work in practice, but I think that's probably the reason why people might be less 328 understanding or interested in it because of that traditional view, that equity shareholder is the 329 owner of the firm. And that's where the voting rights are, obviously bonds don't attract votes unless 330 they're in default and not being a coupon in which case you would have a vote. So I think that's the 331 reason for that.

332

Yeah. But I was thinking that if the investors actually see a risk or see a mispricing, and they see that companies need to change, for example in the oil industry or in utilities, or coal, then it would make sense to try and persuade them to change at any means possible

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337 It does make sense if they're interested in the change. So again, you got that backdrop that, is an 338 engagement genuine, is it real, or is it being done to please client interest; I'm not surprised at all 339 that someone told you they were doing engagement, they have to say that, you know, many of 340 these funds and fund managers have signed up to the stewardship code and then they're meant to 341 be doing it. The questions you can ask to try and find out whether or not it's real engagement would 342 be, who are you engaging with and can you evidence change directly attributed to your activities? 343 And how do you track progress and monetary change, how many companies have you engaged 344 with, and at what level? All these things are important, but it's very difficult because people can 345 pretend to do something or they can piggybag off work done elsewhere. You know, and if a company 346 changes and they change in a way where you were trying to get them to do, did you do that? Was 347 it you? And even at Hermes, where we got a lot of resource, it's difficult to evidence that you actually 348 made the difference, so all these things are quite hard. It's also the seniority of the staff, the 349 experience of the staff, the number of people involved in the engagement, you know at Hermes, we 350 have to fully understand the business, to do the engagement, and that's expensive. Not as expensive 351 as to run the money, but you know the team of 27 people, our revenues were about 7.5 million 352 pounds and we made a bit of a profit, but not a lot, about 5% margin on that, so it's a relatively 353 expensive thing to do engagement properly, which is quite...

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Yeah, a lot of them say that they have developed their own metrics of tracking change, do you think that's a good idea or should there be an industry standard?

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- Yeah, I think it'd be good to get some standardization, I'd just be concerned that the standardization
   process would be captured by the industry and people who are self-interested and interested in
   window dressing
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Yeah, because I found the internal metrics a bit, I find it a bit shady, because it's easy to hide thingsif you develop the metrics yourself

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365 Yeah, and in some ways, the fundamental problems, as long as they're still there, the ones we 366 discussed, it doesn't really matter how you try to measure things, because the underlying issues will 367 not be going away, so I think it requires a restructuring, a disruption of the investment industry to 368 get the engagement done properly. You know, Hermes EOS can do so much, but yeah, it would need 369 to double, triple, quadruple in size to have the impact that's necessary I think. So yeah, I think that's 370 the, the problem is not measurement. It's a bit like, you know one of the classic governance issues 371 is directors pay. Everyone gets interested in how much the executives and directors of a company 372 are paid, and then there's this big conversation about the metrics used, and the international 373 markets for chief executives, and so on. But of course, the fundamental problem there is that we're 374 interested in the wrong thing. The chief executive you want for a company, is that the person who's 375 the most interested in money? Or interested in the success of the company? And being the most 376 money-obsessed chief executive should be a disqualification for the job. That sort of mind-set, we 377 need to take into these discussions as well is trying to understand what we're really trying to do. 378 And rather than getting caught up in the detail of measuring something which everyone bases in 379 the first place.

- Do you think things like the FSB task force and there are some other task force kinds of initiatives going on right now, do you think that they will help?
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384 I think it's helpful. But we need to distinct symptoms from causes, and a lot of the work done on 385 stewardship and sustainability on the corporate side is addressing symptoms, and some of it's 386 useful. I think of, say integrated reporting, you'd be familiar with that, so everyone wants companies 387 to report on an integrated basis, that makes sense, and you understand what integrated reporting 388 is, it's taking a broader set of information to report on your business model and its implementation, 389 and I've been involved in these initiatives so I still share the investor network at the International 390 Integrated Reporting Council, and what we thought there was, well maybe the reason why 391 companies aren't producing integrated reporting is because they don't know how to do it, so let's 392 show them how to do it, so we produced this wonderful framework, very detailed on how to 393 produce integrated reporting, but of course it doesn't work, and why doesn't it work? Because the 394 primary stakeholders, the shareholders, still, is not interested, so the underlying cause is still there. 395 And I would say directors pay is one, carbon footprinting is another and it's not that we shouldn't 396 try and deal with that as well, but we have to get to the underlying problem.

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398 Do you think that the political community and the investment community can look at it and realise399 that they actually need to change their worldview completely?

400

I think we deep down know we need to change, and here you could link it to the rise in populism in
 politics. There's a crisis of trust in the political class, in the business class and the investment class.

403 You know, the Americans would have elected a monkey in a suit – they elected Trump – he's even 404 admitted it himself, not because they wanted his politics, once they realise what he's like and that 405 he is part of the same system, and a very bad example as well, I think there may be a revolution of 406 some kind, so this is all connected. And I think we realise and our politicians are starting to realise 407 that we can't keep going the way we've been going the way we've been going. Selling the long term 408 for the short term over and over again, behaving in a narrow, competitive, individualistic way is 409 damaging and undermining our culture and society and the environment and the economy. And so 410 it requires a different mindset. So I think we must change. Now, can we break the cultural 411 stranglehold on this, which is largely, you can see it as a neoliberalist thing. Think of what Thatcher 412 and Reagan did in the 70s which is based on Hayek, are kind of very narrow, short-term 413 individualistic, neoliberalist approach. That's still here. And it's at its strongest in the financial sector 414 where individual fund managers sees it as their jobs to make money for themselves. That's the 415 purpose of a fund management company, to enrich its Principles. That's it, the people who run it. 416 And that's what needs to change. And do the politicians get it yet? I'm not sure they do. I think they 417 know that something needs to change, but they don't understand the nature of the change. We 418 have that in the UK with Theresa May's government. They came in, saying that they were going to 419 put workers on the boards of companies and get the workforce a say on how much the directors 420 are paid and management, and all of this is going away. You know, the lobbyists are working. 421 Because that's what happens. The culture crumbs everything. So I don't know. I think it needs 422 disruption and I think it may need something a bit more radical politically to get the change. 423

Yeah, because I can see it also from my friends, who aren't that interested in climate change, they
can see that they need to change and they know that they need to change, but there's kind of a
difference between knowing and then acting upon it, and if it has to happen on a global financial
system scale

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Yeah, I agree. Consumers, we are not changing our behaviour to the extent we need to. It's a little bit like Larry Fink, as I mentioned earlier, he knows that he's investing in ways that's damaging the environment, and the society and the economy. And he knows that he can't stop doing it. Isn't that amazing?

- 433
- 434 It's really frustrating.

435

436 Yeah, I think that's fascinating. Frustrating for sure, but also a massive opportunity if we can 437 somehow get this right. And to get the change. There's lots of initiatives around. [examples]. We 438 need the language and tools to properly implement the intention [of change]. And that's what I 439 hope to provide as investment. But yeah, I don't quite see how we're going to get there politically. 440 One of the major sources of short-termism is the political cycle, the electoral cycle itself. We all like 441 democracy and it's the least bad system that we have. But that needs to get re-elected every 3, 4 or 442 5 years militates against getting the regulation we need so we can invest the right way. If we had a 443 proper carbon tax internationally agreed, then the money would flow the right way. But we don't. I 444 was in Paris at the COP21 at the discussions twice last year, sitting on one side investors and business 445 leaders who were arguing strongly for an internationally agreed carbon tax and the environmental 446 ministers were saying that they couldn't do it. And that's still the case.

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448 Do you think the French article 173 [on disclosure of ESG risks and opportunities by investors and 449 companies] will help lead the way or something?

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451 Yeah, I think the French article is a really interesting start and that was one of the really encouraging

things about what happened last year, and they really put a lot of effort and diplomatic effort behind

453 it, and they did achieve something, it's not like if we didn't get anywhere, but I'm concerned that 454 we need much quicker, more radical action than we're seeing it at the moment. And the longer

455 things take, the more opportunities there is to water down what is coming. And the system is

456 reversed the tide, just like the companies do as well. Yeah, so not really optimistic.

457

458 [saying goodbye and small-talking].