Fossil Fuels, Climate Change, and the Unitarian Universalist Common Endowment Fund (UUCEF)

The Investment Committee and the Socially Responsible Investment Committee for the UUCEF are currently receiving many inquiries about fossil fuel divestment. We have prepared this document to answer many of the frequently asked questions on this topic.

Is the UUCEF going to divest from fossil fuels?

Complete divestment is not planned. Currently, the only types of companies that are excluded from the UUCEF because of their core business models are tobacco and weapons manufacturers. These exclusionary screens were each put in place by an action of the General Assembly (GA). In theory, a fossil fuel screen could be adopted by the same method, although no such resolution has been offered for consideration for the 2013 GA at this time. In the absence of a directive from the GA, the Investment Committee must use its best judgment, informed by consultation with the Socially Responsible Investment Committee. Both committees are examining the issue very thoroughly, consulting with researchers, investment professionals, environmental advocates, and both current and prospective participants in the UUCEF. We will be holding a workshop on this issue at the 2013 GA, and welcome email communication before then from anyone with thoughts on the topic.

What is the Investment Committee's opinion about fossil fuel divestment?

Both the Investment Committee and the Socially Responsible Investment Committee unanimously recommend *against* fossil fuel divestment for the UUCEF, We believe that we can more effectively pressure companies to address climate change through shareholder advocacy than through divestment. We are also concerned that divestment (for reasons explained in more detail below) could expose the UUCEF to significant additional investment risk.

Why don't you think the UUCEF could make a big difference through divestment? Didn't it help in South Africa?

When people cite the success of the South African divestment campaign, it is important to distinguish between the companies that disinvested from their operations in South Africa and the shareholders that divested their stock in those companies.

The success of the anti-apartheid movement is often remembered as a triumph of divestment. In reality, progress resulted from investors pursuing an array of actions and tactics. They included total divestment (there were several lists of target companies), promotion of the Sullivan Principles (a code of conduct for companies operating in S.A.), ratings of companies on compliance with those Principles, selective divestment of companies based on their ratings, and shareowner engagement.

Divestment is often lumped together with disinvestment, but they are really quite distinct. While some shareowners divested, others used their ownership position to press companies to disinvest; that is, to reduce or eliminate their capital investments in South Africa. It was disinvestment, particularly the cessation of lending to the South African government by US banks, that was most effective in weakening the regime.

Maintaining South African investments provided an opening for investor dialogues with corporate management—much of it conducted by religious investors--- and was an important part of the anti-apartheid struggle. We are concerned that if all the investors who are concerned about climate change sell their fossil fuel holdings, there will be no one left to put shareholder pressure on the management of those companies about how to improve our energy system.

How can shareholder advocacy address climate change and other issues related to fossil fuel companies?

Shareholder advocacy has already played an important role in leading the utility industry to report its greenhouse gas emissions and make efforts to reduce its use of fossil fuels. Shareholders are continually finding new ways to use their power as investors to put effective pressure on companies to tackle climate change. Just this year, the UUA was one of the first two investors to file a resolution that broke new ground by asking the company to report on how its business might be affected by future greenhouse gas regulation. Our resolution at Alpha Natural Resources, a major coal mining company, notes that the International Energy Agency recently estimated that as much as two-thirds of the world's proven fossil fuel reserves may need to remain unburned if severe climate consequences are to be avoided, and asks the company to report publicly on its thinking and strategy on this issue.

For the past several years, in addition, we have been engaging fossil fuel companies on other issues. For instance, we have filed shareholder resolutions at Chevron to press the company to address what we believe was directors' inadequate oversight of the company's operations in Ecuador, where a court issued an $19 billion judgment against the company last year for pollution of campesino and indigenous communities. The fact that Chevron has gone to great effort and expense to try to block this shareholder advocacy is strong evidence that this work is effective.

We believe that by filing resolutions and lobbying top corporate executives directly, we put effective pressure on companies while also building support for change in the financial community and beyond. We are exploring ways to further increase our level of shareholder advocacy on climate issues going forward, including possibly engaging electricity utilities, which currently use the most coal and gas, and even regulatory agencies that oversee key aspects of the fossil fuel industry.

What else can we do, as investors, to address climate change?

There are a number of public equity funds that invest in clean energy, green technologies, and solutions to climate change. In conjunction with our investment consultant, we are currently exploring options of this kind for the UUCEF. In addition, we are investigating ways that we can add our voices, as religious investors, to calls for improved public policy on climate issues.

Shouldn't we at least reduce our exposure to fossil fuel stocks?

Currently, just over 3% of our portfolio is invested in the largest 200 fossil fuel companies in the world, and only about 7% of our portfolio is in the energy sector. In response to our community's deep concern about fossil fuels, we are consulting with our research providers and investment consultant

about possible ways to strengthen the screens we use for our investments, in order to avoid fossil fuel companies with the most corrosive effects on the environment and on public policy with regard to climate change.

However, from a fiduciary perspective, we have several concerns about the practical impact that a strict divestment policy would have on our endowment. Some members of our committees believe that maintaining some fossil fuel holdings in the short and medium term is an important part of diversification, which lowers risk to the portfolio. Other committee members disagree about this aspect of diversification by industry. However, all of us note that in order to achieve the diversification by geographic region and asset class which we believe to be prudent, we must often invest in pooled vehicles such as mutual or comingled funds. We are not able to impose custom screens on our investment in these funds, and in many cases, the kinds of funds we need are not available in versions that exclude fossil fuels.

Why not divest just in the directly managed accounts? Is the degree of additional volatility or risk that fossil divestment would impose on a portfolio really that significant?

We believe reasonable people can differ on this point, since the answer really depends on beliefs about the future. We are aware of some recent research indicating that over long periods of time in the past, hypothetical portfolios without fossil fuel stocks would have closely tracked the market. But actual investment results are highly dependent on start and end dates. For a long time, from the 1980s to the end of the 20th century, oil prices were relatively low, and the exclusion of oil stocks from a portfolio might not have made a huge difference. But since the early part of the 2000s, when oil prices rose sharply, portfolios without fossil fuels would have underperformed. Since future oil price movements are uncertain, many investment professionals recommend maintaining some energy sector exposure. They often note that oil and gas companies can be a particularly useful hedge against inflation, as well as against the potential economic impacts of instability in oil producing regions.

To be sure, many people believe that the market currently overvalues oil and gas companies by assuming all their reserves will be burned in a regulatory environment that lacks substantial taxes or costs imposed on carbon emissions, although stronger global carbon constraints are likely to be imposed eventually. Indeed, in 2013, the UUA was one of the first investors to file a shareholder resolution raising this issue. However, the timing of any meaningful regulatory response to the climate crisis is uncertain, and even many critics of the "carbon bubble" acknowledge that it may persist for some time. Moreover, concerns about underperformance are heightened in the current investment climate, when average returns are quite low. Over the past five years, the UUCEF has performed better than 96% of its like-sized endowment peers. Even our relatively strong returns, however, have been less than 5% in gross annualized terms. We are keenly aware that the money invested in the UUCEF is intended to support congregational and UUA expenses and programming, and that a decrease in returns may mean real-world cuts that affect people in our communities.

Let's set all these other considerations aside for a moment. Isn't profiting from fossil fuel companies just morally wrong?

The moral question is a profound one, and must be answered individually by every person, congregation and faith community. Some people believe that fossil fuel companies are more responsible than any other entities for our current climate crisis. Others believe that demand for fossil fuels---from the utilities, transportation, manufacturing and agriculture sectors, as well as from end consumers like most of us---is an equally important part of the problem. Many people also point to the failures of regulation.

Moreover, even people who agree about an industry from a moral perspective may disagree about whether and how to invest in it. For example, as noted above, Unitarian Universalists have decided not to invest in tobacco and weapons due to ethical concerns about those companies' business lines. Many religious investors associated with the Interfaith Center on Corporate Responsibility share those concerns, but have chosen to stay invested in those companies and to press them to mitigate their worst business practices, such as marketing tobacco to minors or producing weapons with the most severe long-term environmental and social effects. As a community, we are currently in the process of discerning how we want to respond, as people of faith and as investors, to the human and environmental crisis of climate change. This process is a dynamic one, and will involve many views and voices.

How can individuals and congregations contribute more to this conversation?

Look for our workshop on climate change and responsible investment at the 2013 GA. You can also reach the Investment Committee by contacting Tim Brennan, UUA Treasurer, at tbrennan@uua.org.

In faith,

The Investment Committee and Socially Responsible Investment Committee