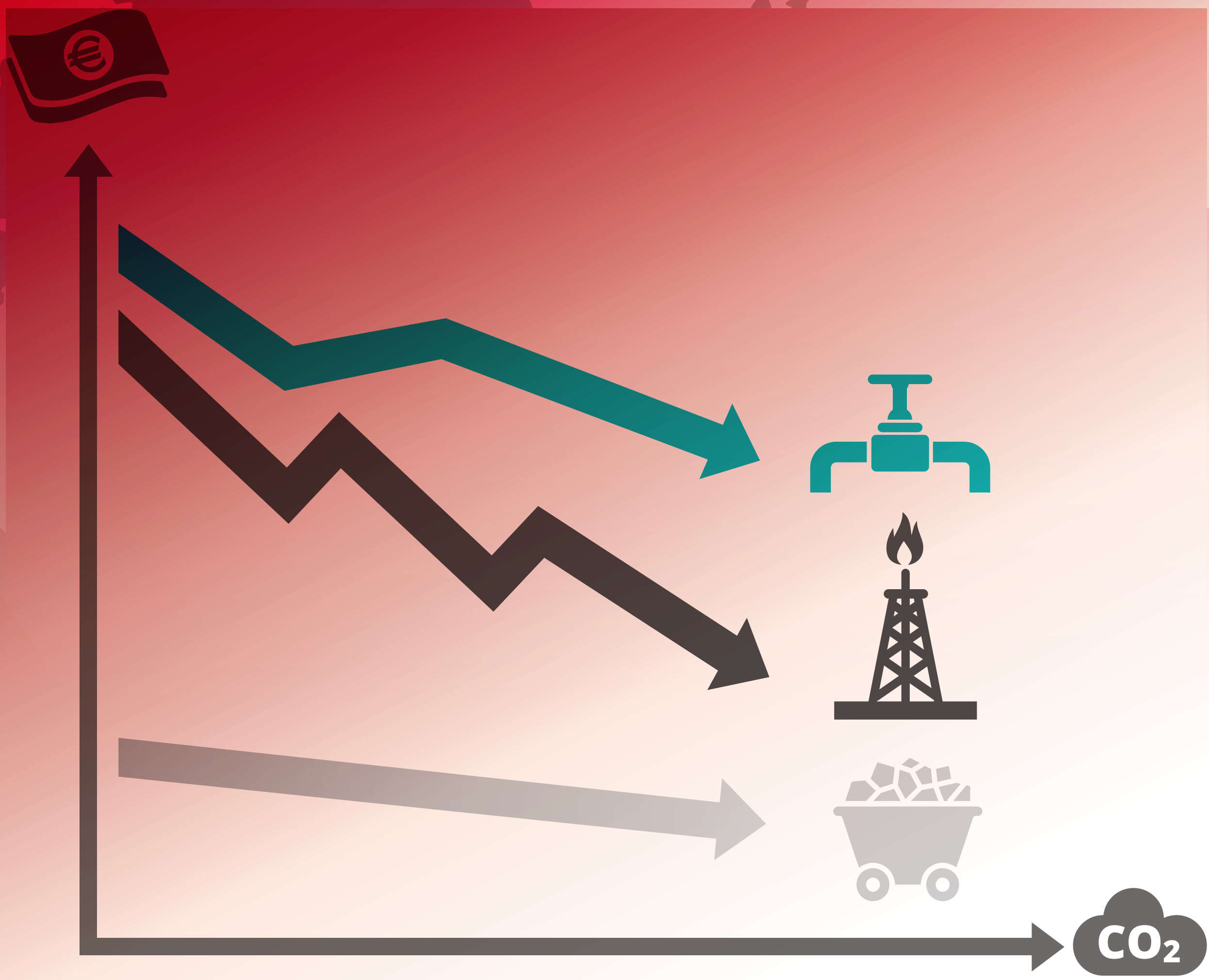
EXCLUSION OF FOSSIL FUELS:
ARE INVESTORS READY TO CHANGE TACK?



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novethic

Caisse des Dépôts GROUPE

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INTRODUCTION From coal exclusion to fossil fuel exit

The incompatibility of exploiting a large portion of fossil fuel reserves within a climate-friendly economy became clear in 2015 with the signing of the Paris Agreement. The movement to exclude companies most closely linked to fossil fuels gained momentum at that time. Initially focused only on coal, with sometimes little constraining thresholds, exclusion policies have gradually been refined and extended to other fossil fuels. Some Nordic investors are even taking the step of complete exclusion.

There has never been consensus about this movement. Its effectiveness in terms of greenhouse gas reduction is contested, as is its credibility in terms of "decarbonising portfolios" when the exclusion thresholds are too high. In early 2021, Larry Fink, CEO of BlackRock, accused divesting investors of greenwashing, pointing to the need for shareholder pressure to push these companies to accelerate their energy transition. In practice, the exclusion of fossil fuels is part of a two-pronged strategy: anticipate the sector's loss of value in the hope that this will contribute to its stigmatisation and complicate access to finance for companies. On the other hand, listed oil majors are only one piece of the climate puzzle, with around two-thirds of the world's production generated by state-controlled companies.

Yet recent investor buy-in to the exclusionary strategies detailed in this study show that the fossil fuel sector is running out of credit. While the bulk of coal assets are now held by North American and Asian institutions, as a recent study by the specialist NGO Urgewald has shown, more and more European investors are turning away from oil and gas to further reduce their exposure to transition risks. Taken together, investments in equities and bonds in the sectors most directly linked to fossil fuels (extraction and production of electricity) represent around 3% of the asset portfolios of insurers in the European Economic Area, i.e. around €200 billion. For pension funds in OECD countries, the percentage is about 4%.

Exclusion built into regulations

Exclusion of fossil fuels has gained sufficient momentum for the Australian Parliament to request the local financial regulators to enquire into the prudential regulation in response to the many shareholders who divest from Australian companies in the sector. The same is true in Alberta, Canada, where the local government has expressed outrage at the Norwegian sovereign wealth fund's decision to exclude companies from the oil sands sector because of "unacceptable greenhouse gas emissions". In the US, on the one hand, Texas is preparing legislation to prohibit local pension funds from investing in financial institutions that divest from fossil fuels, while on the other, on the East Coast, Maine recently passed a law that will require the state's pension fund to divest from fossil fuels.

Exclusionary practices

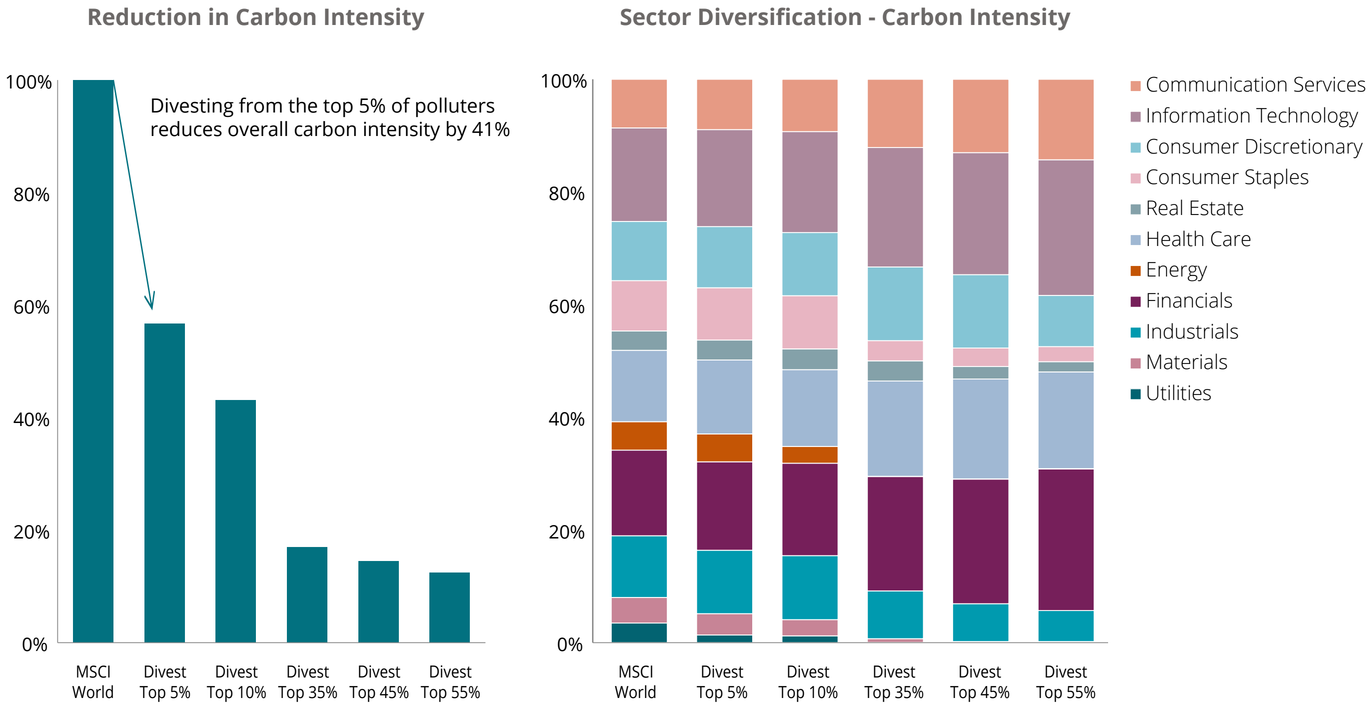
They are of three types of exclusion:

- **Norms-based exclusion** aims to protect the reputation of investors by avoiding association with controversial practices of companies whose reputation they damage by excluding them. In the case of fossil fuels, this strategy focuses on companies developing pipeline projects that infringe the rights of indigenous communities.
- **Ethical exclusion** is aimed at sectors that are excluded because they are considered harmful for moral or religious reasons. This is the reason put forward by Bill Gates to justify the exclusion of fossil fuels by his trust, with his foundation spending $3 billion a year on public health.
- **Sector exclusion** addresses more environmental imperatives, as in the case of GMOs or nuclear power, but in the case of fossil fuels, it is coupled with the logic of preventing financial risks linked to the depreciation of assets in the sector.

Linking exclusions and climate strategies

Targeted exclusion of the most carbon-intensive sectors is often the first step in a portfolio decarbonisation strategy *(see graph)*. Divesting from the most carbon-intensive issuers can quickly reduce the carbon intensity of a portfolio without disrupting sector diversification too much.

The effects of point-in-time decarbonisation on portfolio carbon intensity and sector diversification



Source: AXA Investment Managers, Rosenberg Equities, Trucost, MSCI, as of August 31, 2019. Sector diversification chart uses GICS sector classifications.

The next step is to define sectoral policies to exclude companies whose level of exposure to certain fossil fuels (coal, unconventional energy) is too high to be compatible with a commitment to align with the Paris Agreement. In the case of coal, European investors are gradually starting to implement the timetable that reflects the impact of the Paris Agreement on the sector (*see sidebox*).

For other fossil fuels, with the exception of oil sands, analysis is usually on a case-by-case basis, taking into account various "2°C scenarios", the hydrocarbon reserves still held by the companies, their capital expenditure on new production fields, their methane emissions, or their anti-regulation lobbying activities *(see page 10)*.

Timetable for phasing out coal under the Paris Agreement

- By 2030 in OECD and European countries, and by 2040 at the latest elsewhere
- Drying up of financial services for companies developing or planning to expand their thermal coal activities

The NGO Reclaim Finance, through its Coal Policy Tool, where 500 financial institutions are already rated on their investment and financing policies, encourages them to commit to gradually lowering their exclusion thresholds to zero in order to meet this timetable.

Exclusions and commitments to carbon neutrality, known as “net zero”

Acceleration of the implementation of climate strategies by investors has resulted in the creation of common frameworks provided by collaborative initiatives. They help to define the "carbon trajectory" of portfolios and the main action levers. The level of incentive to exclude or divest by these initiatives varies.

Name	Paris Aligned Investment Initiative (IIGC) - Net-Zero Investment Framework	Net-Zero Asset Owner Alliance - Target Setting Protocol	Science Based Targets initiative - Framework for financial institutions
Type	• Investment Alignment Protocol • High-level recommendations	• Investment Alignment Protocol • Targets setting framework • Commitment to act	• Targets setting framework (Net Zero framework under development)
Position on divestment and exclusions	Selective divestment should be considered when stewardship actions are failing or likely to fail. Divestments or exclusions can be decided: • As a consequence of climate financial risk assessment. • As a consequence of escalation following engagement. • Based on inconsistency of company activity with credible net zero pathways New investments should also exclude companies which are planning or constructing new thermal coal projects & infrastructure or new exploitation of tar sands.	No direct requirement for a fossil fuel exclusion policy other than strict guidelines for companies to align their transition pathways towards decarbonization with the remaining carbon budgets. A first Position Paper on Thermal Coal was published in 2020, and more are expected to follow for Oil Sands and Arctic Oil.	Financial institutions are recommended to phase out financial support to coal across all their activities in line with a full phase-out of coal by 2030 globally, within six months from the time of target approval.
Other recommendations for the Energy sector	Minimum portfolio goal of 70% of financed emissions from high impact sectors attributable to: • companies assessed as net zero or aligned with a net zero pathway • companies subject of direct or collective engagement and stewardship actions	Oil & Gas and Utilities are among the priority sectors for Sector Targets whose role is to reflect emissions reductions requirements in the highest emitting sectors. These targets also aim at limiting exposure to stranded assets and direct capital towards climate change leaders within a sector.	Targets for power generation equity and bond portfolios, including: decarbonization trajectory converging towards sectoral carbon intensity defined by the Sectoral Decarbonization Approach (SDA), and 2040 target of 100% of portfolio issuers covered by a validated Science-Based Target in required sectors. The Oil & Gas sector is awaiting a methodological framework (planned for 2021).

Exclusionary practices to strengthen climate commitments

Defining the exclusion thresholds for coal-related businesses

These practices have become much more structured since 2015. The GCEL (Global Coal Exit List), administered by the German NGO Urgewald, is the benchmark. It includes not only coal miners and coal-fired power producers, but also companies involved in coal exploration, coal processing, coal trading, coal transport and logistics, coal equipment manufacturing, coal-related operation and maintenance services and coal-to-liquids conversion. In total, almost 950 companies and 1,800 subsidiaries are included.

The list is built on three types of criteria: relative criteria, absolute criteria, and expansion criteria. In practice, the 400 financial institutions that use this list according to Urgewald do not apply all the criteria, which explains the variability of exclusion policies. In addition, some exclusions may only apply to new investments and not to stocks. The table below shows the varying exclusion practices of the 16 largest French asset management companies in terms of assets under management with a public policy to exit thermal coal in force by 31 July 2020.

Type of company	Criterion	Number of investors	Min. threshold	Max. threshold	Comment	Current GCEL threshold
All	Weight of thermal coal in turnover (%)	15	10%	50%	Relative criteria	20%
	Companies developing coal-related projects (energy production, mining and infrastructure projects)	6	300 MW	3 000 MW	Expansion criteria	300 MW (power) and 1 Mt (extraction)
Mining companies	Production of thermal coal (million tonnes extracted)	8	10 Mt	100 Mt	Absolute criteria	10 Mt
Electricity producers	Power generation capacity from coal (GW)	3	5 GW	10 GW	Absolute criteria	5 GW
	Share of electricity from coal (% of installed capacity or production)	9	20%	30%	Relative criteria	20%

Source: Joint ACPR/AMF Report - "Coal" Policies of Paris Financial Centre Participants (Dec. 2020). The report uses the GCEL

Broadening of exclusion policies

After 2017, investments in oil sands companies and those drilling in the Arctic Ocean have come under increased scrutiny for their climate impacts. Oil or tar sands are one of the most carbon-intensive sources of oil on their scope 1 & 2 emissions (generated during the extraction and preparation of the raw material for refining), and the profitability of their exploitation depends on a high barrel price. Drilling for oil or gas in the Arctic Ocean poses greater risks of leakage than conventional exploration, and may have irreversible impacts on the Arctic ecosystem and indigenous peoples in the region.

PRACTICE 1: "Norms-based"-like exclusions, widespread in Northern Europe

As a 2020 Robeco study[1] of the 10 largest pension funds in the four Nordic countries and the Netherlands shows, the publication of exclusion lists is already very common in Denmark, Sweden and the Netherlands, and coal and oil sands feature prominently. In the case of oil sands, the turnover threshold for exclusion is generally 25 or 30%, which leads to the exclusion of around ten companies. Asset managers domiciled in these regions adopt similar lists and publish them. Examples include DnB AM, NN IPP, Nordea AM and Robeco.

However, the scope of these strategies remains limited as coal and non-conventional fossil fuels represent only a very small share of fossil fuel investments. A statistical study[2] conducted by Banque de France estimates this share at €15 billion out of more than €500 billion of "fossil" holdings held by asset management companies, institutional investors and banks across Europe.

PRACTICE 2: Generalised exclusion of fossil fuels

Still very much a minority practice, it is implemented mainly by religious investors and a few mid-sized Nordic financial institutions. They have exclusionary policies that do not adapt the minimum share of turnover to the type of fossil fuels. This is the case of the Swedbank Robur (Swedish asset management) and AP1 (Swedish pension fund), the Irish sovereign wealth fund (ISIF), or SPP, the Swedish subsidiary of the Norwegian asset manager Storebrand AM. The latter excludes "only" 136 coal, oil sands and anti-climate lobbying companies, but its subsidiary SPP excludes 502 for deriving more than 5% of their turnover from fossil fuel production and distribution or holding more than 100 million tonnes of CO_2 in their hydrocarbon reserves.

Their motivations are both client expectations, since Scandinavian savers express a very high demand for "fossil free funds", and the financial risks generated by a sector whose activity is mostly incompatible with the Paris Agreement. When announcing its phased exit, AP1 commissioned an empirical financial impact study on its high yield corporate bond and emerging market equity mandates. It concluded that replacing the excluded companies with others with the same diversification characteristics does not produce any change in the risk or return pattern. Finally, the decision of the Irish Sovereign Wealth Fund, in application of the Fossil Fuel Divestment Act passed in 2018 by the Irish parliament and that sets the exclusion threshold at 20% of turnover, emanates from a desire to "take public money" out of fossil fuels to align with the Paris Agreement.

Halfway through these approaches, the Norwegian sovereign wealth fund (NBIM) and Ircantec have endorsed the exclusion of shares and bonds in "upstream" companies (specialised companies in the oil and gas sector, as defined by stock market indices). This does not yet include the oil majors, except for Ircantec, which includes companies whose capital expenditure is incompatible with a 2°C strategy.

NGOs in the UK putting pressure on pension funds

Friends of the Earth launched a campaign back in 2015 to raise awareness about fossil fuel investments in local government pension funds. It intensified in 2021 under the name "*Divesting to protect our pensions and the planet*", using the environmental but also financial argument that these pension funds have already lost €2.3 billion over the last 4 years due to their fossil fuel investments. Considering that their modest size (around €400 billion) does not allow for an active shareholder dialogue, the NGO is calling on them to exit the sector "while they still can", relying on several legal opinions issued in the UK to dismiss the argument that divestment and fiduciary duty are incompatible. So far, Guy Opperman, the Parliamentary Under-Secretary for Pensions, has aligned himself with BlackRock's position that the exclusion would hamper efforts to combat climate change, even going so far as to call divestment reverse greenwashing.

[1] Comparing ESG policies of pension funds in the Nordics and Netherlands, Robeco (Nov. 2020)
[2] Showing off cleaner hands: mandatory climate-related disclosure by financial institutions and the financing of fossil energy

PRACTICE 3: Whitelisting companies in transition to limit exclusions

The gradual lowering of the exclusion thresholds to 5% (see Practice 2) leads to a sharp increase in the number of companies targeted. Among several hundred names, exclusions lists can contain companies that investors consider to be drivers of the energy transition, but where some of the assets running on fossil fuel (legacy assets) are still in operation. In order to allow themselves to keep these companies in their portfolios or continue to support them, a number of investors, all of them Scandinavian, have developed their own criteria for defining which companies are eligible for an exception to the policy. The result is the emergence of "transition lists".

Methodologies for constructing transition lists

The majority of the criteria used are based on ratings by the Transition Pathway Initiative (TPI), which is supported by 105 investors representing $26 trillion under management. It is based, on the one hand, on the assessment of the quality of greenhouse gas emissions management and governance by companies (Management Quality), and on the other hand, an assessment of their carbon performance with regard to the objectives and commitments set by the Paris Agreement (Carbon Performance). TPI assessments, which are freely available, are divided into 17 sectors, 4 of which are directly related to fossil fuels (Coal Mining, Electricity Utilities, Oil & Gas, Oil & Gas Distribution). Out of 168 companies rated in these 4 sectors in June 2021, only 12 had the highest score on both assessments, a figure that rises to 22 if companies at level 3 on the quality of their transition management are also included (rated from 0 to 4).

Transition lists can also be developed based on the work of the Science-Based Targets Initiative (SBTi), which enables investors to rely on external validation of companies' climate commitments compared to sectoral greenhouse gas emission trajectories compatible with the Paris Agreement. It distinguishes between companies whose reduction targets are under development ("Committed") and those who have obtained scientific validation of these targets by the initiative ("Targets Set"). Three sectors covered are relevant to this study: Electric Utilities & IPP & Energy Traders, Gas Utilities, and Oil & Gas. Only validated targets are used to build the transition lists, which only concerned 27 companies from these sectors at the end of June 2021.

Investor	List	Number of companies "salvaged"	Criteria for the transition list	Fossil fuels exclusion criteria
Swedbank Robur	Green list	3	Fossil operations generate less than 50% of company revenue; no revenue from shale oil/gas, arctic oil/gas or oil sand; "2°C" alignment target or commitment considered credible.	• Turnover > 5% for coal, oil and gas extraction. • Turnover > 50% for the rest of the gas value chain • Turnover > 50% for services
Länsförsikringar	Climate Smart Vision	13	Companies with between 5 and 20% of their turnover from coal-fired power generation if one of the following criteria is met: • SBT approved or alignment with a 2°C scenario in 2030 according to TPI • Share of turnover from renewable electricity exceeds that of turnover from fossil electricity	• Turnover > 5% for coal and non-conventional fossil fuels. • Turnover > 50% for conventional fossil fuels • Oil majors not receptive to dialogue
Nordea AM	PAFF list (Paris-Aligned Fossil Fuel)	163 (including subsidiaries)	Companies that are covered by the Transition Pathway Initiative are put on the list if they have emissions targets that are aligned with 2°C or less, and a climate governance rated at 3 or higher (out of 4). If not covered by the TPI, ratings such as CDP are used	• Turnover > 5% for conventional fossil fuels • Turnover > 0% for non-conventional fossil fuels • Turnover > 50% for oilfield services (Applies to approx. 60% of AuM)

Linking exclusions and investment in green bonds

Green bonds are often promoted by issuers and investors as a way to help finance the low-carbon transition. To ensure the environmental integrity of this financial product, issuers commit to transparency in the use of the proceeds raised and to financing only projects within a green taxonomy. This principle of separation between the activity of the issuer that may fall within the scope of the exclusions and the nature of the projects financed opens the possibility of formulating exceptions.

Green bonds that are "salvaged" in this way must generally comply with a specific eligibility framework that is designed to assess the contribution of the bond to the issuer's transition funding. Few fossil fuel companies have ventured into the green bond market so far, with the notable exception of Repsol in 2017. Since then, companies wishing to issue "sustainable" bonds have opted instead for the Sustainability-Linked Bond format, which allows them to align themselves with general sustainability objectives. This is the case of the Italian company Enel or the US-based NRG Energy. Finally, it should be noted that several asset management companies, including Amundi and Axa IM, revealed at the end of 2020 that they had disinvested from the green bond issued by the State Bank of India because of the bank's involvement in the granting of a loan to Adani Enterprises, one of the Indian coal giants, which is particularly controversial because of its Carmichael mining project in Australia that threatens the Great Barrier Reef.

PRACTICE 4: Exclusion based on index management

As part of its Sustainable Finance Action Plan, the European Commission has launched two climate benchmarks, often referred to by their acronyms: PAB stands for Paris-Aligned Benchmark and CTB for Climate Transition Benchmark. They serve as a benchmark for investors who want to align their index management with their climate policies, but only the most demanding leads to a strict policy of excluding fossil fuels.

Paris-Aligned Benchmark

The Paris-Aligned Benchmark is designed to link carbon intensity reduction trajectory to compliance with the Paris Agreement targets, and is the more ambitious of the two. It is based on two principles:

- an initial reduction (of 50%) in the carbon intensity of the investment universe combined with an annual reduction of 7% at index level
- maximum turnover thresholds related to coal, oil and gas, which govern which companies in the fossil fuel and power generation sector can be included in the index (see below)

Rules for exclusion from the PAB index (% of turnover for each company)	• exploration, mining, extraction, distribution or refining of hard coal and lignite (1%) • exploration, extraction, distribution or refining of oil fuels (10%) • exploration, extraction, manufacturing or distribution of gaseous fuels (50%) • electricity generation with a GHG intensity of more than 100gCO_2/kWh (50%)

Two financial institutions have announced a portfolio adjustment to apply the PAB exclusion rules across the majority of their investments. They are the Swedish pension fund AP2 and Banque de France for its own funds and pension liabilities investment portfolios. AP2, which has €36 billion in assets under management and applies the PAB rules to around €20 billion, said in December 2020 that the adoption of these exclusions had led it to place 250 companies on its divestment list. For Banque de France, these new management rules, not associated with index management, will apply from 2024, in addition to rules already in place for coal and non-conventional hydrocarbons. The threshold on electricity generation was not retained.

The percentages used in the PAB index in accordance with the recommendations of the technical expert group mandated by the European Commission result in the exclusion of a majority of the fossil energy sub-sectors, leaving only a few companies whose gas business represents a minority share. The rule for electricity generation (which follows the 100gCO2/kWh threshold formulated in the Taxonomy) also leads to the exclusion of a large number of diversified power producers, whereas the European average was 296gCO2/kWh according to the latest PwC Carbon Factor study. However, NGOs such as Reclaim Finance believe that the exclusion criteria for this index should be strengthened by specifically targeting unconventional hydrocarbons and companies developing new hydrocarbon exploration/exploitation projects or coal-fired power generation projects.

Exclusion of sovereign bonds based on climate criteria

Not yet widely practised, the lever of "2°C" alignment of portfolios via the exclusion of certain sovereign bonds was activated at the end of 2019 by the Swedish Central Bank (Riksbanken). It revealed that it had sold bonds issued by the Canadian state of Alberta and the Australian provinces of Queensland and Western Australia on the grounds that their per capita greenhouse gas emissions are among the highest in the world. For Alberta, the oil sector represents around a quarter of GDP and it should be noted that the recent cancellation of the Keystone XL pipeline will cost the province around $1.3 billion.

PRACTICE 5: Coupling shareholder engagement with the threat of exclusion

Some large investors prefer to use divestment as the ultimate weapon when dialogue has failed. This is the case for Aviva Investors and CNP Assurances, which adopted a strategy of targeted engagement with 30 and 8 high-emitting companies respectively in early 2021. Extremely precise in their wording, these investors want more transparency and above all commitments to reduce greenhouse gas emissions, including scope 3. In addition to the formulation of interim carbon neutrality targets, ideally within the framework of the Science-Based Targets initiative, these investors are demanding an alignment of corporate lobbying policies with the Paris Agreement. Both include a possible escalation through graduated measures, notably at annual general meetings (AGMs), "the ultimate sanction being divestment".

In the UK, Legal & General Investment Management (LGIM, £58 billion under management) has already taken the step of divesting after an unsuccessful shareholder engagement. The UK index fund asset manager uses an internal rating of over 1000 companies (the Climate Impact Pledge score which is available on its website) to define its targets. In 2021, LGIM said it sanctioned the management of 130 companies during 2020 proxy season, and excluded PPL Corporation, which operates coal and gas plants, after ExxonMobil, KEPCO and Rosneft in 2020.

Investors practising this form of ultimatum monitor the adoption of carbon neutrality targets by targeted companies. Of the 58 companies on its priority list, LGIM counts 13 companies that have taken this step. Aviva Investors notes that in 2020, "Shell, Repsol, Total, ENI, Equinor and Woodside Petroleum have committed to the goal of carbon neutrality by 2050".

These positions provide a temporary 'breathing space' for the oil sector. Until now, it was the main sector that did not yet have a Science-Based Targets methodological framework. Its publication, announced for 2021, should allow investors to challenge the targets set by the fossil fuel sector with greater precision.

Swedish pension funds AP struggle to convince on shareholder engagement

This strategy is often criticised by NGOs as being too slow and not producing tangible results. The Swedish pension funds AP (about €200 billion in total, of which €1.5 billion is invested in 66 of the 200 largest fossil fuel companies) were attacked in March 2021 by the Swedish Nature Conservation Society (Naturskyddsföreningen). Its analysis focused on companies targeted by the Climate Action 100+ coalition, in which the AP funds participate. A study of voting statistics confirms that AP funds broadly supported 19 climate resolutions at the general meetings of target companies in 2020. However, after four years of operation, Naturskyddsföreningen concludes that the significance of the coalition's action is limited. Given the state of climate progress in key sectors (see Net Zero Company Benchmark rating below), the NGO believes that divestment would still be most effective for the oil sector while focusing efforts on electric utility companies.

Sector	Ambition of carbon neutrality in 2050 or earlier		GHG reduction targets 2020-2025	GHG reduction targets 2026-2035	GHG reduction targets 2036-2050
	Of which Scope 1 & 2 emissions	Of which Scope 3			
Oil & Gas	15/41	3/41	Partial: 25 No: 16	Yes: 1 Partial: 21 No: 19	Yes: 2 Partial: 15 No: 24
Utilities	21/30	2/16 (not applicable: 14)	Partial: 9 No: 7	Yes: 4 Partial: 10 No: 2	Yes: 2 Partial: 13 No: 1

Source: Net Zero Company Benchmark, CA100+. Data at of end of January 2021

Most frequently excluded companies

In order to identify which companies are most often excluded under climate exclusion strategies, Novethic has compiled 30 exclusion lists of European investors, 22 of which are signatories to the Climate Action 100+ initiative.
This table of companies at the top of the exclusion lists are divided into four categories with the number of investors refusing to invest in them.

European energy suppliers excluded		Oil companies excluded		Oil sands companies excluded		Companies targeted by CA100+ most excluded by its signatories	
PGE	18	Phillips 66	12	Canadian Natural Resources	26	Coal India, Suncor Energy, Canadian Natural Resources	18
RWE	11	ConocoPhillips	12	Suncor Energy	26	Imperial Oil	17
CEZ	10	ExxonMobil	11	Cenovus Energy	25	NTPC	14
PPC	8	Occidental Petroleum, Marathon Petroleum, Lukoil, Chevron, Repsol	8	Imperial Oil	24	PPL Corp, PGE, Bumi Resources	12
Enel, Uniper	7			MEG Energy	21	Enbridge	11

Of the companies excluded by at least 10 investors in the panel (109 companies), only 9 companies have a carbon performance deemed by the Transition Pathway Initiative to be aligned with the 2°C trajectory set by the Paris Agreement and only 4 can claim an approved Science-Based Target.

Investor panel: This overview is based on a sample of 30 investors (mainly pension funds and asset managers), whose exclusion lists are public and whose asset size exceeds €10 billion.
Pension funds: AP Pension, AP7, APG, ATP, Danica/Danske Invest, Industriens Pension, KLP, Lærernes Pension, Länsförsäkringar, PFA, PFZW (formerly PGGM), PGB, PKA, Pplus, Rabobank Pensioenfonds, UWV, Velliv. Asset managers: Achmea IM, AEGON AM, DNB AM, LGIM, NN IP, Nordea AM, Robeco, SEB IM, Skandia, Storebrand, Swedbank Robur. Sovereign Wealth Funds: ISIF, NBIM

Three cases of frequently excluded companies

- **ExxonMobil :** Among the oil majors, ExxonMobil is considered to be lagging the furthest behind on the energy transition. It suffered a setback in May 2021 when the activist fund Engine No. 1 succeeded in getting three of its nominees elected as directors to the company's board.
- **RWE:** The German energy company, which according to GCEL operates 14 GW of coal-fired power plants, is one of the largest emitters of CO2 in Europe and aims at a coal exit in 2038. The company is a textbook case, as it is demanding financial compensation from the Dutch government for its coal phase-out schedule, but has also had its Science-Based Target (SBT) for 2030 approved.
- **Enbridge:** The Canadian company specialises in the transportation and distribution of fossil fuels, including a network of 28,000 kilometres of oil and gas pipelines in North America. It has also invested in 5 GW of renewable energy generation, including the first offshore wind farms off the coast of Normandy.

Exclusion (Yes/No)	Exxon	RWE	Enbridge
Practice 1 Exclusions of coal and oil sands	No	Yes, in most cases. The company exceeds the absolute and relative thresholds set by the Global Coal Exit List	No if oil and gas distribution not part of exclusion policy
Practice 2 Almost complete sectoral exclusion	Yes	Yes	Depends on whether pipelines are included in the exclusion policy
Practice 3 Exclude with exceptions	Yes (assessed as "unaligned" by TPI)	Yes/No depending on the criteria used. Likely reintegration via its approved SBT	Yes/No according to criteria
Practice 4 Rules for exclusion from the PAB index	Yes	Yes	Yes
Practice 5 Dialogue before exclusion	Very likely. Already excluded by LGIM.	Uncertain. Carbon neutrality target adopted but rated C- by InfluenceMap on lobbying	Likely. Poorly rated by TPI (Management Quality)

Conclusion

Initially focused on coal, exclusion and divestment practices are experiencing a real acceleration. The desire of investors to align the greenhouse gas emissions of their portfolios with the Paris Agreement is conjugated with that of reducing their overall financial exposure to transition risks by exiting one or more sectors.

Exclusions are now accepted as a financial management practice and occur in all fossil fuel sectors, even going as far as total exclusion by some Nordic investors.

This study lists the five main exclusion practices:

- Exclusion of coal gradually coupled with that of unconventional fossil fuels such as tar sands,
- Global exclusion of all fossil fuels,
- Whitelists of companies adopting ambitious transition policies,
- Threat of exclusion to give more impact to a shareholder engagement strategy and finally,
- Adoption of the exclusion rules of climate indices.

To understand the consequences on portfolios of each approach, one must analyze the technical and scientific frameworks used to implement them. In practice, the number of excluded companies can vary from ten to several hundred, depending on the size of the initial investment universe but above all on the selectivity of the criteria. This study provides a statistical analysis of the exclusion lists made public, most often by large investors from Northern Europe and the Netherlands. Frequently excluded companies have been classified into several categories: electric utilities, oil companies, tar sands companies.

As a sign that these practices are on the rise, the secondary market's share of Oil & Gas equity proceeds rose from 6% to 78% between 2016 and 2019, according to a note published in March 2021 by the Carbon Tracker Initiative.

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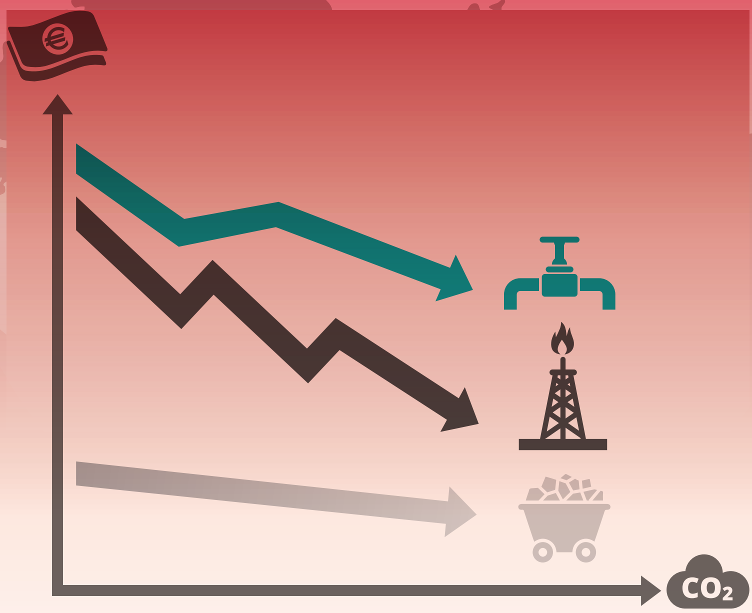

A study by Nicolas Redon, Novethic's green finance expert,
under the supervision of Anne-Catherine Husson-Traore