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Accélérateur de transformation durable

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ESG exclusion:
Fossil fuels are losing ground with investors

Sustainable Finance Research

In their race to achieve "carbon neutral" portfolios, major European investors are increasingly resorting to exclusion and divestment practices. Initially focused on coal, fossil fuel exclusion practices are now spreading to the gas and oil sub-sectors, even going as far as total exclusion in Northern Europe.

Novethic's study entitled "Exclusion of fossil fuels: are investors ready to change tack?" provides an overview of the main exclusion strategies and highlights their limitations in terms of effectively reducing greenhouse gas emissions. It also enlightens on the contribution of collaborative initiatives, such as the Net-Zero Asset Owner Alliance and the Science Based Targets Initiative, in defining the "carbon trajectories" of investment portfolios and the possible levers for action.

5 approaches to fossil fuel exclusions of varying nature
Novethic has listed the five most widespread approaches whose consequences for portfolios can be understood by analysing the technical and scientific frameworks for their implementation:

1. The exclusion of coal gradually coupled with that of non-conventional oil (oil sands)
2. Global exclusion of all fossil fuels
3. Whitelists of companies in transition that "escape" the exclusions
4. The threat of exclusion if the shareholder engagement strategy fails
5. The adoption of exclusion rules set up for indices with climate objectives

Source: Novethic

Frameworks for aligning portfolios with the Paris Agreement targets, such as the Science Based Targets initiative or one of the indices launched by the European Commission as part of its action plan on sustainable finance (Paris-Aligned Benchmark), all incorporate exclusionary approaches of varying levels and intensity:

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 100gCO2/kWh (50%)

Lower the carbon intensity of a portfolio or reduce greenhouse gas emissions?

Many investors can act on the carbon emissions of their portfolios. Divesting the top 5% of carbon-intensive emitters can reduce the carbon intensity of their portfolio by as much as 41%! The next step is to define sectoral policies that exclude companies whose level of exposure to fossil fuels is too high to be compatible with the Paris Agreement. But these exclusion strategies may have a limited impact on the actual reduction of greenhouse gas emissions. This is why some actors favour shareholder engagement, which involves remaining a shareholder in the companies they want to pressure. However, this strategy can also lead to exclusion by blacklisting companies who eventually cannot be influenced to adopt climate-friendly.

Novethic's in-depth analysis of the exclusion lists published by 30 investors, mainly from Northern Europe, allows to draw up the table of the most excluded companies in the fossil fuel sector above.

European energy suppliers excluded	
PGE	18
RWE	11
CEZ	10
PPC	8
Enel, Uniper	7

Oil companies excluded	
Phillips 66	12
ConocoPhillips	12
ExxonMobil	11
Occidental Petroleum, Marathon Petroleum, Lukoil, Chevron, Repsol	8

Oil sands companies excluded	
Canadian Natural Resources	26
Suncor Energy	26
Cenovus Energy	25
Imperial Oil	24
MEG Energy	21

Companies targeted by CA100+ most excluded by its signatories	
Coal India, Suncor Energy, Canadian Natural Resources	18
Imperial Oil	17
NTPC	14
PPL Corp, PGE, Bumi Resources	12
Enbridge	11

Source: Novethic

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To better understand how exclusion strategies and pressures on companies are articulated, Novethic illustrates the diversity of exclusion practices with three emblematic companies: the oil company Exxon, the German energy company RWE and the Canadian pipeline operator Enbridge.

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)

Source: Novethic

The Paris Agreement has cast a growing shadow over the financial outlook of the sector, which has already been partly incorporated by financial markets that tend to limit their exposure to depreciation risks.
The Carbon Tracker Initiative think tank found that the share of the secondary market in oil and gas equity sales rose from 6% to 78% between 2016 and 2019.
Exclusion is a growing practice. It is at the heart of debates as it is not only used by investors to limit their exposure to financial and climate risks but is also contested on its effectiveness in terms of greenhouse gas (GHG) emissions reduction. It can even be described as "reverse greenwashing" by its critics. In any case, it is gradually becoming a financial management practice used in various ways by investors who have made climate commitments.

Discover the full analysis

About Novethic, the sustainable transformation accelerator of the Caisse des Dépôts group.

Our mission is to inform, train and encourage action by financial actors, companies, and citizens.
At the crossroads of sustainable finance strategies and corporate social responsibility practices, Novethic deploys its expertise - **media, research, audit, and training** - to enable professionals and decision-makers to meet the challenges of sustainable transformation.
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