

BURNED

How superannuation funds have lost billions on fossil fuels



**MARKET
FORCES**

YOUR MONEY AS A FORCE FOR GOOD



**SUPER
SWITCH**

SUMMARY

- The fossil fuel industry is causing massive environmental damage and driving climate change.
- People are inadvertently supporting the fossil fuel industry through the investment decisions of their super funds, the custodians of their retirement savings.
- Many super funds have recognised the dangers of climate change, as well as the risks it poses to fossil fuel-related assets. However, the vast majority of Australian super funds are still invested in fossil fuels.
- We estimate losses on fossil fuel company investments in fifteen of Australia's largest default super fund options at over \$5.6 billion over the period 2014-15.
- Fossil fuel stocks have underperformed over the two years studied, after many financial experts expressed concerns about the sector.
- The Paris climate summit confirmed the urgent global need to act on climate change. To have any hope of keeping temperature rise below two degrees, we cannot continue to invest in companies that would expand or prolong the fossil fuel industry.
- Super funds need to fully disclose their fossil fuel holdings and immediately divest from pure play fossil fuel companies. They must also engage with diversified companies to encourage a swift exit from the fossil fuel sector.
- Super fund members can use Super Switch to examine their exposure to coal, oil and gas companies and take action to get their retirement savings out of fossil fuels.

INTRODUCTION

Having dominated global discussion for decades, no one should be in any doubt about climate change's threats or the strategies necessary to avoid the worst of its impacts. Certainly climate change should not be a news flash for investment managers or Trustees responsible for administering Australia's almost \$2 trillion in superannuation.

Climate change is driven by the accumulation of greenhouse gases in our atmosphere, like the carbon dioxide that is produced in large measure by burning coal, oil and gas. Current global fossil fuel reserves, if extracted and burnt, would emit far more carbon than is compatible with meeting the internationally agreed limit of less than two degrees of global warming.(1)

Fossil fuels also pose a raft of other local and near-term risks to both humans and the environment.

In Australia, open cut coal mining in the Leard State Forest, dredging to construct coal and gas export facilities in the Great Barrier Reef World Heritage Area and invasive coal seam gas mining in some of Queensland's most fertile farmlands serve as prominent recent examples. Studies show that particulate pollution from coal mining and combustion result in health costs to humanity in the order of billions of dollars, and tens of thousands of premature deaths per year.(2)



Open cut coal mining encroaching on Leard State Forest, NSW. Credit: Dan Sewell - Greenpeace.

For any or all of these reasons, many Australians are concerned about the impacts of fossil fuels and the prospect of financially supporting the coal, oil and gas industries. Market Forces empowers individuals to change the behaviour of financial institutions that are invested in the fossil fuel industry.

DISCLAIMER: The information provided in this document does not constitute financial advice. The information is of a general nature only and does not take into account your individual financial objectives, situation or needs. It should not be used, relied upon or treated as a substitute for specific professional advice. Market Forces recommends that you obtain your own independent professional advice before making any decisions in relation to your particular requirements or circumstances.

SUPER - INVESTING AGAINST AUSTRALIANS' VALUES?

The vast majority of Australians are invested in fossil fuels via their superannuation fund. Market Forces maintains the website superswitch.org.au, which profiles over 40 Australian superannuation funds in terms of their fossil fuel investments. Most funds are invested in coal, oil and gas companies, meaning that close to fifteen million Australians have their retirement savings exposed to the fossil fuel sector.

This stands in stark contrast to the 67% of Australians who would choose a superannuation fund which does not invest in fossil fuels over one that does,³ and the 24% who would be willing to switch their super fund based on coal or coal seam gas investments.⁴

Superannuation funds, as custodians of millions of Australians' retirement savings, have a duty to manage those funds in accordance with the best long term interests of their members. In a 2015 article on corporate governance and climate change, Minter Ellison stated, "boards must actively engage with the impact of these financial risks and opportunities on their portfolios".⁵ It is clear that many funds, including those not included in our analysis, are simply not engaged on this issue. This is doing a great disservice to their members.

IS YOUR SUPER INVESTED IN FOSSIL FUELS? FIND OUT AT

SUPER SWITCH.ORG.AU

STARING DANGER IN THE FACE

While campaigning groups call on super funds to divest from fossil fuels on environmental and moral grounds, many within the financial sector have been raising the alarm about the risks to investments that are inconsistent with action on climate change.

For years financial analysts have been warning us about the growing risks associated with a carbon bubble.⁶ As early as 2013, concerns about thermal coal's long term viability in a carbon-constrained world were being raised by analysts from some of the world's most prominent financial institutions and researchers.⁷ By 2014, even Standard and Poor's had publicly recognised the likelihood that coal assets would be left stranded due to restrictive carbon emissions policies.⁽⁸⁾

In 2015 coal consumption in the world's two largest economies - China and the US - dropped significantly,⁽⁹⁾ and many financial analysts have now concluded that the global thermal coal industry is in structural decline.⁽¹⁰⁾

While less carbon intensive than coal, the oil and gas industries have also been flagged as susceptible to devaluation due to carbon constraints.⁽¹¹⁾ It is important to note that past losses do not necessarily guarantee future poor performance, however the financial analysis and predictions cited should be given consideration by fund managers.

It has also been documented that companies with positive social and environmental credentials tend to outperform the rest of the market.⁽¹²⁾

Many within the super industry have acknowledged climate risk. For example, large industry super fund Cbus recently took part in a study by Mercer into climate change risk, stating: "Cbus sees climate change as a significant issue for our investment portfolio over the longer term. We believe that participation in this study gives us insights into the range of impacts that climate change may have on our investments, and enable us to better prepare for the climate change-related challenges ahead." - Kristian Fok, Executive Manager Investment Strategy, Cbus⁽¹³⁾

Deb Clarke, Mercer's Global Head of Investment Research prefaced the study by acknowledging that Mercer "have understood for a number of years that climate change presents a series of risks to institutional investors".⁽¹⁴⁾

Climate risk has also been recognised by others in the super industry, including HESTA: "The push to limit the impact of global warming requires economies to move to a lower-carbon intensive future and investors have an important role to play in this transition... HESTA believes that further investment in developing new, or expanding existing, thermal coal reserves is inconsistent with this imperative to reduce carbon emissions." - Anne-Marie Corboy, Chief Executive Officer, HESTA⁽¹⁵⁾

Clearly there is an understanding within the managed funds industry that climate risk is real, and manifests both financially as well as environmentally. Yet it is difficult to reconcile this against the ongoing investments of superannuation companies in the fossil fuel sector, as it looks like our super funds are staring this danger in the face.

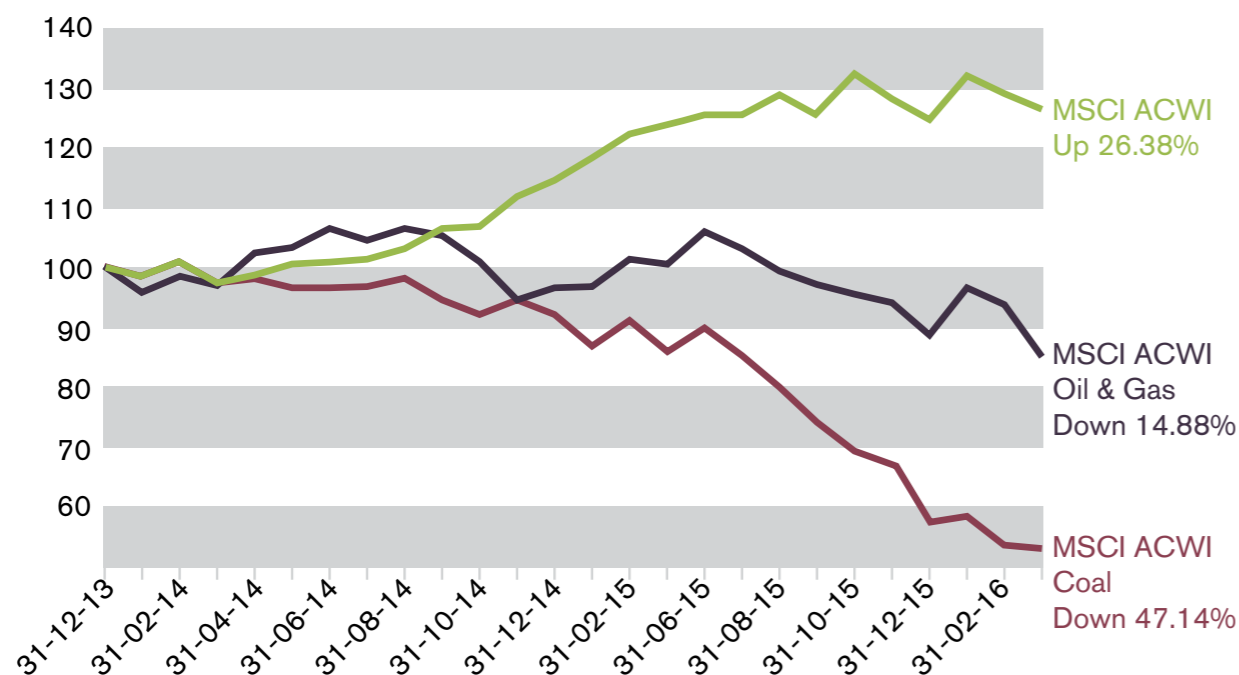
EXPERT WARNINGS REALISED

The chief driver of greenhouse gas emissions is burning fossil fuels such as coal, gas and oil.¹⁶ These sectors have been well documented as having performed poorly in recent times.⁽¹⁷⁾

The graph below shows how coal, oil and gas company stocks have performed relative to the MSCI All Countries World Index (Gross AUD) since the start of 2014 when MySuper came into effect.

Market Forces is aware of several factors that could drive poor performance in coal, oil and gas that are not necessarily climate policy related. However, these results seem consistent with the concerns and theories outlined by the experts cited on the previous page, which in aggregate appears to be a substantial body of evidence.

MSCI ALL COUNTRY WORLD INDEX (AUD) 2014-2015



KEY FINDINGS

- The 15 default products analysed lost an aggregate of \$5.62 billion on fossil fuel equities investments since the introduction of MySuper
- Approximately 58% of these losses were on pure play coal, oil & gas companies; the remainder was on diversified companies and utilities
- Funds sacrificed, on average, 1.81% of returns over the two year period (range - 2.59% to -0.86%)
- Funds lost, on average, \$1109 per member (range -\$3024 to -\$226)
- Given that most funds only disclose limited equity holdings, it is likely that further losses were experienced across other asset classes
- Losses on international shares were buffered by the decline in the AUD; without that benefit, losses would have been significantly higher
- Estimated losses do not include the opportunity cost of not investing in other asset classes (potentially another 1-2% p.a.)

LOSSES MADE BY MAJOR SUPERANNUATION FUNDS ON FOSSIL FUEL COMPANY SHARES 2014 TO 2015

MySuper product name	Fund size	Estimated losses	Estimated losses per member	Estimated impact on return
Colonial FirstChoice Superannuation Trust*	\$ 8,339m	-\$209m	-\$ 3,024	-2.59%
MLC MySuper*	\$11,669m	-\$272m	-\$1,056	-2.34%
AMP MySuper No.2*	\$12,757m	-\$255m	-\$ 878	-2.12%
Mercer SmartPath*	\$ 7,493m	-\$181m	-\$2,165	-2.11%
AustralianSuper MySuper	\$63,644m	-\$1,232m	-\$ 848	-2.04%
HESTA Core Pool	\$26,807m	-\$485m	-\$ 735	-1.91%
BT Super For Life MySuper*	\$13,054m	-\$219m	-\$1,305	-1.89%
Sunsuper for Life	\$20,840m	-\$370m	-\$ 593	-1.86%
Cbus Growth (Cbus MySuper)	\$27,454m	-\$466m	-\$ 735	-1.78%
First State Super MySuper Lifecycle	\$40,565m	-\$685m	-\$1,174	-1.74%
HOSTPlus Balanced	\$16,145m	-\$254m	-\$ 297	-1.64%
UniSuper Balanced	\$13,500m	-\$202m	-\$1,823	-1.60%
VicSuper for Life MySuper*	\$ 8,443m	-\$114m	-\$ 881	-1.37%
REST Super Core Strategy	\$34,738m	-\$446m	-\$ 226	-1.34%
QSuper Lifetime	\$27,972m	-\$229m	-\$ 892	-0.86%
Total	\$333,421 m	-\$5,620m	-\$1,109	

* Retail funds include accrued default accounts

All monetary values are in Australian dollars with m signifying millions

METHODOLOGY

Data for our calculations in the above table was sourced primarily from the Australian Prudential Regulatory Authority (APRA), or publicly disclosed information provided by funds studied. The only asset class analysed for returns was equities, which typically accounts for just under half a fund's assets under management.

For lifecycle style products, rather than using one segment, a weighted average of the asset allocation was applied, based on the assets under management in each segment.

Where available, holdings data was collated from all managers from 2012 onwards. The least transparent funds – Colonial First State and MLC – didn't disclose any holdings at all; while the most transparent funds – Cbus and HOSTPlus disclosed over 90% of their shareholdings.

Standard market indices were used as a proxy for the undisclosed portion of each fund's equities allocation. For Australian shares, we used the S&P ASX 300 Index (Gross returns in AUD); for International shares, we used the MSCI All Countries World ex Australia Index (Gross returns in AUD).

Figures for the average losses per member were calculated by assuming the proportion of assets under management in the default product studied is representative of the relative membership of the product. Member numbers for each manager were sourced from ChantWest.

Most default superannuation funds do not hedge the currency movements in their international shares portfolio. If they do hedge, it is just over a minor portion of the allocation. With this in mind, we used the Australian dollar returns of the MSCI All Countries World ex Australia Index as proxy for the entire International Shares allocation.

In order to be classified as fossil fuels, a company must have a direct role in the industry. This includes the exploration, production, mass combustion or transportation of fossil fuels. The complete list of companies included in the analysis can be found on www.superswitch.org.au/about.

The analysis started with data from January 2014 as this coincided with the introduction of MySuper and the options listed in the table. For retail funds, assets under management were aggregated for MySuper products, corporate MySuper plans and accrued default amounts.

While we expect the analysis to be broadly accurate, the lack of disclosure from most funds has meant we conducted this analysis having to make assumptions, namely the proxy allocation of equities to the S&P ASX 300 and MSCI All Countries World ex Australia indices. We would welcome greater transparency and are happy to update this and future material if a fund would be willing to share the necessary information with us.

ANALYSIS

Riskier by default

As of January 2014, all super members who did not actively choose an investment option were directed into newly legislated MySuper products. Most industry and public sector funds simply converted their old default funds into MySuper products. On the other hand, most retail funds introduced new 'lifecycle' type products, where customers are gradually shifted into more conservative assets as they aged. MySuper products generally have the most assets under management - this is particularly the case for industry and public sector funds.

Most fund managers view climate change through the lens of responsible investment. It certainly is a matter of responsible investment, but unlike other sectors which are typically excluded in 'responsible' options – tobacco, alcohol, gambling – there is a substantial body of expert opinion to suggest that climate change is likely to have systemic impacts and be felt by all investors.(18)

Super funds are well aware that the vast majority of members are apathetic about their super.(19) Whether this apathy is due to laziness or a lack of financial literacy is up for debate. However, by confining climate change to the realm of responsible investment, only engaged members will make the switch to an appropriately low-carbon fund.

Therefore, it is no longer acceptable to treat climate change as a bespoke issue, where only active and concerned members are offered lower carbon exposed options. Climate change must be confronted where the majority of superannuants are invested – in the default, MySuper fund.

Disclosure

The federal government legislated changes that would require superannuation funds to disclose their entire holdings in 2014.(20) This has become the proverbial can that is kicked down the road, as the industry lobbied to delay its implementation until July 2016.(21) Increased disclosure

provides consumers with the necessary information to make an educated decision about their retirement. From our experience, retail funds typically disclose less about that holdings than industry and public sector funds. If retail funds do disclose their holdings, it is often hidden away and at most, the top ten holdings. To their credit, both Cbus and HOSTPlus disclose the vast majority of their holdings in an easily accessible page on their websites.

The industry generally needs to perform much better on disclosure. Legislation should not be required to force the issue. Fund managers complain that portfolio construction is their intellectual property, and publishing it online would compromise their ability to outperform their peers. This argument falls over, however, if they were to publish three or six month old data. It is in the interests of members to be informed about what they're invested in, and how that contributes to the fund's performance.

Other important factors

In the 2014 and 2015 calendar years, the Australian dollar declined 18% against the US dollar. This is particularly significant for our analysis as losses on international shares were buffered by the decline. Without that benefit, losses would have been significantly higher.

The Australian share market is heavily weighted towards financial services and natural resources. Given the global decline in commodities over the last 18 months, the Australian share market was heavily impacted – returning just 5.3% in 2014 and 2.8% in 2015. BHP Billiton Ltd, Rio Tinto and various energy producers dragged the broader market down. Therefore, if a fund was more heavily weighted to Australian shares, or specifically the Energy or Materials sectors, then its performance was comparatively worse than its peers.

REFERENCES

1. Nature, 8 January 2015, 'The geographical distribution of fossil fuels unused when limiting global warming to 2 °C'
2. Nature, 17 September 2015, 'The contribution of outdoor air pollution sources to premature mortality on a global scale'
3. Lonergan Research, 4 June 2014, 'Majority want carbon free bank account, super fund'
4. The Australia Institute, March 2013, 'Time to get engaged with super?'
5. Minter Ellison, 27 January 2015, 'Institutional investment, corporate governance and climate change: what is a trustee to do?'
6. Carbon Tracker Initiative (CTI), 2013, 'Unburnable Carbon 2013'
7. Deutsche Bank, 9 May 2013, 'Thermal coal: Coal at a crossroads'; Goldman Sachs, 24 July 2013, 'The window for thermal coal investment is closing'; Bernstein Research, June 2013, 'Asian coal & power: Less, less, less... The beginning of the end of coal'
8. Standard and Poor's, 21 July 2014, 'Carbon constraints cast a shadow over the future of the coal industry'
9. Institute for Energy Economics and Financial Analysis (IEEFA), 18 January 2016, 'Data bite: China continues to drive global markets lower'
10. CitiGroup, May 2015, 'Survival of the fittest'; IEEFA, 15 January 2015, 'Global energy markets in transition'; Goldman Sachs, 30 November 2015, 'The low carbon economy'
11. Deutsche Bank Research Haus, 19 January 2015, 'Peak carbon before peak oil'; CTI, July 2015, 'Carbon supply cost curves: Evaluating financial risk to gas capital expenditures'
12. Responsible Investment Association Australasia, 'Responsible investment benchmark report 2015 Australia'
13. Mercer, 2015, 'Investing in a time of climate change'
14. Ibid
15. HESTA, September 2014, Media release
16. Science, 3 December 2004, 'The Scientific Consensus on Climate Change'
17. The Guardian, 20 August 2015, 'Wellcome Trust loses millions as its fossil fuel investments plunge in value'
18. University of Cambridge, 2015, 'Unhedgeable risk'
19. The Australia Institute, March 2013, 'Time to get engaged with super?'
20. Australian Treasury, 10 December 2015, 'Improved superannuation transparency'
21. Investor Daily, 29 May 2015, 'Portfolio holdings disclosure a moral hazard'
22. The Guardian, 19 January 2015, 'China's coal burning in significant decline, figures show'

Protesters demand climate justice during COP21, Paris. Credit: Luka Tomac - Friends of the Earth International



WHAT DOES PARIS MEAN FOR OUR SUPER?

The December 2015 Paris climate talks and resulting international agreement confirmed the urgent need for global action to cut emissions to reign in global warming. The internationally agreed commitment to keep temperature rise well below two degrees - with an ambition to not exceed 1.5 degrees - showed us that world leaders are finally recognising the gravity of the problem.

A number of countries have already committed to carbon reduction policies, and if the 'less than two degree' target is to be met, more policies and more severe cuts in greenhouse gas emissions are inevitable. 2015 is thought to have been the first year since industrialisation that carbon emissions have decreased due to a changing energy mix rather than economic contraction, with significant decreases in Chinese and US coal consumption recorded over the year.(22)

While we expect the financial sector will need to have quick feet to adapt to what Paris mandates for high carbon investments, if nothing else Paris underscored the sheer urgency and moral compulsion to act.

WHAT SUPER FUNDS NEED TO DO

The production of fossil fuels is severely damaging our natural environment, while their use as energy sources is driving dangerous climate change. Superannuation funds must divest all fossil fuel holdings on environmental and moral grounds. Furthermore, the assumptions and calculations in this report have led us to believe that many super funds have been losing money on their fossil fuel investments.

Market Forces has proposed a four-step process for super funds to reduce their exposure to environmentally damaging assets, reduce the climate risk of their portfolios and act in the best interests of fund members:

1. Disclose the value of fossil fuel exposed assets to their members and explain to members their plan to manage climate risk.
2. Divest from pure play fossil fuel companies.
3. Invest in renewable energy and energy efficiency.
4. Engage with diversified companies that pose some environmental and climate risks, asking for a swift exit from the fossil fuel sector. Engagement must be carried out under the premise that unsatisfactory or insufficient change by the target company will be met with divestment.

WHAT MEMBERS CAN DO

USE SUPER SWITCH TO:

- Find out your super's exposure to fossil fuels
- Tell your fund to divest from fossil fuels
- Tell your fund to fully disclose their fossil fuel holdings

If you aren't satisfied that your super fund is taking steps to get your retirement savings out of fossil fuels, you can also use Super Switch to research funds that align more closely with your values.



DISCLAIMER: The information provided in this document does not constitute financial advice. The information is of a general nature only and does not take into account your individual financial objectives, situation or needs. It should not be used, relied upon or treated as a substitute for specific professional advice. Market Forces recommends that you obtain your own independent professional advice before making any decisions in relation to your particular requirements or circumstances.



Super Switch is a project of Market Forces. Market Forces is an affiliate project of Friends of the Earth Australia.

312 Smith Street, Collingwood Victoria 3066

This is a non-commercial product for public dissemination only. Not for sale.