



## **Written Testimony of Fossil Free Indexes, LLC**

**April 30, 2019 Public Hearing on Fossil Fuel Divestment before the New York State Senate Standing Committee on Finance hearing convened by Senator Liz Krueger**

**By Stuart Braman, PhD, Founder and Chairman**

I want to thank Senator Liz Krueger's Office for offering me the opportunity to speak with you today. And I want to thank Senator Liz Krueger for her leadership in addressing the impact of climate change on New York State and the beneficiaries of the Fund.

### **FFI Genesis**

In 2012, after attending Bill McKibben's "Do the Math" presentation, my wife and I became aware that fossil fuel reserve owning companies will need to keep 80 percent of their carbon reserves in the ground to limit the global temperature rise to the critical 2-degrees Celsius mark.

We decided to replace the broad market index investments in our personal retirement portfolio with fossil free versions. Because it was early days we weren't so surprised that the fossil free S&P 500 index fund we were looking for didn't exist, but we were surprised that after 6 months of looking we couldn't find anyone even thinking about it. So we set about creating our own and founded Fossil Free Indexes (FFI) in April of 2013. Building on the Carbon Tracker Initiative's 2010 list of fossil fuel companies adopted by the 350.org movement, FFI developed The Carbon Underground 200™ (CU200) and launched the FFIUS benchmark index in June of 2014, the first fossil-free iteration of the S&P 500.

Fossil Free Indexes, LLC | 130 Murray Avenue | Port Washington, NY 11050 | +1 (917) 658-7215

[www.fossilfreeindexes.com](http://www.fossilfreeindexes.com)



## **Fossil Fuel Screening**

Six years later it's hard to find an asset manager or index provider that doesn't offer fossil free and low carbon investment options.

Now, the CU200, those public companies ranked by the amount of embedded CO<sub>2</sub> emissions in their coal, oil and gas reserves, is used by asset managers as a basis for their own fossil free investment products and separately managed accounts. Governments, endowments, pension funds and faith-based organizations use the CU200 to assess their exposure to fossil fuel investment risk and set investment and divestment policies. They deploy it as screening and compliance tool. As of today asset managers and asset owners have licensed the CU200 to screen over \$2.8B in assets and many others are doing similar fossil free work with their own versions of a fossil fuel company exclusion list.

## **Toward Decarbonization**

Divestment has matured from simple exclusionary screens to more nuanced and sophisticated strategies. The range of screening programs that FFI has helped to analyze and implement include:

- Screening of the full list CU200 companies <sup>[1]</sup><sub>[SEP]</sub>
- Screening beyond the CU200 to include all companies holding fossil fuel reserves <sup>[1]</sup><sub>[SEP]</sub>
- Screening of full GICS sectors <sup>[1]</sup><sub>[SEP]</sub>
- Partial divestment of coal and/or oil sands <sup>[1]</sup><sub>[SEP]</sub>

Fossil Free Indexes, LLC | 130 Murray Avenue | Port Washington, NY 11050 | +1 (917) 658-7215

[www.fossilfreeindexes.com](http://www.fossilfreeindexes.com)



- Screening of companies based on their capital expenditures in fossil fuel extraction [L] [SEP]
- Asset allocation tilts, long-short hedging and derivatives swaps [L] [SEP]
- Integration of the CU200 as part of broad ESG allocation and investment frameworks [L] [SEP]
- Scoring and ranking reserve-owning fossil fuel companies them based on climate action obstruction

## Analyzing Performance [L] [SEP]

When the CU200 and FFIUS, based on the S&P 500 screened for the CU200, were released in 2014, analyses of the investment performance of fossil free indexes were scarce and the 10 year analysis from 2004 to 2014 showing no statistical difference between the S&P 500 and the fossil free of the S&P 500 was instrumental in discussions with individuals and institutions considering divestment

<http://fossilfreeindexes.com/2014/07/01/fossil-free-indexes-us-inside-numbers-part/> .

Since the release of the CU200 in 2014, fossil free and low carbon investment options have been launched by all major asset managers. There is now a track record demonstrating that screening fossil fuel investments from portfolios does not hurt long-term returns.

Nonetheless, Fossil Free Indexes strongly supports the Decarbonization Advisory Panel's Foundational belief with respect to thinking about performance of fossil free investments –

Fossil Free Indexes, LLC | 130 Murray Avenue | Port Washington, NY 11050 | +1 (917) 658-7215

[www.fossilfreeindexes.com](http://www.fossilfreeindexes.com)



*“The Panel believes that approaches that rely on backtesting may lead to wrong conclusions in investment decisions in light of the nature of climate change impacts. Backtesting is akin to navigating a car down the road using only the rear-view mirror. This strategy works when the road ahead mirrors the past - it does not work when a hard turn is needed to avoid a cliff up ahead. Climate change promises sharp turns ahead.”*

The rationale for decarbonizing the portfolio is not based on returns in the past but based on the local and global consensus about changes in climate with global economy-wide impacts that we’re just at the beginning of.

Historically some have argued against divestment based on the idea that limiting the investment universe by turning away from fossil fuel reserve holders guarantees diminished returns. In February 2015 a Fossil Free Indexes blog outlined the flaws in this reasoning <http://fossilfreeindexes.com/2015/02/10/flawed-argument-fossil-fuel-divestment/>. As noted in Appendix A to the Decarbonization Advisory Panel Report Jeremy Grantham has addressed this issue empirically going back to 1925 and finds that “it makes no difference to an investor whether one holds or eliminates the energy sector of the market from its ten major sectors.”

## **Moving Forward**

In fact the tide has turned, and it’s widely acknowledged that addressing the risk of holding fossil fuel companies in your portfolio is not only not a risk, it’s a risk to not act, and the Decarbonization Advisory Panel notes that “Being too early in avoidance of risk of permanent loss is much less of a danger than being too late.”

Fossil Free Indexes, LLC | 130 Murray Avenue | Port Washington, NY 11050 | +1 (917) 658-7215

[www.fossilfreeindexes.com](http://www.fossilfreeindexes.com)



But we acknowledge that it's hard for a large Fund to do this and we support the Decarbonization Advisory Panel recommendations, especially the Ambition and First Step Recommendations and the Recommendations on the Fund's Investment Process.

Mindful of the need for a broader range of investment opportunities to support the energy transition, FFI has developed an Energy Transition Long Short strategy <http://fossilfreeindexes.com/energy-transition-strategies/> .

The Strategy is long publicly-traded clean energy, advanced transportation and smart grid companies while shorting companies that own fossil fuel reserves. The long components will be selected from a universe of clean energy companies compiled and maintained by Clean Edge, Inc., a leading global provider of clean energy indexes and research. CE maintains clean energy, water and grid infrastructure indexes that are used as the basis for several ETF's.<sup>1</sup>

The short components will be developed using a subset of FFI's Carbon Underground 200™ (CU200). FFI has identified those companies within the CU200 whose reserve type (e.g., tar sands, etc.) and business models make them most vulnerable to the risk of stranded assets in a transition to a low-carbon economy.

Today you'll be hearing arguments for aligning investments with the 1.5 - 2° climate scenario. Fossil Free Indexes was founded on the belief that it is possible and necessary to facilitate the transition to a low carbon economy through responsible investing. We believe that addressing the impact of stranded asset risk on long-term shareholder and beneficiary value strongly supports fulfilling fiduciary responsible investing duties.

---

<sup>1</sup> Exchange traded funds on these indexes are offered by First Trust under the ticker symbols QCLN, FAN, FIW and GRID, respectively. AUM in these ETFs is approximately \$550 million as of 6/30/18.

Fossil Free Indexes, LLC | 130 Murray Avenue | Port Washington, NY 11050 | +1 (917) 658-7215

[www.fossilfreeindexes.com](http://www.fossilfreeindexes.com)



Fossil Free Indexes, LLC | 130 Murray Avenue | Port Washington, NY 11050 | +1 (917) 658-7215

[www.fossilfreeindexes.com](http://www.fossilfreeindexes.com)