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Undermining transition, risking capital:

RISE Guidance Paper #3 – the need for a new investor blueprint for the fossil fuel sector

ShareAction»

Contents

Background to this report

Background to this report

The RISE guidance papers

Finance is critical to powering action to meet globally agreed climate targets and the Sustainable Development Goals. To ensure that finance is driving action to tackle social and environmental challenges at the scale and pace needed, ShareAction urges the investment community to align with its ambitious definition of responsible investment:

> "Responsible investment is a transparent approach, embedded throughout the investment process, that takes the negative and positive impacts on people and planet as seriously as financial risk and return."

ShareAction is supporting the investment community to meet this ambition by publishing a series of guidance papers that set out **Responsible Investment Standards & Expectations (RISE)** for asset managers across specific topics. The papers recommend actions that asset managers can – and should – take in today's investment environment in pursuit of being a truly responsible investor.

This is the third guidance paper in the series. In it, we address fossil fuel policies, recommending how asset managers can take a much more purposeful and effective approach to investing in and engaging with the sector. It is supported by a more detailed technical paper: 'Effective fossil fuel policies for asset managers'. Throughout this guidance paper we direct the reader to the relevant sections in the technical paper for a deeper discussion of the topic being addressed.

Report summary

In this paper we propose that investors take a more purposeful approach to investing in and stewarding upstream fossil fuel companies. We argue that the growing understanding of the long term economic damage from rising temperatures translates into substantial financial risk, which asset managers (and investors more broadly) have a responsibility to address and mitigate.

We review what transition means for fossil fuel companies. We assess current asset manager approaches to fossil fuel companies and challenge some of the arguments asset managers commonly present against adopting more robust policies. Finally, we present five recommendations for asset managers.

This paper is focused on listed equity and debt in companies active in fossil fuel extraction (*see p5 in the technical paper*). However, it should be considered as part of a broader

investment strategy that covers the whole fossil fuel value chain. In this report the phrase 'fossil fuel companies' refers to upstream fossil fuel companies (i.e. those engaged in extraction), while 'the fossil fuel sector' encompasses upstream, midstream and downstream companies.

How to use this report

Asset managers should use this report to:

- reframe their investment in and stewardship of fossil fuel companies to reflect the long-term risks to transition posed by the fossil fuel sector's current strategies. The recommendations have been developed to balance the urgent need to reduce fossil fuel-derived emissions with a recognition of the limitations that some interpretations of client mandates may place on asset managers' ability to implement robust fossil fuel sector policies. As such, the recommendations should be considered a baseline standard. Asset managers can implement policies that are more rigorous than this baseline today and should increase robustness over time.
- inform discussions with their clients to refine investment mandates to better mitigate the threat to their long-term financial interests.
- advocate with policy makers for a rebalancing of incentives to encourage transition of energy systems away from fossil fuels.
- enhance disclosure of exposure to and stewardship of fossil fuel companies.

See Appendix 1 for a model investment policy matrix.

Asset owners can use this report and its recommendations to:

- help evolve their own strategies for fossil fuel companies, incorporating or exceeding the baseline recommendations to best represent their beneficiaries' financial interests and non-financial preferences. We recognise that some asset owners already have stronger policies or preferences than our baseline recommendations, including full exclusion of fossil fuel companies.
- inform their assessment, selection and monitoring of asset managers. They can also use the report to address challenges that asset managers present to implementing stronger fossil fuel sector policies, to shape the expectations they set for asset managers with regard to the fossil fuel sector and to incorporate those expectations clearly in the investment mandate. Indeed, it is critical that asset owners give clear mandates to their asset managers to implement or exceed these recommendations and work to reorient incentives away from short-term opportunity towards mitigating long-term risk.
- set expectations of asset managers for enhanced disclosure in relation to fossil fuel companies.

See Appendix 2 for an Asset Owner checklist.

Investment consultants can use this report to inform their assessment of asset managers' investment and stewardship strategies for the fossil fuel sector and to inform their fund recommendations.

Policy makers can use this report and its recommendations to inform their thinking on the solutions that may be required to rebalance incentives and promote more responsible investment in and stewardship of fossil fuel companies.

Introduction

Introduction

The climate emergency threatens everyone

We are all affected by the climate crisis – whether that means coping with extreme temperatures in the summer, reduced availability of the food we eat, or facing higher insurance premiums in areas prone to flooding or at risk from wildfires. In 2023 the world witnessed record temperatures with widespread associated damage. It also saw record greenhouse gas emissions. The causal link between greenhouse gas emissions and rising temperatures is well understood. These damaging effects will accelerate if emissions are not urgently reduced.

Fossil fuels are the largest cause of greenhouse gas emissions. Therefore limiting temperatures requires reducing the consumption of fossil fuels and transitioning the global economy to renewable energy sources and feedstocks.

The 196 signatory countries to the landmark Paris Agreement committed to pursue efforts to *"limit the temperature increase to 1.5°C above pre-industrial levels"*.[1] The window for achieving this target is rapidly closing. Efforts to limit temperature rises need to intensify. Rethinking the approach to investing in and stewarding the fossil fuel sector has a central place in those intensified efforts.

The fossil fuel sector is not like other sectors

Fossil fuel companies have the most to lose from the transition to a low carbon economy. The need to transition the global economy is an existential challenge for them. For most companies with a high carbon footprint, transition means changing their *means of production* – the source of the energy they consume and the feedstocks they use. However, for fossil fuel companies, transition means changing their *product*.

Moreover, fossil fuel companies can hinder the transition of the global economy. Orderly transition requires full utilisation of available renewable energy and feedstock capacity, with fossil fuels only deployed where necessary to meet the remaining demand. As renewable capacity grows and efficiency gains are achieved, residual demand for fossil fuels will reduce. But fossil fuel companies are not currently planning to reduce production. They are planning to increase it. Over-supplying fossil fuels will leave renewable capacity under-used and put pressure on energy prices in the short term, disincentivising the necessary investment in renewable capacity that creates cheaper and cleaner energy in the long term. It will put the transition at risk.

The financial case for transitioning the global economy is strong

The environmental and moral case for transitioning away from fossil fuels to limit temperature rises is well understood (*see p12 in the technical paper*). Many investors, including end beneficiaries, care about the adverse environmental and social impacts that their capital is contributing to and want to mitigate those impacts.

But alongside environmental reasons, there is a financial case for urgent action to limit global warming to the minimum possible (*see p13 in the technical paper*). Recent research has addressed how traditional economic models of climate effects have materially understated the risks.[2] Emerging evidence suggests that even small temperature rises will cause economic damage over the long term.[3] 'Tipping points' elevate climate unpredictability, which correspondingly implies higher financial risk.[4] Finally, research suggests that meeting energy demand from renewable sources will be cheaper than doing so from fossil fuels.[5] In other words, it is financially rational to transition to renewable energy even before taking into account the benefits of mitigating the economic and environmental damage of climate change.

Growing recognition of the financial case for limiting even modest temperature rises creates a strong motive for asset managers to robustly influence fossil fuel companies to reduce production. Asset managers possess significant influence over their investee companies. The obstacles to deploying this influence are, in our view, not as compelling as they are sometimes presented to be. Key to that influence is asset managers' willingness to apply 'consequence' to their interactions with fossil fuel companies which are not meeting investor expectations. Most obviously, that consequence comes in the form of reallocating their clients' capital elsewhere.

Asset managers have both the motive and the opportunity to influence fossil fuel companies towards transition by adopting a more purposeful investment and stewardship strategy. The urgency of the need to address the climate crisis and transition away from fossil fuels demands that they do so.

Summary of recommendations

Recommendation #1: Set tight investment restrictions on thermal coal and unconventional oil & gas companies which are expanding capacity, including no participation in their primary debt or equity offerings, and excluding or divesting secondary exposure.

Recommendation #2: Set rule-based restrictions limiting exposure to conventional oil & gas companies which are expanding capacity or planning to increase production, including no participation in their primary equity offerings, significantly restricted participation in primary

debt offerings, and recycling capital in secondary market holdings away from those companies most resisting the need to reduce production.

Recommendation #3: Prioritise and engage robustly with fossil fuel companies where exposure is retained, setting clear expectations and time-bound milestones, aligning voting to those expectations, and proactively applying other escalation tools if those expectations are unmet.

Recommendation #4: Engage with asset owners, policy makers, customers and other relevant third parties to influence the mandates, rules, incentives, demand for and financing of fossil fuels to support reduced production.

Recommendation #5: Enhance public disclosure of investment in and stewardship of fossil fuel companies, covering portfolio exposure, engagement and escalation, and policy-related activity.

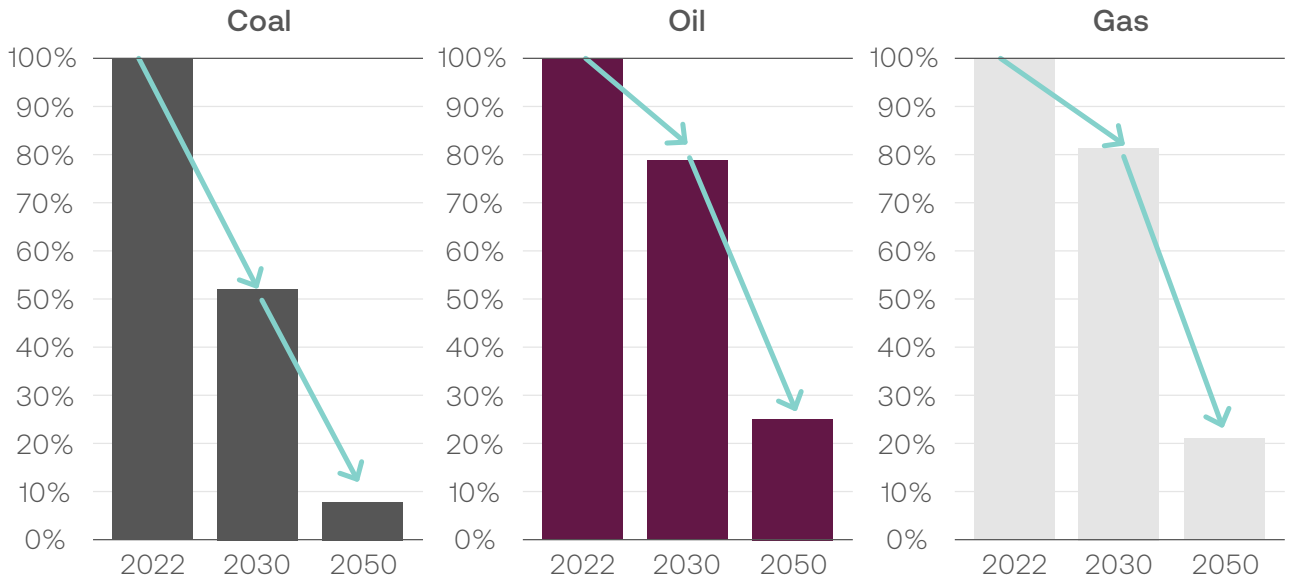
A purposeful approach to the fossil fuel sector

A purposeful approach to the fossil fuel sector

Transition means substantially reducing fossil fuel production, starting this decade

The International Energy Agency's (IEA) 1.5°C[i] Net Zero Emissions (NZE) scenario requires coal production to nearly halve by 2030 and be almost fully phased-out by 2050, with oil & gas production to reduce by circa 20% by 2030 and 75% by 2050[6] (Figure 1) (*see p18 in the technical paper*).

Figure 1: The Net Zero Emissions scenario requires meaningful reductions in fossil fuel production by 2030, accelerating to 2050



Source: ShareAction, adapted from IEA (2023)

However, most fossil fuel companies are currently planning to increase, not reduce, production over the next few years – by 11% in aggregate through 2027 for the group of large fossil fuel

i The IEA estimates a range of temperature outcomes for each scenario, to reflect uncertainties in climate modelling. The emissions pathway for the NZE scenario ascribes a 50% probability to the mid-point estimation of limiting temperature rises to 1.5°C. In other words, even if the emission reductions are achieved, there is a 50% probability that temperature rises will still exceed 1.5°C. Evolving understanding of tipping points and recent research suggesting that the carbon budget may be smaller than estimated mean that probability is in reality much less than 50%. Thus, the emissions reductions outlined in the NZE scenario could be regarded as a minimum ambition.

Fossil fuel companies are planning to increase production, making transition more likely to fail.

companies assessed in our technical paper (*see p21 in the technical paper*).

Where it comes to exploration, the IEA has recently reiterated that "*no new long-lead time conventional oil and gas projects are required*" under the NZE scenario beyond existing and already approved projects. Exploration for new capacity is not needed – indeed "*some existing production would even need to be shut in*".[7] But fossil fuel companies continue to explore for new capacity that will be redundant under the NZE pathway.

The IEA has also said that fossil fuel companies should be allocating a material portion of their capital expenditure towards clean energy solutions – increasing to 50% by 2030. Yet the IEA indicates that less than 3% of total investment by fossil fuel companies went into clean energy in 2022 (a year in which those companies generated record cash flow).[8]

Investors can aid the transition by placing investment restrictions that relate to fossil fuel production growth and exploration for new capacity, as well as by clearly signalling their expectations that fossil fuel companies must align with transition scenarios.

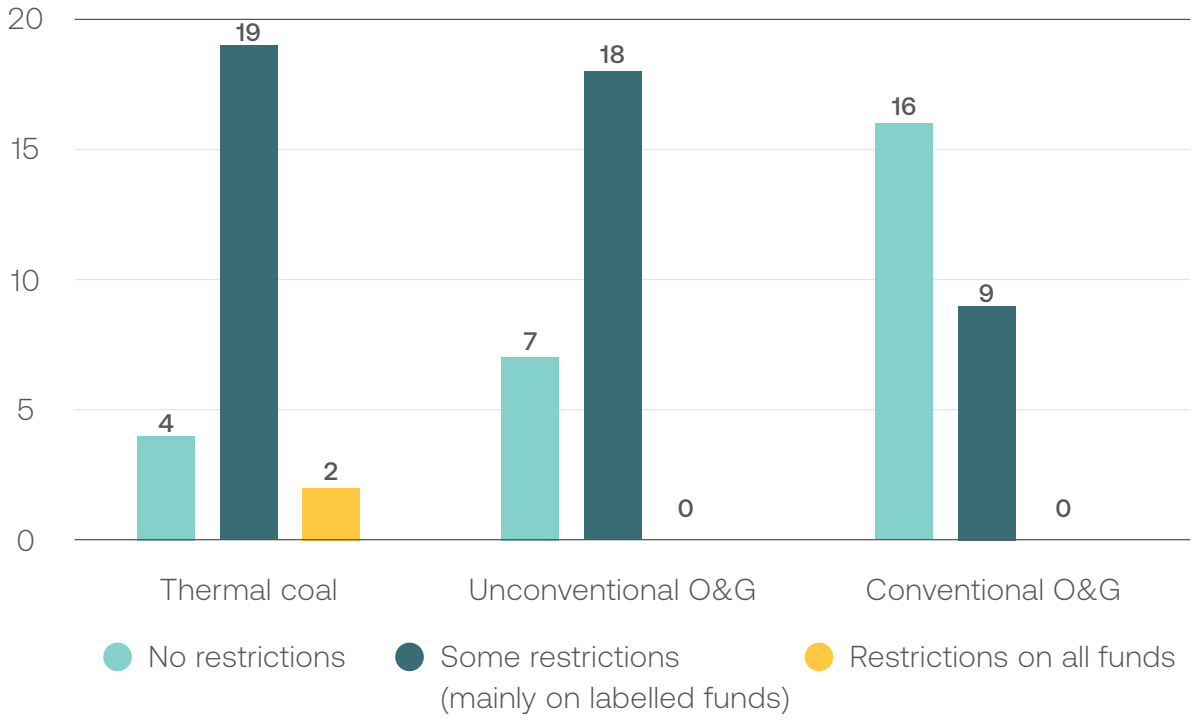
Current asset manager policies for fossil fuel companies fall short of what is needed

Asset managers are under-using their levers of influence

Most, though not all, large asset managers apply some form of fossil fuel-related investment restrictions (Figure 2) (*see p29 in the technical paper*). However, these are mostly limited to coal or unconventional oil & gas and applied only to 'labelled' funds.[ii] 21 of the 25 large asset managers we assessed had restrictions relating to thermal coal, but only two applied those restrictions to all funds. 18 asset managers had some restrictions on unconventional oil & gas, but none were applied across all funds. Only nine asset managers applied any restrictions on conventional oil & gas, none of which applied to all funds.

ii 'Labelled' funds refers to funds that are designed as 'responsible', 'sustainable', 'ESG', '1.5°C aligned' or similar.

Figure 2: Most asset managers have limited restrictions on fossil fuel companies



Source: ShareAction

In order for engagement to be most effective, asset managers need to ensure there are consequences when companies fail to respond sufficiently to their asks. That consequence should come in the form of the use of escalation tools and, ultimately, selling holdings. Yet our review of investment policies suggests this consequence is being applied weakly or not at all. Further, NGO Reclaim Finance has reported that none of the asset managers it surveyed were calling for a reduction in production or end to exploration in their engagements with fossil fuel companies.[9]

Asset managers' arguments against adopting robust policies for fossil fuel companies can be challenged

> Invesment policies need to reflect the long-term financial risks of rising temperatures

Asset managers have put forward various arguments for not adopting more comprehensive, robust investment policies for fossil fuel companies (*see p34 in the technical paper*). Some of these arguments reflect real world regulatory, practical and commercial factors. However in serving to constrain a more robust approach, these arguments risk missing the bigger picture of what's at stake: not just environmental damage to the planet and its people, but long-term financial risks to clients resulting from the expected negative impact of climate change on economies.

We touch on some of these reasons and how we think they should be challenged here:

'Fossil fuel companies are just meeting demand'

We fully recognise that economic prosperity depends on energy access. Meeting energy demand plays a critical social function. But transitioning the global economy doesn't hinge on demand being left unmet, but rather on *how* demand is met. As renewable capacity is built out, the role of fossil fuel energy should diminish.

Fossil fuel companies aren't planning for that. There is a clear difference between planning to complement growing renewable capacity through an orderly transition and planning to compete with, and disincentivise, that capacity. By planning to over-produce fossil fuels relative to the demand anticipated in adequate transition scenarios, companies are both betting against that transition and putting it at risk.[iii]

'Restricting investment in the fossil fuel sector would deny investment opportunities to clients'

We hear that excluding a material portion of the investment universe would not be in the client interest. But there is a clear asymmetry between the financial size of the fossil fuel sector and its impact on the environment on which the global economy depends. (For instance, energy consumption accounts for around three quarters of all greenhouse gas emissions, while the size of the MSCI World Energy Index is less than 5% of its parent MSCI World Index).[10, 11] The long-term economic benefits of limiting temperature rises fundamentally change the calculus of client interest. The 'cost of the opportunity' needs to be considered against the 'opportunity cost'.

'If we divest, we lose our influence'

Many asset managers argue that retaining a 'voice' is a more effective way to influence corporate behaviour than divestment. We completely agree that engagement is a crucial part of a responsible investor's toolkit – but that voice only has value if it is effective. Effective engagement needs the credible potential for material consequences, including divestment, for companies that fail to meet investor expectations.

iii Of course, it is possible that insufficient renewable capacity is installed or efficiency gains achieved and that therefore more fossil fuel will be required to satisfy demand than is allowed under the NZE scenario. At that point, there will be a difficult trade-off over whether it is better to leave some demand unmet or see further temperature rises, both of which will affect emerging market and developing economies most. But planning to over-produce fossil fuel is not the same as anticipating that contingency. Rather it is making the need for the contingency more likely.

The lack of adequate progress from fossil fuel companies shows engagement so far has been ineffective. Some recent actions by fossil fuel companies, such as suing their investors,[12] seem designed to restrict the shareholder voice. The sector's history of misinformation and lobbying has hindered engagement on the climate challenge by investors.[13] Asset managers should divest from those fossil fuel companies that are proving resistant to influence and concentrate their finite engagement resources on those which can plausibly be influenced. This will enhance the effectiveness of the investor voice in catalysing change (Figure 3).

'Divestment doesn't work'

There is much debate about whether divestment 'works' – whether it incentivises a change in company behaviour by affecting the cost of capital or whether it simply results in forgoing an investment opportunity for no tangible benefit.

The cost of capital argument misses the point that the primary purpose of divestment isn't to engineer a drop in the price of a company's shares or bonds. It is to remove clients from being directly exposed to companies whose strategies don't align with their long-term interest and which aren't responding to engagement.

The argument also overlooks the point that there is a supply–demand tipping point beyond which the share or bond price will be affected. A single asset manager selling might not materially change the supply-demand balance for those shares or bonds. But if a critical mass of asset managers arrived at similar conclusions, the supply–demand equilibrium would be more significantly affected – and therefore the cost of capital would increase. Moreover, the point at which a company starts to pay more serious attention to the expectations of their shareholders and funders may well precede the tipping point for the price of their securities.

'Passive funds can't adopt investment restrictions'

Capital allocation for passive funds is pre-determined by the inclusion rules on which the fund is based. Sometimes those rules are designed by the asset manager (for bespoke products). Sometime they are designed by an index provider (with the fund replicating the performance characteristics of that index). That does place some limits on the potential for connecting capital allocation decisions to engagement outcomes. But there is still much that an asset manager oriented to passive funds can do.

They can commit to introducing robust, science-based alignment rules for fossil fuel companies into all new passive fund products. They can actively create aligned products and engage clients on the rationale for migrating capital to those products.

They can propose amendments to existing bespoke funds to include misalignment-based restrictions. They can engage index providers to strengthen exclusion criteria for misaligned fossil fuel companies on thematic climate or sustainable indices. And they can engage fossil fuel companies purposefully, with clearly articulated expectations and the application of consequence through non-divestment escalation tools, including voting.

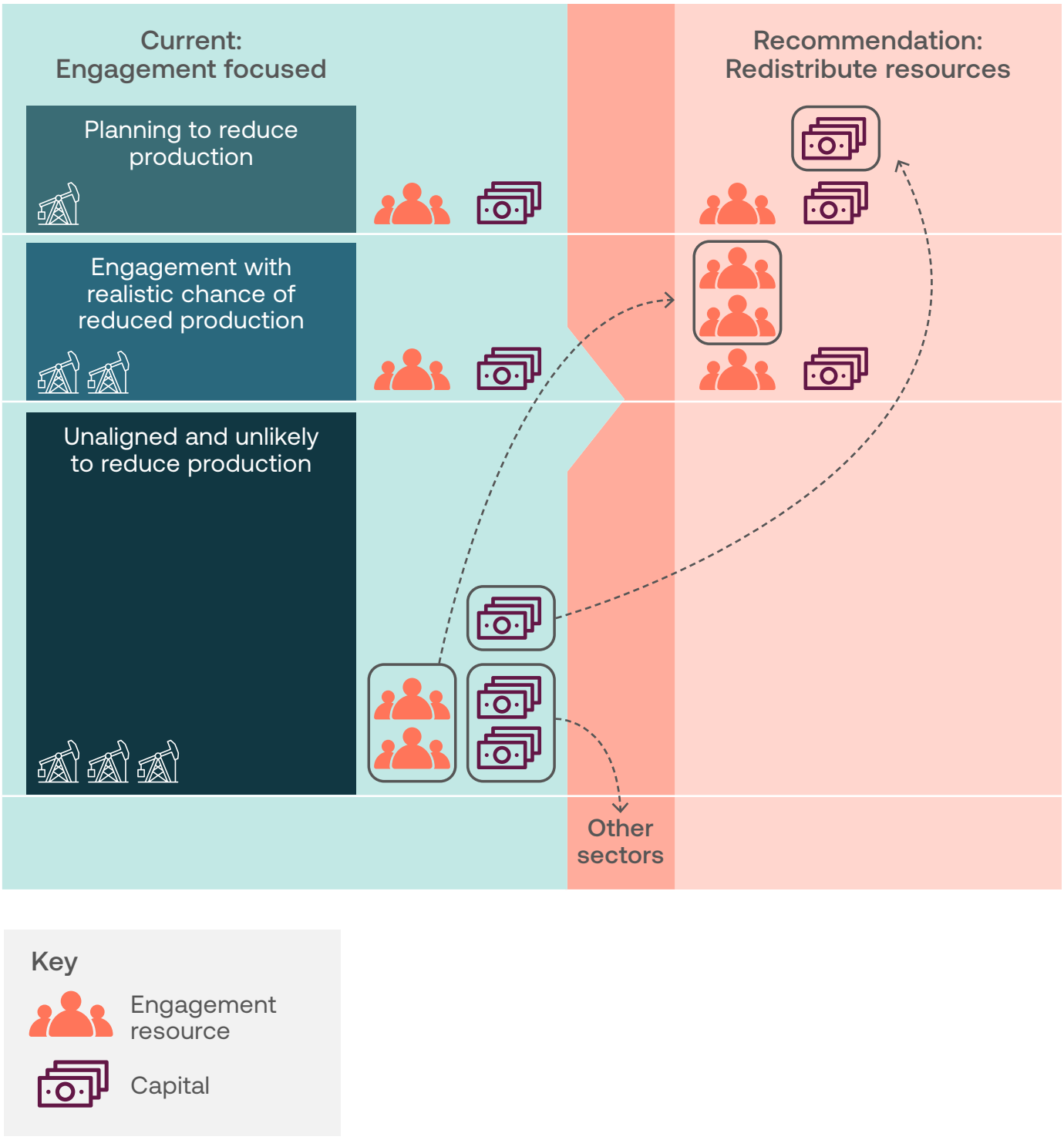
Selective investment, concentrated engagement

A step change in investment approach is needed – more pressure is required

The fossil fuel sector has the most to lose from transition. US Congressman Jamie Raskin recently described the sector's history of seeking "*to confuse and mislead the public while working unceasingly to lock down a fossil fuel future*".[14] Therefore a step-change is needed in how investors approach the fossil fuel sector. The current approach isn't working, at least not at anything like the speed needed. Faced with inertia, more pressure is required.

That pressure comes from the application of consequence to engagement, ultimately through responsive capital allocation. The sizing of capital allocation to the fossil fuel sector should reflect the risks it poses to the transitioning of the global economy. In short, this means a much more selective approach in allocating capital to the sector, which in turn allows for a concentration of intensified engagement efforts, including applying escalation levers.

Figure 3: Capital and engagement should be more selectively deployed to where it can influence fossil fuel companies.



Source: ShareAction

Investment restrictions should be prioritised for maximum impact

> Investment restrictions should be prioritised to reflect the type of asset class, fund, fossil fuel and relative alignment of the company.

As noted previously, some investors already take the view that any fossil fuel company that is not aligned to the NZE scenario should be excluded from their portfolios. For asset managers which interpret their duties to clients as requiring some exposure to fossil fuel companies, even when they are engaged in exploration activity or planning production growth, that exposure should be limited and targeted at a narrow constituency of companies most actively engaging with the need to reduce fossil fuel production. There are four core vectors through which a more selective investment lens should be applied (*see p48 in the technical paper*):

1 **Asset class**: debt plays a different role from equity. Companies frequently need to access debt capital. Therefore debt investors have significant potential influence, which they can exert by conditioning their capital on expectations being met.

2 **Fund type**: clients' expectations are connected to the goals and strategies of the funds they are invested in. Investors in labelled funds have a higher expectation of transition alignment. But general funds are also exposed to the long-term economic risks of climate change and should adopt policies designed to mitigate those risks.

3 **Fossil fuel type**: *all* fossil fuels generate greenhouse gas emissions and therefore the production of *all* fossil fuels needs to be reduced.[iv] Coal is more emission-intense on average than oil & gas, while production of unconventional oil & gas[v] causes a variety of additional environmental and social harms. Therefore coal and unconventional oil & gas should be prioritised for accelerated reduction.

4 **Relative misalignment**: while the sector overall is failing to plan to reduce production in line with climate targets, there are degrees of misalignment within the sector. Where capital and engagement resources are allocated to the fossil fuel sector, they should be actively targeted at the companies most proactively engaging with the need to reduce production.

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iv The fallacy of the narrative, popular among fossil fuel companies, that gas is a 'transition energy source' was highlighted in an April 2024 report from the US House Oversight and Senate Budget committees, which found that 'Big Oil' companies "*seek to portray natural gas as a green, climate-friendly fuel, while internally acknowledging that there is significant scientific evidence that the lifecycle emissions from gas are as bad as coal and are incompatible with scientific emissions reduction targets*". https://www.budget.senate.gov/chairman/newsroom/press/new-joint-bicameral-staff-report-reveals-big-oils-campaign-of-climate-denial-disinformation-and-doublespeak/

v NGO Urgewald defines unconventional oil & gas as "*tar sands oil, coalbed methane, extra heavy oil and Arctic oil & gas, as well as oil & gas from unconventional production methods such as fracking or ultra deep drilling*". https://gogel.org/unconventionals101

Recommendations

Recommendation #1:

Set tight investment restrictions on thermal coal and unconventional oil & gas companies which are expanding capacity, including:

1.1 no participation in primary debt or equity offerings and no new holdings in secondary market debt and equity (active funds);

1.2 divest existing debt and equity holdings[vi] (active funds); and

1.3 exclude all debt and equity holdings in new passive products (passive funds).

A model for implementing this recommendation can be found in Appendix 1. Further details are in the 'Constructing an effective fossil fuel policy – Capital allocation' section of the accompanying technical paper (*see p53 in the technical paper*).

Recommendation #2:

Set rule-based restrictions limiting exposure to conventional oil & gas companies which are expanding capacity or planning to increase production, including:

2.1 no participation in primary equity offerings (active funds);

2.2 no participation in primary debt offerings for labelled funds and significantly restrict participation in primary debt offerings for general funds, investing only in those closest to alignment (active funds);

2.3 exclude new and divest existing secondary market debt and equity holdings in labelled funds (active funds);

2.4 exclude new[vii] and recycle existing secondary market debt and equity holdings away from those companies most resisting the need to reduce production in general funds[viii] (active funds); and

2.5 exclude all debt and equity holdings in new labelled products and significantly restrict exposure to those closest to alignment in new general products (passive funds).

vi Subject to 'acceptable loss' considerations for general funds, as further defined in the technical paper

vii 'Exclude new' refers to adding exposure in isolation, as distinct from recycling capital from a less-aligned to a more-aligned company

viii Subject to 'acceptable loss' considerations

A model for implementing this recommendation into investment policies can be found in Appendix 1. Further details are in the 'Constructing an effective fossil fuel policy - Capital allocation' section of the accompanying technical paper (*see p53 in the technical paper*).

Recommendation #3:

Prioritise and engage robustly with fossil fuel companies where exposure is retained (see p62 in the technical paper), including:

3.1 set clear expectations and time-bound milestones for their production plans, capital expenditure and other key metrics; and

3.2 align voting activity and proactively apply other escalation tools if expectations are unmet.

Recommendation #4:

Engage with:

4.1 asset owners to align goals and create clear mandates for investing in and stewarding fossil fuel companies;

4.2 policy makers to provide the necessary balance of incentives to transition away from fossil fuels, including levers to rapidly scale up the creation of renewable energy capacity and to stimulate demand;

4.3 financial regulators to address barriers to the adoption of robust investment policies for the fossil fuel sector that protect clients' long term financial interests and adequately incorporate non-financial preferences; and

4.4 the fossil-fuel value chain: setting expectations for midstream and downstream, power companies, and financers of the fossil fuel sector that are consistent with the transition expectations set for upstream companies. Encourage demand-side signals for clean energy and feedstocks from consumers of energy and companies that use petrochemical based materials in manufacturing.

Recommendation #5:

Enhance public disclosure on investment in and stewardship of fossil fuel companies including:

5.1 aggregate portfolio exposure to fossil fuel companies;

5.2 the transition scenario on which engagement is founded; sector expectations and time-bound milestones; a list of companies engaged with; a summary of the use of escalation tools and outcomes; and

5.3 engagement on policy and membership of fossil fuel-relevant trade organisations. (*see p65 in the technical paper*).

Conclusion

Conclusion

The fossil fuel sector is a special case within investment and stewardship. The sector has the most to lose from the transition to a net-zero global economy. By planning to over-produce, it can hinder that transition.

Uncritical investment in fossil fuel companies creates a licence for those companies to undermine the transition. Engagement without consequence is failing to move the fossil fuel sector at the necessary speed. A new blueprint is required.

We have set out how asset managers can adopt a more selective approach to investing in fossil fuel companies and a more purposeful use of stewardship levers, in their clients' long-term financial interests. Adopting this blueprint carries some complexities. But the stakes are too high, for society and for the financial system, for complexity to stand in the way of clear-eyed progress.

Appendices

Appendix 1: Investment policy matrix

	THERMAL COAL	OIL & GAS (CON = conventional / UNCON = unconventional†)
	Total restriction if: • any expansion (per Urgewald's GCEL^)	**Total restriction if:** • any expansion overshoot or exploration capex (per Urgewald's GOGEL^), or • 2027 production planned to be higher than 2022 levels (company disclosures)
Primary debt		
Labelled funds	No exceptions	No exceptions (CON & UNCON)
General funds	No exceptions	No exceptions (UNCON) Restrict (CON) except if: • in 20% least misaligned per GOGEL^ expansion overshoot and exploration capex; and • 2027 production plan <3% above 2022
Secondary-market debt		
Labelled funds	No exceptions	No exceptions (CON & UNCON)
General funds	Sell existing exposure: • if base case breached; • and price is above par	Sell existing exposure (UNCON) if: • base case breached; and • price is above par Sell existing exposure (CON) if: • base case breached; and • price is above par except if: • in 30% least misaligned per GOGEL^ expansion overshoot and exploration capex; and • 2027 production plan <5% above 2022
Primary equity		
Labelled funds	No exceptions	No exceptions (CON & UNCON)
General funds	No exceptions	No exceptions (CON & UNCON)
Secondary-market equity		
Labelled funds	No exceptions	No exceptions (CON & UNCON)
General funds	Sell existing exposure: • if base case breached; and • subject to acceptable loss threshold*	Sell existing exposure (UNCON): • if base case breached; and • subject to acceptable loss threshold* Sell existing exposure (CON): • if base case breached; and • subject to acceptable loss threshold* except if: • in 40% least misaligned per GOGEL^ expansion overshoot and exploration capex; and • 2027 production plan <8% above 2022

† company categorised as ‘unconventional’ if more than 35.5% of its total oil & gas production in 2022 was from unconventional sources or if unconventional represents more than 35.5% of total expansion, based on GOGEL data; otherwise categorised as ‘conventional’

^ Urgewald is a German NGO whose Global Coal Exit List (GCEL) and Global Oil & Gas Exit List (GOGEL) are comprehensive public databases of fossil fuel companies’ production and expansion activities – see https://www.coalexit.org/ and https://gogel.org/

* ‘acceptable loss’ threshold set by asset manager reflecting impact of sale on total portfolio performance with reference to either (absolute or relative) purchase price or historic (e.g. one year) mark-to-market

Appendix 2: Asset owner checklist

Set minimum standards for your asset managers

- ✓ Set and communicate clear expectations of how asset managers should invest in and engage with fossil fuel companies.
- ✓ Incorporate those expectations into mandates or otherwise document them.
- ✓ Underline your commitment to those expectations by conveying a willingness to amend, reduce or remove the mandate if expectations are inadequately implemented.

Monitor your asset managers, including:

- ✓ The transition pathway and associated implications for fossil fuel production on which the asset managers base their investment in and stewardship of fossil fuel companies.
- ✓ Their formal investment policies for the fossil fuel sector and how they are being implemented through existing portfolio exposure to the sector.
- ✓ Their formal engagement policies for the fossil fuel sector, together with sectoral expectations and the time-bound milestones that have been conveyed, an overview of engagement activity (including focus companies) and outcomes, the use of escalation tools and voting.
- ✓ Their interaction with policy makers to advocate for rebalanced incentives that support the transition away from fossil fuels.
- ✓ The quality, granularity and timeliness of disclosure on their exposure to (disaggregated by asset class and fossil fuel type) and engagement with companies in the fossil fuel sector.
- ✓ Discuss the findings of this ongoing monitoring with the asset managers covering how well your expectations are being met, where the asset manager is falling short of these expectations, and what future mechanisms the asset manager will implement to align its policies and strategy with your expectations.

Use levers of influence directly within your control:

- ✓ Consider strategic engagement with fossil fuel companies to complement the engagement conducted by the asset manager.
- ✓ Participate directly in escalation with fossil fuel companies (such as co-signing letters and co-filing resolutions) as well as encouraging the asset manager to apply these escalation tools.
- ✓ Engage with policy makers and other system participants in order to create a supportive environment for transition.

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