Investor Expectations: Oil and Gas Company Strategy
Supporting investor engagement on carbon asset risk
About Institutional Investors Group on Climate Change (Europe)

The Institutional Investors Group on Climate Change (IIGCC) is a forum for collaboration on climate change for investors. IIGCC’s network includes over 90 members, with some of the largest pension funds and asset managers in Europe, representing €9 trillion in assets. IIGCC’s mission is to provide investors a common voice to encourage public policies, investment practices and corporate behaviour which address long-term risks and opportunities associated with climate change.

www.iigcc.org

About Ceres’ Investor Network on Climate Risk (United States)

The Investor Network on Climate Risk (INCR) is a North America-focused network of institutional investors dedicated to addressing the financial risks and investment opportunities posed by climate change and other sustainability challenges. INCR currently has more than 110 members representing over $13 trillion in assets. INCR is a project of Ceres, a nonprofit advocate for sustainability leadership that mobilizes investors, companies and public interest groups to accelerate and expand the adoption of sustainable business practices and solutions to build a healthy global economy.

www.ceres.org

About Investors Group on Climate Change (Australia/New Zealand)

IGCC is a collaboration of 52 Australian and New Zealand institutional investors and advisors, managing approximately $1 trillion and focusing on the impact that climate change has on the financial value of investments. The IGCC aims to encourage government policies and investment practices that address the risks and opportunities of climate change, for the ultimate benefit of superannuants and unit holders.

www.igcc.org.au

About the Asia Investor Group on Climate Change

The Asia Investor Group on Climate Change (AIGCC) is an initiative set up by the Association for Sustainable and Responsible Investment in Asia (ASrIA) to create awareness among Asia’s asset owners and financial institutions about the risks and opportunities associated with climate change and low carbon investing. AIGCC provides capacity for investors to share best practice and to collaborate on investment activity, credit analysis, risk management, engagement and policy. With a strong international profile and significant network, including pension, sovereign wealth funds insurance companies and fund managers, AIGCC represents the Asian voice in the evolving global discussions on climate change and the transition to a greener economy.

http://aigcc.asria.org/
Introduction

Institutional investors recognise climate change will have an impact on our holdings, portfolios and asset values in the short, medium and long term. This is an important issue for us and the clients and beneficiaries on whose behalf we invest. We have particular concerns regarding the oil and gas sector, given that this sector is a meaningful proportion of most major indices and represents trillions of dollars of market capitalisation.

We recognise the importance of energy to economic development and prosperity. However, we are concerned that current business strategies of some companies in the oil and gas sector may not be sufficiently sustainable given the changing nature of demand, emerging technologies and policy interventions which can and will impact on the sector.

We are aware that business decisions and capital allocation decisions being made now will determine the future sustainability and profitability of the sector. We look to the boards and management of major oil and gas companies to make these decisions in the long term interests of investors.

Purpose

The purpose of this document is to provide a guide for investors to have constructive engagement with boards and management of oil and gas companies. We aim to stimulate and facilitate meaningful discussion of climate risk to mitigate the long term risks to us as investors. It is to be used as required by investors in their engagement with companies and in conjunction with the previously released Institutional Investors’ Expectations of Corporate Climate Risk Management.¹

Changing dynamics for the Oil and Gas sector

There is evidence that an energy transition towards lower carbon energy sources is occurring. Major macroeconomic and technological trends are shaping a new direction of travel in favour of low carbon energy systems. This shift is being driven partly by the policy implications of the UNFCCC objective to keep global temperature increase to within 2°C, but also by a number of other factors.

Under the IEA new policies, current policies and 450ppm scenarios we see both incremental and disruptive changes in policy, technology and demand dynamics presenting material risks and opportunities to the sector. It is a critical time for the oil and gas sector. We would like to see resilient business strategies that have been sufficiently stress tested within the context outlined below. Not all companies in the sector will be impacted to the same extent, but all companies should have a considered response.

Policy dynamics

The IEA ‘Redrawing the Climate-Energy Map’ highlighted that 78% of CO₂ emissions globally are already covered by some form of climate mitigation policy such as carbon pricing, energy savings measures and fuel efficiency standards. In addition, we see regulations addressing air pollution import tariffs and national energy policy priorities translating into support for renewables. The policy environment is therefore likely to become more challenging for oil and gas companies. Examples include:

- **Emissions trading schemes and taxes** – currently 40 countries have an emissions trading scheme and 12 countries have taxes on carbon with another 13 countries working towards implementation of some carbon pricing policy.
- **Energy Performance standards** – minimum energy performance or fuel efficiency standards are applied to an increasing range of consumer products and industrial facilities across multiple jurisdictions.
- **Fossil fuel subsidies** – India has been reducing its fuel subsidy for diesel gradually since January 2013. Malaysia, Indonesia, Thailand and Vietnam are all exploring similar policies.

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4 Neumann, F., October 2014: “Asia should keep cutting subsidies” HSBC Global Research.
Technology dynamics

The energy sector is no stranger to disruptive technology change. Most recently the exploitation of shale oil and gas in North America has changed the international energy market. The following areas of technology development are of particular interest:

- **Renewable energy** – projections for renewable investment, newly installed capacity and parity pricing suggest a growing share of the energy mix.
- **Energy storage** – developments in energy storage solutions are anticipated to further reduce costs (for example for small-scale solar installations) and to reduce problems with intermittent generation of power supply.
- **Electric vehicles** – new solutions and the decreasing price of batteries transform the economics. For countries seeking to invest significantly in new transport infrastructure, electric vehicles are becoming a viable proposition.
- **Urban design** – The New Climate Economy report highlights the options for future urban design which radically reduces reliance on fossil fuels.\(^5\)
- **Carbon Capture & Storage** – post-combustion CCS technology is not yet deployed at scale.

Demand & price dynamics

The assumptions that underpin many of the industry’s demand and price projections are open to challenge and should be re-examined.

- **Global demand profile** – GDP growth, government policies on energy generation, energy independence and associated policies such as those addressing air pollution at a regional level, are key drivers which influence demand.
- **Oil price scenarios** – in a low oil price scenario new oil projects that are at the higher end of the cost curve could be unprofitable. According to one recent comprehensive analysis, a number of oil majors have a significant percent of potential capex on projects requiring a $95/barrel breakeven price.\(^6\) Additionally, in a high oil price scenario there are also demand risks as fossil-fuel energy may be uncompetitive with renewable energy and in danger of losing market share.\(^7\)

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\(^7\) Lewis, M., September 2015: “Toil for oil spells danger for majors, unsustainable dynamics mean oil majors need to become ‘energy majors’” Kepler Cheuvreux ESG Sustainability Research.
## Investor expectations

In order to ensure robust and resilient business strategies and encourage a smooth transition to a lower carbon energy system, we have set out expectations and guiding questions for investors to raise in their discussions with board and management of oil and gas sector companies. These are intended as parameters under which to ‘stress test’ business strategy to prepare for the next decade and beyond.

### 1 Governance

**EXPECTATION:** Clearly define board and management governance processes to ensure adequate oversight of climate change risk and the strategic implications of a transition to low carbon energy systems.

**QUESTIONS FOR INVESTORS TO ASK THE BOARD:**
- **Understanding the science and economics of climate change** – What processes does the board have in place to ensure that it carefully and diligently assesses climate change risk?
- **Focus** – What governance structures does the board use to ensure adequate oversight of climate change risk? For example, how is climate change risk factored into the risk management system, final investment decisions, capital efficiency, the setting of KPIs and remuneration?

### 2 Strategy

**EXPECTATION:** Integrate the management of climate change risks and opportunities into business strategy and ensure business models are robust and resilient in the face of a range of energy demand scenarios through appropriate stress testing.

**QUESTIONS FOR INVESTORS TO ASK THE BOARD:**
- **Scenarios** – Does the company have a comprehensive outlook on energy which is reflected in the company's strategy? Which IEA reference scenario is considered most robust?
- **Capital expenditure/investment** – How does the board ensure there is flexibility in the company’s strategy to adjust for significant changes (upwards and downwards) in demand for oil and gas particularly given increasing sources of renewable energy? How is this reflected in capital allocation decisions? How often is this reviewed?

### 3 Implementation

**EXPECTATION:** Embed ‘stress testing’ within key business processes and investment decisions.

**QUESTIONS FOR INVESTORS TO ASK THE BOARD:**
- **Carbon pricing** – Is a price on carbon incorporated into decisions regarding long term projects and does the board’s approach differ depending on jurisdiction? Is this applied to products as well as operations?
- **Cost curves** – Does the board target a specific cost return profile? How is this measured?
- **R&D** – Can the policies relating to R&D expenditure with respect to new technologies designed to reduce the overall carbon footprint of your operations please be explained?
- **Renewable strategy** – Given the primary function of the business is the provision of energy resources, has the board considered the potential role of renewable energy within the business strategy?
4  Transparency & disclosure

**EXPECTATION:** Disclose in annual reports and/or on the corporate website the company’s view of and response to its material climate change risks and opportunities and the key assumptions used.

**QUESTIONS FOR INVESTORS TO ASK THE BOARD:**
- **Scenarios & strategy** – Has the company published a comprehensive outlook on energy which is reflected in the company’s strategy? Has the board disclosed how the company’s strategy can adjust for significant changes (upwards and downwards) in demand for oil and gas particularly given increasing sources of renewable energy?
- **Project profile** – Have proven and probable reserves (including breakeven oil price) been disclosed in different projects categorised by nature of environment (ultra-deep waters, oil sands etc.)? Is the average break even oil price for your portfolio disclosed?

5  Public policy

**EXPECTATION:** Engage with public policy makers and other stakeholders in support of cost-effective policy measures to mitigate climate change risks and support low carbon investments, such as those advocated for in the 2014 Global Investor Statement on Climate Change. Ensure there is broad oversight and transparency about the company’s lobbying activity and political spending on this topic and related energy and regulatory issues.

**QUESTIONS FOR INVESTORS TO ASK THE BOARD:**
- **Policy positions** – Can you please explain the company’s public policy on climate and energy policy and how this relates to your strategy? Where relevant this may include your position on carbon pricing, renewable energy targets and UNFCCC negotiations.
- **Trade associations** – What processes are in place to identify and manage consistency between the company’s public policy positions and those of the trade associations of which it is a member?
- **Activity** – What is the company’s lobbying policy at a national and international level?

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