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From Zero To 50: Global Finance Is Fleeing Oil and Gas

Initial Trends Show Oil and Gas Exits Will Follow a Similar Path To Thermal Coal Exits

The looming stranded asset risk of oil and gas, and particularly high cost, high risk Arctic drilling and oil sands projects, have encouraged many globally significant financial institutions to reconsider their investment strategies.

This year, the financial risk of investing in oil sands was finally recognised. Oil sands – or tar sands oil – is considered the dirtiest and most climate destructive form of oil in the world, being 20% more carbon intensive than conventional crude oil. The scrapping of C$20 billion (US$15bn) oil sands project by **Teck Resources**[1] in February 2020 exposed the severe financial risk associated with such projects. Canadian oil sands producers have been losing money on every barrel dug out since 2018, given oil prices below US$50 per barrel.[2]

In February 2020, the financial risk of investing in oil sands was finally recognised.

The situation is similarly bleak for oil drilling project developers in the Arctic region. There have been several reports[3] showing the locking in of new oil infrastructure projects in the Arctic region will create a slow-fuse time bomb that will increase carbon emissions for decades. While these facts have been largely ignored by governments, project developers and financiers until now, the ongoing moves towards alignment with the Paris Agreement by globally significant financiers has seen growth in fossil fuel investment / lending / insurance policy restrictions, particularly thermal coal and coal-fired power generation, but more recently also oil exploration. This has wider implications for an industry already smashed by the combined demand destruction of COVID-19 and the oil trade war started by Saudi Arabia and Russia at the start of 2020.

Wall Street is also starting to bow to growing global pressure[4] around such financially risky projects with a growing number of top banks coming out with statements. This includes **Goldman Sachs** which stated there is no financial

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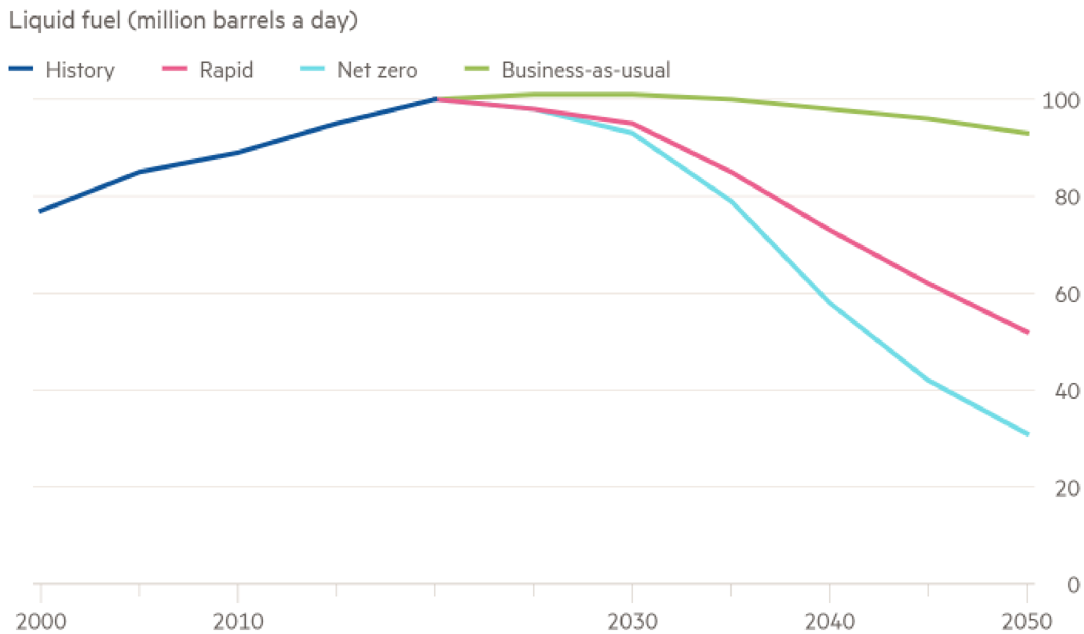
[1] Financial Times. Death of Frontier oil sands project highlights Canada dilemma. February 2020.
[2] Digital Journal. Oilsands bitumen — Producers losing money on every barrel sold. October 2018.
[3] Alaska Wilderness League. The Energy and Climate Impacts of Oil Drilling in the Arctic National Wildlife Refuge. June 2019.
[4] World Oil. Wall Street is feeling the pressure to stop Arctic oil funding. April 2020.

rationale for Arctic exploration as these projects are immensely complex, massively expensive, and the cost overruns are making whole projects economically unviable.[5]

In 2020 alone there has been a 50% drop in Standard & Poor's S&P Oil & Gas Exploration & Production Select Industry Index (SPSIOP)[6], a tracker measuring the performance of oil and gas exploration plus production companies. Similarly, the weightage of energy stocks has dropped to a mere 2.3% of the benchmark S&P 500 from 16% as recently as 12 years ago.

Figure 1: Oil Demand by BP – Drifting Lower Or Dropping Hard



Source: BP Energy Outlook 2020 ©FT.

This deterioration in oil and gas companies' stocks and bond ratings will likely increase due to the significant slump in oil demand in coming decades, as now projected by BP. Fitch Ratings has already raised its energy sector 2020 high-yield bond default forecast to 17% in August from 7% back in March on account of dwindling crude oil prices coupled with the pandemic crisis.[7]

A 2018 IEEFA report[8] found there was no financial rationale to remain invested in fossil fuel companies. Today, financial vulnerabilities are further exposed on account of the slump in demand due to the ongoing COVID-19 crisis.[9]

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[5] CNBC. There's almost zero rationale for Arctic oil exploration, says Goldman Sachs analyst. March 2017.
[6] Bloomberg Quint. How One Fossil Fuel Free ETF Proved Oil Doesn't Pay. September 2020.
[7] Fitch Ratings. Energy, Power and Commodities Bankruptcy Enterprise Values and Creditor Recoveries (2020 Fitch Case Studies). August 2020.
[8] IEEFA. The Financial Case for Fossil Fuel Divestment. July 2018.
[9] Bloomberg. Coronavirus Special Report: Crude in Crisis. May 2020.

There is significant evidence now which shows the material impact of unabated carbon emissions on the financials of fossil fuel companies. For instance, GE in its investor call mentions that the demand in 1HCY2020 was down by two-thirds this year, a continuation of the downward trend evidenced in 2019 highlighting the collapse in the new gas turbine market globally.[10]

Financial Industry Begins Its Oil and Gas Exit

A flurry of recent announcements by major global financial institutions motivated IEEFA to investigate the policy action against oil sands and Arctic drilling projects.

IEEFA has tracked 50 significant global financial institutions to date that have announced oil and gas investment restrictions, specifically on oil sands exploration and/or Arctic drilling. While 39 have declared a formal policy against oil sands and 37 on Arctic drilling, 26 financial institutions have restricted both. Most are an extension of existing policies restricting thermal coal power and coal mining lending, which IEEFA has also been tracking.[11]

IEEFA's new oil and gas tracker highlights the massive upward trend in oil sands and Arctic drilling restrictions.

IEEFA's new oil and gas tracker[12] highlights the massive upward trend in oil sands and Arctic drilling restrictions by some 50 commercial banks, multilateral development banks (MDBs), asset management groups, insurers/reinsurers, and pension funds.

From Zero To Fifty in Four Years

Led by four financial institutions announcing exits in 2017 - **The World Bank**[13], **BNP Paribas**[14], **Crédit Agricole Group**[15] and **Axa**[16] – the momentum grew to 5 in 2018 and then 18 in 2019. The first half of 2020 has seen a doubling in oil sands and/or Arctic drilling exclusion policies with 23 significant global financial institutions announcing restrictions.

European financial institutions have taken the lead in exiting oil and gas. To date, 36 European financial institutions have announced a formal policy against either Arctic

[10] Power. GE Will Decarbonize Uniper's Gas Power Fleet. July 2020.
[11] IEEFA. Over 100 and Counting - Financial institutions are restricting thermal coal funding. February 2019.
[12] IEEFA. Finance is leaving oil and gas. October 2020.
[13] The World Bank. World Bank Group Announcements at One Planet Summit. December 2017.
[14] BNP Paribas. BNP Paribas takes further measures to accelerate its support of the energy transition. October 2017.
[15] Crédit Agricole Group. Climate financing: Crédit Agricole S.A. is taking its commitments further. December 2017.
[16] AXA. AXA accelerates its commitment to fight climate change. December 2017.

drilling or oil sands projects. In the U.S., just six financial institutions have done the same.

In the last 16 months, five of the six top U.S. banks – **Goldman Sachs**[17], **JPMorgan Chase**[18], **Citigroup**[19], **Wells Fargo**[20] and **Morgan Stanley**[21] – all released formal exclusion policies against Arctic drilling. And in Europe, **HSBC**[22], **Banco Santander**[23], **BNP Paribas** and **Deutsche Bank**[24] are amongst the largest banks which have restrictive policies against oil exploration projects.

Commercial banks are at the forefront in restricting lending, followed by insurance companies. Out of 50 financial institutions to date, 26 banks have come out with restrictive policies, followed by 11 insurance companies, 7 multilateral development banks/development finance institutions, 5 asset management companies, and 1 pension fund.

Best Practice in Policy Restrictions

IEEFA notes the best practice of each restrictive policy would include prohibiting any sort of financial product or service for all climate/financially risky fossil fuels across the globe with a speedy phase out from existing fossil fuel investments.

The closest to best practice policy restrictions to date are the ones adopted by **ABN AMRO**[25] of the Netherlands, **BNP Paribas** of France, and **Crédit Mutuel Asset Management**[26] of France, as they all have fewer loopholes.

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The strongest of all the restrictive policies is the one adopted by the **European Investment Bank** (EIB)[27]. EIB commits to end financing for unabated fossil fuels – oil, fossil gas, traditional gas infrastructure, power generation technologies, and large-scale heat production infrastructure based on unabated oil, gas, coal or peat -from the end of 2021. No other financial institution is

[17] Goldman Sachs. Sector Guidelines. June 2019.
[18] JPMorgan Chase. Environmental and Social Policy Framework. February 2020.
[19] Citigroup. Environmental and Social Policy Framework. July 2020.
[20] Wells Fargo. Issue Brief – Climate Change. March 2020.
[21] Morgan Stanley. Environmental and Social Policy Statement. April 2020.
[22] HSBC. HSBC Energy Policy. February 2020.
[23] Banco Santander. Energy Sector-General Policy. November 2018.
[24] Deutsche Bank. Environmental and Social Policy Framework. July 2020.
[25] ABN-Amro. Sustainable Banking – Exclusion List. November 2018.
[26] Crédit Mutuel Asset Management. Press Release. February 2020.
[27] EIB. EIB energy lending policy. November 2019.

committing to end financing for all kind of unabated fossil fuels within such a short timeframe.

The other strongest restrictions belong to **Agence Française de Développement (AFD) Group**[28] and **Crédit Agricole Group** of France. AfD's policy actions are 100% aligned with the Paris Agreement goals, and it has committed to a blanket restriction against any kind of exploration or production project dedicated exclusively to the transport of coal, gas or oil (conventional or unconventional).

Crédit Agricole Group, with assets worth US$2.35 trillion comprising a banking arm, an insurance division, and the asset management giant **Amundi**, has one of the most exemplary policies against climate risky assets. The policy states that the group will not participate in financing or investments directly related to the development, construction or extension of oil and gas facilities, including any oil sand projects irrespective of the extraction process, Arctic drilling projects, and projects to convert fossil gas or liquification of coal into petroleum, with several other restrictions.

Weaker policy restrictions include those from **Robeco**, **Citigroup** and **JPMorgan**. Asset manager **Robeco** from the Netherlands (owned by **ORIX** of Japan)[29] which manages assets worth US$181 billion (EUR155bn), has a policy barring companies from its investment portfolios that derive 25% or more of their revenues from thermal coal or oil sands, or 10% or more from Arctic drilling. We understand there may not be many oil majors deriving over 10% of revenue from Arctic drilling so this partial restriction allows financial institutions to continue financing these risky sectors in the long run.

Citigroup, with assets worth US$1.95 trillion, has put in place restrictions only for Arctic drilling projects at project financing level and does not include restrictions on other financial offerings. It also does not exclude oil sands projects from financing and simply mentions that it has an enhanced risk review process against such projects.

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The noteworthy policy among the sovereign funds is the one recently adopted by **Government Pension Fund Global** (GPFG)[31] of Norway. The fund with assets worth US$1.1 trillion commits to divesting all the companies in its portfolio which are solely into the business of oil and gas exploration. However, the fund will remain

[28] Agence Française de Développement (AFD). Energy Transition. June 2019.
[29] Robeco. Climate Change Investment Policy. September 2020.
[30] Metlife. MetLife Statement on Climate Change. July 2020.
[31] Government Pension Fund Global. Energy stocks in the Government Pension Fund Global. September 2019.

invested in oil refineries including vertically integrated oil firms such as Royal Dutch Shell and ExxonMobil.

The **Royal Bank of Canada** (RBC)[32] with assets under management of US$500 billion is one of the largest financiers of oil sands projects along with **JPMorgan Chase** and the **Canadian Imperial Bank of Commerce**[33]. In October 2020, RBC released new policy guidelines for climate risky projects. While the policy mentions that RBC will not be providing any direct financing to Arctic drilling projects, similar restrictions for oil sand projects are absent. These policy loopholes raise questions regarding RBC's commitment towards the Paris goal.

While banks and insurance companies are increasingly divesting from oil and gas, export credit agencies (ECA's) are lagging. To date, no ECA's have instated policy restrictions on oil sand and Arctic drilling projects. The primary reason seems to be their alignment with OECD parameters for the assessment of projects with environmental concerns, which do not cover guidelines for oil exploration projects.

While many oil and gas exit policies may be too weak to achieve the Paris goal of limiting the temperature rise to below 1.5° Celsius, these are still very important announcements showing the momentum of divestment from fossil fuels. IEEFA expects these financial institutions will continue to tighten loopholes in subsequent policy measures to show a greater commitment towards the global Paris accord.

Oil and Gas Is the New Coal

During 2020 there have been a string of financial institutions divesting from thermal coal, starting with the giant U.S. asset manager BlackRock, ABSA bank of South Africa and Citi from the U.S. By the end of 2025 Citi will halve its coal credit exposure from a 2020 baseline. By 2030 it will reduce it to zero.

And in Asia, Japan's two largest institutional banks, Sumitomo Mitsui Financial Group and Mizuho Financial Group, the Japan Bank for International Cooperation, and Ayala Corporation of the Philippines all announced the end of financing for new coal-fired power projects in April. This follows coal exit announcements in 2019 by Singapore's United Overseas Bank, DBS Bank, and Overseas Chinese Banking Corporation.

Global banks, insurers and asset managers/owners from Europe, Africa, Australia and the United Kingdom have also been announcing coal exclusion policies at an average rate of one every two weeks for the past couple of years. In sum, IEEFA counts 142 significant global financial institutions with coal exclusion policies to date, with 54 new or improved coal exit policies announced in 2020 to-date.[34]

These exits indicate to the market that coal is a very poor investment and we expect other lenders to accelerate their policy shift away from coal and coal-power.

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[32] Royal Bank of Canada. Policy Guidelines for Sensitive Sectors and Activities. October 2020.
[33] Banktrack. Banks and tar sands. June 2020.
[34] IEEFA. Finance exiting coal.

We expect to see a similar magnitude of capital flight away from oil and gas exploration projects now starting to build, similar to what we are witnessing in capital fleeing thermal coal.

Although financial institutions may be driven by climate-related goals in their exodus from the extraction and burning of coal, LNG/gas and oil, most are driven by the numbers and the need to stay relevant as the technology driven energy transition accelerates and permanently undermines the economics of fossil fuels.

We expect to see a similar magnitude of capital flight away from oil and gas projects.

As stranded asset risks in fossil fuels continue to rise, and fossil fuel share prices continue to decline, financial institutions are refining their ESG policy frameworks and increasingly taking a commercial line aimed at avoiding losing even more capital – be it debt, equity or via insurance losses.

While the recent oil and gas announcements by global financial institutions are encouraging, it will be critical to track whether actions on the ground follow their commitments.

The Investor Push To Reach Zero Emissions

There are various initiatives, alliances and taskforces which are playing an instrumental role in ensuring that the financial institutions adhere to the Paris goal of limiting carbon emissions. Some of the few notable alliances are RE100[35], Climate Action 100+[36] and The Task Force on Climate-related Financial Disclosures (TCFD)[37].

RE100, a global initiative bringing the world's most influential businesses committed to transition to 100% renewable energy systems, has now reached 263 members. Climate Action 100+ is an investor initiative launched in 2017 to ensure that the world's largest corporate greenhouse gas emitters take necessary action on climate change. More than 500 investors with over US$47 trillion in assets collectively under management are engaging companies to curb emissions, improve governance and strengthen climate-related financial disclosures. Those making significant progress include **Aviva**[38] which has now set a new net zero target for its default pension fund by 2050; **ArcelorMittal**[39] which announced a group-wide commitment to being carbon neutral by 2050 across its global operations; and

LafargeHolcim[40] which also committed to net zero emissions.

[35] RE100.
[36] Climate Action 100+
[37] TCFD. The Task Force on Climate-related Financial Disclosures (TCFD).
[38] Business Green. Aviva targets net zero for its default pension funds by 2050. October 2020.
[39] ArcelorMittal. ArcelorMittal sets 2050 group carbon emissions target of net zero. September 2020.
[40] LafargeHolcim. Our net zero climate pledge. September 2020.

Coal exit policies have likewise accelerated by global corporations and utilities, with October 2020 seeing Samsung C&T and KEPCO commit to build no new coal power plants during a South Korea government audit hearing in the Trade, Industry, Energy, SMEs and Startups Committee[41], followed by Japan's JERA committing to net zero by 2050 as well as making a pledge to close all the outdated subcritical and supercritical coal-fired power plants it owns 2030.[42]

IEEFA's tracker also includes an assessment of how aligned the financial institutions' investments are with the Paris goal of limiting the temperature rise to below 1.5° Celsius. However, it becomes quite a subjective exercise in the absence of a credible target-based investment pathway.

The Science Based Targets Initiative (SBTi) recently launched a new science-based target validation to help financial institutions align their investments with the Paris Agreement.[43] In total, 55 financial institutions including **Standard Chartered** of the UK, **Eurazeo** of France, and **Bank. J. Safra Sarasin** of Switzerland have already committed to set their investment per the science-based targets.

Another approach to showcase the commitment towards the Paris goal in an objective manner and avoid the scepticism of greenwashing is the Terra progress report[44], developed by **ING**. The report intends to provide a detailed assessment of the progress of ING's pathway to steer its US$708 billion (EUR600 billion) lending book towards the Paris climate goals. ING, in its second Terra progress report[45] released this year, has included a target to reduce financing to upstream oil and gas by 19% by 2040 from 2019 levels.

But IEEFA expects momentum to continue to build rapidly as climate risks understanding is built. The October 2020 report by Ceres concludes that most financial institutions' policies and preparedness are inadequate for dealing with the magnitude of climate risks, and the magnitude of exposure is significantly higher than most currently acknowledge.[46]

Given this, we expect formal oil and gas policy announcements to continue to accelerate.

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[41] Global Construction Review, Samsung admits brand damage in building coal plant, won't build another, 8 October 2020
[42] Economic Times, Japan's JERA to shut inefficient coal-fired power plants by 2030, 13 October 2020
[43] Science Based Targets Initiative. Financial Institutions. 2018.
[44] ING. ING publishes first Terra progress report. September 2019.
[45] ING. ING publishes second progress report on climate alignment. October 2020.
[46] Ceres. Financing A Net-Zero Economy. October 2020.

About IEEFA

The Institute for Energy Economics and Financial Analysis examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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