NEPC, LLC

**To:** Vermont Pension Investment Committee

**From:** Douglas Moseley

**Date:** July 28, 2015

**Subject:** Fossil Fuel Divestment Recommendation

---

## Executive Summary & Recommendation

***NEPC believes that the Energy divestment initiative, if enacted, will have significant implications for VPIC, including the generation of transaction costs, increase in asset management fees, impact on active management and most importantly, the potential to significantly alter the risk/return profile of the VPIC portfolio (due to the higher concentration of the resultant portfolio). Because perceived benefits of a divestment strategy are not clearly defined or measurable, NEPC believes that an energy divestment initiative would violate the current VPIC ESG Policy. Therefore, NEPC recommends that VPIC not adopt any energy divestment initiative.***

## Background

Based on information provided by VPIC staff regarding the VPIC portfolio's energy sector holdings, VPIC currently has exposure to approximately $67.7 million in energy sector equities and fixed income energy sector securities in separately managed accounts and approximately $165.1 million in commingled energy sector equity securities.

VPIC has been engaged since 2013 in assessing a policy response to the concern of carbon emissions tied to its portfolio investments. In response to this interest, NEPC produced a study that focused on the potential cost of divesting from the energy sector. We presented a summary report at the VPIC meeting in February 2013, and recommended that VPIC not pursue a strategy of fossil fuel divestment at that time.

This analysis and the assumptions that NEPC relied on in our 2013 analysis was an effort to provide VPIC with a framework to evaluate the potential costs of this initiative. The impact on actual expenses, expected portfolio return and risk will depend heavily on how a divestment requirement is interpreted and eventually implemented. The individual implementation decisions will have a significant impact on the variability of these projections.

## Investment Implications of Fossil Fuel Divestment

As further detailed in our report to the VPIC in February 2013, and based on the updated analysis we have conducted for other clients examining this issue, we recommend that VPIC not pursue a strategy of divestment from energy sector for the following reasons:

- **Divestment reduces expected risk-adjusted performance by decreasing portfolio diversification.**

- **Divestment reduces expected performance in high inflation periods.**

- **Divestment implies that VPIC has a view on the impact of the Stranded Assets thesis on the value of CU200 companies that is different than the collective market perspective as reflected in prevailing prices.**

- **Divestment is inconsistent with the predominant strategy in VPIC's U.S. large cap public equity portfolio of passive management.**

- **Divestment reduces the opportunity set for our active managers to earn excess returns.**

- **Divestment incurs additional transaction costs and ongoing management fees that are can not projected to be recouped through stronger investment performance.**