EAGA

EASTERN ALLIANCE FOR GREENHOUSE ACTION

Divestment from Financial Organisations Supporting Fossil Fuel Industries

A snap-shot of progress in the local government sector

May 2017

EXECUTIVE SUMMARY

The purpose of this document is to share insights from councils who have implemented divestment strategies. It is based on desktop research and direct consultation with finance officers in six councils across the country. The findings and recommendations are intended to provide practical guidance to Victorian councils seeking to divest. These include:

- Councils can substantially divest without comprising on returns
- The management of council finances are governed by self-adopted investment policies that must comply with the prudential requirements of the Local Government Act
- There are no legislative restrictions in Victoria to prevent councils from divesting
- Evidence indicates that most progress to date has been confined to the investment of surplus council funds to manage cash flow requirements
- Divestment levels of around 50-70% are being achieved by the councils participating in this study
- Opportunities exist to divest to other financial activities (including transactional banking services, council borrowings and employee superannuation funds) however these areas are not currently being addressed
- Compliance with a council's investment policy is the key determinant of the extent to which a council can divest
- The availability of products from financial institutions with a required credit rating is a major limitation on the extent of divestment that is occurring

CONTENTS

Primary Author:
Andrew Gelbart
EAGA Researcher

Contributing Author and Contact:
Scott McKenry
EAGA Executive Officer
scott.mckenry@maroondah.vic.gov.au
03 9298 4250

Revision Nº	Prepared By	Description	Date
A	Andrew Gelbart	For Review & Comment	6/04/17
B	AG/SM		19/4/17
C	AG/SM	Final	10/5/17

1. INTRODUCTION

Divestment is a financial management practice that is increasingly being adopted by the Australian local government sector. Generally, it involves moving money away from financial institutions that fund fossil fuel industries.

To date, thirty councils have adopted formal policies to divest from fossil fuels to ensure that their financial management practices are not at odds with their objectives and commitments to take action on climate change.

The purpose of this document is to share insights from councils who have implemented divestment strategies and provide practical guidance to other councils seeking to divest.

2. BACKGROUND

Whilst councils must work within stringent legal and regulatory frameworks, there is no legislation or regulations in Victoria (or other states) that prevent councils from divesting.

Councils typically adopt formal investment policies that define how they meet the key legislative requirements of the Local Government Act. The policies set out the guidelines and principles that need to be followed by council officers when investing fund with financial institutions. The policies generally require councils to take advantage of the interest earning potential of their surplus funds whilst reducing its exposure to financial risk and ensuring sufficient funds are kept available to meet cash flow requirements.

The ability to implement a divestment commitment requires a considered and pragmatic approach to ensure that it is applied in compliance with the council's investment policy. There are currently 53 Authorised Deposit-taking Institutions (ADI) that do not support fossil fuel related organisations[1.] The credit rating of each ADI is a key factor when determining suitability for investment.

3. SCOPE AND METHODOLOGY

This review is based on:

- a desktop review of reports and published data related to financial practices in the local government sector
- consultations with finance managers within six councils regarding their council's experience in the implementation of divestment policies and strategies[2]

The findings of this review are based on the **investment of surplus council funds to manage cash flow and increase income.** It does not consider the following:

- Day to day transaction services (i.e. Bpay, EFTPOS etc.)
- Borrowing money for longer term requirements
- Facilitating access to default superannuation funds for employees

---

[1] http://www.marketforces.org.au/banks/compare
[2] A list of councils is provided in Appendix I

Whilst divestment commitments are not necessarily restricted to the investment of surplus council funds, the majority of evidence collected through this review indicates that most progress to date has been confined to this area.

Divestment opportunities in these other areas are discussed in Section 5.

4. FINDINGS

The process of redirecting council funds towards ADIs that do not invest in fossil fuel industries is principally governed by the council policy that guides investment of funds. These policies address State Government requirements for the prudent management of public funds.

4.1. Compliance with investment policy

Compliance with a council's investment policy is the key determinant of the extent to which a council can divest. A council's investment policy typically specifies which products can be used for the investment of surplus council funds, which in turn dictates the amount of funds divested.

When considering the investment of surplus councils funds, all councils interviewed referred to their participation in the short term market. Only small amounts are invested for more than twelve months and there was no evidence of money invested for more than three years.

Following the global financial crisis, the requirements imposed on councils have tightened considerably. This has effectively meant that these investments are largely restricted to *term deposits* at ADIs.

The regulated requirement that council funds are managed prudently and with consideration of risk has influenced investment policies to stipulate the use of the Standard & Poor (S&P) or Moody's rating of ADIs. This limits the allocation of funds that can be invested according to risk level. The S&P credit rating systems are most commonly used. The S&P short term rating was the most prevalent tool used, though the long term assessment was not unusual.

The 'big four' banks hold the highest S&P rankings and as such have the greatest scope for investment. The fossil fuel free banks and other financial institutions typically hold lower rankings, meaning there are stricter limits on the extent to which these banks can be invested in. Feedback from finance departments indicated that the availability of suitable "fossil fuel free" product was a major limitation in their ability to divest.

Table 1 lists sixteen divested ADIs as identified by Market Forces as having a short term S&P rating of A-2 or better. Some councils rely on the short term rankings while others use long term.

Note: that the ratings are continually being reviewed and are subject to change from the rating agency. The data below is drawn from a diverse range of sources and may not be current. This table is supplied for indicative purposes only.

TABLE 1: Divested ADIs as listed by Market Forces

Fossil Free ADIs	S&P Long Term Rating	S&P Short Term Rating
Suncorp Bank	A+	A-1
Rabobank	A	A-2
Bank of Queensland	A-	*
Bank Australia [mecu]	BBB+	A-2
Heritage Bank	BBB+	*
IMB Bank	BBB+	*
Newcastle Permanent	BBB+	*
ME Bank	BBB+	A-2
Auswide Bank	BBB	A-2
P&N Bank	BBB	*
MyState Bank	BBB	*
Credit Union SA	BBB	*
Adelaide Bank	BBB	A-2
Bendigo Bank ***[now merged with Adelaide]***	BBB	A-2
Rural Bank ***[now merged with Adelaide & Bendigo]***	*	A-2
People's Choice Credit Union	*	A-2

* *Rating is not clear for these classifications*

Investment policies placed limits in two ways, on how funds are invested.

- Each ranking had a limit that controlled the total proportion of funds that could be invested at that level or lower
- At each ranking, there was a limit on the proportion of funds that could be invested with any single ADI

Larger proportions of funds can be invested with higher ranked ADIs. It was common that policies limited investment at lower rankings to less than 30% of the total portfolio.

4.2. Policy Implementation

The day to day operation of the finance departments meant that surplus cash became available at certain times for investment. The various ADIs each offer different daily interest rates for the different term deposits.

The process of selecting an investment option typically followed these steps:

i. Cash flow predictions were made as to when cash would be required

ii. Existing investment maturities were reviewed and used to set the time periods that the new cash could be invested for

iii. The market was then surveyed for suitable terms and rates from the many ADIs

iv. Where suitable "fossil fuel free" product was available at competitive rates, then that product would be used subject to:

  - The maximum amounts in total invested at that ADIs rating
  - The maximum amounts in total invested with that ADI

The decision process above determines what proportion of funds is invested with an ADI.

There appears to be little relationship between interest rates offered by ADIs and their ranking. Discussions with finance departments indicate that the large banks offer similar rates to their smaller competitors and that giving preference to fossil free ADIs had not compromised returns.

The amount divested varies from day to day as different investments mature and others are made. If a series of investments with fossil free ADIs mature and are replaced on that day with non-fossil free investments then the divested proportion will decrease. Figure 1 indicates the typical variation in divestment experienced with time.

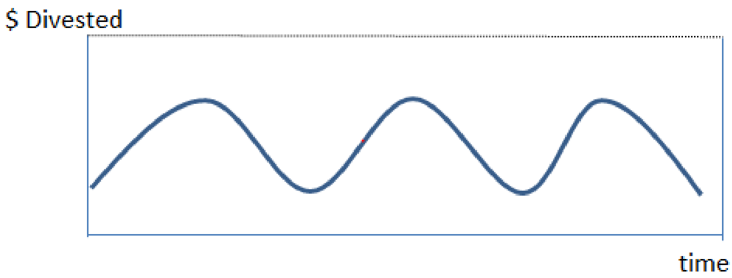

FIGURE 1: Illustrative example of divestment proportions changing over time

The variations between maximum and minimum divested varies between 10 – 30% of the total investments depending on the market at different times. However, consultations with councils indicated that divestment levels of 50-70% were being achieved.

Some councils benchmark overall investment returns against external financial benchmarks such as the 90 day Bank Bill rate[3]. Often there are expectations as to the overall return expected compared to the benchmark.

e.g. If the published 90 day Bank Bill Rate was 3%, then the policy may dictate an expectation that returns achieved are within say 1% of that value

It's likely that this method of implementing an investment policy creates more freedom for the finance department to maximise the amount of divestment achieved whilst still delivering responsible returns and keeping the risk profile within the limits of the investment policy.

5. OTHER DIVESTMENT OPPORTUNITIES

The following financial activities are areas where the extent of divestment could be increased.

5.1. Transaction Services

The 'big four' have a very large market share overall, but none have made significant progress in divesting from the fossil fuel industry. A recent report estimates that the 'big four' invested $7B more in fossil fuel projects than renewables 2016.[4] Some councils indicated

[3] The Australian Securities Exchange's 90 Day Bank Bill Futures and Options product is used as a benchmark indicator for short term interest rates in Australia.
[4] www.marketforces.org.au

that divestment was a criteria in tendering processes for day to day banking services, however it was unclear whether this was influencing the outcome of the tenders or the upstream practices of the ‘big four’. Consultation with council finance officers indicated that the ‘big four’ banks are the only institutions able to fully meet the range of day-to-day services required by councils, though some councils are working with smaller banks in this area.

5.2. Council Borrowings

Council borrowings in Victoria, are often minimal. Those that do exist, typically have access to Victorian state government funds or borrowing capability. Some councils have mentioned borrowings in their divestment strategy documents, but there was no evidence demonstrating any progress in this area in the sample of councils.

5.3. Council Employee Superannuation Funds

Superannuation funds for employees is an area that does not strictly involve council funds. However, councils can play an important facilitation role in ensuring their employees have access to funds that avoid fossil fuel investments. Some councils disclosed that they had actively supported external divestment campaigns targeting local government employees by disseminating collateral and other information.[5] By using a suitable fund as a default selection, the amount of fossil free investment can be increased.

6. CONCLUSIONS AND RECOMMENDATIONS

Findings indicate that the finance departments are divesting the maximum potential of surplus council funds. Divestment levels of around 50-70% are being achieved without compromising financial returns or compliance with existing investment policies.

Increasing the amount divested (to 100%) will require refinement of investment policies to allow the finance departments greater discretion. Areas of focus could include:

- Having the policy define minimum performance benchmarks and allowing the finance department freedom to operate within those areas
- Having the policy give preference to “fossil fuel free” ADIs where a suitable product exists, subject to financial requirements

These are refinements to the policies currently being used that would allow greater uptake of “fossil fuel free” products.

Consideration could also be given to other areas of council financial activity involving ADIs. This would increase the extent and effectiveness of the overall strategy without exposing the council to increased risk.

[5] www.marketforces.org.au/did-vision-super-divest-on-the-quiet/

APPENDIX I

Councils consulted include:

- Fremantle Council – W.A.
- Swan Council – W.A.
- Armadale Council - W.A.
- Moreland Council – Victoria
- Lismore Council – N. S.W.
- Leichhardt Council (Innerwest) – N.S.W.