DIVESTMENTFACTS.COM

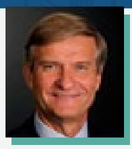
A project of the Independent Petroleum Association of America

As activists push universities and pension funds to give up their holdings in fossil fuels, many groups have focused on the symbolic reasons to divest without considering the numerous financial impacts of such a decision. Now, a new report by Prof. Hendrik Bessembinder from Arizona State University's Carey School of Business looks at the hidden costs that accompany divestment, specifically those fixed costs related to executing often-complicated transactions and then actively managing an endowment to ensure it remains compliant with ever-changing definitions of what it means to actually be "fossil-free."

AMONG THE STUDY'S KEY FINDINGS:

- According to Bessembinder's research, transaction and management costs related to divestment – what he refers to as "frictional costs" – have the potential to **rob endowment funds of as much as 12 percent of their total value over a 20-year timeframe.** This includes the one-time immediate transactions costs an endowment must endure, as well as ongoing annual management fees to stay in line with the changing definition of "fossil free."
- Focusing on a sample of 30 universities, including large, medium-sized, and small endowments, conservative estimates of these transaction costs range between 60 basis points and 269 basis points for large endowments, between 25 basis points and 180 basis points for medium endowments, and between nine basis points and 124 basis points for small endowments. Meanwhile, conservative estimates of ongoing annual compliance costs range between 8 basis points and 58 basis points.
- For a typical large endowment, this **would translate into a loss in value of as much as $7.4 billion over 20 years.** For medium and small endowments the loss is equal to between $52 million and $298 million, and $17 million and $89 million respectively.
- Since many endowments hold assets in mutual funds, commingled funds, and private equity funds, **divestment generally requires the sale of an entire fund** – not just its fossil fuel holdings. This imposes substantially larger transaction costs for endowments.
- Given the changing and varying definitions of what fossil-free actually means, investment managers would need to **actively undertake substantial and ongoing research and management costs** to maintain compliance with their divestment goals.
- The top 10 actively managed funds with an environmental focus charge management fees 10 basis points higher than peers in the active management space, and 73 basis points higher than the **passively managed** funds that long-term investors tend to favor.
- Even if you believe the reduction in average rates of return from divestment is small, **the frictional costs of divestment are substantial.**

ABOUT DR. BESSEMBINDER



ARIZONA STATE UNIVERSITY — **Professor** of Finance at the W.P. Carey School of Business

UNIVERSITY OF WASHINGTON — **Affiliate Professor** in Business Economics and Finance at the Foster School of Business

UNIVERSITY OF UTAH — **Professor and member** of the Investment Advisory Committee for the University of Utah Endowment (2006-2015)

COMPASS LEXECON — **Senior Consultant**

Managing Editor of Journal of Financial and Quantitative Analysis

Associate Editor of the Journal of Financial Economics and the Journal of Financial Markets

LOSS IN VALUE TO ENDOWMENTS

LARGE	$1.4 -$7.4B
MEDIUM	$52-$298M
SMALL	$17-$89M

Over 20 Years

ACADEMICS AGREE DIVESTMENT A COSTLY PLAN

"Consistent with basic financial economic principles, divestment almost always generates long-term investment shortfalls due to reduced diversification, and the shortfalls are typically substantial, given the size and importance of the energy sector being divested…Over a 50-year time frame, the value of a divested portfolio would be 23 percent lower than a non-divested portfolio. These costs of reduced diversification are in addition to other costs of divestment, such as transaction costs associated with selling and buying securities and the costs of compliance with fossil fuel divestiture goals, both of which are often material as well."

Prof. Brad Cornell
Professor of Financial Economics,
California Institute of Technology

"The costs of divestment are clearly substantial. Trading costs like commissions are incurred in virtually every securities transaction. Costs associated with reductions in diversification are a bedrock principle of financial economics. Ongoing compliance costs mean that every future securities transaction will need to be analyzed for its environmental impact. These costs have real financial impacts on the returns generated by an investment portfolio, and therefore, real impacts on the ability of an educational institution to achieve its goals."

Prof. Daniel Fischel
Professor of Law and Business Emeritus,
Univ. of Chicago Law School

INSTITUTIONS AGREE

WILLIAMS COLLEGE:

(9/10/15)
"The initial cost of divestment would be in liquidating the portfolio which, even done in an orderly fashion over the course of a year, would cost $75 million or more… The expected cost to Williams of divestment has nothing to do with projecting whether the particular class of targeted companies are themselves good or bad investments, and is entirely a result of the expected cost of fundamentally changing the college's strategy for managing the endowment."

AMERICAN UNIVERSITY:

(11/21/14)
"Divesting from these companies would require that AU investments be withdrawn from index funds and commingled funds in favor of more actively managed funds," and cited the results of an internal study indicating that "this withdrawal would cause manager fees to double."

CUNY COLLEGE:

(8/26/15)
"The majority of spending derived from the University's investment pool is utilized for student scholarships. We are concerned that a restructuring of current investments would restrict diversification, lower expected returns, and result in higher transaction costs."

MIDDLEBURY COLLEGE:

(8/28/13)
"At this time, too many of these questions either raise serious concerns or remain unanswered for the board to support divestment. Given its fiduciary responsibilities, the board cannot look past the lack of proven alternative investment models, the difficulty and material cost of withdrawing from a complex portfolio of investments, and the uncertainties and risks that divestment would create."

BATES COLLEGE:

(1/21/14)
"To guarantee divestment from these 200 public companies, our investment advisers estimate that between a third and a half of the entire endowment would need to be liquidated and replaced with separately managed accounts. Were we to guarantee a fossil fuel free endowment more broadly than the 200 companies, greater than half of the endowment would need to be liquidated. In either scenario, the transition would result in significant transaction costs, a long-term decrease in the endowment's performance, an increase in the endowment's risk profile, and thus a loss in annual operating income for the college…In short, divestment would potentially threaten core aspects of the college's mission."

SWARTHMORE COLLEGE:

(5/2/15)
"If Swarthmore decided to divest, we would have to find replacements for all the commingled funds because an institution has no power to impose a constraint on a commingled fund…If Swarthmore were to follow this approach, it would forego the 1.7% to 1.8% added return per year. This would amount to lost earnings each and every year…The loss the first year would be $11.2 million, but by five years it would be a cumulative $73.1 million, and by ten years it would be $203.8 million. It would be even greater if all the affected portfolios of the endowment were invested in this way."