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IPAA INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

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Tuesday, February 10, 2015 202.857.4722

Report: Real Costs of University Divestment Grossly Outweigh Hypothetical Benefits

WASHINGTON, D.C. – As opponents of oil-and-gas development continue to attack the industry by waging symbolic campaigns aimed at forcing colleges and universities to divest their endowments of fossil-fuel related stocks, new research commissioned by the Independent Petroleum Association of America (IPAA) and produced by Compass Lexecon, a leading economic consulting firm, suggests the costs associated with adopting such policies are likely to be enormous, resulting in the displacement of billions annually from school endowments that could be otherwise used to improve services, enhance academic programs, and provide support to students from disadvantaged backgrounds.

Led by Prof. Daniel R. Fischel, president of Compass Lexecon and a professor emeritus of law and business at the University of Chicago Law School, the study team tracked the performance of two investment portfolios over a 50-year period: one that included energy-related stocks, and another that did not. Based on those models, Prof. Fischel and his team found optimal portfolios that included energy stocks generated average, absolute returns 0.7 percentage points greater than portfolios that excluded them -- meaning the "divested" portfolio lost roughly 70 basis points relative to the optimal scenario *for each and every year over the 50-year period in which the portfolios were active*.

Applying that figure to the roughly $456 billion that constitutes total U.S. university endowment assets, and the collective impact of divestment on school endowment and investment funds has the potential to approach $3.2 billion per year – and that's before even accounting for the hundreds of millions of dollars in additional management fees that schools will be required to pay in order to comply with divestment policies.

"*Every bit of economic evidence available to us today demonstrates that fossil-fuel divestment is a bad idea," said* ***Prof. Fischel****, who previously served as dean of the Univ. of Chicago Law School. "The costs of divestment are clearly substantial and stand to have real financial impacts on the returns generated by endowment funds. And since many of these schools rely on their endowments to finance significant portions of their student aid programs, divestment has the very real potential to adversely affect those who can least afford it."*

"For those who argue that divestment is just a harmless, symbolic act, with no ability to impact either a company's stock price or a school's endowment performance, it turns out they were only half right," said ***Barry Russell****, president and CEO of IPAA. "In fact, what this first-of-its-kind study confirms is that the costs associated with divestment are real and enormous, all while having no discernable effect on the companies actually being targeted by the policy."*

"Whether through our successful Oil & Gas Investment Symposium events, the NAPE summits and expos we hold several times a year, or the various other programs we lead, IPAA is proud to serve as a bridge that connects our members to the capital markets and investment communities," said ***Jeff Eshelman****, Senior Vice President for Operations and Public Affairs at IPAA. "Part of that responsibility includes addressing and confronting instances of misinformation on these issues as they arise, as a service to our members. We're hopeful that the Fischel study can help inform a more fact-based debate on this topic moving forward."*

The Fischel study is available on DivestmentFacts.com, a new campaign microsite launched by IPAA.

About the Independent Petroleum Association of America

The Independent Petroleum Association of America (IPAA) is the leading, national upstream trade association representing oil and natural gas producers that drill 95 percent of the nation's oil and natural gas wells. These companies account for 54 percent of America's oil production, 85 percent of its natural gas production, and support over 2.1 million American jobs. Learn more about IPAA by visiting www.ipaa.org.

Key Findings from the Report:

- "This optimal portfolio experienced an average annualized excess return over the 1965-2014 period of 6.5 percent, while the similarly-calculated return for the non-energy stock index was only 5.8 percent. This indicates a **gross reduction in return of 0.7 percent per year due to divestment**." (p.10). A 0.7 percent decrease in portfolio performance impact on the estimated $456 billion in university endowment assets would **decrease annual growth by over $3.2 billion annually**.

- "As of December 31, 2014, the $100 invested in the optimal risk-adjusted portfolio would have grown to about $14,600, whereas the $100 invested in the divested portfolio would have grown to only about $11,200, indicating a **loss of 23 percent due to divestment**." (p.11)

- "The National Association of College and University Business Officers reports that university endowments hold approximately **$23 billion in energy-related assets**. If all of these assets were divested, the benchmark …would indicate a **total cost for processing and execution alone of $40.2 million**. In addition, if … divestiture generated a 0.35 percent price impact for stock sales and a 1.0 percent impact for stock purchases, this **additional price impact would add $308 million in transaction costs**." (p.5)

- "Of the 10 [industry] sectors, the energy sector has the lowest correlation with all other sectors, and therefore the **largest potential diversification benefits relative to the other nine sectors.** Moreover, the sector with the second lowest correlation with other sectors is the utility sector, another sector that includes many likely fossil fuel divestment targets. These results indicate the **potential for substantial diversification costs associated with fossil fuel divestment**." (p.8)

- "An increase in compliance costs of 1 percent on the estimated $23 billion of those endowments invested in energy stocks would **further decrease annual growth by an additional $230 million**. A reduction in wealth of this magnitude **could have a substantial impact on the ability of universities to achieve their goals**, such as the research, scholarships and services that universities are able to offer." (p.17)

- "Basic and widely-accepted financial principles indicate that **divestment is in fact highly unlikely to have any substantial effect on these companies**. …There is **no basis to believe that divestment can affect the stock prices or business decisions of targeted firms**." (p.26)

New Report's Findings In-Line with Statements from Other Prominent Universities:

- **Harvard Univ. (Mass.):** "I also find a troubling inconsistency in the notion that, as an investor, we should boycott a whole class of companies at the same time that, as individuals and as a community, we are extensively relying on those companies' products and services for so much of what we do every day." (Letter from President Faust, Oct. 3, 2013)

- **American University (D.C.):** "[D]ivesting from these [energy] companies would require that AU investments be withdrawn from index funds and commingled funds in favor of more actively managed funds. Cambridge has estimated this withdrawal would **cause manager fees to double**." ("Memorandum on Divestment," Nov. 21, 2014)

- **Swarthmore College (Pa.):** "The documents lay out the College's estimate that divestment from fossil fuels **would cost a total of at least $200 million** (cumulative) over the next ten years. The value of the College's endowment was approximately $1.5 billion as of June 30, 2012." ("Swarthmore Pegs Cost of Divestment at $200 Million Over 10 Years," *Swarthmore Daily Gazette*, May 9, 2013)

- **Cornell Univ. (N.Y.):** "The publicly-traded energy companies in our portfolio, for example, collectively have large research and development budgets committed to alternative energy strategies. The top five energy companies have more than $20 billion committed to alternative and sustainable energy research and development. Divesting from these companies would give us no ability as shareholders to influence the decisions that these companies make concerning a revised energy future." (Op-ed by President Skorton, *Cornell Daily Sun*, Apr. 15, 2013)

- **Univ. of Tennessee:** "Last year, 90 percent of the endowment's payout went to supportive scholarships, instruction, and research. Eliminating a broad segment of the market from investment could hinder future funding of these endeavors." (Letter from Board of Trustees, Dec. 13, 2013)

- **Bryn Mawr College (Pa.):** "While divestment would hurt the College financially, we don't believe it would have any impact on the companies being targeted by your proposal." (Letter from Board of Trustees, Aug. 2013)

- **Pomona College (Calif.):** "It also remains unclear that divestment would have anything more than a symbolic impact in fighting climate change… Although symbolism does matter, it is hard to make the case that it would be worth the significant cost to future Pomona students." (Statement from the president, Sept. 24, 2013)

About the Author

Prof. Daniel R. Fischel is the president of the economic consulting firm Compass Lexecon and the Lee and Brena Freeman Professor of Law and Business Emeritus at The University of Chicago Law School. The previous Dean of The University of Chicago Law School, Prof. Fischel has published over 50 articles in leading legal and economics journals, many of which have been cited by courts at all levels including the Supreme Court, and has authored two books on economics and corporate law. He is a former professor at Northwestern University Law School and was a Supreme Court clerk for Justice Potter Stewart. Read more about Prof. Fischel here.

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