Subject: AMA to Protect Human Health from the Effects of Climate Change by Ending its Investments in Fossil Fuel Companies (Resolution 607-A-17)

Presented by: Gerald E. Harmon, MD, Chair

Referred to: Reference Committee F (Julia V. Johnson, MD, Chair)

At the 2017 Annual Meeting, Resolution 607-A-17 was introduced by the American Association of Public Health Physicians and referred. Resolution 607-A-17 asked that: (1) the American Medical Association (AMA), AMA Foundation (Foundation), and any affiliated corporations, work in a timely and fiscally responsible manner to end all financial investments or relationships (divestment) with companies that generate the majority of their income from the exploration for, production of, transportation of, or sale of fossil fuels; (2) the AMA, when fiscally responsible, choose for its commercial relationships vendors, suppliers, and corporations that have demonstrated environmental sustainability practices that seek to minimize their fossil fuels consumption; and (3) the AMA support efforts of physicians and of other health professional associations to proceed with divestment, including to create policy analyses, support continuing medical education, and to inform our patients, the public, legislators and government policymakers.

BACKGROUND

The AMA, as a science-based organization, has long supported environmental issues and spoken out on climate change, including policy H-135.973, “Stewardship of the Environment,” and H-135-969, “Environmental Health Programs,” that encourage physicians to be spokespersons for environment stewardship among other things; H-135.938, “Global Climate Change and Human Health,” that concurs with the scientific consensus that Earth is undergoing adverse climate change and that anthropogenic contributions are significant and will create conditions affecting public health with disproportionate impacts on vulnerable populations; and finally H-135.923, “AMA Advocacy for Environmental Sustainability and Climate,” outlining AMA’s support of initiatives to promote environmental sustainability and other efforts to halt global climate change. (See Appendix)

The AMA also has policy prohibiting investments in the tobacco industry as part of our broad strategy to oppose tobacco use (H-500.975[5], “AMA Corporate Policies on Tobacco”).

DISCUSSION

Over the past decade, groups concerned about climate change have pressured academic institutions and endowments to divest fossil fuel-related securities. While some have divested, most have decided not to do so. AMA engaged an independent advisor, Mercer Investments, to review the status of fossil fuel divestment for major investment portfolios and to perform a study evaluating the potential impact of implementing Resolution 607-A-17 and making a recommendation from an investment advisor viewpoint.
Mercer is a subsidiary of March & McLennan Companies ($13.2 Billion in revenue), and is a global leader in providing institutional investment services. It is an independent advisor that has not been involved with the AMA investment portfolios.

The AMA also received an outside legal opinion from Sidley Austin LLP, AMA’s outside counsel. Sidley reviewed Resolution 607-A-17 in the context of the governing standard, the Uniform Prudent Management of Institutional Funds Act (“the Act”) that is incorporated into Illinois law, the state law that governs the AMA and the Foundation.

Mercer’s analysis included: (1) an overview of fossil fuel divestment among large institutional investors; (2) back tests over the last 20 years, evaluating the impact of fossil fuel divestment on both the actual AMA portfolio and market index portfolios with respect to return and risk; and (3) future return and risk projections utilizing Mercer’s capital market assumptions, comparing a portfolio with no constraints and a portfolio implementing fossil fuel divestment.

The overwhelming majority of institutions have made a decision not to divest from fossil fuels. Of the largest 1,000 retirement plans, only 11 have committed to divest fossil fuels in some form. Of the 100 largest endowment and foundations, six have committed to divest in some form. The most common focus of those institutions implementing divestment has been limited to divestment of investments in coal mining companies. Divestment has not gained traction among US pension funds, due primarily to the fiduciary standard of best interest of plan participants under ERISA. The US Department of Labor (DOL) has issued an interpretive bulletin stating “fiduciaries may never subordinate the economic interests of the plan to unrelated objectives, and may not select investments on the basis of any factor outside the economic interest of the plan except in very limited circumstances.” The DOL subsequently opined that fiduciaries may pursue such options but “may not accept lower expected returns or take on greater risks.” While the market has seen some divestment activity, most institutions have researched divestment and decided not to proceed at this time.

As noted above, Mercer performed back tests on both the specific AMA portfolios reflecting holdings as of December 31, 2017, and index data utilizing the MSCI All Country Index, to quantify the historic impact of a divestment strategy on return, risk, and return for unit of risk. Due to data limitations, the Mercer analysis covered only market activity over the last twenty years, for the period ending December 2017. This period was dominated by low interest rates, low inflation and generally low market volatility. Over this same period, there was a general decline in energy prices. As such, this period may not be representative of future periods. Mercer’s analysis of this period suggests that a divestment of fossil fuels from the AMA Reserve Portfolios is unlikely to result in a material change to return/risk expectations of the current portfolio. In particular, the analysis suggests that divestment would result in an increase in total risk (roughly 15 basis points), as would be expected by a more constrained portfolio, and this increase in risk would be partially offset by an increase of 7 basis points in expected return. While a divested portfolio in the back test period would have delivered a slightly higher return on a prospective basis, it would do so with higher risk or volatility resulting in the same return for risk measurement as the current portfolio.

Independent of the Mercer analysis, scenarios in which higher inflation, higher interest rates and greater market volatility are more prevalent must be considered in evaluating fossil fuel divestment. Specific to inflationary risk, energy holdings are likely to prove beneficial to the current portfolio relative to the divested portfolio, as historically rising inflation results in higher commodity prices, such as energy. Other academic studies, covering longer time frames and more market cycles, conclude that the estimated cost of fossil fuel divestment is significant. One such study, by Professor Daniel Fuschel of the University of Chicago, estimates a diversification cost
from divesting energy stocks of approximately .5 percent per year. Another study, by Dr. Bradford Cornel of Caltech, estimates the mean risk-adjusted shortfall due to divestment at .23 percent per year. Based on the current size of the AMA’s portfolio and these studies, an investment shortfall of $1.3 million to $2.9 million per year could be expected. This investment shortfall does not include other costs of divestment, such as transaction costs associated with selling and buying securities and the cost of compliance with fossil fuel divestiture goals, both of which are often material but not estimable at this point. From a judgment perspective, consideration needs to be given to the tradeoffs of a less diversified portfolio and how relationships may change over time. From an investment perspective, not implementing a divestment process is consistent with current market practice and provides investment flexibility, particularly if the markets return to a higher growth, higher inflation environment.

In response to those who may question whether investments in fossil fuels may result in wasted capital/stranded assets, professional asset managers uniformly integrate environmental issues into their investment due diligence and decision-making process. These professional asset managers weigh valuation against risk and opportunities, including environmental issues. Markets are efficient and expectations of future states and events are factored into security prices.

Sidley Austin noted that one of the duties imposed by the Act is “An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification”. Since Resolution 607-A-17, if adopted, would potentially rule out a large sector of the economy (dissimilar to the AMA’s policy restriction on investment in tobacco, which is a much smaller sector), Sidley opined that such a resolution “would unduly interfere with the fiduciary obligations of the AMA Board of Trustees and the Board of Directors of the Foundation to manage the assets of these organizations in a fiscally prudent manner.” Sidley stated that its belief is that “the related objectives of (1) managing assets so as to produce a reasonable return without undue risk and (2) diversification of investments to achieve this result would require managers of the assets of the AMA and the Foundation at least to have the option of investing in the fossil fuel sector of the economy. If these managers concluded that investment in fossil fuel companies and related enterprises was not necessary to achieve a reasonable return with reasonable risk, they would not have to make such investments. But absolutely to preclude such investments would be to tie the hands of these managers in a way that would prevent them from carrying out their responsibilities under the Act.”

The Sidley Austin legal opinion also noted that there is a critical distinction between the current AMA policy on investments in tobacco companies and the proposed resolution on investment in fossil fuel companies. Importantly, the tobacco industry is a far less substantial portion of the economy than the fossil fuel industry and the companies that depend on or serve that industry. The tobacco sector represents only 1% of the MSCI All World Index, while fossil fuels represent 6% of the MSCI All World Index. Sidley Austin concluded that with regard to investments in tobacco stocks, the current AMA policy does not materially prevent AMA asset managers from exercising the care that an ordinarily prudent person in a like position would exercise. By contrast, ruling out any investment in fossil fuel companies and in enterprises which depend on or serve those companies would place a very major constraint on AMA asset managers.

CONCLUSION

Given the results above, with a bias towards maintaining diversification and flexibility, Mercer recommends against implementing a divestment requirement. Rather, Mercer recommends the decision concerning exposure to energy sector investments remain with the AMA’s selected
investment managers. As noted above, a broad number of companies across industries are involved in fossil fuels, resulting in divestment from them having a much more significant impact on the diversification of the portfolio. In addition, not implementing a full divestment process is consistent with the approach taken by most major endowments and pension funds in the United States.

Sidley’s opinion concludes that the proposed resolution, if adopted, “would unduly interfere with the fiduciary obligation of the AMA Board of Trustees and the Board of the AMA Foundation to manage the assets of these organizations in a fiscally prudent manner.” The Board believes it should not be handicapped in fulfilling its fiduciary duty.

The Board shares a strong belief in the scientific consensus on global climate change and its threats to public health, especially for vulnerable populations. However, given the number of companies involved in fossil fuels and the Board’s fiduciary obligations outlined in this report, the Board believes it should focus on legislative, regulatory, and other policy efforts as called for in existing House policy to address the threats of climate change.

RECOMMENDATION

Based on the above analysis, the Board of Trustees recommends that Resolution 607-A-17 not be adopted, and the remainder of this report be filed.
Appendix - AMA Policy

Stewardship of the Environment H-135.973
The AMA: (1) encourages physicians to be spokespersons for environmental stewardship, including the discussion of these issues when appropriate with patients; (2) encourages the medical community to cooperate in reducing or recycling waste; (3) encourages physicians and the rest of the medical community to dispose of its medical waste in a safe and properly prescribed manner; (4) supports enhancing the role of physicians and other scientists in environmental education; (5) endorses legislation such as the National Environmental Education Act to increase public understanding of environmental degradation and its prevention; (6) encourages research efforts at ascertaining the physiological and psychological effects of abrupt as well as chronic environmental changes; (7) encourages international exchange of information relating to environmental degradation and the adverse human health effects resulting from environmental degradation; (8) encourages and helps support physicians who participate actively in international planning and development conventions associated with improving the environment; (9) encourages educational programs for worldwide family planning and control of population growth; (10) encourages research and development programs for safer, more effective, and less expensive means of preventing unwanted pregnancy; (11) encourages programs to prevent or reduce the human and environmental health impact from global climate change and environmental degradation. (12) encourages economic development programs for all nations that will be sustainable and yet nondestructive to the environment; (13) encourages physicians and environmental scientists in the United States to continue to incorporate concerns for human health into current environmental research and public policy initiatives; (14) encourages physician educators in medical schools, residency programs, and continuing medical education sessions to devote more attention to environmental health issues; (15) will strengthen its liaison with appropriate environmental health agencies, including the National Institute of Environmental Health Sciences (NIEHS); (16) encourages expanded funding for environmental research by the federal government; and (17) encourages family planning through national and international support.

Environmental Health Programs H-135.969
Our AMA (1) urges the physicians of the United States to respond to the challenge for a clean environment individually and through professional groups by becoming the spokespersons for environmental stewardship; and (2) encourages state and county medical societies to establish active environmental health committees.

Global Climate Change and Human Health H-135.938
Our AMA: 1. Supports the findings of the Intergovernmental Panel on Climate Change's fourth assessment report and concurs with the scientific consensus that the Earth is undergoing adverse global climate change and that anthropogenic contributions are significant. These climate changes will create conditions that affect public health, with disproportionate impacts on vulnerable populations, including children, the elderly, and the poor.

2. Supports educating the medical community on the potential adverse public health effects of global climate change and incorporating the health implications of climate change into the spectrum of medical education, including topics such as population displacement, heat waves and drought, flooding, infectious and vector-borne diseases, and potable water supplies.

3. (a) Recognizes the importance of physician involvement in policymaking at the state, national, and global level and supports efforts to search for novel, comprehensive, and economically sensitive approaches to mitigating climate change to protect the health of the public; and (b) recognizes that whatever the etiology of global climate change, policymakers should work to reduce human contributions to such changes.
4. Encourages physicians to assist in educating patients and the public on environmentally sustainable practices, and to serve as role models for promoting environmental sustainability.

5. Encourages physicians to work with local and state health departments to strengthen the public health infrastructure to ensure that the global health effects of climate change can be anticipated and responded to more efficiently, and that the AMA's Center for Public Health Preparedness and Disaster Response assist in this effort.


**AMA Advocacy for Environmental Sustainability and Climate H-135.923**

Our AMA (1) supports initiatives to promote environmental sustainability and other efforts to halt global climate change; (2) will incorporate principles of environmental sustainability within its business operations; and (3) supports physicians in adopting programs for environmental sustainability in their practices and help physicians to share these concepts with their patients and with their communities.