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IENE Comment

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If you want to take the pulse of the energy transition, look at banks and insurers. The two industries were eager to join the shift from oil and gas to wind, solar, and EVs but now this is starting to change. And it's not because of oil and gas lobbying.

Last month, a report from Bloomberg revealed that most passive investment funds still have a substantial exposure to oil and gas, even though they were being promoted as sustainable. We're talking about funds by BlackRock, UBS, Amundi, and Deutsche Bank, among others.

Of course, the obvious explanation here is that passive funds track indices and these indices contain oil stocks. They are not, in other words, doing it on purpose. Or are they? Because another, more recent report told us that Big Oil stocks have beaten Big Tech—the all-time favourite industry of transition-minded fund managers thanks to all the low-carbon energy consumption pledges said Big Tech has been making.

Asset managers are not alone in their attachment to the oil and gas industry. Insurers like their business with traditional energy as well. In February, Euronews reported, citing figures from climate NGO Insure Our Future, that Lloyds's List market members had annual insurance premium income of between 1.5 billion and 2 billion euro from oil and gas projects.

According to another survey, quoted by Energy Voice in a recent article, the annual gross premium income for insurers from oil and gas projects was over $21.25 billion. Not only this, but, per Euronews and Insure Our Future, "Over two-thirds of the US' insurers surveyed held fossil fuel-related assets worth $536 billion (€493 billion) in 2019."

It seems, then, that for all their talk about betting on the transition and exiting oil and gas, asset managers, also known as institutional investors, and insurers, which are also institutional investors, are fans of oil and gas.

This is because they are making money from oil and gas—and they are not making that much from alternative energy sources. In fact, some are incurring quite significant losses on their exposure to transition technology. This includes insurance payouts for weather-related damage on utility-scale solar arrays and offshore wind, not to mention the high-risk—and high-premium—endeavor that is EV insurance because of the battery risk that forces writeoffs even after a minor accident.

This is a problem, and not only because staying invested in oil and gas encourages future production. Financiers' investment behaviours are problematic for pro-transition governments because they mean there is less money to put into that transition—and this money is urgently needed.

The European Union alone will need investments to the tune of 800 billion euro per year in energy infrastructure if it wants to have a chance of meeting its decarbonisation targets for 2030. There is no way this money can all come from government funds. The financial industry would need to shoulder a significant chunk of that load—but it won't do it willingly. Not after the last two years.

These two years have been quite a revelation in energy matters. First, there was the oil and gas price surge of 2022, which can obviously be blamed on geopolitical events but this is the more superficial explanation. The deeper one is that even such a transition frontrunner as the EU is so dependent on oil and gas that a supply disruption leads to sky-high prices—and demand continues to grow despite them.

Then came 2023, seen by many as a year of reckoning for the wind and solar industry. Again, the stock crash, massive losses and even bankruptcies were attributed to factors outside of the energy realm such as higher interest rates and lack of cash buffers. While this is true, it was not the whole truth. The whole truth involves factors such as the inadequacy of LCOE as a comprehensive indicator of wind and solar electricity costs and raw material fundamentals, independent of borrowing cost trends.

EVs also got a reality check last year, despite record sales. Towards the end of the year sales began to weaken and the weakening became so pronounced within just the last quarter of the year that analysts began talking about an extended downward trend in EV demand. One big reason for this was the phaseout of EV subsidies. Another was the persistent obstacles to mass EV adoption, chiefly charging infrastructure.

All of the above problems are considered solvable—with the help of bankers and insurers. But bankers and insurers are taking a step back from the transition table. Because they are not going to commit financial suicide just like that.

The head of regulatory strategy at UBS summarised the situation recently at an industry meeting: "The world's biggest banks can't live up to the green regulatory ideal unless they start dumping huge numbers of clients worldwide at a reckless pace and also roil economies in large swathes of the globe that primarily rely on dirty fuels."

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