RECLAIM Finance

RECOMMENDATIONS FOR ASSET MANAGERS | COAL SECTOR

February 2023

This document is part of a set of recommendations for asset managers to develop their climate policies. To be found HERE.

General sector overview

The coal sector is a long way from aligning with 1.5 °C and even continues to expand. Today, 2,400 coal-fired power plants are in operation, with a total capacity of nearly 2,100 GW.[1] Global coal use is set to rise by 1.2% in 2022, surpassing 8 billion tonnes in a single year for the first time and eclipsing the previous record set in 2013.[2] 476 GW of new coal-fired power capacity are still in the pipeline worldwide (enough to increase the world's current coal power capacity by 23%), 61% of this in China.[3]

Only 27 of the 1,064 listed in the Global Coal Exit List have announced coal exit dates aligned with a 1.5 °C scenario, and 490 of them still plan to develop new coal assets. 2,500 Mtpa of new coal mining capacity is in the pipeline worldwide (37% of the world's current thermal coal production), with 39% of this in China.[4]

Any delay in phasing out coal would jeopardize meeting the 1.5°C target and significantly increase financial risks. Coal companies risk wasting more than US$1.4 trillion in stranded assets under a 1.5°C scenario.[5] 42% of global coal power plants already run at loss, this could rise to about 50% of the thermal coal capacity by 2030, and 72% would be unprofitable by 2040. In a "below 2°C" scenario, investors and governments would likely face over US$267 billion in stranded assets. [6]

Beyond its major contribution to global warming, coal poses serious environmental and public health issues: air pollution from outdoor sources caused more than four million premature deaths in 2021 (85% of which were in emerging and developing countries), and coal was responsible for over 60% of global SO2 emissions.[7] The IMF estimated the world can realize a global net social benefit equivalent to US$85 trillion by phasing out coal.[8]

Overall objectives

According to the IPCC,[9], UNEP[10] and the IEA,[11] for the coal sector to be aligned with the objective of limiting global warming to 1.5°C, several conditions must be met.

- The development of coal mines must stop immediately: 89% of coal reserves proven in 2018 must remain unextracted in 2050.[12] Therefore, no new coal mines must be developed, and the lifetimes of existing mines must not be extended.[13]
- Investment in coal supply must fall by 75% from 2021 to 2030, with the remaining coal-related investment focused on maintaining production at existing mines and on reducing their emissions intensity while waiting for definitive closure.
- Coal demand must fall by 45% by 2030, and by 90% by 2050 (reaching 540 million tonnes of coal equivalent (Mtce))[14] and all coal power plants must be closed by 2030 in advanced economies and by 2040 worldwide.[15] As a result, coal trade must decline to about 50% its current level by 2030, and 90% by 2050.[16]
- Coal mine methane emissions must decline about 70% from 2021 levels by 2030 and about 95% by 2050.[17]. This result can only be achieved through large-scale mine closures.[18]

What to expect from companies

Asset managers shall expect portfolio coal companies not to have any coal expansion plan, and to adopt a credible and public coal phase-out plan aligned with a 1.5°C scenario. Such a plan shall include, at least, the following indicators:[19]

- ✓ A commitment to close all the global coal facilities in the OECD and European countries by 2030, and globally by 2040.
- ✓ No expansion plans.
- ✓ Facility-by-facility closure dates.[20] Assets shall not be sold or converted to fossil-based activities or biomass.
- ✓ Just and sustainable transition plans, including guarantees concerning the capacity to fund and implement all worker and environmental obligations (decontamination, retraining, infrastructure decommissioning, etc.)[21]
- ✓ A commitment not to open any new met-coal mine or to expand any existing met-coal mine.

In case the facility is not closed but sold, asset managers shall expect strong guarantees from the coal company that the new owner will:

- Close the facility before 2030 if it is located in the OECD or European countries, or before 2040 elsewhere.
- Not convert coal plants to fossil fuel-fired or biomass-fired plants.
- Provide sufficient financial means and measures to ensure that all social and environmental obligations are duly met.

In case the facility is not closed but converted to another use, asset managers shall expect strong guarantees from the coal company that:

- A comparative analysis shows that this conversion is economically, ecologically, financially, and technically more advantageous than closure or replacement by renewable energies with equivalent production capacity.
- An environmental and climate impact assessment demonstrates that the conversion will not result in increased GHG emissions across the value chain (and not just at the combustion stage).
- A closure deadline consistent with a 1.5°C scenario with a just and sustainable transition plan, including guarantees concerning the capacity to fund and implement all worker and environmental obligations.[22]

Claims of future retrofitting with carbon capture and storage (CCS) or conversion to fossil gas, biogas, hydrogen, biomass, or ammonia co-firing shall not be used to delay coal-fired plant closures.[23]

Asset managers shall not consider a decarbonization target or a net-zero commitment as a substitute for a credible coal phase-out plan, regardless of their validation by the SBTi.

Recommendations on targeted restrictions

Asset managers shall adopt time-bound restrictions on coal companies, with the aim of preventing the expansion of the coal sector and supporting its phase-out. Achieving these measures will require asset managers to:

- ✓ Make public their expectations from coal companies and associated exclusions.
- ✓ Implement an engagement policy towards the relevant companies to induce them to meet expectations.
- ✓ Implement a progressive escalation strategy that would ultimately lead to a full exclusion in case the expectations are not met.

Asset managers shall immediately end support to coal expansion by:

- ✓ Excluding companies which participate in the expansion of the coal sector (see definition in "General Recommendations").
- ✓ Ceasing all new investment in coal mines, plants, or infrastructure projects.

Asset managers shall commit to have no further portfolio exposure to coal projects and companies active in OECD and European countries by 2030, and by 2040 worldwide.

Asset managers shall adopt timed exclusions to progressively reduce their exposure to the coal sector and encourage companies that remain in the portfolio to reduce their coal activities and aim for full exit:

- ✓ Immediate exclusion of companies which derive more than 10% of their revenues from coal mining, and of companies which produce annually more than 10 million tons of coal.[24]

- ✓ Immediate exclusion of companies which derive more than 10% of their power production or installed power capacity from coal, and of companies with more than 5 GW of coal-fired power capacity.[25]

Until December 2024, companies that are above these exclusion thresholds may be exempted if they demonstrate their practical ability to move below the exclusion thresholds in the short term through the implementation of a credible and public coal phase-out plan.

- ✓ Commitment to reduce the relative and absolute exclusion thresholds used in the coal policy to zero, with the aim to exit completely from coal by 2030 in OECD and European countries, and by 2040 worldwide.
- ✓ Immediate commitment to exclude by 2027 companies that do not have a credible and public phase-out plan, aligned with a 1.5°C scenario, which includes, at least:
  - → A detailed asset-by-asset closure (and not selling) timetable aligned with the objective to exit from the coal sector by 2030 in OECD and European countries, and by 2040 worldwide.
  - → A just and sustainable transition plan for workers, local communities, and the environment.[26]
- ✓ Immediate commitment not to make any new investments:
  - → From 2024, in companies with no public commitment to phase-out their coal activities by 2030 in OECD and European countries, and by 2040 worldwide.
  - → From 2025, in companies with no detailed asset-by-asset closure (and not selling) timetable aligned with the objective to exit from coal by 2030 in OECD and European countries, and by 2040 worldwide.
  - → From 2026, no new investment in companies with no credible coal phase-out plan aligned with a 1.5 °C scenario, completed with a just and sustainable transition plan for workers, local communities, and the environment.[27]
- ✓ Immediate commitment to exclude any company that sells (and does not close) a coal asset, unless the new owner offers sufficient guarantees that the asset will be closed by 2030 in OECD and European countries, and by 2040 at the latest elsewhere via a just and sustainable transition plan for workers, local communities, and the environment.[28]

An exception to the above measures may be made for the financing of activities or subsidiaries dedicated to the energy transition (e.g., the deployment of renewable energy). Dedicated funding (for example via use of proceeds bonds) must be explicitly earmarked and must not be used for other activities. More specifically, an exception could be tolerated for green bonds or other sustainable use of proceeds bonds if the issuer's definition of green is rigorously verified. A Second Party Opinion on the issuer's framework alone does not guarantee the sustainable attributes of these debt instruments. It is recommended for asset managers to have a public framework that clearly defines the projects they may finance with sustainable debt market instruments and to verify the compatibility of the overall strategy of the issuer with their own commitments.

This exception must remain temporary, and only apply for the time needed for the company to align its corporate strategy with a 1.5°C scenario. Sustainability linked bonds (SLBs) cannot be subject to such an exception because they benefit the whole company, including its dirty activities.

N.B.: These recommendations come on top of the recommendations made in “Power sector” and “Engagement and voting policies”.

N.B.: Asset managers shall disclose the database used to evaluate the companies exposed to the coal sector. It is therefore recommended to use the GCEL (For more information, see “*Companies database to be used*” above).

[1] For more information : Global Energy Monitor, CREA, E3G, Sierra Club, SFOC, Kiko Network, CAN Europe, LIFE, BWGED, BAPA, and Waterkeepers Bangladesh, Boom and bust coal 2022, April 2022

[2] International Energy Agency, Coal 2022: analysis and forecast to 2025, December 2022

[3] For more information : Urgewald, Global Coal Exit List 2022 : no transition in sight, October 2022

[4] For more information : Urgewald, Global Coal Exit List 2022 : no transition in sight, October 2022

[5] Environmental Research letters, Quantifying the regional stranded asset risks from new coal plants under 1.5 °C, Volume 17, Number 2, February 2022)

[6] Carbon Tracker, Powering Down Coal: Navigating the economic and financial risks in the last years of coal power, November 2018

[7] International Energy Agency, Coal in Net Zero Transition: Strategies for rapid, secure, and people-centred change, November 2022

[8] International Monetary Fund, The Great Carbon Arbitrage, June 2022

[9] IPCC, Sixth Assessment Report: Mitigation of Climate Change, April 2022

[10] For more information : UNEP, The production gap : Governments' planned fossil fuel production remains dangerously out of sync with Paris Agreement limits, November 2021

[11] International Energy Agency, Coal in Net Zero Transition: Strategies for rapid, secure and people-centred change, November 2022

[12] Nature, Unextractable fossil fuels in a 1.5 °C world, September 2021

[13] International Energy Agency, Coal in Net Zero Transition: Strategies for rapid, secure and people-centred change, November 2022

[14] *Ibid.*

[15] Climate Analytics, Coal phase-out

[16] International Energy Agency, Coal in Net Zero Transition: Strategies for rapid, secure, and people-centred change, § 1.4.3, November 2022

[17] 3.2.1 International Energy Agency, Net Zero by 2050 : A roadmap for the global energy sector, § 3.2.1, October 2021

[18] International Energy Agency, Coal in Net Zero Transition: Strategies for rapid, secure, and people-centred change, § 1.4.4, November 2022

[19] For more information : Reclaim Finance, How to exit coal : 10 criteria for evaluating corporate coal phase-out plans, October 2021

[20] For more information : Climate Analytics, Global and regional coal phase-out requirements of the Paris Agreement: Insights from the IPCC Special Report on 1.5°C, September 2019

[21] For more information : International Energy Agency, Phasing out unabated coal : current status and three case studies, October 2021. Beyond Coal, Just transition in the context of European power utilities and Asset managers, August 2020.

[22] *Ibid.*

[23] For more information : International Energy Agency, CCS Retrofit : Analysis of the Globally Installed Coal-Fired Power Plant Fleet, 2012. Bloomberg NEF, Japan's Ammonia-Coal Co-Firing Strategy a Costly Approach to Decarbonization, Renewables Present More Economic Alternative, September 2022

[24] Urgewald's GCEL currently lists 20%. They will be lowered to 10% of the revenues in the updated plan of 2023.

[25] Urgewald's GCEL currently lists 20% of power production or installed power capacity from coal thresholds. They will be lowered to 10% of the coal share of power capacity/generation in the updated plan of 2023.

[26] For more information : International Energy Agency, Phasing out unabated coal : current status and three case studies, October 2021. Beyond Coal, Just transition in the context of European power utilities and Asset managers, August 2020.

[27] *Ibid.*

[28] *Ibid.*