



NORGES BANK

## **Grounds for decision – Product based coal exclusions**

14 April 2016

**Background**

The Ministry of Finance has introduced a new product related criterion under the Guidelines for observation and exclusion from the Government Pension Fund effective 1 February 2016.

Where thermal coal is a significant part of a company’s business activities, the company may be excluded from the fund.

The new criterion states that coal power companies and mining companies who themselves, or through other operations they control, base 30 percent or more of their activities on coal, and/or derive 30 percent of their revenues from coal, may be excluded from the GPFG. Coal in this case refers to thermal coal.

In the process of considering recommendations for exclusion or observation of companies that breach the thresholds above, emphasis should also be given to the forward looking product/fuel mix transition as well as the degree to which the company utilizes renewable energy in its activities.

**Terms and definitions**

While the criterion provides guidance on which metrics and factors should be considered during the operationalization of the criterion, there are certain specifics which need to be defined and measured to ensure a transparent, consistent analysis and related implementation. Some of key terms and their related definitions can be seen as follows:

*Table 1 Terms and definitions*

<b>Term</b>	<b>Operational definition</b>
<i>Revenue</i>	The sales of the organization, also referred to as turnover.
<i>Activities</i>	Business activities of the organization, typically natural groupings of revenue in segments.
<i>Fuel mix</i>	The elements of fuel stock that go into power generation. These elements can be fossil fuels like coal and oil or renewables like solar and wind.
<i>Generation</i>	The actual energy produced in a period, typically measured in GwH/MwH.
<i>Capacity mix</i>	The measurement of the capacity to generate power and is typically measured in MW.
<i>Thermal coal</i>	Coal that is used for energy generation
<i>Metallurgical coal</i>	Also called “met coal” or “coking coal”. This is coal that is predominantly used in the steel and metallurgical industries.

<i>Renewables</i>	Energy from a source that is not depleted when used, such as wind or solar power.
<i>Power company</i>	A company that has generation of energy as part of its activities (threshold dependent).
<i>Mining company</i>	A company that has mining as part of its activities (threshold dependent).
<i>Green bonds</i>	Bonds that are used to fund projects that have a positive environmental and/or climate benefit

## Application

### *30 percent or more of revenue from thermal coal*

The threshold related to 30 percent or more of revenue is typically more applicable to the thermal coal extraction business than the power industry. The reason for this is that companies in this sector often report revenue values split by extraction related to thermal and met coal which makes measurement against the criteria more transparent.

### *30 percent or more of their activities on thermal coal*

This threshold entails an assessment of what a company bases its business on and is more relevant to companies in the power industry than to mining companies. As an example, companies deriving 30 percent or more of their revenue from self-generated energy production can be identified. The mix of fuel sources used in these companies' energy production can then be assessed. If 30 percent or more of a company's aggregate self-generated energy production measured in energy units is based on coal, it will be covered by the criterion.

The selection criteria described above may mean that the way a company chooses to organize its activities could play an important role in whether the company is covered by the criterion or not. For example, integrated power companies with significant distribution or network operation activities may not be covered, even if coal accounts for a significant share of their energy production in isolation. At the same time, companies deriving less than 30 percent of their revenue from coal-based energy production may be covered by the threshold referred to in the previous paragraph.

The criterion focuses on thermal coal. This means that renewable energy cannot be offset against energy production from thermal coal when assessing the thresholds in isolation. As a result, the criterion could, for example, capture companies deriving 30 percent of their revenue from coal-based energy production and 70 percent from renewable energy. To address this, the criterion further states that importance should be attached to forward looking assessments including the share of business activities based on renewable energy sources.

## **Data**

We have collected data from numerous sources that cover both revenue as well as the amount of coal that is used in the fuel mix. Data related to the levels of granularity required to facilitate the operational analysis and implementation of the criterion is a particular challenge. There is a lack of centralized, or even company reported information, of the various levels required for analysis. Where a company does report related information, this is frequently at an aggregated level which means deriving representative values is challenging. As such, we engaged multiple, reputable data sources and vendors to assist us in this analysis. Through this process, one often sees that while the general level of data points between vendors is reasonable, the actual data points can vary significantly. Reporting across different time periods and measurements is an additional challenge. All of the data sources used are centrally stored. Examples of data sources that have been used are as follows:

Revenue data: Data is sourced from market data vendors, company financial statements, internal analysis and selected investment banks.

Fuel mix data: Data is sourced from market data vendors, company SRI reports, internal analysis, non-governmental organizations (NGOs) and selected investment banks.

## **Green bonds**

The guidelines for observation and exclusion address the issue of green bonds specifically. They state that recommendations and decisions on exclusion of companies based on the coal criterion shall not include a company's green bonds where such are recognized through inclusion in specific indices for green bonds or are verified by a recognized third party.

All bonds issued by the proposed exclusions have been screened against the universe of green bonds in the Barcap MSCI Green bond index.

## **Company dialogue**

Quantitative and qualitative data related to a company's granular business activities, fuel types and fuel mixes is often difficult to obtain. In certain cases, it does not exist as public information and as such communication with the company provides the best and only source of relevant current and forward looking information. Certainly forward looking plans related to fuel mix transitions and the development of renewables capacity is best suited to be provided by the company. To support this information gathering, letters were sent to the companies. Five companies responded.

## Companies excluded

Based on the application of the criterion and the data analysis described above, as well as replies from companies, companies listed in table 2 will be excluded from the Government Pension Fund Global.

The list includes companies in the utilities and mining business that NBIM previously has identified for various portfolio adjustments. We will continue our research to identify companies that may be excluded according to the product based coal criterion. The intention is to assess the remainder of relevant companies in the portfolio by the end of 2016.

*Table 2 Companies excluded*

<b>Name</b>	<b>Country</b>
Aboitiz Power Corp	Philippines
AES Corp/VA	United States
AES Gener SA	Chile
ALLETE Inc	United States
Ameren Corp, including bonds issued by <i>Union Electric Co (d/b/a Ameren Missouri)</i>	United States
American Electric Power Co Inc, including bonds issued by <i>Appalachian Power Co</i> <i>Indiana Michigan Power Co</i>	United States
Capital Power Corp	Canada
CESC Ltd	India
China Coal Energy Co Ltd	China
China Power International Development Ltd	China
China Resources Power Holdings Co Ltd	China
China Shenhua Energy Co Ltd	China
CLP Holdings Ltd	Hong Kong
Coal India Ltd	India
CONSOL Energy Inc	United States
Datang International Power Generation Co Ltd	China
Drax Group PLC	United Kingdom
DTE Energy Co	United States
Dynegy Inc	United States
E.CL SA	Chile
Exxaro Resources Ltd	South Africa
FirstEnergy Corp	United States
Gujarat Mineral Development Corp Ltd	India

Hokkaido Electric Power Co Inc	Japan
Huadian Power International Corp Ltd	Hong Kong
Huaneng Power International Inc	China
IDACORP Inc	United States
Lubelski Wegiel Bogdanka SA	Poland
MGE Energy Inc	United States
New Hope Corp Ltd	Australia
NTPC Ltd	India
Okinawa Electric Power Co Inc/The	Japan
Peabody Energy Corp	United States
PNM Resources Inc, <i>including bonds issued by</i>	United States
<i>Public Service Co of New Mexico</i>	United States
Public Power Corp SA	Greece
Reliance Infrastructure Ltd	India
Reliance Power Ltd	India
Shikoku Electric Power Co Inc	Japan
Tata Power Co Ltd	India
TransAlta Corp	Canada
WEC Energy Group Inc, <i>including bonds issued by</i>	United States
<i>Wisconsin Electric Power Co</i>	United States
Whitehaven Coal Ltd	Australia
Xcel Energy Inc, <i>including bonds issued by</i>	United States
<i>Northern States Power Co MN</i>	United States
<i>Public Service Co of Colorado</i>	United States
<i>Southwestern Public Service Co</i>	United States
Yanzhou Coal Mining Co Ltd	China