association française de la gestion financière

GUIDE TO DEVELOPING

A COAL STRATEGY

FOR ASSET MANAGEMENT COMPANIES

MARCH 2020

The Association Française de la Gestion Financière (French Asset Management Association - AFG) represents and promotes the interests of third-party asset management professionals.

Established in 1961, it brings together all asset management players from the discretionary and collective portfolio management segments via collective investment vehicles (CIV). Its members are asset management companies, either independent or subsidiaries of French and foreign banking or insurance groups. In 2009, AFG opened its doors to "correspondent members" (88 at the end of 2019) representing the asset management ecosystem: lawyers, consulting firms, IT services companies, data providers and branches.

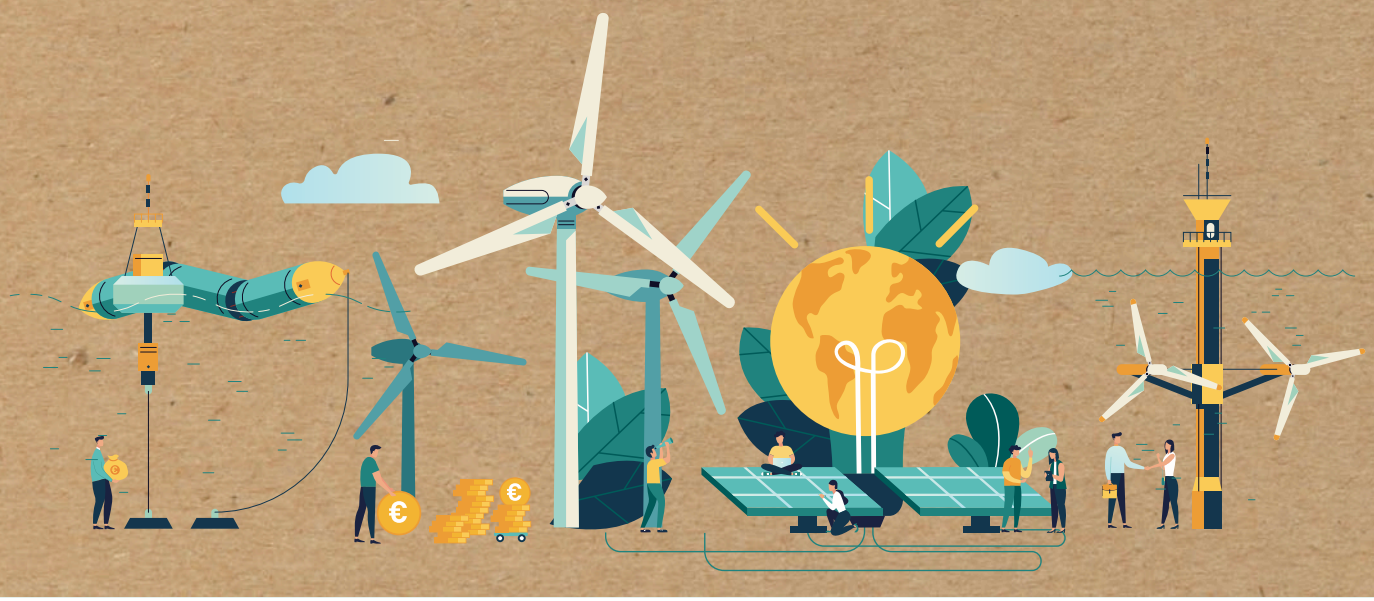
The French asset management industry manages more than €4,000 billion in assets, which represents a quarter of continental Europe's asset management market. It accounts for over 85,000 jobs, including 26,000 at management companies, and plays a vital role in financing the economy.

AFG's mission is to inform, assist and train its members. It provides them with ongoing assistance in the legal, tax, economic, accounting and technical fields.

It takes the lead in discussions in the industry on changes in management techniques, research, investor protection and investment strategies.

AFG acts as a contact point for French, European and international public authorities and plays an active role in driving regulatory changes. It defines the industry's ethical rules and acts as a driving force in the area of corporate governance.

AFG is also instrumental in promoting and furthering awareness of the French asset management industry (one of the largest in the world) among relevant stakeholders: investors, issuers, political leaders and the media, in France and internationally.



1. DECLARATION

In line with the collective commitment made by the financial industry on 2 July 2019 at the Ministry for the Economy and Finance, AFG is encouraging asset management companies to adopt a "coal strategy". To assist them, this guide identifies best practices for reducing the exposure of investments to coal in order to contribute to the objective of the national carbon neutrality strategy: to stop financing the coal industry[1].

AFG recommends that asset management companies consider the maximum risk they are willing to take, i.e. assess the risks for the assets in the portfolio and define their overall strategy with respect to exposure to coal.

AFG has identified two complementary courses of action for implementing this coal strategy:

- **Exclude coal-exposed companies from portfolios based on combined thresholds, a scope and a timetable defined by each asset management company;**

- **Engage with coal-exposed companies to withdraw from coal according to the above timetable, stop financing new projects and adopt a strategy that supports the energy transition, based on a scope, a timetable and specific objectives defined by each asset management company.**

AFG recommends that:

- **The coal strategy implemented by asset management companies apply to thermal coal and, where applicable, gradually extends to coking (or metallurgical) coal;**

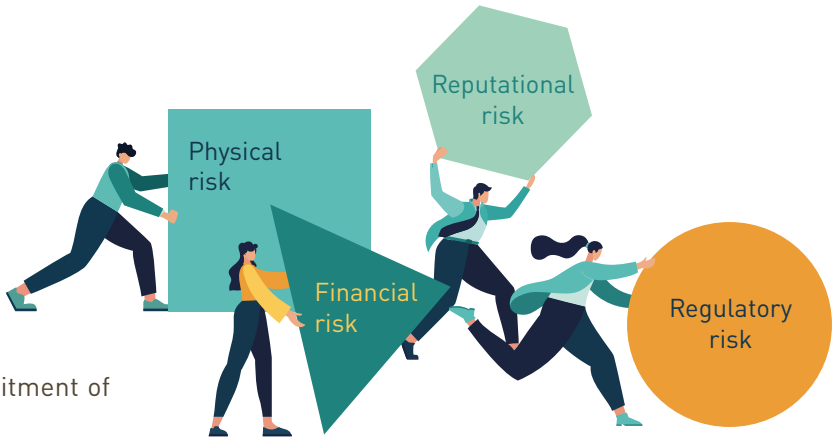
- **The coal exit timetable takes into account the 2030 deadline for Europe and the OECD and the 2040 deadline for the rest of the world.**

Lastly, AFG recommends that:

- **The coal strategy be transparent, measurable and binding for asset management companies, be made public and be the subject of annual or more frequent reporting pursuant to the requirements of Article 173 of the energy transition law[2].**

1 - https://www.paris-europlace.com/en/news/la-place-financiere-de-paris-se-mobilise-pour-franchir-une-nouvelle-etape-en-faveur-dune
2 - Law No. 2015-992 of 17 August 2015 on Energy Transition for Green Growth

2. BACKGROUND



In July 2019, the Paris financial centre committed[3] to encourage its members to develop a coal strategy. The asset management industry supports this initiative in order to contribute to the collective commitment of the signatories to the Paris Agreement.

One course of action available to asset management companies, banks and insurance companies is to withdraw from the coal sector. Bruno Le Maire, France's Minister of Economy and Finance, recalled this objective on Climate Finance Day 2019[4]:

> *« Each financial actor will define and make public its coal exit strategy by mid-2020 [...] Banks, insurance companies and asset management companies have set a date to permanently withdraw from coal in Europe by 2030. I call on all other financial actors to do the same and to quickly publish an ambitious coal strategy." »*

This speech echoes the climate issues that we are collectively facing. Indeed, coal is the leading source of greenhouse gases (GHG): 40% of GHG are attributable to coal, 32% to oil and 19% to natural gas[5]. And coal, by its very nature, releases more GHG (scopes 1, 2 and 3) than oil or gas for electricity generation. According to the ADEME[6], the carbon intensity of coal to generate electricity is 1050 gCO_2e/kWh versus 443 gCO_2e/kWh for natural gas.

In addition, various expert reports (Climate Analytics[7], IEA[8], IPCC[9], UNEP[10] and Potsdam Institute[11]) all come to the same conclusion: regardless of the scenario considered, ending coal financing is one of the requirements that must be met to keep global warming well below 2°C by 2100.

Asset management companies face four main types of risk when investing in a coal-related company:

- **Regulatory risk**: many countries are making commitments to reduce their CO_2 emissions and developing regulations that promote decarbonisation of the economy;
- **Financial risk** : In the event of a carbon price increase, the issue of stranded assets (i.e. investments that lose their value due to a change in legislation, environmental or technological requirements, withdrawal strategies) becomes more urgent, and the growing number of investors who abandon this sector increases the risk related to valuations;
- **Reputational risk** : with a consensus among financial players to consider an exit from thermal coal, coal financing has become highly controversial and asset management companies that have not defined an exit strategy are left exposed;
- **Physical risk** : since coal is the highest GHG emitting energy source, continuing to finance coal is likely to worsen climate change, which will negatively impact the economy and financial stability.

3 - https://financefortomorrow.com/actualites/declaration-de-place-financiere-une-nouvelle-etape-pour-une-finance-verte-et-durable/
4 - https://www.vie-publique.fr/discours/272147-bruno-le-maire-29112019-climat
5 - https://www.statistiques.developpement-durable.gouv.fr/sites/default/files/2019-05/datalab-46-chiffres-cles-du-climat-edition-2019-novembre2018.pdf, global GHG emissions excluding land use and forestry in 2016
6 - http://www.bilans-ges.ademe.fr/documentation/UPLOAD_DOC_FR/index.htm?renouvelable.htm
7 - https://climateanalytics.org/briefings/coal-phase-out/.
8 - https://www.iea.org/reports/world-energy-outlook-2019 and https://www.iea.org/reports/tracking-power-2019
9 - https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Full_Report_High_Res.pdf
10 - https://www.unenvironment.org/interactive/emissions-gap-report/2019/
11 - https://www.pik-potsdam.de/

3. SCOPE OF THE COAL STRATEGY

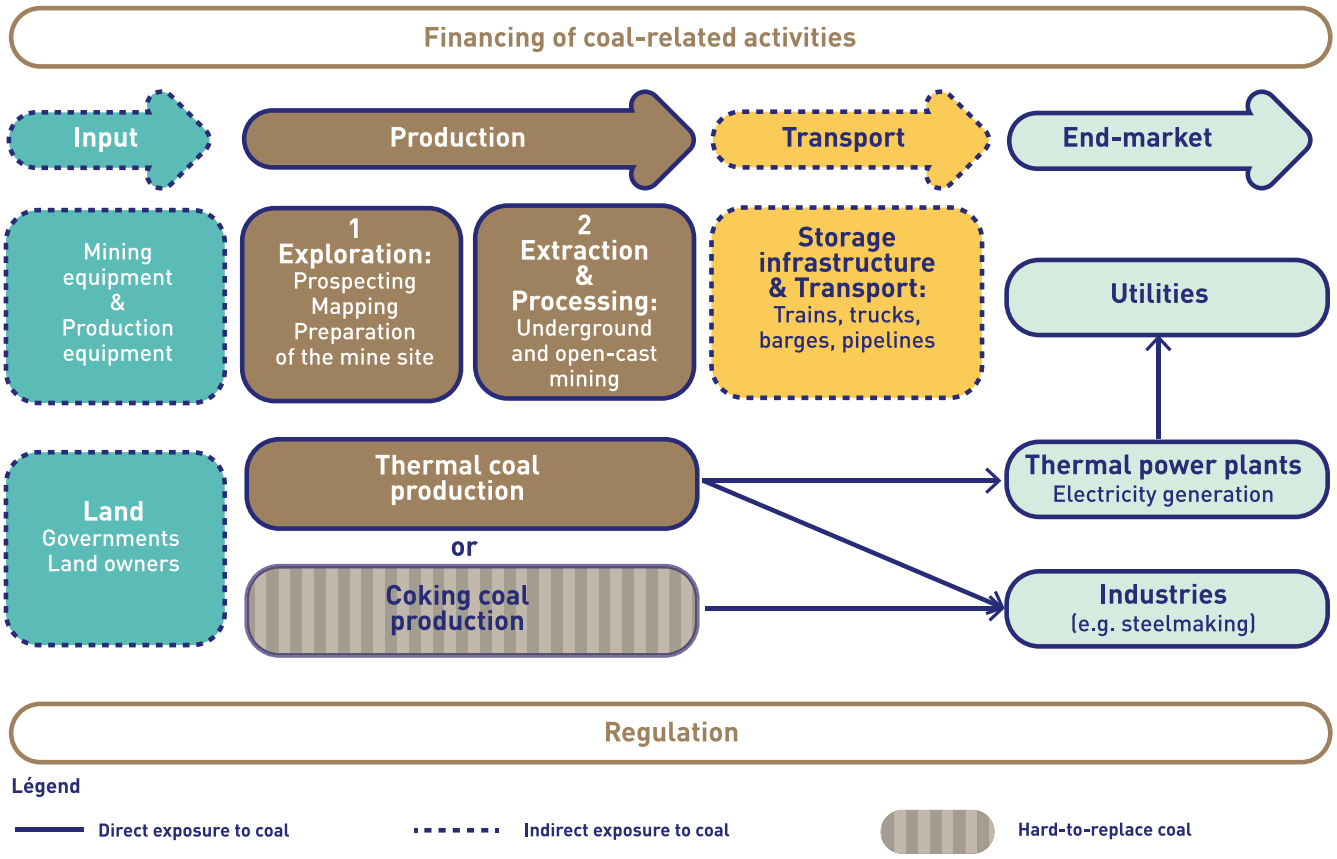
This guide encourages asset management companies to define the scope of their coal strategy by focusing on the following areas.

COAL VALUE CHAIN

The following diagram illustrates the coal value chain, from extraction to related services. Coal extraction and mining are major sources of pollution, particularly for energy providers and utilities.

From a practical standpoint, coal-related companies are mainly active in the following GICS sectors: energy, materials, industry and utilities.

Other sectors may also be impacted, such as equipment manufacturers, transport companies and financial institutions.



Source : AFG

Distinction between thermal and coking coal

The European "Taxonomy" regulation being adopted by the European Commission[12] makes a distinction between thermal coal, i.e. coal mining as a source of electricity generation, and coking (or metallurgical) coal. Coking coal is used for steelmaking. Currently, there are no economically viable substitutes for coking coal, whereas such substitutes do exist for thermal coal. Moreover, unlike thermal coal, coking coal does not produce CO_2 emissions related to final consumption of the product (scope 3[13] - steel).

AFG therefore recommends that its members implement a coal strategy for investments in activities related to thermal coal (extraction/electricity generation) and that, where applicable, the strategy is gradually extended to coking coal when economically viable substitutes exist. AFG asks asset management companies to be vigilant should the data on the breakdown between coking and thermal coal be unavailable.

Companies involved in the coal value chain

A possible change in scope recommended by AFG could be to extend the coal strategy, where applicable, to coal-exposed companies or companies with coal-related activities (for example, specific products to extract coal, storage and transport infrastructures, etc.).

TYPE OF MANAGEMENT CONCERNED

If a uniform coal strategy is not applied across the different types of management, AFG recommends the following practices:

Scope	AFG's recommendations
Active management	Apply the coal strategy to all open-ended funds: exclusion and engagement strategy
Passive management	Prioritise the use of ex coal indices when an equivalent offering exists and dialogue with index providers for the development of an ex coal offering Develop an engagement strategy vis-à-vis exposed companies
Dedicated funds and mandates	Propose application of the coal strategy to the investor Dialogue with investors on the list of excluded companies Promote engagement between the client and the asset management company AFG recommends that each of its members apply a 'best effort' coal strategy and advise its clients to apply its coal strategy if they have not expressed their objection to such strategy.

12 - https://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=CONSIL:ST_5487_2020_ADD_1&qid=1581068502592&from=FR
13 - Scope 3 is one of the three GHG emissions levels established in the GHG Protocol. Scope 3 corresponds to indirect emissions not related to the energy consumption required to produce the product.

TYPES OF STRATEGIES CONCERNED

If a uniform coal strategy is not applied across the different types of strategy, **AFG recommends the following practices based on the asset class:**

Type of strategy	AFG's recommendations
Equity	• Systematic application of an exclusion strategy for coal-exposed companies, except in specific cases • Development of a systematic engagement strategy
Fixed Income	• Systematic application of an exclusion strategy for coal-exposed issuers, except in specific cases • Development of a systematic engagement strategy • Investment in instruments with the shortest possible maturities only as part of a buy & hold strategy
Green bonds	• Implement a transparent process for analysing the projects financed by the green bond to avoid exposure to coal and ensure the financing of the transition. • Be particularly aware of investments in green bonds of parent-subsidiary companies[14] that are active in coal
Bonds issued by public issuers (supranational, sovereign, regions)	Countries have very diverse energy mixes, including in Europe. The common goal of withdrawing from coal by 2030 for European and OECD countries and by 2040 for other countries now provides a basis for challenging countries whose energy mix includes a large share of coal. As the Paris Agreement seeks to be "fair and differentiated", AFG encourages asset management companies to: • Take an informed decision based on concrete arguments; • Provide encouragement through dialogue on the issuance of green bonds; • Engage in a broader dialogue on the coal exit strategies considered by public issuers.

EXISTING AND NEW INVESTMENTS

AFG recommends applying the coal strategy to :

- New investments after the coal strategy is implemented
- The existing investment stock only as long as investors' interests are protected:
  - An exception may be made under unfavourable market conditions;
  - For bonds, it would be possible to retain the stock until maturity and to divest by no later than 2030.

14 - The case of parent-subsidiary companies is addressed in section 4 of the guide.

4. IMPLEMENTATION OF THE COAL STRATEGY

The next step is to determine how this strategy is implemented.

TIMELINE FOR IMPLEMENTING THE COAL STRATEGY

An international consensus was reached to keep global warming well below 2°C by 2100. Various scenarios have been developed by Climate Analytics[15], IEA[16], IPCC[17], UNEP[18] and Potsdam Institute[19] to maintain a carbon budget in line with the objective set in the Paris Agreement. The first step clearly identified and approved at the international level is the gradual phase-out of coal at a differentiated rate based on the regions given their different contexts, with the result that coal-fired power plants are to be shut down in European and OECD countries by 2030 and in the rest of the world by 2040.

AFG therefore recommends that asset management companies make an informed choice in light of issues related to full or gradual divestment or the adoption of a transition period.

AFG recommends that the 2030 and 2040 dates, depending on the geographic areas, be used as deadlines for all asset management companies.

AFG therefore recommends that asset management companies develop and make public their coal strategy by the end of 2020 along with a specific monitoring timetable and an exit plan in order to meet this deadline.

EXCLUSION

Indicators and exclusion thresholds

Special attention must be given to the choice of indicators and thresholds used by asset management companies to exclude coal-related companies.

AFG recommends that asset management companies:

- **Combine various relative and absolute indicators;**
- **Set downward scalable thresholds, which will put them on a path to achieving a climate target of well below 2°C.**

More specifically, **AFG recommends that the exclusion thresholds used for coal mining companies be lower than those for energy producers** since mining is often more diversified, which implies a high risk of dilution.

See pages 10 and 11 the indicators' list the AFG proposes its members to use.

15 - https://climateanalytics.org/briefings/coal-phase-out/
16 - https://www.iea.org/reports/world-energy-outlook-2019 and https://www.iea.org/reports/tracking-power-2019
17 - https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Full_Report_High_Res.pdf
18 - https://www.unenvironment.org/interactive/emissions-gap-report/2019/
19 - https://www.pik-potsdam.de/

Expansion of coal activities

With regard to new coal-related projects (coal-fired power plant, infrastructure, etc.), **AFG is advising its members not to invest in companies that may undertake new coal-related projects** involving:

- Coal mine expansion
- Installed capacity expansion
- Infrastructure expansion
- New financing

Case of parent company/subsidiary

AFG wishes to make its members aware of the issue of companies with a parent company/subsidiary legal structure and **recommends adopting a strategy in this regard.**

It is advisable for asset management companies to be able to identify practices that will result in a change in the company's behaviour. To that end, **AFG recommends that asset management companies make every effort to conduct their analysis at parent company-level including all subsidiaries.**

There are two specific cases where asset management companies are asked to treat subsidiaries differently from their parent company:

- Include in their exclusion strategy subsidiaries with coal operations that are being financed through the bond market

- Exclude from their coal strategy subsidiaries that are mainly involved in green activities.

Data sources

The various types of information may come from third-party data providers or internal sources.

For information, a coalition of 30 NGOs, the Global Coal Exit List, publishes quantitative data by company free of charge: https://coalexit.org.

Below is a list of indicators which AFG advises its members to use:

Indicator level	Indicator	Pros	Cons	Examples of exclusion thresholds recommended by NGOs starting in 2020[20]
Relative	% of revenue	Understandable data Data widely disseminated by data providers	Estimates (with sometimes divergent sources) Indicator that is not always published by utilities Fixed threshold Dilution in industrial conglomerates (coal-related revenue can be hidden by the group's other activities) Dependence on price changes, source of volatility of the % of coal-related revenue from one year to another Indicator not related to climate scenarios	> 20%
	% of the energy mix (MWh generated)	Identification of the company's actual activity and therefore its environmental impact Indicator used by many climate scenarios (IEA and others)	Data rarely reported or only as a % and MWh are then estimated based on the installed capacity figures[21] Dependence on the level of activity, source of volatility (OPEX)	> 20%

Most of the indicators are based on historical data, **AFG recommends adopting a forward-looking view and routinely combining them with an analysis of the issuer's coal strategy** (investment plans and scheduled shutdown of plants, etc.).

20 - https://coalexit.org/methodology

21 - Example of estimate for the % of energy production by type of fuel = installed capacity by type of fuel * the plant's average load factors by type of fuel

Indicator level	Indicator	Pros	Cons	Examples of exclusion thresholds recommended by NGOs starting in 2020[20]
Absolute	Annual thermal coal production (MT)	A company's impact depends on the absolute size of its coal operations More representative than the % of revenue from mining Allows mining activities to be identified since mining projects are often integrated into coal power plants.	Unavailability of data	>10 MT per year
	Installed capacity (GW)	Available data Companies report only on the volume of installed capacity Indicator used by many climate scenarios (IEA and others) Relatively stable data resulting from the company's strategy (CAPEX) Easier forward-looking view Additional data that can be used in case of an issue with the revenue threshold.	Installed capacities can be different from the MWh actually generated Can be combined with investment plans to make the indicator forward-looking.	> 5 GW
	Construction of new coal-fired power plant capacities (MW)	Projects: future MW of installed capacity are not aggregated with those that exist.	Data not widely reported by companies	0
	Carbon intensity	Includes all sources of GHG, not only those related to coal, and includes energy efficiency efforts Indicator included in the objectives of the Paris Agreement, used by the IEA in its climate scenarios and in the European Commission's Green Taxonomy Indicator widely published by companies in the electricity generation sector (particularly in Europe)[22].	Does not provide information about mining companies exposed to coal and therefore needs to be supplemented by other indicators to determine their exposure to coal Does not allow the use of coal to be differentiated from the other fossil energy sources used by the company.	Indicator not tracked by NGOs

22 - Transition Pathway Initiative (TPI) allows access to data for major global electricity producers: https://www.transitionpathwayinitiative.org/.

ENGAGEMENT

AFG recommends adopting an engagement strategy in addition to the exclusion strategy.
The coal engagement strategy can be proportionate to each asset management company's capacities.

AFG also recommends that:

- **The engagement strategy cover, to the extent possible, all companies involved in the coal value chain;**
- **The voting strategy takes into account the asset management company's coal strategy;**
- **A targeted engagement be undertaken in cases where it is difficult to fully and quickly divest from a coal-exposed company, or for companies that are still exposed to coal but below the exclusion thresholds to encourage them to adopt a complete exit strategy;**
- **Coal-related activities be disposed of responsibly within the framework of the dialogue with issuers;**
- **Priority be given to shutting down rather than disposing of coal-related activities during the dialogue with the issuer.**

Types of engagement

AFG recommends that its members use all appropriate types of engagement.

Individual engagement

To ensure their effectiveness, AFG recommends, as much as possible, that the actions that issuers are asked to take through individual engagement be specific, attainable and measurable and include indications of reasonable but ambitious deadlines.
AFG also encourages asset management companies to ask coal-related issuers to issue green bonds.

Collaborative engagement

Many collaborative platforms exist. The PRI and the Carbon Disclosure Project (CDP) initiative are particularly powerful as they already bring together many asset management companies. In addition, some organisations undertake initiatives that focus specifically on the issue of climate, such as Climate Action 100+[23], TCFD[24] and IIGCC[25]. **AFG recommends that priority be given to collaborative engagement**, for example through coalitions of investors, with public statements on platforms or in professional committees.

Reputational engagement

It is entirely possible to be engaged without being invested in the issuer.
Fiduciary responsibility can be understood as:

- In the short term, when it concerns the exposure of an asset management company's clients to stranded assets;
- In the longer term, for example and depending on the case, when it relates to an asset management company's overall involvement in the fight against climate change, which could have a broader impact on portfolios.

AFG therefore recommends that its members also consider the possibility of overarching firm led engagement when necessary and appropriate.

23 - http://www.climateaction100.org/
24 - https://www.fsb-tcfd.org
25 - https://www.iigcc.org/

Cases where an engagement strategy must be implemented

Case	AFG's recommendations
Coal-based energy producers	Require that issuers be transparent about specific, strong and clear objectives to be met, in line with AFG's above recommendations These objectives will be set in light of international regulatory standards. Performance must be measured against these indicators and continue over time until the complete exit from coal activities
Coal-related issuers close to the exclusion thresholds	Stronger engagement to encourage the issuer to comply with the defined thresholds as quickly as possible
Management of the existing investment stock of coal-related issuers	Engage with these issuers if excluding them is not possible in the near future
Coal-related financial services	As a condition for all financial services to require that the engagement strategy of these companies include their adoption of a plan to phase out their existing "coal" assets by no later than 2030 in EU and OECD countries and by 2040 in the rest of the world Dialogue with the sectors that finance coal in order to put an end to financing at the project level (similar to the way in which some banks already refrain from financing new projects).

5. TRANSPARENCY

AFG recommends that asset management companies be transparent about their coal strategy by making it public and by reporting on any changes to it in their annual extra-financial reporting, in accordance with Article 173 of the Energy Transition law.

AFG recommends that the coal strategy be measurable and binding for asset management companies.

AFG also recommends an annual review of the coal strategy.

These recommendations were made by an ad hoc AFG working group within the Sustainable Finance Commission.
They were approved by AFG's Board of Directors on 6 February 2020. They are intended to apply to all AFG asset management companies members.

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