



NORGES BANK

Grounds for decision – Product-based coal exclusions

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Background

The Ministry of Finance introduced a 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 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.

In April 2016 Norges Bank made public the first round of exclusions based on the product related coal criterion. We said we would continue our research to identify companies that may be excluded according to the product based coal criterion. In this document we present the results from the second round, which also includes decisions to put companies on observation. We will continue our research and provide results from the third round at a later stage.

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 the key terms and their related definitions can be seen as follows:

Table 1 Terms and definitions

Term	Operational definition
<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, selected investment banks and our external managers.

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

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.

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 of company exclusions made public in the first round (announced April 2016) comprised companies' subsidiaries issuing bonds only if these subsidiaries themselves were deemed to breach the relevant thresholds on a stand-alone basis. In this second round of exclusions based on the product related coal criterion, the operationalization has been altered to exclude all companies' subsidiaries that issue bonds, unless these subsidiaries issue green bonds or are deemed to have significant renewable energy activity. For consistency, this has now also been applied to all remaining subsidiaries of companies excluded in the first round.

The second round has led to the exclusion of 15 companies and their non-listed subsidiaries issuing bonds, of which there were 9. To align the operationalization methodology of round one with that used in round two, 21 subsidiaries related to companies excluded in the first round have also now been excluded. Going forward, exclusion decisions will include all non-listed subsidiaries issuing bonds of an excluded company, unless explicitly stated.

The list includes companies in the utilities and mining business that Norges Bank Investment Management previously had identified for various portfolio adjustments.

Companies put on observation

The guidelines for observation and exclusion states that "observation may be decided when there is doubt as to whether the conditions for exclusion are met or as to future developments, or where observation is deemed appropriate for other reasons." For the product related coal criterion, observation applies to companies that are above the relevant thresholds but where there is information related to stated plans, initiatives or other material factors that are likely to bring the company below said thresholds in the foreseeable future.

Examples of plans, initiatives and other material factors include:

- Material corporate actions such as divestment/spinoffs or planned acquisition of generation capacity,
- Publicly stated plans to close, add or alter capacity, such as mothballing of plants,

addition of new non-coal or conversion of existing coal capacity.

- Events such as drought for large hydro-power utility companies or critical failure/fire/shut-down of existing capacity resulting in the need for backup coal to run above normal levels.

Based on the application of the criterion and the data analysis described above, as well as replies from companies, companies listed in table 3 will be put on observation. Companies put on observation will be afforded extra scrutiny and attention to monitor their progression according to plan.

Table 2 Companies excluded

Name	Country
Alliant Energy Corp	United States
Chugoku Electric Power Co Inc/The	Japan
DMCI Holdings Inc	Philippines
Electric Power Development Co Ltd	Japan
Electricity Generating PCL	Thailand
Emera Inc	Canada
Empire District Electric Co	United States
Great Plains Energy Inc	United States
Guangdong Electric Power Development Co Ltd	China
Hokuriku Electric Power Co	Japan
Inner Mongolia Yitai Coal Co Ltd	China
Jastrzebska Spolka Weglowa SA	Poland
NRG Energy Inc	United States
Tenaga Nasional Bhd	Malaysia
Westar Energy Inc	United States

Table 3 Companies put on observation

Name	Country
CMS Energy Corp	United States
EDP Energias de Portugal SA	Portugal
Endesa SA	Spain
Glow Energy PCL	Thailand
Kyushu Electric Power Co Inc	Japan

OGE Energy Corp	United States
Pinnacle West Capital Corp	United States
SCANA CORP	United States
Southern Co/The	United States
Talen Energy Corp	United States
Tohoku Electric Power Co Inc	Japan