



# Implementing M&G Investments Thermal Coal Investment Policy in our funds

This document, referred to in M&G funds' prospectuses, provides further information on how M&G Investments will be implementing its Thermal Coal Investment Policy between April 2022 and October 2024.



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# 1. Background for the Policy

Thermal coal is coal that is used for the purpose of power generation. It represents 36% of total electricity produced but contributes around 72% of electricity-related CO<sub>2</sub> emissions, or circa 27% of the world's carbon emissions. This is not sustainable. The science is clear: to keep the earth's average warming within the Intergovernmental Panel on Climate Change (IPCC) guidelines for adhering to the Paris Agreement's temperature targets requires a rapid energy transition, with the complete phase-out of thermal coal from the Member States of the Organisation for Economic Co-Operation and Development (OECD) and the European Union (EU) countries by 2030 and the rest of the world by 2040.

M&G Investments' Thermal Coal Investment Policy (the "Coal Policy") will be effective from 27 April 2022. This will mean that all of our active funds will be applying an active engagement and divestment strategy when analysing companies exposed to the thermal coal industry. Our focus on responsible investment has always meant that such concerns were part of our fundamental analysis when deciding which companies to invest in. However, to develop this approach further, the Coal Policy will mean that fund managers will be engaging with management of these companies and re-aligning their portfolios where necessary. By adopting a forward-looking Coal Policy and harnessing our stewardship capabilities, we aim to encourage companies to transition their businesses towards Net Zero and phase-out thermal coal from the energy system in line with the IPCC guidelines. This means that companies in OECD and EU countries should be thermal coal-free by 2030, and companies in the remaining countries should be thermal coal-free by 2040.

Once the Coal Policy has been implemented in full, our active funds will have substantially removed their exposure to companies that are unable or unwilling to transition away from thermal coal<sup>1</sup> within the necessary timelines to keep the earth's average warming within the target of 1.5 degrees Celsius above pre-industrial levels by the end of this century set by the Paris Agreement.

This will be a significant step on M&G's journey to ensure that we achieve our ambition to be Net Zero by 2050 across its invested assets.

## 1.1. Why is M&G implementing a Coal Policy?

Climate risk analysis is bi-directional: how does your money impact the climate, and how does the climate impact your money? Climate risk has the potential to impact the valuation of companies, and significantly change the risks and opportunities that fund managers face. The risks can stem from a variety of sources, including physical occurrences (increasingly extreme weather patterns causing unexpected financial losses), technological change as well as societal and policy changes that result in climate risk-exposed assets losing value, potentially becoming 'stranded' and increasing their risk of litigation. Additionally, maintaining investments in companies which prolong the use of thermal coal and thereby continue to increase global warming is elevating the exposure to climate risk for all other investments.

In order to manage the climate risk of, and caused by, thermal coal-related companies, we are aiming to eliminate our funds' exposure to investments in mining, power generation and thermal-coal exposed companies that are either unable or unwilling to transition away from thermal coal within the necessary timelines to keep the earth's average warming within the targets set by the Paris Agreement. We aim to use our influence as a global investor to drive positive change, to decarbonise the energy system and increase energy and resource efficiency. As such, the primary focus is on engagement and enacting real-world change within the companies we invest in that do not yet meet the thresholds we insist on. Where this is not possible, we believe it is in the best interests of clients to divest from the holding. In addition to supporting the transition away from thermal coal and improving the impact the funds' portfolios have on the climate, this also helps us to mitigate the transition risks in the funds resulting from the gradual global phase-out of thermal coal. Governments around the world are introducing CO<sub>2</sub> taxes, setting firm restrictions on the extraction and use of thermal coal in order to meet domestically agreed decarbonisation plans and support their commitment to the Paris Agreement. As a growing proportion of the financial system takes similar approaches to funding companies that are not aligned to the required transition paths, the risk of their assets losing value increases. This increases the investment risk associated with thermal coal-related companies, as well as the potential for these assets to experience a premature write-down or devaluation, ie to become 'stranded'.

The pace of change required to transition the global energy system away from using thermal coal means that we now consider our funds' ability to deliver their long-term financial objectives is best served by implementing a dedicated Thermal

<sup>1</sup> The Coal Policy does not apply to metallurgical coal, which is used in the steel production process.

Coal Investment Policy. The Coal Policy is applicable to public assets in pooled funds actively managed by M&G Investments on behalf of its clients. Its objective is to achieve real-world positive change by supporting a just transition toward a more sustainable economy. As such, encouraging companies to transition away from thermal coal within the required timelines (and publishing credible plans for doing so while remaining viable businesses) via engagement and active stewardship will always be preferable to divestment. While divestment removes the direct link to a climate-risk exposed company, it will not help the company shift to a low carbon business model necessary to support the transition to Net Zero and the broader objective to achieve planetary sustainability. Conversely, divestment needs to be seen as a potential consequence of a failure to respond to encouragement for the engagement efforts to have real bite.

## 1.2 The Just Energy Transition

M&G supports the transition of the global economy and society to sustainable consumption and production methods as well as the reduction of carbon emissions to net zero by 2050, in a way in which costs and benefits are shared fairly between generations, communities and regions (a ‘just transition’).

In order to meet the Paris Agreement’s temperature target to limit global warming to 1.5 degrees Celsius and counteract the effects of climate change and carbon emissions on nature and human well-being, scientific evidence suggests that the combustion of thermal coal needs to be phased out by 2030 in EU and OECD countries and by 2040 in the rest of the world.

However, we recognise that countries are not all at the same stage in decarbonising their energy system, and a divestment-first approach will not achieve the sustainable economic transition the world needs. The requirements of the Coal Policy therefore take into account the different transition timelines between EU/OECD and non-EU/OECD countries.

We also recognise, that decarbonisation without taking account of the needs of affected communities may cause long term harm to social inclusion, economic development, and population health and wellbeing, and loss of the public support necessary to achieve successful change. Therefore, where we consider it appropriate, we may operate exceptions to the Coal Policy in the interests of a just transition.

## 2. Implementing the Policy Over Time

### 2.1. From April 2022 – Effective date of policy

M&G uses proprietary analysis combined with third party data to identify companies within the thermal coal industry which do not yet meet our expectations for the transition. M&G continues to engage with these companies in order to encourage management to align the company to internationally recognised requirements for phasing out thermal coal. However, with effect from 27 April 2022, where this engagement has not been not successful, and/or where we consider there to be no realistic prospect of the company transitioning away from thermal coal while remaining a viable investment in the relevant fund(s), we will consider selling the holding.

### 2.2. Exclusions from October 2022

We aim to use our influence as a global investor to drive positive change. At the same time, there will come a point where engagement has run its course and the company can no longer be considered an eligible holding for an M&G fund. By 31 October 2022, if a company remains unable or unwilling to transition away from thermal coal by 2030 and located<sup>2</sup> in a country of the OECD and/or the EU, securities issued by that company will usually<sup>3</sup> be excluded from M&G funds.

<sup>2</sup> There are various ways in which investment managers such as M&G determine where companies are located, such as where they are incorporated, listed, operate in, generate revenues from and so on. We will adopt a similar approach to this question as we do for other areas of our business.

<sup>3</sup> There are limited exceptions to this general policy to divest, for example if a company has a credible plan to complete its phase out marginally later than our preferred timeline.

## 2.3. Exclusions from October 2024

Companies located in countries outside the OECD and/or the EU that, in our opinion, have credible transition plans, will still be permitted to be held within funds. The longer time period for engagement in such countries is needed to ensure a just transition away from thermal coal – please see section 1.2 for more information on this. However, by 31 October 2024, if such a company remains unable or unwilling to transition away from thermal coal by 2040, securities issued by that company will be excluded from M&G funds.

## 2.4. Liquidity

The ability to sell assets from some excluded companies may be hampered by poor liquidity (ie the ability to sell the assets without negatively impacting their value). This may result in a small number of these companies still being held after 31 October 2022/2024. We will, however, seek to sell these assets as soon as practicable after these dates should this be required.

## 3. Assessment Process

The Coal Policy seeks to exclude companies that are either unable or unwilling to transition away from thermal coal within the necessary timelines to keep the earth’s average warming within the targets set by the Paris Agreement. This means that companies in OECD and EU countries should be thermal coal-free by 2030, and companies in the remaining countries should be thermal coal-free by 2040.

The policy is a forward-looking one that goes beyond basic quantitative screening, to assess the credibility of transition plans, and involves engaging with investee companies to achieve real-world positive change, by supporting them in transitioning towards a more sustainable economy. We use third party data providers to identify the initial list of ‘coal-related’ issuers in scope. In order to assess whether or not a company is sufficiently engaged in the energy transition to remain an eligible investment we consider the data points in the table below.

Our phase out criteria and restrictions on coal-related investments	
<b>Mining</b>	<p>Excluding companies that fit one or more of the conditions below:</p> <ul style="list-style-type: none"> <li>• Undertaking new coal expansion</li> <li>• Where coal production is greater than 20 million tonnes per annum or represents more than 30% share of their revenue</li> <li>• No credible public plan to phase-out coal production completely by 2030 (EU and OECD)/2040 (Rest of the World)</li> </ul>
<b>Power Generation</b>	<p>Excluding companies that fit one or more of the conditions below:</p> <ul style="list-style-type: none"> <li>• That are building new unabated<sup>4</sup> coal generation capacity</li> <li>• That have coal-fired power generation greater than 10GW</li> <li>• Where coal represents more than 30% share of energy mix output<sup>5</sup></li> <li>• No credible public plan to phase-out coal production completely by 2030 (EU and OECD)/2040 (Rest of the World)</li> </ul>

<sup>4</sup> “Unabated” refers to power generation without technologies to substantially reduce emissions, such as operational carbon capture and storage.

<sup>5</sup> Exemption permissible for power generation of 300MW or less.

## Our phase out criteria and restrictions on coal-related investments

**Other Sectors** Where the company's main business is not coal, but there are coal-related operations<sup>6</sup>, excluding companies that fit one or more of the conditions below:

- That are planning new or expansion of coal related operations
- That have no credible public plan to phase-out coal related operations completely by 2030 (EU and OECD)/2040 (Rest of the World)

If a company meets any of these flags, it is likely to be unable or unwilling to transition away from thermal coal sufficiently within the required timeframes. However, we wish to place due emphasis on forward-looking factors in addition to the coal expansion criteria, and therefore we also undertake detailed qualitative analysis of companies across funds in order to determine:

- The accuracy of the population captured by the screens, undertaking further investigation to eliminate what we would consider to be false positives, ie companies that are flagged by third party screens but in our opinion shouldn't have been.
- The nature of companies' transition plans, the extent to which they are aligned to the Paris Agreement, and the further information required to determine their credibility and to evidence progress made towards Paris alignment.
- The list of companies which clearly fail our criteria and therefore qualify for divestment or exclusion.
- Where engagement is appropriate, to define the objectives and actions required within a specified time period for each company, to support their phase-out from coal and transition to Paris alignment.

Following this analysis and the subsequent engagement, we will divest from assets where companies do not have a credible plan to phase-out thermal coal-related activities by 2030 (OECD and EU) or by 2040 (rest of the world), and where they fail to achieve specific, time-bound objectives in supporting their exit from thermal coal.

If at any point during the time-bound engagement period an investment is determined not to have a credible transition plan and be unable to move into the thresholds as shown in the table above, then the investment will be reclassified for divestment and sold.

All thermal coal-related investments will be subject to regular review at least annually.

## 4. Scope of Policy

### 4.1. Instruments

The Coal Policy applies to publicly listed shares and public bonds listed by a single corporate entity, and single name derivatives thereof including credit default swaps and equity warrants.

Investment in "green bonds" that have successfully passed our themed bond assessment process may be permissible irrespective of the issuing company.

Bonds issued by Governments or Government-related institutions, Asset Backed Securities, Money Market Instruments, Private Assets, Direct Property, Index Derivatives and funds that are not managed by M&G are currently out of scope. Once sufficiently robust and granular approaches capable of widespread implementation are established, these asset classes will be considered for inclusion within the Coal Policy.

<sup>6</sup> It is currently not possible to screen for some sectors where involvement is a step removed, such as financials

## 4.2. Passive Funds

For funds whose objective is to replicate the performance of an index (ie passive funds), it will not be possible to implement the Coal Policy in full, as its requirements are not reflected in the benchmark that the funds are seeking to perform in line with.

However, where these passive funds own shares in companies in the thermal coal industry, we will seek to use our influence and encourage management to transition away from thermal coal in line with IPCC recommendations.



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