SUMMARY FOR WORKING PAPERS:

Advancing the Role of Private Finance in the Managed Phaseout of Coal Power

January 2023

For the global economy to remain on track with the goal of limiting global warming to 1.5°C, low-carbon solutions must be scaled up. However, just as importantly, high-carbon assets must be phased out. Any credible decarbonization pathway that achieves the Paris Agreement temperature goals must include the early phaseout of fossil fuels — in particular, coal power assets. The pace of phasing out coal assets around the world must significantly accelerate, and continued financing and support from financial institutions (FIs) committed to net zero can accelerate just and equitable outcomes.

Yet, although FIs have stepped up with climate commitments and sustainable finance targets, many have become hesitant to finance high-emitting assets even when that financing could contribute to decarbonization through early retirement. Two of the main challenges include: (1) reputational issues and (2) a lack of understanding of the financial risks and returns. The first challenge stems from stakeholder pressure for FIs to divest or withdraw finance from high-emitting assets to meet their financed emissions targets and comply with policies designed restrict such exposure. The second challenge stems from managed phaseout being a new field, with few examples available to demonstrate how different financing mechanisms can be used by private FIs to support climate-aligned outcomes while upholding their fiduciary duty. Overcoming these barriers can help FIs pursue managed phaseout as a means of supporting the net-zero transition and real-economy emissions reductions.

To support FIs in adopting managed phaseout as a viable and effective net-zero financing strategy, RMI's Center for Climate-Aligned Finance (the Center) has prepared two working papers at the request of the Glasgow Financial Alliance for Net Zero (GFANZ) and with the support of Bloomberg Philanthropies that lay out guidance on:

- **Metrics and targets:** How new and supplementary approaches to measuring, setting targets for, and disclosing progress on managed coal phaseout financing can remove barriers and even incentivize and accelerate FI involvement.
- **Financing mechanisms:** How, where, and when FIs can use different financing mechanisms to support a transition away from coal power generation while securing risk-adjusted returns.

These working papers focus on coal power generation, given the global momentum for coal phaseout and significant negative externalities involved. Coal power has also become increasingly uneconomic, yet barriers to its phaseout persist. Complex and multifaceted challenges make coal a unique test bed for exploring new approaches for the managed phaseout of high-emitting assets. Although transition pathways and barriers to phaseout may vary by industry, we expect our findings and approaches could be leveraged for other real-economy sectors.

Our work builds on the recommendations outlined in GFANZ's June 2022 report, *The Managed Phaseout of High-emitting Assets*, in which GFANZ describes managed phaseout as a viable and critical net-zero strategy for FIs.[i] RMI has worked at the forefront of market-based coal transition solutions, developing practical insights including *How to Retire Early*, *Financing the Coal Transition*, and *Guidelines for Financing a Credible Coal Transition*, as well as supporting Indonesia in its groundbreaking climate deal to shift away from coal.

To ensure that our guidance on FI involvement in managed coal phaseout meets real-world needs for accountability, results in alignment with real-economy decarbonization objectives, and is practicable and applicable to FI decision-making, this work has been informed by stakeholder engagement and feedback from over 30 practitioners, including sustainability and sector experts from global private FIs, multilateral development banks (MDBs), nongovernmental organizations (NGOs), and standard-setting bodies. Sustainable finance practitioners and power and utility financiers can reference these two papers as they engage with clients to execute phaseout deals and measure and disclose their progress, and other stakeholders such as standard setters, coal plant owners, service providers, and civil society can use the papers to better understand, support, and collaborate with FIs in this area.

With appropriate guardrails and accountability, this role for private FIs represents a unique climate-aligned investment opportunity, and, in many ways, a more proactive and additional contribution to real-economy decarbonization outcomes in line with their climate commitments. Indeed, near-term and widespread participation of private FIs in deploying capital to accelerate the managed phaseout of global coal power assets may be the only way to realize power-sector decarbonization in line with global climate goals. Private FIs now have the guidance needed to take critical steps toward decarbonizing the power sector.

Managed Coal Phaseout: Metrics and Targets for Financial Institutions

Introduction

Current approaches to measuring and tracking the climate impacts of private FIs' financing activities fall short of supporting managed phaseout strategies. To date, FIs have mainly set climate-related targets rooted in reducing their financed emissions, and many have policies in place to reduce exposure to high-emitting sectors such as coal power generation. Measuring decarbonization progress in this way can create incentives for FIs to divest or withdraw finance from the coal power sector, an action with little proven influence to drive emissions reductions in the real economy, creating barriers for FIs that might otherwise finance managed phaseout activities.

Proposed Approaches

To address these challenges, the Center recommends that FIs adopt specific, more nuanced approaches to measure, track, and set targets for their managed phaseout financing activities. Our proposed approaches are

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[i] GFANZ's *Financial Institutions Net-zero Transition Plans — Fundamentals, Recommendations, and Guidance* outlines four key net-zero financing strategies including financing or enabling the accelerated managed phaseout (e.g., via early retirement) of high-emitting physical assets. https://assets.bbhub.io/company/sites/63/2022/09/Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf.

designed to alleviate barriers, unlock opportunities to finance the early retirement of coal power assets, and demonstrate whether financing leads to real-economy decarbonization. They are also designed to enable comparability, accountability, and transparency across the financial sector. Given that FI portfolios and counterparties vary and cannot be captured in a one-size-fits-all approach, we propose a menu of options (see Exhibit 1) for metrics that are not mutually exclusive and that could work in tandem with existing metrics and

Exhibit 1

Summary of Proposed Approaches to Metrics and Targets for Managed Phaseout

Approach	1 Phaseout Plan Coverage	2 Financed Emissions for Phaseout	3 Phaseout Alignment Mapping	4 Phaseout Impact Assessment
Metrics	Share of coal assets with a managed phaseout plan	Financed emissions related to eligible coal phaseout assets	Share of 1.5°C-aligned coal assets	Forward-looking impact of managed phaseout (e.g., emissions savings)

Source: RMI, 2023

These proposed metrics vary in complexity and can be adjusted depending on the type of FI and financing involved as well as on the available data. Fundamental to all approaches is being able to assess which coal assets or clients have a credible phaseout plan, and our first approach simply (1) tracks the portion that do and do not. Additionally, FIs can (2) calculate the financed emissions associated with eligible managed phaseout coal assets, set separate decarbonization targets to measure and drive progress, and provide detailed narratives to explain any increase or decrease in the separate sub-portfolio. To add further rigor and steer engagement to drive impact, FIs can (3) assess to what extent coal assets are aligned with 1.5°C pathways. Additionally, FIs may (4) evaluate the forward-looking impact of managed phaseout using, e.g., emissions savings from planned early retirement, which could further enable structuring incentives for managed phaseout outcomes, including the potential monetization of carbon credits.

Time to Act

The proposed metrics are designed to empower FIs to play a bigger role in accelerating the managed phaseout of coal and to communicate how this is a key net-zero financing strategy that supports real-economy greenhouse gas emissions reductions. We urge FIs to take active steps to integrate managed phaseout into their net-zero transition planning, target setting, and reporting.

We acknowledge the field is emerging and requires development of clearer guardrails and standards. To accelerate the adoption and effectiveness of managed phaseout, we encourage financial-sector practitioners and standard setters to continue working toward refining, expanding on, and standardizing these approaches.

Read our full working paper on how adopting a specific approach for managed phaseout–focused metrics and targets can advance FI involvement in managed phaseout: *Managed Coal Phaseout: Metrics and Targets for Financial Institutions*.

Financing Mechanisms to Accelerate Managed Coal Power Phaseout

Introduction

Although renewable energy generation has become more cost competitive than coal, over 90% of coal plants globally are insulated from market forces. Long-term asset obligations and incentives overextend global reliance on uneconomic coal power, upholding a leading source of carbon emissions. Managed phaseout of coal power can drive positive economic and climate outcomes, but proactive interventions are needed.

Financing mechanisms are one tool for aligning incentives and accelerating managed coal power phaseout outcomes. Financing mechanisms are financial products and services that enable FIs to provide finance where a managed phaseout plan is in place, thereby improving financing conditions for increasingly challenged assets and enabling socially just and climate-aligned transition outcomes. For private FIs, managed phaseout financing can also be a strategy for deepening client relationships. Both public and private capital have a role in deploying financing mechanisms for managed phaseout transactions, though we focus on the role of private capital providers.

Key Takeaways

The relative nascency of managed phaseout transactions means there are few examples to illustrate how they can simultaneously drive climate-aligned outcomes and satisfy the fiduciary duty of private capital providers. However, existing examples of managed phaseout deals showcase the roles that early actors have already played. Further, learnings from countless examples of private FIs playing similar roles in other power-sector deals help demonstrate a path forward.

This working paper shows how financing mechanisms for managed coal power phaseout transactions achieve phaseout outcomes through three financial levers that: (1) lower cost of debt, (2) lower cost of equity, and (3) enhance future cash flows. These approaches can rebalance the interests of different stakeholders that may be vested in a coal plant's continued operations, such that an accelerated retirement becomes viable and valuable for all stakeholder groups. Using the three levers as a framework can help stakeholders envision roles that private FIs can play in managed coal phaseout, including by translating established expertise toward new managed phaseout frontiers, and tailoring experience to different contexts.

Through this working paper, we aim to build common understanding of the diverse and high-impact opportunities for private capital to get involved in managed phaseout transactions, including by taking an "all-of-firm" approach that mobilizes different business units. Though managed phaseout is a relatively new investment activity for private capital providers, the core goals of adjusting risks and returns through the cost of capital are squarely in their wheelhouse. Ultimately, each managed phaseout transaction will introduce unique constraints and opportunities, and global learning will accumulate with leadership, experimentation, and experience from private and public FIs, which will further lower transaction costs and risks.

Read our full working paper on the roles private FIs can play to accelerate managed phaseout outcomes for coal power assets: *Financing Mechanisms to Accelerate Managed Coal Power Phaseout*.