



Assessing Sovereigns' Progress Towards Net Zero for Fixed Income Investors

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KEY POINTS

- **Corporates' progress towards net zero can be evaluated according to frameworks and guidelines – but until recently there has been no such foundation for assessing sovereigns' progress.**
- **AXA IM has developed a framework that can help investors assess a country's net zero strategy and performance in accordance with the Paris Agreement objectives on climate change.**
- **This will allow us to assess net zero alignment across sovereign and corporate fixed income assets, which are typically a considerable weight in our clients' overall allocation.**

Is the US on track to achieve net zero emissions by 2050?

How do developed economies compare to emerging markets in terms of their ambitions for reaching net zero?

Is there significant variation in progress towards net zero among European Union countries?

Which countries are leading the way in these areas on each continent?

Until recently, there was no systematic, widely recognised methodology for answering these questions.

At AXA IM, we have developed a framework that evaluates progress towards net zero for corporates, based on the Net Zero Investment Framework (NZIF) and resulting Institutional Investors Group on Climate Change (IIGCC) implementation guidelines. However, extending this framework to other major liquid asset classes, first and foremost sovereign bonds, has been a long-awaited challenge for investors.

The primary obstacle has been the lack of widely recognised public data sources that could serve as the foundation for asset managers in their approach to sovereigns, ensuring consistency across interpretations while maintaining a common methodological ground. In contrast, the corporate asset class has many such sources, including the Science Based Targets initiative, Transition Pathway initiative and Climate Action 100+.

This year, the Assessing Sovereign Climate-related Opportunities and Risks (ASCOR) project released its first country database. The IIGCC conducted a workshop with market practitioners focused on developing guidelines based principally on this database, together with Climate Action Tracker (CAT) and the Climate Change Performance Index (CCPI). As a committed investor in sovereign assets, AXA IM actively participated in these workshops, leading to the publication of the IIGCC's first guidelines for assessing progress towards net zero for sovereigns in mid-2024.

AXA IM's Climate Colour Framework for Sovereigns based on IIGCC Guideline Principles

The IIGCC's guidelines help investors in assessing a country's net zero strategies and performance in accordance with the Paris Agreement global warming objectives. As shown in the table below, this assessment relies on six criteria. Depending on the level of progress across a range of metrics, a country's level of alignment to net zero is classified, ranging from Committed to Aligning (the lowest level) to Achieving Net Zero (the highest).

		NZIF CRITERIA (AXA IM Climate Colour)			
		Committed to Aligning (Orange)	Aligning towards Net Zero (Light Blue)	Aligned to Net Zero (Blue)	Achieving Net Zero (Dark Blue)
DETERMINING CRITERIA	Ambition	✓	✓	✓	✓
	Targets		✓	✓	✓
	Disclosure		✓	✓	✓
	Decarbonisation strategy		✓	✓	✓
	Emissions Performance			✓	✓
	Capital Allocation Alignment				✓

STEP 1:

We apply thresholds using quantitative data from IIGCC-recommended sources, primarily ASCOR, CAT and CCPI, to assess progress for each determining criteria* as follows:

| Ambition

- Have a net zero target ambition, compatible with a 1.5°C warming climate scenario

| Targets

- Have credible 2030 net zero targets

| Disclosure

- Have established mandatory climate-related disclosure

| Decarbonisation

- Show commitment to not build coal plants
- Show progress in either adaptation or energy use per capita towards decarbonisation or show a commitment to clean innovation or green transport

| Emissions performance

- Show progress in reducing greenhouse gas emissions
- Show progress in biodiversity impact reduction, through increasing protected areas or improved reforestation

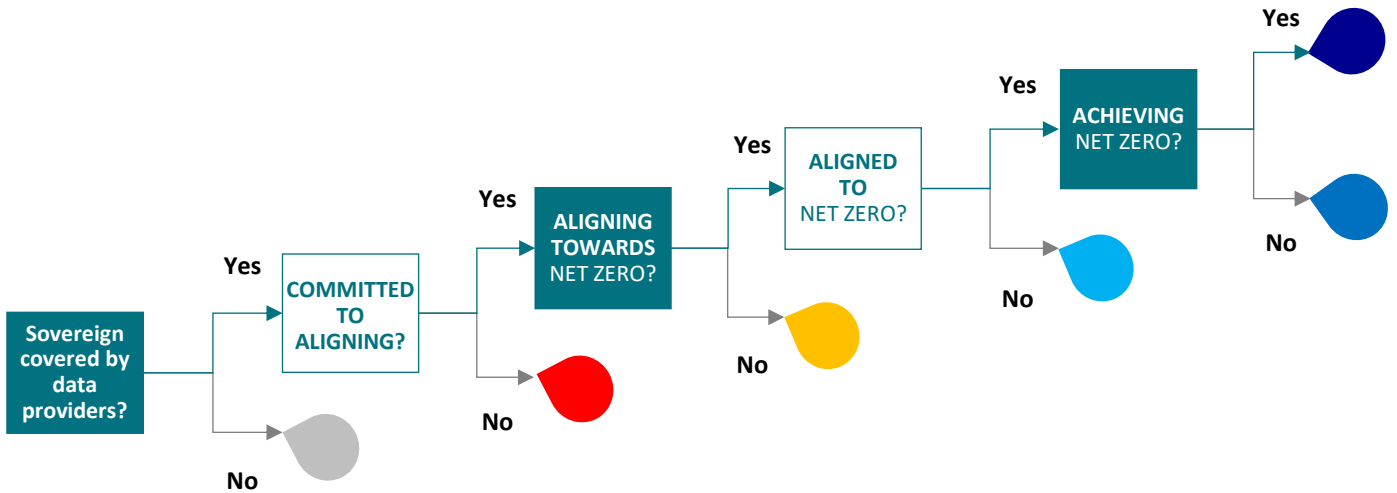
| Capital allocation alignment

- Show progress in renewable energy production, including an active deadline for phasing out fossil fuel subsidies and show a current and growing high use of renewable energy
- Show progress in carbon pricing initiatives
- Show net zero transition planning and disclosure clarity to implement its Nationally Determined Contributions and any other climate-related expenditure

*Exemptions to some criteria may be applied for Emerging markets, the most important one being the level of detail required for the mandatory climate-related disclosure. It is less onerous than for Developed markets.

STEP 2:

Next, according to the country’s resulting level of alignment, we designate a colour representing the commitment level ranging from red (No Commitment to Net Zero) to dark blue (Achieving Net Zero), in line with our existing net zero colours methodology for corporates. Approximately 180 countries are assessed, though if the data coverage for a country is limited, that country may currently only achieve orange classification (Committed to Alignment).

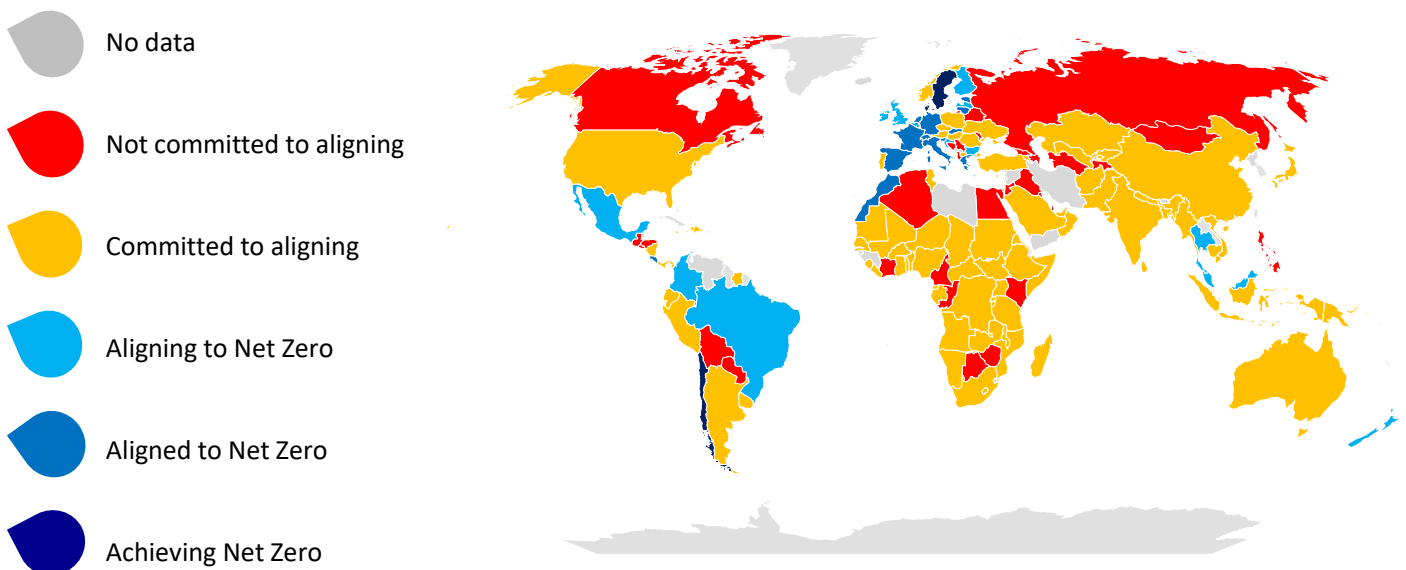


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To determine the colour, we use quantitative data from multiple industry-leading sources to give breadth and depth of coverage. This also compensates for the typically low correlation of environmental, social and governance data among suppliers, allowing a fairer and more balanced assessment of determining criteria thresholds, thereby avoiding potential portfolio concentration risk. When deemed necessary, our sovereign analysts may conduct an additional qualitative analysis which may result in the colour being adjusted.



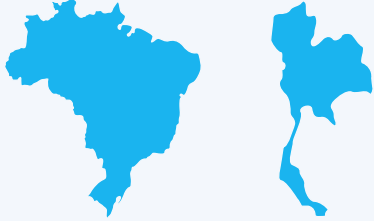
Results

As at February 2025, AXA IM’s net zero sovereign colour assessment was as seen below:



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Taking four countries as an example:

US	UK	BRAZIL AND THAILAND
 <p>The US is classified as orange (Committed to Aligning) as its net zero 2030 and 2050 targets and decarbonisation strategy meet the orange quantitative threshold. Yet, it hasn't currently implemented climate disclosure legislation which is mandatory at light blue level.</p>	 <p>The UK is assigned Light Blue as it has set 2030 emission reduction target and meets credibility checks. It has also established mandatory climate-related disclosure. Finally, on decarbonisation strategy, it has shown an overall progress on adaptation and ranks well on clean innovation & green transportation.</p>	 <p>Brazil and Thailand are classified as light blue (Aligning toward Net Zero): they pass target thresholds and are exempt from climate disclosure checks as emerging market countries. However, they don't meet blue (Aligned to Net Zero) criteria given concerns with emissions performance in both countries and land use in Thailand.</p>

Adopting for sovereigns the same principles and structure as the framework we have previously developed for corporates, enables our investment teams and clients to assess portfolio alignment towards net zero across fixed income assets. A key benefit of our approach is that, over time, this will allow us to build net zero-focused strategies across a global aggregate universe to help our clients aim to meet their sustainability goals.

Current Limitations and Future Work

Different methodological approaches among data providers can impact assessment of net zero alignment. For example, most data suppliers use production level data to compute emissions metrics, and not consumption level (except in limited-use cases by ASCOR); this can lead to understated emissions levels. There are also differences in opinion regarding nuclear energy and its classification as a renewable energy source.

AXA IM's implementation of the IIGCC guidelines avoids supplier metrics specifically related to the United Nations Framework Convention on Climate Change 'fair share' concept, which propose determining a country-specific allocation of the global emissions budget on the basis of equality, capability and responsibility. We consider these concepts still lack methodological consensus and rigour in apportioning global emissions allocations. This may be revisited in future iterations of our implementation.

As a result of this work on sovereigns, we believe we are among the first asset managers to disclose a net zero framework for sovereigns. Our framework covers countries globally and aims to help our investment teams and clients gain valuable insights into past progress, the current state, and the remaining journey in transitioning towards net zero emissions by 2050.

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