Sovereign Bonds

Alignment targets
• Asset alignment target: Set a 5-year target for increasing the % of sovereign bonds allocation to issuers that are categorised as ‘aligned’ to a net zero pathway, or ‘achieving’ net zero.
• Engagement threshold target: A threshold of financed emissions from sovereign bonds in a portfolio and undertake engagement actions with the relevant countries and territories.

Scope
• Include sovereign bonds of all maturities issued in domestic or foreign currencies.
• All sovereign issuance from national governments is considered in scope, including holdings required for liability matching, regulatory purposes, and cash management. However, inevitable restrictions likely exist that will affect the practical extent these assets can be aligned. Any restrictions should be disclosed.
• Sub-sovereigns, municipal or state authorities and supra-nationals that issue bonds are not explicitly covered, although investors may apply similar concepts on a best effort basis. As data availability improves, these will be considered in future workstreams. However, labelled and climate-related instruments issued by these entities may be considered under the climate solutions objective.

• Where the issuer is a publicly (majority) owned company (i.e., state-owned enterprises), investors should follow the guidance for corporate fixed income and include it in targets associated with this asset class.
• It is acknowledged that investors face limitations specific to this asset class, some of which they do not have full agency to address. Consequently, a singular performance expectation is not considered possible. However, investors are invited to use all the levers they have at their disposal to achieve their maximum contribution towards real-economy decarbonisation and transparently disclose where limitations apply.

Asset Level Assessment and Targets continued

IIGCC NZIF 2.0
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Asset Level Assessment and Targets continued
### Criteria underpinning alignment assessment

**Key**

- Green ticks represent when a criterion is required to be fulfilled for a particular alignment category to be obtained.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Committed to aligning</th>
<th>Aligning to a net zero pathway</th>
<th>Aligned to a net zero pathway</th>
<th>Achieving net zero</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budget / capital / allocation alignment:</strong> A clear demonstration that the budgeting actions of the country are consistent with global net zero goals (e.g. climate budget tagging, where an ambitious share of the budget is green).</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td><strong>Emissions performance:</strong> Current absolute GHG emissions trend is at least equal to a relevant net zero pathway, or converging in a manner that is satisfactory.</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td><strong>Decarbonisation plan:</strong> A robust quantified plan setting out the measures that will be deployed to deliver GHG targets (LT-LEDS), and how the sovereign is enacting the policies necessary to deliver against its NDCs.</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Disclosure:</strong> Comprehensive and timely disclosure of emissions (e.g. data quality, historical data, LULUCF, etc.)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Targets:</strong> Short and medium term emissions reduction targets aligned with global net zero goals. These are set at the production emissions level (scope 1) and should be consistent with the Paris Agreement (NDCs).</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Ambition:</strong> A long term goal consistent with the global goal of achieving net zero by 2050, as well as interim goals and targets that are coherent with it (NDCs absolute emissions targets).</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

To account for ‘fair share’ considerations, investors can relax some of the criteria for the countries they classify as EMDEs.

The alignment criteria apply to issuers exclusively; hence labelled bonds should not be allocated an alignment status. Providing that they meet external validation and safeguards, labelled bonds and other climate related issuance are to be considered under the climate solutions objective.

Further guidance may qualify these criteria for some countries, based on principles of fair share and common but differentiated responsibilities and respective capabilities.

The criteria laid out above provide a high level framework for the alignment assessment of sovereigns, and their net zero transition plans. Methodologies used to assess the alignment of assets should include the above features.

The recommended existing data sources which are publicly available and can be used in the assessment of this asset class are: ASCOR, CAT, and CCPI. Investors can use a mixture of data sources, to make as much of an informed judgement as possible.

However, whilst these are recommended sources, investors are free to choose the source of data that they wish to use and are not expected to use all to form an assessment. Additionally, it is not guaranteed that these sources of information allow an investor to make a comprehensive judgement on alignment.
Approaches to achieve asset level targets

The approaches below can be used to achieve asset alignment targets. However, they are presented agnostically (regarding their efficacy) as this will depend on the context an individual investor operates within.

Portfolio construction

- Tilt portfolios towards higher performing issuers based on the alignment criteria and climate solutions.
- Explore allocations to climate solutions, such as verified labelled bonds, when possible, taking measures to assess their credibility.
- For indexed-based strategies, utilise a benchmark incorporating tightening alignment criteria requirements to inform portfolio weights that improve portfolio alignment over time.

While these actions are theoretically available to support alignment efforts, the limited issuer universe creates limits to the extent to which they can be practically used without exacerbating material risk factors (e.g. concentration risk).

Asset engagement

- Active engagement with highest impact sovereigns or largest exposures, based on % financed emissions, that do not perform well against the criteria.
- Participate in engagement efforts, both directly with governments or indirectly through investor network initiatives.
- Engage with issuers, investment banks and development agencies to increase issuance of labelled bonds, including sustainability-linked bonds (SLBs) with Paris-aligned KPIs.
- Commence engagement well in advance of the issuance process itself and seek opportunities to shape bond characteristics, such as KPIs for SLBs, in a manner that enhances climate ambition.

Stewardship

Broader stewardship is likely required for this asset class as currently several impediments to alignment exist. Some examples of stewardship topics are listed below:

- Advocate for data providers to develop and continuously improve indicators to assess criteria set out by the asset alignment target methodology.
- Advocate for the enhancement and standardisation of pathway tools to incorporate and make explicit the assessment of fair share principles within national level assessments.
- Advocate for governments to enhance and standardise national disclosures based on the alignment criteria set out.
- Advocate for issuers to improve land use, land use change, and forestry (LULUCF) and methane emissions reporting.
- Advocate for issuers to improve consumption emissions disclosures.
- Advocate for issuers to increase the issuance of labelled bonds.