Ninety One

A fair assessment of governments' transition to net zero: Ninety One's Net Zero Sovereign Index

Index rationale and overview

When asset owners began setting net-zero targets, sovereign debt portfolios were often placed in the 'too-hard' basket, with initial efforts focussing on corporate exposure. The task of prioritising real-world decarbonisation is different – and can be more complex – in sovereign allocations. That said, there has been considerable progress in this field to help investors include their sovereign allocations in their net-zero efforts and gain exposure to positive momentum in countries that are advancing their climate goals. At Ninety One, we created the Net Zero Sovereign Index (launched in 2021) to help do that.

Countries are required to measure carbon emissions at a national level as mandated by the Paris Agreement. Investors can use this data to assess their sovereign portfolios' emissions profile: i.e., comparing countries in terms of their footprint or carbon intensity (via measures such as emissions as a proportion of GDP). However, such an approach does not provide a complete picture, which introduces the risk that investors will use carbon intensity measures to reduce portfolio-level emissions by simply avoiding the highest emitters. Many of those high-emitting countries are developing or emerging markets with meaningful plans to address climate change – countries that can build momentum if appropriately funded. For a successful transition to net zero, we need a different approach – one that covers all corners of the globe and is forward-looking in nature.

The Net Zero Sovereign Index facilitates a shift in focus from carbon intensity-based measures towards transition alignment. We believe portfolios targeting net-zero alignment can make a meaningful contribution to transition goals. In contrast, reducing portfolio-level emissions risks slowing decarbonisation efforts by potentially starving developing economies of the capital they need to transform. The Index embeds the Common but Differentiated Responsibilities principle – a critical component of the Paris Agreement, aiming to build fairness into net-zero assessments. By analysing the climate actions of governments in 117 countries – examining trends in emissions, energy use, land use, renewable energy and policies – the Index provides an independent, quantitative assessment of whether a sovereign investment or sovereign portfolio is aligning to a net-zero pathway that works for the world.

Methodology

Investors interested in evaluating net-zero alignment rather than pursuing portfolio-level carbon targets now have an expanding set of tools and data. These encompass Climate Action Tracker, ClimateWatch, Climate Equity Reference Checker and the Climate Change Performance Index. Commercial providers like Bloomberg offer Government Climate Risk Scores. Additionally, the Assessing Sovereign Climate-Related Opportunities and Risks (ASCOR) Project assessment tool has been developed, and Ninety One actively contributed to the project.

We analysed the underlying methodologies and outcomes of these tools in detail. All provide helpful insights, but a typical drawback is that smaller emerging economies are not covered. Also, several aspects of the assessments are based on qualitative analysis, meaning it is not always easy to get to the bottom of differences in scoring, let alone replicate the methodology. Ultimately, we chose to use the Climate Change Performance Index (CCPI) as the foundation scoring methodology of our Net Zero Sovereign Index. It aligns with the recommendations of the IIGCC's Sovereign Bond Working Group, in which Ninety One participated.

The CCPI tracks countries' efforts to combat climate change and compares climate-protection efforts and progress made by individual countries. In particular, we like that the CCPI framework considers future pathways, climate policy and 'hard data' on recent emissions and energy usage trends. It is also encouraging that, unlike many other environmental indices, there is no inherent income bias. The main problem with the CCPI scoring mechanism is that it only covers 63 countries and the European Union. We hope that coverage increases in the coming years. The Net Zero Sovereign Index is based on a simplified version of the CCPI with an added measure of climate justice applied to each country in the universe.

Filling the data gaps – extending coverage

Several data points underpinning the CCPI scores are readily available, like data on GHG emissions, total primary energy supply and renewables. The main challenges are modelling 1.5-degree pathways for countries not covered under CCPI and scoring climate policy for those countries. The CCPI's climate policy section evaluates national and international climate policy performance based on contributions from around 350-400 climate and energy experts. This is a challenge when trying to replicate such analysis across the wider emerging market universe. Therefore, we opt for a simplified score for climate policy, taking a more quantitative approach. For instance, we review fiscal policy assessing factors such as energy subsidies and environmentally-aligned tax revenue.

We have added the Emissions Target Assessment, conducted by Net Zero Tracker and a land use category, where we show trends in deforestation. This is partly captured in the emissions score of CCPI, but we think it is crucial and, therefore, give it a more specific weight.

While the CCPI Project incorporates the concept of fair pathways to net zero, we expand on this by using the Climate Equity Reference Project (CERP), given the high level of transparency CERP provides around its methodology. The CERP Calculator covers the full list of countries in our EM investment universe. It offers great flexibility to apply metrics that fit a fair transition and is a valuable tool for introducing the equity principles that are part of the Paris Agreement into transition pathways. To quantify this fairness element, we set key parameters, as outlined below.

- **Mitigation pathway:** 1.5 degrees standard pathway, which is based on the Climate Action Tracker pathway and is consistent with the Paris Agreement's objective of "well below 2 degrees".
- **Responsibility:** We measure historical responsibility for emissions since 1990 rather than go further back in the past. We believe that all countries must play their part within their respective capabilities and that putting too much weight on historical responsibility could lower the chances of aligning with the desired global pathway.
- **Capability:** exempting emissions from individuals below this income threshold – effectively allowing the lowest-income individuals to move out of poverty without incurring an additional cost due to carbon emissions.
- **Progressivity:** purchasing power parity terms). Fair emissions allocations are progressively pro-rated between the development and luxury threshold, allowing for a gradual path out of poverty and towards developed status.

Together, these settings give us a fair-share pathway for each country. The tool then tracks the distance between an expected emission pathway (based on current trends) and the fair-share pathway. We use the predicted gap between these pathways as at 2030 as a critical score under 'climate policy'. Countries that see emissions rise and do not move in line with the fair-share pathway receive a lower score than those moving closer to the pathway. These fairness measures do not absolve low- and middle-income countries from responsibility for meeting ambitious emissions-reduction pathways; their design creates room for the least-developed nations to generate the sustainable growth needed to lift the poorest out of poverty.

Bringing it all together: The Net Zero Sovereign Index scorecard

We have adopted a scorecard approach for the Net Zero Sovereign Index, similar to the CCPI methodology, but somewhat simplified to allow an extension to the full range of countries typically included in both developed and emerging market portfolios. Each country's index score is made up of six metrics – the table below lists these, their weights and the respective indicators for each.

Emissions	Energy use	Renewable energy	Pathways	Land use	Policy & potential
CO_2 emissions per capita (production). CO_2 emissions per capita (production) trend.	Total Primary Energy Supply (TPES) per capita. TPES per capita trend.	Renewable energy (excl. hydro) % total electricity production. Renewable energy (excl. hydro) % total electricity prod.– trend. Renewable energy (incl. hydro) % total electricity prod.	Current GHG emissions vs 2030 'fair share' pathway. TPES per capita vs 'well below 2˚C' pathway. Renewable energy share vs. the well below 2˚C pathway.	5-year deforestation trend. Recent change in deforestation trend.	Climatescope renewable energy potential. Energy subsidies % GDP. Environmentally aligned taxes % of revenue. Quant. Assessment of emission targets.
20%	15%	20%	25%	5%	15%

Overall results

For each metric in the Index, we score countries for Paris-alignment, with scores falling into one of five categories, ranging from 'very high' alignment to 'very low'. A country's alignment score across the various metrics is then aggregated. Below are the top 10 markets in the Index.

Net Zero Sovereign Index – Top 10

Rank	Country	Overall alignment	Emissions	Energy use	Renewable energy	Pathways	Land use	Policy & potential
1	Costa Rica	Very High	Very High	Very High	Very High	High	High	High
2	Albania	High	High	Very High	Very High	Very High	Very High	Very Low
3	Kyrgyzstan	High	Very High	Very High	Very High	Very High	Medium	Very Low
4	Ecuador	High	High	Very High	Very High	Very High	High	Very Low
5	Jordan	High	Very High	Very High	High	Very High	Medium	Very Low
6	Angola	High	Very High	Very High	High	Very High	Very Low	Very Low
7	Mozambique	High	Very High	Very High	Very High	High	Very Low	Very Low
8	Kenya	High	Medium	High	Very High	Very High	High	Medium
9	Ethiopia	High	Medium	Very High	Very High	Very High	High	Very Low
10	Uganda	High	Medium	High	Very High	Very High	High	Medium

Source: Ninety One, 31 December 2023. For illustrative purposes only. Full index ranking available on request.