

Axiom Climate Readiness Score

1 - WHAT IS THE AXIOM CLIMATE READINESS SCORE?

The Axiom Climate Readiness Score (ACRS) is a **proprietary methodology** developed by Axiom AI to better assess financial institutions' **climate performance** in terms of their exposure to climate-related risks and efforts to contribute to the energy transition. The ACRS enables the identification and analysis of best-practices on climate integration by financial institutions as well as the leaders promoting these practices. It equally allows us to identify laggards and their areas of improvement. The ACRS can therefore provide helpful input when engaging with financial institutions.

Axiom AI developed the ACRS to overcome an information gap. Indeed, we evidenced that the analysis provided by third parties remained superficial and not comprehensive enough as it mainly relied exclusively on self-disclosure and had limited focus on the climate impact of financial institutions' indirect activities (i.e. investment and lending). In addition, its proprietary nature allows for timely updates, which is of utmost importance in a fast evolving field.

2 - WHAT IS ASSESSED THROUGH THE ACRS?

The ACRS uses both qualitative and quantitative analysis to assess financial institutions' climate performance. The assessment between banks and investors differs to capture subsector specificities, however, both are analysed through three macro pillars:



Corporate engagement, which identifies the level of priority given to climate change by the management, the level of integration and ambition of climate change in the company's strategy including their decarbonization targets and related disclosure.



Climate risks and opportunities management, which assesses the issuers' approach to integrating climate-related risk and opportunities in their general risk management framework as well as an input in decision making. In the case of banks, Axiom AI carries out an additional quantitative assessment.

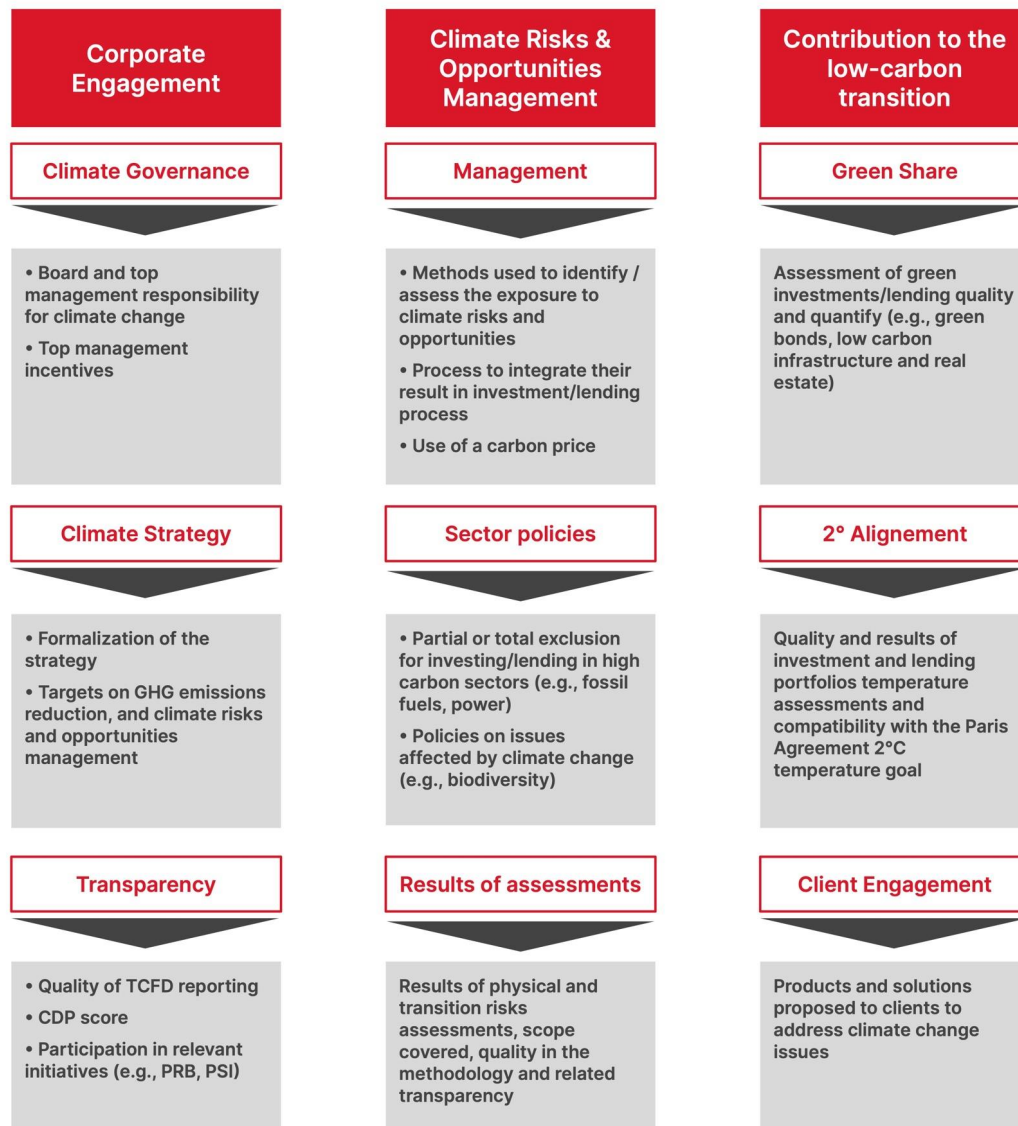


Contribution to the low-carbon transition, which seeks to understand the issuer's efforts to contribute to the energy transition through their investments or lending activities with corporates, as well as through thematic products. In the case of banks, Axiom AI estimates the temperature of the corporate lending portfolio.

The figure below shows the topics being analysed under each of these pillars and some of the criteria assessed through the ACRS.

The ACRS ranges from 0% to 100%, with 0% being the worst score. Pillar 1 contributes to 20% of the total score, Pillar 2 to 50% and Pillar 3 to 30%. Likewise, each topic has its own weight ranging from 20% to 50%.

To reduce subjectiveness in the scoring of companies, a “maturity matrix” guides the scoring of most topics. This matrix was developed to capture current average and best practices as well as tomorrow’s best practices. This means that no financial institution can reach 100% in its ACRS score, the average and maximum scores seen so far are of 34% and 53%, respectively.



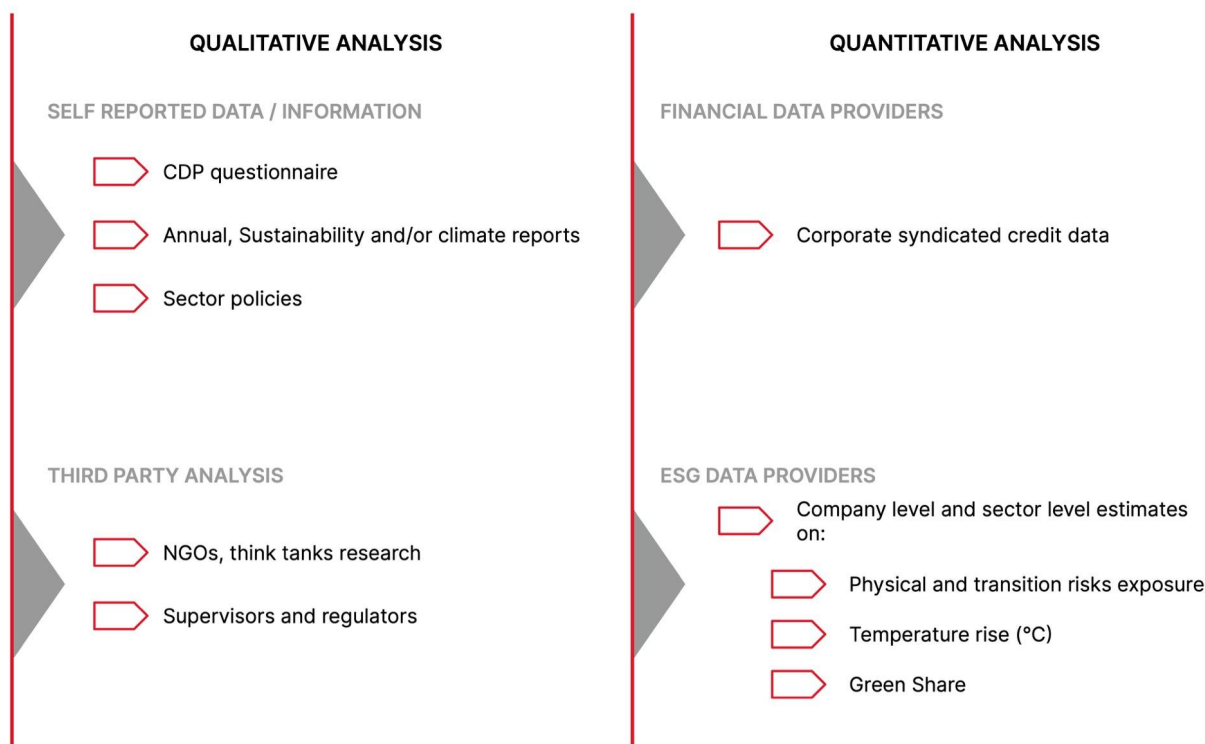
3 - WHAT DATA SOURCES WE USE TO ESTIMATE THE ACRS?

The ACRS relies on both qualitative and quantitative data analysis. The quantitative analysis only covers banks as it is based on company level data and, as of today, there are no public nor private databases that provide similar information of insurers’ investment portfolios or other financial institutions.

The benefits of carrying out the quantitative analysis are numerous, among the most relevant we find:

- **Better comparability.** As we are applying the same methodology across all banks, there is less uncertainty in the identification of leaders and laggards.
- **Better visibility on the challenges to transition.** The analysis enables the identification of the specific areas or exposures that differentiate banks which a single, aggregate indicator hides (e.g. total risks exposure, portfolio temperature). For example, the corporate portfolio of two banks might have the same temperature warming (°C), however, for Bank A the companies contributing the most to that warming are in the power sector while for Bank B the companies are in the steel sector. Since the deployment of low carbon technologies is more advanced in the power sector than in the steel sector, and assuming there are not substantial changes in the credit allocation of the portfolios, the portfolio of bank A could align faster to the well below 2°C temperature goal of the Paris Agreement than the portfolio B provided the power companies decide to increase their investments in renewables and decrease those in fossil fuels.
- **Higher quality of engagement.** Quantitative and granular information enables discussions with banks that are more technical and forward thinking which helps to persuade banks to better steer their portfolio.

The different data sources used in the ACRS are described in the table figure below.



Although there are several shortcomings associated with these different data sources, their combination allows one to have a more complete view and reduce reporting bias as each stakeholder has a different objective behind its disclosure. Some of the shortcomings we have identified are:

- **Self-reported data.** This is data disclosed directly by financial institutions, which is generally not audited, although this practice is becoming more common. The data provided is most of the time qualitative and high level. Even if quantitative estimates are given, their use for comparisons with other financial institutions is very limited either because methodologies differ or because the disclosure on the scope and assumptions used is poor.
- **Third party analysis** from non for profit organizations such as NGOs or think tanks, and government bodies such as supervisory authorities or ministries. In the first case, uncertainties exist on the accuracy of the information as most of the time it does not come directly from the source (i.e. the financial institution). As for the second, although the likelihood to have more accurate data is higher and comparability is better as the supervisor applies the same methodology to all financial institutions, disclosure is most of the time done at aggregate sector level or with anonymized individual data.
- **Financial data providers.** Investee level data is needed to carry out a more accurate “bottom-up” analysis on financial institutions' climate performance. Our methodology focuses on corporates as main contributors to GHG emissions. Thus, in the case of banks, we are interested in having better visibility on their corporate lending portfolio. The only data at the corporate level that can be sourced is syndicated credit data. Thus the coverage of the loan book is partial as corporate level data on other types of credit (e.g. revolving, instalment, open) cannot be sourced. Depending on the bank this data can cover between 10% to 30 % of their loan book. Data accuracy issues are also present as in some cases the data does not include the stake that each bank has in the deal, thus the allocation needs to be carried out by Axiom. This means that to complete the analysis the “bottom-up” data needs to be complemented with “top down” data (see next question).
- **ESG data providers.** Climate-related data at corporate level is sourced from Iceberg Data Lab (IDL). Three assessments are carried out with this data (see question 4). The shortcomings of the data varies depending on the type of assessment, however, among the common points we find are: reliance on self-reported data, use sector averages when company disclosure is nonexistent or insufficient, lack of forward looking data that is reliant on more than company commitments, and uncertainties related to the climate data modelled and related assumptions.

Despite these shortcomings, we believe that there is no need to wait to have the “perfect data” as the data available today can be already used to drive decision making. In parallel, we will continue to identify and integrate other potential data sources that help improve our analysis.

4 - WHAT ARE THE QUANTITATIVE METRICS WE ESTIMATE?

Axiom AI estimates three metrics used in the ACRS: The portfolio green share, the portfolio temperature and the portfolio exposure to physical and transition risks. This is done by combining IDL's climate company data or sector level estimates and corporate syndicated credit data as well as sector exposure data available through the Basel Committee pillar III disclosures.

Green share. This indicator tells us the percentage of a bank's lending that is channelled or provided to companies considered "green" or that carry out "green activities" as defined by the EU Taxonomy regulation¹. It is a proxy metric used to understand a bank's contribution to the low carbon transition (pillar 3 of ACRS) as the percentage estimated does not imply that the bank is providing direct financing to green activities but rather financing companies that may or may not use that specific financing to refinance or further develop green activities as well as non-green activities.

The green share is calculated by using companies' revenue data by type of segment sourced from annual reports or other relevant documents disclosed by the company. The segments are compared against the sectors classified as "aligned" by the EU Green Taxonomy (i.e. 7 macro-sectors and 72 sectors according to the European nomenclature of activities (NACE Rev 2)) as well as the companies' activities "eligible" to the taxonomy (i.e. sector specific performance thresholds). The total revenue by activity is then aggregated to estimate the total green share per company.

IDL provides the green share data for more than 800 companies, when data for the company is not available, IDL assigns an average share using the company's primary sector and headquarters country location together with an internal model that provides green share values for each activity.

Portfolio temperature. This indicator tells us the temperature warming (°C) of the corporate lending portfolio. It is a function of the temperature warming of the companies' in their portfolio. It is a proxy metric used to understand a bank's contribution to the low carbon transition (pillar 3 of ACRS) as, like in the case of the green share, the temperature warming does not only capture the bank's efforts to help the company to transition but as well the results of other stakeholders involved in helping or persuading the company to transition (e.g. shareholders, bondholders, NGO's, regulators, the company itself).

The portfolio temperature is the weighted average of the temperature of the companies in the portfolio. The company's temperature is built by first estimating its carbon intensity trajectory (tCO₂eq/specific metric activity until 2100). The carbon intensity trajectory is a projection of companies' current and past performance as well as future performance in the case of companies that have set decarbonization targets. It is based on Scope 1 and 2 emissions mostly, and scope 3 emissions for sectors in which these emissions account for the highest impact (i.e. Oil & Gas and Transport). This trajectory is then compared against the sector's trajectory in a ~2°C pathway, which is based either on the Science Based Targets Initiative's Sectoral Decarbonization approach² or on the ACT Initiative³. The comparison allows one to determine if the company is going to overshoot or undershoot its carbon budget. The percentage of overshooting or undershooting is then used to compute the company's temperature through an affine relationship which has a lower boundary of 0.5°C and with no upper boundary.

IDL provides the alignment temperature of more than 600 companies. When data for the company is not available, IDL assigns an average temperature based on the company's primary sector and location of headquarters. When there is no specific SDA pathway for a specific part of the value chain within a sector (e.g. car parts manufacturer) IDL uses a model that considers their different customers and suppliers and associates a temperature according to those stakeholders which can in turn be covered by the SDA or ACT. For companies in sectors which are not covered by the SDA nor ACT, nor belong to the value chain (e.g., finance, media, health care), IDL assigns a temperature estimate that is based on the average temperature of the sectors for which a "bottom-up" analysis exist in a specific geographical area. The geographical exposure of the company (either based on regional activity or headquarters location) is then used as a weighting factor to obtain the company's temperature.

¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R0852&from=EN>

² <https://sciencebasedtargets.org/resources/files/Sectoral-Decarbonization-Approach-Report.pdf>

³ <https://actinitiative.org/resources-2/>

Climate risks exposure. Two types of risks are analysed: physical and transition risks. The exposure to each risk is a function of the economic sector(s) in which the company operates and its activities within the sector's value chain as well as the location(s) of the company. The risk is expressed in a % from 0 to 100%, with 0 being no exposure and 100% being the highest exposure. It is a proxy metric used to understand a bank's exposure to climate-related risks (pillar 2), as it provides a sense on the level of risk exposure but does not quantify the value loss in case of the materialization of such risks.

The portfolio's physical and transition risk exposure is the weighted average of the companies' risks exposure. In the case of physical risks, companies activities exposure to five externalities that can be affected by physical risks are analysed qualitatively (presence of fix assets, air temperature variations, dependence on energy, transport and natural capital) together with their geographical exposure, which determines their vulnerability to physical risks (e.g. heat stress, sea level rise, changing wind patterns, soil degradation). In the case of transition risks, these are assessed qualitatively using a scale from 0 to 3 that considers companies': i. exposure to risks arising from changes in the regulatory framework, market prices and consumer behaviour ii. vulnerability to such risks due to their level of energy dependence (i.e. fossil fuels and power related imports), and iii. economic output per unit of energy (i.e. GDP per unit oil equivalent).

IDL provides the climate risk exposure of more than 6800 companies. When data for the company is not available, IDL assigns an average risk exposure based on the company's primary sector and nationality. The analysis is available for 400 sectors/subsectors and 100 geographical regions.

5 - HOW OFTEN IS THE ACRS REVIEWED?

The ACRS is reviewed at least yearly to identify areas for improvement, these could include the integration of subjects linked to climate change (e.g. biodiversity), review of the criteria's stringency to adapt to emerging market practices and regulatory requirements, as well as updates to the quantitative metrics estimated by Axiom.