

Transitioning S&P Sustainability Indices to S&P Global ESG Scores and Business Involvement Screens

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On Dec. 6, 2023, S&P Dow Jones Indices launched a consultation to propose two key enhancements to its sustainability index offerings. S&P DJI periodically conducts market consultations to help ensure its indices continue to stay timely and relevant, while reflecting financial markets and the sustainability landscape's ongoing evolution.

The consultation's proposed enhancements, which have been adopted as per S&P DJI's announcement on Jan. 23, 2024,¹ resulted in:

- Changing from Sustainalytics' Product Involvement Screens to S&P Global Sustainable1's (S1's) Business Involvement Screens (BIS); and
- Changing from the S&P DJI ESG Scores to S1's S&P Global ESG Scores.²

Here, we explore in more detail the rationale and impact of each of these changes.

¹ Please see the [announcement](#) for more details.

² The S&P Global Business Involvement Screens and S&P Global ESG Scores are published by S&P Global's independent business, S&P Global Sustainable1.

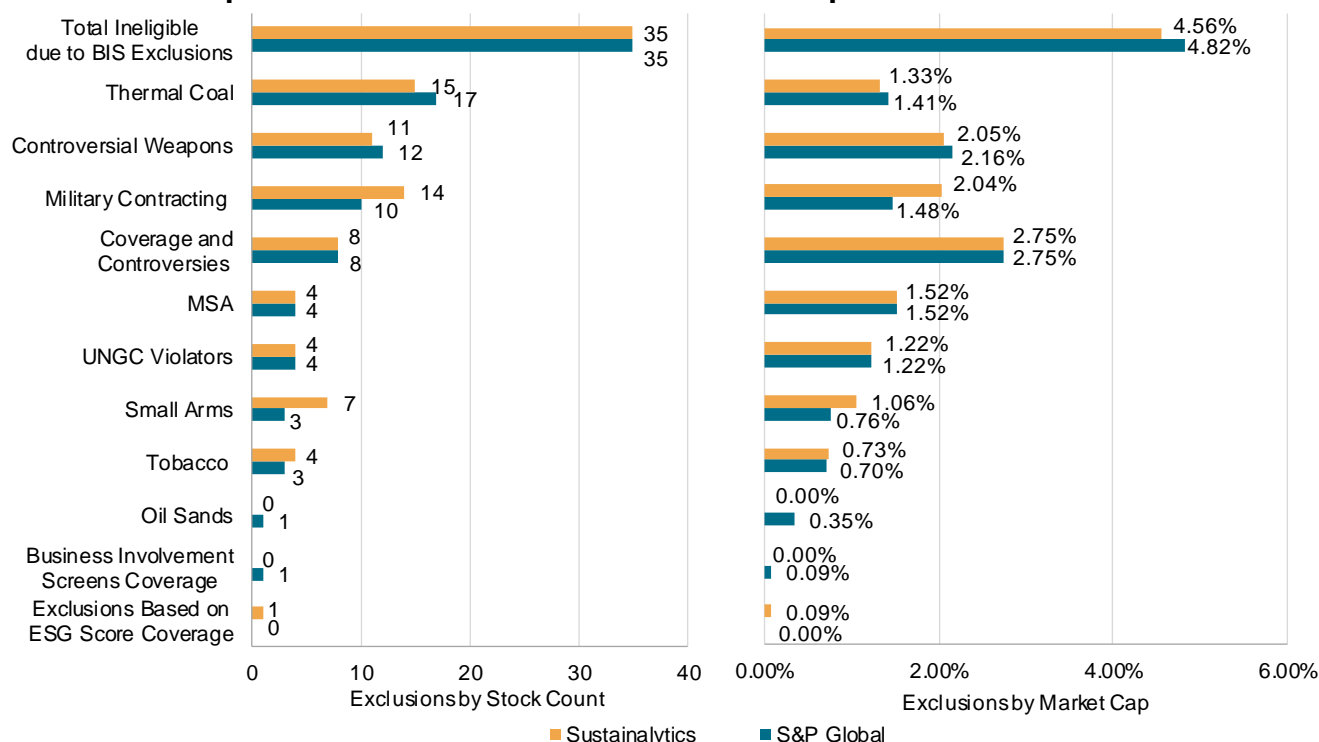
S&P Global Business Involvement Screens

BIS are used to help remove companies involved in business activities not aligned with investors' sustainability goals, such as thermal coal, tobacco and controversial weapons. While levels of involvement deemed acceptable for index inclusion can differ across investor goals, these and other screens are often considered minimum standards for sustainability-focused investors.

Further strengthening transparency and providing additional granularity around reasons for exclusions drove the transition of S&P DJI's sustainability indices to the S&P Global BIS dataset.

S&P Global BIS dataset covers 17,000 companies across 32 relevant categories for both revenues and significant ownership exposure.³ This dataset seeks to objectively measure the exposure of companies to different activities, and hence, we expect relatively high correlation between Sustainalytics and S&P Global. This has been observed for the [S&P 500® ESG Index](#) across exclusion categories (see Exhibit 1).

Exhibit 1: Comparison of S&P 500 ESG Index Screens per Dataset



Source: S&P Dow Jones Indices LLC, S&P Global Sustainable1. Data as of April 29, 2023. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

³ S&P BIS [Methodology](#).

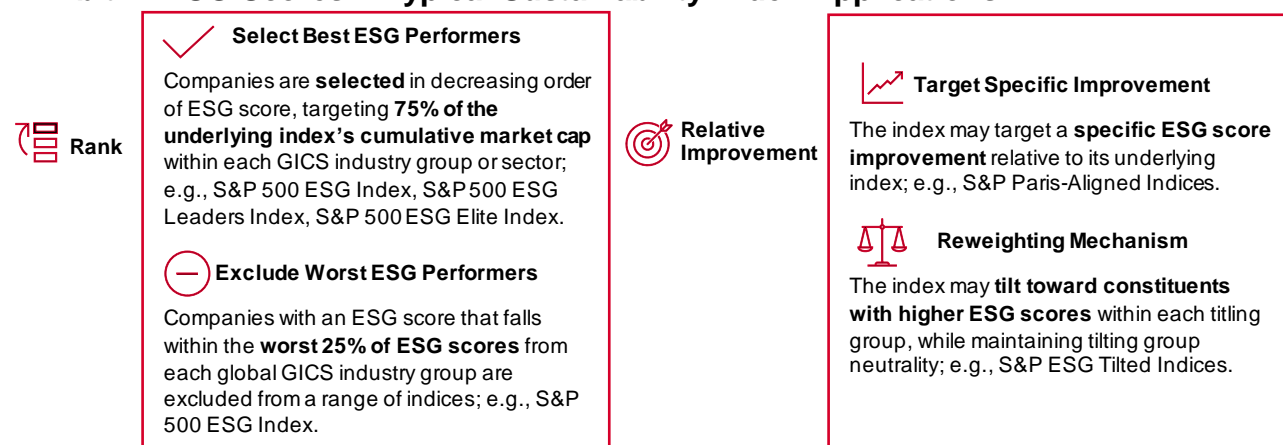
S&P Global ESG Scores

The S&P Global ESG Scores measure a company's performance on and management of material environmental, social and governance (ESG) risks, opportunities and impacts informed by a combination of company disclosures, media and stakeholder analysis, modeling approaches and in-depth company engagement via the S&P Global Corporate Sustainability Assessment (CSA). It is a relative score measuring a company's performance on and management of ESG risks, opportunities and impacts compared to their peers within the same industry classification.

Within sustainability indices, ESG scores are used in two main ways.

1. Ranking
2. Targeting a relative improvement

Exhibit 2: ESG Scores – Typical Sustainability Index Applications



Source: S&P Dow Jones Indices LLC. Chart is provided for illustrative purposes.

Thus far, the S&P DJI ESG Scores⁴ have served as the main set of ESG scores used in most of S&P DJI's sustainability indices. The S&P DJI ESG Scores were launched in 2018 and are overseen by S&P DJI. However, the recent introduction of enhanced modeling approaches⁵ to the S&P Global ESG Scores⁶ made a compelling case to standardize on a common scoring framework across S&P Global. Historically, the S&P Global CSA, the building block to derive the S&P Global ESG Scores, had a binary approach to non-disclosure. As noted by Steve Bullock, S&P Global Sustainable1's Global Head of Research and Methodology, "The CSA has historically assigned the minimum possible value of zero to questions that are unanswered or where the data is not publicly disclosed, thus taking a conservative approach to scoring in the

⁴ S&P DJI ESG Scores [Methodology](#).

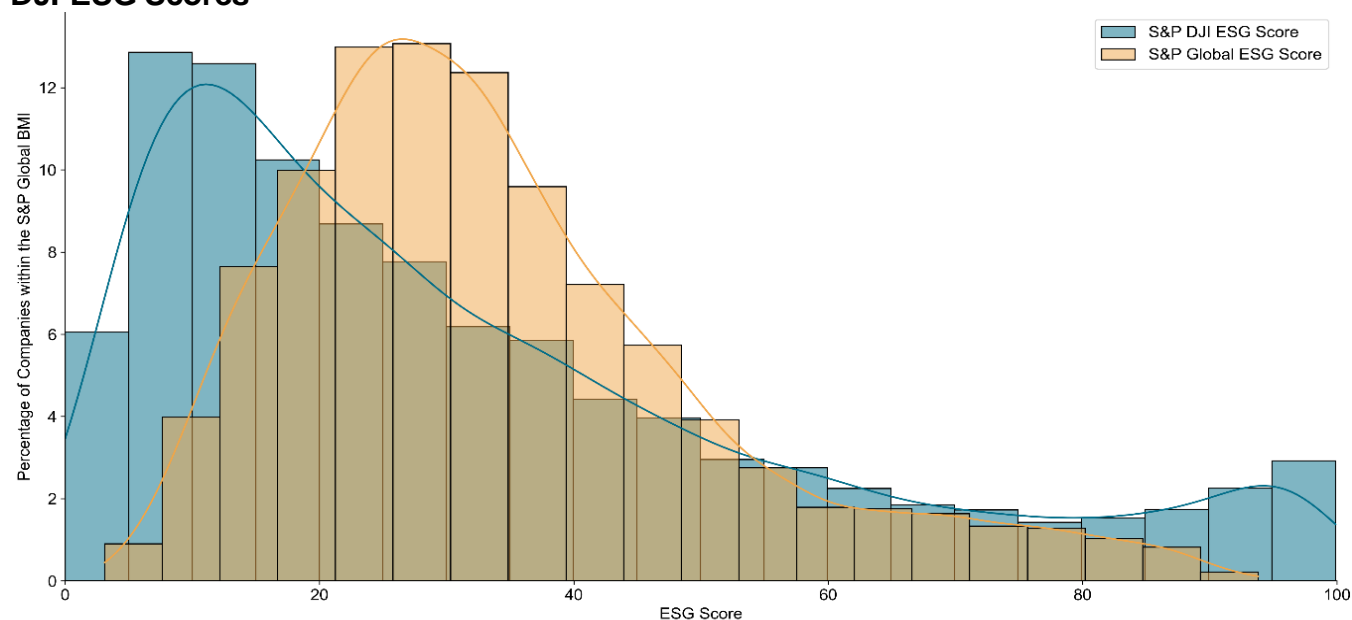
⁵ Bullock, Steve. "[How our approach to ESG Scores is evolving](#)." S&P Global Sustainable1. Aug. 22, 2023.

⁶ S&P Global ESG Scores [Methodology](#).

absence of disclosure. But assigning zero to undisclosed questions has limitations, which we seek to address with a key methodology update to scores calculated from the 2023 CSA: **We will now apply modeling approaches where disclosure is unavailable.**⁵

The revamped S&P Global ESG Scores minimize disclosure and associated size bias, as undisclosed data that was previously marked as “zero” when calculating a score is now assigned a modeled number based on industry correlations and companies’ performance across peers. This results in a fairer and more accurate representation of the sustainability performance of companies across size and regions, and it negates the need for similar modeling that was previously done to produce the S&P DJI ESG Scores. With this transition, S&P DJI will sunset the S&P DJI ESG Scores.

Exhibit 3: S&P Global ESG Scores Show a More Normalized Distribution Relative to S&P DJI ESG Scores



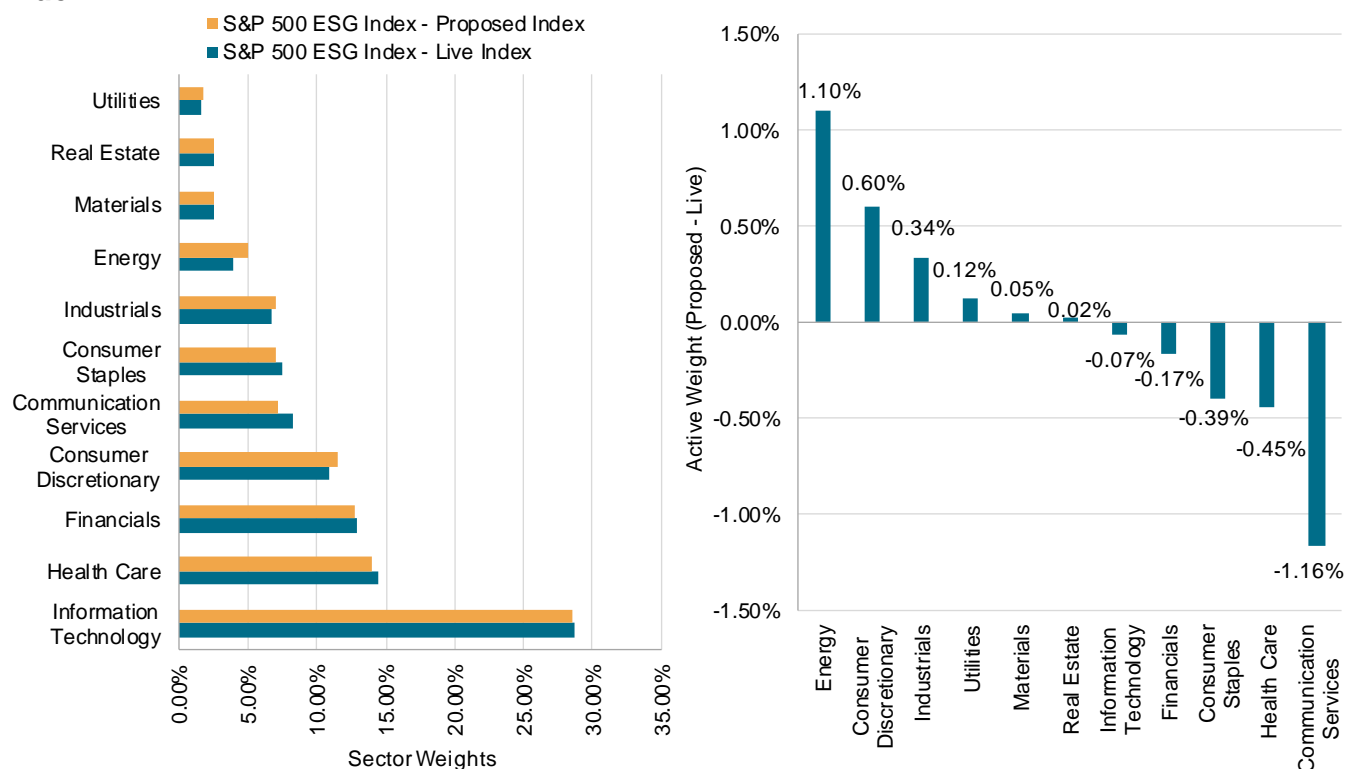
Source: S&P Dow Jones Indices LLC, S&P Global Sustainable1. Data as of March 31, 2023. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Although the distribution of scores has shifted to the right (see Exhibit 3), we observe that the ranking of companies has mostly been preserved in the S&P Global ESG Scores. Hence, largely the same companies would have been selected when targeting the companies with the top ESG scores in ranking-based indices. As for strategies targeting an ESG score improvement, this objective continues to be achieved, a feature enabled by index design.

Impact on the S&P 500 ESG Index

We examine the impact of this transition on the flagship S&P 500 ESG Index from a sectoral and performance perspective. Both changes resulted in similar sector weights to the live index, with a relative overweighting in Energy and underweighting in Communication Services (see Exhibit 4).

Exhibit 4: Similar Sector Weights Observed between Live and Proposed S&P 500 ESG Index

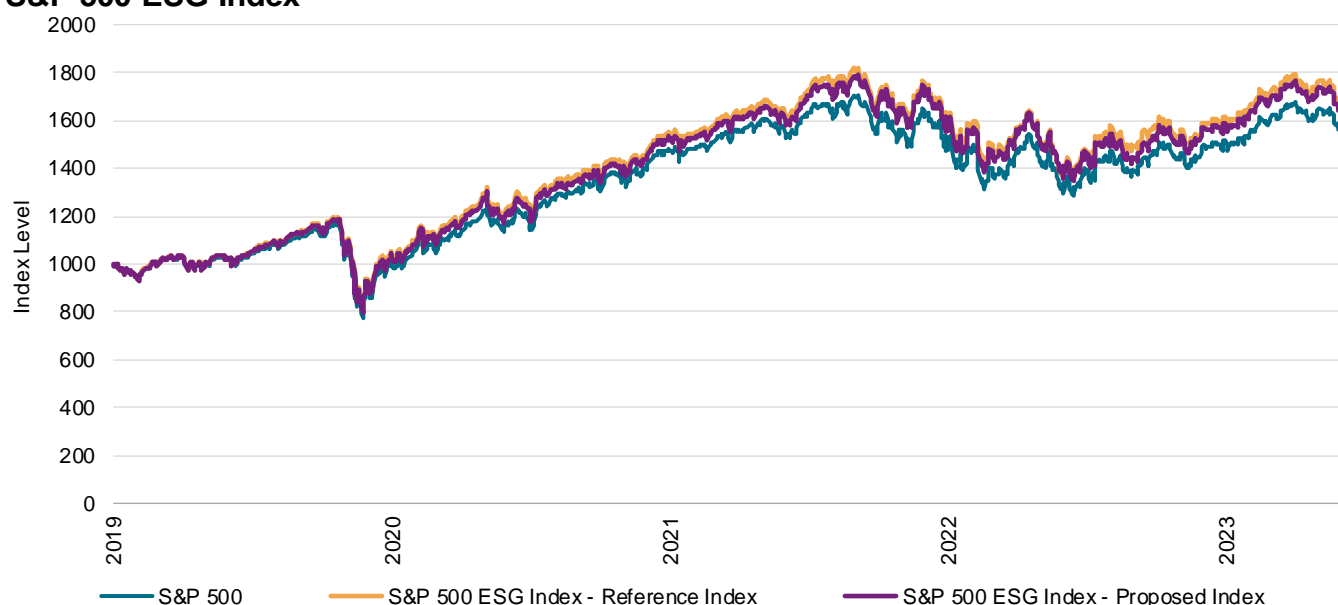


Source: S&P Dow Jones Indices LLC. Data as of April 29, 2023. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Based on hypothetical back-tested data, the proposed index would have maintained a similar risk/return profile relative to the reference S&P 500 ESG Index⁷, while still significantly improving its index-level S&P Global ESG Score (see Exhibit 5).

⁷ The S&P 500 ESG Index - Reference Index is a hypothetical index that was constructed for back-testing purposes to more easily assess the isolated impact of both transitions. In 2020, the S&P 500 ESG Index introduced a thermal coal screen, and in 2022 the index introduced oil sands, small arms and military contracting screens, as well as amended the controversial weapons and tobacco screens, added quarterly eligibility reviews, and switched UNGC compliance data from Arabesque to Sustainalytics. Additionally, some S&P DJI ESG Scores may have been restated later in each year, after the S&P 500 ESG Index live rebalance after the last business day in April. Due to these factors, we've built a reference index that applies the current methodology backward in time to 2019, always using final S&P DJI ESG Scores for each relevant year, and measured the impact of the switch to S1's BIS and S&P Global ESG Scores against this reference index to isolate the transition impact.

Exhibit 5: Similar Back-Tested Historical Performance between Reference and Proposed S&P 500 ESG Index



Horizon	S&P 500 ESG Index - Reference Index	S&P 500 ESG Index - Proposed Index
Excess Return versus S&P 500 (%)		
3-Year	0.75	0.71
Since Inception	1.71	1.30
Tracking Error versus S&P 500 (%)		
3-Year	1.71	1.38
Since Inception	1.68	1.41

The S&P 500 ESG Index - Reference Index and S&P 500 ESG Index - Proposed Index are hypothetical indices.

Source: S&P Dow Jones Indices LLC. Data as of April 29, 2023. Index performance based on total return in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

As sustainability-related data evolves, so will S&P DJI's sustainability indices. We will continue to actively source and implement the most rigorous, robust and high quality data available to ensure our sustainability indices deliver ever more meaningful and representative outcomes.

Performance Disclosure/Back-Tested Data

All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at www.spglobal.com/spdji. Past performance of the Index is not an indication of future results. Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results. Please refer to the methodology for the Index for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations. Back-tested performance is for use with institutions only; not for use with retail investors.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the index is set to a fixed value for calculation purposes. The Launch Date designates the date when the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its data feed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

Typically, when S&P DJI creates back-tested index data, S&P DJI uses actual historical constituent-level data (e.g., historical price, market capitalization, and corporate action data) in its calculations. As ESG investing is still in early stages of development, certain datapoints used to calculate S&P DJI's ESG indices may not be available for the entire desired period of back-tested history. The same data availability issue could be true for other indices as well. In cases when actual data is not available for all relevant historical periods, S&P DJI may employ a process of using "Backward Data Assumption" (or pulling back) of ESG data for the calculation of back-tested historical performance. "Backward Data Assumption" is a process that applies the earliest actual live data point available for an index constituent company to all prior historical instances in the index performance. For example, Backward Data Assumption inherently assumes that companies currently not involved in a specific business activity (also known as "product involvement") were never involved historically and similarly also assumes that companies currently involved in a specific business activity were involved historically too. The Backward Data Assumption allows the hypothetical back-test to be extended over more historical years than would be feasible using only actual data. For more information on "Backward Data Assumption" please refer to the [FAQ](#). The methodology and factsheets of any index that employs backward assumption in the back-tested history will explicitly state so. The methodology will include an Appendix with a table setting forth the specific data points and relevant time period for which backward projected data was used.

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