S&P Dow Jones Indices

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TalkingPoints

Setting a New Low-Carbon Standard with the S&P/NZX Carbon Efficient Indices

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To meet the growing demand for sustainable index-based strategies in New Zealand, S&P DJI has launched the S&P/NZX Carbon Efficient Indices, including the S&P/NZX 50 Carbon Efficient Index and S&P/NZX 50 Portfolio Carbon Efficient Index. The index series is designed to incentivize companies to compare their carbon intensity to their industry group peers.

1. Can you share some background on the S&P Carbon Efficient Indices? What are the key elements and objectives that went into creating the S&P/NZX Carbon Efficient Indices?

Ryan: The idea of implementing a carbon efficient methodology to a benchmark index has been around for over a decade, and S&P DJI began launching the S&P Carbon Efficient Indices in 2009.

The key objective behind the index is to apply a weighting methodology that incentivizes companies to compare their carbon intensity to their industry group peers around the world—recognizing that there is global consensus around climate change, and that environmental threats comprise the top five long-term global economic risks.[1] A company's weight may be adjusted positively or negatively based on its carbon intensity; however, companies are not excluded from the index solely due to their carbon intensity.

In addition to the respective comparison to global industry peers, company disclosure of carbon emissions is also reviewed and affects the weight adjustment of the constituent within the index. Utilizing S&P Global Trucost's environmental dataset, we review both the Scope 1 and Scope 2 carbon emission disclosure statuses.

With the launch of the S&P/NZX Carbon Efficient Indices, we have revamped the entire methodology to recognize the carbon impacts of companies by comparing them to their global industry peers, in addition to their peers in New Zealand.

[1] World Economic Forum's (WEF) 2020 Global Risk Report.

From a performance perspective, the index series is designed to track the baseline S&P/NZX 50 Index and S&P/NZX 50 Portfolio Index closely, with the aim of providing risk/return characteristics that are similar to the benchmarks.

2. What other types of considerations are taken when evaluating constituents for the S&P/NZX Carbon Efficient Indices?

Ryan: With regard to the weight adjustments, one other component we review is the industry group's "impact level," which is classified as high, medium, or low. High impact industry groups include those such as Energy and Materials, whereas low impact industry groups include those such as Media and Financial Services.

There are two factors that we consider for constituent selection, and these are the "High Non-Disclosing Carbon Emitters" and "Controversies Monitoring" screens. **As of March 2021, these two screens applied to zero companies in the S&P/NZX 50 Index.**

The "High Non-Disclosing Carbon Emitters" screen excludes any company that is deemed to have high carbon emissions while also not disclosing their carbon intensity. This screen is in line with the objective of the index, as it incentivizes the disclosure of environmental impacts even if the company's emissions are high.

The "Controversies Monitoring" screen uses a third-party data source called RepRisk. Index constituent companies are monitored by RepRisk, a leading provider of business intelligence on environmental, social, and governance (ESG) risks. RepRisk analyzes companies for a range of issues including economic crime and corruption, fraud, illegal commercial practices, human rights issues, labor disputes, workplace safety, catastrophic accidents, and environmental disasters. Using these data, each company is assigned a daily RepRisk Index (RRI) indicator.

If RepRisk reports that a company has met or exceeded an RRI indicator of 75, the company will be removed from the index. It will be considered for reinstatement only when it satisfies all the eligibility criteria and its RRI score has remained below 75 on all days since the previous year's rebalancing date.

3. What S&P Global Trucost carbon data are used in the S&P/NZX Carbon Efficient Indices?

Ryan: The carbon efficient index series utilizes the environmental dataset published by S&P Global Trucost. Specifically, the data used are the absolute and intensity figures for carbon emissions, as well as the disclosure status. Carbon intensity is calculated using the Direct + 1st Tier Indirect emissions, which is a combination of Scope 1, 2, and Upstream Scope 3.

S&P Global Trucost's environmental data are comprehensive, covering over 15,000 companies globally, and locally in New Zealand it covers all 50 stocks within the S&P/NZX 50 Index. Data are updated on an annual basis following a strict process that reviews publicly disclosed information, or in the absence of public disclosure, uses a proprietary environmentally extended input-output (EEI-O) model.

4. Can you walk us through the S&P Global Trucost carbon data assessment?

Ryan: The S&P Global Trucost research process aims to minimize the reporting burden on companies, while ensuring as much transparency as possible.

The S&P Global Trucost research process consists of four steps.

1. **Research the environmental reporting of companies**

   The research team reviews publicly available information including annual reports, sustainability reports, websites, and other sources. In addition, S&P Global Trucost is a CDP Gold Data Partner, receiving data annually at year end.

2. **Standardize reported data and correct reporting errors**

   S&P Global Trucost analysts standardize the disclosed environmental data to best practice guidelines such as GRI Standards and SASB, so that it can be compared across various countries and regions. To correct reporting errors, outliers for datapoints are identified.

3. **Complete environmental reporting gaps**

   To fill the gaps in disclosure, S&P Global Trucost supplements the disclosed data with estimated data calculated using its proprietary EEI-O model. An additional benefit of calculating the estimated data is that S&P Global Trucost analysts are able to assess the reported data against modeled expectations to further identify potential reporting errors.

4. **Engage with companies to verify their environmental performance profile**

   The final step of the process consists of an engagement process where S&P Global Trucost reaches out to all companies in its research universe, either by email or letter. Companies are also welcomed to contact S&P Global Trucost analysts at any point in their environmental reporting cycle to provide the most recently available data.

More information may be found at: https://www.spglobal.com/spdji/en/documents/additional-material/the-trucost-research-process.pdf

5. What are the key characteristics of the S&P/NZX Carbon Efficient Indices?

Ryan: The indices are designed to closely track the performance of the underlying S&P/NZX 50 Index and S&P/NZX 50 Portfolio Index. This is done by adjusting the weight of companies only within industry groups, while maintaining the weight of each of the industry groups.

Carbon reduction for carbon efficient indices in comparison to the benchmark typically ranges between 18%-50%. This reduction varies due to the number of stocks that are within the index and the variance of carbon intensities. The S&P Global Carbon Standard that each of the companies are compared to is determined on an annual basis and can be found on the S&P Dow Jones Indices website.

6. What's driving the increasing desire by investors to understand, measure, and manage environmental impacts in their portfolios and investments?

Nathan: Increasingly investors and asset managers are becoming more conscious about where they are putting their money, how they are managing portfolios, and looking for companies that align with ESG factors. It is now not just about the return, but rather a stronger consideration of environmental and sustainable elements, which is a strong reflection of the global demand for climate change action and New Zealand's climate change targets.

7. What are some examples of successful investment integration and product creation with the S&P Carbon Efficient Indices?

Ryan: The S&P Carbon Efficient Index Series has been launched in markets all around the world and has seen integration by several different APAC markets. Notably in 2018, the Government Pension Investment Fund of Japan announced investment allocation into both a global and domestic Japanese S&P Carbon Efficient Index. Also in Japan, there have been several different asset management companies that have launched ETFs based on the domestic S&P Carbon Efficient Index that was launched in collaboration with the Japan Stock Exchange. In 2020, the S&P/KRX Carbon Efficient Capped Index was launched in partnership with the Korea Stock Exchange, and as of March 2021, four different asset managers have launched ETFs linked to this index.

8. What impacts do you envision the S&P/NZX Carbon Efficient Indices will have on the New Zealand market?

Nathan: The S&P/NZX Carbon Efficient Indices could help market participants that wish to align their values with New Zealand's climate change targets through the reduction of carbon exposure and by maintaining similar levels of risk and return to the underlying benchmark. The indices will help create a more transparent marketplace by providing listed companies an opportunity to engage with their investors.

The index series will also play an influential role in incentivizing behavioral change among listed companies by encouraging:

- Rewards for those that disclose greenhouse gas emissions; and,
- A diversification of business models toward low-carbon alternatives, as companies seek to improve their standing in the index.

As an important tool aligned with best practices across markets globally, incorporating the S&P/NZX Carbon Efficient Indices will help create a standardized measurement, allowing more visibility for investors to be able to easily compare New Zealand companies with those internationally.

For more information about the carbon efficient indices, please visit

- S&P DJI's carbon efficient designated webpage: https://www.spglobal.com/spdji/en/landing/investment-themes/carbon-efficient/
- Carbon Metrics and S&P Global Trucost's Research Process https://www.spglobal.com/spdji/en/landing/investment-themes/carbon-metrics/