

# TalkingPoints

## ESG Goes Mainstream in Australia: Get to Know the S&P/ASX 200 ESG Index



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With growing interest in environmental, social, and governance (ESG) investing around the world, S&P DJI has launched the S&P/ASX 200 ESG Index in order to provide a transparent measure of the Australian equities market with a sustainability lens.

### 1. Why is the S&P/ASX 200 ESG Index significant to the Australian market?

The S&P/ASX Index Series has played a significant role in characterizing the performance of the Australian equity market since its inception in April 2000. Since then, the S&P/ASX 200 has served as the foundation for benchmarks and index-based investing strategies in Australia. The S&P ASX/200 ESG Index combines the broad-market coverage of the S&P/ASX 200 with improved ESG characteristics. By targeting 75% of each GICS® industry group's float-adjusted market capitalization in the S&P/ASX 200, the S&P/ASX 200 ESG Index offers similar industry group weights to that of its benchmark, thereby resulting in a risk/return profile that closely tracks its underlying index.

The S&P/ASX 200 ESG Index is part of the S&P ESG Index Series, which is designed to help investors integrate ESG objectives without compromising their investment objectives. The indices enhance overall ESG performance, targeting companies that rank highly according to our S&P DJI ESG Scores. The index design allows this ESG performance boost to come at a low cost in terms of tracking error as well.

The index eligibility and constituent selection process are driven by the S&P DJI ESG Scores. These scores employ data gathered through SAM's Corporate Sustainability Assessment (CSA), which SAM<sup>1</sup> has developed and administered over the past 20 years. The CSA and resulting S&P DJI ESG Scores provide an unparalleled view into companies' sustainability performance in Australia. The CSA raises corporate awareness on upcoming ESG issues, challenging Australian companies to think about emerging ESG risks and opportunities in their industries. As a result, the CSA helps identify companies that are ahead of the curve on these topics. The CSA also contributes toward more transparency and reporting on these issues to the benefit of the broader investment community.

<sup>1</sup> SAM, part of S&P Global, provides the data that powers the globally recognized Dow Jones Sustainability Indices, S&P 500 ESG Index, and others in the S&P ESG Index Series. Each year, SAM conducts the Corporate Sustainability Assessment, an ESG analysis of over 7,300 companies. The CSA has produced one of the world's most comprehensive databases of financially material sustainability information, and serves as the basis for the scores that govern S&P DJI ESG indices.

## 2. How and why would market participants use this new index in their practice?

With the S&P/ASX 200 ESG Index, investors are now able to move ESG from the periphery of their portfolios into the core. By providing a similar risk/return profile to that of the S&P/ASX 200, it has become easier and more attractive to allocate more to ESG than ever before. In addition, the S&P/ASX 200 ESG Index methodology is simple and accessible to everyone, particularly to those considering making their first ESG investment. By offering improved ESG characteristics without needing to make too many exclusions, the tracking error of the S&P/ASX 200 ESG Index to the S&P/ASX 200 can be kept low. This profile makes the S&P/ASX 200 ESG Index appealing to institutions, retail investors, and the financial advisor community alike.

In addition, as with any of our benchmark solutions, this index has a range of potential applications, such as defining an investable universe, benchmarking investment performance, or supporting the construction of passive portfolios through investment vehicles like ETFs that are now available in the Australian market.

## 3. How does the S&P/ASX 200 ESG Index work?

The methodology of the S&P/ASX 200 ESG Index is constructed to be simple, with straightforward exclusions and a selection process that is meant to keep the index's industry weights in line with those of the S&P/ASX 200.

At each rebalancing, starting with the S&P/ASX 200, the following companies are excluded from eligibility.

- Companies with an S&P DJI ESG Score that is in the bottom 25% of scores within their GICS industry group in the [S&P Global LargeMidCap](#) and [S&P Global 1200](#).
- Companies that either extract or generate electricity from thermal coal accounting for greater than 5% of their revenue.
- Companies that produce tobacco, have tobacco sales accounting for greater than 10% of their revenue, derive more than 10% of their revenue from tobacco-related products and services, or hold more than a 25% stake in a company involved in these activities.
- Companies involved in controversial weapons, including cluster weapons, landmines, biological or chemical weapons, depleted uranium weapons, white phosphorus weapons, or nuclear weapons, or hold more than a 25% stake in a company involved in these activities.
- Companies with a UN Global Compact (UNGC) score that is in the bottom 5% of scores in the eligible universe.

Once the exclusions are made, the index constituents are selected in the following manner.

1. Companies are ranked by their S&P DJI ESG Score.
2. Within each GICS industry group, companies are selected from the top down by S&P DJI ESG Score to get as close as possible to 75% of the float-adjusted market capitalization of the S&P/ASX 200 GICS industry group.

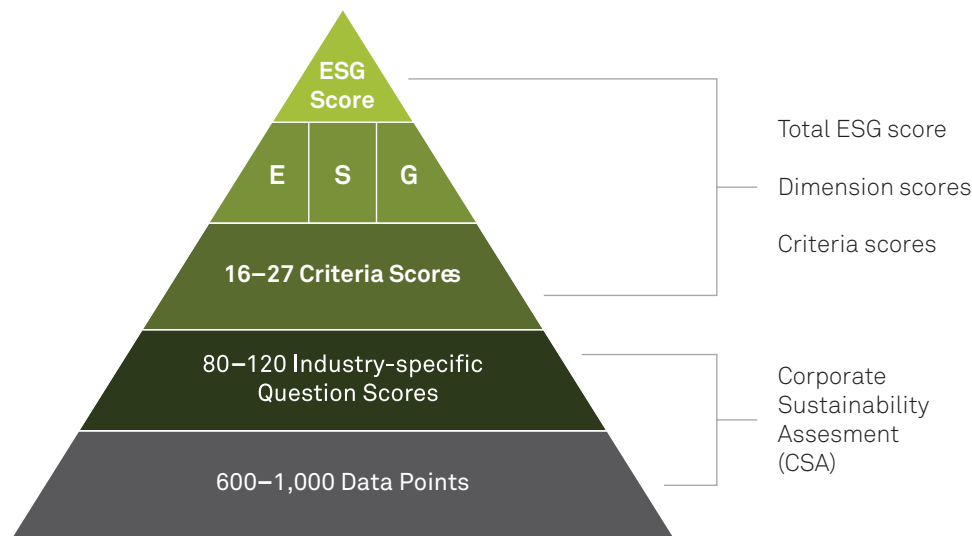
The resulting index constituents are then weighted by float-adjusted market capitalization.



## 5. If the data is the key driver, can you walk us through the process of data collection and what makes this data stand out?

The data that goes into the S&P DJI ESG Scores is collected via the CSA. The CSA is an industry-specific questionnaire that assesses a company's ESG performance, focused on financially material sustainability factors that are linked to a company's long-term financial performance. Up to 1,000 individual data points are captured by the CSA, rolling up to the individual environmental, social, and governance dimensions and then once more to create a holistic, top-level ESG score. In addition, there is a unique CSA questionnaire for each of the 61 industries covered, ensuring that the most material factors relevant to each industry are reflected in a company's score.

### Exhibit 2: S&P DJI ESG Scores Aspect Levels



Source: SAM, part of S&P Global. Chart is provided for illustrative purposes.

The CSA is completed by companies themselves, should they choose to participate. This provides an intimate look at a company's sustainability performance and features information not necessarily available in the public domain. Not all companies choose to participate in the CSA, however, and in these instances, SAM's analysts will perform the CSA on behalf of the company using publicly available data. This ensures that every company in the S&P/ASX 200 receives an S&P DJI ESG Score, which is used in the constituent selection and rebalancing of the S&P/ASX 200 ESG Index.

This particular data set stands out because it not only provides a detailed view of how companies operate from a sustainability perspective, but also because the data set has been refined through 20 years of investment experience by SAM. This underlies the financial materiality of the scores, as SAM's experience in this area over the past two decades has shaped how each individual data point is weighted. For example, if the environmental dimension weight in a company's S&P DJI ESG Score is 42%, it means there is a data-driven reason for that. While the majority of ESG scores available in the market reflect only publicly available data, the S&P DJI ESG Scores stand out in their uniqueness.

S&P DJI ESG Scores are currently available for 4,700 publicly listed companies (representing ~90% of global market capitalization), with coverage expanding to 7,000 companies by 2020 (representing approximately 95% of global market capitalization).

## 6. What are the key benefits of the S&P/ASX 200 ESG Index?

The S&P/ASX 200 ESG Index is designed to increase exposure to companies with strong ESG performance without significant deviation from the risk/return profile of the S&P/ASX 200. Sample ESG impacts of the S&P/ASX 200 ESG Index are illustrated in Exhibit 3.

**Exhibit 3: S&P/ASX 200 ESG Index – Measuring the Impacts**



Source: S&P Dow Jones Indices LLC. Data as of June 30, 2020. Increased index exposure to each ESG theme in the metrics included here are calculated using the question-level data in SAM's CSA (2019 methodology year). These metrics are calculated using index data as the percentage difference between the performance of the S&P/ASX 200 ESG Index and the S&P 200 constituents across these metrics, on a weighted average basis. Chart is provided for illustrative purposes.

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