

Smart Beta Meets Smart Sustainability

Climate change risk protection objective



Challenge

The client, the HSBC Bank UK Pension Scheme, wanted a new equity index fund that incorporated factor risk premia and climate parameters.

Criteria

Target better long-term risk-adjusted returns, incorporate climate change risks, and improve the effectiveness of stewardship and engagement.

Solution

The FTSE All-World ex CW Climate Balanced Factor index incorporates four equity factors and tilts towards three climate change parameters.

Seeking a new multi-factor strategy

The HSBC Bank UK Pension Scheme is one of the largest corporate pension funds in the UK. It wanted to develop a new, index-based institutional equity mandate for its mainstream defined contribution (DC) fund, into which new pension savers are enrolled by default. Together with its asset manager (Legal & General Investment Management) and its investment consultant, HSBC worked collaboratively with FTSE Russell to design the new index.

The goal was for the index to incorporate both “smart beta” equity risk factors and sustainability parameters, allowing the fund to target better long-term risk-adjusted returns while also hedging against climate change risks.

Calculating transition pathways

When seeking a new index to underlie its DC accumulation fund, the HSBC Pension Scheme set itself a number of objectives, specifying that the index should:

- Target better long-term risk-adjusted returns through equity factors
- Incorporate protection against climate change risks
- Allow for improved stewardship and engagement
- Follow a transparent, rules-based methodology

“The collaborative development of the FTSE All-World ex CW Climate Balanced Factor Index was key in achieving two of the Trustee’s objectives. The first was to establish an improved risk-adjusted neutral position by the use of factors for our mainstream DC accumulation fund, and the second was to incorporate climate change risk protection by the inclusion of climate change tilts into the index. We believe that managing our fund against this index rather than a market capitalisation one will lead to better outcomes for our members.”

– Mark Thompson, Chief Investment Officer, HSBC Bank UK Pension Scheme



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The index solution

The outcome of this collaborative effort was the FTSE All-World ex CW Climate Balanced Factor index. This “smart sustainability” index combines a smart beta factor approach with climate change tilts.

The index provides increased, balanced exposure to four of the most widely utilised equity factors: value, quality, low volatility, and size. It then incorporates three climate change parameters: carbon emissions, fossil fuel reserves and green revenues.

The index, which draws upon eligible equities from the FTSE All-World index, also excludes companies involved in manufacturing weapons banned under international treaties, such as cluster munitions and landmines.

The index follows a transparent, rules-based methodology, allowing for more effective stewardship and engagement. It is reviewed, with a phased rebalancing schedule, twice a year.



Fossil fuels

The index methodology reduces exposure to companies that own or are engaged in the exploration or production of fossil fuels or the suppliers of equipment and services to the fossil fuel industry.



Carbon emissions

The index methodology reduces exposure to companies that emit high levels of CO² relative to other companies in the same ICB sector.



Green revenues

The index methodology increases exposure to companies that produce goods, products and services that allow the world to adapt to, mitigate or remediate the impacts of climate change, resource depleting and environmental erosion.

Reflecting investment beliefs in index design

This index shows how it is possible for an index firm to work collaboratively with a client and its external advisors to create a new benchmark that reflects important investment beliefs in its design.

The FTSE All-World ex CW Climate Balanced Factor index is smart in two ways: it provides exposure to factors, the drivers of long-term equity returns, while also reflecting the growing importance of sustainable investment.

Climate change is expected to have profound impacts on the prospects and performance of companies across a variety of industrial sectors. As a result, climate considerations are now an important investment issue, and many investors wish to hedge climate risks in their portfolios. However, they also wish to retain exposure to the potential upsides that climate change may bring to stocks with particular attributes.

Additional information

Learn more about FTSE Russell's [smart sustainability index solutions](#).

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