Integrating climate risk in a global bond allocation

“It has been an important step for us to have an extended ‘ecosystem’ in our ESG-related fixed income product line up, whereas we have already developed various types of ESG equity-related products for both active and passive fund management.”

– Mr. Hideki Suruga, Managing Executive Officer and Head of Products, Mitsubishi UFJ Kokusai AM

About the client

Profile

Mitsubishi UFJ Kokusai AM, the core asset management company of Mitsubishi UFJ Financial Group (MUFG), is one of the largest asset managers in Japan, with AUM of over ¥18 trillion.

Objectives

To provide Japanese retail and institutional investors with a way to invest in global government bonds while mitigating climate risk.

Solution

The FTSE Climate Risk Adjusted World Government Bond Index integrates the physical climate risk, transition risk and climate resilience of sovereign debt issuers.

A pioneer in responsible investment

The Mitsubishi UFJ Financial Group (MUFG) promotes investment management that focuses on environmental, social and governance (ESG) concerns.

In May 2006, MUFG was one of the first Japanese institutional investors to become a signatory of the United Nations Principles for Responsible Investment (UN PRI).

The Group also endorses the Japanese Stewardship Code, which was formulated by the Financial Services Agency for the purpose of increasing the medium- to long-term return on investment for customers and beneficiaries.

Mitsubishi UFJ Kokusai AM: Client profile

Mitsubishi UFJ Kokusai AM promotes investment management that focuses on environmental, social and governance (ESG) issues. By suggesting to clients that they should consider non-financial information when making investment decisions, the firm is contributing to the realisation of a sustainable environment and society.

Objective: Integrating climate risk in global bond investments

Government bonds are the largest single asset class in the world's securities markets, and their issuers are highly exposed to energy and climate risks.

For example, governments own 78 percent of world fossil fuel reserves, and up to 20 percent of public expenditures and fiscal revenues are directly linked to fossil fuels.

Governments are also the primary source of funding for the world's future low-carbon infrastructure, and they are the key stakeholders in setting environment-related fiscal and regulatory policy.

However, up to now, investors in global government bonds have had less success in integrating ESG considerations into their portfolios than investors in global equities, where ESG frameworks are more established.

Mitsubishi UFJ Kokusai AM therefore wished to:

- Foster ESG integration in a global government bond portfolio
- Base its ESG framework on a flagship global bond benchmark
- Focus on managing and mitigating climate-related risk

Solution: the FTSE Climate Risk Adjusted WGBI

Mitsubishi UFJ Kokusai AM selected the FTSE Climate Risk-Adjusted World Government Bond Index ("FTSE Climate WGBI") as the underlying performance target for a new index fund, launched in March 2021.

The fund is designed for Japanese defined-contribution (DC) pension schemes, other institutional investors, and financial institutions seeking to integrate climate risk in their global bond allocations.

The FTSE Climate WGBI is derived from the flagship FTSE World Government Bond Index (WGBI), launched in 1984 and widely used by bond investors. The WGBI measures the performance of fixed-rate, local currency, investment-grade sovereign bonds, and comprises sovereign debt from over 20 countries, denominated in a variety of currencies.

The FTSE Climate WGBI incorporates climate risks into its construction methodology in a comprehensive, robust, and transparent manner. It does this by integrating three climate risk "pillars":

- **Physical risk** (the level of climate-related risk exposure to a country and its economy from the physical effects of climate change)
- **Transition risk** (the risks of economic dislocation or financial losses associated with the future transition to a low-carbon economy)
- **Climate resilience** (a country's preparedness and actions to cope with its level of climate-related risk exposure)

The FTSE Climate WGBI is constructed by "tilting" the starting weight of each country in the parent index (the FTSE WGBI) to reflect its climate risk, as measured using the three climate risk pillars.

The net effect of these tilts is to provide higher exposure to the government bonds of countries that are more resilient to climate change risks, and lower exposure to the bonds of countries that are more exposed to climate risks.

Three climate risk "pillars" in the FTSE Climate WGBI

Physical
Idiosyncratic geographical exposure to the adverse impact of climate change

Transition
The level of future carbon emissions reduction needed to meet the Paris conference target*

Resilience
The degree to which an individual economy is prepared for climate change

* Paris conference target of less than two degrees of global warming and the recent trend of historical carbon emissions

Source: FTSE Russell and Beyond Ratings

Additional information

[Learn more about FTSE Climate WGBI]

Further information on our range of products and services is available at lseg.com/ftse-russell

ABOUT FTSE RUSSELL

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For over 35 years we have been at the forefront of driving change for the investor, always innovating to shape the next generation of benchmarks and investment solutions that open up new opportunities for the global investment community.

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