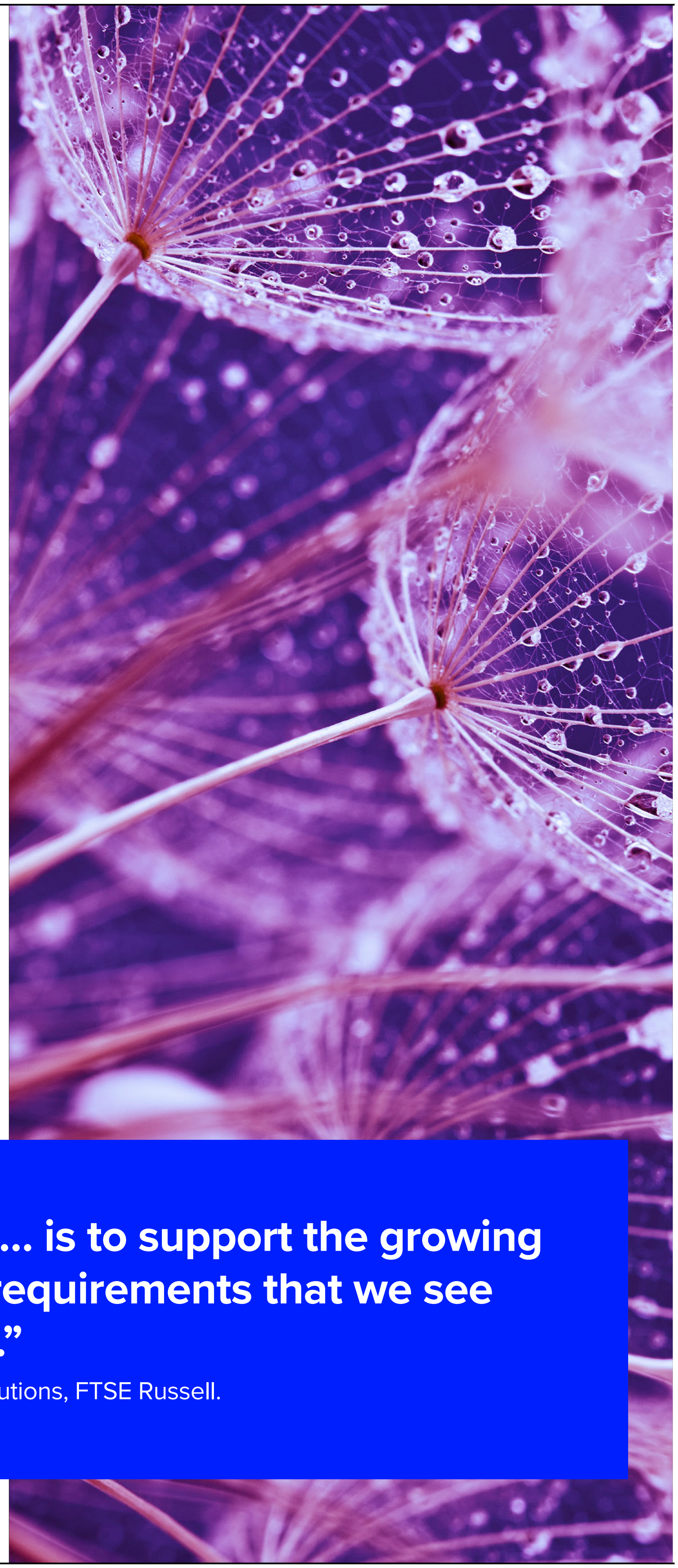
FTSE RUSSELL
An LSEG Business

Squaring the circle on carbon, ESG and tracking error

Clear criteria and quality benchmarks create a foundation for success with new FTSE UK ESG Risk-Adjusted Index Series licensed to ICE for futures contracts



Asset managers seeking to prioritize environmental, social and governance concerns of the investor can sometimes struggle to decipher the sustainable investment space. Adding to uncertainty is a plethora of ways to measure corporate ESG initiatives. For many asset managers, understanding the details of ESG rankings and how products are structured is vital to evaluating risk/return profiles.

FTSE Russell has launched an index series to help investors integrate ESG considerations into portfolios without considerably altering the risk/return profiles associated with its indices. Variance between the underlying starting weight and the ESG index is limited, allowing the ESG index to closely track the original. This measured approach allows equity investors to improve portfolio sustainability yet minimize risk and maintain exposure to large-cap UK equities.

"Our aim with this launch is to fulfill client need in our ESG index product range, whilst also providing a straightforward ESG adjusted version of the flagship UK equity benchmark series, to support the growing range of implementation requirements that we see across our customer base," said Aled Jones, head of sustainable investment solutions at FTSE Russell.

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Tracking ESG characteristics in four indices

Based on the FTSE UK Index Series, the new series measures the performance of top companies in the FTSE 100, FTSE 250, FTSE 350 and the All-Share index based on their ESG practices.

The FTSE 100 tracks the UK's biggest 100 stocks. FTSE 250 features the mid-capitalized companies not covered by the FTSE 100 and represents about 15% of UK market capitalization. FTSE 350 tracks both. Adding the FTSE Small-Cap Indexes to the FTSE 100 and FTSE 250 creates the FTSE All-Share Index, which represents as much as 99% of UK market capitalization.

Companies are weighted on ESG characteristics and investable market capitalization. Excluded are firms involved in activities such as thermal coal energy generation, Arctic oil and gas exploration, tobacco production and retail, and involvement with controversial weapons.

While the series doesn't eliminate exposure to fossil fuels, it reduces them by 50% compared with underlying benchmarks. The indices also offer a 5% ESG score improvement and 50% reduction in carbon emissions intensity via semiannual rebalances. By tilting the weight to companies with higher scores, the ESG indices incorporate

FTSE UK ESG Risk-Adjusted Series Construction

Flagship UK benchmarks

FTSE 100
FTSE 250
FTSE 350
FTSE All-Share

ESG screens
Reducing index exposure to contentious/controversial products, services and conduct

+

ESG targets
Target specific ESG score improvement and carbon risk reduction vs. benchmark

+

Construction
Target Exposure methodology ensures the index closely matches the risk/return of the benchmark

sustainable investment data sets including FTSE ESG scores and carbon reserves. This allows investors to see how companies are selected and weighted. It also minimizes risk by allowing control over tracking errors, diversification, capacity and concentration.

The index methodology provides those seeking ESG investments:

Stable risk and return profiles

The underlying indices in the FTSE UK Index series have measured the UK's stock market and economy for decades, as evidenced by the $575 billion in passive and active funds that track them. With the FTSE UK ESG Risk-Adjusted Index Series, investors continue to benefit from this risk and return profile. However, a bias toward companies with higher ESG scores is added.

Transparency

Clear criteria for evaluating and scoring companies in the index series helps asset managers understand which companies are included and the reasons others are excluded. As a result, the methodology can help investors meet ESG goals with consistent parameters.

Clear and clean goals

The aim of the series is to reduce carbon emissions and reserves exposure, while improving the index-level ESG performance compared to the benchmark.

Investing in a trusted exchange's series

In 2023, Intercontinental Exchange launched futures based on the FTSE 100 ESG Risk-Adjusted Index and the FTSE All-Share ESG Risk-Adjusted Index.

"ICE's sustainable derivatives address a specific need in the UK market -- for portfolio managers to enhance the sustainability characteristics of their UK equity holdings, while maintaining a similar risk/return profile to their FTSE 100 or FTSE All-Shares benchmark," said Franc Sportiello, head of equity derivatives at ICE.

ICE offers the broadest suites of FTSE Russell index-linked derivatives, representing a partnership that has spanned over 35 years and offers the most liquid market to trade FTSE derivatives. ICE's FTSE franchise has £160 billion of notional open interest, making ICE the leader in UK-listed derivatives. The franchise incorporates well-known indices such as the FTSE 100, FTSE 250 and FTSE 100 Dividend futures and options, which provides a comprehensive set of tools to measure the performance of all capital and industry segments of the UK equity market.

"By trading these contracts, investors can tap into the substantial liquidity of ICE's FTSE derivatives complex and benefit from the efficiencies of central clearing, providing them with a cost-effective path to embark on their sustainable investing journey," Sportiello said.

With investor demand rising for sustainability-oriented financial products, understanding the details of these indices' investment opportunities can help asset managers meet their ESG and return goals.

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> Franc Sportiello, head of equity derivatives, ICE

FTSE Russell is your essential index partner for a changing world. We provide category defining indices across asset classes and investment objectives to create new possibilities for the global investment community. To learn more about the FTSE UK ESG Risk-Adjusted Index Series, contact us here or visit us here.