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Guest Opinion:

How Climate-Related Indices Can Help Decarbonize Investment Portfolios

Contributor:

J. Kochetygova, London (44) 20-7176-3024; julia.kochetygova@spdji.com

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(Editor's Note: The interviewee in this article is Julia Kochetygova, based in London, who works as the head of sustainability indices at S&P Dow Jones Indices. S&P Dow Jones Indices, like Standard & Poor's Ratings Services, is a subsidiary of McGraw-Hill Financial. The thoughts expressed in this article are those of the author and do not necessarily reflect the views of Standard & Poor's.)

Here, Standard & Poor's interviews Julia Kochetygova, head of sustainability indices at S&P Dow Jones Indices, about creating indices for investors involved in green finance. For the past four years, Ms. Kochetygova has been focusing on designing the methodologies for the global S&P ESG (environmental, social, and governance) Indices, S&P ESG Sovereign Bond Indices, S&P Green Bond Indices, S&P ESG Sovereign Bond Indices, and S&P Global Carbon Efficient Indices. She will be speaking in events organized around the U.N. Climate Change Conference in Paris (COP21) on Nov. 30-Dec. 11, 2015.

Why would investors want to use low-carbon indices?

The climate-related risks that companies face are now widely recognized. They include the possibility of stricter carbon regulation, physical damage, technology change, and modifications to consumer behavior. As a result, some carbon assets may depreciate in the future. But there may also be opportunities with greener technologies and products--such as electric cars, renewable energy, energy-saving technologies, and climate-resilient infrastructure. Companies in this segment are becoming more competitive in response to climate-related opportunities and changes in market behavior. Those investors who see climate change as part of a new reality need investment tools to help them find opportunities. S&P Dow Jones Indices has developed a few families of green indices to provide investors with transparent and rules-based solutions.

What different approaches are investors taking today regarding decarbonization?

There are three main approaches--carbon-efficient, fossil-free, and green investing--and for that reason we've developed indices in each of these areas:

- S&P Carbon Efficient Indices. These indices are designed to underweight or exclude the worst carbon emitter companies on the basis of their carbon footprint. Even though the carbon footprint of constituent companies for these indices is smaller, the indices closely track the risk-return profile of the larger benchmark indices from which the S&P Carbon Efficient Index components are selected.
- S&P Fossil Fuel Free Indices. To appeal to investors who want to exclude exposure to fossil fuels or divest from them, these indices are designed to exclude companies that own fossil fuel reserves.
- S&P thematic green indices. These indices focus on green opportunities rather than risks. One example is the S&P Global Clean Energy Index. In the fixed-income area, last year we launched the S&P Green Bond Index (for bonds

labeled by the issuer as "green") and S&P Green Project Bond Index (for any bonds that are not labeled "green," but may be considered "green"). This index includes bonds issued by companies to finance projects in green segments such as renewable energy.

How do you define "carbon efficiency" for the purposes of the carbon-efficient indices?

Carbon efficiency is measured by a company's carbon footprint, which is the size of a company's greenhouse gas emissions assessment divided by annual revenues. The carbon efficiency measures that Standard & Poor's uses to compile these indices come from Trucost PLC, which is the world's leading environmental economics company.

What's next for the family of green indices, and why are they important to the future of climate finance?

We are looking at the possibility of distinguishing among different types of bonds in our green bond indices, whether by shade of green or by credit rating, size, liquidity, or currency, etc., to better meet the varying needs of investors. What's more, we are considering a wider scope of carbon-related and climate-related projects, not only in renewable energy or climate adaptation, but also in green transportation, agriculture, and forestry, among others. By doing this we want to be able to identify a green growth story for investors, who can determine for themselves whether greenness comes at the expense of profitability. And if the story is impressive, then it may help mobilize the investment that's needed for green infrastructure projects and for making industry more eco- and climate-friendly.

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.

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