



LSEG

Japan Financial Services Agency Questionnaire on FTSE Russell Environmental, Social and Governance (ESG)-Related Products

LSEG Response - Public Version

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About LSEG

The London Stock Exchange Group (LSEG), through its FTSE Russell business, welcomes the opportunity to respond to Japan FSA's Questionnaire on ESG - related products. LSEG is proud to be a leader in sustainable finance and is well positioned at the heart of global financial markets to act as a facilitator for growing the green economy and supporting the transition to net zero. LSEG was the first global exchange group to join the United Nations Climate Change 'Race to Zero' and is member of the Glasgow Financial Alliance for Net Zero.

LSEG is committed to supporting investors in aligning their capital allocation with long term sustainability objectives, through the provision of data, analytics and indexes that enable the integration of climate and sustainability into investment strategies. We also address market barriers through promoting more reliable and consistent sustainability-related disclosures.

Through FTSE Russell, a wholly owned business of LSEG, we are a leading global index provider creating and managing a wide range of indices, data and analytic solutions to meet client needs across asset classes, style and strategies. Covering 98% of the investable market, FTSE Russell indices offer a true picture of global markets, combined with the specialist knowledge gained from developing local benchmarks around the world. FTSE Russell index expertise and products are used extensively by institutional and retail investors globally.

For over 30 years, leading asset owners, asset managers, ETF providers and investment banks have chosen FTSE Russell indices to benchmark their investment performance and create investment funds, ETFs, structured products and index-based derivatives. FTSE Russell indices also provide clients with tools for asset allocation, investment strategy analysis and risk management.

A core set of universal principles guides FTSE Russell ESG scoring and index design and management: a transparent rules-based methodology is informed by independent committees of leading market participants. FTSE Russell is focused on index innovation and customer partnership applying the highest industry and international standards.

As a key provider of ESG data and indices to Japan's finance community, LSEG support the efforts by Japan Financial Services Agency to address sustainability challenges and facilitate the flow of sustainable data and capital and we look forward to working with you as a trusted partner. Should you have any further queries, we will be pleased to share further details with you at your convenience.

LSEG Response to Japan Financial Services Agency Questionnaire on FTSE Russell Environmental, Social and Governance (ESG)-Related Products

Please tell us about your company's thoughts and your current efforts on the following items:

1. Basic Information (Business description, objective, fee model on each ESG-related product you provide (e.g. ESG-related rating, data providing services, any form of advisory services))

Designed to meet the diverse sustainable investment needs of investors, FTSE Russell offers data and expertise to integrate sustainability and other investment considerations into a single sustainable investment (SI) index solution. With over two decades of SI experience, FTSE Russell provides clients with sustainable investment data models, scores, analytics, and indices covering thousands of companies and the main sovereign issuers globally. Please see our response to Q2 for more details on FTSE Russell's offering on sustainability and climate related products.

FTSE Russell adopts a user fee based model where users are charged for the usage of our SI indices and SI data such as ESG scores. This is unlike credit rating agencies where fees are paid by issuers for the rating services. When fees are paid by users, there is a strong alignment of interests to ensure the accuracy of the products, and this creates an arms' length relationship between the data provider and the firm under review. This is important from a governance perspective.

We believe it is important to highlight this distinction in relation to FTSE Russell's offering as comparison of ESG scores is often drawn with credit ratings. The ESG scoring market is very different to credit ratings, which is aimed at understanding likelihood of credit default hence has a very clear aim and definition shared by all providers. In contrast, ESG scorings are much broader because of the breadth of sustainability themes where the definitions and views of relevant importance or "materiality" of different themes vary by provider and user of the scores. While a credit rating is an assessment of the creditworthiness of a borrower, an ESG scoring may measure both sustainability-related risks and opportunities.

2. Principles and/or Policies in providing ESG-related products in light of:

- Ensuring transparency of methodologies
- Better quality of data and methodologies, such as securing enough resources
- Mitigation and management of potential conflicts of interest
- Communication with evaluated companies

Transparency

FTSE Russell relies on publicly disclosed information for ESG data, which we consider to be more reliable and less subjective compared to private, survey-based data. We do not send questionnaires to issuers to reduce the scope for self-assessments, which will enhance the transparency process.

Our primary sources of data are therefore annual reports and other materials issued by public companies. We also supplement this data with other sources such as climate related data from Carbon Disclosure Project (CDP).

FTSE Russell's approach is fully traceable: we are able to disclose the source from where data was collected, and the calculation methodologies for the companies' scores. The score is based on a rules-based methodology which is not reliant on analyst subjective views.

To help companies understand how ESG scores are calculated, companies are provided with a full copy of the methodology document. The document describes in detail the rules-based process through which FTSE Russell applies datapoints to a company and how it combines these datapoints into an ESG Score. Through this process, companies can see their own detailed ESG evaluation and are given an opportunity to review and provide their feedback and comments.

Methodology

(i) ESG Scores

FTSE Russell currently adopts a rule-based approach and methodology in assessing companies. The overview of our ESG Scores and data model can be found in [ESG Ratings | FTSE Russell](#).

FTSE Russell's ESG scoring methodology is aligned with international standards. It supports alignment with the ten [UN Global Compact \(UNGC\) principles](#), which lay out a principles-based approach to doing business. This means operating in ways that, at a minimum, meet fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption.

Our ESG evaluation criteria are derived from pre-existing global standards and aim to support the drive towards the global harmonization of sustainable investment methodologies. For example, they draw from GRI (the Global Reporting Initiative), TCFD (Task Force for Climate Related Financial Disclosures), the OECD Guidelines, the GHG Protocol, and Transparency International's Business Principles for Countering Bribery.

(ii) Indices

The list of FTSE Russell sustainable investment (SI) indices are listed on [Sustainable investment category | FTSE Russell](#). It includes detailed methodology documents and benchmark statements for all the indices. Some of the SI indices are built on ESG scoring methodology, such as FTSE4Good index series.

Under FTSE4Good index series, one of the best known indices in the Japanese market is the [FTSE Blossom Japan Index | FTSE Russell](#). This index was launched in July 2017 and is designed to measure the performance of Japanese companies that demonstrate strong ESG practices. The list of constituents of [FTSE Blossom Japan index](#) and its parent index [FTSE All Cap Japan Index](#) are available on our website.

Engagement and Conflict of Interest

(i) ESG Scores

FTSE Russell follows a structured engagement process when communicating with companies. All engagement with companies is carried out as part of the standard operations of FTSE Russell to conduct analysis and compile indexes and there are no paid services provided to companies. FTSE Russell follows four key principles:

- To enable all companies to review the information we have collected, as an additional data-check mechanism;
- To aim to ensure companies are treated and assessed fairly and transparently;

- To take on board corporate feedback on the ESG Scores criteria to improve and refine our methodology over time; and,
- To aim to catalyse improvements in corporate disclosure, practice and performance, while giving constituents adequate time to respond to queries.

To support the engagement process for companies to provide feedback before making any decision on its final ESG score, FTSE Russell provides:

- A client service desk to provide services in several local languages (including Japanese) and can arrange for a call/meeting with companies upon request, subject to resource constraints.
- Analyst feedback (comments/rationale of assessments) which can be provided to each company upon request.
- Access to our web-based research platform (Sustainable Investment Data Platform). Companies are given around 4 weeks to review and provide feedback (by providing, for example, additional public information) that could be factored into our analysis. Analysts review this feedback and determine if a change in assessment is warranted.
- Established process for corporate communications. This process enables companies to engage with us directly (email: ftse4good@ftserussell.com) to enhance the understanding of our ESG research process, inputs, outputs and investor use cases

Unlike credit rating providers, FTSE Russell does not charge companies for assessing them to provide investors with ESG scores. We have put in place robust policies and procedures to manage any potential conflicts of interest.

(ii) Indices

FTSE Russell has in place robust governance arrangements which include a clear organisational structure and a framework to identify and to prevent or manage potential conflicts of interest and to ensure that where any judgement or discretion in the benchmark determination process is required, it is independently and honestly exercised.

FTSE Russell's external advisory committees help FTSE Russell to ensure that its indices reflect the underlying market and index methodologies (a set of strict rules by which all FTSE Russell indices are governed) evolve appropriately. There are 3 advisory committees on ESG which support FTSE Russell in maintaining, managing and calculating FTSE Russell's Sustainable Investment indices. These are:

- [ESG Advisory Committee](#);
- [Sustainable Investment Advisory Committee](#);
- [Green Industries Advisory Committees](#)

The ESG Advisory Committee provides a forum to interact with index users and relevant experts with a view to enhancing the underlying methodologies of the FTSE ESG Ratings Model, as well as the associated methodologies and indices.

3. Your views on the following items:

a. Please provide if you would like to highlight any important issues other than the above when we discuss code of conducts for ESG rating and data providers and the roles expected for companies and investors, etc. at the Technical Committee for ESG Rating and Data Providers.

FTSE Russell is supportive of legislative efforts that will increase transparency and disclosure in ESG data and related services. This would improve the quality and comparability of the underlying data that ESG ratings and scores are based on.

For example, FTSE Russell is very supportive of the global initiatives to develop comparable corporate reporting such as the International Sustainability Standards Board (ISSB) and TCFD. This should make it much easier for companies to make meaningful disclosures, and for investors to conduct accurate assessments of their sustainability performance. For ISSB to be effective, it needs to be adopted by key markets and incorporated into domestic laws. We are very encouraged by Japan's support for this initiative so far.

In line with this, FTSE Russell is supportive of the European Commission's Corporate Sustainability Reporting Directive (CSRD) proposal to improve corporate ESG disclosure. This will require 50,000 European companies to report on the integration of sustainability into their strategy, business models and governance from 2024. In particular, to effectively support the transition towards a low-carbon economy, we support the Commission's proposal to include large non-listed companies in the scope of CSRD. Whilst a public listing may be a differentiator, it is not a measure of a company's impact on the environment.

b. We note the importance of the roles to be played by investors as users of ESG rating and data services as well as companies who are the subject of evaluation and database, in order to develop the capital market in a healthy manner. Please provide if you have any thoughts or comments on this point.

In IOSCO's Consultation Report on ESG Ratings and Data Products Providers, it is shown that investors use ESG data and products for very different purposes – and not necessarily for their investment decisions. The use case and purpose of ESG scores are evolving – including risk management, alpha generation, impact on wider economy and society. The use case will then influence the type of model and the weightings on various Environment, Social and Governance factors. To reflect that, ESG scorings providers have a broad range of methodological approaches – including quantitative rules-based scores which are transparent and objective. In addition, ESG scorings models differ depending on asset class use case – as equity, fixed income, real estate and alternative investors each have different needs and priorities.

We should avoid standardising and oversimplifying ESG scorings as it risks limiting cognitively diverse approaches to different elements of sustainability and discouraging investors from engaging actively with sustainability as part of their investment strategy.

The primary challenge faced by ESG scoring providers is data gaps. The underlying data that feeds into ESG models and scorings needs to improve in terms of quality, relevance, availability, and comparability. This would reduce the need for estimations and improve comparability of ESG scorings. Therefore, we believe the primary issue to be resolved is the

lack of mandatory and standardised reporting and disclosure of ESG data at company (or in fact sub-entity) level.

Market participants, end investors and issuers should have adequate visibility on the assessment performed and access to the underlying logic in order to ensure full understanding of what the scoring is meant to measure. This is particularly important given the different use cases and purposes of ESG scorings. To this end, FTSE Russell is supportive of legislative efforts that will increase transparency and disclosure in ESG data and related services. To this effect, we support and welcome the IOSCO recommendations emphasising the need for transparency in the methodologies used by ESG scorings providers.

4. Your answers will be disclosed to the members of the Technical Committee (TC) for ESG Rating and Data Providers and also posted on the FSA's website. However, if you do not consider it appropriate to disclose your answers to the TC, general public or to other organizations in the same industry, we consider anonymizing or withholding part or all of the information upon your request.

FTSE Russell will submit 2 versions of the response to the questionnaire. We propose for one version to be shared only with Japan FSA as it includes proprietary information (this is marked as "additional information in Q2") that we are not prepared to share publicly but are of view that it may be useful for Japan FSA's deliberation on these important issues. We request for this information to be excluded in the version to be posted on FSA's website.

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