

ESG integration into Japan's passive investments

About the client

Profile

The FTSE Blossom Japan Index was developed with input from the Government Pension Investment Fund (GPIF) in Japan for their first passive investment to track an ESG index. FTSE Russell was selected as one of two index providers for a total passive fund of 1 trillion Japanese yen. GPIF have made ground-breaking steps forward to incentivize Japanese companies to improve their ESG evaluations and enhance enterprise values in the long term.

Objectives

- Increase transparency and disclosure in the capital markets and improve corporate performance
- Improve awareness and activities within the Japanese market
- Improve effectiveness of stewardship and engagement within a passive mandate
- Develop market standard indexes in Japan to incentivize companies on their ESG practices

Index criteria

An industry neutral benchmark that reflects the performance of companies demonstrating strong environmental, social and governance practices (ESG) in Japan

The need

In 2014, the Japanese Stewardship Code was established to encourage ownership and dialogue between investors and investee companies to support the long term growth of companies and investments.

The emphasis on a longer time horizon has put additional focus on incorporating environmental and social risks into both the investment and engagement activities.

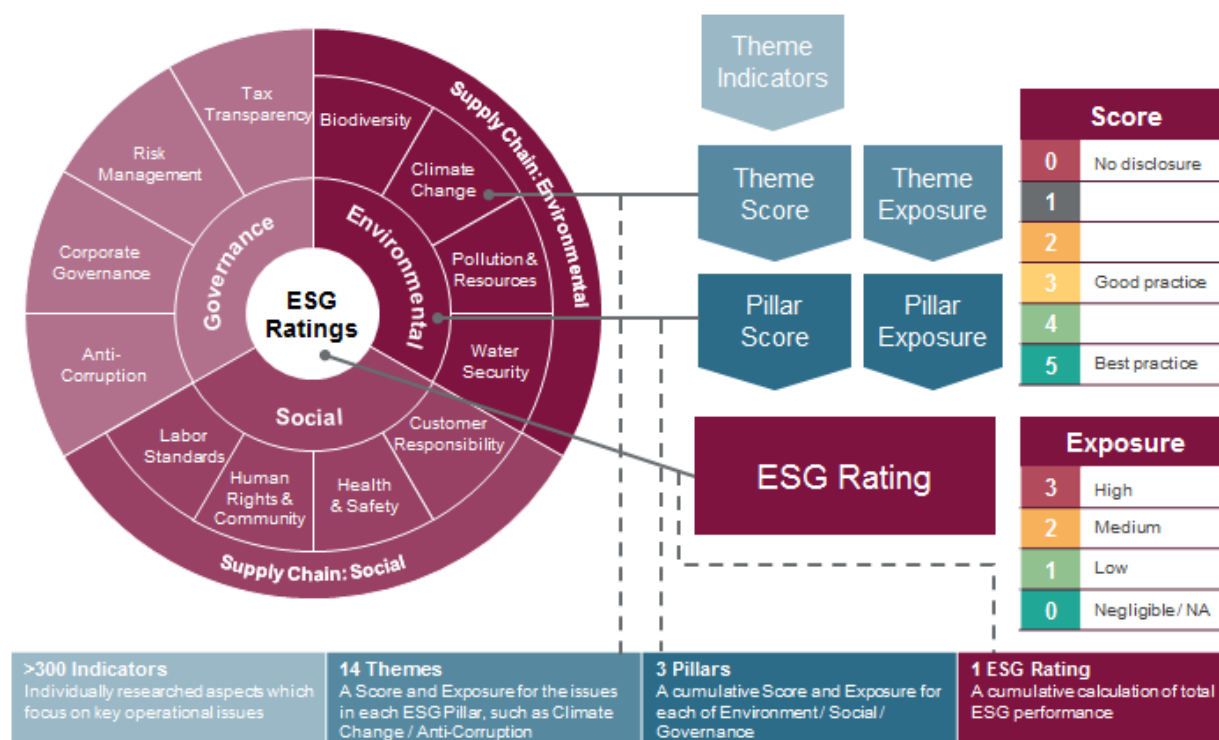
As signatories to the Japanese Stewardship Code, investors needed a tool to showcase the ESG performance by the Japanese corporate issuers, as well as to track the impact of engagement activities conducted by the market participants.

The index solution

The FTSE Blossom Japan Index is constructed using FTSE Russell's ESG Ratings data model, which draws on existing international ESG standards, including the UN Sustainable Development Goals. The inclusion thresholds are aligned with the globally established FTSE4Good Index Series.

The index enables investors to identify companies that have strong ESG practices while at the same time achieving index characteristics similar to the underlying market capitalization index.

Figure 1. FTSE Russell's ESG Ratings framework



Index features

- Demonstrates a clear ESG standard for market participants and companies to utilize in their stewardship and engagement efforts
- Utilizes the globally established FTSE4Good Index Inclusion Rules and ESG Ratings methodology
- Minimizes any industry bias through industry neutral weighting, thereby providing a benchmark designed to closely reflect the constituents of the underlying index universe
- Provides a benchmark solution that incorporates ESG considerations and has similar index characteristics, including industry weights and performance, of the traditional market capitalization weighted benchmark, the FTSE Japan Index¹

¹ Source: FTSE Russell as at 28 February 2018. Past performance is no guarantee of future results. Returns for the FTSE Blossom Japan Index reflect hypothetical historical performance. See the end for important legal disclosures.

Index construction

The FTSE Blossom Japan Index uses FTSE Russell's transparent ESG Ratings to measure exposure to and management of ESG-related risks.

FTSE Japan Index

Inclusion Selection (Overall ESG score 3.1 and above)*

E (Climate Change, Pollution & Resources, Biodiversity, Water Use, Supply Chain)

S (Customer Responsibility, Health & Safety, Human Rights & Community, Labor Standards, Supply Chain – Social)

G (Anti-Corruption, Corporate Governance, Risk Management, Tax Transparency)

Industry Neutral weighting

Equal industry weighting to the underlying (FTSE Japan) Index**

FTSE Blossom Japan Index

* Currently companies must score 3.1 and above for new inclusion, and will be at risk of deletion when the company scores below 2.7

** A single constituent's weight within the index is capped at 15%, and 20 times its index weight in the FTSE Japan Index



Result of deep client collaboration

- In 2015, FTSE Russell contributed to a research mandate from GPIF to help the pension fund consider best practice approaches to stewardship responsibilities and ESG integration by asset owners globally
- Following the report, GPIF have been working through the recommendations including becoming a signatory of the Principles for Responsible Investment, and issuing an RFP for ESG indexes
- The FTSE Blossom Japan Index was launched in July 2017 upon selection by GPIF
- As part of the constituent outreach program, FTSE Russell grants permission to index constituents to use the FTSE Blossom Japan Index logo in their corporate literature to promote their inclusion in the index and help to communicate their achievements in ESG performance to their broader constituents
- Later in 2017, two Exchange Traded Funds tracking the FTSE Blossom Japan Index listed on Tokyo Stock Exchange by two leading ETF providers showing the blossoming trend for accessible ESG funds

Financial products launched

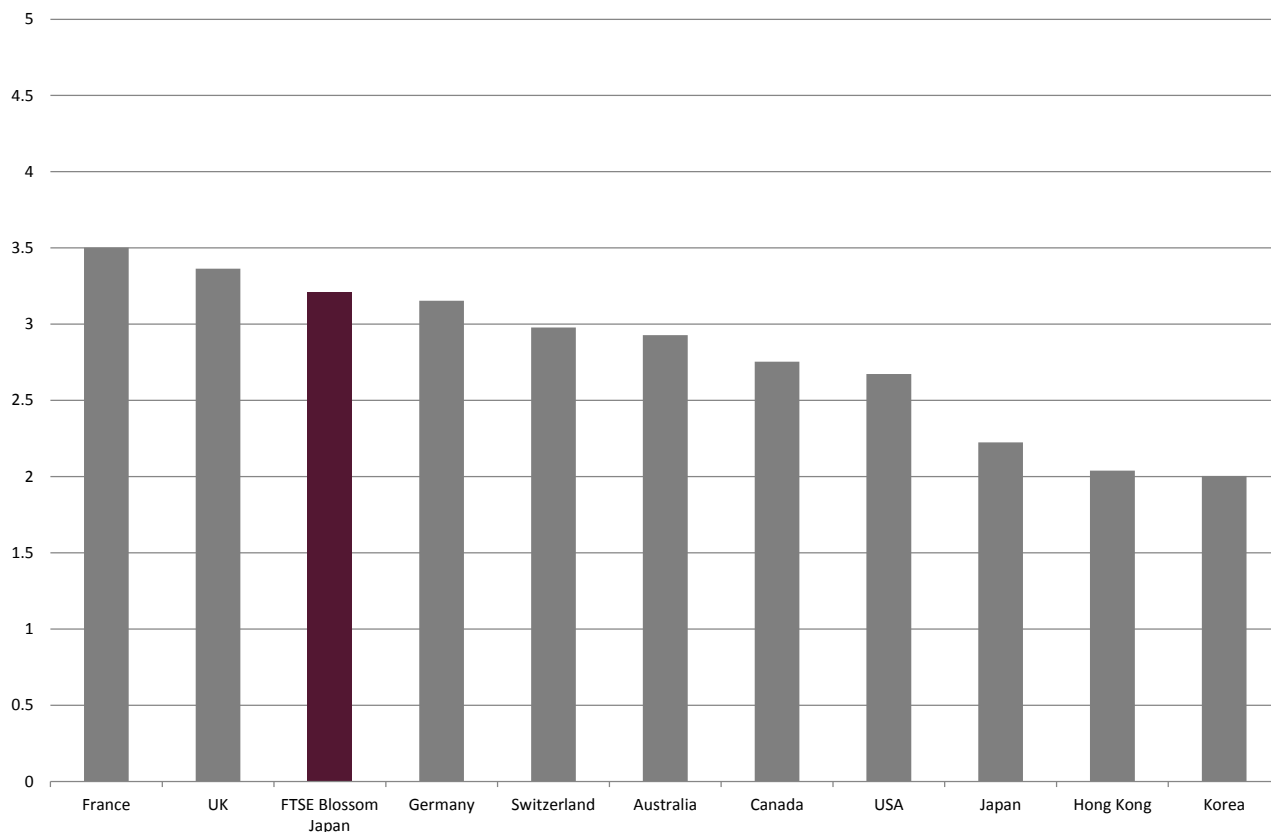
Since the launch of the index, two Exchange Traded Funds have been introduced to the Japanese institutional and retail market:

Daiwa Asset Management selects FTSE Blossom Japan index for 'Daiwa ETF FTSE Blossom Japan Index' – 26 September 2017

Asset Management One selects FTSE Blossom Japan index for 'One ETF ESG' – 28 November 2017

Figure 2. ESG Ratings: Global overall score comparison

Japan features in the bottom three countries within the Developed Markets when comparing overall ESG scores of each market. The FTSE Blossom Japan Index selects companies meeting a certain ESG standard, and therefore on par with markets with a higher average.



Source: FTSE Russell as at 20 June 2017. Companies identified as large or mid size by market capitalization in the FTSE Developed Index in markets with 40 or more constituents, as well as FTSE Blossom Japan Index constituents are shown. The overall ESG Ratings score data from 20 June 2017 is used, and the average score for companies represented in each respective market and the FTSE Blossom Japan Index are shown.

Mr. Norihiro Takahashi, president of the Government Pension Investment Fund said:

“GPIF expects that the selected ESG indices incentivize Japanese companies to improve their ESG evaluations and enhance enterprise values in the long term.”

Source: GPIF statement, 3 July 2017

Mr. Hiromichi Mizuno, Chief Investment Officer of the Government Pension Investment Fund said:

“GPIF wants to incentivize Japanese corporates to perform better on environmental, social, and governance issues, and allocate more to corporates and managers that took such issues seriously.”

Source: IPE article, 7 June 2017

Additional information

[FTSE Blossom Japan Index >](#)

For more information about our indexes, please visit ftserussell.com.

© 2018 London Stock Exchange Group plc and its applicable group undertakings (the "LSE Group"). The LSE Group includes (1) FTSE International Limited ("FTSE"), (2) Frank Russell Company ("Russell"), (3) FTSE Global Debt Capital Markets Inc. and FTSE Global Debt Capital Markets Limited (together, "FTSE GDCM"), (4) MTSNext Limited ("MTSNext"), (5) Mergent, Inc. ("Mergent"), (6) FTSE Fixed Income LLC ("FTSE FI") and (7) The Yield Book Inc ("YB"). All rights reserved.

FTSE Russell® is a trading name of FTSE, Russell, FTSE GDCM, MTS Next Limited, Mergent, FTSE FI and YB. "FTSE®", "Russell®", "FTSE Russell®", "MTS®", "FTSE4Good®", "ICB®", "Mergent®", "WorldBIG®", "USBIG®", "EuroBIG®", "AusBIG®", "The Yield Book®", and all other trademarks and service marks used herein (whether registered or unregistered) are trademarks and/or service marks owned or licensed by the applicable member of the LSE Group or their respective licensors and are owned, or used under licence, by FTSE, Russell, MTSNext, FTSE GDCM, Mergent, FTSE FI or YB. "TMX®" is a registered trademark of TSX Inc. FTSE International Limited is authorised and regulated by the Financial Conduct Authority as a benchmark administrator.

All information is provided for information purposes only. All information and data contained in this publication is obtained by the LSE Group, from sources believed by it to be accurate and reliable. Because of the possibility of human and mechanical error as well as other factors, however, such information and data is provided "as is" without warranty of any kind. No member of the LSE Group nor their respective directors, officers, employees, partners or licensors make any claim, prediction, warranty or representation whatsoever, expressly or impliedly, either as to the accuracy, timeliness, completeness, merchantability of any information or of results to be obtained from the use of the FTSE Russell Products or the fitness or suitability of the FTSE Russell Products for any particular purpose to which they might be put. Any representation of historical data accessible through FTSE Russell Products is provided for information purposes only and is not a reliable indicator of future performance.

No responsibility or liability can be accepted by any member of the LSE Group nor their respective directors, officers, employees, partners or licensors for (a) any loss or damage in whole or in part caused by, resulting from, or relating to any error (negligent or otherwise) or other circumstance involved in procuring, collecting, compiling, interpreting, analysing, editing, transcribing, transmitting, communicating or delivering any such information or data or from use of this document or links to this document or (b) any direct, indirect, special, consequential or incidental damages whatsoever, even if any member of the LSE Group is advised in advance of the possibility of such damages, resulting from the use of, or inability to use, such information.

No member of the LSE Group nor their respective directors, officers, employees, partners or licensors provide investment advice and nothing contained in this document or accessible through FTSE Russell Products, including statistical data and industry reports, should be taken as constituting financial or investment advice or a financial promotion.

Past performance is no guarantee of future results. Charts and graphs are provided for illustrative purposes only. Index returns shown may not represent the results of the actual trading of investable assets. Certain returns shown may reflect back-tested performance. All performance presented prior to the index inception date is back-tested performance. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. However, back-tested data may reflect the application of the index methodology with the benefit of hindsight, and the historic calculations of an index may change from month to month based on revisions to the underlying economic data used in the calculation of the index.

This publication may contain forward-looking assessments. These are based upon a number of assumptions concerning future conditions that ultimately may prove to be inaccurate. Such forward-looking assessments are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially. No member of the LSE Group nor their licensors assume any duty to and do not undertake to update forward-looking assessments.

No part of this information may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission of the applicable member of the LSE Group. Use and distribution of the LSE Group data requires a licence from FTSE, Russell, FTSE GDCM, MTSNext, Mergent, FTSE FI, YB and/or their respective licensors.

About FTSE Russell

FTSE Russell is a leading global index provider creating and managing a wide range of indexes, data and analytic solutions to meet client needs across asset classes, style and strategies. Covering 98% of the investable market, FTSE Russell indexes 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 indexes to benchmark their investment performance and create investment funds, ETFs, structured products and index-based derivatives. FTSE Russell indexes also provide clients with tools for asset allocation, investment strategy analysis and risk management.

A core set of universal principles guides FTSE Russell 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 standards and embracing the IOSCO Principles. FTSE Russell is wholly owned by London Stock Exchange Group.

For more information, visit ftserussell.com.

To learn more, visit ftserussell.com; email info@ftserussell.com; or call your regional Client Service Team office:

EMEA

+44 (0) 20 7866 1810

North America

+1 877 503 6437

Asia-Pacific

Hong Kong +852 2164 3333

Tokyo +81 3 4563 6346

Sydney +61 (0) 2 8823 3521