Ground Rules

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Glossary of Terms used in FTSE Russell ESG Methodology Documents

v1.1

The objective of this glossary is to provide definitions for terms used in FTSE Russell ESG Index methodology documents, such as ground rules published on www.lseg.com/en/ftse-russell/.

This supplements the FTSE Russell Glossary of terms used in FTSE Russell Equity Methodology Documents and the Glossary of terms used in Fixed Income Methodology Documents.

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Carbon Emissions

Carbon emissions refer to seven greenhouse gases (“GHGs”) emitted from terrestrial sources, which accumulate in the atmosphere and contribute to climate change. As a long-lived, well-mixed gas, each tonne of carbon dioxide in the atmosphere contributes equally to radiative forcing and subsequent temperature rise, regardless of geography or time of emissions, enabling the construction of an accounting framework for emissions disclosure.

For accounting purposes, emissions of other greenhouse gases such as methane and nitrous oxide are converted to carbon dioxide equivalent emissions (CO2e) through the application of global warming potential (GWP) factors.

Though there are multiple standards for emissions accounting, most companies and disclosure frameworks have adopted the standards set out by the GHG protocol, a partnership between the World Resources Institute and the World Business Council for Sustainable Development. The GHG Protocol recommends that firms report emissions relative to equity stake or either operational or financial control of operations. Emissions are divided into three categories relative to their source and relation to the reporting entity.

Emissions scopes:

Source		Definition	Example
Direct	**Scope 1**	Emissions from sources that are owned or controlled by the reporting company.	**Emissions from:** – A utility’s power stations – Company-owned gasoline-powered cars
Indirect	**Scope 2**	Emissions from consumption of electricity, heat, steam, and cooling. This can be calculated via two methods (see Appendix): – **Location-Based** refers to emissions calculated through emission rates of the local power grid. – **Market-Based** refers to emissions calculated based on purchasing agreements with electricity suppliers. For most corporates, this tends to result in lower estimations than Location-Based emissions.[3]	**Emissions associated with:** – Electricity consumption of company-owned EV vehicles – Electricity consumption of company-owned computer servers
	Scope 3	**Upstream:** GHG emissions embedded by processes in the value chain that contribute to a company’s products or services.	**For an automaker:** – Emissions produced by suppliers, while manufacturing vehicle components, such as steel or tires.
		Downstream: GHG emissions originating from the activities of customers using a company’s products and services.	**For an oil & gas firm** – Emissions from the combustion of oil, gas, and other derived products **For an automaker:** – Emissions from their cars’ tailpipes throughout their lifecycle

For more information, please see mind_the_gaps_–_clarifying_corporate_carbon_final_5.pdf (ftserussell.com)

Conduct-Related Exclusions

This concerns companies that are involved in controversies related to the UN Global Compact (UNGC) principles or that do not meet specific diversity indicators. UNGC Principles are classified into four categories: Human Rights, Labor, Environment and Anti-Corruption. For example, these companies may be excluded from an ESG index as set out in the ground rules.

For more information, please see the ESG index ground rules and Guide_to_the_Construction_and_Maintenance_of_FTSE_Exclusion_Lists.pdf (ftserussell.com)

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ESG scores

FTSE Russell's ESG Scores and Data Model allows investors to understand a company's exposure to and management of ESG issues in multiple dimensions. FTSE ESG Scores are comprised of an overall Score that breaks down into underlying Pillar and Theme Exposures and Scores. The Pillars and Themes are built on over 300 individual indicator assessments that are applied to each company's unique circumstances.

FTSE ESG Scores and data model has clearly defined rules for assessing companies. The output is a data tool that is quantitative, rather than qualitative company research reports. ESG Scores are calculated using an exposure-weighted average, so the most material ESG issues are given the most weight when determining a company score.

For more information, please see the ESG Scores | FTSE Russell and the Guide_to_FTSE_and_Third_Party_Sustainable_Investment_Data_used_in_FTSE_Russell_Indices.pdf (ftserussell.com)

EU Climate Transition Benchmark (CTB) and EU Paris-Aligned Benchmark (PAB)

Benchmarks with methodologies that are designed to align with the minimum requirements of the Paris Aligned Benchmarks and Climate Transition Benchmarks set out in the EU Benchmark Regulation and the UK Benchmark Regulation.

The requirements are set out in Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financthanks!ial instruments and financial contracts or to measure the performance of investment funds (the European Benchmark Regulation) and the Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. The European Benchmark Regulation is retained EU law in the UK under The Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019 (the UK Benchmark Regulation).

For more detail on FTSE Russell's approach, please see FTSE_EU_Climate_Benchmarks_Index_Series_Ground_Rules.pdf (ftserussell.com). In particular, Section 8 in the ground rules explains the index weighting methodology, CTB and PAB minimum requirements and index targets. Appendix A sets out the CTB and PAB aligned exclusions for these indices.

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Green Bond

This refers to bonds whose proceeds will be used to finance general climate or environmental projects such as renewable energy, low carbon transport and water management.

For more information, please see benchmarking_the_green_bond_market_final_0.pdf (ftserussell.com)

Green Revenues Classification System (GRCS)

FTSE Russell's taxonomy to define and measure the industrial transition to a Green Economy. This comprehensively assesses all companies with revenue exposure to the green business activities defined by GRCS. Company activities are assessed against seven environmental objectives to determine the net environmental impact. GRCS is aligned to the EU taxonomy.

For more detail, please see [Green Revenues data model | FTSE Russell]

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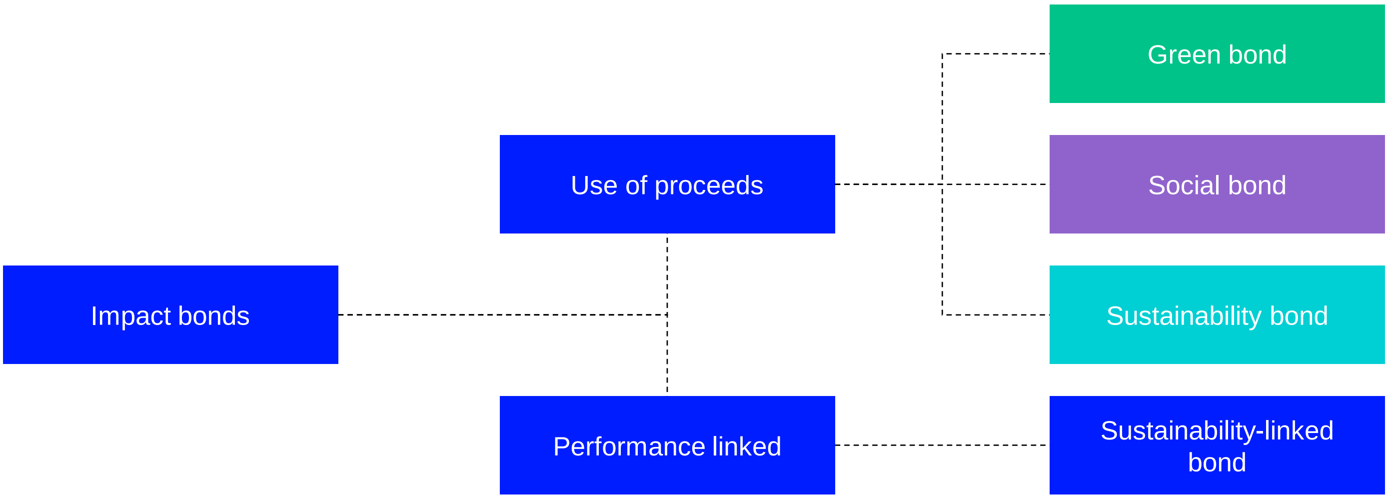
Impact Bond

Impact bonds differ from conventional bonds in that they aim for not just contractual financial returns, but also positive climate, environmental or social outcomes.

The impact bond universe can be grouped into 'use-of-proceeds' and 'performance-linked' types of bonds:

– Green bonds, social bonds and sustainability bonds (GSSBs) are normally categorised as 'use-of-proceeds' impact bonds, as their proceeds are usually earmarked and dedicated to specific green and/or social projects.
– 'Performance-linked' bonds normally raise funds for general corporate purposes (as opposed to earmarked projects), and their coupon payments are linked to one or multiple predetermined sustainability performance target(s)

Classification of the impact bonds universe:



For more information, please see FTSE Research paper navigating_social_and_sustainability_bonds.pdf (ftserussell.com)

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Net Zero Pathway for Indices

There are a variety of approaches to assess this. For example, specific FTSE Russell climate indices include an annual decarbonisation (carbon emissions reduction) target to reach 'net zero' over a specific number of years.

For an example, please see FTSE_EU_Climate_Benchmarks_Index_Series_Ground_Rules.pdf (ftserussell.com)

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Paris Agreement

The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at COP21 in Paris in 2015, and entered into force in 2016. Its goal is to limit global warming to well below 2 (and preferably to 1.5) degrees Celsius, compared to pre-industrial levels.

For more information, please see The Paris Agreement | UNFCCC

Product Involvement Exclusions

Specific business activities that cause a company to be excluded from an ESG index as set out in the ground rules e.g. thermal coal production or tobacco retail.

For more information, please see the relevant ESG index ground rules and the Guide_to_the_Construction_and_Maintenance_of_FTSE_Exclusion_Lists.pdf (ftserussell.com)

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Sustainable Development Goal (SDG)

The 17 United Nations (UN) Sustainable Development Goals (SDGs). This is a key part of the 2030 Agenda for Sustainable Development which was adopted by an UN Member States in 2015.

For more information, please see THE 17 GOALS | Sustainable Development (un.org)

Social Bonds

This describes any type of bond instrument for which the net proceeds are exclusively used to finance or re-finance projects and/or assets that can deliver positive social impacts.

For more information, please see FTSE Research paper navigating_social_and_sustainability_bonds.pdf (ftserussell.com)

Social Impact Bonds (SIBs)

This refers to a type of government public services purchase contract, rather than a bond per se. We do not consider SIBs to fall under the ESG fixed income umbrella and they should be considered as separate from ‘social bonds’.

ESG Index

FTSE Russell has two core frameworks to mirror our clients’ objectives and convictions.

Firstly, looking at an investor’s objectives towards incorporating the risks and opportunities of climate change, we align our indices with three climate investment strategies:

1. Accelerating the green economy
2. Transitioning to a low-carbon economy
3. Aligning with external commitments brought on by climate regulations and policies that are constantly shaping standards

Secondly, again with the investor’s broader view of environmental, social and governance (ESG) issues in mind, we align our indices with three clear ESG investment strategies:

1. Selective investments including positive and negative screening
2. Integrating ESG into investment strategy with the aim of maintaining financial performance
3. Aligning with regulatory objectives with broader ESG considerations, such as the EU’s SFDR and the UN’s SDGs

ESG Data

ESG data is defined as any data that has the clear objective to measure environmental, social or governance characteristics of financial securities and issuers. ESG data may be provided by FTSE Russell or by a third-party.

For more information, please see the Guide_to_FTSE_and_Third_Party_ESG_Data_used_in_FTSE_Russell_Indices.pdf

ESG Metrics

To encourage greater transparency and comparability across its ESG benchmarks, FTSE Russell publishes metrics to align with the requirements in the EU Benchmark Regulation and UK Benchmark Regulation at SI Metrics | FTSE Russell.

We have prepared a Metric Methodology and Calculation Guide to provide further information on how the metrics are constructed.

The methodologies and benchmark statements for the benchmarks are publicly available on the FTSE Russell website.

Sustainability Bonds

These are defined as any type of bond instrument where the net proceeds are exclusively used to finance or re-finance a combination of green and social projects.

For more information, please see FTSE Research paper navigating_social_and_sustainability_bonds.pdf (ftserussell.com)

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Transition Pathway Initiative (TPI)

The Transition Pathway Initiative was developed as an asset owner-led initiative, with partnership support from FTSE Russell and the Grantham Research Institute at the London School of Economics, to assess the quality of companies' management of climate change-related risks and opportunities, and their carbon performance.

TPI has developed methodologies for Management Quality (MQ) and Carbon Performance (CP) scores. For more details, please see the Guide_to_FTSE_and_Third_Party_ESG_Data_used_in_FTSE_Russell_Indices.pdf and Methodology – Transition Pathway Initiative.

Further information

To learn more, visit www.lseg.com/en/ftse-russell/; email info@ftserussell.com; or call your regional Client Service team office:

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