

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.

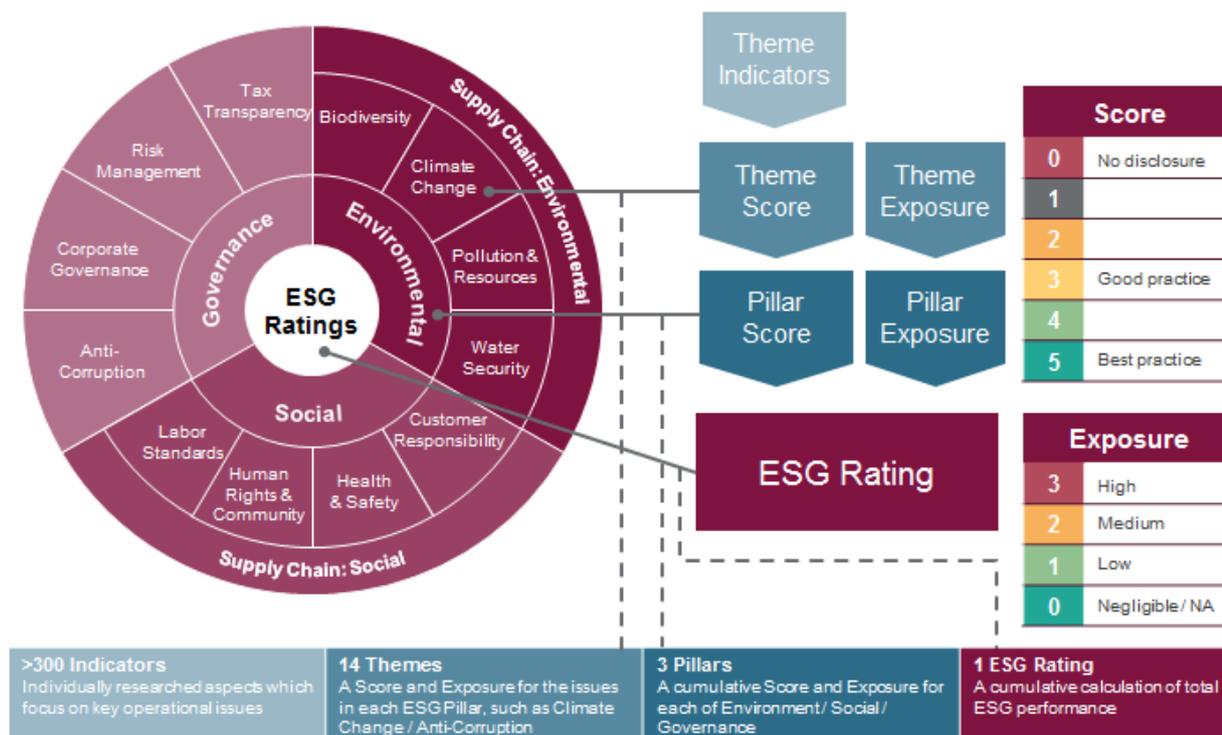
As signatories to the Japanese Stewardship Code, investors needed a tool to showcase the ESG performance by the Japanese corporate issuers, as well as to track the impact of engagement activities conducted by the market participants.

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

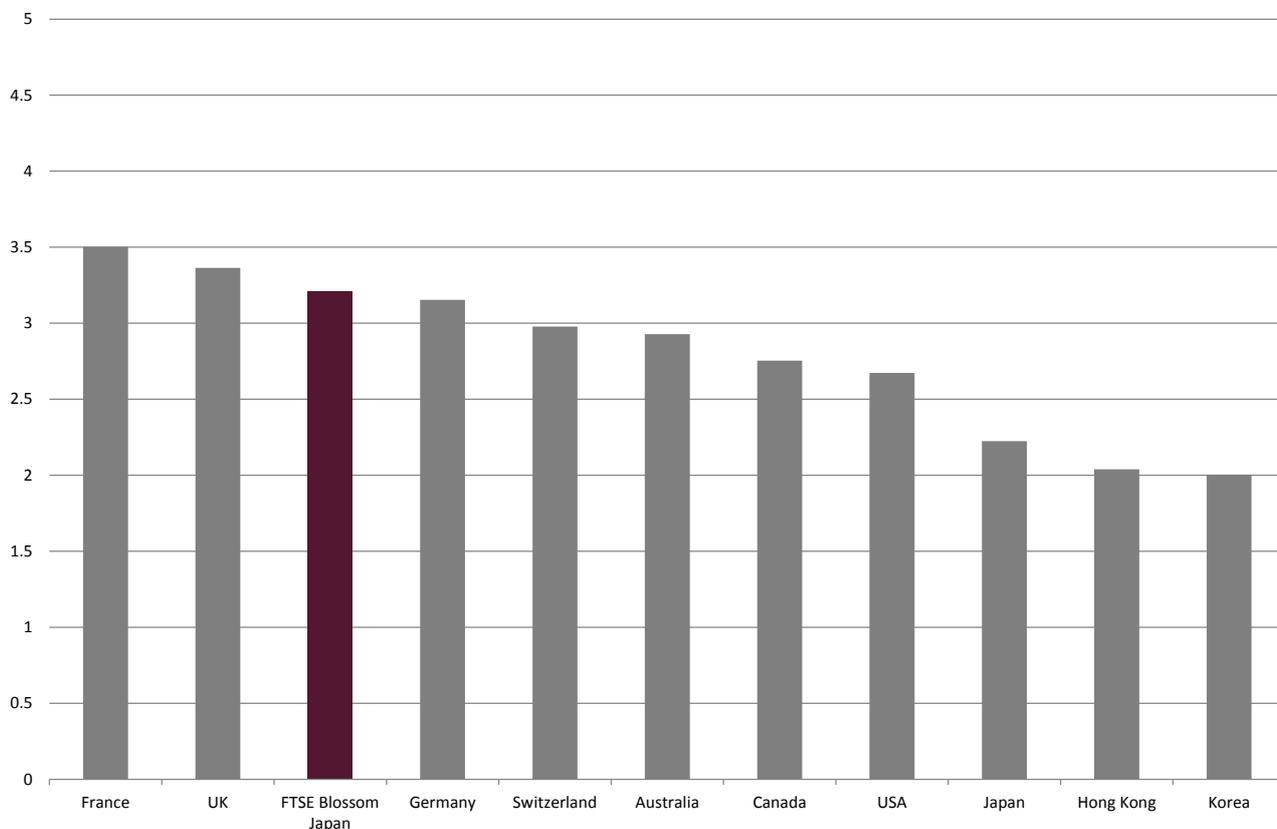
Since the launch of the index, two Exchange Traded Funds have been introduced to the Japanese institutional and retail market:

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 Takahasi, 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.

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