

# Investing sustainably with a custom credit index

CLIENT STORY

February 2022

“Our investments and investment policies should align with the norms and values of our beneficiaries, as well as reflecting their preferences. It should also reflect our role as asset owner and a good steward of assets.”

“The other main driver is our belief that responsible investment contributes to long-term value creation. We believe by taking ESG-factors into account, we can contribute to better investment results.”

– PENSIOENFONDS DETAILHANDEL, RESPONSIBLE INVESTMENT POLICY STATEMENT, SEPTEMBER 2021

## Pensioenfond Detailhandel

### ABOUT THE CLIENT

#### Profile

The client, Pensioenfond Detailhandel, wished to tilt its credit portfolio's investment policy towards the United Nations' Sustainable Development Goals (SDGs).

#### Objectives

To align the credit portfolio with four SDGs: decent work and economic growth; responsible consumption and production; climate action; peace, justice and strong institutions.

#### Solution

The FTSE EuroBIG ex-Sovereigns SDG benchmark is a custom index of corporate, sub-sovereign and covered bonds, designed to integrate the desired SDGs.

## Extending sustainable investment to credit: an innovative approach to fixed income indices

Pensioenfond Detailhandel is one of the Netherlands' largest pension funds and a signatory to the Principles for Responsible Investment (PRI). In 2019, Detailhandel chose an innovative equity benchmark, the FTSE Custom Developed ex Korea SDG Aligned index, to help align its developed equity portfolio with four of the United Nations' (UN) Sustainable Development Goals (SDGs). In 2020, Detailhandel extended this approach by investing in a new fund tracking a new FTSE Russell emerging market equity SDG index.

In 2021, Detailhandel went a step further by deciding to align its fixed income assets, starting with the credit portfolio, with the same four SDGs. Detailhandel engaged FTSE Russell (as its benchmark provider) to develop a way to implement the policy within the pension fund's overall investment strategy.

With the three launches Detailhandel has now aligned almost 50% of its €32bn investment portfolio to the three SDG funds tracking FTSE Russell indexes (correct as of Dec 2021).

### A custom credit index

Launched in 2021, the FTSE EuroBIG ex-Sovereigns SDG benchmark is a custom index of corporate, sub-sovereign and covered bonds, designed to integrate the desired SDGs.

## Embedding SDGs in a credit index

In 2015, the UN's General Assembly set 17 global goals, designed to be a "blueprint to achieve a better and more sustainable future for all," that are intended to be achieved by 2030. Detailhandel identified the following four SDGs as particularly relevant to its sustainable investment policy:

- **SDG 8 – Decent work and economic growth**
- **SDG 12 – Responsible consumption and production**
- **SDG 13 – Climate action**
- **SDG 16 – Peace, justice and strong institutions**

Embedding the SDGs in a credit index required a new design approach from FTSE Russell, when compared to the SDG-aligned FTSE equity benchmark used by Detailhandel in 2019.

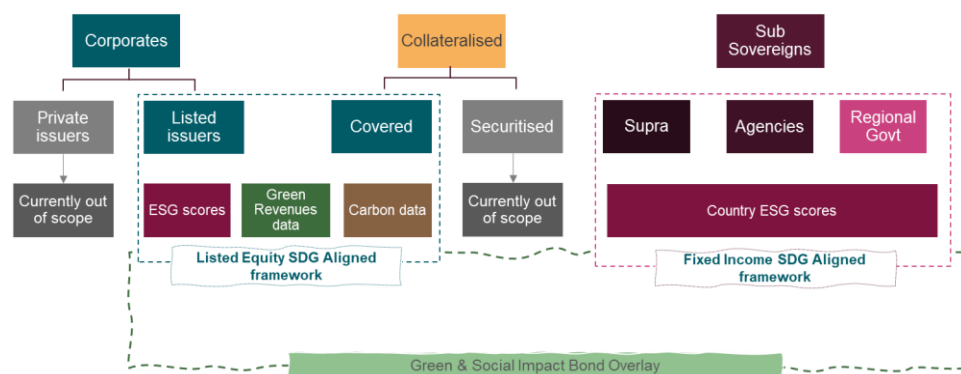
This is because the underlying credit benchmark—the FTSE EuroBIG ex-Sovereigns index—consisted of **corporate**, **sub-sovereign** and **collateralised** bonds, not all of which could be categorised using the existing SDG alignment framework (that used for equities).

## Rewarding sustainable bond issuance

The FTSE EuroBIG excluding Sovereigns SDG benchmark is a custom index of corporate, sub-sovereign and collateralised bonds, designed to integrate the desired SDGs.

The design of the index enabled Detailhandel to translate its responsible investment priorities into a passive (index-tracking) bond portfolio. The index design also incentivises the ownership of bonds issued by entities whose activities are aligned with the SDGs.

## Index design overview



### The key elements of the index design are as follows:

- **Listed corporate bond issuers (c. 50% of benchmark)** – the index follows the existing SDG-aligned equity approach (using FTSE Russell's sustainable investment data inputs, covering ESG scores, green revenues and carbon), tilting constituent weights towards desired issuers and excluding certain categories of bond (e.g., those issued by arms suppliers)
- **Sub-sovereign bond issuers (c. 28% of benchmark)** – the index uses a customised country-level scoring system, based on the alignment of a group of indicators with each of the desired SDGs (for agency and supranational bonds, GDP-weighted scores are used), then tilts towards the desired constituents
- **Collateralised bond issuers (c.17% of benchmark)** – these were determined to be out of scope for the index design.
- **Private corporate bonds and securitised debt (c.5% of benchmark)** – these are also out of scope for the index design
- **Green impact bond overlay** – an additional SDG-aligned overlay rewards the issuers of green bonds by means of an additional tilt factor (with the option to add further social/sustainability-linked tilts)

The new SDG credit index achieves a substantial improvement in sustainability: a November 2020 simulation of the index's methodology showed a 62% reduction in CO<sub>2</sub> emissions, a 69% reduction in carbon intensity and a 64% reduction in carbon reserves for the index's corporate bonds, compared with the reference benchmark (the FTSE EuroBIG ex-Sovereigns index). It also doubled the starting index's green bond exposure.

## Broadening sustainable investment goals

In 2021, Pensioenfonds Detailhandel decided to extend its sustainable investment policy to the fund's credit portfolio, building on its past success in embedding UN SDGs into a passively managed equity portfolio. Through a custom index solution, the fund was able to target several objectives simultaneously:

- **Align credit investment policy with four selected SDGs**
- **Help advance the SDGs through its efforts**
- **Create longer-term value for fund beneficiaries**

### Additional information

For more information on the FTSE ESG index series, [click here](#)

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