



Evolution of the Methodology for the FTSE Climate Risk-Adjusted Government Bond Indices

30 July 2024

In April 2024, FTSE Russell launched a [market consultation](#) to gather views from market participants on the evolution of the methodology for the FTSE Climate-Risk Adjusted Government Bond Indices with respect to the underlying sustainable finance metrics that are used in the index construction. After considering the feedback received as part of the consultation, which was supportive of the proposed approach, FTSE Russell are pleased to announce several changes to the index methodology, which are detailed in the remainder of this announcement. The changes ensure that the indices continue to meet their stated objectives and incorporate the most appropriate, transparent, and stable Key Performance Indicators (KPIs), including more forward-looking and fewer lagged metrics.

The annual country score updates for all FTSE Climate-Risk Adjusted Government Bond Indices will be applied at September 2024 month-end and effective with October 2024 index profiles.

Methodology Changes for the FTSE Climate Risk-Adjusted Government Bond Indices

The FTSE Climate Risk-Adjusted Government Bond Index Series is designed to measure the performance of fixed-rate, local currency government bonds that are eligible for flagship FTSE indices, such as the FTSE World Government Bond Index (WGBI), incorporating a tilting methodology that adjusts index weights according to each countries' relative climate risk performance. Individual country scores are assigned across three core pillars (physical risk, transition risk and resilience), each having several underlying indicators.

Since the launch of these indices several years ago, the fixed income sustainable finance market has continued to mature, requiring a more holistic approach to climate-risk assessment that appropriately captures both the extent to which a sovereign is exposed today and in the future. The methodology changes simplify the assessment, while also rebalancing and rationalizing the domestic resilience assessment, for example, by addressing part of the income bias of resilience scores. The changes also include a re-evaluation of the ecological assessment framework in response to the growing developments in nature and biodiversity regulatory frameworks, and availability of third-party data sets. On the quantitative methodology, a smoothing function has been integrated to reduce the volatility of the assessment output over time.

Changes to the Physical Risk and Transition Risk Assessments

Several enhancements to the physical risk and transition risk assessments are designed to result in a more data-driven and market-oriented approach. Instead of using proxies for the physical risk analysis, the new index methodology incorporates scientifically recognized climate datasets to construct backward and forward-looking indicators. These consider the main seven climate hazards, account for countries' economic activity structure and take scenarios into account. The updated methodology also shifts the focus from emission reduction to the alignment to the Paris Agreement as part of the transition risk assessment, by considering countries' carbon footprint today and accounting for their commitments to the climate transition, by using their Nationally Determined Contributions (NDCs).

Changes to the Resilience Assessment

As part of the changes, the resilience pillar has been streamlined and narrowed down. The previous institutional, social, economic and ecological sub-pillars have been replaced with the domestic, and territorial and ecosystems resilience sub-pillars.

The enhanced domestic resilience pillar focuses on the reduction of the income bias and allows for additional transparency and efficiency in its assessment. The income bias is reduced by removing indicators that are directly linked to the level of a country's development and do not provide complementary information on key dimensions of a country's resilience. The new methodology prioritises indicators that reflect a country's governance, social and business resilience.

The new territorial and ecosystems resilience pillar includes risk-related natural capital metrics that assess metrics such as ecosystem integrity, ocean health and forest cover. An additional third-party data set has also been incorporated.

Upcoming 2024 Country Score Update for the FTSE Climate-Risk Adjusted Government Bond Indices

According to published index methodology, the country climate scores used within the FTSE Climate Risk-Adjusted Government Bond Index Series are updated on an annual basis. Since the launch of the indices, these updates have been applied at each May month-end rebalance, and effective for June index profiles. As previously announced, the 2024 update will be applied following the implementation of the model changes considered as part of the consultation. They will be applied for all FTSE Climate-Risk Adjusted Government Bond Indices at September 2024 month-end, and effective for October 2024 index profiles.¹ Going forward, the country score updates will also be applied at each September month-end.

The indices will continue to reflect the monthly rebalancing mechanics of the standard FTSE government bond indices with respect to security-level index membership.

Updated Ground Rules for the following indices will be made available on the FTSE Russell website:

- FTSE Climate Risk-Adjusted Government Bond Index Series
- FTSE Advanced Climate Risk-Adjusted Government Bond Index Series
- FTSE Climate Risk-Adjusted World Inflation-Linked Securities Index Series
- FTSE Climate Carry and Roll Down Government Bond Index Series
- FTSE Nomura Climate Risk-Adjusted Carry and Roll Down World Government Bond Index
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A standalone methodology document that details the enhanced FTSE Climate Risk Assessment Model will also be made available on the FTSE Russell website to supplement these index Ground Rules.

FTSE Russell thanks index stakeholders who have responded to its consultation and welcomes further feedback and engagement with the market on its climate risk-adjusted government bond indices.

Please contact us at fi.index@lseg.com with any comments or questions

FTSE Russell

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¹ The index consultation had initially proposed implementation of the changes for October 2024 month-end, effective with November 2024 index profiles.

