

# FTSE4Good Climate Change Criteria

## 1. Introduction

The impact of climate change is likely to have a highly significant and increasing influence on the global environment, society and on the economic value of companies. As a result, investors, governments and wider society expect companies to take responsibility for identifying and reducing their climate change impacts. Consequently there will also be opportunities for companies to capitalise on related business opportunities.

To reflect this growing importance, eligibility for inclusion in the FTSE4Good Series will be expanded to include climate change.

Criteria for the FTSE4Good Series are normally based on established international standards. However, no single comprehensive standard has yet been established for the management of greenhouse gas (GHG) reduction. Therefore as well as considering existing standards, FTSE Group has received the kind assistance of and guidance from: The Climate Group; The Institutional Investors Group on Climate Change (IIGCC); The Carbon Trust; Forum for the Future and the World Wildlife Fund (WWF). In addition, broad consultation over an 18 month period involved input from many stakeholders, including corporations, fund managers, government representatives, non-governmental organisations, business associations and private investors.

These criteria are not yet set at a level compatible with the substantial emissions reductions expected to be necessary to stabilise atmospheric GHG concentrations at a sustainable level. Instead, this reflects what is currently possible for leading companies within the current regulatory and business environment. In future, as governments' policies, international frameworks, and corporate responses mature, the criteria will become more congruent with the demands of long-term sustainability (see 'Future Criteria' Section).

### Key Principles and Challenges of the Climate Change Criteria

**Policy:** As well as establishing a company's commitment to addressing climate change impacts, these criteria aim to encourage companies to support and contribute to scientific understanding and consensus on climate change; and to participate in strengthening public policy frameworks to address climate risk and reduce GHG emissions.

**Management:** These criteria recognise that one element of an effective management system is the use of targets so this is therefore a requirement for high impact companies. Criteria for medium impact companies will be initially focused on disclosure rather than management.

**Disclosure:** The disclosure criteria recognise it is essential that companies disclose reliable, consistent and comparable data on GHG emissions. This is important to provide a basis for effective management of emissions and for evaluation of the company by stakeholders. However, while it is important that companies use a robust and standardised methodology for compiling GHG data, FTSE may allow some flexibility in the early stages of criteria implementation, reflecting that no single methodology is yet accepted as the single global standard.

**Performance:** FTSE recognises that the key performance measure for assessing companies' action in response to climate change is their level of absolute GHG emissions (adjusted for changes in company structure) which should decline over time. However, at present it is difficult to measure and compare such reductions in an objective manner. As the understanding of how to fairly and accurately measure corporate performance improves, FTSE intends to further develop these performance requirements and also introduce criteria for medium impact companies.

**Scope:** Some activities are more within the control of companies than others. Companies have the greatest responsibility to reduce their impact on climate change for the activities most under their control. These criteria therefore apply to companies' operational GHG emissions and their product GHG emissions. Upstream emissions (the consequence of suppliers' activities and the extraction or production of raw materials) are not included at this stage. This is partly because these are often less within a company's control, but mainly because at present there are insufficient common frameworks to measure and address these emissions.

### Which Companies Need to Meet these Criteria?

All companies have some level of associated GHG emissions. However, these FTSE4Good criteria will initially prioritise companies in those industry subsectors (using the ICB classification<sup>1</sup>) with the highest levels of associated emissions, and thus the greatest need to address this issue. Therefore subsectors have been classified into high or medium operational impact according to the approximate magnitude of their operational GHG emissions.

Within the medium impact subsectors, some may be considered to have higher operational climate impacts than the others and will therefore be reviewed at a later date to be considered for re-categorisation as high impact. In addition, a number of high and medium operational impact subsectors have been identified as having a particularly high product-related impact, and these subsectors will be required to meet specific additional criteria to address their product impacts.

<sup>1</sup> ICB: FTSE and Dow Jones Industry Classification Benchmark; <http://www.icbenchmark.com/>

# FTSE4Good Climate Change Criteria

## 2. The High and Medium Impact Subsectors

The table below outlines the high and medium impact subsectors for operational emissions. Subsectors that have a high product impact will be required to meet additional product impact criteria (flagged below †).

		Impact Categories	
		High Operational Impact	Medium Operational Impact
Additional High Product Impact		<ul style="list-style-type: none"> <li>• Exploration &amp; Production †</li> <li>• Integrated Oil &amp; Gas †</li> <li>• Coal †</li> </ul>	<ul style="list-style-type: none"> <li>• Aerospace †</li> <li>• Automobiles †</li> </ul>
	Subsectors (from ICB)	<ul style="list-style-type: none"> <li>• Diamonds &amp; Gemstones</li> <li>• General Mining</li> <li>• Gold Mining</li> <li>• Platinum &amp; Precious Metals</li> <li>• Commodity Chemicals</li> <li>• Aluminium</li> </ul>	<ul style="list-style-type: none"> <li>• Nonferrous Metals</li> <li>• Steel</li> <li>• Building Materials &amp; Fixtures</li> <li>• Airlines</li> <li>• Electricity</li> <li>• Delivery Services</li> </ul>
		<ul style="list-style-type: none"> <li>• Speciality Chemicals*</li> <li>• Paper*</li> <li>• Heavy Construction*</li> <li>• Defence</li> <li>• Commercial Vehicles &amp; Trucks</li> <li>• Trucking</li> <li>• Waste &amp; Disposal Services</li> <li>• Tires</li> <li>• Brewers*</li> </ul>	<ul style="list-style-type: none"> <li>• Distillers &amp; Vintners*</li> <li>• Soft Drinks*</li> <li>• Farming &amp; Fishing*</li> <li>• Food Products*</li> <li>• Home Construction</li> <li>• Pharmaceuticals</li> <li>• Travel &amp; Tourism</li> <li>• Multiutilities</li> <li>• Water</li> </ul>
		<p>* Subsectors to be reviewed at a later date for consideration or re-categorisation to high impact.</p>	

**Business Related Activities:** In certain cases a company may be classified in a subsector that is not on the above lists, but will be involved in a diverse range of business activities, some of which are associated with high or medium climate change impacts. Therefore companies will be assessed by EIRIS for business activities that are related to the subsectors identified above, to identify additional companies that should be categorised as high or medium operational impact, and those with additional high product impacts.

# FTSE4Good Climate Change Criteria

## 3. The Criteria Requirements for Companies

	High Operational Impact	Medium Operational Impact	Additional High Product Impact †
Policy & Governance	<ul style="list-style-type: none"> <li>Board level or senior executive responsibility for climate change related issues (individual or committee).</li> <li>Public statement/policy identifying climate change as relevant to business activities and the need to address climate change as a key concern*.</li> </ul>	<ul style="list-style-type: none"> <li>Board level or senior executive responsibility for climate change related issues (individual or committee).</li> <li>Public statement/ policy identifying climate change or energy consumption as relevant to business activities and the need to address climate change as a key concern*.</li> </ul>	<ul style="list-style-type: none"> <li>Responsibility: No additional requirement.</li> <li>Public statement/ policy should also include a commitment to reduce product related emissions or climate change impact.</li> </ul>
Management & Strategy	<p>At least <i>one</i> of the following must be met (unless the company meets the performance requirements):</p> <ul style="list-style-type: none"> <li>Long-term strategic goal of significant quantified reductions of operational GHG emissions or carbon intensity improvement over more than five years, which should be publicly available.</li> <li>Short/medium-term management targets for quantified GHG operational emissions reduction over less than five years.</li> </ul>	No requirements yet: Criteria for medium impact companies are initially focused on disclosure rather than management.	No requirements yet: For companies with product-related emissions reduction targets are currently regarded as impractical so commitment is established separately in policy.
Disclosure	<p>Public disclosure of <i>both</i> the following:</p> <ul style="list-style-type: none"> <li>Total operational CO<sub>2</sub> or GHG emissions as tonnes of CO<sub>2</sub> equivalent.</li> <li>Sector metric where established as an industry norm. For example, for cement companies, kg CO<sub>2</sub> per tonne of cement; or efficiency ratio.</li> </ul>	<p>Public disclosure of <i>one</i> of the following:</p> <ul style="list-style-type: none"> <li>Total operational CO<sub>2</sub> or GHG emissions as tonnes of CO<sub>2</sub> equivalent or operational energy consumption.</li> <li>Sector metric where established as an industry norm. e.g. kgCO<sub>2</sub>/t cement; or efficiency ratio.</li> </ul>	<p>Public disclosure of product related emissions/ efficiency. This will vary for different sectors:</p> <ul style="list-style-type: none"> <li>Oil &amp; Gas: end user emissions.</li> <li>Coal mining: end user emissions.</li> <li>Automobiles: fuel efficiency.</li> <li>Aerospace: fuel efficiency.</li> </ul>
Performance	<p>At least <i>one</i> of the following must be met:</p> <ul style="list-style-type: none"> <li>At least a 5% reduction in carbon intensity over the last two years.</li> <li>The company is able to demonstrate that for the previous two years it is in the top quartile of companies in its subsector when assessed on accepted carbon efficiency metrics.</li> <li>A Transformational Initiative<sup>2</sup> or a combination, providing they are quantified and significant.</li> </ul>	No requirements yet: As the understanding of how to measure performance increases, performance requirements to be introduced for medium impact companies.	<p>Automobile and Aerospace companies must meet <i>one</i> of the following:</p> <ul style="list-style-type: none"> <li>Emissions Reductions: Fuel efficiency improvements above average for subsector.</li> <li>Eco-efficiency Metrics: Above average fuel efficiency relative to subsector peers.</li> <li>A Transformational Initiative<sup>2</sup> to reduce product emissions.</li> </ul> <p><i>NB: Oil &amp; Gas and Mining: no further "product" requirement at this time, but still need to meet performance criteria for their operational impact.</i></p>

\* These criteria recognise that companies have a valid and important role to play in the development of effective and appropriate regulation, and companies are encouraged to play a constructive part in the public policy process. However, the assessment of a company against these FTSE4Good criteria may take into account any credible evidence that a company has deliberately and consistently misrepresented the scientific consensus on climate change (as represented by the IPCC reports), or attempted to undermine public policy frameworks that aim to reduce greenhouse gas emissions (including, but not limited to, those regarding mandatory emission reductions).

## 4. Implementation Timetable

	1st Jan 2008	1st July 2008	1st Jan 2009	1st July 2009
High and medium impact companies that are <b>currently</b> FTSE4Good constituents must meet the criteria to remain in the index, according to the timetable of phased deadlines below. Those companies currently not in the index will need to meet these criteria in full in order to gain inclusion to the series.				
Policy & Governance <i>or</i> Disclosure		M		
Policy & Governance <i>and</i> Disclosure	H		M	
Management & Strategy <i>or</i> Performance		H		
Performance			H	
Product				H

<sup>2</sup> A transformational Initiative is a strategic initiative that makes a significant contribution to the reduction of GHG emissions. FTSE will consult a panel of climate change experts and industry sector data will be assessed to identify significance levels. Example categories include buying 'low carbon electricity' and fuel switching; demand side management; research, development and production of low carbon technologies; generation of renewable energy; product/service innovation; carbon capture and storage; supply chain/upstream emissions reductions; new business models; breakthrough project.

# Future Criteria

## Future Criteria Requirements (to be confirmed by FTSE4Good Committee)

In order to stabilise GHG emissions at a sustainable level, more demanding criteria will be required in the future. However at present our data indicates that a very substantial number of companies will have difficulty in meeting the current criteria set out above.

Therefore these criteria are considered a first step to assessing good practice on this issue. The FTSE4Good Policy Committee will monitor the progress companies achieve when implementing these criteria and aims to introduce the following indicators of best practice in due course:

### Policy and Governance

- **Policy context:** Rationale behind the policy should include reference to: national/international targets; regulations; current scientific consensus on climate change; and the economic impacts of climate change.
- **Public Policy Leadership:** Active advocacy of public policy initiatives, including binding national and international targets, to reduce GHG emissions over the appropriate time frame in order to achieve an acceptable atmospheric CO<sub>2</sub> concentration.

### Management and Strategy

- **Goals and targets:** All companies to have a long-term GHG emissions reduction goal.

### Disclosure

- **Comparability/Scope:** Clear explanation on GHG data calculations; methodology and coverage.
- **Verification/Assurance** of the GHG data.
- **Upstream impacts (suppliers):** Disclosure requirements for upstream impacts to be considered.

### Performance

- **Performance requirements for High** Operational Impact companies to be enhanced.
- **Performance requirements for Medium** Operational Impact companies to be introduced.
- **Further product performance requirements** for Oil & Gas and Mining sectors to be considered.

## Industry Sectors (to be confirmed by FTSE4Good Committee)

The FTSE4Good Committee will review extending the criteria to cover more subsectors, following implementation of the initial criteria. The following subsectors were identified in the public market consultation, held in the summer of 2006, as most likely:

- **Computer Hardware and Consumer Electronics** have also been identified as having significant product emissions. It is therefore proposed that since these two subsectors have a lower product impact than those subsectors already identified in the criteria, an appropriate sub-set of the criteria will be developed and extended to these subsectors.
- **House Builders and Commercial Premises Developers** have also been identified for their product impact.
- **All Medium Impact sectors** already identified (with '\*' in previous table on subsector categorisation) will be reviewed for possible consideration of re-categorisation to high impact.