

The FTSE CDP Carbon Strategy Index Series aims to support investors in incorporating climate change risks into their investment strategy. It features future-oriented criteria to assess the exposure of individual companies to higher future costs associated with greenhouse gas emissions.

INDEX PARTNERS

Carbon Disclosure Project (CDP)

CDP holds the largest database of corporate climate change information in the world. It represents some 534 institutional investors, with combined assets under management in excess of US \$64 trillion. CDP supplies the core data for the indices.

CARBON DISCLOSURE PROJECT

ENDS Carbon

ENDS Carbon is a carbon benchmarking and performance ratings specialist. It is a sister company of the ENDS Report, the leading technical environmental regulation publication. ENDS Carbon is responsible for company analysis and scoring for the indices.



INDEX CONSTRUCTION

The FTSE CDP Carbon Strategy indices are sector neutral, carbon-risk-tilted versions of FTSE's established benchmark indices. The constituent companies remain the same but the weights of the companies are varied on the basis of their exposure to carbon risk, relative to their sector peers. The overall weights of each sector are the same as for their benchmark indices, but some companies in each sector are over-weighted, while others are under-weighted.

Investment Hypotheses: Material Risk and Carbon Efficiency

The index series is founded on two hypotheses. Material Risk Hypothesis suggests that climate change and climate change regulation is expected to have a material impact on the corporate earnings of companies in certain key industry sectors over the medium and long term. The Carbon Efficiency Hypothesis suggests that carbon efficiency is valuable for all companies as it can reduce operating costs, help drive lean business, encourage product innovation and strengthen supplier relationships.

Assessment Models: Carbon Risk and Carbon Scorecard

Companies in the index series are then assessed using two kinds of framework – a series of sector-specific 'Carbon Risk Models' and a 'Carbon Scorecard'. For the UK indices, the companies with the most material medium-term financial risks and opportunities associated with GHG emissions fall into the following ICB sectors: Oil & Gas Producers, Electricity Utilities, Mining, and Airlines, and are assessed using both assessment frameworks above. Companies in other sectors are assessed using the Carbon Scorecard Model only.

Company Scores and Weight tilting

Companies are scored on a range from +2.5 to -2.5 on both models. A weighted average is applied for companies in material risk sectors, with most of the weight placed on Carbon Risk Model scores. The extent of reweighting is related closely to the two investment hypotheses that underpin the index series with the tilts for companies in the material risk sectors being ten times those for low risk sectors. The Material Risk Hypothesis is a strong hypothesis and justifies a more significant tilting factor (+/- 25% of market capitalisation). The Carbon Efficiency Hypothesis is weaker, and as a result the tilt factor is reduced to +/- 2.5% of market capitalisation.

INDEX FEATURES

Carbon risks:

There is an expectation that carbon risks will have material impact on corporate earnings in certain industry sectors over the next decade and beyond.

Future-oriented:

In assessing how well positioned a company is the index series places emphasis on future risks, trends and strategy, not simply on current emissions performance.

Transparent models:

The index series aims to use the simplest credible models and when modelling risk, the indices will be transparent about assessment methods and sources of forecasts.

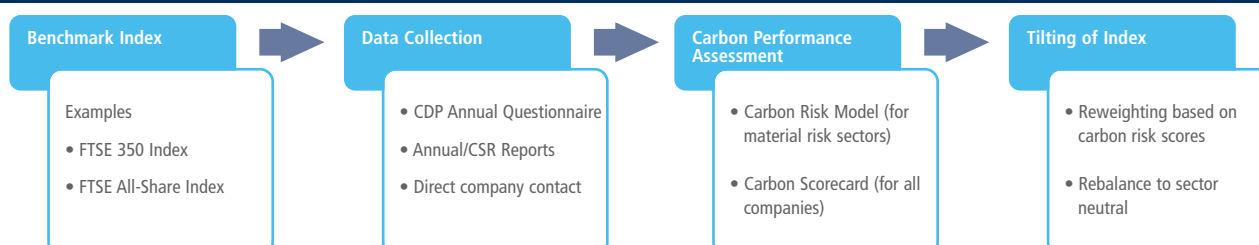
Material risk focus:

Carbon risks are much more material in some sectors than others. Companies in the most exposed sectors will see their weights varied to the greatest extent, those in lower risk sectors will have small adjustments.

Tracking error and performance:

The index series aims to closely track performance of established underlying FTSE benchmark indices. It is designed with an aim that it should only diverge as carbon risks become increasingly incorporated into share prices.

INDEX ASSESSMENT AND TILTING PROCESS



Carbon Risk Models

Companies in the sectors most financially exposed to climate change regulation are assessed on the basis of a series of carbon risk models. These models attempt to reflect in a simple and transparent manner, the relative risk exposure of companies. There are two different kinds of model, reflecting two broad categories of risk.

COST OF CARBON MODELS

Aim: To assess the relative financial exposure to carbon market mechanisms and regulations

Key factors: These are emissions growth, geographic location, efficiency improvements, free permit allocations, and cost pass through.

Applied in the UK to the following ICB Sectors and Subsectors for – Electricity Utilities, Mining, and Airlines. Other sectors may be included in other markets.

RESERVES INTENSITY MODELS

Aim: To assess the relative carbon intensity of resource companies' mineral reserves, to identify the extent of exposure to reduced demand for carbon intensive commodities

Key factors: Reserve type, reserve location, revenue exposure

Applied to the following ICB Sectors and Subsectors in the UK – Oil and Gas, Mining (coal). Other sectors may be included in other markets.

CARBON SCORECARD

In addition to the Carbon Risk Models which are used for companies in the sectors most at risk from climate change, all companies are assessed using a Carbon Scorecard.

The Scorecard is designed to reflect best practice carbon management approaches used by companies as well as those represented by standards such as the UK Carbon Trust Standard, the GHG Protocol, the FTSE4Good Climate Change Criteria, the Caring for Climate Principles and the Carbon Disclosure Leadership Index.

Effective carbon management is assessed for the index using a Scorecard approach. The Carbon Scorecard assessment comprises three broad elements: carbon management quality, carbon efficiency performance, and disclosure quality, and these are organised into six activities. The main elements of the scorecard are listed (right). For companies with carbon intensive products or supply chains, special weight is given to their activity in these areas.

As support for CDP indicates, many investors wish to engage with companies on climate change. The Scorecard provides a useful starting point.

For further details on the assessment methodology or suggestions about improvements, please contact index@endscarbon.com
For details on the Index Series, please visit www.ftse.com/carbon

CARBON SCORECARD ELEMENTS

Policy and targets

- Explicit, board-endorsed, commitments to reduce carbon emissions. Strong, quantified emissions reduction targets covering all emissions, over appropriate time periods.

Emissions measurement

- Quantifying direct and indirect carbon emissions, using accepted standards such as the Greenhouse Gas Protocol. Measuring cost savings, carbon intensity, and forecasting future emissions.

Assessing performance

- Benchmarking carbon performance of business units and against competitors. Assessing carbon risks and return on investment of abatement opportunities. External performance accreditation.

Decision-making

- Senior level accountability for carbon management and incentives for carbon efficiency. Capital expenditure budgets for energy efficiency. Integrating carbon efficiency into product design and procurement decision-making.

Emissions performance

- Emissions intensity reductions over time, both short and long-term. Demonstrating low carbon intensity relative to the sector.

Emissions disclosure

- Full public disclosure of carbon emissions, verified to a high standard and segmented informatively (e.g. by scope, region). Emissions history over time, restated to take account of material changes.

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