CONSULTATION

# Index Guidance to Support Real-Economy Decarbonization

**Executive Summary**

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**GFANZ**
Glasgow Financial Alliance for Net Zero

## Overview

The Glasgow Financial Alliance for Net Zero (GFANZ) consultation paper on "Index Guidance to Support Real-Economy Decarbonization" outlines voluntary guidelines for the development and adoption of "transition-informed" indices, which can support real-economy decarbonization and global net-zero targets. It highlights three main types of indices—"transition-potential", "transition-engaged", and "net-zero"—that can drive investment in companies at different stages of their climate transition. Index participants—such as asset managers and stock exchanges—can play a key role in integrating climate transition considerations into their indices and engaging with companies on net-zero transition.

**GFANZ has launched a public consultation on this proposed voluntary guidance for "transition-informed" index construction.** The consultation paper and feedback received will inform the final paper to be released in Q1 2025. Feedback from all stakeholders will be considered. To provide feedback, please respond to the survey available here. The survey will be open from 9 October 2024 to 9 January 2025.

## Context and rationale

Achieving net-zero greenhouse gas emissions by 2050 is essential to limiting global warming to 1.5°C, as agreed in the Paris Agreement.[1] Financial institutions, including asset managers and index providers, can significantly influence this transition by incorporating climate risk into their investment strategies. "Transition-informed" indices offer a way to align financial investments with real-economy decarbonization, supporting companies at various stages of climate action.

### Defining "transition-informed" indices

In this consultation paper, "transition-informed" indices are designed by index providers to align with the global goal of achieving net-zero greenhouse gas emissions by 2050. With improved availability, quality, and comparability of climate data, these types of indices go beyond the goal of reducing the carbon footprint of an investment portfolio; they support the real-economy transition to a low-carbon economy over time. The indices may include companies at early stages of aligning with the transition to net zero, and support companies to reduce real-economy emissions through targeted financing and escalated engagement. Companies are assessed by index providers for potential phased non-inclusion through historical and forward-looking GHG emissions and other data.

## Encouraging real-economy decarbonization

In this paper, "transition-informed" indices focus on *real-economy* decarbonization through enhanced engagement with companies, rather than only reducing portfolio-level emissions. High-emitting companies should not be automatically excluded from indices. Instead, engaging with companies to improve their transition plans, decarbonize their value chains, and hold them accountable for progress can drive meaningful climate action. Different sectors, particularly hard-to-abate industries, may require longer transition periods. The paper suggests that index providers incorporate flexibility in timelines based on the unique challenges of each sector.

[1] UNFCCC. Glasgow Climate Pact 2021, 2021, p. 3

**<u>Types of "transition-informed" indices</u>**

Indices may continue to evolve to support transition to net zero objectives. This consultation paper acknowledges index approaches that currently exist in the market and those that may be introduced over the long term. Existing indices may focus on portfolio-level decarbonization impact, including Flagship, Screened and Scored, Climate Transition Benchmark, and Paris-aligned Benchmark indices.

The consultation paper also describes three example categories of "transition-informed" indices that may be introduced over the long-term with a focus on real-economy decarbonization, including "transition-potential," "transition-engaged," and "net-zero" indices (see Figure 1 on next page):

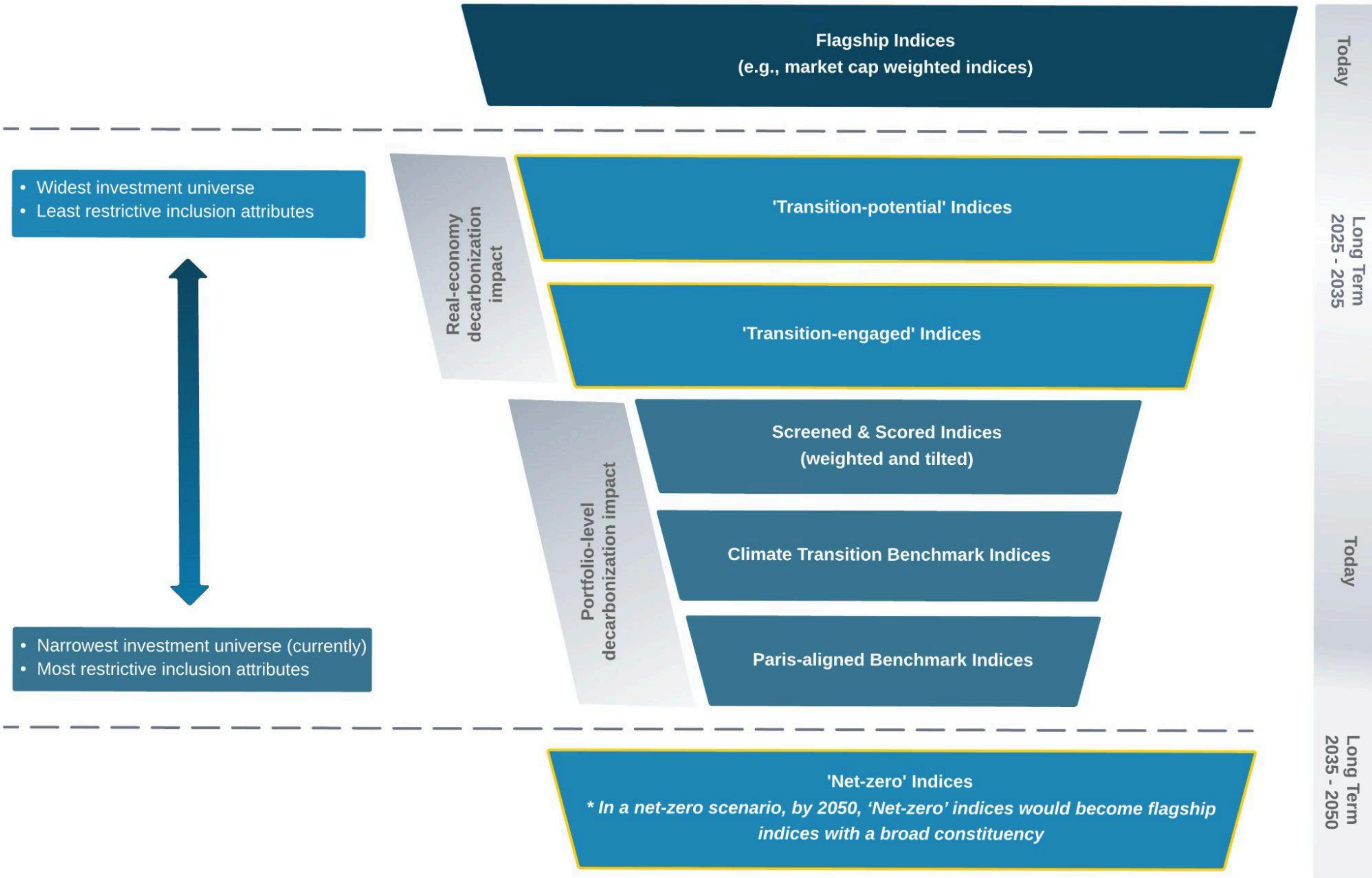
- **"Transition-potential" indices**: These indices focus on companies that have the potential to transition to net zero but have yet to fully commit or develop comprehensive transition plans. Index providers should ensure these indices include a time-bound approach, encouraging companies to demonstrate progress toward alignment.

- **"Transition-engaged" indices**: Companies in these indices are actively engaging with net-zero pathways. They have established targets and are taking meaningful steps toward decarbonization. The index assesses whether the companies are aligned with the transition through attributes such as emissions reduction, climate-related investments, and net-zero transition plans.

- **"Net-zero" indices**: These are more exclusive indices composed of companies that are fully aligned with a net-zero pathway. These companies have comprehensive and credible transition plans for achieving net-zero emissions by 2050.

In line with the The GFANZ Secretariat Technical Review Note on Scaling Transition Finance, GFANZ proposes several framing questions to help guide individual index providers in their individual development or selection of criteria for "transition-engaged" and "net-zero" indices. These framing questions are aimed at supporting index providers in determining whether a company falls within the four key transition finance strategies suggested for use by GFANZ.

**Figure 1. Categories and Potential Timeline of "Transition-Informed" Indices**



**Voluntary guidance for index participants**

The paper suggests a phased, voluntary approach for index participants to independently create and adopt "transition-informed" indices:

- **Phase 0: Set objectives** – Index providers should start by defining clear objectives, such as aligning with a science-based pathway to reduce emissions over time. They should also engage with stakeholders like investors and portfolio companies.
- **Phase 1: Assess climate commitments** – Companies should be evaluated on their climate commitments, transition plans, and progress. This phase focuses on assessing the credibility of companies' net-zero targets and their readiness to align with transition pathways.
- **Phase 2: Reduce weightings** – If a company fails to show progress toward its transition goals, its weighting in the index may be reduced in phases or fully reduced after a certain year. Engagement with companies to improve their alignment should continue before any removal from the index.
- **Phase 3: Re-entry** – Companies that improve and meet transition criteria may be re-included in indices after demonstrating alignment with net-zero objectives.

**Importance of data and metrics**

Quality and comparable climate data, available at scale, is critical for creating credible "transition-informed" indices. The paper emphasizes the need for reliable data on companies' emissions, transition-related investments, and forward-looking indicators such as expected emissions reductions[2]. Better standardization and quality of data across sectors and regions would help ensure that companies' progress toward decarbonization is measured consistently. The paper further advocates for the development of public climate data utilities (such as the Net Zero Data Public Utility) to improve access to verified, comparable climate data across industries.

**Areas for further work**

The GFANZ Index Investing Workstream identifies two areas where further work is likely to improve the development and uptake of these indices:

- **Increased development and disclosure of credible transition plans**, which outline specific milestones and actions toward achieving net-zero emissions. Net-zero transition plans are a key source of forward-looking information that may complement the limited availability of climate data, such as by identifying decarbonization levers specific to the company. The GFANZ Net-zero Transition Plan Framework provides voluntary guidance on how companies can undertake transition planning to deliver on their net-zero commitments.

[2] Expected emissions reductions (EER) measures the potential decarbonization impact of companies at the portfolio level.

- **Improvement in climate data availability, quality, and comparability**, particularly forward-looking metrics, to assess companies' alignment with net-zero pathways. To obtain quality data, an index participant will need to determine what data a company should disclose to present a complete picture of its climate-related risks and opportunities. Furthermore, real-economy companies may consider providing more transparency by disclosing the underlying calculation data of their GHG emissions and reduction targets, which would allow an index participant to understand the quality of the data.

The consultation paper on "Index Guidance to Support Real-Economy Decarbonization" advocates for the voluntary development and adoption of "transition-informed" indices as a key strategy to support real-economy decarbonization and the global transition to net-zero emissions. By improving climate data, developing robust transition plans, and engaging with high-emission companies, index participants can drive meaningful progress toward a sustainable, low-carbon future.