CSF Center for Sustainable Finance India

# Climate Indexes

## WHAT ARE CLIMATE INDEXES?

A climate index is a stock market index that is designed to meet the needs of passive investors looking to invest in stocks and bonds issued by companies that integrate climate change considerations in their business decision-making[1]. These specialized indices serve as benchmarks for investors to integrate climate change into their securities selection, portfolio construction, and risk management.

Globally, popular climate indices include the FTSE Global Climate Index, the S&P Paris-Aligned & Climate Transition (PACT) Index, and The MSCI Climate Change Index. In India, the development of climate indices is at a nascent stage compared to global counterparts. India has two climate-related stock indices: S&P BSE GREENEX and S&P BSE CARBONEX.

## HOW ARE CLIMATE INDEXES CONSTRUCTED?

Climate indexes typically follow a systematic methodology for selecting and weighing constituent companies based on their plans and performance related to climate change . The following methodology is usually used to construct a climate index.

1. **Scoring and Ranking**: Assigning scores or rankings to companies based on their climate performance relative to peers (e.g., carbon emission intensity).
2. **Index Construction**: Selecting companies with the highest climate scores (e.g., carbon risk rating) or rankings to be included in the index.
3. **Weighting**: Determining the weight of each constituent within the index, which may be based on market capitalization, climate scores, or other factors.

## HOW CAN THEY MOBILIZE CAPITAL FOR CLIMATE ACTION?

Climate indexes play a crucial role in driving corporations to integrate climate change in their strategic and operational decision-making process in several ways:

- **Capital Allocation**: By highlighting companies with strong climate change orientation in their business practices, climate indices incentivize them to accelerate capital allocation to low-carbon technologies.
- **Risk Mitigation**: By enabling investors to decrease climate-related risks in their portfolios.
- **Market Signals**: Companies' inclusion or exclusion in climate indices signals the importance of climate change mitigation and adaptation, influencing corporate behavior.

1 https://www.dws.com/insights/global-research-institute/navigating-the-climate-index-jungle

2 https://www.unpri.org/climate-change/low-carbon-investing-and-low-carbon-indices/3283.article

## CHALLENGES

Despite their potential benefits, climate indices face several challenges, including:

**Data Quality and Availability**

Limited availability and quality of data related to climate change, especially in emerging markets like India, pose challenges for index construction and evaluation.

**Methodological Differences**

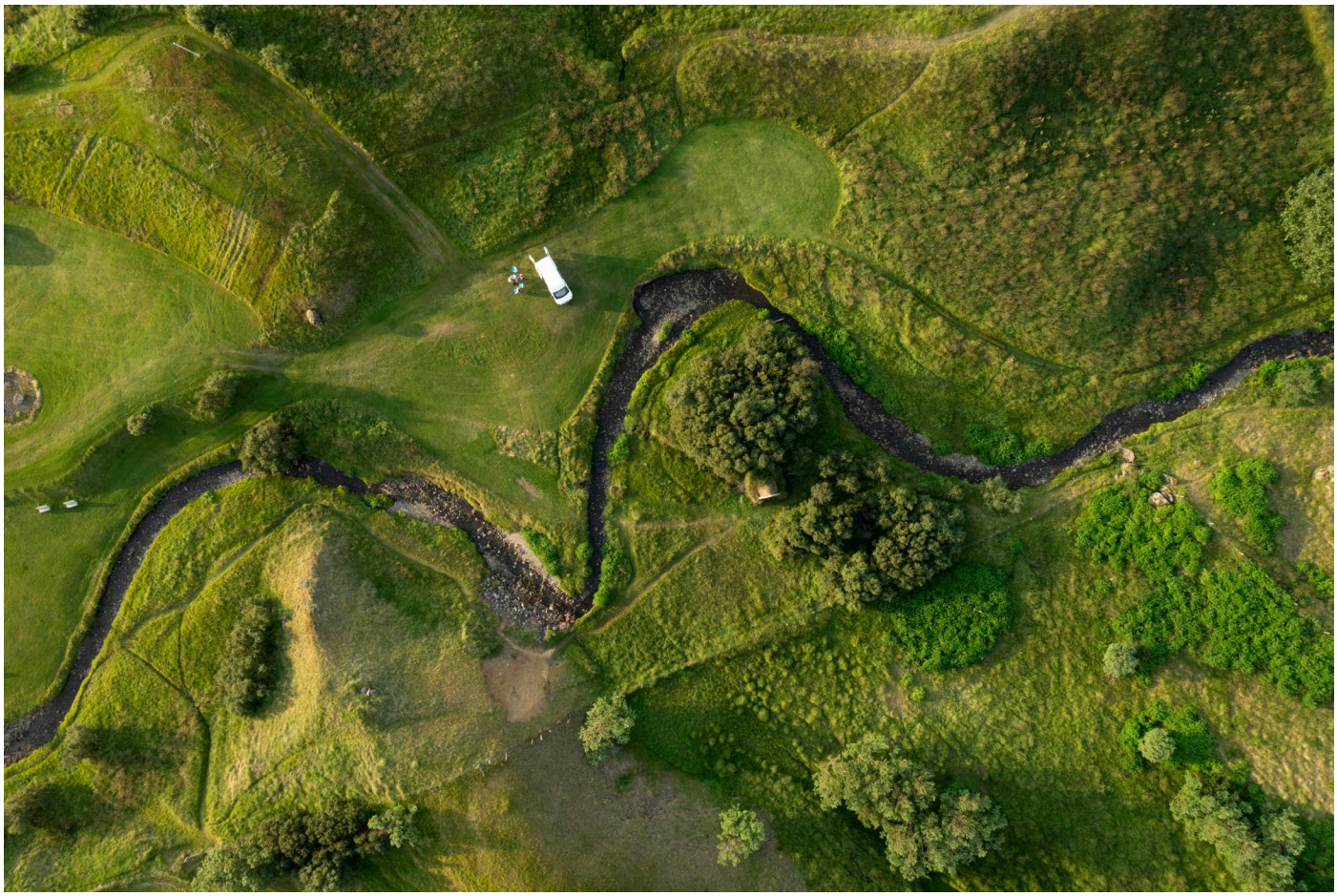
Divergent methodologies used by different index providers may lead to inconsistencies in index composition and performance, making comparisons challenging across different indexes.

**Greenwashing**

Some companies may engage in greenwashing—misleadingly portraying themselves as environmentally friendly—to improve their climate scores and gain inclusion in climate indices.

**Regulatory Hurdles**

Regulatory barriers, such as a lack of standardized climate-related reporting requirements for companies, hinder the development and adoption of climate indices, particularly in emerging markets.



## THE WAY FORWARD

The following measures could help to further develop climate indices as novel capital market products to nudge corporations to reduce their carbon emissions and manage climate risks.

- Educating investors, companies, and other stakeholders on the importance of climate indices and sustainable investing can increase awareness and adoption.
- Better reporting and disclosure by corporations can improve data quality and comparability, facilitating index construction and evaluation.
- Continued innovation in index construction methodologies, data analytics, and technology can enhance the effectiveness and relevance of climate indices in addressing climate change and sustainability challenges.
- Collaboration among regulators, index providers, investors, and companies can foster the development of robust climate indices tailored to local market dynamics.

## REFERENCE


1. DWS Asset Management (2023), Navigating the climate index jungle, https://www.dws.com/insights/global-research-institute/navigating-the-climate-index-jungle
2. UNPRI (2018), Low-carbon indices. https://www.unpri.org/climate-change/low-carbon-investing-and-low-carbon-indices/3283.article


## READING LIST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2. Schoenmaker, Dirk and Cosemans, Mathijs (2022), Carbon bias in index investing, Rotterdam School of Management, Erasmus University, Erasmus Platform for Sustainable Value Creation, https://www.rsm.nl/fileadmin/Faculty-Research/Centres/EPSVC/20220218_Carbon_bias_in_index_investing.pdf



The Clarifying Concepts series provides short explanations of foundational ideas and terminology in sustainable finance to help professionals from different fields navigate emerging issues.

It is produced by the Center for Sustainable Finance (CSF), a knowledge and net-working hub which aims to accelerate India's financial sector towards a more sustainable future. CSF is managed by Climate Policy Initiative (CPI).