A Comprehensive Study of Current Transition Index Landscape and Recommendations

This project delves into a comprehensive study of the current landscape of transition finance - including the existing transition taxonomies and index products, and provides recommendations as to improve transition-based indices. We focus on three index series, which serve to broadly represent the universe of transition index: MSCI Climate Action Index, FTSE TPI Climate Transition Index Series, and S&P Climate Transition Base ESG Index. We leverage these products to show how they may support climate change mitigation and the transition to a net zero economy and evaluate their construction. Finally, we incorporate transition taxonomies, particularly Singapore-Asia Transition Taxonomy by the Monetary Authority of Singapore (MAS) and the European Union (EU) extended environmental taxonomy, as well as our own recommendations, to build a methodology for index construction that is best suited for achieving a just transition.

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1 Literature Review: Maximum Common Ground of Global Taxonomy

1) Designed for all players in the financial world – the taxonomies are not just built for investors in capital investments that will lead to a low-carbon transition. Rather, they are also designed for all other participants that could participate in the transition, such as governments, debt providers, auditors, etc.

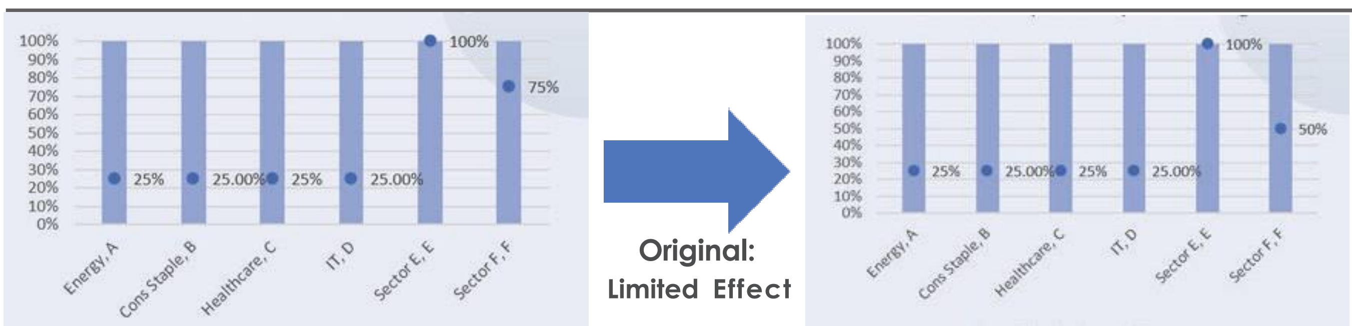
2) Traffic light system for signaling – the taxonomies attempt to differentiate between companies within sectors or specific economic activities relative to their ability to transition towards a low-carbon economy. They use dynamic boundaries that are science-based in order to distinguish between these companies or activities.

3) Alignment on TSC foundations – both MAS and EU in particular are drawing on the same types of methodologies and metrics

4) Use of falling curves, differing by sector – all taxonomies anticipate a series of 'falling steps' which would differ by sector and activity. As the boundaries are reviewed every few years and put in perspective with net zero goals, they will tighten and converge to a low-carbon economy-compatible level.

2 Choice of Base Index Methodology - MSCI Climate Action Index

1) Sector-focused: minimizing sector bias and tracking error
2) More frequent update as review made on semi-annual basis to incorporate most recent information in relation to ESG data



3 Gaps Identified in Methodology

1) Focus on large market cap companies
2) Misalignment of sectors covered for green revenue
3) Exclusion of sectors with high low-carbon transition potentials
4) Binary indicator for green revenue

4 Proposed Modifications to Base Methodology

1) Dual Sector-Based Ranking

Rationale: MSCI Indexes use GICS sector classification which includes 11 sectors and branched out into various industrial groups. On the other hand, MAS Transition Taxonomy uses a 10-sector classification system.

Misalignment imposes difficulties while considering sector-based alignment and eligibility with taxonomy-aligned transition activities. As such, a taxonomy-aligned sector-based ranking is therefore proposed on top of the original sector-based ranking.

2) Addition of Traffic Light System as Security-Level Assessment Criteria

Rationale: MSCI Indexes use qualitative descriptions as criteria to assess the company's Green Business Score. Traffic light system in the taxonomy gives clear metrics, benchmarks and thresholds to define transition activities of different extent (i.e. green, amber). As such, Taxonomy-Aligned Business Score is proposed which is defined as proportion of the new turnover, CapEx and OpEx derived from products or services that are from activities that are aligned with the Green or Amber technical screening criteria and fulfill the objective of climate change mitigation.

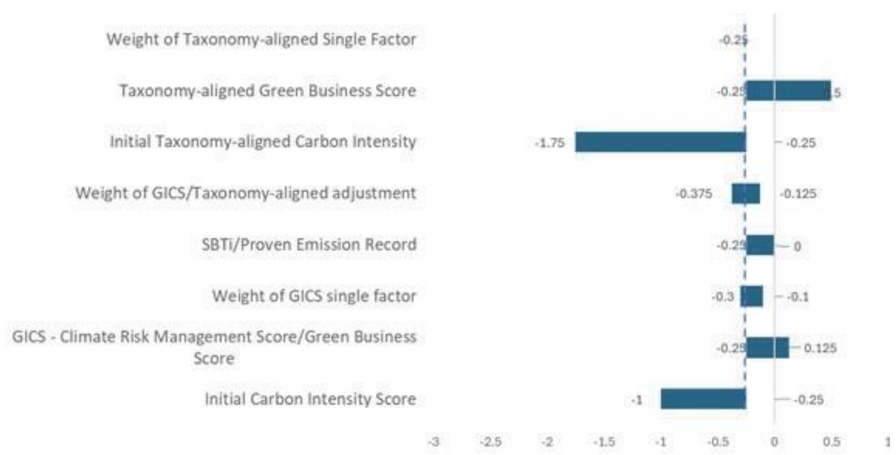
Activity #	1	2	3	4	5
% Revenue	20%	30%	5%	15%	30%
Traffic Light	Green	Green	Amber	Ineligible	Ineligible
Revenue Alignment under Taxonomy	Green		Amber	Ineligible	

Taxonomy-Aligned Revenue: 50%

3) Allow Both Upgrading and Downgrading of the Initial Quartile

Rationale: MSCI Indexes only have promotion system for companies to move up the quartile at present. The group proposes to install the system with both promotion and demotion available so as to allow companies with good climate transition mitigation efforts to be recognized and those with insufficient efforts to be urged.

Sensitivity Analysis



Best-Case Scenario	Baseline	Worst-Case Scenario
Improve by 2.5 quartile	Improve by 0.25 quartile	Downgrade by 2.25 (2.5)* quartile

5 Limitations and Further Discussions

1) Integration Complications: as taxonomy is specific to Singapore and ASEAN context certain benchmarks and indicators might not be compatible with other regional regulations and as such might hinder data quality

2) Data Transparency: the group has faced inability to access to certain key information (e.g. MSCI scores and sectorial data), which imposes difficulty in construction and evaluation of proposed additional criteria

3) Continuous Monitoring Requirement: dynamic landscape of taxonomy and transition activities, coupled with evolution and advancement of technology in various sectors might lead to changes in taxonomy and thus requiring regular update of the criteria in assessing taxonomy-aligned activities

4) Consider Amending Screening Criteria: companies engaged in certain banned business activities that do not contribute directly to carbon emission but actively engage in decarbonization commitment could be included into the transition index to encourage their continued involvement