Investments

Quantifying the financial impact of the net zero transition

STOXX Willis Towers Watson Climate Transition Index and Strategy

For professional investors

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Contents

The impacts of climate change are **already** being felt. A rapid transition to net zero emissions is needed to avert the worst climate scenarios and build resilience against harmful climate impacts.

The transition will affect all areas of our society and economy.

Companies need to **adapt** or face significant challenges. Investors need to be aware of the effects that this transition will have on companies through changes to policy, technology and the consumer landscape. The transition has the potential to create value, but can also cause significant losses.

1. Transitioning to net zero

Introducing the next generation climate transition risk solution.

Willis Towers Watson's Climate Transition Value at Risk (CTVaR) methodology quantifies climate transition risk by integrating forward-looking company assessments with traditional risk and return models. Using CTVaR, we're able to determine the climate transition risk that companies face and help identify risks and potential opportunities.

Willis Towers Watson, in partnership with STOXX, have developed the STOXX Willis Towers Watson Climate Transition Index (CTI) using the CTVaR methodology. The index provides a systematic and transparent way for investors to incorporate climate transition risk into their investment decisions.

Discover the potential for enhanced return and risk reduction with the STOXX Willis Towers Watson Climate Transition Index

- Capture positive economic disruption and growth opportunities by tilting toward companies expected to make key contributions to the transition to a low carbon economy.
- Tilt away from companies with high exposure to climate transition risk and who are likely to lose value or underperform as the economy transitions.
- Align capital allocation with climate or low carbon commitments.

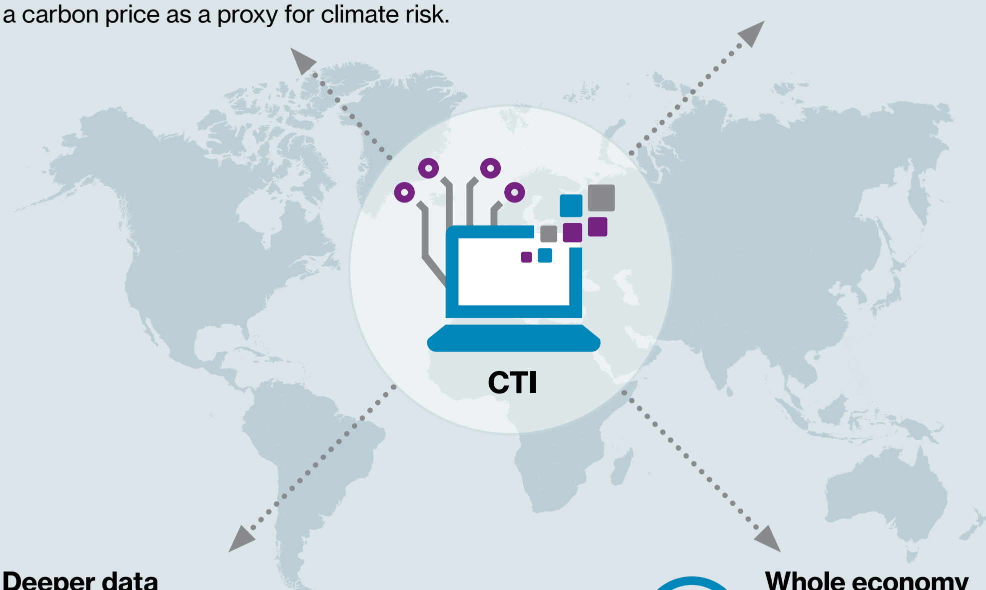
Figure 1. **STOXX Willis Towers Watson Climate Transition Index (CTI) – at a glance**

Beyond carbon

CTI uses a more granular analytical approach that addresses 100s of transition impacts on asset prices that go beyond carbon exposure or a carbon price as a proxy for climate risk.

Forward, not backward

Forward-looking company transition risk is refreshed over time, rather than using historic carbon emissions data.



Deeper data

For companies most impacted by climate transition, CTI curates asset level data from multiple sources to build a higher resolution view of climate transition risks and opportunities.

Whole economy

The CTI is focused on the wide range of changes needed at system level – to different goods, services and commodities – in order to drive down greenhouse gas emissions consistent with the goals of the Paris Agreement.

2. Skilled collaboration

Willis Towers Watson is bringing together experienced solution providers to launch a new type of equity index – the STOXX Willis Towers Watson Climate Transition Index (CTI) – that assesses the anticipated impact of a climate transition on company valuations.

The STOXX Willis Towers Watson Climate Transition Indices, and any subsequent strategies tracking them, will enable investors to manage climate transition risk.. The index allows investors to reduce carbon emissions but does so only where it makes financial sense and on a forward-looking basis. By tilting toward companies expected to benefit from the transition, and tilting away from companies expected to face significant challenges, investors can **capitalize** on opportunities and **manage** risks as we move into a net zero economy.

Net zero

Willis Towers Watson has made a **net zero commitment** across its delegated portfolios to manage clients' risk exposures and align towards a climate resilient future.

The CTI series is part of this commitment – it offers a more sophisticated approach to managing climate transition risk beyond strategies such as divestment, paving the way for the implementation of net zero strategies at the corporate, portfolio and country level.

"STOXX Willis Towers Watson Climate Transition Index is a true innovation. Combining Willis Towers Watson's CTVaR with STOXX portfolio optimization and index construction expertise is a game changer made possible by STOXX's open architecture approach."

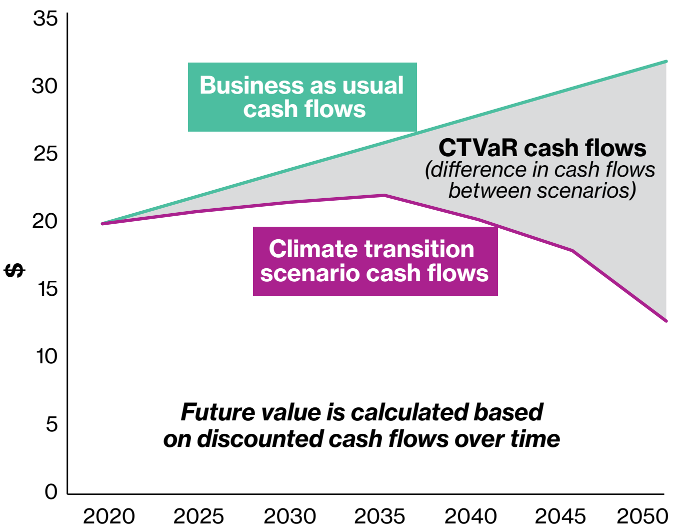
Arun Singhal, Global Head of Index Product Management, Qontigo STOXX

3. Next generation methodology – CTVaR

Transition risk is defined as the loss or gain in value due to the transition to a net zero economy stemming from changes to policy, regulation, technology, and consumer preferences. It is measured by the expected change in today's prices as a result of the transition – we call this measurement Climate Transition Value at Risk (CTVaR).

- CTVaR offers a bottom-up granular approach to measuring the effect of changes to the global economy (driven by climate change mitigation) on a company's valuation.
- CTVaR focuses on the effect of climate on individual companies by integrating a forward-looking assessment of climate transition risk into the traditional risk/return framework, aligning climate transition risk with investors' fiduciary duty.
- This approach looks beyond top-down issues such as the implementation of carbon prices to consider a wide range of underlying climate-related issues that are expected to influence the drivers of company cash flows.
- We take a deeper analysis of scenarios and each company's business model to determine how they are positioned for the transition. The analysis is then used to weight each stock in the index.

Figure 2. **Cash flow illustration of a negative CTVaR company**



The team behind the methodology...

Willis Towers Watson's multidisciplinary Climate Transition Analytics (CTA) team is comprised of 20+ members – with experience across investment and consulting, economics, academia, energy, as well as ratings agencies.

The CTA team use CTVaR for various applications, of which the CTI is one. They work with governments, corporates and investors to help identify and mitigate their transition risk at a company, asset or portfolio level.

The CTA team are part of Willis Towers Watson's wider Climate and Resilience Hub comprising of 70 climate specialists. This is the focal point for our climate expertise and capabilities, pooling knowledge from across businesses and from our collaborations to deliver climate and resilience solutions in response to a range of regulatory, investor, consumer, employee and operating pressures.

"The climate transition is so much more than carbon footprint. In fact, our research shows that less than 10% of the impact of the transition is a result of the carbon footprint. So, we've built an index that starts from the bottom up. Our methodology looks at all of the changes that will happen to each part of a company's business, across each and every industry, to see the effects on the value of assets, of companies and ultimately investment portfolios."

David Nelson, Senior Director of Climate Transition Analytics, Willis Towers Watson

4. Getting access to the index

Many institutional investors have made progress on setting climate objectives (net zero commitments/carbon journey planning discussions) and are looking for simple implementation routes for making immediate progress.

Key portfolio considerations

- **Risk and return:** For most investors, adding the CTI strategy to an investment portfolio could bring material risk reduction as well as accelerating progress towards climate goals. In addition, investors may benefit from potential enhanced returns.
- **Cost and tracking error:** The strategy offers a low cost and low tracking error (versus market cap) way to significantly reduce climate transition risk in a public equity portfolio.

Expected impact on portfolio allocations

The CTI strategy can be incorporated into an equity allocation in many different ways. For investors currently using market cap-weighted indices to access public equity markets, we are encouraging consideration of this strategy to better position portfolios for the climate transition. As well as increasing weights to companies likely to perform well in the climate transition, this strategy reduces investors' exposure to tail risk climate events which could have significant impacts on individual companies' stock prices.

Some investors focused on sustainability factors have already moved away from market cap-weighted indices in favor of smart beta strategies which often consider various ESG and sustainability metrics. As the CTI strategy has an explicit climate transition focus, it will be a diversifying exposure to other wider ESG and smart beta strategies in a portfolio. We believe adding this strategy to a diversified smart beta portfolio will further reduce risk and help investors make progress towards any climate goals and commitments.

The CTI strategy may also be an interesting complement to an active equity approach for those clients wanting to make rapid progress against climate objectives.

"The CTI leads to lower portfolio emissions, but only where it makes financial sense to do so. It increases your expected return and reduces your risk from the climate transition. We believe it is appropriate for consideration by all institutional investors as it aligns with fiduciary duty, is forward-looking, simple to implement and low cost."

Craig Baker, Global Chief Investment Officer, Willis Towers Watson

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Qontigo is a leading global provider of innovative index, analytics and risk solutions that optimize investment impact. As the shift toward sustainable investing accelerates, Qontigo enables its clients – financial-products issuers, capital owners and asset managers – to deliver sophisticated and targeted solutions at scale to meet the increasingly demanding and unique sustainability goals of investors and asset owners worldwide.

Qontigo's solutions are enhanced by both our collaborative, customer-centric culture, which allows us to create tailored solutions for our clients, and our open architecture and modern technology that efficiently integrate with our clients' processes.

Part of the Deutsche Börse Group, Qontigo was created in 2019 through the combination of Axioma, DAX and STOXX. Headquartered in Eschborn, Germany, Qontigo's global presence includes offices in New York, London, Zug and Hong Kong.

About Willis Towers Watson

Willis Towers Watson (NASDAQ: WLTW) is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has 45,000 employees serving more than 140 countries and markets. We design and deliver solutions that manage risk, optimize benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. Our unique perspective allows us to see the critical intersections between talent, assets and ideas — the dynamic formula that drives business performance. Together, we unlock potential. Learn more at willistowerswatson.com.

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