

Democracy-screened ESG emerging market government bond indices

“FTSE Russell helped us design a democracy filter for our ESG emerging market sovereign bond universe. Research shows that better-governed countries have higher GDP growth rates, while autocratic regimes have a higher probability of economic failure and higher default rates.”

Philipp Luginbühl, Senior Portfolio Manager, Swiss Federal Pension Fund PUBLICA
Manuela Guillebeau, Sustainability Specialist, Swiss Federal Pension Fund PUBLICA



About the client

Profile

PUBLICA is one of the largest pension funds in Switzerland, covering the federal government and associated organisations. It has over 68,000 active members and 42,000 pension recipients.

Objectives

PUBLICA was seeking to improve its emerging markets bond index's risk/return profile by replacing the incumbent index provider and adding selected ESG criteria.

Solution

The FTSE ESG Democracy Emerging Markets bond indices incorporate ESG factors in their design, while focusing on countries governed by democratic principles.



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Client profile

PUBLICA, a non-profit organisation, is one of the largest pension funds in Switzerland. Covering the federal government and closely associated organisations, it has over 68,000 active members and around 42,000 pension recipients. As at 31 December 2023, PUBLICA had total assets under management of CHF40.5bn.

PUBLICA uses the term “responsible investment”, rather than “sustainable investment”, to define its approach to investing pension assets.

It takes account of environmental, social and governance (ESG) criteria, exercises its rights as a shareholder and reduces the CO₂ emissions of the properties it owns. But it believes that investing responsibly does not necessarily mean accepting a lower return on its investments, because it needs that return to safeguard the benefits it pays. Responsible investment allows PUBLICA to improve its risk/return profile.

Developing new ESG emerging markets bond benchmarks

Following this principle, PUBLICA’s main investment objective is to improve the risk/return characteristics of its portfolio by selecting appropriate benchmarks for every asset class it holds. PUBLICA regularly reviews its benchmarks and implements new ones, when appropriate.

As a result of one of its regular reviews, it decided to switch from its incumbent provider of emerging market bond indices and towards a new provider that could help it implement certain environmental, social and governance (ESG) goals.

PUBLICA decided that adding relevant ESG criteria to its emerging market sovereign bond indices could help it enhance the risk/return profile of its investments. Such an approach would also help it take control of regional exposures in its emerging market sovereign bond allocation.

In addition, PUBLICA wished to add a democracy filter to its emerging market sovereign bond benchmarks. This decision reflected academic research showing that the economic growth rates and currencies of democracies tend to be more stable, while their default rates also tend to be lower.

The implementation of ESG tilts and a democracy filter for emerging market bonds can be seen as an extension of PUBLICA’s investment approach in developed fixed income markets, where it uses governance, economic and liquidity criteria to determine the regional allocation.

PUBLICA set the following objectives for its new emerging markets sovereign bond index:

- The benchmark provider should have **long-standing expertise** in building government bond benchmarks;
- The benchmark provider should follow a **rules- and risk-based ESG model**;
- The provider should enable **efficient implementation** of the benchmark;
- The sovereign ESG data underlying the benchmark should have a high level of **quality, availability and frequency**;
- The democracy screens should be **research-based and come from independent sources**;
- The benchmark methodology should be **clear, transparent and easy to understand**.

The FTSE ESG Democracy Emerging Markets Investment-Grade US Dollar Government Bond Index

The FTSE ESG Democracy Emerging Markets Local Currency Government Bond Index

These two indices emerging market government bonds—one hard currency and one local currency—incorporate tilts towards sovereigns’ environmental, social and governance (ESG) performance.

The indices also incorporate a democracy filter to determine countries’ eligibility. It is rules-based, using data from two independent sources: Freedom House and the V-Dem institute.

ESG tilts and a democracy filter

FTSE Russell partnered with PUBLICA to design and implement **the FTSE ESG Democracy Emerging Markets Investment-Grade US Dollar Government bond index** and **the FTSE ESG Democracy Emerging Markets Local Currency Government bond index**, helping meet these objectives.

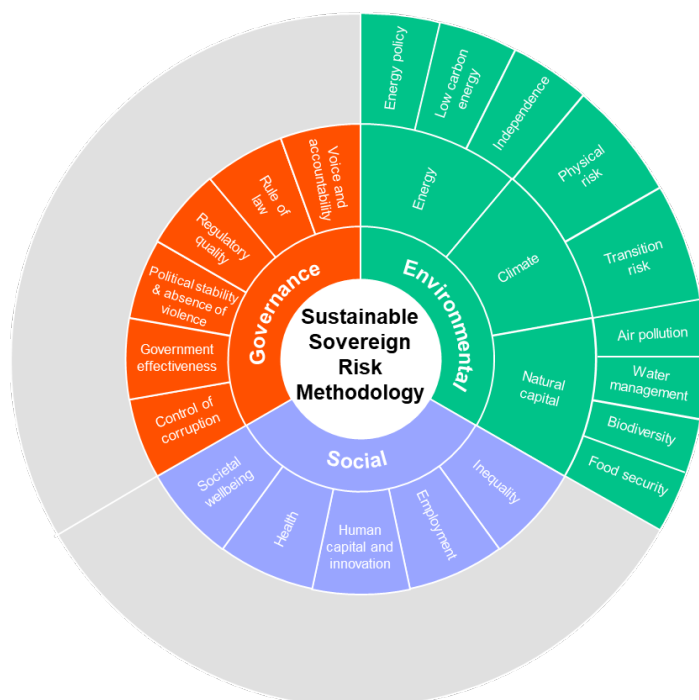
These indices are custom versions of the **FTSE Emerging Markets Government Bond index (FTSE EMGBI)**, FTSE Russell's flagship benchmark for the world's emerging sovereign bond markets.

The FTSE EMGBI follows FTSE's fixed income country classification process¹, which classifies bond markets for index inclusion based on a transparent and sophisticated set of accessibility measures.

The FTSE ESG Democracy Emerging Markets Investment-Grade US Dollar Government bond index and the FTSE ESG Democracy Emerging Markets Local Currency Government bond index have the following principal design features:

- They recalibrate FTSE EMGBI country weightings based on the **LSEG Sustainable Sovereign Risk methodology** (see the infographic for the model's inputs);
- They **assign equal tilts** to sovereign debt issuers' ESG performance;
- They **select eligible countries based on** independent assessments by Freedom House, as set out in its annual "Freedom in the World" report (see the chart) and **Liberal Democracy index scores** by the V-Dem institute.

LSEG Sustainable Sovereign Risk Methodology, used in FTSE Russell ESG bond indices



Source: LSEG Data & Analytics

Beyond Ratings

London Stock Exchange Group's (LSEG's) Sovereign Sustainability Solutions provide the ESG screening and factor methodology for these new indices.

LSEG's Sovereign Sustainability Solutions enable ESG integration into fixed income and multi-asset research, complementing traditional credit analysis with the goal of assisting financial sector clients in the transition towards a sustainable economy.

The solutions are built on in-house expertise on climate/ESG, data science, and financial risk assessment, and cover over 150 countries.

For more on LSEG's Sovereign Sustainability Solutions, visit:

[LSEG | Beyond Ratings](#)

¹ See [FTSE Fixed Income Country Classification Process](#)

After ESG tilts and eligible country selections are applied, individual country weights are capped at 10 percent of each index. The indices are rebalanced once a month at the end of the month.

Greater control over long-term risk and return

PUBLICA views the key advantages of these new benchmarks as: giving the pension fund more control over the country universe for its emerging market sovereign bond allocation; and including ESG metrics that can have a material effect on the willingness and ability of emerging market sovereigns to service their debt and maintain stable currencies.

PUBLICA believes that these two factors should help improve the risk/return characteristics of its emerging market bond portfolio in the long term.

Additional information

Further information on FTSE Russell's comprehensive range of fixed income indices is available at:

[Fixed Income Indices | FTSE Russell](#)

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Market participants look to us for our expertise in developing and managing global index solutions across asset classes. Asset owners, asset managers, ETF providers and investment banks choose FTSE Russell solutions to benchmark their investment performance and create investment funds, ETFs, structured products, and index-based derivatives. Our clients use our solutions for asset allocation, investment strategy analysis and risk management, and value us for our robust governance process and operational integrity.

For over 35 years we have been at the forefront of driving change for the investor, always innovating to shape the next generation of benchmarks and investment solutions that open up new opportunities for the global investment community.

CONTACT US

To learn more, visit [lseg.com/ftse-russell](https://www.lseg.com/ftse-russell); email info@ftserussell.com; or call your regional Client Service team office:

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If you would like to discuss the options for a custom equity, fixed income or multi-asset benchmark, our team is there to help you. Please contact aogeurope@ftserussell.com

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