



Index Insights | Sustainable investment | Equity

Not all ESG scores are the same

FTSE Blossom Japan's impact on
corporate behaviour and engagement

March 2024

AUTHORS

Atsuhito Mori

Head of sustainable Investment Japan
atsuhito.mori@lseg.com

Ken Hirose

Head of Japan, Index Investments Group
ken.hirose@lseg.com

Chuck Chang

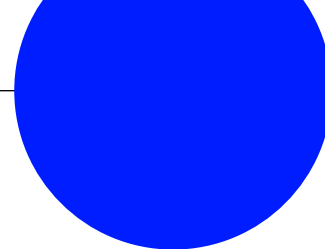
Senior Research Analyst
chuck.chang@lseg.com

Written in collaboration with SGX

SGX 
Equity Derivatives



**FTSE
RUSSELL**
An LSEG Business



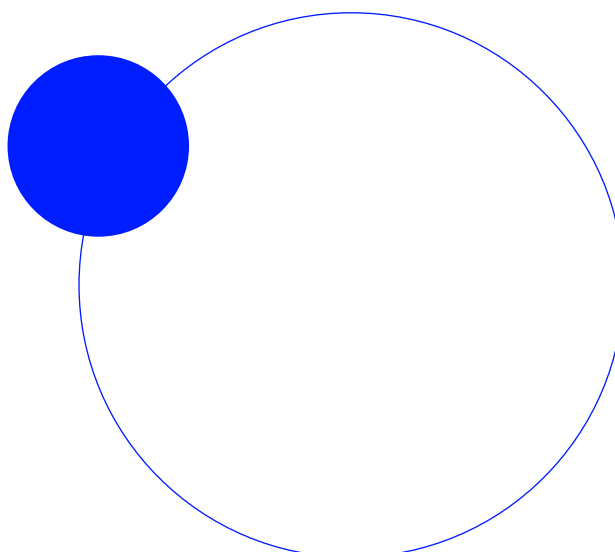
Quarterly analysis

As the NISA (Nippon Individual Savings account) rolls out, we consider ESG disclosure, ESG scores methodologies and ESG factors in Blossom Index performance.

This Japanese sustainable investment and futures report, written in collaboration with SGX, reviews the development of Japan's sustainability standards, the ESG performance of Japanese listed companies compared to the broad-market index, and the growth of index-linked SGX FTSE Blossom Japan Index Futures.

Key highlights from this quarter's analysis:

- FTSE Russell ESG data relies on publicly disclosed information, following a fully transparent approach
- ESG factors continue to drive the performance of the Blossom Index series
- The Notional Open Interest of the SGX FTSE Blossom Japan Index Futures remains robust at US\$119M as of end January 2024



ESG disclosure is essential both for ESG scores engagement and ESG index investing

Record monthly inflow into New NISA 2024

The new NISA (Nippon Individual Savings Account) started in January 2024, and the inflow of funds appears to be strong, partly because Japanese stocks have hit a new high for the first time in 34 years. According to newspaper reports, the total amount of purchases made through accounts at 10 securities companies, both face-to-face and online, exceeded 1.8 trillion yen in January 2024. Although a simple comparison cannot be made, the inflow of funds has been recorded at three times the pace of the old NISA - 80% of the funds flowed into online securities, and 60% of the funds flowed into investment trusts.

As we mentioned in our previous Japanese Sustainable Investment report, the new NISA includes ESG (sustainability) indices for the first time. One such index fund (ETF) that tracks the FTSE Blossom Japan Index is an index that invests in companies with excellent ESG disclosure based on FTSE ESG Scores.

FTSE Russell ESG Scores assessed by company disclosures

FTSE Russell's ESG database relies on publicly disclosed information. The rationale behind the data gathering is due to the data being "more reliable and less subjective compared to private, survey-based data" and to "enhance the transparency process".¹ FTSE Russell ESG scores are based on more than 300 ESG-related indicators, applied depending on the business and country of operation. FTSE Russell states that this approach is "fully traceable: we are able to disclose the source from where data was collected, and the calculation methodologies for the companies' scores."

¹ Source: FTSE Russell, [Corporate engagement within sustainable investment](#), August 2022.

Do larger companies tend to receive stronger ESG Scores due to more completed disclosures?

Some argue that there is a bias that large companies (Large Cap) tend to have higher scores because they disclose more information. However, this is not always the case. Conversely, it may be more difficult for large companies to obtain a high FTSE Russell ESG score than small and medium-sized companies.

First, the more activities and countries a company operates in, the more ESG indicators will be applied, and therefore the more disclosure around ESG information will be required. Given that large companies are more likely than small and medium-sized companies to diversify their operations and operate in multiple countries, it becomes difficult to get high score. Furthermore, in calculating the ESG score, we identify the exposure (low, medium, high) that signals the high degree of relevance for the company in each ESG theme. If the exposure is identified as high, the company will be required to disclose more information to receive a higher score.

Second, there is a theme of "tax transparency" that applies only to large cap companies in Governance evaluations. With the exception of medium cap multinational companies which operate in some tax havens, this indicator does not apply to small and medium caps, meaning that non-disclosure does not affect their overall score.

Tax Transparency Theme (GTX)

The Tax Transparency Theme focuses on companies' tax transparency and oversight as the first step towards tax responsibility. Companies can be classified as having:

- Medium Exposure: All large cap companies classified as being from a Developed market
- Medium Exposure: Mid cap companies classified as being from a Developed market and companies operating in Primary Impact countries and that are also multinationals, regardless of Subsector
- No Exposure: Data is collected for large cap companies from Emerging markets but is not applied to their ESG Ratings

Exhibit 1. Tax Transparency Theme breakdown

Size	Market	Subsector Impact Category	Geography Countries *	Multinational	Exposure Identification
Large	Developed				M
Mid	Developed		<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	M
Large	Emerging				Data collected only

Source: FTSE Russell.

In fact, if you look at the average ESG score for large, medium and small caps in the FTSE classification, the average score for large stocks is certainly higher. We believe the reason for this is that large companies have the personnel and budget for dedicated department focused on sustainability. Whereas small and med cap companies may rely on departments such as investor relations, corporate affairs or accounting to handle sustainability and ESG disclosure.

Additionally, regulations such as the TSE's Corporate Governance Code requiring disclosure of climate change risks in line with TCFD, and the requirement by the Financial Services Agency to disclose carbon emissions apply only to TSE Prime listed companies. This is potentially the reason why large caps are putting more effort into disclosing ESG information.

FTSE Russell ESG Scores are suitable for measuring engagement success

According to "[Analysing the world's largest asset owner's approach to ESG engagement](#)" which won the best paper award at the UN-PRI in Person academic session held in Japan in October 2023, the impact of ESG engagement by managers may be explained by differences in the ESG scoring methodologies. The paper concludes that the FTSE weighted score is more suitable.

Not all ESG scores or ESG indices are the same

Even when it comes to ESG scores or ESG indices, there are various methods and effects. The important thing is to first understand each ESG scoring methodology and the differences between them. Therefore, we should avoid investing in ESG indices for which the ESG scoring methodology is not clear.

It will be effective to compare long-term performance in investment decision or to diversify investments across multiple ESG indices with different ESG scoring methodologies.

ESG continues to drive Blossom Index series performance

In our previous report, we introduced the new ESG factor model in an attempt to better explain the strong performance of Blossom Japan Index Series over traditional market cap indices. Starting this quarter, we will be updating the performance of Blossom index series using this new ESG factor model.

Exhibit 2. FTSE Blossom index series continue to outperform market cap index



Source: FTSE Russell, data as of December 31, 2023.

While both FTSE Blossom Japan Index and FTSE Blossom Japan Sector Relative Index continued to outperform the traditional market cap index on accumulative return basis, there were some differences between the two indices on quarterly performance.

The Blossom Japan Index reported slight underperformance versus its reference benchmark by 69bp. As can be seen in its quarterly factor attribution analysis, the underperformance was primarily caused by negative contribution from Quality factor (-95bp). ESG factor, which remains to be the main positive contributor to the index’s performance, added another +72bp to its accumulative return contribution.

In contrast to the Blossom Japan Index, the Blossom Japan Sector Relative Index outperformed its reference benchmark by +26bp. ESG factor was the largest contributor to its quarterly performance (+43bp), while Quality factor negatively attributed to the performance by -35bp.

Exhibit 3. Attribution Analysis (ESG Factor Model) for Blossom Japan Index and Blossom Japan SR Index

Attribution with Industry and Style Factor - Return Contribution (bps)								
Blossom Japan Index	Industry	Value	Quality	Volatility	Momentum	ESG	Residual	Total Excess
2015/12/31 - 2023/9/30	-199	199	-60	-158	171	1,074	259	1,286
2015/12/31 - 2023/12/31	-187	163	-155	-166	183	1,146	233	1,217
Quarterly Change	12	-36	-95	-8	13	72	-26	-69

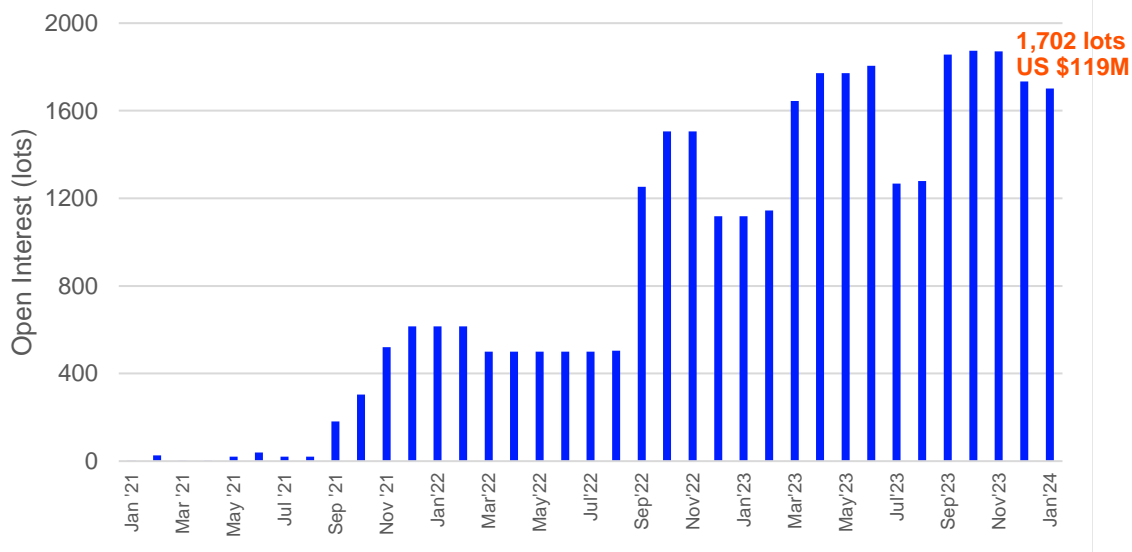
Attribution with Industry and Style Factor - Return Contribution (bps)								
Blossom Japan SR Index	Industry	Value	Quality	Volatility	Momentum	ESG	Residual	Total Excess
2015/12/31 - 2023/9/30	-43	39	-116	-57	247	619	108	798
2015/12/31 - 2023/12/31	-24	34	-151	-60	255	663	107	823
Quarterly Change	18	-5	-35	-3	8	43	-1	26

Source: FTSE Russell, Data as of December 31, 2023. Data covers the period from December 31, 2015 to December 31, 2023

Blossom continues to outperform

The Notional Open Interest of the SGX FTSE Blossom Japan Index Futures remains robust at US\$119M as of end January 2024. The daily average turnover across a 12-month period (February 2023 – January 2024) was US\$3.7M, which further cements SGX’s futures position as the most liquid Japan ESG contract.

Exhibit 4. SGX FTSE Blossom Japan Index Futures Open Interest (lots)

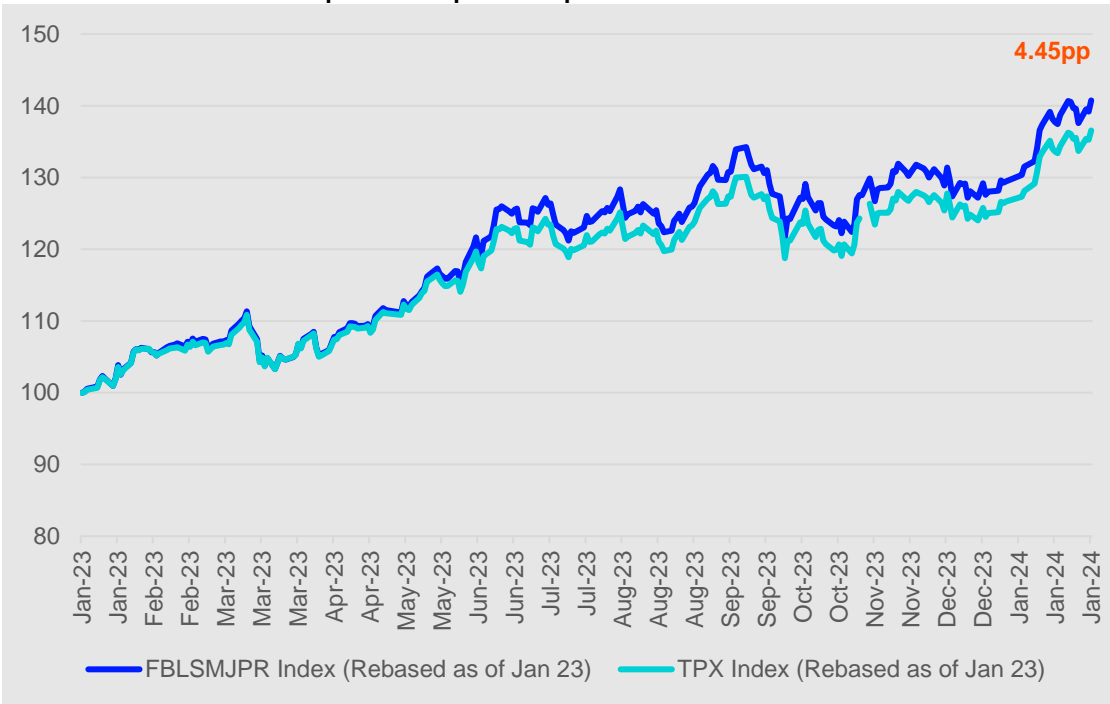


Source: SGX. Data as of end January 2024. Past performance is no guarantee of future results. Please see end for important legal disclosures.

The FTSE Blossom Japan Index continued to outperform against major Japanese benchmark indexes during the period Jan 2023 to Jan 2024, and the performance difference witnessed a historical peak of 4.45 percentage points on 23rd January 2024. To illustrate how derivatives futures can be used, we computed the performance of an initially market neutral portfolio composed of long SGX FTSE Blossom Japan Index futures versus short Topix futures.

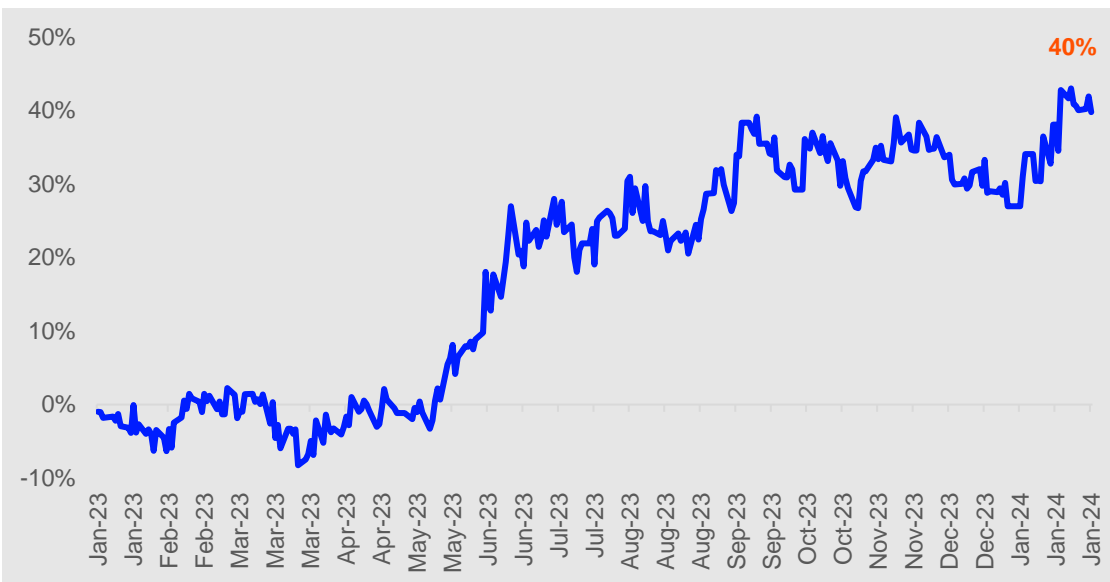
Assuming a funding cost of 3M JPY OIS rate + 100bps, a required total margin of 10% and no other transaction costs, the hypothetical portfolio returned a profit of 40% over the period.

Exhibit 5. FTSE Blossom Japan and Topix Index performance difference



Source: SGX. FIA. Data as of end January 2024. Past performance is no guarantee of future results. Please see end for important legal disclosures

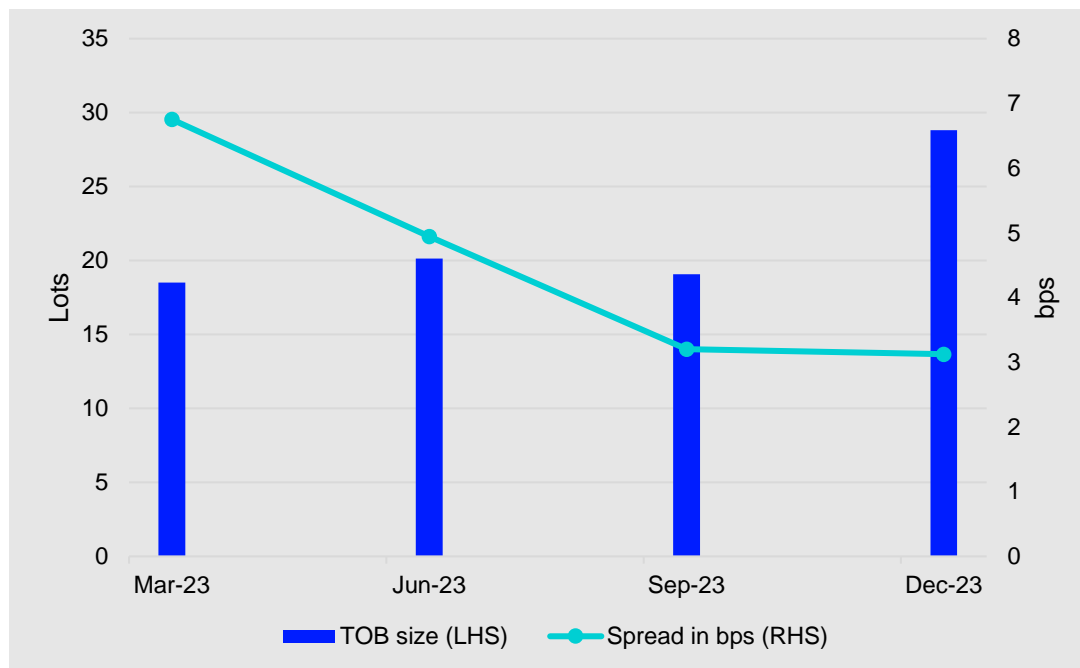
Exhibit 6. 1Y Net Profit (%) for FTSE Blossom Japan Index Futures- TOPIX Index Futures Spread Trade



Source: Bloomberg. Data as of end January 2024. Past performance is no guarantee of future results. Please see end for important legal disclosures.

With the expiry of the March 2024 futures contract, market participants were able to roll their futures position easily to the next quarterly contract which started on 15th February 2024. Exhibit 7 displays the increasing tradability of the futures contract over the past year, with meaningful Top of Book (TOB) size at **30 lots and spreads at 3bps** tight on average.

Exhibit 7. SGX FTSE Blossom Japan Index Futures Screen Orderbook for Calendar spreads



Source: SGX. Data as of end January 2024. Trading hours exclude lunch break between 11.30–12.30 (JST). Past performance is no guarantee of future results. Please see end for important legal disclosures

As we approach the dividend season in Japan, ex-dividend date is expected to be on 28th March 2024 for stocks in the FTSE Blossom Japan Index. SGX’s Blossom futures serve as a convenient tool to equitise dividends in portfolios benched to the FTSE Blossom Japan Index as well as other Japanese benchmarks such as FTSE Japan All Cap Indexes.

About Singapore Exchange (SGX Group)

We are Asia's leading and trusted securities and derivatives market infrastructure, operating equity, fixed income, currency and commodity markets to the highest regulatory standards. We also operate a multi-asset sustainability platform, SGX FIRST or Future in Reshaping Sustainability Together (sgx.com/first). We are committed to facilitating economic growth in a sustainable manner leveraging our roles as a key player in the ecosystem, a business, regulator and listed company. With climate action as a key priority, we aim to be a leading sustainable and transition financing and trading hub offering trusted, quality, end-to-end products and solutions. As Asia's most international, multi-asset exchange, we provide listing, trading, clearing, settlement, depository and data services, with about 40% of listed companies and over 80% of listed bonds originating outside of Singapore. We are the world's most liquid international market for the benchmark equity indices of China, India, Japan and ASEAN. In foreign exchange, we are Asia's leading marketplace and most comprehensive service provider for global FX over-the-counter and futures participants. Headquartered in AAA-rated Singapore, we are globally recognised for our risk management and clearing capabilities. For more information, please visit <https://regco.sgx.com/>

SGX Disclaimer

This document/material is not intended for distribution to, or for use by or to be acted on by any person or entity located in any jurisdiction where such distribution, use or action would be contrary to applicable laws or regulations or would subject Singapore Exchange Limited ("SGX") and/or its affiliates (collectively with SGX, the "SGX Group Companies") to any registration or licensing requirement. This document/material is not an offer or solicitation to buy or sell, nor financial advice or recommendation for any investment product. This document/material has been published for general circulation only. It does not address the specific investment objectives, financial situation or particular needs of any person. Advice should be sought from a financial adviser regarding the suitability of any investment product before investing or adopting any investment strategies. Use of and/or reliance on this document/material is entirely at the reader's own risk. Investment products are subject to significant investment risks, including the possible loss of the principal amount invested. Past performance of investment products is not indicative of their future performance. Any forecast, prediction or projection in this document/material is not necessarily indicative of the future or likely performance of the product. Examples (if any) provided are for illustrative purposes only. While each of the SGX Group Companies have taken reasonable care to ensure the accuracy and completeness of the information provided, each of the SGX Group Companies disclaims any and all guarantees, representations and warranties, expressed or implied, in relation to this document/material and shall not be responsible or liable (whether under contract, tort (including negligence) or otherwise) for any loss or damage of any kind (whether direct, indirect or consequential losses or other economic loss of any kind, including without limitation loss of profit, loss of reputation and loss of opportunity) suffered or incurred by any person due to any omission, error, inaccuracy, incompleteness, or otherwise, any reliance on such information, or arising from and/or in connection with this document/material. The information in this document/material may have been obtained via third party sources and which have not been independently verified by any SGX Group Company. No SGX Group Company endorses or shall be liable for the content of information provided by third parties (if any). The SGX Group Companies may deal in investment products in the usual course of their business, and may be on the opposite side of any trades. Each of SGX, Singapore Exchange Securities Trading Limited and Singapore Exchange Bond Trading Pte. Ltd. is an exempt financial adviser under the Financial Advisers Act (Cap. 110) of Singapore. The information in this document/material is subject to change without notice. This document/material shall not be reproduced, republished, uploaded, linked, posted, transmitted, adapted, copied, translated, modified, edited or otherwise displayed or distributed in any manner without SGX's prior written consent. Please note that the general disclaimers and jurisdiction specific disclaimers found on SGX's website at <http://www.sgx.com/terms-use> are also incorporated into and applicable to this document/material.

ABOUT FTSE RUSSELL

FTSE Russell is a leading global provider of index and benchmark solutions, spanning diverse asset classes and investment objectives. As a trusted investment partner we help investors make better-informed investment decisions, manage risk, and seize opportunities.

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.ftserussell.com); email info@ftserussell.com; or call your regional Client Service team office:

EMEA +44 (0) 20 7866 1810

Asia-Pacific

North America +1 877 503 6437

Hong Kong +852 2164 3333

Tokyo +81 3 6441 1430

Sydney +61 (0) 2 7228 5659

Disclaimer

© 2024 London Stock Exchange Group plc and its applicable group undertakings ("LSEG"). LSEG includes (1) FTSE International Limited ("FTSE"), (2) Frank Russell Company ("Russell"), (3) FTSE Global Debt Capital Markets Inc. and FTSE Global Debt Capital Markets Limited (together, "FTSE Canada"), (4) FTSE Fixed Income Europe Limited ("FTSE FI Europe"), (5) FTSE Fixed Income LLC ("FTSE FI"), (6) FTSE (Beijing) Consulting Limited ("WOFE") (7) Refinitiv Benchmark Services (UK) Limited ("RBSL"), (8) Refinitiv Limited ("RL") and (9) Beyond Ratings S.A.S. ("BR"). All rights reserved.

FTSE Russell® is a trading name of FTSE, Russell, FTSE Canada, FTSE FI, FTSE FI Europe, WOFE, RBSL, RL, and BR. "FTSE®", "Russell®", "FTSE Russell®", "FTSE4Good®", "ICB®", "Refinitiv", "Beyond Ratings®", "WMR™", "FR™" and all other trademarks and service marks used herein (whether registered or unregistered) are trademarks and/or service marks owned or licensed by the applicable member of LSEG or their respective licensors and are owned, or used under licence, by FTSE, Russell, FTSE Canada, FTSE FI, FTSE FI Europe, WOFE, RBSL, RL or BR. FTSE International Limited is authorised and regulated by the Financial Conduct Authority as a benchmark administrator. Refinitiv Benchmark Services (UK) Limited is authorised and regulated by the Financial Conduct Authority as a benchmark administrator.

All information is provided for information purposes only. All information and data contained in this publication is obtained by LSEG, from sources believed by it to be accurate and reliable. Because of the possibility of human and mechanical inaccuracy as well as other factors, however, such information and data is provided "as is" without warranty of any kind. No member of LSEG nor their respective directors, officers, employees, partners or licensors make any claim, prediction, warranty or representation whatsoever, expressly or impliedly, either as to the accuracy, timeliness, completeness, merchantability of any information or LSEG Products, or of results to be obtained from the use of LSEG products, including but not limited to indices, rates, data and analytics, or the fitness or suitability of the LSEG products for any particular purpose to which they might be put. The user of the information assumes the entire risk of any use it may make or permit to be made of the information.

No responsibility or liability can be accepted by any member of LSEG nor their respective directors, officers, employees, partners or licensors for (a) any loss or damage in whole or in part caused by, resulting from, or relating to any inaccuracy (negligent or otherwise) or other circumstance involved in procuring, collecting, compiling, interpreting, analysing, editing, transcribing, transmitting, communicating or delivering any such information or data or from use of this document or links to this document or (b) any direct, indirect, special, consequential or incidental damages whatsoever, even if any member of LSEG is advised in advance of the possibility of such damages, resulting from the use of, or inability to use, such information.

No member of LSEG nor their respective directors, officers, employees, partners or licensors provide investment advice and nothing in this document should be taken as constituting financial or investment advice. No member of LSEG nor their respective directors, officers, employees, partners or licensors make any representation regarding the advisability of investing in any asset or whether such investment creates any legal or compliance risks for the investor. A decision to invest in any such asset should not be made in reliance on any information herein. Indices and rates cannot be invested in directly. Inclusion of an asset in an index or rate is not a recommendation to buy, sell or hold that asset nor confirmation that any particular investor may lawfully buy, sell or hold the asset or an index or rate containing the asset. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Past performance is no guarantee of future results. Charts and graphs are provided for illustrative purposes only. Index and/or rate returns shown may not represent the results of the actual trading of investable assets. Certain returns shown may reflect back-tested performance. All performance presented prior to the index or rate inception date is back-tested performance. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index or rate was officially launched. However, back-tested data may reflect the application of the index or rate methodology with the benefit of hindsight, and the historic calculations of an index or rate may change from month to month based on revisions to the underlying economic data used in the calculation of the index or rate.

This document may contain forward-looking assessments. These are based upon a number of assumptions concerning future conditions that ultimately may prove to be inaccurate. Such forward-looking assessments are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially. No member of LSEG nor their licensors assume any duty to and do not undertake to update forward-looking assessments.

No part of this information may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission of the applicable member of LSEG. Use and distribution of LSEG data requires a licence from LSEG and/or its licensors.

The information contained in this report should not be considered "research" as defined in recital 28 of the Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council ("MiFID II") and is provided for no fee.



**FTSE
RUSSELL**
An LSEG Business