INVESTMENTS

Quantifying the financial impact of the net zero transition

STOXX Willis Towers Watson Climate Transition Index and Strategy

For professional investors

TABLE OF CONTENTS

Quantifying the financial impact of the net zero transition 02

1/ Transitioning to net zero 04

2/ Best-in-class collaboration 05

3/ Smarter decarbonisation 06

4/ Getting access to the index 08

Quantifying the financial impact of the net zero transition

STOXX Willis Towers Watson Climate Transition Index and Strategy

The impacts of climate change are already being felt. A rapid transition to net zero emissions is required 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.

WTW'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 potential opportunities.

WTW, 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 towards 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 under perform as the economy transitions.
- Align capital allocation with climate or low carbon commitments.

> **"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, WTW

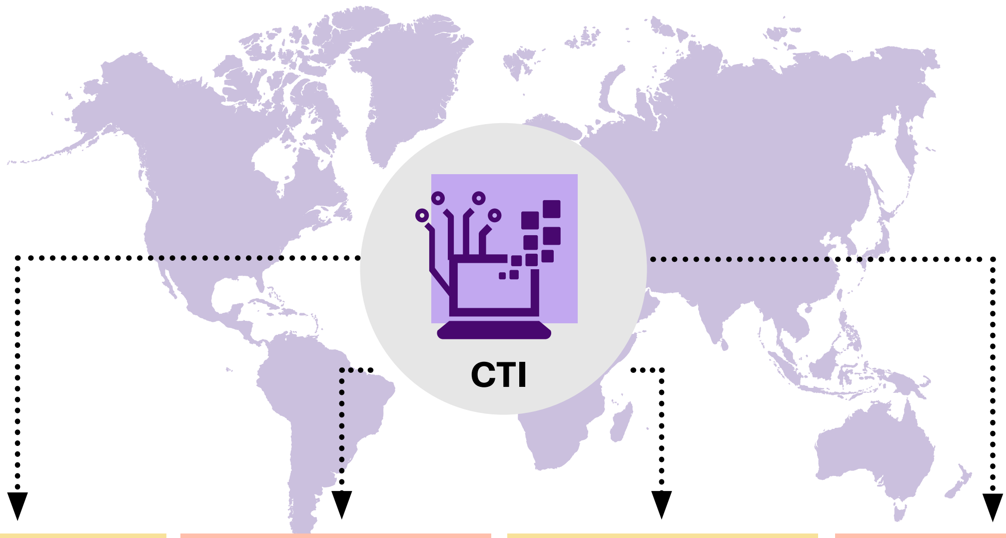
1. Transitioning to net zero

Introducing the next generation climate transition risk solution.

WTW'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.

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

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.

Deeper data

CTI curates asset level data from multiple sources to build a higher resolution view of climate transition risks and opportunities.

Forward, not backward

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

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.Best-in-class collaboration

WTW is bringing together best-in-class 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 WTW Climate Transition Index, and any subsequent strategies tracking it, 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 **capitalise** on opportunities and **manage** risks as we move to a net zero economy.

wtw

CTVaR methodology

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STOXX

Index

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AMX by Carne

Strategy

Net zero

WTW 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 WTW's CTVaR with STOXX portfolio optimisation 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. Smarter decarbonisation – 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), which is part of WTW's Climate Quantified™ analytical tools.

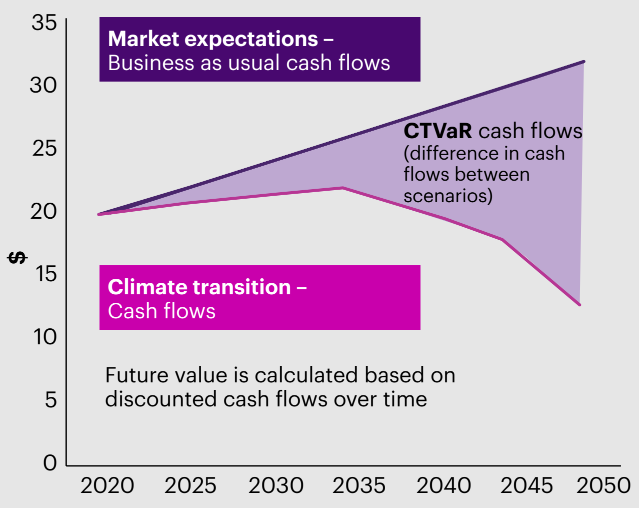
CTVaR offers a bottom-up granular approach to measuring the effect of changes to the global economy (driven by climate change mitigation) on a company's valuation.

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: Indicative predictive cashflows of a negative CTVaR company



Source: WTW 2021

WTW's Climate Quantified™ is used by the world's leading companies, organisations and governments to make informed decisions about climate, environmental, and other emerging risks that capture value and build resilience.

The team behind the methodology

WTW's multidisciplinary Climate Transition Analytics (CTA) team is comprised of 30 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 WTW's wider Climate and Resilience Hub comprising of 100+ 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, WTW

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

To offer investors a cost-effective way of implementing climate objectives, AMX by Carne launched a tax-efficient pooled strategy tracking the STOXX Willis Towers Watson Climate Transition Index.

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.

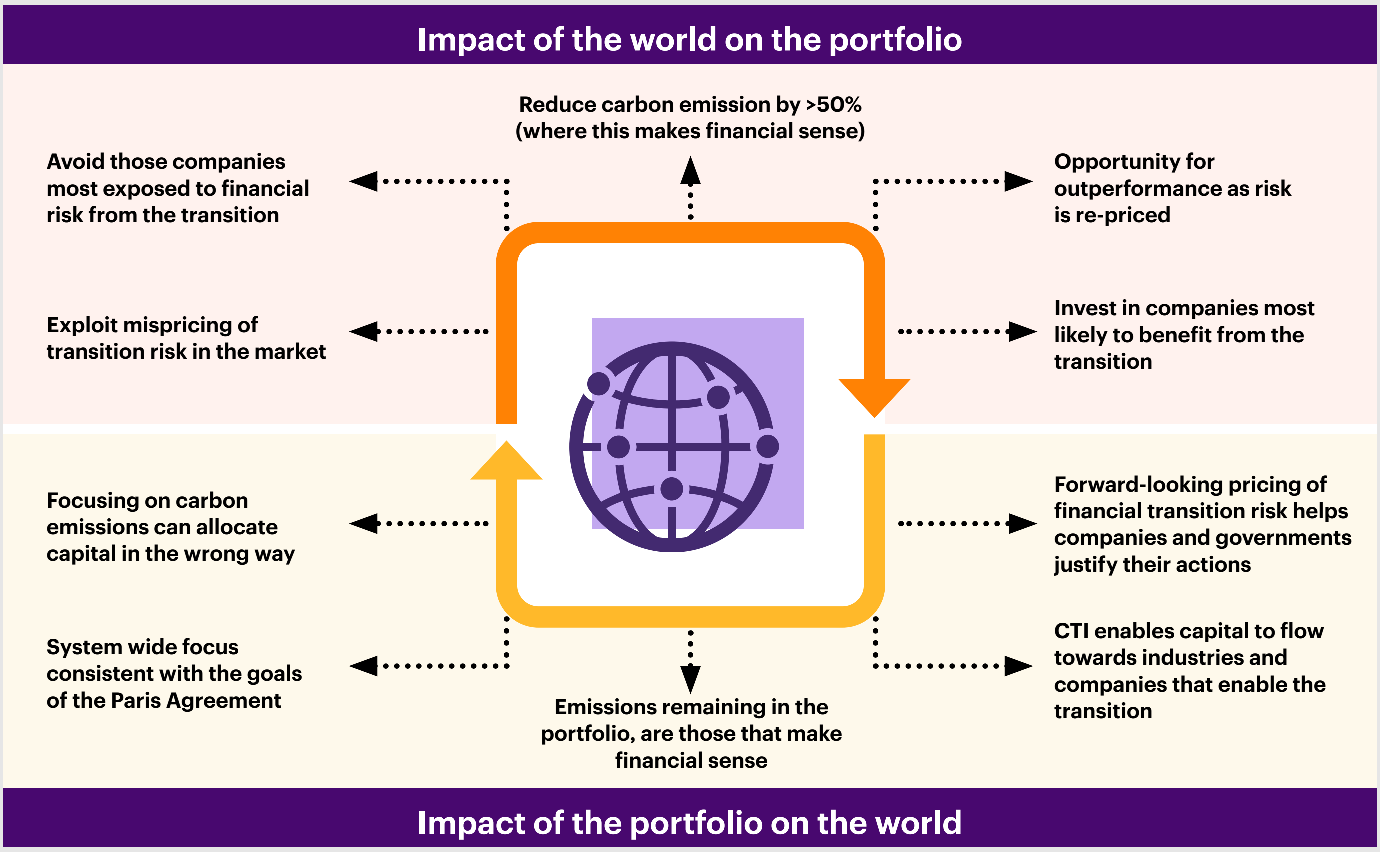
Some investors focused on sustainability factors have already moved away from market cap-weighted indices in favour of smart beta strategies which often consider various ESG and sustainability metrics. As the CTI strategy has an explicit climate transition focus, it will be a diversifying exposure to 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.

Climate benefits

Carbon emissions are often used to indicate the impact portfolios have on the climate, but they are a limited measure of the financial risks of the transition on portfolios. A CTI strategy enables investors to reduce the emissions of their portfolios, manage their risk and identify opportunities across different sectors and regions – while allocating capital to the industries and companies that accelerate the transition to net zero.

Figure 3: A smarter way to decarbonise



Smart implementation

The CTI strategy has been implemented in a tax-transparent way, with EOS's active stewardship providing additional voting and engagement.

The CTI strategy is hosted on the AMX platform. AMX ensures that clients' day-today needs are met. A team of service and implementation professionals are available to support clients - from onboarding during the transition process, to addressing day-today needs.

Standardised documentation through AMXConnect means that clients can save time in legal agreements and paperwork, and increase overall efficiencies.

There is also independent risk oversight performed independently of the Portfolio Manager's internal risk process, adding an extra layer of oversight.

Stewardship overlay

EOS at Federated Hermes is a leading stewardship service provider - with whom WTW has a strong relationship. For the CTI, EOS will be providing voting and engagement, which means that the assets in the strategy will benefit from EOS's corporate engagement work and voting.

About AMX

In August 2022, AMX became part of Carne enabling AMX to offer a wider choice of products and services to institutional investors and asset managers.

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We've seen huge demand for this kind of solution – as investors look to take action following setting net zero objectives and targets for eliminating climate transition risks from their portfolios over time.

Sarah Hopkins,
Head of Equity Solutions, WTW

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About Qontigo STOXX

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 AMX Carne

The Asset Management Exchange, AMX and AMX by Carne are trading names of Carne International Financial Services (UK) Limited and The Asset Management Exchange (IP Co.) Limited. Carne Global Financial Management (Ireland) Limited, registered in Ireland (No. 377914).

About WTW

At WTW (NASDAQ: WTW), we provide data-driven, insight-led solutions in the areas of people, risk and capital. Leveraging the global view and local expertise of our colleagues serving 140 countries and markets, we help you sharpen your strategy, enhance organizational resilience, motivate your workforce and maximize performance. Working shoulder to shoulder with you, we uncover opportunities for sustainable success — and provide perspective that moves you. Learn more at wtwco.com.

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