

## INTRODUCTION

### SUSTAINABILITY INDICES IN STOCK EXCHANGES

Dow Jones was the first large group to incorporate the concept of sustainability in its products. The Dow Jones Sustainability Index (DJSI) was launched in 1999 by the Dow Jones Indexes and SAM (Sustainable Asset Management), a Swiss resource management group specialized in companies that have a commitment to social, environmental and cultural responsibility.

The index, which accompanies financial performance of leading corporations in the field of sustainable development, includes 318 corporations of 24 countries in the edition covering 2004–2005. The selection of the companies is made based on a broad questionnaire focused on environmental, social and economic performance, including indicators of corporate governance.

The DJSI adopts the method known as Best in Class, which selects the companies with the best performance in each of the economic sectors, excluding only defense companies where more than 50% of revenues come from the sale of arms.

Influenced by the American experience, the London Stock Exchange and the Financial Times launched in 2001 the FTSE4Good. The series, composed of four indices, was developed by the EIRIS research group and evaluates the performance of global companies through analysis of environmental and human rights criteria and the engagement and commitment of stakeholders. Excluded from the list are corporations in the nuclear, tobacco and arms industries.

South Africa was the first emerging country to incorporate sustainability in its stock exchange and launched, through the Johannesburg Stock Exchange (JSE), a Socially Responsible Investment (SRI) Index in 2003. Although it was largely inspired by the FTSE4 Good, The SRI of the JSE did not exclude any economic sector. Instead of excluding them, the JSE categorized these sectors as “high impact” corpo-

rations. The rating is made based on social, economic, environmental and corporate governance criteria, evaluated from the point of view of policies, management, performance, transparency of reporting and public consultation. Some criteria are crucial in eliminating candidates and for this reason the corporations have to receive high scores in these categories to be on the JSE list.

### **THE BOVESPA CORPORATE SUSTAINABILITY INDEX (ISE)**

The Brazilian experience in Social Responsible Investments (SRI) began in January 2001, when Unibanco launched its first research service for green funds. The reports from the bank, containing social and environmental information on corporations listed on the Bovespa, were aimed exclusively at socially responsible funds abroad. At the end of 2001, Banco Real ABN Amro launched the “Fundos Ethical” (FIA), the first two SRI funds in emerging markets. Since then the two funds of the Ethical I family have performed better than the general Bovespa Index for the same period. In 2004 Banco Itaú launched the Itaú Excelência Social fund, focused on performance in corporate social responsibility.

After having perceived that the fine-tuning of the capital market is a decisive factor in fulfilling its role in financing economic growth, The São Paulo Stock Market Exchange (BOVESPA) created the New Market- Novo Mercado. The “Novo Mercado” seeks to create a more appropriate environment so that corporations may, based on the best practices of corporate governance and transparency of information, provide greater security to investors and, consequently, reduce their costs of obtaining funding. Mention should also be made of the “Índice de Ações com Governança Corporativa Diferenciada” (or simply “IGC”), with the objective of measuring the performance of a portfolio composed of shares of corporations that show high levels of corporate governance. These are the companies that are admitted to operate in the New Market and in the Levels 1 and 2 of BOVESPA.

In the last four years, questions such as socio-environmental performance and corporate governance became an integral part of the vocabulary of Brazilian corporate leaders. The ethical crises faced by international giants such as Enron and WorldCom revealed the vulnerability of financial statements and independent auditors in terms of guaranteeing transparency. This strengthened the SRI sector. The incentive of market groups such as the Brazilian Association of Market Analysts (APIMEC) in the debate on sustainability in the capital markets was of fundamental importance, enabling investment analysts to widen the scope of their research.

Associated with the segmentation movement of international markets, BOVESPA was the first stock exchange to unite with the signatories of the Global Compact of the United Nations. As part of this process and triggered partly by the lack of a benchmark for SRI funds, a work group was set up to prepare a sustainability index for BOVESPA. It was made up of representatives of institutions that focused on themes such as social responsibility, corporate governance, environment and capital markets.

The group defined the basic guidelines for creating an index and the design for a technical-financial proposal to the International Finance Corporation (IFC), the private arm of the World Bank and the source of funding for research on methodology for the index. Like other sustainability indices, the BOVESPA joined efforts with the Centro de Estudos em Sustentabilidade - GVces (Center for Sustainability Studies) of the “Escola de Administração de Empresas de São Paulo da Fundação Getulio Vargas - FGV-EAESP” (Sao Paulo Business Administration School of Fundação Getulio Vargas), a research center whose main focus lies in the areas of corporate sustainability and sustainable finance. The GVces was created by FGV-EAESP owing to the urgent need for corporations, financial institutions, shareholders, management, insurance companies, consultants and auditors, in understanding, measuring and evaluating the risks and opportunities associated with areas of impact that are apparently non-financial, such as the environment, social responsibility and corporate governance. ([www.ces.fgvsp.br](http://www.ces.fgvsp.br)).

The work group later gave way to the board of the ISE - CISE (ISE's Council), composed of the Brazilian Assoc. of Private Pension Funds (ABRAAP), Brazilian Association of Investment Banks (ANBID), Brazilian Association of Market Analysts (APIMEC), São Paulo Stock Market Exchange (BOVESPA), Brazilian Institute of Corporate Governance (IBGC), Ethos Institute (ETHOS), International Finance Corporation (IFC), Brazilian Institute of Social and Economic Analysis (IBASE)\*, and the Sustainable Development Secretariat of Brazilian Environment Ministry (SDS/MMA).

The GVces conducted a broad review of the literature on criteria and sustainability indices and analyzed in detail, among other items, the guidelines for the social balance sheet of the IBASE, Instituto ETHOS and the Global Reporting Initiative (GRI), as well as questionnaires applied to the DJSI, FTSE4 Good and the JSE indices. Specialists in the various themes that compose the index participated through public consultations, hearings, workshops and specific meetings. The resulting questionnaire based on these studies was presented to companies, which submitted their comments and suggestions. Subsequently these questionnaires were presented to the public in general in a public hearing.

## **METHODOLOGY**

The BOVESPA Corporate Sustainability Index (ISE) will be launched in 1st December 2005.

Yearly reviews of the parameters are foreseen to ensure the correct level of corporate sustainability of the companies listed on the BOVESPA exchange.

There is no categorical exclusion of any economic sectors in the index.

On the first and only occasion that the CISE discussed the matter, the majority of its nine members decided against any prior exclusion of any sector. The positive screening, that is, the non-exclusion as a prin-

ciple of any sector was the model that was chosen. This means that all companies with a minimum liquidity in the market defined by CISE will be able to fill out the questionnaire and participate in the selection. All the items associated with sustainability of each sector will be evaluated in depth, including potential risks and adverse impacts associated with the nature of the products and services of each company.

### **GENERAL OBJECTIVES OF THE ISE**

The main objective of the index is to create an investment environment compatible with the demands of sustainable development of contemporary society and stimulate corporate ethical responsibility.

The index also has become a tool for a comparative analysis of the performance of corporations listed on the BOVESPA under the issue of corporate sustainability, based on economic efficiency, environmental balance, social justice and corporate governance. It will serve as an instrument of instruction for interested parties on how to understand better and distinguish between corporations and related groups committed to corporate sustainability and to differentiate them in terms of quality, level of commitment, transparency, performance, as well as other relevant factors for investors concerned about ethics.

This index may serve as another instrument to attempt to resolve the challenges imposed for sustainable development as it is a useful tool which may help companies reduce waste and protect socio-environmental rights, at the same time they create greater value and, consequently, more wealth and more profit. It may also serve as a sign to corporations and business groups which pathways are more appropriate to build a more efficient economy from the point of view of using natural resources and generating a lesser impact on the environment and society, and generating a greater potential value to the products and services per unit of applied environmental resources.

The creation of such an index is also important in an international context. It serves as an example that Brazil is giving to the rest of the world and to the other stock exchanges.

## **PRINCIPLES**

The definition of the criteria and indicators to verify selected corporate sustainability was based on a series of principles that have been discussed and generally accepted in literature on corporate sustainability.

These principles include:

- Public information
- Comparability
- Auditability
- Breadth of scope
- Timeliness and ability to trace data back in time

## **SCOPE**

The basic concept of ISE is the triple bottom line (TBL), introduced by the English consulting group SustainAbility, which analyzes economic-financial, social and environmental items and data in an integrated fashion. Also added to the triple bottom line concept were criteria and corporate governance indicators based on the model of the Johannesburg Stock Exchange, which spawned a fourth theme group. The four blocks are preceded by a group of general basic indicators and on data related to the nature of the product.

## **CRITERIA AND INDICATORS**

The economic-financial, social and environmental scope has been divided into four series of criteria. Policies (indicators of commitment); management (indicates plans, programs, goals and monitoring procedures); performance (indicators of performance): and adherence to the laws (evaluates the conformity to the norms in such areas as competition, consumer rights, labor and environmental legislation and norms, among *others*.)

The environmental scope, owing to the relevance and the difference of

impacts on the environment of various different sectors, deals with the nature of each company's business operations. The companies listed in the financial sector receive a different environmental questionnaire adapted to their characteristics. The other companies were divided into two impact levels- high and moderate —and will respond to the same questionnaire. However, the criteria of environmental scope will receive a different weight in the financial evaluation according to the two levels.

The scope of corporate governance presents indicators of the best practices organized in the following criteria: Property, Administrative Council, Management, Auditing and Monitoring, Conduct and Conflict of Interests. In this focus one has attempted to respect the transversal form of the principles of transparency, equity, accountability and corporate responsibility, defined by the Brazilian Institute of Corporate Governance (IBGC).

The analysis of the corporations' responses to the questionnaire will be considered and will be referred to the Director of Investor Relations.

Although no audit system has yet been foreseen, the Conselho do Índice (Index Council) may request further information or clarification based on sample testing or by a relevant fact that is not consistent with the responses provided in the questionnaire.

## **FINAL EVALUATION**

The methodological design of the ISE is innovative in that it introduces the “cluster analysis” as one of the statistical tools in the final classification process of the companies. It avoids the biases based on the sum of scores of evaluations of scope in different areas such as the environment and corporate governance. This analysis of clusters identifies groups of companies that present similar performances, which present the best practices in the five different category series.