

The Bovespa Corporate Sustainability Index (Índice de Sustentabilidade Empresarial – ISE) is the first index tracking the economic, financial, corporate governance, environmental and social performance of leading companies listed in the São Paulo Stock Exchange. It will be launched in December 2005 to provide asset managers and investors with a reliable and objective benchmark of the best corporate sustainability practices in the country.

The ISE project was financed by the International Finance Corporation (IFC), the private sector arm of the World Bank Group, an organization that promotes sustainable private sector investment in developing countries as a way to reduce poverty and improve quality of life.

Developed by the Center for Sustainability Studies of Fundação Getulio Vargas, a leading business school in Brazil, the ISE will include up to 40 companies that seek excellence in managing sustainability. By rewarding companies that deliver solid economic results and incorporate environmental, social and corporate governance elements to their business model, the ISE will encourage other firms to follow the example.

## A BRIEF HISTORY OF SUSTAINABILITY AND THE STOCK MARKET

The stock market began incorporating sustainability issues in the 1960's. A turbulent decade, remembered for its protests and the birth of the counterculture movement, it proved to be fertile ground for the questioning of the ethics associated with the stock market. Concepts such as corporate social responsibility and accountability were born, wrapped up in the controversy over the war in Vietnam, the civil rights movement in the United States, and the struggle for women's rights. During the 1970's, concerns over workers' rights and nuclear energy also entered into the picture.

These issues gained strength in the 1980's and 1990's, catalyzed by apartheid in South Africa and environmental disasters such as Bhopal in India, Chernobyl in the former Soviet Union, and

Exxon Valdez off the Alaskan coast. Ecological disasters, climate change, and the deterioration of the ozone layer brought environmental issues into the spotlight, and the stock market was not immune.

By 1997 investments that took into account social and environmental criteria, or Socially Responsible Investing (SRI), totaled over US\$ 1 trillion. By 2003, with the launch of the Dow Jones Sustainability Index (DJSI) and the FTSE4Good Series along with the corresponding licensing of associated products, over 200 funds were marketed for modern investors of a variety of profiles, from ethical and religious funds to funds based on latest generation technology. These products attracted more than US\$ 2.3 trillion in investments.

## STOCK MARKET SUSTAINABILITY INDEXES

Dow Jones was the first big player to incorporate sustainability into its products. The Dow Jones Sustainability Index was launched in 1999 by Dow Jones Indices and Sustainable Asset Management (SAM), a Swiss asset management company specialized in investing in businesses committed to social responsibility, cultural and environmental issues.

In 2004-2005, the index tracked the financial performance of 318 companies from 24 countries in terms of sustainable development. The evaluation process takes into account the companies' environmental, social, and economic characteristics, which includes measures of corporate governance. The DJSI uses a methodology known as Best in Class, that selects companies with the highest ratings in each economic sector, excluding those defense companies that record 50% of total revenues from arms sales.

Inspired by the American experience, the London Stock Exchange and the Financial Times

launched the FTSE4Good. The series, made up of four indices, was developed by the research company EIRIS and evaluates the development of global businesses according to environmental and human rights criteria and the engagement of stakeholders. It excludes weapons, nuclear, and tobacco industries.

South Africa was the first emerging market to incorporate sustainability into its stock market. The Johannesburg Stock Exchange (JSE) launched its SRI index in 2003. In spite of the example provided by the FTSE4Good, the JSE's index does not exclude any sectors, choosing to classify these sectors as "high impact". The rating is based upon social, economic, environmental, and corporate governance criteria, evaluated from the point of view of policy, management, development, reporting, and public consulting. Some of the criteria are eliminatory, thus companies must score well in these categories to qualify for ranking in the JSE.

## THE BOVESPA CORPORATE SUSTAINABILITY INDEX (ISE)

Brazil's experience in SRI began in January of 2001, when Unibanco launched the first SRI research service. The bank's reports, containing social and environmental information about businesses listed at Bovespa, were produced exclusively for SRI funds abroad. At the end of 2001, Banco Real ABN Amro launched its Ethical Funds FIA (Fundos Ethical FIA), the first two SRI funds based in emerging markets. Since their inception, both funds have outperformed the Bovespa index. In 2004, Banco Itaú launched its Itaú Social Excellence Fund (Fundo Itaú Excelência Social), focussing on corporate social responsibility.

With the growing appreciation of the critical role of capital markets in financing economic growth, Bovespa created the New Market (Novo Mercado). The New Market aims to create a suitable environment for businesses to ensure investors of better corporate governance practices and improved transparency, resulting in reduced costs of capital. Bovespa also launched the Corporate Governance Stock Market Index (Índice de Ações com Governança Corporativa Diferenciada or IGC), which tracks the performance of a portfolio made up of companies that demonstrate high levels of corporate governance. This portfolio includes all the companies listed at the Bovespa's New Market and Levels 1 and 2.

# Bovespa Corporate Sustainability Index



In the past four years, issues such as social, environmental, and corporate governance have become part of the vocabulary of Brazilian managers, who were more accustomed to regarding such notions as romantic excesses.

The ethical crises confronted by multinational corporations such as Enron and WorldCom demonstrated the fragility of financial reports and independent auditors charged with guaranteeing transparency, which further strengthened the SRI sector. The influence of experts such as the Association of Capital Market Analysts and Investment Professionals (Associação dos Analistas e Profissionais de Investimentos do Mercado de Capitais or APIMEC) proved to be fundamental to convince investment analysts to broaden the scope of their analyses.

In conjunction with the trend to segmentation in the international markets, Bovespa became the first stock exchange to join the signatories of the United Nations' Global Compact. As part of this process, and instigated by the lack of a benchmark for SRI funds, a Working Group was created to develop a sustainability index for the Brazilian stock market. Made up of representatives from environmental, social, corporate governance, and capital market institutions, the group defined the basic guidelines for the development of the index's methodology. The development of the methodology became the center of a proposal presented to the International Finance Corporation (IFC), that became the sponsor of such initiative.

Bovespa joined forces with the Center for Sustainability Studies at Fundação Getúlio

Vargas (GVces) to develop the new index. The original working group was transformed into the index's advisory board, composed of the following entities: Associação Brasileira das Entidades Fechadas de Previdência Complementar (ABRAAP), Associação Nacional de Bancos de Investimentos (ANBID), Associação de Analistas e Profissionais de Investimentos de Mercado (APIMEC), Bolsa de Valores de São Paulo (BOVESPA), Instituto Brasileiro da Governança Corporativa (IBGC), Instituto Ethos de Empresas e Responsabilidade Social (ETHOS), International Finance Corporation (IFC), Instituto Brasileiro de Análises Sociais e Econômicas (IBASE), and the Secretaria de Desenvolvimento Sustentável do Ministério do Meio Ambiente (SDS/MMA).

GVces conducted a thorough literature review on the criteria and indicators of sustainability and analyzed in detail social balance directives put forth by IBASE, ETHOS, and the Global Reporting Initiative (GRI), as well as the questionnaires used by DJSI, FTSE4Good, and JSE. Specialists at the different fields that make up a sustainability index were active participants in this process. The resulting questionnaire was presented to companies, who responded with their own comments and suggestions. The methodology and questionnaire were opened for public consultation that took place in different occasions, through workshops opened for specialists, as well as workshops for the interested private sector stakeholders. Also, a public audience was held where the questionnaire was presented for discussion and comments by the general public. The following step was a beta-test evaluation of the electronic system in place.

## ISE'S METHODOLOGY

# Bovespa Corporate Sustainability Index



The Bovespa Corporate Sustainability Index will be revised annually to ensure that it reflects the real business sustainability level of companies listed on Bovespa and to incorporate the evolution of sustainability practices and theoretical benchmarks.

According to a decision by ISE's Advisory Board ("CISE"), no sectors will be excluded from the index. The first – and only – time that CISE considered the subject, the majority of its nine members decided not to exclude any sector.

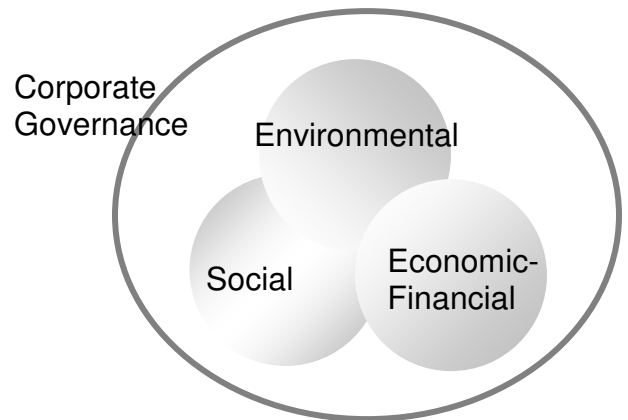
Instead, they opted for Positive Screening rather than outright exclusion of sectors. This means that all companies whose shares show a minimum level of liquidity in the market will have the opportunity to fill out the questionnaire and participate in the selection process. However, all elements associated with sustainability for each sector will be closely evaluated, including potential risks and adverse impacts associated with the nature of the products and services of each business.

## DIMENSIONS

ISE is based on the triple bottom line (TBL) concept introduced by the English consulting firm SustainAbility, which evaluates the economic-financial, social, and environmental elements in an integrated manner.

To the TBL principles were added corporate governance indicators and criteria, following the JSE model. Those indicators created a fourth thematic group to evaluate the companies. The four blocks are preceded by a group of general indicators.

These include, for example, publication of a sustainability or social report, endorsement of the Global Pact of the United Nations, and



damages or risks to health, physical safety or integrity of consumers and third-parties, as well as to public health and safety, posed by the consumption or use of the company's products.

## CRITERIA AND INDICATORS

The economic-financial, social, and environmental dimensions were divided into four programs, goals, and monitoring); Performance; and Legal Compliance (with environmental and consumer regulation, among others).

The environmental dimension, given the different impact on the environment of different economic

groups of criteria: Policies (commitment indicators); Management (indicating plans, sectors, takes into account the nature of each business. For example, the financial sector, due to its specific characteristics, will respond a customized environmental questionnaire. Other businesses were divided into two impact levels -- high and moderate, and will fill out the same

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questionnaire. However, for this last group, the environmental criteria will receive different scores in the final evaluation. The sectors defined as high impact are weighted more heavily in terms of “management” and “performance”, while for the moderate impact sectors criteria such as “policies” and “management” will be emphasized. This methodology was inspired by the solutions offered by the FTSE4Good and the JSE.

The Corporate Governance dimension includes best practice indicators for the following criteria: Property; Administration Council; Management; Monitoring and Auditing; and Conduct and Conflict of Interests. The goal is to evaluate, in a

transversal manner, the principles of transparency, equity and accountability, as they are defined by the Brazilian Institute of Corporate Governance (Instituto Brasileiro de Governança Corporativa or IBGC).

The questions are 100% objective. The Advisory Board will analyze the replies sent by listed companies, which will be signed by the Director of Investor Relations. In spite of not providing an auditing system, Bovespa can ask for clarification of a relevant fact that is not consistent with answers given in the questionnaire.

## FINAL ASSESSMENT

ISE’s methodology introduces cluster analysis as a statistical tool in the final classification process. Avoiding deviations generated by a simple adding of assessment scores of such distinct dimensions as the environment and corporate governance, cluster analysis identifies groups of

businesses that exhibit similar performance in each dimension. The final portfolio will be made up of the cluster of businesses that demonstrates the best practices in all five dimensions

ISE will be launched at the **II International Conference on Sustainable Finance in Emerging Markets**, as well as the Latin American Sustainable Finance Forum (LASFF), a network that will promote the development of business with a sustainability focus.

The Conference will happen in São Paulo, 1-2 December 2005. It is an initiative of the International Finance Corporation (IFC) and the Center for Sustainability Studies (GVces) that has as its main objective the establishment of a network of sustainable finance players in developing markets, sharing experiences and planning regional coordinated advances in this field.

More information available at [www.ces.fgvsp.br](http://www.ces.fgvsp.br)

## REALIZATION:

