EXECUTIVE SUMMARY

Brazil is the world’s tenth largest economy. The São Paulo stock exchange (operated by BM&F Bovespa) has a market cap of some US$585 billion, as of the end of October 2008, having fallen by about 50 percent over the last year in common with most markets around the world. The stock market is dominated by the financial sector, oil & gas, mining, and steel. As of the end of October 2008, 34 percent of the benchmark IBOVESPA Index was concentrated in just two stocks – the oil & gas company Petrobras, and the mining company Vale R Doce. Domestic savings have increased significantly in recent years: the top 40 asset managers in Brazil control about US$500 billion in mutual funds and other products, whilst the country’s 278 pension funds have combined assets of about US$185 billion. Foreign portfolio investment has also become increasingly important to the economy: the total stock of such investment stood at about US$232 billion by the end of August 2008. In addition, American Depository Receipts (ADRs), issued by Brazilian companies and traded on the New York Stock Exchange, have a total ownership value of a further US$110 billion.

Uniquely amongst emerging economies, ESG issues have had a prominent place in the Brazilian financial and investment community for nearly a decade. Bovespa introduced its corporate governance-themed Novo Mercado listing segment in 2001 and in the same year Banco Real launched Brazil’s first socially responsible investment (SRI) mutual fund, Fundo Ethical. A key feature in Brazil’s sustainable investment landscape is BM&F Bovespa’s Corporate Sustainability Index, the ISE. Launched in December 2005, the ISE was swiftly followed by a dramatic increase in the number and size of Brazil’s retail SRI funds and has generally matched the IBOVESPA benchmark in performance. As of October 2008, 10 asset managers offer retail SRI funds with combined assets under management of about US$315 million. Several of these asset managers came together to support the growth of sustainable capital flows, IFC’s advisory services seek to influence, support, and enable capital market stakeholders to better integrate environmental, social, and governance (ESG) factors into capital allocation and portfolio management processes, using IFC’s own investment practices as a model. IFC is playing its part to support the growth of the market by funding the development of enhanced stock market indices, financial instruments, and through targeted market research.

Compiling data on the state of development of the sustainable investment industry is important for global investors and investment managers to understand the scale and location of opportunities in the market for sustainable investment products. While a number of organizations provide this information in developed economies, such data is scarcely available in emerging markets.

IFC thus decided to launch a series of Sustainable Investment Country Reports initially covering the largest emerging capital markets attracting global portfolio investors – Brazil, China, and India. Further regional reports will be added to the series covering Sub-Saharan Africa and the Middle East.

This summary version of the report Sustainable Investment in Brazil 2009, which may be downloaded in full from IFC’s website, provides a snapshot of the Brazilian market. Brazil has made significant progress in developing a sustainable market over the last decade, building to its reputation as a leader in emerging markets. While there has been an increase in sustainable-related research and investable products (e.g., Brazil’s sustainability index, which was funded by IFC), challenges lie ahead for the growth of sustainable investments in Brazil.

In our own investments and through our interactions with clients and other stakeholders, IFC will continue to play a role in promoting sustainable investment in Brazil.
in 2006 to create the Latin American Sustainable Finance Forum (LASFF) in association with Center for Sustainability Studies at the Fundação Getúlio Vargas Business School (CES-FGV), a specialized center of excellence for sustainability studies within Brazil’s leading business school. CES-FGV is also the data provider for the ISE and designed the index’s ESG methodology. Seed funding from IFC played a critical role in the creation of both the LASFF and the ISE.

Figure 2. Retail SRI Funds Assets Under Management in Brazil

(Based on: CVM)

Brazil’s pension funds have taken a proactive stance on ESG issues, largely due to the leadership of their largest member, PREVI. Eighteen pension funds have signed the UN Principles for Responsible Investment (PRI). Together they represent combined assets of US$110 billion, or about 60 percent of the country’s total pension fund corpus. Although implementation is still at a relatively early stage, momentum is high and is supported strongly by the UNPRI Secretariat, which has helped establish a PRI Brazil Network aided by a full time in-country coordinator. The PRI Brazil Network has now developed a well-organized work program focusing on shareholder engagement, ESG integration, and recruitment of new signatories. Shareholder engagement on ESG issues is still in its infancy, and currently focuses on labor standards in charcoal producers associated with Brazil’s iron and steel industry.

This engagement involves cooperation with some international PRI signatories as well as LASFF members and Brazil’s pension funds. In general, though, foreign portfolio investors have thus far not been actively engaged in Brazil’s sustainable investment market and have shown little interest in using the ISE index, for example. However, quantitative data on this point are extremely limited; in the absence of hard facts, TERI-Europe has used a working assumption that ESG investment styles account for about 1 percent of foreign portfolio investment and investment in Brazilian ADRs (approximately US$2.2 billion).

Table 1. Estimates of the Stock of Sustainable Investment (SI) in Brazil

<table>
<thead>
<tr>
<th>Segment</th>
<th>Estimated stock of SI (US$ billion)</th>
<th>Percentage of segment total</th>
<th>Basis for % comparison</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset manager signatories to UNPRI (excluding NAV of SRI funds, below)</td>
<td>US$7.9</td>
<td>11%</td>
<td>ANBID data (Oct. 2008); estimation 15% allocation to equities; assuming UNPRI implementation</td>
</tr>
<tr>
<td>Retail SRI mutual funds</td>
<td>US$0.3</td>
<td>2%</td>
<td>ANBID data (Oct. 2008) and CVM data (Jan. 2009); estimation that 15% of total retail AUM are allocated to equities</td>
</tr>
<tr>
<td>Pension fund signatories to UNPRI</td>
<td>US$35.0</td>
<td>60%</td>
<td>ABRAPP data (Sep. 2008); estimation 32% allocation to equities; assuming UNPRI implementation</td>
</tr>
<tr>
<td>BNDES (US$16 billion listed equities)</td>
<td>Unknown</td>
<td>Unknown</td>
<td>BNDESPAR holdings as of June 30, 2008; Bovespa trading data as of Jan. 23, 2009</td>
</tr>
<tr>
<td>Foreign investment under SI management</td>
<td>US$1.2</td>
<td>&lt;1%</td>
<td>CVM data (Aug. 2008); guessing that 1% of total stock is SI</td>
</tr>
<tr>
<td>ADR investment under SI management</td>
<td>US$1.0</td>
<td>&lt;1%</td>
<td>ADR data as of Jan. 2009; guessing that 1% of total stock is SI</td>
</tr>
<tr>
<td>HWNI assets available for sustainable investment</td>
<td>US$24.5</td>
<td>&lt;5%</td>
<td>Independent estimates of HWNI wealth; guessing that allocation to equities is 35% and SI could be 5% of this</td>
</tr>
<tr>
<td>TOTAL excluding BNDES</td>
<td>US$70 billion</td>
<td>12%</td>
<td>Percentage of total domestic market cap (US$585 billion as of Oct. 2008) (World Federation of Exchanges data)</td>
</tr>
<tr>
<td>TOTAL including BNDES</td>
<td>US$86 billion</td>
<td>15%</td>
<td></td>
</tr>
</tbody>
</table>

(Source: TERI-Europe)

Other market participants may also be relevant for the future of Brazil’s sustainable investment market. The Brazilian Development Bank (BNDES), for example, has stakes in over 30 publicly listed Brazilian companies; this portfolio is worth about US$16 billion. BNDES follows environmental and social policies for its project finance operations, but is unclear whether or how these are applied to its equity holdings. The wealth management market may also be important: Brazil has 143,000 high net worth individuals (HNWIs) constituting a market of about US$1.4 trillion. About 16 percent of Latin American HNWIs allocate some part of their portfolio to “green investments” such as clean technology and alternative energy. However, more detailed information is not currently available.
The enabling environment for sustainable investment in Brazil is relatively strong compared to large emerging economies such as China or India, particularly in terms of voluntary non-financial reporting by companies. About 60 percent of companies in the IBOVESPA publish sustainability reports, many of which are based on the international good practice guidelines issued by the Global Reporting Initiative (GRI). The number and quality of corporate responses to the annual survey of the international Carbon Disclosure Project (CDP) is also improving.

Nevertheless, further progress is needed on ESG-related transparency and disclosure, especially regarding regulatory filings and IPO prospectuses. Furthermore, Brazilian stocks do not receive much ESG coverage from international sustainability research firms or equity analysts. Lack of commercial demand on the domestic front also means that Brazil has not yet developed any home-grown infrastructure in this respect, despite the capacity building efforts of organizations such as the Association of Capital Markets Analysts and Investment Professionals (APIEC). Other Brazilian industry associations taking a proactive advocacy position on sustainable investment include the Brazilian Association of Pension Funds (ABRAPP) and the National Association of Investment Banks (ANBID).

Looking to the future, sustainable investment in Brazil faces some important challenges. Many of these are essentially about adapting to success through a new phase of market evolution.

The key issues include:
- Updating the ISE’s commercial business model
- Making greater use of the underlying ISE data
- Creating demand for the commercial provision of ESG research
- Developing human capital
- Establishing effective outreach and engagement with international investors
- Investing in research and development
- Fostering renewed competition and innovation in the asset management industry
- Building on LASFF and the PRI Brazil Network to increase the effectiveness of national cooperation in the sustainable investment community.

Detailed analysis and recommendations on each of these issues can be found in the full report.

Sustainable Investment in Brazil 2009, full report (English and Portuguese):
http://www.ifc.org/sustainableinvesting

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