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TalkingPoints

Capturing ESG in Brazil: The S&P/B3 Brazil ESG Index



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To address the need for a broad market ESG benchmark in Brazil, S&P DJI and B3 joined forces to launch the [S&P/B3 Brazil ESG Index](#). S&P DJI's Silvia Kitchener and Iuri Rapoport from BTG Pactual sat down to discuss how this innovative index captures a more complete picture of ESG in Brazil, and how it could be used to address the growing demand for ESG solutions in the region.

1. We know that there are many types of environmental, social, and governance (ESG) indices. What is the objective of the S&P/B3 Brazil ESG Index?

Silvia: Correct; there are various ESG indices with different objectives. Some indices use the “best-in-class” approach like the [Dow Jones Sustainability MILA Pacific Alliance Index](#), which selects the top 30% of companies by sustainability score within each GICS® sector. The focus here is to feature the companies with the best ESG practices and policies. Then, we have the S&P ESG Indices, which are designed to provide improved ESG representation while maintaining similar overall industry group weights as their underlying indices as in the case of the [S&P 500® ESG Index](#).

The objective of the S&P/B3 Brazil ESG Index is to serve as a broad representative index of the Brazilian equity market with an improved ESG profile and maintain similar overall industry group weights as the [S&P Brazil BMI](#). The index does not focus on selecting companies based on their ESG scores; however, the score determines their representation in the index. This means that companies with higher ESG scores have a higher weight in the index. Companies with lower scores are incentivized to improve their programs, practices, and policies to help increase their scores and possibly their index weight.

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2. What has demand for ESG looked like in recent years, and how important do you think ESG will be moving forward?

Iuri: Several studies have shown that companies with better ESG practices enhance long-term returns. In general, these companies develop resilient and solid businesses, as they are more capable of dealing with externalities and adapting to new consumer behavior and regulatory demands.

The capitalist model has changed, and nowadays companies need to add value to a diverse spectrum of stakeholders—shareholders, employees, suppliers, local community members, and society. The urgency of ESG is a global societal commitment, as defined by the UN Sustainable Development Goals and Paris Agreement, and each individual and company must play their role in helping achieve a better, more sustainable world.

We believe companies with better ESG practices will be investors' priority in the long run.

3. Why are you launching an ESG index in Brazil now?

Silvia: Similar to many other countries around the world, we have found that in Brazil right now, there is growing appetite for information on ESG. The concept of sustainable investing has been around for quite some time—our oldest ESG indices, the Dow Jones Sustainability Indices (DJSI), go back to 1999. Since then, there has been a growing interest in ESG, and it has especially picked up in recent years. B3 launched a sustainable index, the Corporate Sustainability Index (ISE), in 2005 that helped bring the concept of sustainability to the Brazilian market. Fifteen years later, issuers, asset managers, asset owners, and regulators are actively participating in the evaluation process and sustainable investing. Many are looking for ESG tools that are sharper than the first generation of sustainable indices. Thanks to advancements in ESG data and continued innovations in indexing, we are able to meet this demand with an index built on deeper datasets.

4. Why do you think that market participants are looking for ESG strategies at this particular moment in Brazil?

Iuri: ESG is a global movement and the Brazilian financial market is evolving with it.

ESG has been evolving for at least 20 years and gained traction in 2018. International institutional investors have pushed the local agenda, demanding information on ESG integration from local asset managers. There has also been recent demand from wealthy families, especially second-generation clients, as they request sustainable products from their banks.

5. Can you explain in more detail how the index is constructed, and how it's different than the existing B3 ISE?

Silvia: The S&P/B3 Brazil ESG Index uses a straightforward and easy to replicate methodology. It starts with the broad universe of the S&P Brazil BMI, which had 167 stocks as of Aug. 31, 2020. Companies not trading on B3 are removed. Next, all companies that are not in compliance with the United Nations Global Compact (UNGC) principles or that don't have an S&P DJI ESG Score are excluded. The remaining companies make up the index; there were 96 as of Aug. 31, 2020. Then, the stocks are weighted by their S&P DJI ESG Scores, subject to a company capping of 10% or a liquidity cap that limits the weight of a company to no more than four times its liquidity, whichever is less. This is important to ensure that the index is replicable.

For the calculation of the S&P DJI ESG Scores, the S&P/B3 Brazil ESG Index uses the world-renowned S&P Global Corporate Sustainability Assessment (CSA). S&P Global has been working with listed companies since 1999, teaching and advising companies how to participate in these assessments, which they can do directly by answering the questionnaires themselves or indirectly, by having S&P Global assess the companies using public information.

Meanwhile, B3's ISE is one of the oldest ESG institutions themselves or indirectly, by avidices in the world. It has a narrow, domestic focus, and it selects a maximum of 40 liquid stocks that meet sustainability criteria as determined by the ISE Advisory Board (CISE). As of Aug. 31, 2020, there were 36 stocks in the index. The assessment is carried out by the Sustainability Research Center at Fundação Getulio Vargas (GVces) and is governed by CISE. The board is presided over by B3 and is made up of more than 10 local entities, including Abrapp, Anbima, and the International Finance Corporation (IFC), among other illustrious members.

6. Why did you select the S&P/B3 Brazil ESG Index as the building block for an index-based strategy?

Iuri: The index is broad (96 stocks), diverse, and less concentrated; the top 10 positions represent 38% of the market versus 45% for the IBovespa and 62% for the ISE. The bank, consumer, and industrial sectors have the biggest weightings in the index, while the commodities and oil sectors are less representative.

Stocks are weighted in the index according to their S&P DJI ESG Scores, a unique methodology favoring companies with high ESG standards.

7. What are you hoping to accomplish with the S&P/B3 Brazil ESG Index?

Silvia: We hope to accomplish several goals with this index. First, we want to elevate the concept of sustainable investment in general. Second, we hope that the index will serve as the country's premier broad ESG benchmark and serve as the underlying base of financial products, both active and passive. Third, we expect to motivate listed companies to continue to participate in the evaluation process and thereby improve their ESG programs each year. Finally, from an idealistic standpoint, we hope that in time all companies will establish responsible practices to manage their ESG goals with the highest standards and responsibility for the sake of the environment, for human capital, and good corporate governance.

8. What challenges were faced when creating this index and, in the end, what did you find surprising?

Silvia: With so many different ESG design options, it was a bit of a challenge to find the right mix of having an ESG index that focuses on the best ESG scoring companies and a representative, replicable index. I think that after several runs, our Global Research & Design team was able to find the right balance. The surprise for me came after the launch. It was interesting to see the impact of the index and how it prompted many listed companies to find out more about ESG, whether it was about their ESG scores, the process, the timelines, or the index itself. This response does not happen often, but we are aware that the impact this index can have on the market is not unlike the movements of the [S&P 500®](#) or the IBovespa.

To learn more about the index, including specifics on the scoring methodology and ways to access the data, read the [FAQ](#) and [index methodology](#).

9. What remains to be done to further promote ESG in the region, and how can your new index-based strategy help with those efforts?

Iuri: To promote ESG in the Brazilian market, companies need to be more transparent in disclosing the material ESG factors that positively or negatively affect their performance. There is a broad range of ESG characteristics, and investors need to be educated about which could bring risks and opportunities for each sector and company.

The new index-based strategy will motivate companies to enhance their ESG practices, as they are weighted in the index according to their S&P DJI ESG Scores. We predict that companies will pursue internal ESG improvements, since they depend exclusively on them to achieve a better position in the indices.

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