

# The integration of ESG aspects in asset management: Itaú Asset Management's experience, challenges and opportunities

November, 2017

# Responsible Investment



## The Evolving Risks Landscape, World Economic Forum

Top 5 Global Risks in Terms of Likelihood

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
1st	Breakdown of critical information infrastructure	Asset price collapse	Asset price collapse	Asset price collapse	Storms and cyclones	Severe income disparity	Severe income disparity	Income disparity	Interstate conflict with regional consequences	Large-scale involuntary migration	Extreme weather events
2nd	Chronic disease in developed countries	Middle East instability	Slowing Chinese economy (<6%)	Slowing Chinese economy (<6%)	Flooding	Chronic fiscal imbalances	Chronic fiscal imbalances	Extreme weather events	Extreme weather events	Extreme weather events	Large-scale involuntary migration
3rd	Oil price shock	Failed and failing states	Chronic disease	Chronic disease	Corruption	Rising greenhouse gas emissions	Rising greenhouse gas emissions	Unemployment and underemployment	Failure of national governance	Failure of climate-change mitigation and adaptation	Major natural disasters
4th	China economic hard landing	Oil and gas price spike	Global governance gaps	Fiscal crises	Biodiversity loss	Cyber attacks	Water supply crises	Climate change	State collapse or crisis	Interstate conflict with regional consequences	Large-scale terrorist attacks
5th	Asset price collapse	Chronic disease, developed world	Retrenchment from globalization (emerging)	Global governance gaps	Climate change	Water supply crises	Mismanagement of population ageing	Cyber attacks	High structural unemployment or underemployment	Major natural catastrophes	Massive incident of data fraud/theft

Top 5 Global Risks in Terms of Impact

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
1st	Asset price collapse	Asset price collapse	Asset price collapse	Asset price collapse	Fiscal crises	Major systemic financial failure	Major systemic financial failure	Fiscal crises	Water crises	Failure of climate-change mitigation and adaptation	Weapons of mass destruction
2nd	Retrenchment from globalization	Retrenchment from globalization (developed)	Retrenchment from globalization (developed)	Retrenchment from globalization (developed)	Climate change	Water supply crises	Water supply crises	Climate change	Rapid and massive spread of infectious diseases	Weapons of mass destruction	Extreme weather events
3rd	Interstate and civil wars	Slowing Chinese economy (<6%)	Oil and gas price spike	Oil price spikes	Geopolitical conflict	Food shortage crises	Chronic fiscal imbalances	Water crises	Weapons of mass destruction	Water crises	Water crises
4th	Pandemics	Oil and gas price spike	Chronic disease	Chronic disease	Asset price collapse	Chronic fiscal imbalances	Diffusion of weapons of mass destruction	Unemployment and underemployment	Interstate conflict with regional consequences	Large-scale involuntary migration	Major natural disasters
5th	Oil price shock	Pandemics	Fiscal crises	Fiscal crises	Extreme energy price volatility	Extreme volatility in energy and agriculture prices	Failure of climate-change mitigation and adaptation	Critical information infrastructure breakdown	Failure of climate-change mitigation and adaptation	Severe energy price shock	Failure of climate-change mitigation and adaptation

■ Economic 
 ■ Environmental 
 ■ Geopolitical 
 ■ Societal 
 ■ Technological

Source: World Economic Forum, The Evolving Risks Landscape, 2007-2017

# SRI across the Market

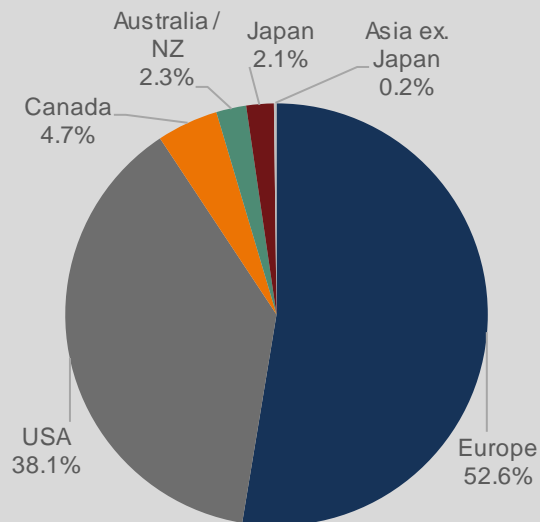
## Global Panorama



### SRI Investment strategies

Have been growing across all markets for Professionally managed Assets since 2012

Global proportion of SRI Assets per Region



Proportion of SRI Assets relative to Managed Assets

US\$ Bi	2012	2016	Growth	CAGR
Europe	8,758	12,040	37%	8%
USA	3,740	8,723	133%	24%
Canada	589	1,086	84%	17%
Australia / NZ	134	516	285%	40%
Japan	40	52	30%	7%
Asia ex. Japan	-	474	-	-
<b>Total</b>	<b>13,261</b>	<b>22,891</b>	<b>73%</b>	<b>15%</b>

Source: GSIA (Global Sustainable Investment Alliance), Dec/2014 and Dec/2016

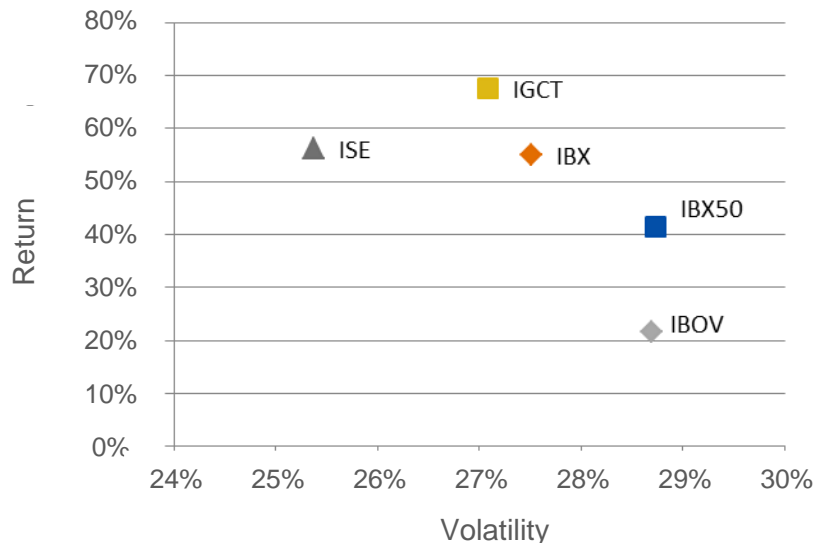
# Does ESG creates value?



In Brazil, ISE and IGCT indexes present over performance with lower volatility compared to mainstream indexes in 10 years.

## Risk x Return | Brazilian Indexes

July.2007 a July.2017



Source: Bloomberg | Dados de 01/08/2007 a 31/07/2017

## Company Benefits

- 1 New business opportunities
- 2 Anticipate legal liabilities
- 3 Reduction in production costs
- 4 Talent attraction and retention
- 5 Access to capital markets
- 6 Risk mitigation
- 7 Positive reputation

Source: *The Reference Compendium on Business and Sustainability*, University of Cambridge Programme for Industry, 2004 (interpretação e adaptação Fundação Brasileira para o Desenvolvimento Sustentável) | Extraído do Guia Novo Valor -Sustentabilidade nas Empresas da BM&FBovespa Sep 09, 2016

# SRI at Itaú Asset Management

## Capabilities and timeline



### Coverage

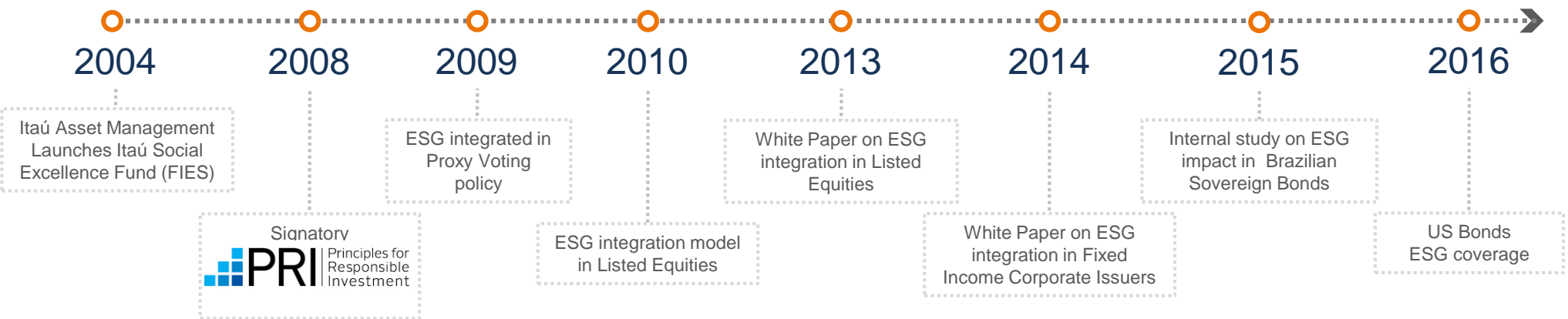
- 100% of Ibovespa, IBrX-100 and ISE Indexes
- 85% of Fixed Income Corporate Issuers Portfolio
- Brazilian Sovereign Bonds

### Team

- SRI Equities PM;
- ESG Analyst.
- External Consultants

### Activities

- Engagement with analyzed companies
- Company visits
- Active Ownership



# Itaú Asset Management ESG Integration Model



## Overview

### ESG Integration in listed equities

Cross-sector  
dimensions



Sector-specific  
value drivers



Company  
performance

1<sup>st</sup>  
stage

Research

- Revenues
- Costs
- Expenses

- Provisions
- Capex
- Cost of capital

2<sup>nd</sup>  
stage

Quantifi-  
cation

Calculation  
of ESG  
issues NPV

Company  
fair value  
adjustment

3<sup>rd</sup>  
stage

Valuation

Source: Itaú Asset Management

# Itaú Asset Management ESG Integration Model



Cross Industry Dimensions | Associated Risks and Opportunities



## Operational

- Productivity
- Costs
- Expenses
- Capex

## Legal / Regulatory

- Fines and penalties
- Capex
- Business interruption

## Market

- Premium pricing
- Access to new markets

## Reputational

- Revenues
- Cost of capital

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model

Cross Industry Dimensions | Associated Risks and Opportunities



	<b>Oil &amp; Gas</b>	<ul style="list-style-type: none"> <li>▪ Large spills (-)</li> <li>▪ Minor spills (-)</li> </ul>
	<b>Mining</b>	<ul style="list-style-type: none"> <li>▪ Mining Dams (-)</li> <li>▪ Water contamination (-)</li> <li>▪ Iron ore dry beneficiation (+)</li> </ul>
	<b>Retail</b>	<ul style="list-style-type: none"> <li>▪ Ugly Food trend (+)</li> <li>▪ Recycling (+)</li> <li>▪ Reverse Logistics (-)</li> </ul>
	<b>Pulp and Paper</b>	<ul style="list-style-type: none"> <li>▪ Odor (-)</li> <li>▪ Effluents (-)</li> <li>▪ Reverse Logistics (-)</li> </ul>
	<b>Electric Utilities</b>	<ul style="list-style-type: none"> <li>▪ Particulate emissions (-)</li> <li>▪ Capex for filters (-)</li> </ul>

Source: Itaú Asset Management.



# Itaú Asset Management ESG Integration Model

Cross Industry Dimensions | Associated Risks and Opportunities



**Electric Utilities**

- Water rights (-)
- Social license (-)



**Mining**

- Water pricing (-)
- Water availability (-)



**Retail**

- Eco-efficiency initiatives (+)



**Pulp and Paper**

- Water pricing (-)
- Energy co-generation (+)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model



Cross Industry Dimensions | Associated Risks and Opportunities



**Oil & Gas**

- Biodiversity damage fines (-)



**Mining**

- Biodiversity damage fines (-)



**Bio-fuels**

- Sugar cane burning fines (-)



**Pulp and Paper**

- Productivity loss (-)
- Land compliance issues (-)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model



Cross Industry Dimensions | Associated Risks and Opportunities



**Oil & Gas**

- Carbon tax (-)
- Stranded assets (-)



**Aviation**

- Carbon tax (-)



**Food / Retail**

- *Ecoflation* (-)



**Pulp and Paper**

- Agricultural impacts (-)
- Carbon tax (+ / -)
- Carbon markets (+)



**Electric Utilities**

- Hydrologic risks (-)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model

Cross Industry Dimensions | Associated Risks and Opportunities



**Oil & Gas**

- Weak supply chain (-)



**Electric Utilities**

- H&S issues (-)
- Strikes (-)



**Retail**

- Compliance ILO (-)
- Collective moral damage suits (-)



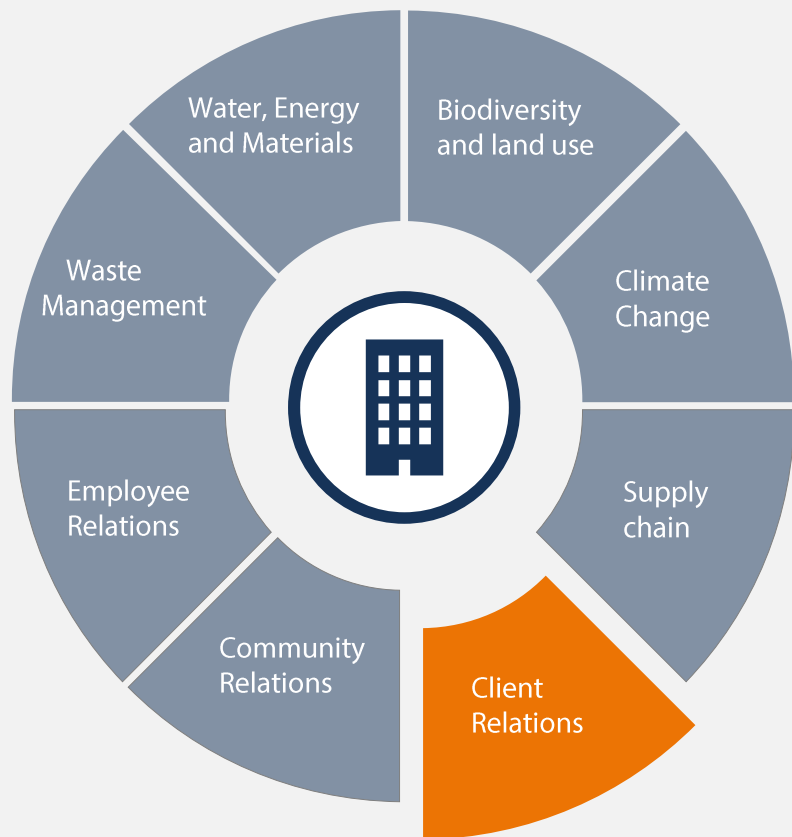
**Pulp and Paper**

- Illegal land use (-)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model

Cross Industry Dimensions | Associated Risks and Opportunities



**Home Builders**

- Deliveries delay (-)
- Premium price LEED (+)
- Abusive clauses (-)



**Toll Roads**

- Road security issues (-)



**Retail**

- Healthy foods (-)
- Consumer rights (-)
- Suspension due to delivery delays (-)



**Pulp and Paper**

- FSC certification (+)
- Premium price (+)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model

Cross Industry Dimensions | Associated Risks and Opportunities



**Food**

- Prohibition to foreclose units (-)



**Electric Utilities**

- Social licence (-)



**Home Builders**

- Urban requirement fines (-)
- Delays regarding urban requirements (-)



**Pulp and Paper**

- Land invasions (-)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model

Cross Industry Dimensions | Associated Risks and Opportunities



**Oil & Gas**

- H&S standards (-)
- Accidents (-)
- Strikes (-)



**Mining**

- Fines for labor conditions (-)



**Retail**

- Labor liabilities (-)



**Pulp and Paper**

- Accidents (-)
- Strikes (-)
- H&S fines (-)

Source: Itaú Asset Management.

# Itaú Asset Management ESG Integration Model



## Fixed Income Corporate Issuers Overview | Example

- ESG analyst has veto power in the Credit Committee;
- Estimation of the ESG impact in debt indicators;
- Portfolio and new operations analyzed;
- Company visits (when necessary);
- 85% Fixed Income Corporate Issuers coverage.

### Ex-ESG Analysis

Environmental licensing enforcement is not considered, only growth in net debt and EBITDA.

### ESG Baseline

The financial impact considering the enforcement of environmental licensing

### ESG Stress

The total financial impact of ANP's new regulation, considering all service stations without licenses and with soil contamination will demand investment.

### COMPANY 1

Debt Indicators (Scenarios)	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5
Net debt / EBITDA (1)	3,98	4,01	4,04	4,08	4,11	4,14
Net debt / EBITDA (2)		4,47	4,49	4,51	4,54	4,56
Net debt / EBITDA (3)		5,56	5,55	5,53	5,52	5,51
EBITDA/Interest expenses (1)	1,51	1,50	1,49	1,48	1,46	1,45
EBITDA/Interest expenses (2)		1,35	1,34	1,33	1,33	1,32
EBITDA/Interest expenses (3)		1,08	1,08	1,09	1,09	1,09

### COMPANY 2

Debt Indicators (Scenarios)	Baseline Year	Year 1	Year 2	Year 3	Year 4	Year 5
Net debt / EBITDA (1)	1,75	1,85	1,96	2,08	2,21	2,34
Net debt / EBITDA (2)		1,98	2,09	2,21	2,34	2,48
Net debt / EBITDA (3)		2,23	2,35	2,48	2,62	2,76
EBITDA/Interest expenses (1)	3,91	3,69	3,48	3,28	3,10	2,92
EBITDA/Interest expenses (2)		3,46	3,27	3,09	2,92	2,76
EBITDA/Interest expenses (3)		3,06	2,90	2,76	2,61	2,48



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