

Responsible Investment in Brazil 2016

ESG incorporation by pension funds

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part of
vigeoeiris
network

 **SITAWI**
FINANCEforGOOD

About SITAWI

- Non-profit founded in 2008, **managed by entrepreneurs** with background in **BUSINESS, FINANCE and SUSTAINABILITY** acquired in management consulting firms (McKinsey, Accenture), banks (BankBoston, ABN AMRO), NGOs (Ashoka, Friends of the Earth) and international MBAs (HBS, IE)
- Offices in **RIO DE JANEIRO** (Botafogo, 18fte) and **SÃO PAULO** (Itaim, 6fte), international network
- **PIONEERED** in Brazil new concepts such as **company ESG research, responsible investment advisory**, social loans and donor-advised funds
- **PROGRAM AREAS:** Social Finance, Sustainable Finance, Impact Business
- Advised financial institutions and investors with over **USD 350 billion in assets**, more than **USD 2 million deployed** to impactful social enterprises and organizations
- **LEADERSHIP** in Brazil Social Finance Task Force, PRI Brazil Network, Social Impact Bonds, Green Bonds

SITAWI mobilizes capital for positive social and environmental outcomes

Social Finance

- Social Loans
- Donor-advised funds
- Social business modelling
- Social Impact Bonds



Sustainable Finance

- Consulting to responsible investors
- Company and thematic ESG research
 - ESG risk management for banks and insurers
- Green Bonds

Founded in 2008 | Offices in Rio and SP | 24 professionals

SITAWI is part of Vigeo Eiris global network

- **Worldwide network**
 - 180 experts
 - Offices in 15 countries
- **Independence and transparency of certified methodologies (ARISTA)**
 - International and multistakeholder shareholder structure
 - Exclusive methodology reviewed by an independent Scientific Committee
 - Strict separation between rating activities and consulting missions



ESG integration in investment strategies

Large range of products and services (analysis, opinion, rating and ranking, risks review, portfolios review,...) for investors and asset managers willing to integrate ESG factors into their operations:

- 4,000+ issuers covered (corporates, regions, states)
- 300+ clients worldwide: investors and asset managers, civil society organisations and international institutions



ESG integration in corporate strategies

Audit and ESG integration missions for companies from all sectors, local authorities and NGOs, in order to help them assess and develop their ESG practices:

- Second Party Opinion for Green and Sustainable Bonds issuances (CBI verifier)
- Independent third-party for social responsibility labels and certifications: LUCIE, CGEM, Diversity,...
- 700+ missions in 41 countries since 2002

The objective of this study is to assess the degree of ESG incorporation by Brazilian pension funds

■ Sources

1. Investment Policies
2. Annual reports, websites
3. PRI transparency reports
4. Other ESG documents available

■ Topics investigated:

- 1) **Availability** of an investment policy
- 2) **ESG incorporation** in the investment policy
- 3) **Degree of sophistication** of ESG practices
- 4) ESG incorporation across **different asset classes**
- 5) Participation in **sustainability initiatives**

CMN Resolution 3792/2009

Chapter V Investment Policy

Art 16. § 3º

The investment policy shall contain, at minimum, the following items:

VIII – whether the fund employs social and environmental criteria in decision making.

We focus on examining how much of a PF's assets are invested in accordance with Responsible Investment principles

We have analysed:

- 1) **How sophisticated are the investment policies and how are they put into practice?**
- 2) **Which asset classes are mentioned in the investment policy?**

The **PRI Transparency Reports** allowed us to assess more thoroughly **12 of the 50 largest pension funds**, which are signatory to the initiative

*Normalised for Brazil: "Advanced" means local best practice, instead of global benchmark

Policy Rating*

Aspirational

Mentions RI but does not include any commitment and/or practice

Basic

Use of simple RI strategies, such as negative screening, to one or more asset classes

Intermediate

Investment decision depends on formalized ESG qualitative analysis

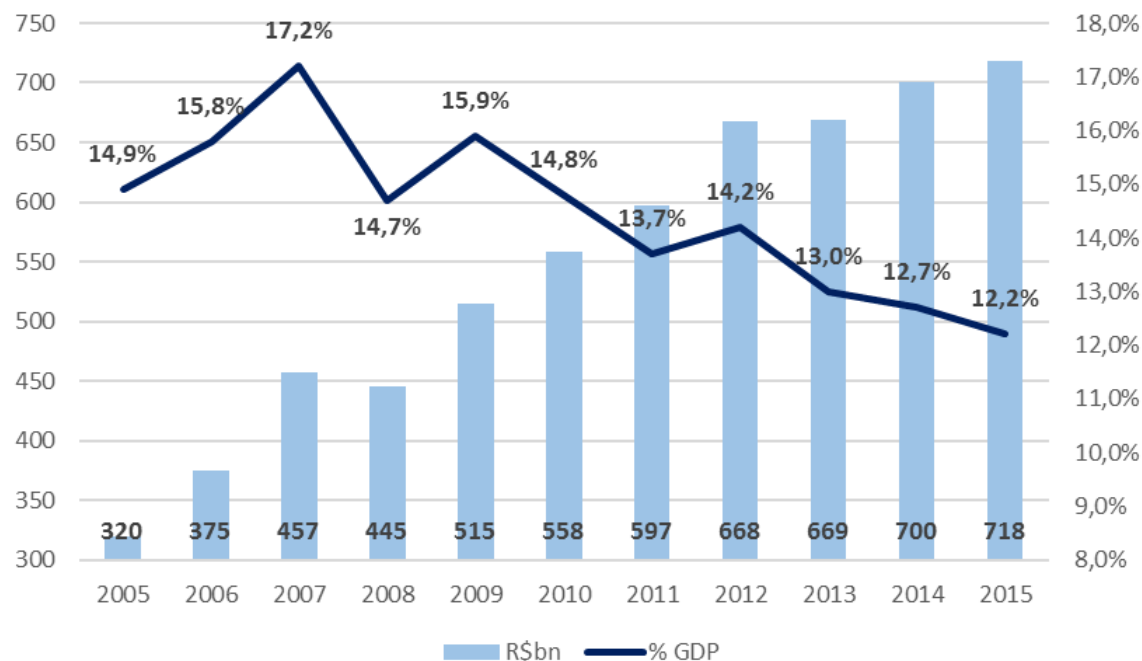
Advanced

Use of quantitative or qualitative methods with formal ESG objectives

Brazil has one of the world's largest closed pension fund industries

- Brazil has over US\$180 bn in assets managed by closed pension funds, ranking 13th in the world (Tower Watson, 2015).
- The downfall of the Brazilian economy and the devaluation of Brazil's currency impacted its position in the world ranking and reduced the sector's participation in the GDP.

Pension funds NAV x GDP

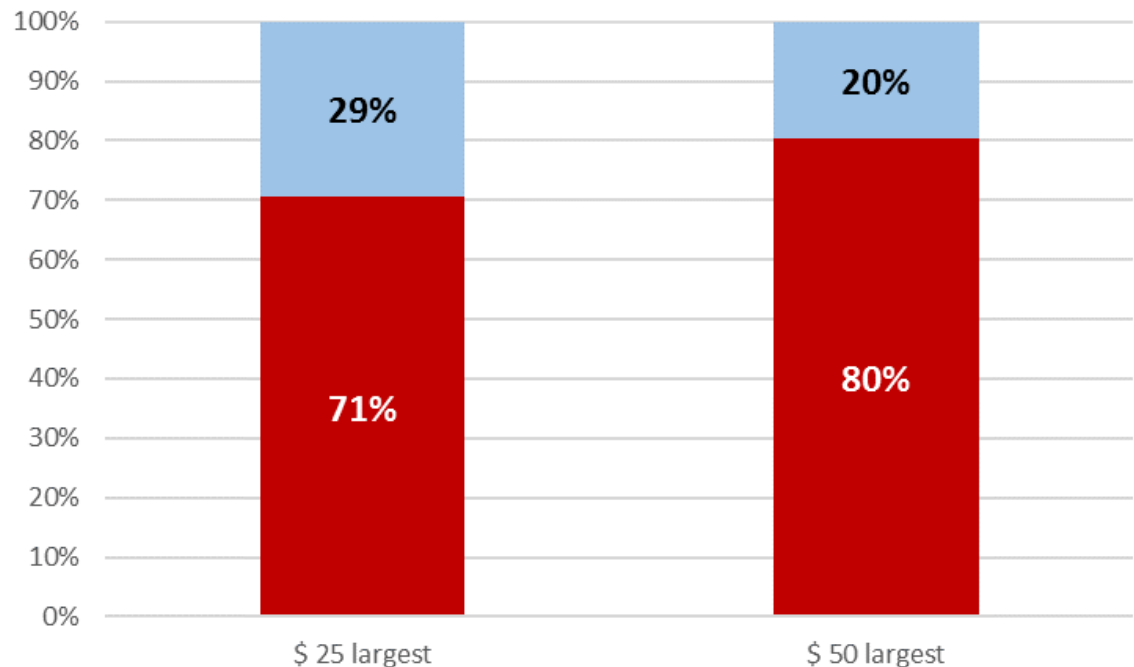


Source: ABRAPP, BACEN; Analysis: SITAWI

The PF industry is highly concentrated, which could speed up ESG incorporation...

- With most assets concentrated in a few pension funds, the process of ESG incorporation (in AUM) could be faster
- The largest pension funds have more resources and know-how to develop more sophisticated policies and practices
- These funds could act as *trend setters*

Pension funds' assets concentration (25 and 50 largest / sector's NAV)

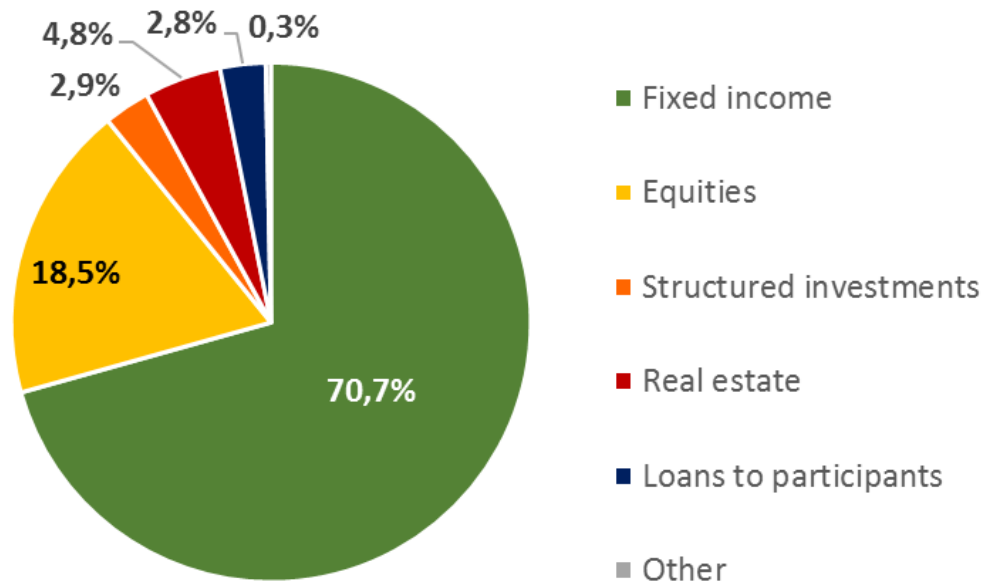


Source: ABRAPP; Analysis: SITAWI

...on the other hand, conservative asset allocation undermines ESG incorporation in investments

- **PFs' asset allocation is conservative** regarding investment in equities (26.9%), reflecting the requirements of CMN Resolution 3792/2009 and the country's high interest rates
- Brazil's profile is closer to Canada, Austria and Switzerland
- US, Chile and Australia have an average 40% of investments in equities

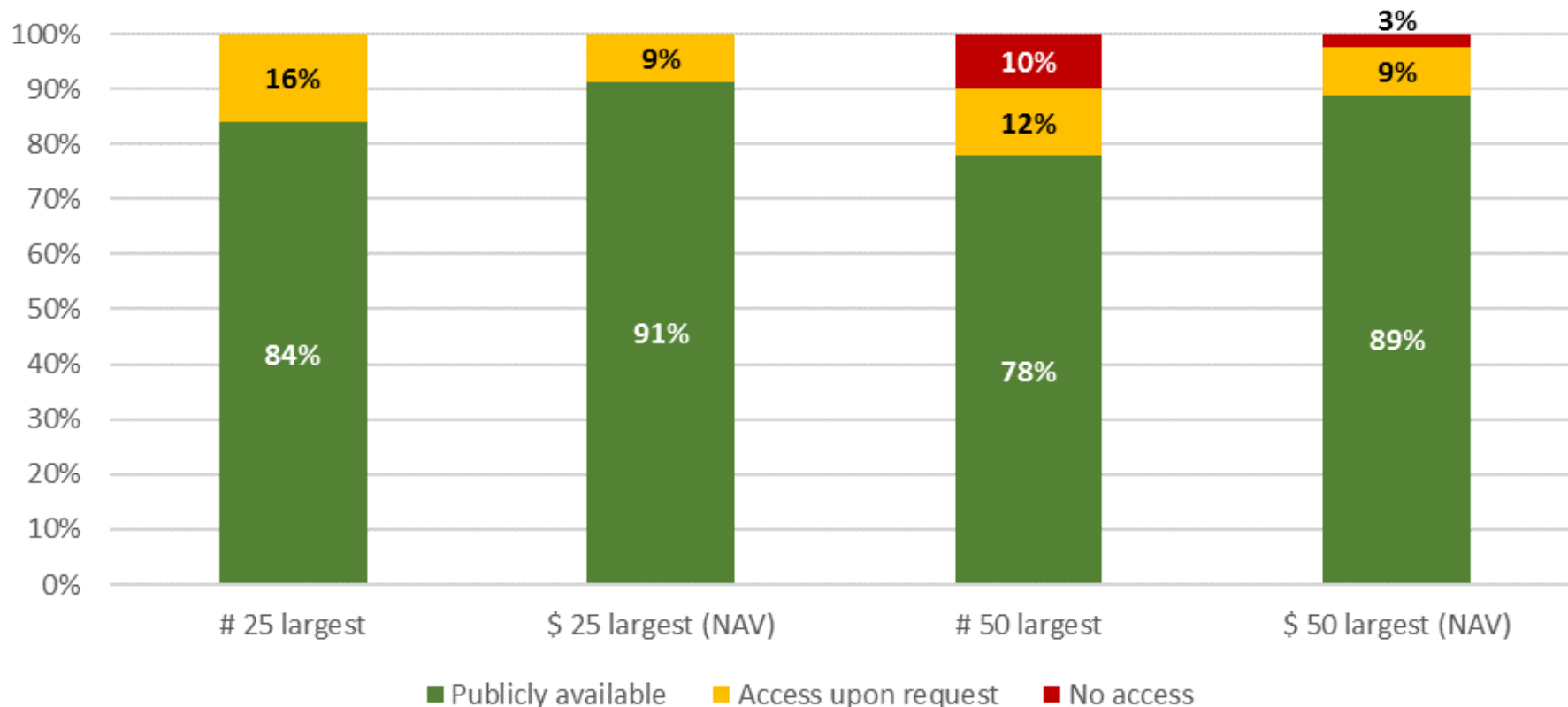
Pension funds asset allocation 2015



This makes ESG incorporation more challenging, since ESG issues are more easily assessed in equities than in sovereign bonds

Brazilian PFs are fairly transparent in relation to their investment policies, allowing a reasonable analysis of their RI practices

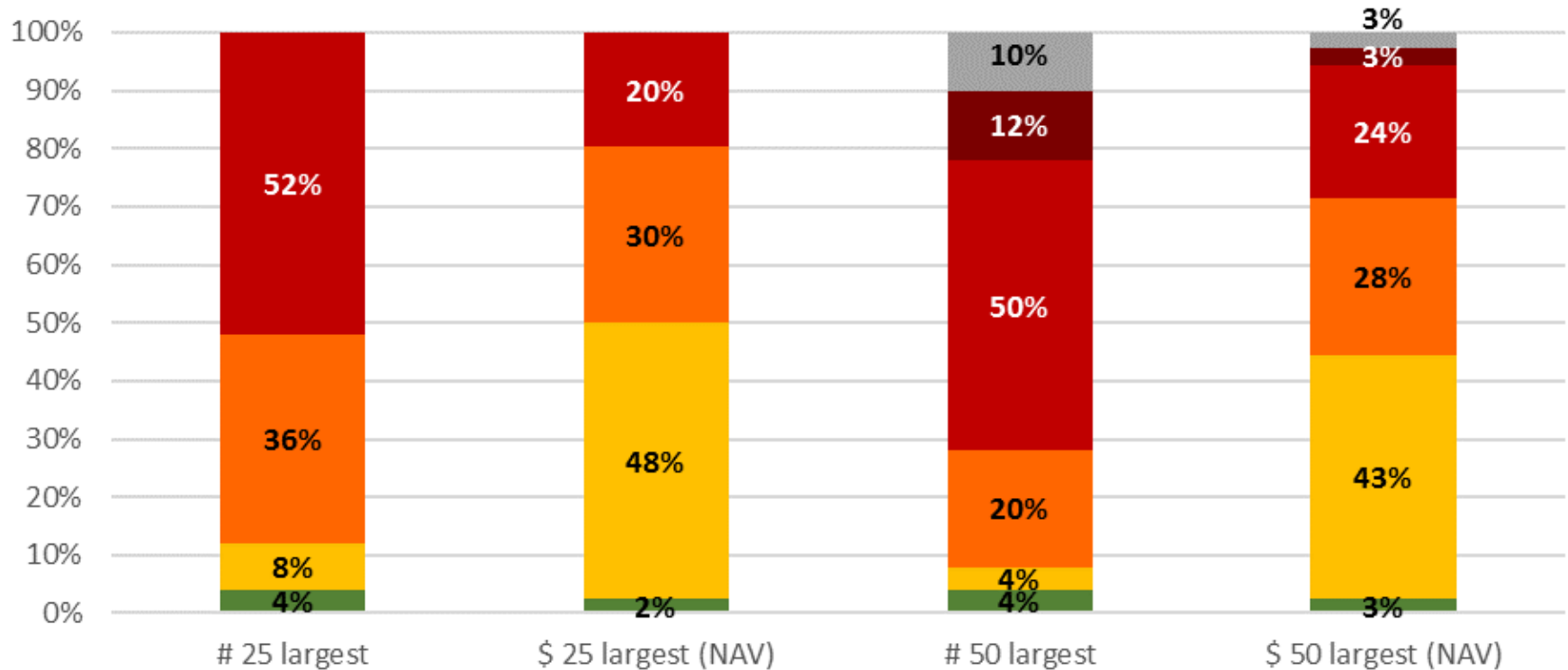
Investment policy disclosure



Source: SITAWI

However, their ESG policies are still incipient, with small improvements compared to 2014

ESG policy sophistication

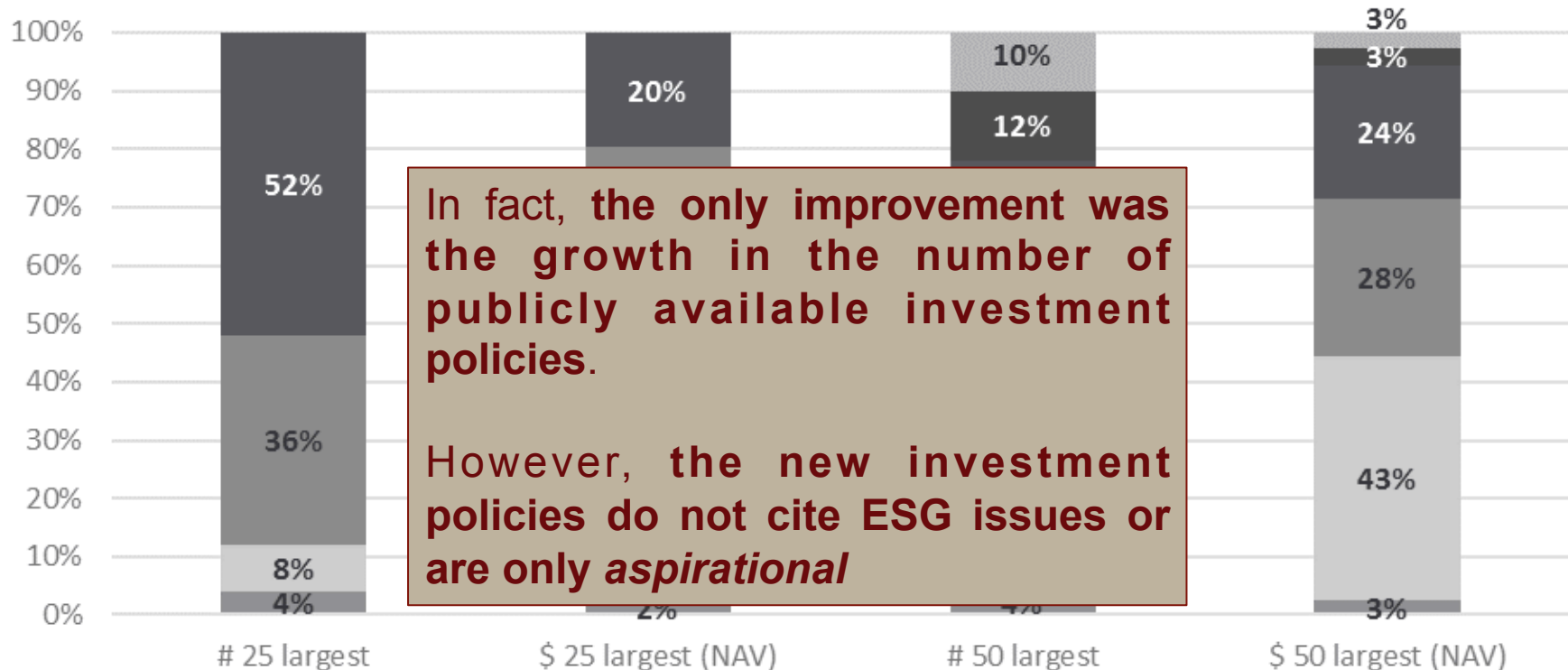


Source: SITAWI

■ High ■ Medium ■ Basic ■ Aspirational ■ None ■ N/A

However, their ESG policies are still incipient, with small improvements compared to 2014

ESG policy sophistication



Source: SITAWI

■ High ■ Medium ■ Basic ■ Aspirational ■ None ■ N/A

Hence, actual commitment to ESG incorporation is mostly aspirational or basic...

Example of *aspirational* policy (50% of largest 50 pension funds)

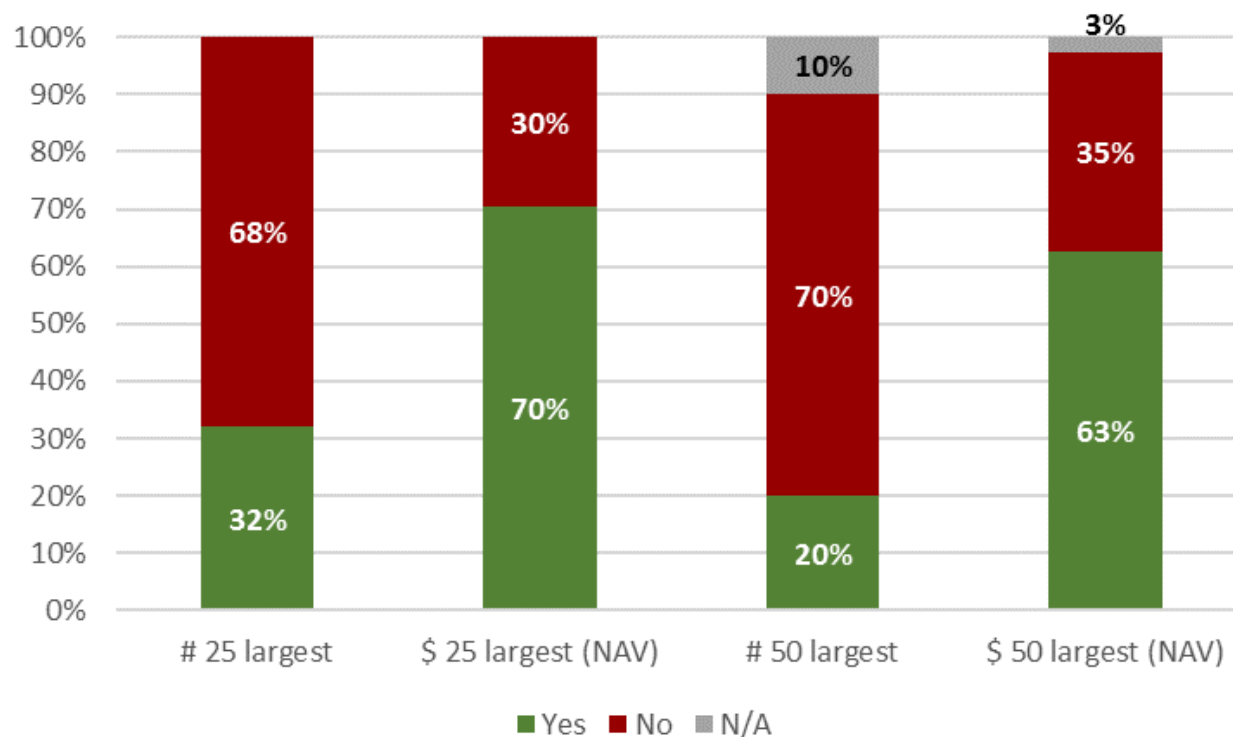
“In adopting this policy, the fund will consider, whenever possible, social and environmental principles, as well as factors that could contribute to the dissemination of this theme”

Example of *basic* policy (20% of largest 50 pension funds)

“The fund considers social and environmental principles in the management of its assets and incentivizes operational improvements that could benefit the environment. In credit analysis, environmental licenses and impact, among other themes, are assessed. The fund also incorporates social and environmental criteria in the selection of external managers”

The use of basic RI strategies, such as negative screening, are relatively common

Use of negative screening



Common exclusion criteria:

- Child labor
- Forced labor
- Tobacco
- Arms
- Alcohol,
- Pornography
- Gambling

Few pension funds have more advanced ESG policies and practices

Real Grandeza



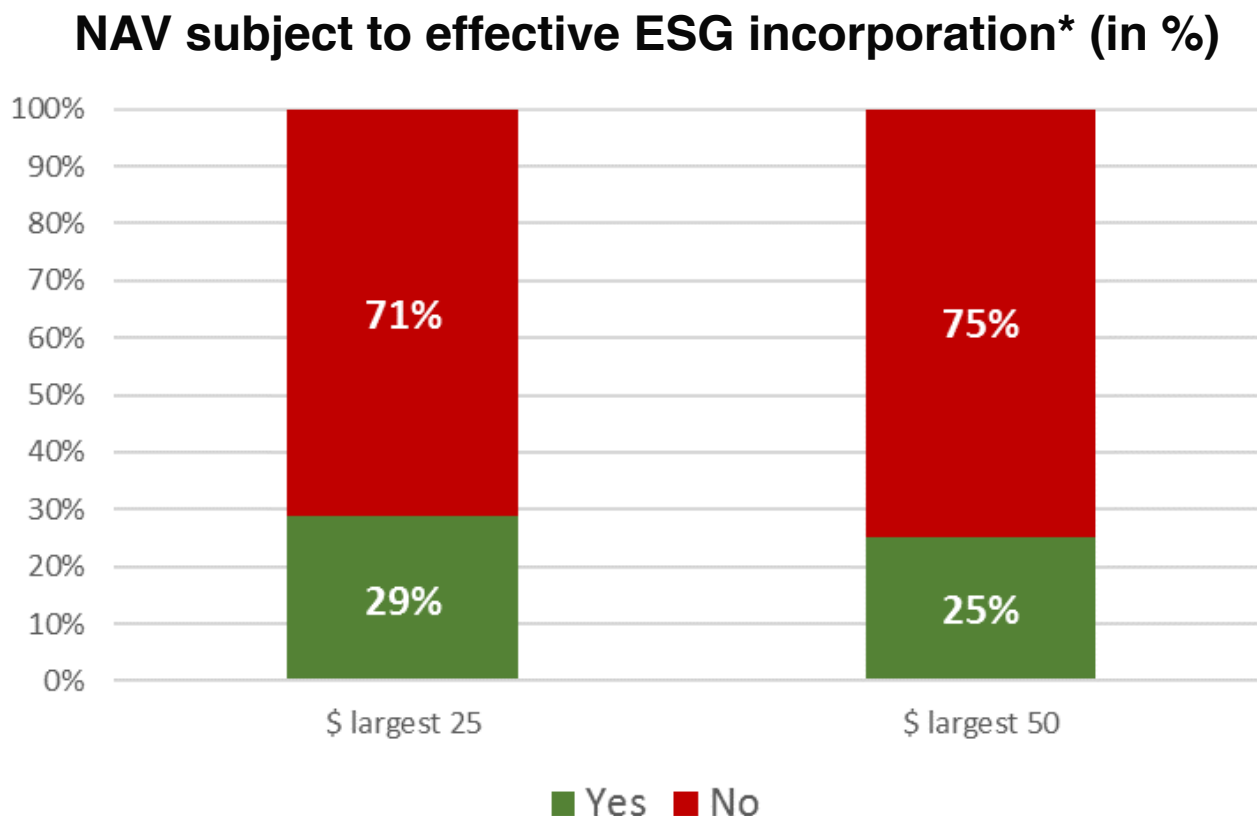
The fund has developed a method to assess the social and environmental performance of investee companies in different asset classes, with a qualitative rating. Each company is graded from 0 to 3, according to its ESG performance, and the fund excludes from investment those with a performance below 1. Real Grandeza also has ESG guidelines for administrative operations, supply chain and external manager selection.

Infraprev

In 2014, the fund enhanced its negative/positive screening system including specific social and environmental themes to be assessed according to the sector and type of investment. The Investment and Risk departments are responsible for identifying and monitoring social and environmental risks.



In fact, only 29% of the top 25's NAV and 25% of the top 50 are subject to **effective ESG incorporation*** ...

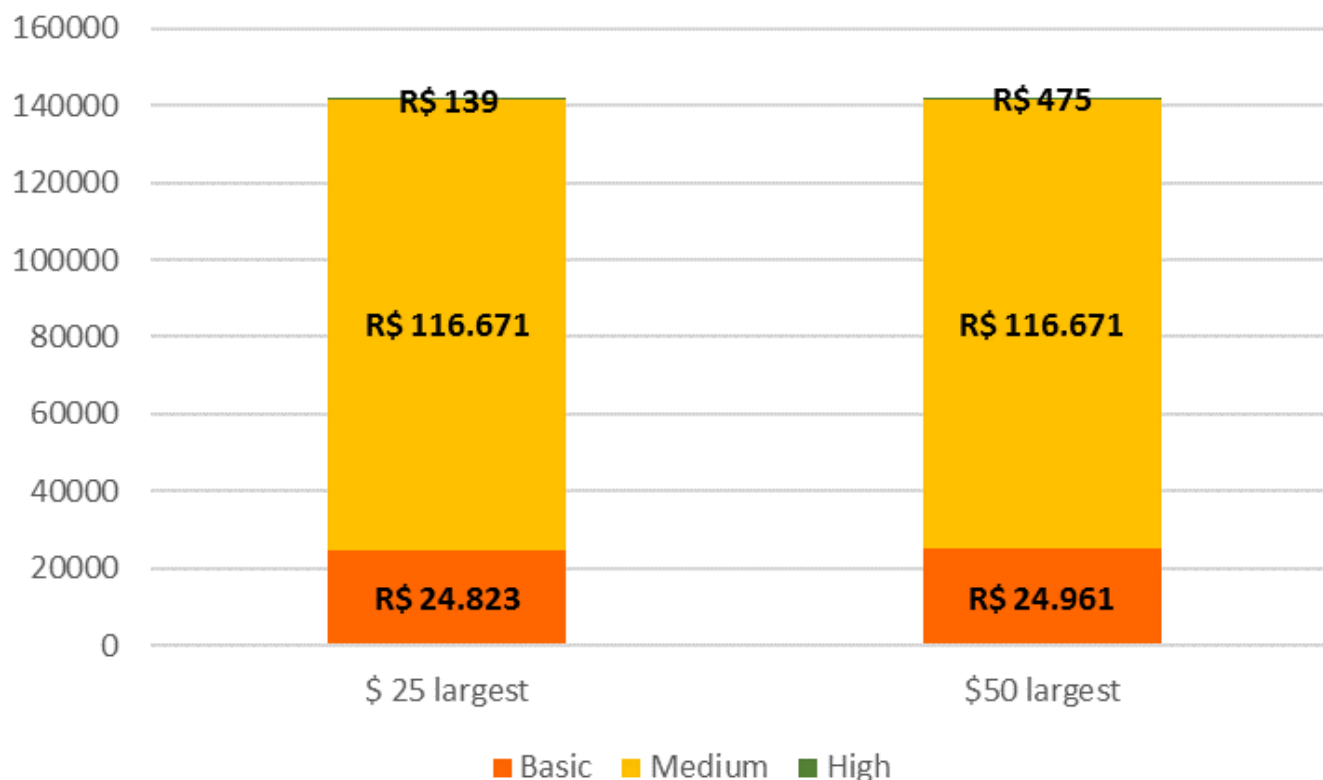


* Includes only equities and structured investments. Aspirational policies excluded.

Source: SITAWI

...which means R\$141.6bn of the top 25's NAV and R\$142.1bn of the top 50

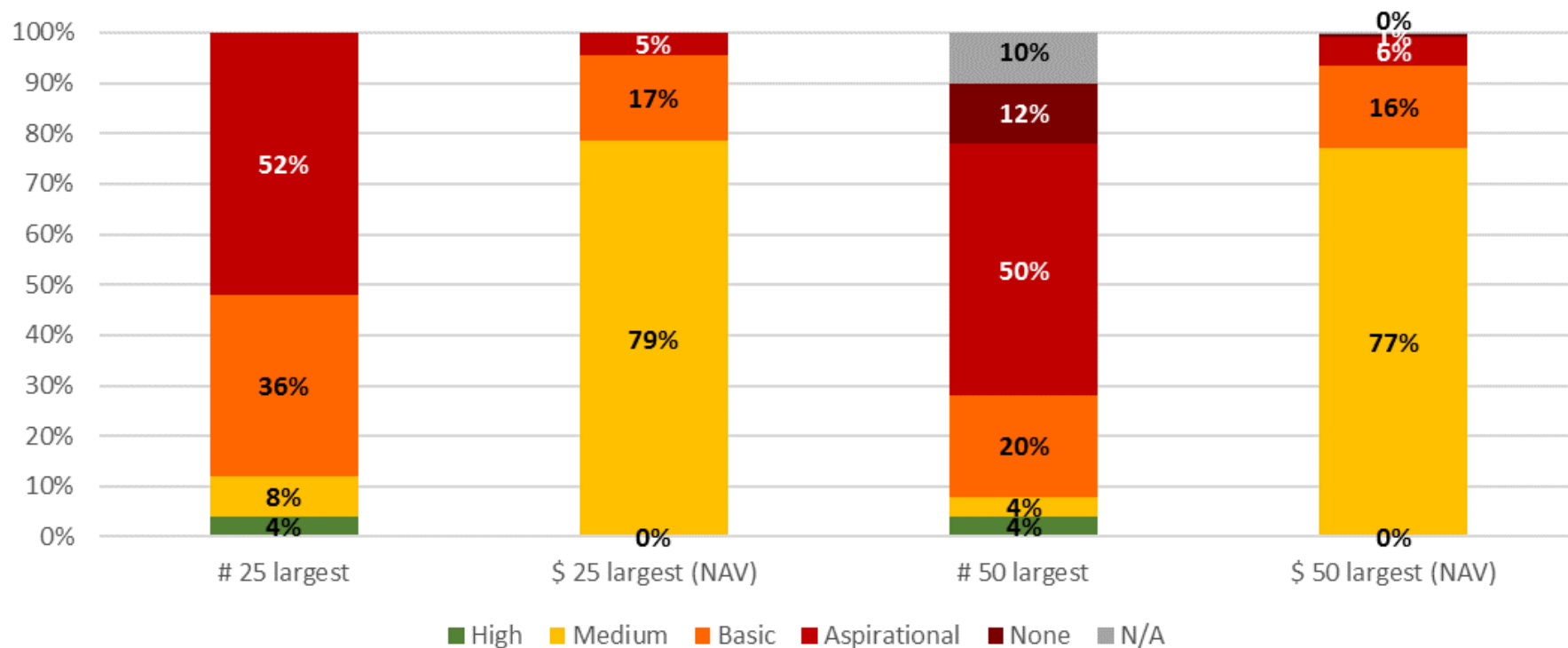
NAV subject to effective ESG incorporation* (in R\$ MM)



* Includes only equities and structured investments. Aspirational policies excluded.

Source: SITAWI

Considering only Equities and Structured Investments, a bigger part of assets is covered by effective ESG incorporation*

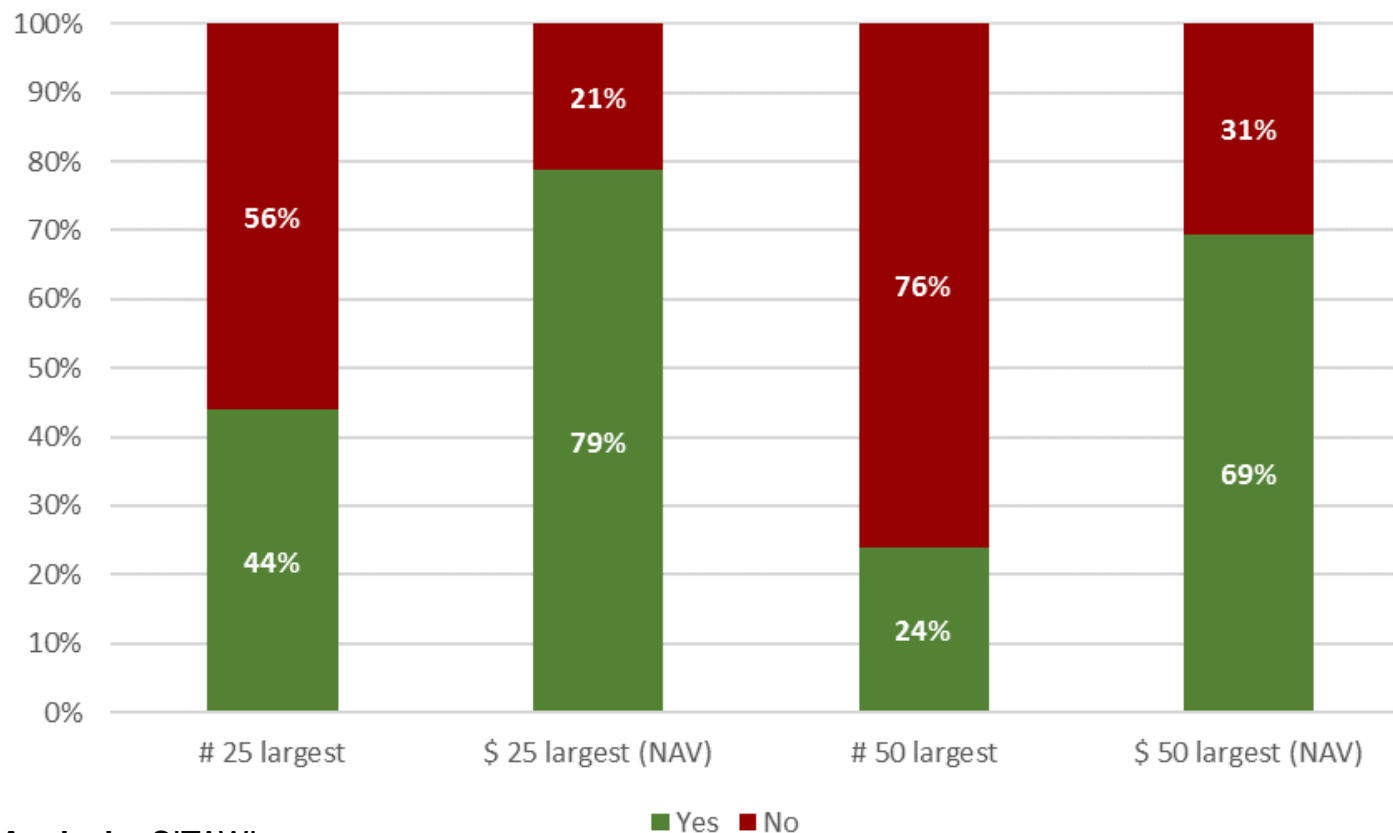


* Aspirational policies excluded.

Source: SITAWI

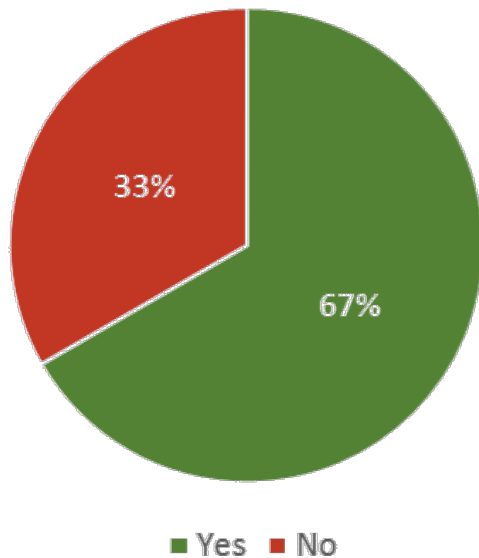
The PRI Transparency Reports allowed us to assess more thoroughly 12 of the 50 largest pension funds

Signatories to the PRI

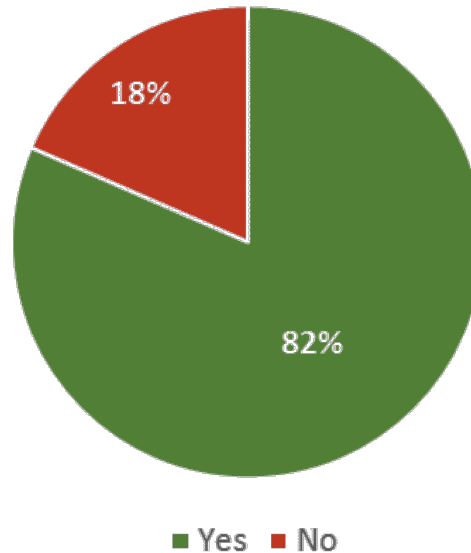


PRI signatories' internally managed assets are covered by more effective* ESG policies than non-signatories

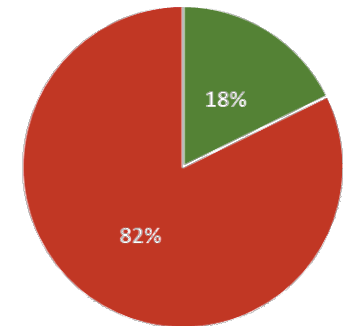
In % of pension funds



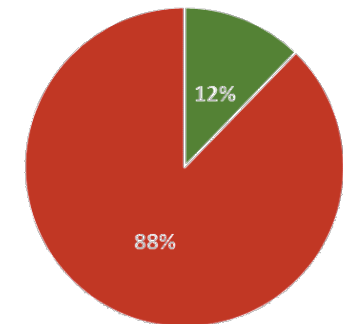
In % of NAV



Non-signatories
(in % of NAV)



Top 25



Top 50

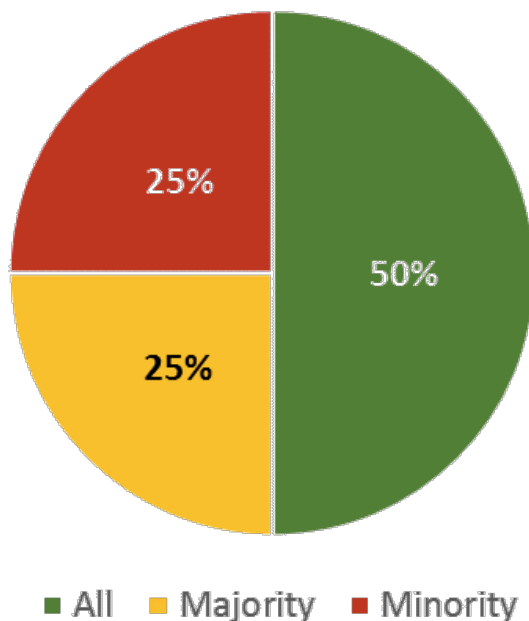
20

* Basic, medium and highly sophisticated policies

Source: PRI; Analysis: SITAWI

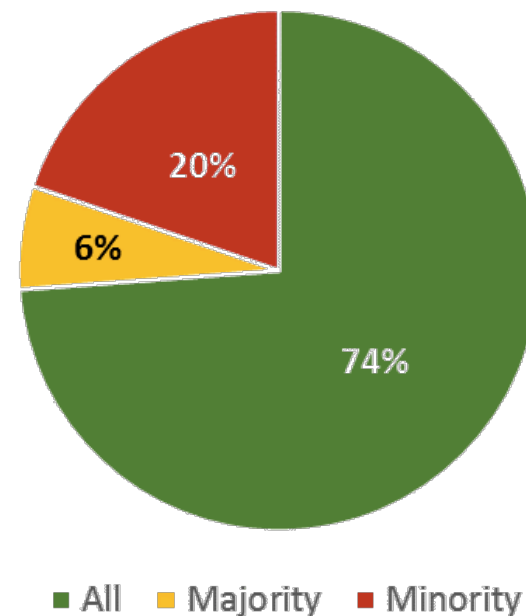
And their policies usually cover all or the majority of asset classes

In # pension funds



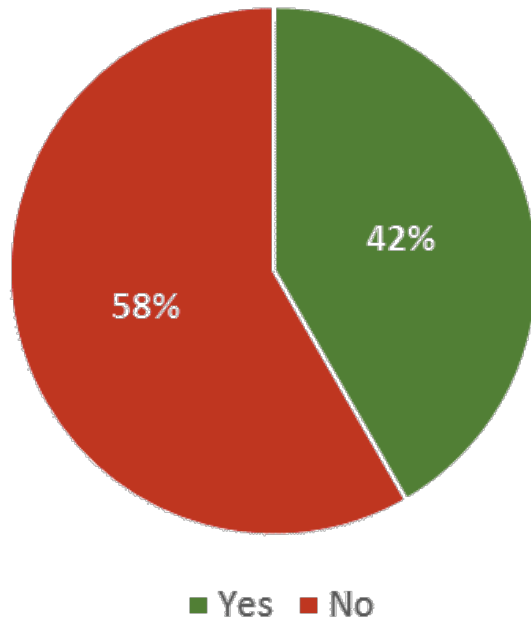
When they do not, such policies often cover equities and structured investments (asset classes that can more easily incorporate ESG issues)

In % of NAV



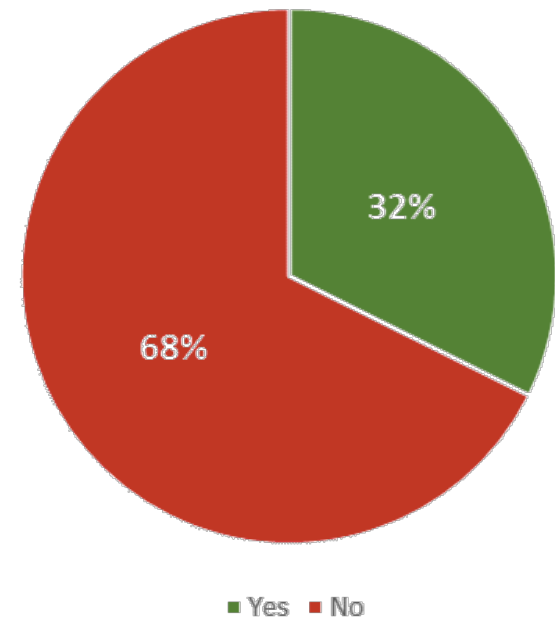
However, there is low incentive provided to external asset managers

In # pension funds

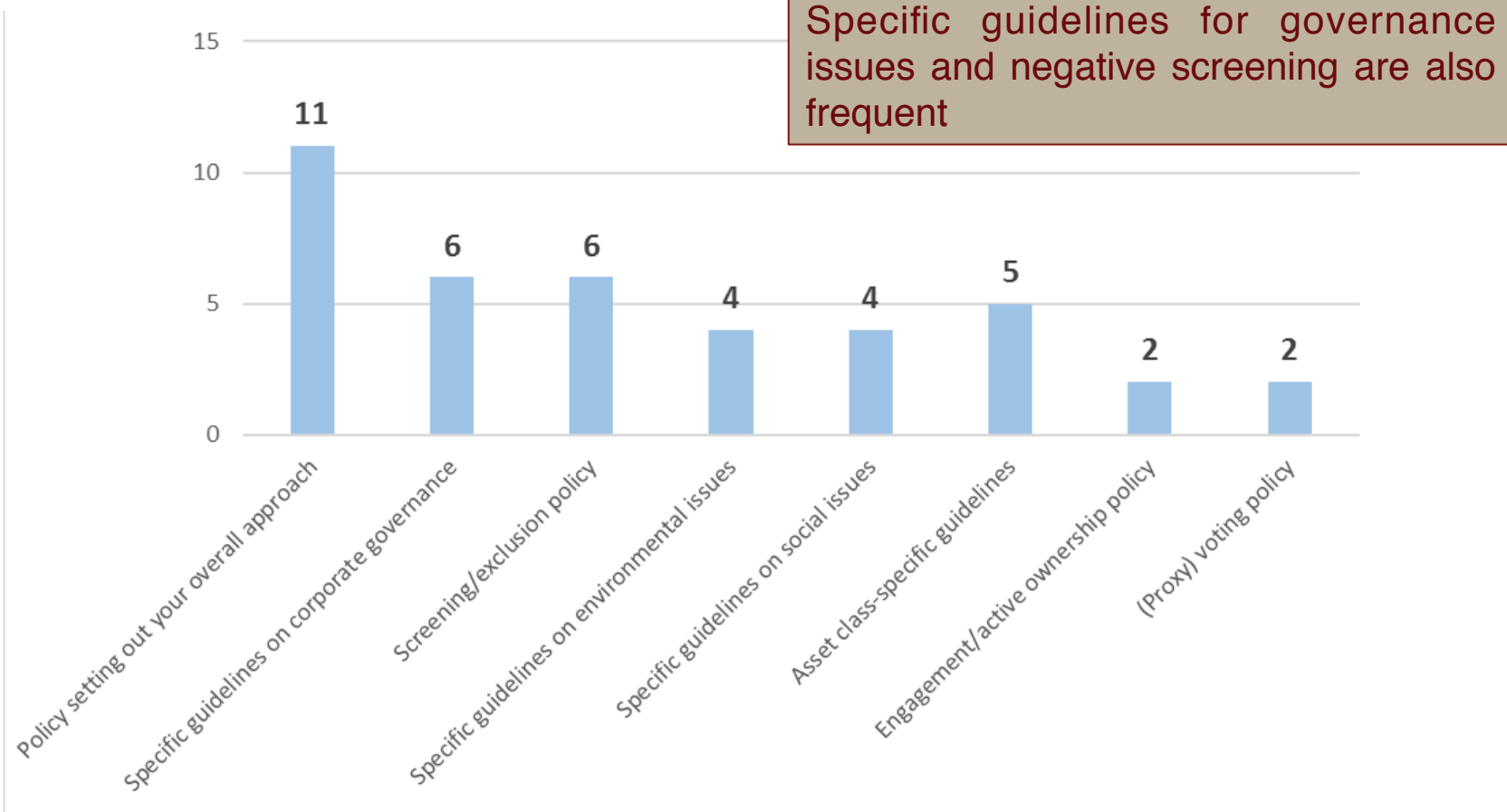


ESG incorporation is more common among internally managed funds

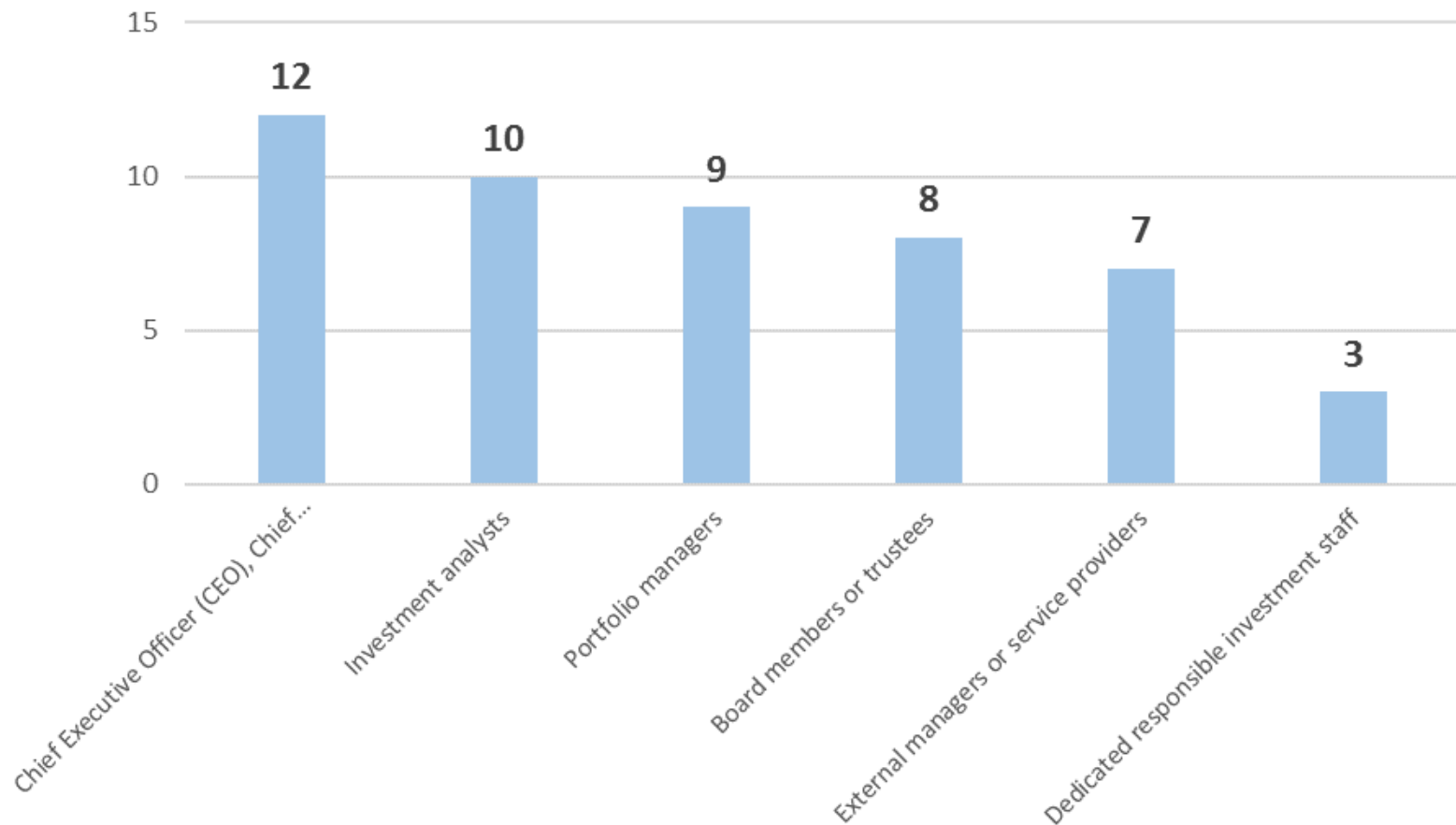
In % of NAV



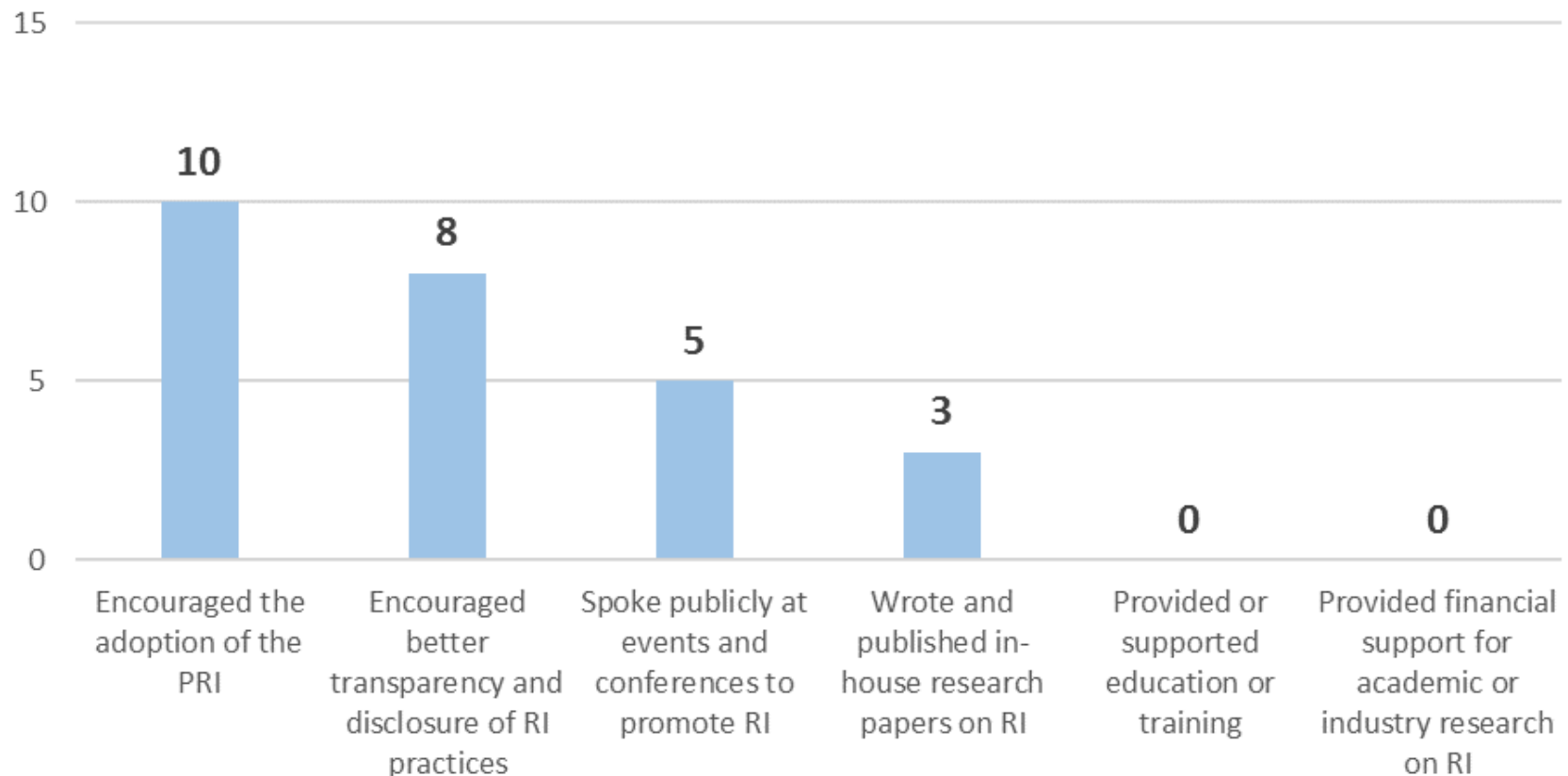
The most common guidelines in these policies include a general approach towards ESG



CEOs, investment analysts, and portfolio managers are usually responsible for implementing and monitoring policy's guidelines

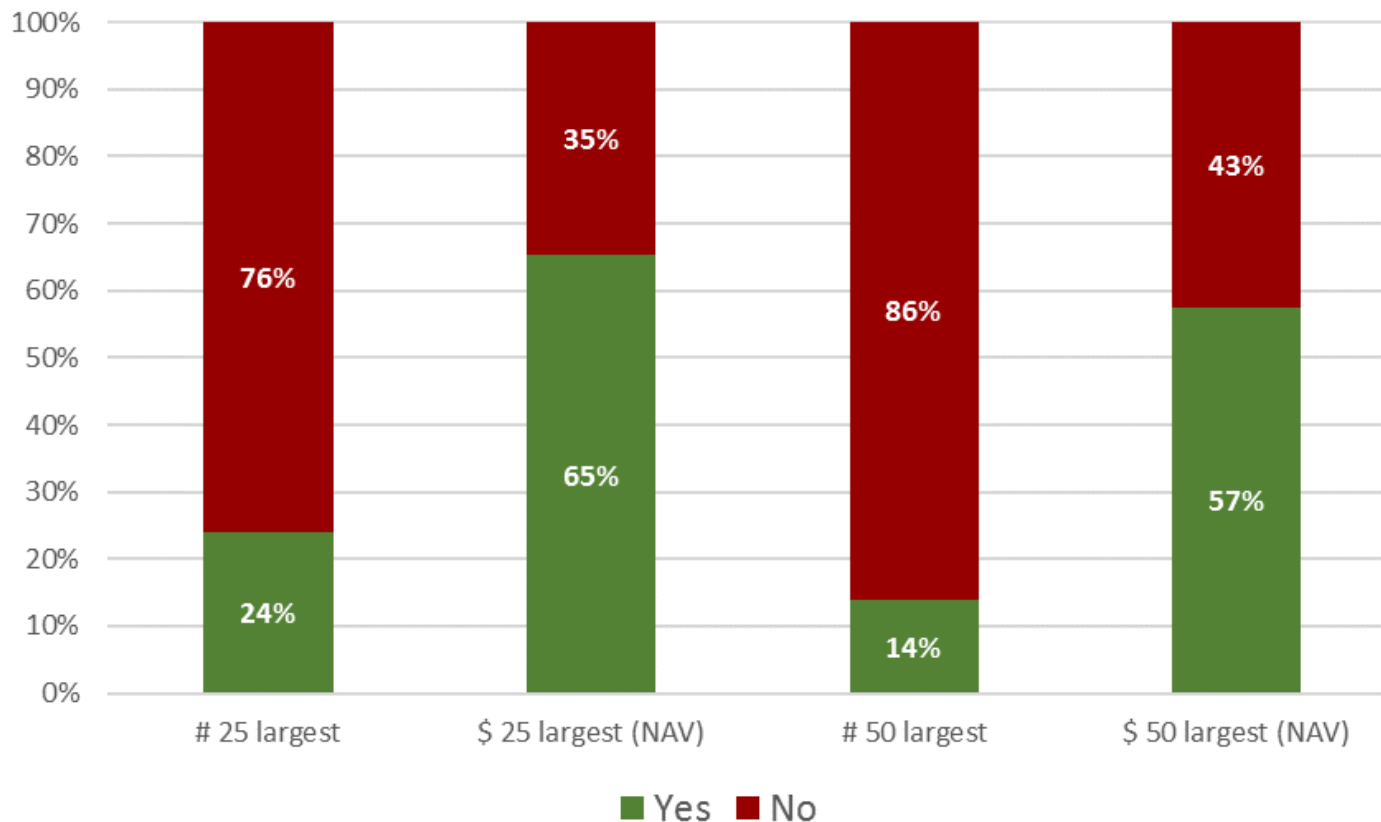


Encouraging the adoption of the PRI is the most common action taken to disseminate RI to the investment ecosystem



Participation of Brazilian PFs at other initiatives, such as CDP, remains low (7 of the top 50)

CDP Pension Fund Signatories



This study found some positive trends in the Brazilian PF industry...

- **Brazilian PFs are aware of RI** and most of them include ESG aspects in their investment policies
- **The investment policy is often publicly available** or available upon request
- **Issues such as child/forced labor are often analysed**, as well as investment in controversial sectors
- **Brazil has PFs with sophisticated RI practices** that could act as trend setters



...but there is still a long way to go for effective ESG incorporation in the sector...

- The significant coverage of ESG issues in the **investment policies is not yet translated into effective practices** in most cases
- **Less than a third of the sector's total assets incorporate ESG criteria.** Partially due to conservative asset allocation, but also as a result of lack of action
- **There was minor improvement in ESG incorporation in the past two years**
- Participation in important initiatives, such as PRI and CDP, which could stimulate more discussion in the sector, has stagnated



...which creates opportunities for different stakeholders

- **Beneficiaries:** request the adoption of ESG criteria in investments for higher returns and/or lower volatility
- **Pension Funds:** effective ESG policies and practices reduce investment and regulatory risks and may provide access to new resources
- **Regulatory Agencies:** strengthening regulations and policies (e.g.: requiring the adoption of RI practices) may contribute to a more resilient sector and address investors' and society's requests



Thank you!

Authors



Fred Seifert
Consultant

- Joined SITAWI in Aug/2011, ex BNDES
- Winner of Itaú Sustainable Finance Award 2012: ESG valuation in oil & gas
- Economist (UFRJ), MA in Public Policy candidate (UFRJ), Economics for Transition (Schumacher College)



Gustavo Pimentel
Managing Director

- 10+ years in Sustainable Finance advising banks, insurers, asset managers and pension funds
- Ex Accenture, ABN AMRO, SR Rating
- Elected best ESG analyst by investors globally (Extel IRRI 2015)
- Economist (UFRJ), MBA (IE), Responsible Investing (Univ St Andrews)

Contributors



Carolina Rosa
Research fellow



Clinton Mallet
Researcher

Top 50 pension funds in Brazil

#	Fund	NAV	#	Fund	NAV	#	Fund	NAV
1	PREVI	R\$ 166.593.634.000	18	HSBC FUNDO DE PENSÃO	R\$ 5.677.906.000	35	BRASLIGHT	R\$ 2.837.983.000
2	PETROS	R\$ 68.172.573.000	19	FACHESF	R\$ 5.198.016.000	36	FIBRA	R\$ 2.733.618.000
3	FUNCEF	R\$ 56.145.686.000	20	Fundação CEEE	R\$ 5.032.582.000	37	BRF PREVIDÊNCIA	R\$ 2.775.408.000
4	FUNCESP	R\$ 22.687.904.000	21	VISÃO PREV	R\$ 4.841.504.000	38	INFRAPREV	R\$ 2.672.230.000
5	FUND. ITAÚ UNIBANCO	R\$ 19.711.797.000	22	ECONOMUS	R\$ 4.719.131.000	39	PREVINORTE	R\$ 2.527.390.000
6	VALIA	R\$ 17.904.327.000	23	SERPROS	R\$ 4.616.517.000	40	PSS	R\$ 2.556.156.000
7	SISTEL	R\$ 14.594.611.000	24	CERES	R\$ 4.340.479.000	41	CELOS	R\$ 2.524.369.000
8	FORLUZ	R\$ 12.545.006.000	25	CBS PREVIDÊNCIA	R\$ 4.232.440.000	42	SANTANDERPREVI	R\$ 2.267.154.000
9	BANESPREV	R\$ 11.841.023.000	26	FUNBEP	R\$ 3.700.872.000	43	FUNDAÇÃO LIBERTAS	R\$ 2.350.029.000
10	REAL GRANDEZA	R\$ 11.997.429.000	27	BB PREVIDÊNCIA	R\$ 2.575.121.000	44	ELOS	R\$ 2.361.690.000
11	FUNDAÇÃO ATLÂNTICO	R\$ 8.918.478.000	28	FUNDAÇÃO IBM	R\$ 3.753.303.000	45	UNILEVERPREV	R\$ 2.276.873.000
12	FAPES	R\$ 8.632.075.000	29	CAPEF	R\$ 3.345.418.000	46	VWPP	R\$ 2.216.669.000
13	POSTALIS	R\$ 7.916.641.000	30	MULTIPREV	R\$ 3.061.107.000	47	FUNSSEST	R\$ 2.144.781.000
14	FUNDAÇÃO COPEL	R\$ 7.331.251.000	31	FUNDAÇÃO BANRISUL	R\$ 3.432.158.000	48	CITIPREVI	R\$ 2.224.979.000
15	PREVIDÊNCIA USIMINAS	R\$ 7.115.931.000	32	ELETROS	R\$ 3.423.980.000	49	FUNDAÇÃO ITAÚSA	R\$ 2.120.082.000
16	CENTRUS	R\$ 6.746.445.000	33	GERDAU PREVIDÊNCIA	R\$ 3.355.585.000	50	ODEBRECHT PREVIDÊNCIA	R\$ 1.984.095.000
17	TELOS	R\$ 6.051.293.000	34	PREVI-GM	R\$ 3.191.798.000			

CMN resolution n° 3,792/2009

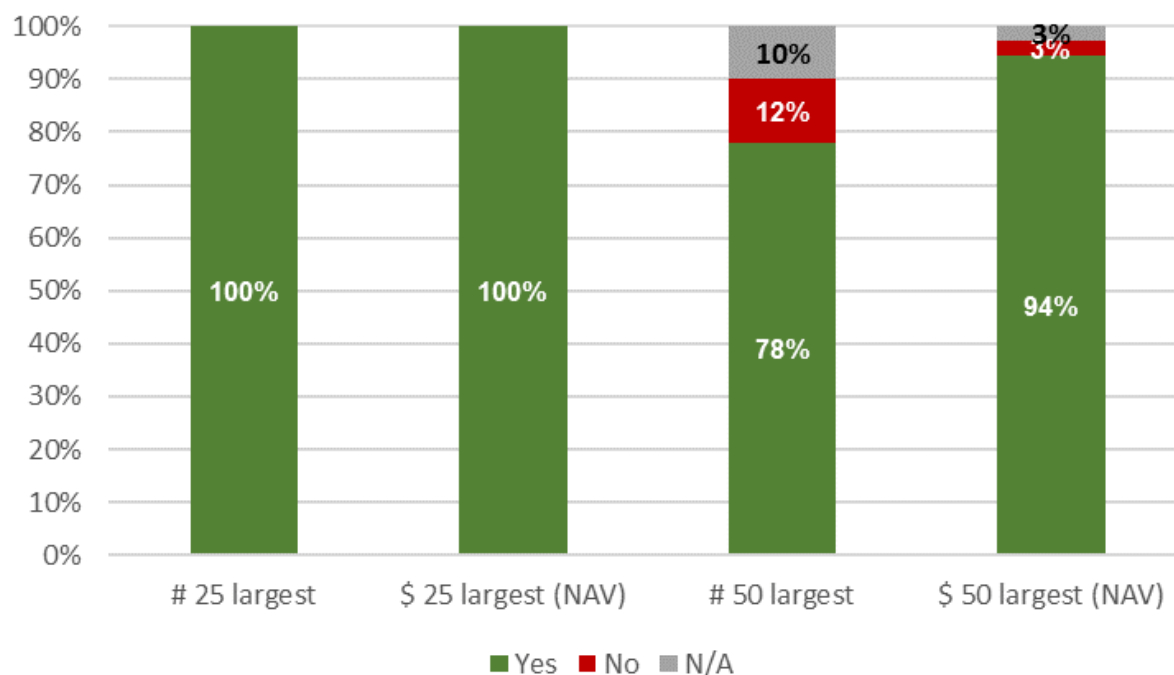
Asset allocation limits

Fixed Income (≤ 100%)	Brazilian Government Bonds (≤ 100%)	
	Other Fixed Income Securities (≤ 80%)	CCB - private credit (≤ 20%)
		NCE - export credit (≤ 20%)
		FIDC or FICFIDC - receivables funds (≤ 20%)
		CRI or CCI - real estate credit (≤ 20%)
		CPR, CDCA, CRA or WA - agri credit (≤ 20%)
		Company's bonds, except debentures (≤ 20%)
Equities (≤ 70%)	Listed companies (≤ 70%)	Novo Mercado (≤ 70%)
		Level 2 - BOVESPA (≤ 60%)
		BOVESPA Mais - BOVESPA (≤ 50%)
		Level 1 - BOVESPA (≤ 45%)
		Other segments or quotas in Equity Funds (≤ 35%)
	Specific Purpose Enterprises - SPE (≤ 20%)	
Other Investments (≤ 3%)		
Structured Investments (≤ 20%)	Property Funds (≤ 10%)	
	Multimarket Funds or Fund of Funds (≤ 10%)	
Loans to Participants (≤ 15%)		
Offshore Investments (≤ 10%)		
Real Estate (≤ 8%)		

There were some improvements in comparison to 2014's study...

- All of Brazil's top 25 PFs mention ESG in their policies (72% in 2015)
- Among the top 50, the percentage drops to 78%, or 94% of the sector's NAV (67% and 89% in 2014, respectively)
- Only 5 of the top 50 funds did not disclose the investment policy (publicly or upon request)

Reference to RI in investment policies

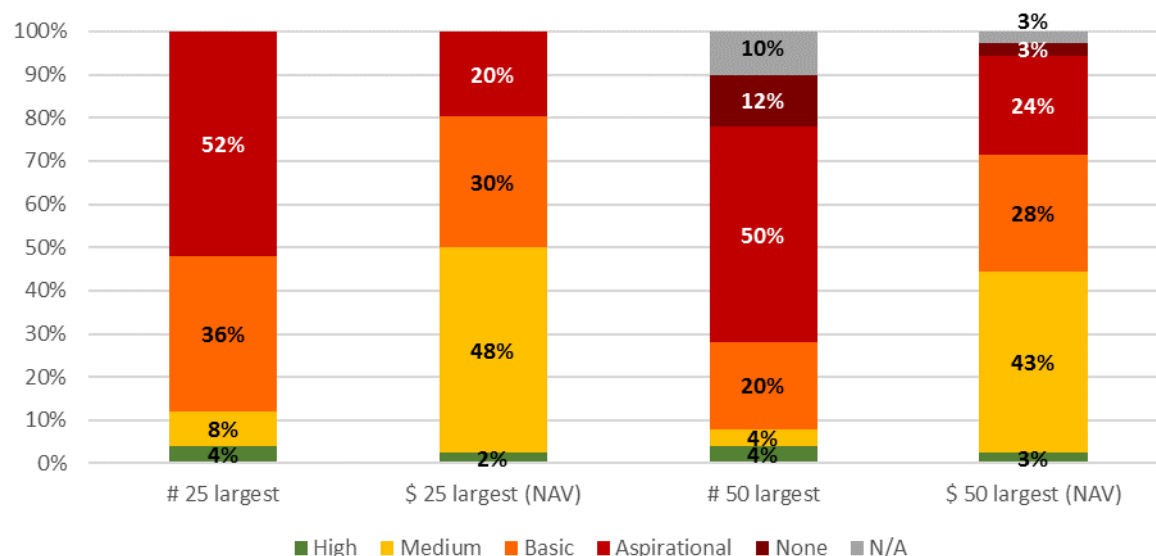


Source: SITAWI

...but these high percentages reflect regulatory requirements more than voluntary RI practices

- High percentages reflect CMN resolution 3.792/2009, which requires that PFs state in their investment policies whether they consider social and environmental issues in their investment decision making.
- In practice, ESG policies are still largely *basic* or *aspirational*, with small improvements compared to 2014**

ESG policy sophistication



Source: SITAWI