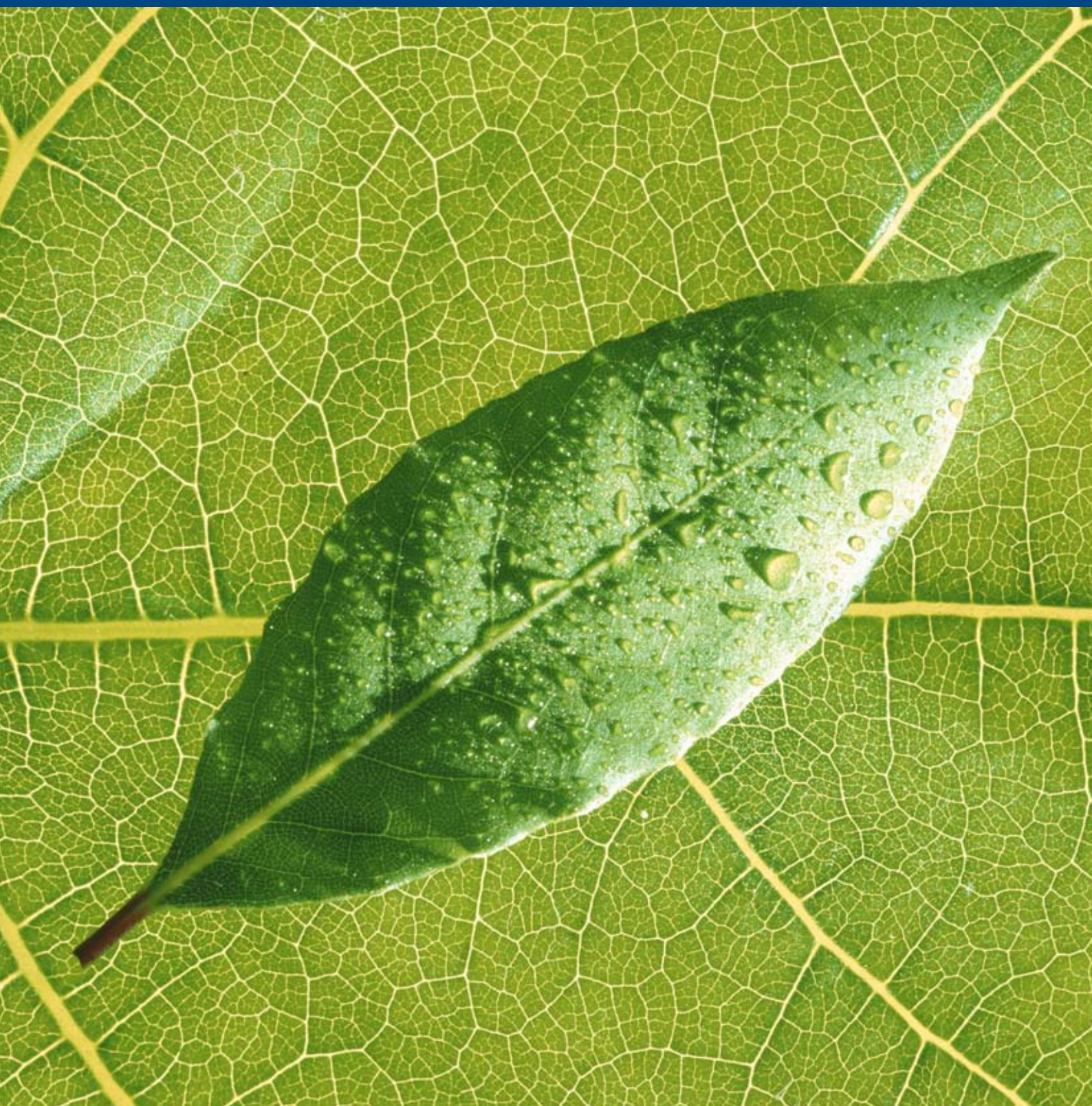


**Corporate  
Sustainability  
Index** **ISE**



## Corporate Sustainability Index – ISE

# CORPORATE SUSTAINABILITY INDEX (ISE)

Years ago a worldwide trend was initiated: investors started to seek socially responsible, sustainable and profitable companies to invest their funds. These investments were called “socially responsible investments” (SRI). They believe that sustainable companies create value to the shareholder in the long term, because they are better prepared to face economical, social and environmental risks. This demand increased in time, and today it is widely attended by many financial instruments in the international market.

In Brazil this trend has already began, and the expectation is that it will increase and consolidate rapidly. Aware of this movement, BM&FBOVESPA, together with many other institutions – ABRAPP, ANBIMA, APIMEC, IBGC, IFC, Ethos Institute and Brazilian Ministry of the Environment<sup>1</sup> – decided to join efforts to create a stock index to be a benchmark for socially responsible investments, the **Corporate Sustainability Index – ISE**. For this purpose, these institutions established a deliberative Board presided by BM&FBOVESPA, which is the organization responsible for ISE development. Later, the **United Nations Environment Programme** joined the Board. The Exchange is responsible for the index calculation and technical management.

ISE is designed to measure the return on a portfolio composed of shares of companies highly committed to social responsibility and corporate sustainability, and also to promote good practices in the Brazilian corporate environment.

### Selection Criteria

In order to evaluate the performance of BM&FBOVESPA listed companies about their sustainability aspects, the Board considered adequate to engage an institution expert in this subject – the **Center for Sustainability Studies** of the **Business Administration School of São Paulo** (CES-FGV).

CES-FGV designed a questionnaire to verify the performance of the companies which issued BM&FBOVESPA's 200 most liquid stocks, which considers the “**triple bottom line**” concept (developed by the English consulting company **SustainAbility**). The TBL concept involves the integrated analysis of environmental, social and economical aspects. Specifically in ISE questionnaire, to these three TBL principles were aggregated three more: a) general criteria (which inquires, for example, the company's commitment to global compacts and if the company publishes social balances); b) nature of the product criteria (which inquires if the company's product causes damages and risks to consumers health, among other issues); and c) corporate governance criteria.

<sup>1</sup> Institutions participating in ISE Board:

- ABRAPP: Brazilian Association of Pension Funds;
- ANBIMA: Brazilian Association of Capital and Financial Markets Institutions;
- APIMEC: Association of Capital Markets Analysts and Investment Professionals;
- BM&FBOVESPA: Securities, Commodities and Futures Exchange;
- IBGC: Brazilian Institute of Corporate Governance;
- IFC: International Finance Corporation;
- Ethos Institute of Social Responsibility;
- Brazilian Ministry of the Environment; and
- UNEP: United Nations Environment Programme.

## Corporate Sustainability Index – ISE

The environmental, social and economical dimensions were divided in four groups of criteria: a) policies (commitment indicators); b) management (program, target and monitoring indicators); c) performance; and d) legal compliance. With regard to the environmental dimension, there are different questionnaires per group of economical sectors, in order to consider the particularities of each sector regarding its environmental impact. The fulfilling of the questionnaire is voluntary (the questions are objective), and demonstrates the company commitment with sustainability aspects, which are considered increasingly important all over the world.

The companies' answers will be analyzed by a statistical tool called "cluster analysis", which identifies groups of companies with similar performance and points the group with better general performance. The companies included in this group will compose ISE portfolio (which will have a maximum of 40 companies), after approval of the Board.

ISE questionnaire will be constantly improved, aiming at attending permanently the present demands of society. The index is rebalanced annually, in which occasion the companies are re-evaluated in relation to their sustainability levels.

## Corporate Sustainability Index – ISE

### ISE – CORPORATE SUSTAINABILITY INDEX

#### A. Presentation

**ISE – Corporate Sustainability Index** is an index which measures the total return on a theoretical portfolio composed by stocks issued by companies highly committed to corporate sustainability and social responsibility (maximum of 40 companies). These stocks are selected among BM&FBOVESPA's most actively traded securities in terms of liquidity, weighted according to the outstanding shares' market value.

#### B. Shares Eligible for the Index

ISE is composed by stocks of the companies best ranked in terms of social responsibility and sustainability (chosen among BM&FBOVESPA's most liquid shares), according to the selection and classification criteria approved by the *Corporate Sustainability Index Board*.

#### C. Criteria for Inclusion in the Portfolio

The index portfolio will include the stocks that meet cumulatively the following criteria:

- a) to be among the 200 best classified stocks considering the negotiability index, measured in the twelve months preceding the beginning of the reevaluation process;
- b) to have a trading session presence of at least 50%, measured in the twelve months preceding the beginning of the reevaluation process;
- c) to meet the sustainability criteria approved by ISE Board.

It should be noted that companies that are in a regime of judicial reorganization, files for bankruptcy, are in a special situation or subject for a long period of trade suspension will not integrate Ibovespa. If a company is no longer in any of these exceptional situations, its trading history shall begin to be counted - in order to meet the all of the criteria for inclusion in the portfolio - as of the date on which BM&FBOVESPA considers that the company has effectively come out of its exceptional situation.

#### D. Criteria for Exclusion from the Portfolio

- a) A share will be excluded from the portfolio, during the periodical reevaluations, if it no longer meets any inclusion criteria.
- b) If, during the life cycle of the portfolio, the issuing company enters a regime of preventive composition with creditors or files for bankruptcy, its shares will be excluded from the index portfolio. In case of a public offering which results in the removal from the market of a significant proportion of shares, the company will be excluded from the portfolio. In such cases, the necessary adjustments will be made to ensure the continuity of the index.
- c) ISE Board can decide to exclude a company from the portfolio at any time if, in its understanding, any event had altered significantly this company's sustainability level.

## Corporate Sustainability Index – ISE

### E. Term of the Portfolio

The theoretical portfolio will be valid for one year, being reevaluated according to the procedures and criteria of this methodology.

### F. Weighting Criterion

ISE will measure the return on a theoretical portfolio consisting of the securities that meet all the criteria described above, which are weighted according to the respective outstanding shares' market value (of the type included in the portfolio), that is, those shares belonging to the controlling group will be excluded ("free float").

The participation of an economic sector in ISE portfolio (considering all types of stocks of the component companies) will not be higher than 15%, at the moment of its periodical reevaluations.

The base for ISE has been set at 1,000 points for the date of November 30<sup>th</sup> 2005, and its diffusion initiated on December 1<sup>st</sup> 2005. In order to adapt to the initial base, the portfolio market value has been adjusted using a reducer (adjustment coefficient), designated by  $\alpha$  in the index formula. That is,

$$\text{Initial index} = \text{Value of portfolio} / \alpha = 1,000$$

The reducer for the index will be altered whenever necessary to accommodate inclusions in or exclusions from the portfolios, on the occasion of the periodical rebalancing or on the occasion of any adjustments arising from benefits/events given by the companies, so that the index is automatically adjusted.

As of January 2, 2011, the ISE portfolio will be valid from the first business day in January to the last business day in December of each year.

The specific weight of each share in the index may be altered during the term of the portfolio, due to the price evolution of each share and/or the benefit distribution by the issuing company.

When the issuing companies of component shares distribute benefits, the necessary adjustments will be made to guarantee that the index reflects not only the share price variations, but also the impact of the benefit distribution. Because of this methodology, ISE is considered to be an index that evaluates the total return of the shares comprising its portfolio.

### G. Index Calculation

BM&FBOVESPA calculates ISE during the regular trading hours, taking into consideration the prices of the last trades carried out on the cash market (round lot) with the component shares.

### H. Suspension of Trading

In case of suspension of a component share, the index will use the price of the last trade registered on the Exchange until the resumption of trading. If trading is not permitted for a period of 50 days, as of the date of suspension, or if there are no perspectives that trading will be resumed, or in case of rebalancing of the portfolio, the share will be excluded from the portfolio. In such a case, the necessary adjustments will be made to ensure the continuity of the index.

## Corporate Sustainability Index – ISE

### I. Procedures for Rebalancing

In the annual rebalancing the following procedures will be adopted:

**I.1.** The rebalancing of the index's theoretical portfolio will occur after the closing of the last trading session of the base-year and will adopt the index closing value of this day as its base.

**I.2.** Once selection (share/type) of the companies that will compose the portfolio for the coming base-year has been concluded, the respective market value of each company/share in the share type is calculated – by multiplying the number of outstanding shares by their closing price –, and the results are summed up. That is, the economic value of the new portfolio is calculated according to the closing prices of the day.

**I.3.** The reducer adjusted for the new portfolio is reached by dividing the economic value, calculated in accordance with item I.2, by the closing index of the base-year.

**I.4.** The adjustment of the reducer aims to ensure the continuity of the index, in such a way that the number of index points does not change because of rebalancing. Thus, both the division of the “new market value” of the index theoretical portfolio by the new reducer, and the division of the “market value of the previous theoretical portfolio” by its respective reducer, result in the same index in terms of points.

### J. Index Adjustments

So as to measure the total return on its theoretical portfolio, ISE will be adjusted for all benefits distributed by the issuing companies of the shares included in the portfolio.

#### J.1. Adjustments for benefits in shares of the same type (Bonuses/Splits/Reverse Splits/Subscriptions)

After the last trading day prior to the benefit distribution, the market value of the component share/type is recalculated. In order to do so, the theoretical quantity adjusted to the benefit distributed and the “ex-theoretical” price of the share are used. The value thus obtained will be the basis for comparing the evolution of this share on the following trading session.

#### Example:

Let's consider company XPT which distributed a share bonus of 50% on the share type, D0 being the last trading day before the benefit distribution.

| Date    | Price (R\$) | Qty. XPT shares in the index | Market value of XPT share | Variation (%) | Index (*) |
|---------|-------------|------------------------------|---------------------------|---------------|-----------|
| D0 (1)  | 300.00      | 1,000,000                    | 300,000,000.00            | -             | 100       |
| D0A (2) | 200.00      | 1,500,000                    | 300,000,000.00            | -             | 100       |
| D+1 (3) | 220.00      | 1,500,000                    | 330,000,000.00            | + 10.0        | 110       |
| D+2     | 230.00      | 1,500,000                    | 345,000,000.00            | + 4.5         | 115       |

(1) Closing position of the component share/type on the last trading day before the benefit distribution, that is, the quantity of shares before distribution of the benefit multiplied by the last asset price registered for that day.

(2) Adjusted closing position of the component share/type on the last trading day before the benefit distribution, that is, considering the new quantity of shares and the “ex-theoretical” price. This data will be used as a basis for comparison for the following day.

(3) Closing position of the component share/type on the first “ex-rights” trading day, taking into consideration the new quantity of shares and the “ex-market” closing price.

(\*) If necessary, the index reducer will be adjusted to guarantee that the number of index points suffers no alteration due to the adjustment to the benefit.

## Corporate Sustainability Index – ISE

In the case of reverse splits, the theoretical quantity will be reduced on the proportion determined by the company and a special “ex-theoretical” price will be calculated in order to maintain the economic value of the component share/type unaltered.

Apart from these situations, whenever the issuing company communicates the occurrence of facts that result in changes in its total share quantity (conversion of debentures into shares, cancellation of shares, conversion of one type of share into another, etc.), the relevant adjustments will be carried out.

### J.2. Benefits in cash or other events

After the closing of the trading session of the last trading day prior to benefit distribution, the market value of the component share/type is recalculated, maintaining the theoretical quantity of this share in the portfolio unaltered and using its “ex-theoretical” price. This value will serve as a basis for comparison of the share price evolution on the following day.

#### Example:

Let’s consider company ABC which distributed a dividend of R\$ 30 per share, D0 being the last trading day before the benefit distribution”.

| <b>Date</b>                | <b>Price (R\$)</b> | <b>Qty. ABC shares in the index</b> | <b>Market value of ABC share</b> | <b>Variation (%)</b> | <b>Index (*)</b> |
|----------------------------|--------------------|-------------------------------------|----------------------------------|----------------------|------------------|
| D0 <b>(1)</b>              | 250.00             | 1,000,000                           | 250,000,000.00                   | -                    | 100.0            |
| D0 <sub>A</sub> <b>(2)</b> | 220.00             | 1,000,000                           | 220,000,000.00                   | -                    | 100.0            |
| D+1 <b>(3)</b>             | 230.00             | 1,000,000                           | 230,000,000.00                   | + 4.5                | 104.5            |
| D+2                        | 235.00             | 1,000,000                           | 235,000,000.00                   | + 2.2                | 106.8            |

(1) Closing position of the component share/type on the last trading day before the benefit distribution, that is, the position calculated with the last price of that day.

(2) Adjusted closing position of the component share/type on the last trading day before the benefit distribution, that is, considering the same quantity of shares and the “ex-theoretical” price. This data will be used as a basis for comparison for the following day.

(3) Closing position of the component share/type on the first “ex-rights” trading day, taking into consideration the “ex-market” closing price.

(\*) If necessary, the index reducer will be adjusted to guarantee that the number of index points suffers no alteration because of the adjustment to the benefit.

## L. Special Procedures

### L.1. Adjustments in the Case of Company Spin-off and Mergers

The situation of an ISE component company which decides to make a spin-off or a merger will be analyzed on a case-by-case basis.

### L.2. Adjustments in the Case of Public Offerings

Whenever a company launches a public offering that results in the acquisition of a significant proportion of the outstanding shares, BM&FBOVESPA may adopt one of the following procedures:

- a) removal from the index of the percentage of outstanding shares bought by the company; or
- B) removal of the share from the index.

In either case, an adjustment will be made to the index reducer.

## Corporate Sustainability Index – ISE

# ANNEX

### Calculation Formula and Procedures

#### 1. Negotiability Index

The negotiability index is calculated according to the following formula:

$$IN = \sqrt{\frac{ni}{N} * \frac{vi}{V}}$$

where:

**IN** = negotiability index

**n<sub>i</sub>** = number of trades carried out with stock "i" on BM&FBOVESPA cash market (round-lot)

**N** = total number of trades carried out on BM&FBOVESPA cash market (round-lot)

**v<sub>i</sub>** = financial value generated by the trades carried out with share "i" on BM&FBOVESPA cash market (round-lot)

**V** = total financial value of BM&FBOVESPA cash market (round-lot)

**Note:** In the calculation of the negotiability index, cross trades are not considered.

#### 2. ISE Calculation Formula

ISE may be calculated using the following formulas:

a) *without using the reducer:*

$$ISE_{(t)} = ISE_{(t-1)} * \frac{\sum_{i=1}^n Qi_{t-1} * Pi_t}{\sum_{i=1}^n Qi_{t-1} * Pi_{t-1}}$$

where:

**ISE<sub>(t)</sub>** = index value on day "t"

**ISE<sub>(t-1)</sub>** = index value on day "t-1"

**n** = number of shares included in the index theoretical portfolio

**Q<sub>i,t-1</sub>** = theoretical quantity of share "i" available for trading on day "t-1". In the event of distribution of shares of the same type by the company, it refers to the theoretical quantity of share "i" available for trading on day "t-1", recalculated because of such benefit.

**P<sub>i,t</sub>** = price of share "i" at closing of day "t"

**P<sub>i,t-1</sub>** = closing price for share "i" on day "t-1", or its ex-theoretical price, in the case of benefit distribution on this day.

## Corporate Sustainability Index – ISE

b) using the reducer:

$$ISE_{(t)} = \frac{\text{Portfolio's total value}}{\text{Reducer}} = \frac{\left( \sum_{i=1}^n P_{i,t} * Q_{i,t} \right)}{\alpha}$$

where:

**ISE (t)** = index value at moment "t"

**n** = total number of companies (in the share/type) included in the index theoretical portfolio

**P<sub>i,t</sub>** = last price of share "i" at moment "t"

**Q<sub>i,t</sub>** = quantity of share "i" in the theoretical portfolio at moment "t"

**α** = reducer used to adjust the index value to the current base

### 3. Adjustment Procedure for Benefits

The theoretical quantities of the companies in the share/type (i.e. their number of outstanding shares) will remain constant during the portfolio's year term, and will only be altered in the event of benefit distribution in shares of the same type by the issuing companies (bonuses, splits, reverse splits, subscription, etc.).

The adjustment of the theoretical quantities in the exact proportion to the distributed benefit is carried out after the closing of BM&FBOVESPA's trading session, on the last day prior to the ex-date of the corporate action.

The following formula is used:

$$Q_n = Q_a * (1 + B + S)$$

where:

**Q<sub>n</sub>** = adjusted share quantity

**Q<sub>a</sub>** = previous share quantity

**B** = percentage of bonus and/or split, in index number

**S** = percentage of subscription, in index number

In the event that an approved benefit is partially homologated, or is not homologated, the quantity of shares in the portfolio will be proportionally reduced to reflect the real quantity of outstanding shares.

This adjustment will be carried out on the trading session after the date of receipt, by BM&FBOVESPA, of the communication expedited by the issuing company providing information of these facts. The index reducer will be adapted so that the index value suffers no alteration.

## Corporate Sustainability Index – ISE

### 4. General Formula for Calculation of the “Ex-theoretical” Price

$$P_{ex} = \frac{Pc + (S * Z) - D - J - Vet}{1 + B + S}$$

where:

**P<sub>ex</sub>** = ex-theoretical price

**P<sub>c</sub>** = last price before the benefit distribution

**S** = percentage of subscription, in index number

**Z** = issuing value of the share to be subscribed, in Brazilian currency

**D** = dividends received per share, in Brazilian currency

**J** = interest on capital, in Brazilian currency

**V<sub>et</sub>** = theoretical economic value per share, resulting from benefits distributed in another share type/asset

**B** = percentage of bonus (or split), in index number

**Note:** The Vet is calculated considering the financial amount which would be obtained from the sale of shares of another type and/or other assets (debentures, shares of another company, etc.) received. For example, suppose that company A is distributing to its shareholders, free of charge, one share of company B for every two shares held of company A, and that the shares of company B are evaluated at \$ 5.00/share. In this case, the Vet will be equal to \$2.50.

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