

# Executive summary: WFE study on exchanges and investment



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## Summary

Many exchanges are adopting proactive commercial strategies in response to growing investor interest in environmental, social and governance (ESG) issues and global sustainable development challenges such as climate change, according to a new report published this month by the WFE.

The report was commissioned in late 2008 from the specialist advisory firm Delsus Limited and reveals that WFE's 51 member exchanges are becoming increasingly active in three main 'sustainable investment' themes:

- Raising ESG awareness and standards among listed companies;
- Information products and services for sustainable investors; and
- Specialised markets for specific sustainable investment niches.

## Sustainable investment in a nutshell

Over the last five years or so, social and environmental risks and opportunities (together with corporate governance) have emerged from a long incubation on the fringes of the mainstream investment industry to become commonplace long-term investment themes in the world's capital markets.

For example, according to the US Social Investment Forum, roughly 11 per cent of assets under professional management in the US are now involved in socially responsible investment. Eurosif estimates that socially responsible investment assets represent over 17 per cent of the asset management industry in Europe. Over 170 pension funds and other asset owners – with combined assets under management of around US\$18 trillion - have now signed the UN Principles for Responsible Investment (PRI).

A key driver behind these trends is the growing political and economic prominence of climate change, together with market-based incentives for the transition to a lower-carbon future. Labour standards, human rights, product safety, human capital and poverty reduction are also major issues.

The basic hypothesis behind these powerful trends in sustainable investment is that ESG factors in an economy, sector or company play an increasingly important part in creating or eroding shareholder value. Beyond this business case rationale, many investors and stakeholders also argue a compelling case for treating sustainable development as a straightforward matter of good corporate citizenship and enlightened self-interest.

Participants in the broad sustainable investment market include pension funds and other institutional investors; hedge funds; retail investors; and high net worth individuals and family offices, together with a wide range of advisors, intermediaries, asset managers and other links in the value-chain. There are three main sustainable investment strategies:

- "Socially responsible" or "ethical" investment funds that use corporate social responsibility (CSR) as a positive or negative filter in portfolio construction. This is sometimes combined with shareholder activism.
- "Green" investment strategies specialising in companies that provide solutions to sustainable development problems e.g. clean technology, renewable energy, environmental services, healthcare.
- "Mainstream" integration of non-traditional financial factors (including ESG factors) into financial analysis, portfolio construction and share ownership. This is often combined with shareholder engagement.

This market trend is mirrored in many of the world's publicly listed companies and their strategic management of issues such as climate change, clean technology, labour standards and human rights. Companies (and their investors) recognise that factors like these can be essential to innovation, productivity and market growth as well as to risk management and brand value. Policy-makers, legislators, regulators and accounting standards boards are also focusing on sustainability issues in the corporate and investment spheres.

## Relevance to exchanges

All of this translates into some important strategic and commercial questions for exchanges:

- How can an Exchange help ensure that the market efficiently meets the new ESG-related information needs of investors, analysts and companies?
- Can ESG issues contribute to the badge of quality, integrity and transparency conferred on companies by listing on the Exchange and to the overall profile of individual markets?
- Can the Exchange help to raise corporate awareness and management practices among listed companies?
- Can the Exchange add value by introducing investors and issuers to one another on theme of sustainability excellence?
- Can the Exchange create new listing and trading products geared to specific sustainable investment niches?
- How can Exchanges help to shape the way that regulatory conditions and reforms facilitate ESG transparency and sustainable investment flows?

Many exchanges have taken innovative steps to anticipate and respond to these new opportunities. Their initiatives range from measures to improve information efficiency through sustainability indices and disclosure guidance, to specialist listing and trading platforms.

## Raising ESG awareness and standards among listed companies

Several exchanges – many of them in emerging markets – have taken initiatives in recent years that are designed to raise issuing companies' awareness and/or to promote or require better transparency and disclosure on ESG-related performance and risk factors.

In Malaysia and Thailand, for example, the emphasis has been on promoting corporate social responsibility (CSR) concepts, including publication of annual CSR/sustainability reports on (initially at least) a voluntary basis.

**Bursa Malaysia** began by publishing CSR guidance for companies in September 2006, followed by sponsorship of prestigious annual awards for CSR reporting in conjunction with partners such as the Malaysian Institute of Management. At the same time, Bursa Malaysia has closely monitored and evaluated the quality of CSR reporting in Malaysia, publishing a detailed report on companies' progress in April 2008. The Exchange also worked closely with Malaysia's regulators and policy-makers to begin a carefully

paced transition to mandatory CSR reporting by listed companies: Malaysian companies are now required to include in their Annual Reports a description of their CSR activities and practices or, if there are none, a statement to this effect. This requirement is also incorporated into Bursa Malaysia's listing rules.

China's exchanges have followed a similar path of CSR awareness raising and encouraging companies to publish annual CSR reports. The **Shenzen Stock Exchange** issued CSR guidance for listed companies in early 2006 and has followed this with training programs, whilst the **Shanghai Stock Exchange** introduced equivalent measures in May 2008 in the form of the 'Shanghai CSR Notice' and the 'Shanghai Environmental Disclosure Guidelines'.

## Taiwan Stock Exchange (TWSE):

### Integrating ESG disclosure into best practice principles for corporate governance

In 2006, the TWSE revised its Corporate Governance Best-Practice Principles for Listed Companies (CG Best-Practice) to recommend that listed companies should set up environmental protection or other committees (such as CSR Committees) and have them stipulated in their articles of incorporation.

Furthermore, since 2008, Taiwan's regulator has required all listed companies to include CSR reporting in the corporate governance statement of the annual report and prospectus, including the information on the company's CSR system, measures adopted and performance.

To raise ESG awareness and standards among listed companies, the TWSE is working closely with the Gre-Tai Securities Market, Taiwan Business Council for Sustainable Development and the Taiwan CSR Institute to draft CSR guidance for companies. The final draft was submitted to Taiwan's regulator in May 2009 for approval.

The measures taken by both the Shanghai and Shenzhen Stock Exchanges sit within a wider framework of government policy to harness the capital markets to foster environmentally and socially sustainable private sector development. This includes the "Green Securities" policy, launched by the Ministry of Environmental Protection (MEP) in February 2008 in partnership with the China Securities Regulatory Commission (CSRC). The policy aims to make it harder for polluters to raise capital by requiring companies listed on the exchange to disclose more information about their environmental record.

The “Green Securities” policy was enhanced by the issuance of the “Green IPO” policy in June 2008. This requires enterprises in certain industries to undergo an environmental assessment by the MEP before initiating an IPO or obtaining refinancing from banks. During a 10-day pre-IPO evaluation period, MEP conducts its own assessment and calls for the public’s opinion through a national hotline. If MEP approves the company, it then issues a permit to let the IPO proceed. As of September 2008, this process was responsible for the rejection or further review of IPOs from 20 out of 38 companies reviewed since the policy was implemented in February 2008.

Many exchanges are involved in providing various types of sustainability indices (see below). In several cases - particularly **BM&FBOVESPA** and the **Johannesburg Stock Exchange** - raising corporate sustainability standards among listed companies has been central to the business rationale and project design. This is reflected in a strong emphasis on stakeholder consultation, industry outreach, strategic partnerships with business schools and other capacity-building organizations, and making index components and weightings publicly available.

The National Stock Exchange of India (NSE) provides yet another example of the innovative measures that exchanges can take to raise the ESG awareness of listed companies and help them to improve ESG disclosure and investor relations. In the NSE’s case, the strategy also includes the goals of educating local investors and promoting the Indian market to international investors with an interest in ESG issues (see box).

### National Stock Exchange of India (NSE):

#### Capital Markets Forum on Responsible Investment in India

In September 2009, NSE will host a capital market markets forum in Mumbai on the theme of “Responsible Investment in India” in association with the UN PRI, the International Finance Corporation (IFC), TERI-Europe and Delsus Limited.

NSE’s invitation-only event is aimed at foreign institutional investors, CEOs of India’s leading businesses and senior representatives from Indian pension funds, asset managers and banks.

Confirmed international speakers include the TIAA-CREF, PGGM, APG, Robeco and the Office of the Comptroller, City of New York.

The event is intended to provide two-way benefits by helping Indian companies to get a better understanding of the ESG agenda of foreign institutional investors, and helping foreign institutional investors to get a better understanding of the ESG issues and investment opportunities in India.

In developed markets, the Corporate Governance Council of the Australian Securities Exchange (ASX) has taken an important step by referencing sustainability-related issues in the August 2007 revision to its *Corporate Governance Principles and Recommendations*. ASX listing rules require listed companies to disclose the extent to which they have followed the Recommendations and, if a Recommendation has not been followed, the reasons for not following the Recommendation. Disclosure is on an “if not, why” basis.

The Revised Principles include the recommendation under Principle 7.1 that “companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies”. What is notable in the sustainable investment context is that the commentary goes on to add that “...these risks may include but are not limited to: operational, **environmental, sustainability, compliance, strategic, ethical conduct, reputation or brand, technological, product or service quality, human capital, financial reporting and market-related risks**” (emphasis added). The Revised Principles also emphasise the importance of involving internal and external stakeholders – including the broader community – in the development of risk management policies.

### Information products and services for sustainable investors

Table 1 lists the full range of sustainability-related investment indices provided by WFE members, either directly or through subsidiaries. New product launches have increased significantly since 2007, as has the number of exchanges entering this field for the first time (see chart).

#### Number of sustainability indices offered directly by WFE member exchanges

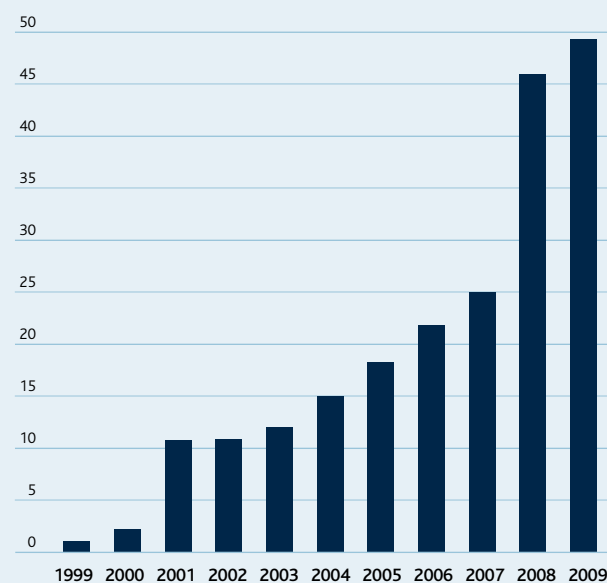


Table 1: Sustainability indices offered by WFE member exchanges

Exchange	Index	Launch year
BME	FTSE4Good IBEX Index	2008
BM&FBOVESPA	Corporate Sustainability Index (ISE)	2005
Deutsche Börse	DAXglobal® Alternative Energy Index	2006
	DAXglobal® Sarasin Sustainability Germany Index	2007
	DAXglobal® Sarasin Sustainability Switzerland Index	2007
The Egyptian Exchange	ESG index in development with S&P	2010 (a)
Indonesia Stock Exchange	SRI-KEHATI Index	2009
International Securities Exchange	ISE Water Index	2000
	ISE-CCM Green Energy Index	2001
	ISE Global Wind Energy Index	2005
Johannesburg Stock Exchange	JSE Socially Responsible Investment (SRI) Index	2004
Korea Exchange	Korean SRI Index (in development)	2009 (b)
London Stock Exchange (via joint ownership of FTSE)	FTSE4Good Global Index	2001
	FTSE4Good US Index	2001
	FTSE4Good Europe Index	2001
	FTSE4Good UK Index	2001
	FTSE4Good Global Index 100	2001
	FTSE4Good US 100 Index	2001
	FTSE4Good Europe 50 Index	2001
	FTSE4 Good UK 50 Index	2001
	FTSE4Good Japan Index	2004
	FTSE4Good Environmental Leaders Europe 40 Index	2007
	FTSE4Good Australia 30 Index	2008
	FTSE4Good IBEX Index	2008
	FTSE KLD Global Sustainability (GSI) Index Series	2008
	FTSE KLD Global Climate 100 Index	2008
	FTSE Environmental Technology Index Series	2008
	The FTSE Environmental Opportunities Index Series	2008
	NASDAQ OMX	NASDAQ Clean Edge US Index
NASDAQ OMX Clean Edge Global Wind Energy Index		2008
Wilder NASDAQ OMX Global Energy Efficient Transport Index		2008
OMX GES Sustainability Nordic Index		2008
OMX GES Ethical Nordic Index		2008
OMX GES Ethical Denmark Index		2008
OMX GES Ethical Finland Index		2008
OMX GES Ethical Norway Index		2008
OMX GES Ethical Sweden Index		2008
OMX GES OMXS30 Ethical Index		2008
OMX GES Sustainability Sweden Ethical Index		2008
OMX GES Sustainability Sweden Index	2008	
National Stock Exchange of India	S&P ESG India Index	2008
NYSE Euronext	NYSE Arca Cleantech Index	1999
	NYSE Arca Environmental Services Index	2003
	NYSE Arca WilderHill Clean Energy Index	2004
	NYSE Arca WilderHill Progressive Energy Index	2006
	Euronext FAS IAS Index	2006
	Low Carbon 100 Europe Index	2008
Tel-Aviv Stock Exchange	Maala SRI (Socially Responsible Investing) Index	2005
Wiener Börse	VÖNIX Sustainability Index	2008
	CEE Responsible Investment Universe Index (CEERIUS®)	2009

(a) Launch planned for Q1 2010

(b) Launch planned for Q3 2009

The early pioneers and current main players are the **London Stock Exchange** (via its 50 per cent ownership of FTSE), **NASDAQ OMX** and **NYSE Euronext**, whilst the majority of new entrants are from developing markets such as South Africa, Brazil, Korea, Indonesia and India.

The latest addition is an ESG Index being developed by the **Egyptian Exchange** in association with the Egyptian Institute of Directors and Standard & Poor's, which should be launched in early 2010.

In general terms, developed market exchanges are focusing primarily on investable indices which can be licensed to tracker funds or customised to client's specific requirements, whilst the agenda in emerging markets has usually begun with profile raising, investor confidence and changing corporate behaviour.

#### Luxembourg Stock Exchange (LuxSE):

##### Microfinance labelling agency

Indices are by no means the only sustainability-related information product that can be provided by exchanges. An interesting example is provided (LuxSE), which has become a leading listing venue for microfinance investment vehicles (MIVs).

A key LuxSE initiative to strengthen this market is the Luxembourg Fund Labelling Agency (LuxFLAG), an independent non-profit association created in 2006 by LuxSE and six other founding Charter Members including ALFI, the European Investment Fund, and the Ministries of Finance and Foreign Affairs.

The Agency aims to promote the raising of capital for microfinance by awarding a recognisable label to eligible MIVs. Its objective is to reassure investors that the MIV actually invests, directly or indirectly, in the microfinance sector.

Until recently, all of these indices have tended to fall into one of two main categories:

- Broad-based indices of stocks from all industry sectors, using extensive ESG criteria and scoring systems to select companies that are "leaders" in social and environmental responsibility. Examples include the FTSE4Good series, the **BM&FBOVESPA** Corporate Sustainability Index (ISE), the **Johannesburg Stock Exchange** Socially Responsible Investment Index, the **NASDAQ OMX** GES Sustainability Nordic Index, and the **Wiener Börse** VÖNIX Sustainability Index.
- Sector-specific indices focusing specifically on companies that provide solutions to sustainability challenges, particularly in relation to clean technology, sustainable energy and environmental services. These are frequently linked to exchange-traded funds

(ETFs). Examples include FTSE's Environmental Technology Index series, **Deutsche Börse's** DAXglobal Alternative Energy Index, the **NASDAQ OMX** Clean Edge Global Wind Energy Index, the **NYSE Arca** Cleantech Index, and several indices offered by the **International Securities Exchange**.

In the last year, **NYSE Euronext** has launched a third variation: a broad-based (non-sector specific) index oriented around a single ESG issue, in this case climate change. The NYSE Euronext Low Carbon 100 Europe® Index is an index weighted by free-float market capitalization designed to measure the performance of the 100 largest European companies having the lowest carbon (CO2) intensity in their respective sectors or homogeneous sub-sectors.

#### Specialised markets for specific sustainable investment niches

Several WFE members are active in servicing national and international carbon trading markets:

- The **Montréal Exchange**, part of the **TMX Group**, created the Montréal Climate Exchange (MCeX) in 2006 as a joint venture with the Chicago Climate Exchange. MCeX officially launched trading in May 2008, two months after the Government of Canada published the final version of its Regulatory Framework for Industrial Greenhouse Gas Emissions. MCeX provides a trading platform for futures contracts based on carbon emission reduction credits, enabling companies that have a 'carbon cap' to manage their emissions risk at lowest cost.
- The **Australian Securities Exchange (ASX)** is at an advanced stage of readiness to introduce futures and options products based on greenhouse gas emission permits and emission reduction credits, pending the introduction of planned legislation to implement the Australian government's Carbon Pollution Reduction Scheme.
- **NYSE Euronext** has a 60 per cent stake in Paris-based BlueNext, whose stated aim is to be the world's largest exchange for carbon and other environment-related products. BlueNext's current products include both spot and futures markets for Certified Emission Reduction (CER) credits under the Kyoto Protocol's Clean Development Mechanism and European Union Allowances (EUAs) under the European Emissions Trading Scheme (ETS).
- **NASDAQ OMX Commodities** and Nord Pool ASA together constitute Europe's leading commodity exchange for power and global emission products, including spot and physical forward contracts for both EUAs and CERs. NASDAQ OMX Commodities also operates the clearing business and offers consulting services to commodity markets globally. More than 50 per cent of the energy consumption in the Nordic countries is based on renewable energy resources.

- **Deutsche Börse** and **SIX Swiss Exchange** jointly operate Eurex, one of the world's leading derivative exchanges. In partnership with the European Energy Exchange (EEX), Eurex offers trading and OTC clearing in EUA futures, CER futures and options on EUA futures. In 2009, Eurex expanded its product range with the addition of weather derivatives. Eurex is also the parent company of the International Securities Exchange (ISE), which offers three cleantech indices with their associated ETFs and index options products.
- In Brazil, **BM&FBOVESPA** has created a Carbon Market comprising a Carbon Facility (which hosts the registration of carbon emission reduction projects validated under the Clean Development Mechanism (CDM) and a Carbon Credit Auction System. The Exchange is currently examining the feasibility of organising an OTC market for CERs.
- The **Buenos Aires Stock Exchange (BBA)** has launched a Carbon Market to promote the development of CDM projects in Argentina. This includes education programs, corporate carbon trading simulations and building relationships between project developers and international investors.

Cleantech investing has enjoyed remarkable growth in recent years as investors have aligned themselves with the way that consumers, businesses and governments are responding to issues such as climate change and energy security.

The European Union's ten largest such funds had more than €10.8 billion of assets under management in late 2008, while dollars invested by US venture capitalists into the cleantech sector during 2008 grew by 52% to US\$4.1 billion, despite the credit crunch and associated economic downturn.

A number of WFE members – most notably the **London Stock Exchange Group** (through AIM), **NYSE Euronext**, **NASDAQ OMX** and the **TMX Group** – have positioned themselves to capitalise on this fast-growing market.

Strategies include:

- Sponsoring and attending cleantech conferences and trade fairs
- Cleantech investor days
- Marketing to attract cleantech IPOs
- Cleantech indices
- Cleantech ETFs (see table 2).

### TMX Group:

#### Focusing on cleantech IPOs

TMX Group has strategically targeted growth-oriented cleantech companies seeking a market to access North American and global capital.

At the end of 2008, TSX and TSX Venture Exchange were home to 110 cleantech companies with a total market cap of over C\$6.4 billion (US\$5.3 billion/€4 billion).

#### TSX and TSXV Cleantech Companies Span a Range of Industries

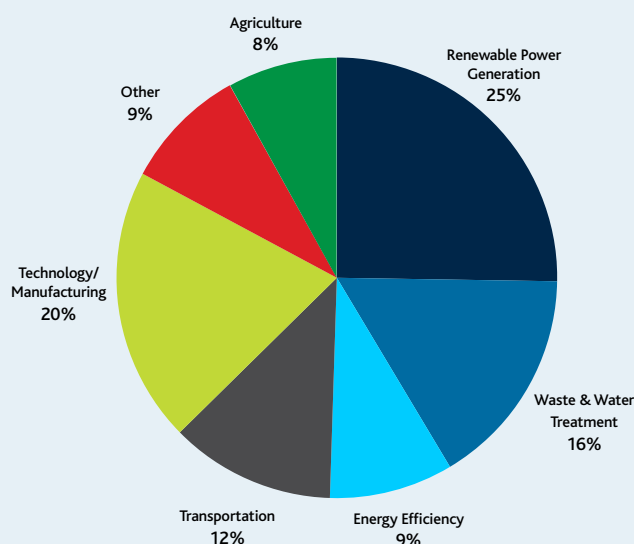


Table 2: Examples of recent cleantech ETFs

Exchange Traded Fund	Exchange	Launch year
First Trust NASDAQ Clean Edge Green Energy Index Fund	NASDAQ	2007
PowerShares Global Wind Energy	NASDAQ	2008
Airshares EU Carbon Allowances Fund	NYSE Arca	2008
Claymore S&P Global Water Index ETF	NYSE Arca	2008
Claymore/MAC Global Solar Energy Index ETF	NYSE Arca	2008
First Trust ISE Water Index Fund	NYSE Arca	2007
First Trust ISE Global Wind Energy ETF	NYSE Arca	2008
iShares KLD 400 Social Index Fund	NYSE Arca	2008
iShares KLD Select Social Index Fund	NYSE Arca	2005
Market Vectors Environmental Services Index Fund	NYSE Arca	2008
PowerShares Global Clean Energy	NYSE Arca	
Euronext Paris	2008	
PowerShares Global Water Portfolio	NYSE Arca	2008
PowerShares WilderHill Clean Energy Portfolio	NYSE Arca	2008
PowerShares WilderHill Progressive Energy Portfolio	NYSE Arca	2008
EasyETF Low Carbon 100 Europe	Euronext Paris	2008
ETFS DAXglobal Alternative Energy Fund	Euronext Amsterdam	
London Stock Exchange	2008	
iShares S&P Global Clean Energy Index Fund	NASDAQ	
Euronext Amsterdam	2008	
Lyxor ETF New Energy	Euronext Paris	2007
Lyxor World Water	Euronext Paris	2007
EasyETF FTSE ET50 Environment	Euronext Paris	2008
EasyETF Water	Euronext Paris	2008

The full report - *Exchanges and Sustainable Investment* (August 2009) – will be available at [www.world-exchanges.org](http://www.world-exchanges.org) and [www.delsus.com](http://www.delsus.com).

### About Dan Sidy

Dan Sidy is the Founder and Managing Director of Delsus Limited, a UK-based consulting and advisory firm specialising in sustainable investment and environmental finance. He is an acknowledged international authority on the environmental, social and governance (ESG) aspects of investment in emerging markets and has been closely involved in most of the major developments in this field over the last 10 years. His experience and networks span portfolio investment, private equity, banking and international development.

Dan has been both a formal and an informal advisor on ESG issues to the WFE for several years, and has spoken at a number of WFE conferences and events. An active member of the UN Principles for Responsible Investment (PRI) network, his current initiatives include helping PRI, the National Stock Exchange of India and leading European and US pension funds to collaborate on a "responsible investment in India" capital markets day to be held in Mumbai in September 2009.

Dan founded Delsus Limited in 2006 following a long career with the World Bank Group. The firm provides bespoke sustainable investment services in three main areas: strategy and policy; product development and business generation; and operational support at the transaction level. Clients include the World Federation of Exchanges, the International Finance Corporation, the InterAmerican Development Bank and a number of confidential private sector clients in the asset owner and asset management sectors.