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Foreword

There are three possible reasons for introducing an index based on the quality of governance. Indices can supplement the regulatory framework around governance by providing companies with an incentive to adopt better practices. They give companies an opportunity to differentiate themselves in the market, as well as the possibility of tapping into a pool of money committed to good governance and sustainability.

All these reasons appear good on the surface, but we need to know more about how such indices actually operate. This study provides some useful evidence based on the experience of indices in eight different markets. It points out not only the strengths of such indices but also their limitations.

Not all indices are constructed in the same way: some focus more on governance and some on issues of corporate responsibility. There is not always evidence of superior performance by companies that are part of an index, perhaps because most companies in the relevant market are included. The standards applied to indices vary from market to market, so membership in an index gives no absolute guarantee of governance standards.

That said, there is a general acceptance that governance indices can be a useful tool for raising both standards in companies and awareness among investors. The use of indices is growing, and it is important to have analysis from which those planning an index can learn.

For companies to reap the full benefits of membership, the criteria for inclusion in an index must be clear and transparent, so that investors can understand what the index delivers. Arguably, where an index is available, all companies should be assessed for inclusion automatically, rather than being allowed to decide for themselves whether to join.

For those wondering what indices can and do deliver, this study provides a good starting point. Governance indices are one tool among many, but they have a potentially important role to play.



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BOSPHORUS BRIDGE, ISTANBUL, TURKEY, CONNECTS ASIA TO EUROPE

This study reviews the different approaches used by stock exchanges to build indices incorporating corporate governance.

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Executive Summary

Since 2001, eight stock exchanges around the world have launched corporate governance indices (CGIs), sometimes as part of a broader environment, social, and governance (ESG) initiative. The comprehensive analysis of these indices presented in this study is the first of its kind, and it reveals that CGIs have a positive impact, enhancing legal and regulatory frameworks by extending governance criteria to develop objective and measurable benchmarks. The study also shows that CGIs present companies with an opportunity to differentiate themselves in the market and, ultimately, offer companies an incentive to adopt better governance practices. Nevertheless, as the process for vetting and evaluation of companies for inclusion in the indices continues to evolve, access to underlying methodologies, disclosure of the ratings and self-assessments of individual companies, and of overall monitoring processes and procedures can still be enhanced.

CGIs offer a market solution to address shortcomings in corporate governance. Common weaknesses in governance frameworks, such as lack of shareholder protection, poor corporate disclosure, and weak requirements for independent directors, are some of the main reasons behind the creation of CGI and ESG indices. CGIs have proven that they can elevate the legal and regulatory “ceiling” for governance, can allow companies to differentiate themselves in the market, and can increase their access to capital.

CGIs also enhance voluntary national codes of corporate governance. Across all the indices studied, stock exchanges tend to pick and choose from the national codes of governance those provisions that are objective and measurable. This approach is critical in elevating the stature of the codes and in supporting the evaluation and monitoring of companies, as well as in boosting the overall credibility of the index. In addition, most indices employ market-based criteria such as minimum free float and liquidity. These factors are important for the marketability of the index, but they can also be detrimental in illiquid markets, since the number of companies eligible for inclusion in an index can be severely reduced.

The commitment of companies to governance differs across types of indices. There are two types of indices: listing tiers and those in which companies meet a rating threshold. Since adherence of companies to mandatory rules in listing tiers is binding, the “tier” option requires a higher level of commitment from the constituent companies. Evaluation and monitoring of the constituent companies and transparency of the index are critical for the index’s credibility. Stock exchanges that have not set up a listing tier tend to outsource the evaluation process to mitigate conflicts of interest with client companies. In most cases, stock exchanges pay for the evaluation to ensure an independent rating process. Most of the stock exchanges disclose index criteria and methodology, but in most cases, access to this information is a challenge. Rating results are rarely disclosed, mainly because of the companies’ reluctance to have their rating reports published. Exclusion from indices occurs primarily during annual reviews and is rarely due to a failure to meet governance criteria. This pattern suggests that stock exchanges are reluctant to exclude companies for governance considerations because of the associated reputational risks.

Indices are growing in numbers but struggle to beat the market. Most of the indices studied have shown strong growth often in only a few years, underlining their attractiveness and their potential to influence corporate behavior. The performance of most indices, however, mirrors that of the broader market. This often reflects the overlap of constituent companies or a lack of depth in the capital markets. The lack of differentiation in performance also explains the slow development of investment products tailored to the indices.



SEOUL, SOUTH KOREA. SKYLINE AT NIGHT.

This study reviews the different approaches used by stock exchanges to build indices incorporating corporate governance.

I. Introduction

Many countries are making reforms to corporate governance (CG) a priority as a way to improve business performance and help companies attract outside investment. As a result, stock exchanges in these countries are looking for ways to promote better governance practices in companies.

Corporate governance indices (CGIs) can raise a country's overall corporate governance standards and can offer companies possible financial and investment benefits from making governance improvements. With these goals in mind, an increasing number of stock exchanges have set up CGIs in the past decade, sometimes as part of a broader environmental, social, and governance (ESG) initiative.

Each stock exchange has its own set of motives for launching an index, however, and each has employed different criteria for vetting company governance. They have also developed distinct evaluation processes, as well as diverging approaches to the disclosure of results.

This study reviews the different approaches used by stock exchanges to build indices incorporating corporate governance. In the case of ESG indices, the focus is on the governance component of these indices. The study also draws lessons from the stock exchange's experiences and highlights success factors and shortcomings. In particular it addresses the following key questions:

1. What are the key drivers for stock exchanges to launch CGIs?
2. What are the critical building blocks in the construction of a CGI?
3. What are the risks faced by those investing in CGIs?

Eight stock exchanges that have their own CGI or ESG index form the basis of the study. Detailed index profiles are provided in Appendix I.

Country	Stock Exchange	Index Name
Brazil	BM&FBOVESPA	Special Corporate Governance Stock Index (IGC)
China	Shanghai Stock Exchange (SSE)	Corporate Governance Index
Italy	Borsa Italiana	FTSE Italia STAR
Mexico	Mexican Stock Exchange (BMV)	Indice IPC Sustentable
Peru	Lima Stock Exchange (BVL)	Good Corporate Governance Index
South Africa	Johannesburg Stock Exchange (JSE)	Socially Responsible Investment (SRI) Index
South Korea	Korea Stock Exchange (KRX)	Korean Corporate Governance Index (KOGI)
Turkey	Istanbul Stock Exchange (ISE)	Corporate Governance Index

Information for this study was collected in three phases:

- Publicly available information on the indices and their host jurisdictions was gathered and analyzed.
- A survey was designed and circulated among the responsible parties for the CGIs at the eight stock exchanges.
- Analysis of the survey responses was followed by phone interviews with the respondents to close knowledge gaps and record their experience.



II. Objectives and Types of Indices

A. Objectives

Three objectives motivate stock exchanges to launch CG or ESG indices:

1. To supplement the legal and regulatory corporate governance framework and thus raise the country's overall corporate governance environment
2. To give companies an opportunity to differentiate themselves in the market
3. To tap into a growing pool of money committed to good governance and sustainability

1. RAISE THE "GOVERNANCE CEILING"

Creating incentives for corporations to apply higher standards of corporate governance is an effective policy tool for improving a country's overall corporate governance environment. For example:

- **China:** In 2007, the Chinese Securities Regulatory Commission (CSRC) started an initiative to improve the corporate governance of listed companies. At the end of 2007, to support this push for reform, the Shanghai Stock Exchange (SSE) launched the SSE CG Board, the basis of the SSE CG Index. Criteria for admission to the CG Board directly address issues related to controlling shareholders—a prevalent concern in Chinese companies. Seven of the 20 questions in the self-evaluation that a company must provide in its application for the SSE CG Board address the ownership dimension. Questions address topics related to conflicts of interest, related-party transactions involving the controlling shareholder—common occurrences among Chinese companies—the controlling owner's influence on dividend distribution in the three preceding years and on board appointments.
- **Brazil:** In Brazil, corporate governance and investor protection have been shareholder concerns for many years. However, reformers found it difficult to attack the problem through changes to the legal and regulatory framework. In December 2000, the Brazilian Stock Exchange BOVESPA launched a new listing segment, the Novo Mercado, and its sister segments, Level 1 and Level 2. These listing segments have corporate-governance requirements that go far beyond Brazil's legal and regulatory framework. Crucially, Novo Mercado, the most demanding of the three levels, has eliminated non-voting shares and requires a company's capital stock to be exclusively represented by common shares. In addition, to ensure that minority shareholders get equal treatment in case of a control change at the company, constituent companies of Novo Mercado or Level 2 must extend full tag-along rights¹ to all shareholders. Tag-along rights for all shareholders are commonly missing in the traditional stock market, as Brazilian corporate law requires tag-along rights only for voting shareholders.
- **Mexico:** In Mexico, regulators have been working to improve corporate governance standards. Since 2005, Mexican Securities Law has required 25 percent of the board to be independent. However, many practitioners have questioned the true independence of some Mexican board members. In 2011, the Mexican Stock Exchange (Bolsa de Valores Mexico, BMV) introduced the IPC Sustentable, in part, to improve CG practices in the country.

Creating incentives for corporations to apply higher standards of corporate governance is an effective policy tool for improving a country's overall corporate governance environment.

¹ Tag-along rights oblige a major shareholder to include the holdings of minority shareholders in any negotiations and to ensure the same terms and conditions apply.

Crucially, one of the two organizations providing evaluations for the Mexican Index, Universidad Anáhuac, has adopted a tougher set of criteria to better assess independence requirements. One example lies with the definition of significant clients and suppliers, since Mexican Securities Law does not allow a candidate to be considered independent if he/she represents a client/supplier that accounts for more than 10 percent of the total sales or purchases of the listed company within the 12-month period immediately preceding the appointment. Universidad Anáhuac, in its evaluation for the IPC Sustentable, lowers this threshold to 5 percent and plans to lower this number further in coming years.

Some stock exchanges use corporate governance indices to improve compliance with a code of corporate governance. As such, standards that were adopted only sporadically can become widespread practice through the index. This is the case in Turkey and Peru.

- **Peru:** The track record of compliance with the country's Corporate Governance Code issued in 2002 had not been positive. To spur the adoption of norms, the Lima Stock Exchange (Bolsa de Valores Lima, BVL) launched the Good CG Index in 2008, encouraging companies to perform self-evaluations against the principles of the code. The BVL also created an annual Corporate Governance Award (the Key Award) for the best performer. Today, the self-evaluation forms the basis of a company's application to the index.
- **Turkey:** The Capital Market Board (CMB) encouraged better application of the Turkish Corporate Governance Principles issued by CMB in 2003.

2. GIVE COMPANIES AN OPPORTUNITY TO DIFFERENTIATE THEMSELVES

Helping companies to distinguish themselves with a label of governance excellence is another key reason for creating a CGI. Companies in the index or market segment can expect to increase their access to capital, particularly that of foreign investors. These investors value information on company governance, especially for emerging-market companies. A quote from a 2009 global survey of fund managers by Mercer for the International Finance Corporation (IFC) underlines the problem:

While corporate governance is regarded as important by investment managers, they may struggle to obtain clarity on companies' governance structures in emerging

markets. Many investment managers Mercer interviewed tend to actively investigate governance standards in their meetings with, and appraisals of, investee companies, and considered it material at a stock selection stage.²

In **Italy**, the STAR segment for small and medium-sized enterprises (SMEs) was launched in 2001.³ By creating a label of governance quality and transparency for these companies, STAR has generated higher liquidity and improved access to capital among member companies. According to data released for STAR's 10-year anniversary, companies belonging to the STAR segment consistently show higher liquidity than other listed SMEs. From 2001 to 2010, their average turnover velocity was 83 percent compared with 66 percent for other SMEs. Even more impressive is the growth in foreign investment. Whereas in 2001 foreign investors represented 54 percent of investment in STAR companies, in 2011 that number had risen to 88 percent.

In **South Africa**, the launch of the Johannesburg Stock Exchange (JSE) SRI Index in 2004 was sparked by the 2002 Earth Summit in Johannesburg and by the desire of South African companies to showcase their commitment in the area of governance and sustainability. Today, the SRI Index has become a base universe for active management and stock picking, with investors paying a premium for companies with good ESG practices.

The example of **Brazil** underlines the attraction of a means through which companies can distinguish themselves in a legal environment that is perceived to be weak. Since 2004, 94 percent of all new listings have occurred on one of the three specialized corporate governance segments, the Novo Mercado (74 percent), Level 2 (14 percent), and Level 1 (6 percent).⁴

3. ACCESS THE MONEY COMMITTED TO GOVERNANCE AND SUSTAINABILITY

Many studies show that CG factors, whether alone or as part of ESG analysis, play an increasingly important role in guiding investment decisions, particularly in emerging markets. Therefore, creating a CG or ESG market index in the local stock market to draw investor capital has serious potential. The above-cited 2009 survey of fund managers by Mercer for IFC showed that ESG considerations factor into the decision-

2 IFC and Mercer, "Gaining Ground – Integrating environmental, social and governance factors into investment processes in emerging markets" (International Finance Corporation, 2009), 4.

3 Companies with a market capitalization between €40 million and €1 billion

4 P. Pellini, "Stock exchanges as an engine for corporate governance improvements: Reaching out to non-listed companies" (Presentation at OECD Roundtable in Lima, Peru, 2011).

TABLE 1: INDEX TYPE

Index	Type	Commitment	Cap	CG or ESG
Brazil BM&FBOVESPA CG Index	Listing Tier	Binding Rules	All qualifying	CG
China SSE CG Index	Index	Voluntary application	All qualifying	CG
Italy FTSE STAR	Listing Tier	Binding Rules	All qualifying	CG
Mexico BMV IPC Sustentable	Index	Automatic evaluation	All qualifying	ESG
Peru BVL Good CG Index	Index	Voluntary application	Maximum 10	CG
South Africa JSE SRI Index	Index	Automatic evaluation	All qualifying	ESG
South Korea KRX KOGI	Index	Automatic evaluation	Maximum 50	CG
Turkey ISE CG Index	Index	Voluntary application	All qualifying	CG

Source: Stock exchange websites and responses to questionnaires

making process behind about US\$300 billion of investment in emerging markets. In fact, according to survey responses:

ESG issues are taken into account in almost half (47 percent) of the Emerging Market Equities (EME) products offered by the managers. (This compares to around a quarter of all managers across all asset classes and outside of EME on Mercer's database). Managers of two-thirds of these strategies saw ESG factors as a means of identifying investment opportunities, with many of the remainder seeing it as a risk-management tool.⁵

A number of more recent studies show that incorporating ESG factors into investment decisions has grown in importance:

- The “Global Sustainable Investment Review 2012” found that globally, US\$13.6 trillion of professionally managed assets incorporate ESG concerns into their investment selection and management. This represents 21.8 percent of the total assets under management in the regions covered by the report.⁶
- In December 2012, Aviva Investors published a survey of global equity and fixed income managers with combined assets under management of about US\$ 6 trillion. The survey shows that 84 percent consider ESG factors as part of their investment process and actively vote on holdings. Of the managers polled, 79 percent believe that ESG factors will be incorporated into all mainstream funds in the future, and 72 percent believe there is a link between a company's ESG performance and total returns for investors.⁷

⁵ IFC and Mercer, 14.

⁶ Global Sustainable Investment Alliance (GSIA), “Global Sustainable Investment Review 2012” (GSIA, 2013).

⁷ Aviva Investors, “Global Equity and Fixed Income Manager ESG Survey” (Aviva Investors, 2012).

Reflecting this growing importance, the Mexican stock exchange BMV explicitly launched the IPC Sustentable in November 2011 to allow the Mexican market to share in the growing market for ESG investment.

B. Types of Indices

CGIs can be categorized in a number of ways:

- Degree of commitment of listed companies to being part of the index
- Whether the company's evaluation occurs automatically or voluntarily
- Whether there is a cap that limits entry
- Whether only governance or broader ESG criteria are evaluated

How an index is constructed has important consequences for the level of company commitment, as well as the credibility and perception associated with the index (Table 1):

1. Listing tiers have mandatory special listing rules and, ultimately, require a higher degree of commitment.
2. Indices based on automatic evaluation appear more credible than those based on voluntary application, since companies are not free to choose whether they want their CG practices analyzed.
3. Capping the maximum number of companies in an index may suggest to investors that it is difficult to be part of the index.
4. Whether to establish a CG or ESG index depends to a large degree on whether the primary goal is to improve the corporate governance culture or to draw investment for well-governed and sustainable companies.

1. LISTING TIER

Two indices in this study are based on listing tiers: BM&FBOVESPA's Corporate Governance Index and the FTSE Italia STAR. While joining the listing segment is voluntary, adherence to all listing rules of the segment is contractually required. This approach differs from that of the other indices where companies must reach a predetermined threshold of compliance to join but are never required to score 100 percent compliance with the index criteria.

In listing segments, violation of the listing governance criteria (Table 2) triggers defined consequences (review, fines, and non-monetary sanctions that include eventual delisting), and compliance is monitored continuously. All companies included in the special listing tiers of BM&FBOVESPA's Novo Mercado, Level 1, and Level 2 automatically constitute the Corporate Governance Index, just as all companies in the STAR tier are part of the Italy FTSE STAR.

2. THE BASE UNIVERSE OF THE INDEX: VOLUNTARY APPLICATION VS. AUTOMATIC EVALUATION

A critical decision for a stock exchange when setting up an index is how to define its base universe. Two basic options exist. All listed companies (or a defined subset such as the main index constituents) can be automatically assessed for inclusion in the index, or companies can voluntarily apply to be evaluated.

The indices in **China**, **Peru**, and **Turkey** rely on the voluntary application of companies to be subject to a corporate governance evaluation. In **Peru**, for example, in order to join the Good CG

Index of the BVL, a company must contract a rating agency to verify its self-evaluation. A side effect of voluntary application is often that only companies that can be assured of qualifying will apply. Meanwhile, companies with poor CG practices can simply claim not to be interested and will not suffer the embarrassment of a bad CG evaluation.

An automatic assessment of all companies in the main index, such as occurs in **Mexico**, **South Africa**, and **South Korea**, carries a stronger message, since evaluation is not voluntary and is therefore a potentially more effective tool for improving governance.

3. CAPPING THE NUMBER OF COMPANIES

If an index is not based simply on strict adherence to specialized rules, it must create a qualifying threshold for companies to meet. In four of the six indices that have not established a listing tier, any company that meets the threshold qualifies for the index. The exceptions are **Peru** and **South Korea**. The BVL Good Corporate Governance Index in Peru has a maximum size of 10 companies. If more than 10 companies were to qualify, which has not occurred to date, the companies with the higher scores would be accepted. The Korea Stock Exchange (KRX) Corporate Governance Index (KOGI) is limited to 50 companies, selected based on their rating (and on market capitalization for companies with the same rating). In theory, if the rating scores were disclosed (which they are not, see below), capping the number of companies gives an index the characteristics of a ranking and makes qualification appear more competitive.

TABLE 2: MANDATORY GOVERNANCE CRITERIA FOR LISTING SEGMENT

Italy STAR	Brazil Novo Mercado
Appointment of investor relations officer	Annual public meeting with analysts
Disclose Quarterly Interim Management Report, Semi-Annual and Annual Report on company website	Common shares only
Publish all reports and financial statements in English	Company bylaws may not limit voting rights for minority shareholders
Composition of board according to Art.2 CG Code	Full tag-along rights
Min. 2 independent directors	Tender offers at least at economic value of company
Establish internal committees	English financial statements
Remuneration of directors	Disclosure of Code of Conduct and Securities Trading Policy
	20 percent independent directors
Establish Internal Control Committee	Separation of CEO/chairman
	Arbitration for dispute resolution

Source: Listing rules of STAR and Novo Mercado

4. G OR ESG?

The decision to establish a pure CGI or an ESG index depends largely on the principal purpose of the index. Listing segments with enforceable rules are perhaps better based only on straightforward governance requirements than on additional social and environmental considerations, which tend to be broader in scope and less easily quantified.

From the perspective of creating a market, investors seem to prefer ESG indices, since they factor in a larger range of issues and often go beyond a narrow definition of governance, even though governance criteria do form the backbone of company ESG evaluations. A 2009 study by the Economist Intelligence Unit for IFC underlines the business case for incorporating ESG factors into investment decisions in emerging markets:

The investment case in emerging markets rests most heavily on the concept of inefficient markets, where not all the available information is incorporated in the current stock price. There is a lack of comprehensive research coverage in emerging markets in general and a dearth of ESG-related analysis in particular. Given the higher levels of both risk and return in emerging markets, investors who make an effort to understand the impact of ESG have a better chance of reducing risk and boosting returns. Because information is scarcer in emerging markets, fund managers see sustainability criteria as a way to make superior investment decisions.⁸

⁸ Economist Intelligence Unit, “Sustainable Investing in Emerging Markets: Unscathed by the Financial Crisis” (IFC, 2009).

This apparent investor preference is supported by the fact that commercial index providers, such as FTSE,⁹ MSCI,¹⁰ and Standard & Poor’s,¹¹ offer a number of ESG indices but no pure CGIs. Even so, governance criteria can generally be viewed as the foundation of ESG indices and are arguably the most important factors from an investor’s perspective. A 2012 survey of more than 1,000 investment professionals by the consultancy SustainAbility supports this view. Of the professionals using ESG factors in their decisions, 59 percent of respondents often or always consider governance issues in their investment decision, followed by social issues (40 percent) and the environment (34 percent).¹² It would certainly be shortsighted, especially in emerging markets, to underestimate the importance of governance factors such as shareholder rights and conflict-of-interest provisions. The exchanges with ESG indices in this study—Mexico and South Africa—are clearly aware of the importance of governance factors. South Africa’s JSE SRI Index, for example, employs a triple-bottom-line approach, with environmental, social, and economic sustainability as the three pillars, and good corporate governance underpinning each of the pillars.

⁹ FTSE has developed a whole series of ESG indices for developed markets, called FTSE4Good, which employ six ESG criteria: environmental management, climate change, supply chain labor standards, human & labor rights, corporate governance, and countering bribery. It also entirely excludes two industries from consideration: tobacco and weapons.

¹⁰ MSCI offers ESG indices for developed Asia Pacific, Europe and the Middle East, Canada and the United States.

¹¹ Standard & Poor’s has three ESG indices for Egypt, India, and the Middle East and North Africa region.

¹² M. Sadowski, “Rate the Raters Phase Five – The Investor View” (SustainAbility, 2012).

III. The Building Blocks of Governance Indices

Four areas have been selected as most critical in the analysis of a CGI or ESG Index:

- A. What criteria is the index based on?
- B. How is the information compiled; i.e., what type of information is used and what is the rating methodology?
- C. What kind of information about the index and about the results is disclosed?
- D. How is the index supervised and compliance with its criteria monitored?

A. Index Criteria

Two types of criteria are used in CG indices: governance and market-based (e.g., free float and liquidity requirements). Turkey’s ISE CGI and China’s SSE CGI are the only two that rely solely on governance criteria as benchmarks. All other indices add market-based benchmark criteria. The Mexican and South African indices, as ESG indices, also add environmental and social criteria, which are not addressed in this study.

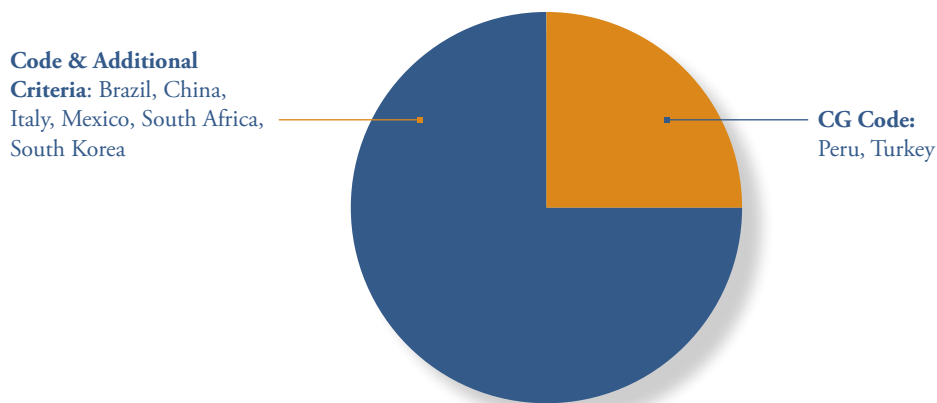
1. GOVERNANCE CRITERIA: SOURCES, COMMONALITIES AND DIFFERENCES

Criteria used in the indices stem predominantly from voluntary national codes of corporate governance. However, if the index criteria are based solely on the corporate governance code, they can be only as strong as the code’s underlying principles. Therefore, in some instances, the index criteria go beyond the national corporate governance framework and incorporate additional criteria derived from international best practices, such as the OECD Principles of Corporate Governance.



Criteria used in the indices stem predominantly from voluntary national codes of corporate governance.

FIGURE 1: SOURCES OF GOVERNANCE CRITERIA



Source: Analysis of listing requirements and index evaluation criteria

Figure 1 illustrates the distribution in the survey sample. Examples include:

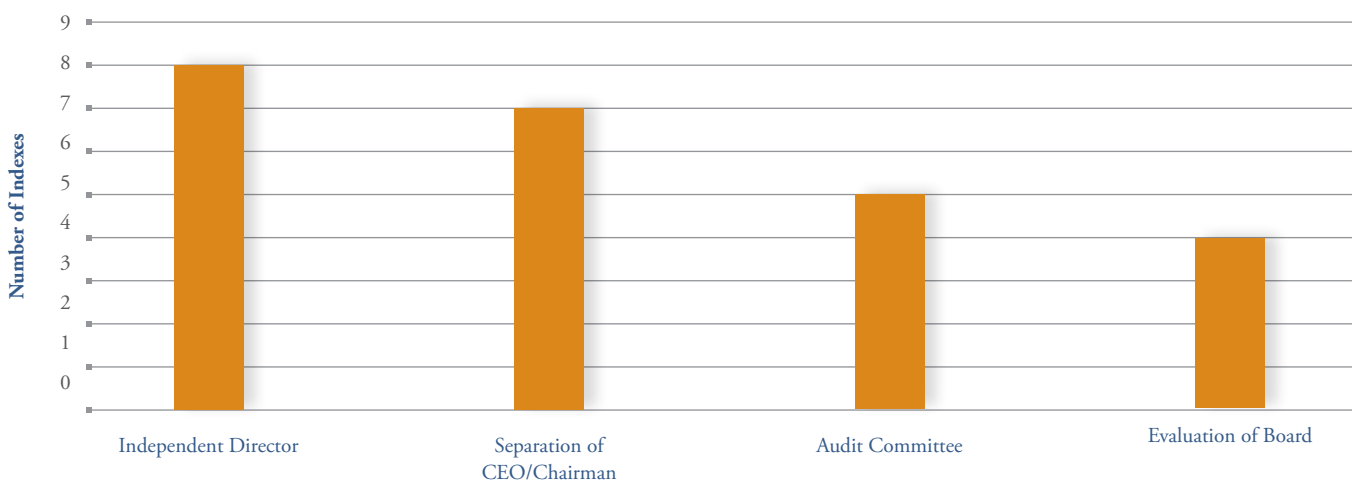
- **Turkey:** The country's Capital Market Board encouraged the development of an index based on Turkish Corporate Governance Principles to promote the voluntary comply-or-explain code. Rating agencies evaluating Turkish companies apply the Principles in their entirety when assessing companies.
- **Italy:** The governance criteria in the STAR segment of the Borsa Italiana are based on compliance with selected articles from the Italian Corporate Governance Code. These criteria are supplemented with conditions designed to make the SMEs in the index more investor friendly, such as hiring an investor relations officer, disclosing management reports with greater frequency, and providing English translations of all company reports.
- **Mexico:** The IPC Sustentable in Mexico uses a mix of criteria based on the Mexican Corporate Governance Code and criteria going beyond the Mexican framework altogether, thus allowing member companies to move beyond national practices. Examples include the separation of CEO

and chairman, which is not covered in the Mexican framework, and the nomination of individual directors, which stands in direct contrast to the general Mexican practice of nominating slates of directors for election.

- **Brazil:** To join BM&FBOVESPA's listing tier, the Special Corporate Governance Stock Index, requires the adoption of corporate governance rules that go beyond the local legal and regulatory framework. Independent directors are not required by law in Brazil, but Novo Mercado companies must have a board of directors that is at least 20 percent independent.

With respect to governance criteria, issues addressing the role of the board of directors overwhelmingly dominate the criteria of all the indices. This reflects the fact that—with notable exceptions—shareholder rights are addressed mainly in law and regulation, while disclosure requirements are usually covered in mandatory listing requirements and accounting standards. By contrast, the composition and role of the board is often addressed only in the voluntary framework of corporate governance codes. Board composition and qualification is thus an effective target with which to differentiate companies from the rest of the market.

FIGURE 2: MOST COMMON GOVERNANCE CRITERIA¹³



Source: Analysis of listing requirements and index evaluation criteria

¹³ For a list of all governance criteria evaluated by the indices in the study see Appendix III: Indices' Governance Criteria.

Table 3: Liquidity and Market Capitalization Criteria

Index	Market-based Criteria
Brazil BM&FBOVESPA CGI	25 percent free float
China SSE CGI	None
Italy FTSE STAR	<ul style="list-style-type: none"> • 35 percent free float entry requirement, cannot fall below 20 percent • Market cap between €40 million and €1 billion
Mexico BMV IPC Sustentable	More than 30 percent free float and/or more than US\$1 billion market cap requirement
Peru BVL Good CGI	Free-float-weighted index: companies need to be in top 80 percent of stocks in terms of liquidity
South Africa JSE SRI Index	Free-float-weighted index: companies must turn over of at least 0.5 percent of their liquid shares per month
South Korea KRX KOGI	Average transaction volume for past 3 months within top 40 percent bracket of listed companies
Turkey ISE CGI	None

Source: Stock exchange websites and responses to questionnaires

While all the indices studied include criteria that require independent directors, they vary greatly on **what constitutes independence** (see Appendix IV). Definitions in the Peruvian and South African codes are brief, and the South African code reflects its principle-driven approach.¹⁴ More-detailed definitions in Brazil, Mexico, Italy, and Turkey cover the typical conditions that a director cannot meet in order to be considered independent: (i) be a controlling shareholder; (ii) receive remuneration from the company other than director fees; (iii) have a significant business relationship (client, provider, debtor, etc.) with the company; and (iv) be related to a person meeting any of the conditions above. However, only the Mexican Securities Market Law defines a threshold above which a business relationship, or influence over a business group, is considered “significant.” The other codes and rules underpinning the criteria leave such thresholds open to interpretation.

The Peruvian Code, underpinning the criteria of the BVL CG Index, requires only a “sufficient” number of directors to be independent. The ISE CGI, based on Turkish Principles, requires at least one-third of the board to be independent. The Novo Mercado requires 20 percent of directors to be independent, and the Mexican index has a 25 percent independence requirement. South Africa’s King Code III, used as the basis for the JSE SRI Index, recommends that a majority of the board be non-executive directors and that a majority of those be independent. The Italian Corporate Governance Code’s recommendation for

independent directors, made mandatory in the STAR listing rules, is for companies to have an adequate number of, and at least two, independent directors.

Even though board criteria dominate, **shareholder rights** are also addressed, particularly in the Brazilian and Chinese indices. In these countries, shareholder rights are considered to be rather weak. Consequently, both BM&FBOVESPA’s Novo Mercado segment and the SSE’s Corporate Governance Board (companies apply to be admitted to the Board, which in turn forms the basis of the index) have a number of listing rules and evaluation criteria that address issues of shareholder rights. These include rules on the mandatory issuance of common shares with tag-along rights, self-evaluation criteria in China that focus on conflicts of interest and related-party transactions (RPTs), and whether 50 percent of the board is nominated by non-controlling shareholders.

2. MARKET-BASED CRITERIA: FREE FLOAT, LIQUIDITY, AND MARKET CAPITALIZATION

When setting up a CGI, particularly in markets with concentrated ownership structures, ensuring the availability of a sufficient number of shares for trading is critical for an index’s marketability. All indices in the study, with the exception of **China’s** SSE CGI and **Turkey’s** ISE CGI, have free float or liquidity requirements (Table 3). These requirements significantly reduce the number of eligible companies in the case of some stock exchanges. Market capitalization is of less importance and is used primarily in the Italian STAR, since it targets a specific market segment, the SME sector.

¹⁴ According to South Africa’s King Code III: “Independence is the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company.”

Free float and liquidity

The free float of shares is commonly defined as shares of a public company freely available for trading. It thus excludes locked-in shares held by controlling shareholders, the stock's promoter, and long-term investors, such as governments and institutional investors, as well as the company's board, senior management, and employees. Differences in the definition of free float can have significant effects on the number of companies eligible for an index.¹⁵ Higher free float is commonly an indicator of better shareholder protection, since dispersed ownership necessitates stronger rights for minority shareholders.

A certain free float is the precondition for a stock's liquidity, but does not guarantee liquidity since even free-float shares might not turn over sufficiently. Applying a liquidity screen can therefore be an additional requirement for companies in an index. For example, this could measure the average transaction volume of a company's stock. Applying requirements for free float and liquidity, in addition to governance criteria, severely affects the number of companies eligible for some of the indices surveyed. Two examples illustrate this effect:

- **Mexico:** The Mexican IPC Sustentable adopts a dual-screen approach where companies must have more than a 30 percent free float and/or US\$1 billion market capitalization. In 2009, the first year of evaluation for the index that launched in 2011, all 134 listed Mexican companies were assessed. In 2010, only 70 companies that passed the dual screen were evaluated, and in 2011 this number fell further to 54. The free float of the 16 companies excluded had fallen owing to the repurchasing of stocks by the company and/or equity swaps entered into by the controlling shareholder(s).
- **Peru:** The BVL employs a liquidity screen for the Peruvian Good CGI. A company must be in the top 80 percent of stocks in terms of liquidity to qualify. This requirement excludes a number of companies that would qualify if only governance criteria were applied. In 2011, 9 companies constituted the Good CGI, while an additional 8 companies were recognized for their good governance practices but failed to meet liquidity requirements.

¹⁵ A change in how the BMV in Mexico calculates free float illustrates this point. As of September 2012, new definitions of free float prevent shares that are tied up in a company's derivative transactions from being included when calculating a company's free float. In a striking example, this change in rules reduces Grupo Elektra SA's free float from 29 percent to 6 percent, making them ineligible for inclusion into the BMV's main index IPC, which requires a free float of 12 percent.

Market Capitalization

Market capitalization has less significance when attempting to determine the availability of a company's shares for trading, but it can be a good indicator of the importance of a company in the market.

Only the Mexican IPC Sustentable and the Italian STAR segment apply restrictions regarding market capitalization. In the case of STAR, a company must have a market capitalization between €40 million and €1 billion, thereby targeting the index constituency of SMEs. In addition, a company must have at least a 35 percent free float to enter the index, and that figure cannot subsequently fall below 20 percent. This may stem from long-term investors locking up a percentage of the stock in the segment.

B. Company Evaluation

The information selected to assess companies and the methodologies employed are critical factors for the integrity of any index, particularly for corporate governance indices that are, at times, based on qualitative considerations. This section examines the type of information collected for the evaluation, the use of outside evaluators, the rating methodology, and the vetting process for the information used in the evaluation, as well as the evaluation results.

Assessment of companies in the eight indices studied is based predominantly on publicly available information. In a few cases, this is supplemented by proprietary research and company feedback (Table 4). The evaluation of governance is outsourced to external providers in all cases but China's SSE CGI. The SSE puts together a team of outside experts from inside the SSE. Rating methodologies for the indices differ in how much they are predetermined by the stock exchange. At times, they are left entirely to the external evaluators. Rating agencies, when paid by the companies, get accredited by the securities market regulator or stock exchange.

1. EVALUATION PROCESS

The information used to evaluate companies is almost exclusively public and includes annual reports, company bylaws, security filings, and corporate governance reports based on comply-or-explain disclosure with the respective corporate governance codes. Evaluations also include:

- In **Brazil and Italy**, the stock exchanges evaluate companies against the segment's listing requirements and make the results public.

TABLE 4: EVALUATORS, EVALUATION PROCESS, AND EVALUATOR COMPENSATION

Index	Evaluator	Evaluation Process	Evaluator Compensation
Brazil BM&FBOVESPA Special CGI	BM&FBOVESPA	Evaluation of listing criteria by stock exchange	N/A
China SSE CGI	SSE and China Securities Index Co., Ltd.	Public self-evaluation and SSE research	SSE
Italy FTSE STAR	Borsa Italiana	Evaluation of listing criteria by stock exchange	N/A
Mexico BMV IPC Sustentable	<ul style="list-style-type: none"> • Universidad Anáhuac • Ecovalores (EIRIS) 	Publicly available information and company feedback	BMV
Peru BVL Good CGI	Accredited rating agencies	Public self-evaluation and proprietary research	Company
South Africa JSE SRI Index	EIRIS and University of Stellenbosch Business School's Unit for Corporate Governance in Africa	Publicly available information and company feedback	JSE
South Korea KRX KOGI	Korea Corporate Governance Services (KCGS)	Publicly available information and proprietary research	KCGS is not-for-profit, partially funded by KRX
Turkey ISE CGI	Accredited rating agencies	Publicly available information and proprietary research	Company

Source: Stock exchange websites and responses to questionnaires

- In **China** and **Peru**, the SSE CGI and the BVL Good CGI rely on companies' self-evaluations of governance. In both cases, these self-evaluations are publicly disclosed, and China solicits public feedback.
- In **Peru**, **Turkey**, and **South Korea** the analysis also includes proprietary research, which can include interviews with company executives, the board, as well as investors.
- Company feedback regarding the initial evaluation is incorporated into the evaluation process in all indices that are not based on a listing tier. **South Africa's** JSE SRI Index, in existence since 2004, now achieves an 80 percent response rate to the initial evaluation it sends to the companies that it automatically assesses.

2. GOVERNANCE EVALUATORS

One of the most common concerns in the evaluation process is the conflict of interest that may arise between company and evaluator. To avoid such conflicts, evaluation against governance or ESG criteria is outsourced in five of the six indices surveyed that are not listing tiers, with the exception of China's SSE GGI.

Even in the case of the **Chinese** SSE CGI, which relies mainly on in-house research, conflict of interest is taken into account

in the evaluation design. Each year, the SSE sets up a Selection Unit to review each application. The Unit consists of rating agencies, fund managers, securities firms, and insurance companies. Based on this review and on feedback from public disclosure, an SSE Expert Consultation Committee (external experts nominated for two years) makes the final decision on company selection.

Most of the stock exchanges (four out of six) pay the evaluators to avoid potential conflicts of interest. In **Peru**, companies have to hire one of the accredited rating agencies to verify their self-assessment. In **Turkey**, companies pay one of the rating agencies registered with the CMB. As an incentive, the cost of the rating is partially offset, as new companies joining the CGI pay only half of the annual listing fee for the first two years, 75 percent for the next two years, and 90 percent thereafter.

3. METHODOLOGY

All indices studied rely on publicly available information, and almost all outsource their research to external providers (Table 5). However, the index methodologies differ substantially in two aspects: (i) Whether the **benchmark criteria** are determined by the stock exchange, and (ii) How much of the **rating methodology** is set by the stock exchanges. Stock exchanges set the rating benchmark criteria in all cases except Mexico and

TABLE 5: INDEX BENCHMARK CRITERIA AND QUALIFYING THRESHOLD

Index	Benchmark Criteria	Qualifying Threshold
Brazil BM&FBOVESPA Special CGI	Novo Mercado, Level 1 and Level 2 listing rules	Compliance with listing rules
China SSE CGI	20 self-evaluation questions	Not disclosed
Italy FTSE STAR	STAR listing rules	Compliance with listing rules
Mexico BMV IPC Sustentable	100 ESG criteria	Higher than global EIRIS ESG average
Peru BVL Good CGI	26 governance criteria	60 percent of max score of 312
South Africa JSE SRI Index	90 ESG Indicators	50 percent of all indicators, 1/3 of core indicators
South Korea KRX KOGI	95 governance criteria	Rating above B+
Turkey ISE CGI	4 chapters of CG Code	Rating of at least 7 out of 10

Sources: Stock exchange websites and responses to questionnaires

South Korea. On the other hand, in Mexico, South Korea, and Turkey rating methods are left entirely to the evaluators.

- **South Africa:** For the JSE SRI Index, the JSE sets environmental, social, and governance criteria, separated into core and desirable indicators. The methodology is set so that in order to qualify, a company must meet a majority of indicators, at least one-third of which must be core indicators. EIRIS and the Stellenbosch Business School's Unit for Corporate Governance in Africa automatically evaluate the JSE's Top 40, FTSE/JSE Mid Cap, and current SRI Index constituents using this methodology.
- **Peru:** The BVL Good CGI is based on 26 criteria derived from the Peruvian Corporate Governance Principles. In the evaluation methodology, the principles are categorized into essential, important, convenient, and desirable, with scores from 54 to 1 assigned to the four categories. One of the rating agencies accredited by the BVL then reviews the self-evaluation of the company against each principle and assigns a level of compliance ranging from not complying (0 percent of the point scale) to full compliance (100 percent of the point scale). A company must score a total of at least 60 percent of the possible points to qualify for the index.
- **Turkey:** The Turkish CG Principles in their entirety form the basis of the ISE CGI. Companies are assessed against the four chapters of the Principles that address shareholder rights, stakeholders, transparency and disclosure, and board of directors. However, the rating agencies engaged by the companies set the actual rating methodology. The CMB determines only the weights for the calculation of the overall company score:

shareholder principles 25 percent, stakeholders 15 percent, disclosure 35 percent and board 25 percent.

- **South Korea:** For the KRX KOGI, Korea Corporate Governance Services (KCGS) sets the benchmark governance criteria and the rating methodology. Companies must score a minimum rating of B+ to be eligible for the index. Since the number of constituent companies is limited to 50, companies with higher scores qualify should more than 50 companies be eligible.
- **Mexico:** The Mexican Stock Exchange, the BMV, on the other hand, disengages entirely from the ESG rating process to avoid any potential conflict of interest with its clients, the listed companies. The methodology, including the ESG benchmarking criteria, is set by the Universidad Anáhuac and Ecovalores (a subsidiary of EIRIS), and both organizations apply their own methodology. After obtaining its overall score from the ratings of both evaluators, a company must be above the global average of EIRIS' ESG rating (based on a universe of 3,500 companies) to be included in the IPC Sustentable.
- By definition, CG listing segments do not need a methodology for evaluating governance criteria since membership is automatically determined by adherence to the listing rules.

4. VETTING OF INFORMATION

Both the information used in the evaluation and the company rating can be verified. In practice, the indices that are not based on listing tiers do not run additional verification on the information feeding into the evaluation. The exceptions are

the indices based on company self-evaluations. Similarly, the company evaluations are not formally verified by a third party or by the stock exchanges.

Information underlying evaluation: Public information, such as financial statements, annual and governance reports, are taken at face value, based on the assumption that such information has been verified by independent external auditors and approved by the securities commissions and the stock exchanges.

Self-evaluations: The indices in **China** and **Peru**, which are based on initial company self-evaluations, employ a verification process, since the information provided by the companies is not necessarily public. The application by a company for the SSE Corporate Governance Board gets posted for public comment and afterwards is evaluated by the SSE CG Selection Team. In Peru, an accredited rating agency verifies the company's self-evaluation.

Vetting of ratings: The ratings provided by the governance and ESG evaluators do not undergo additional verification by the stock exchanges. In **Peru** and **Turkey**, companies are free to choose their evaluator from a list of rating agencies. As

mentioned previously, these rating agencies must be accredited by both the stock exchange and the securities regulator.

C. Disclosure

Effective communication and transparency about the criteria and methods used in assessing companies for inclusion in the index are essential building blocks for an index's market credibility. The disclosure of evaluation results is equally desirable and important for securing an index's credibility. However, companies are reluctant to have the detailed results of their evaluations published.

While criteria and methodology are disclosed almost everywhere (China's SSE does not publish a qualifying threshold or details of a methodology), ease of accessibility differs substantially. With respect to the disclosure of the ratings, only South Korea's KOGI (rating score) and Turkey's ISE CGI (full rating report) go beyond disclosing the bare minimum, i.e., the constituents of the index (Table 6).

TABLE 6: DISCLOSURE OF INDEX CRITERIA, METHODS, AND RESULTS

Index	Index Criteria	Methodology	Rating Disclosure
Brazil BM&FBOVESPA Special CGI	Novo Mercado. Level 1 and Level 2 listing rules in English	N/A	Segment constituents
China SSE CGI	Self-evaluation questions available in Chinese	No details disclosed	Only index constituents
Italy FTSE STAR	STAR listing rules in English	N/A	Segment constituents
Mexico BMV IPC Sustentable	In Spanish on Universidad Anáhuac website	In Spanish on Universidad Anáhuac website	Only index constituents
Peru BVL Good CGI	In Spanish	In Spanish	Index constituents, including best performer
South Africa JSE SRI Index	In English	In English	Index constituents including best performers
South Korea KRX KOGI	In Korean on Korea Corporate Governance Services (KCGS) website	In Korean on KCGS website	Index constituents; rating score in Korean on KCGS website
Turkey ISE CGI	Turkish CG Code, available in English	In Turkish on the rating agencies' websites	Full rating report of constituents on website of Turkish Corporate Governance Association, mostly in Turkish

Source: Stock exchange websites and responses to questionnaires

1. DISCLOSURE OF INDEX CRITERIA AND METHODOLOGY

All stock exchanges in the study offer dedicated pages for CG or ESG indices on their websites. This does not always include access to the index criteria and methodology, however, which are often posted only on the evaluators' websites. English translations of criteria and methodologies are available only in Brazil, Italy, and South Africa. Other observations about disclosure and accessibility:

- BM&FBOVESPA's presentation of the corporate governance tiers in **Brazil** (Novo Mercado, Level 1, and Level2) is exemplary. On a dedicated page, governance provisions are well laid out and easily accessible, and with the recent introduction of the Reference Form (an online annual report that is updated in real time), companies disclose all sorts of governance information.
- In **South Africa**, the JSE SRI Index site offers thorough information on the development of the index, clear presentation of and access to the criteria and methodology used in the evaluation, together with other useful links, such as historical data on index constituents and press releases.
- In **Mexico, Turkey, and South Korea**, the disclosure of the detailed rating methodologies, and in the case of Mexico and South Korea of the rating criteria, is left to the evaluators and rating agencies. The stock exchanges do not even provide a link.
- The only indices offering comprehensive information in English are **Brazil's** BM&FBOVESPA Special CGI and the **South African** JSE SRI Index. In the case of **China's** SSE CGI, the **Korean** KRX KOGI, and the **Turkish** ISE CGI, basic information is available in English, but the governance evaluation methodologies and/or criteria are disclosed only in Chinese, Korean, and Turkish, respectively. In addition, the governance criteria and evaluation methods in Turkey and Korea are available only on the websites of the rating agencies. All information made available by the parties responsible for the **Mexican** BMV IPC Sustentable and the **Peruvian** BVL Good CGI is in Spanish only.
- The **Mexican** IPC Sustentable was launched only in December of 2011. It is, however, the only index that has a dedicated website, which offers presentations and profiles (but no evaluations) of the constituent companies.

2. DISCLOSURE OF RATINGS

The disclosure of detailed results, ideally including the rating report, is important for an index's credibility. It is also critical for investors to know whether the unmet criteria are those important for their investment decisions. This does not apply to governance listing tiers, where the adequate presentation of the special listing rules and company disclosure is sufficient to ensure that a company complies with all governance-related listing requirements.

Despite a strong case for the disclosure of results, four of the six indices studied that are not based on listing segments disclose only the companies that constitute the index. The exceptions are **Turkey** and **Korea**:

- In **Turkey**, the detailed rating reports underlying Turkey's ISE GCI are provided for all constituent companies of the index by order of overall score, including historical reports. The majority of the reports are in Turkish only, however, and they are disclosed not on the ISE website but on the website of the Turkish Corporate Governance Association.
- In **Korea**, companies with rating scores better than B+ are disclosed, but there are no details on how the score was obtained. Like Turkey, the score is disclosed only on the website of KCGS, not by the stock exchange.

The major obstacle to increased disclosure cited by most stock exchanges is the reluctance of companies to have detailed reports and scores published, since it would effectively rank them against other companies. There are, however, a number of ways to work around this obstacle:

- In the annual presentation of the companies that make up **South Africa's** SRI Index, the JSE presents "Best Performers," or companies that meet additional levels of performance, such as fulfilling all social and governance core requirements.
- The BVL in **Peru** annually awards a "Key to the BVL" to the best-performing company.
- Having launched the IPC Sustentable index only recently, in 2011, the BVM in **Mexico** plans to gradually increase disclosure once the index is more established.

D. Index Supervision

A CG or ESG stock exchange index has to be monitored for two distinct reasons. First, the index composition must follow the technical guidelines of the stock exchange. Second, compliance with governance criteria must be monitored. This is of utmost importance to avoid potential reputational damage for all companies in the index as a result of one constituent's corporate scandal. Equally important is a credible procedure for the immediate exclusion of companies that gravely violate index criteria.

For the indices in this study, monitoring, rebalancing, and calculation of market weights occurs on a quarterly, thrice yearly, or semi-annual basis (Table 7). Compliance with CG criteria is formally evaluated annually in all indices with the exception of the Brazilian CG Index, which is monitored continuously. All, with the exception of the BVL's Good GCI, have procedures in place for immediate exclusion of a company, although in practice this has occurred only once.

1. MONITORING OF INDEX COMPOSITION AND CRITERIA COMPLIANCE

Index calculation and rebalancing

The calculation of the index is carried out by the stock exchanges in all eight cases, with the exception of **China's** SSE CGI, for which China Securities Index Co. Ltd. calculates the index. Index maintenance and rebalancing takes place two, three, or four times a year.

Monitoring and review of compliance with governance/ ESG criteria

With the exception of BM&FBOVESPA's corporate governance listing tiers in **Brazil**, where compliance with the segment's listing rules is continuously monitored, all formal evaluations take place on an annual basis. The following observations can also be made:

- In **Mexico**, in addition to the formal annual evaluation, the research providers for the BMV's IPC

TABLE 7: MONITORING OF INDEX AND GOVERNANCE CRITERIA,

Index	Monitoring of		Compliance Monitoring Frequency	Exclusion Procedure
	Index composition	Compliance with CG Criteria		
Brazil BM&FBOVESPA Special CGI	BM&FBOVESPA	BM&FBOVESPA	Continuous	Immediate in case of delisting due to violation of listing rules or voluntary decision of the company
China SSE CGI	China Securities Index Co.	SSE Expert Consultation Committee	Annual	Annual review and immediate for grave criteria violation
Italy FTSE STAR	Borsa Italiana and FTSE	Borsa Italiana	Annual	Annual review and immediate for listing rule violation or voluntary decision of company
Mexico BMV IPC Sustentable	BMV	Universidad Anáhuac and Ecovalores	<ul style="list-style-type: none"> • Annual evaluation • Semi-annual monitoring 	Annual review and immediate for grave criteria violation
Peru BVL Good CGI	BVL	Accredited rating agencies	Annual	During annual review
South Africa JSE SRI Index	JSE	JSE and EIRIS	<ul style="list-style-type: none"> • Continuous for JSE ground rule criteria • Annual evaluation for all criteria 	Annual review and immediate for unsatisfactory handling of controversial issue
South Korea KRX KOGI	KRX	KCGS	Annual	Annual review and immediate for grave criteria violation
Turkey ISE CGI	ISE	Accredited rating agencies	Annual	Annual review and immediate for grave criteria violation

Sources: Stock exchange websites and responses to questionnaires

Sustainable monitor the index's constituent companies semi-annually. At this time, ESG issues raised during the previous evaluation are discussed and progress, or lack thereof, is noted.

- While there is a formal annual evaluation of the companies in **South Africa's** JSE SRI Index, the criteria of the index that are based on the JSE's Ground Listing Rules are continuously monitored.
- For most indices, the annual review takes place at the same time for all companies. The exception is the ISE CGI in **Turkey**. Turkish companies wishing to join the index can get their evaluation at any time and are eligible to join once they pass the rating threshold of 7 out of 10. Constituent companies must be re-evaluated at least once a year.
- The JSE's SRI Index in **South Africa** is also a good example of the **engagement of civil society** for the purpose of monitoring compliance with index criteria. On numerous occasions, the JSE has received comments from individual and institutional shareholders on the practices of companies in its index, the majority on environmental issues, but some on governance topics.

2. EXCLUSION FROM THE INDEX

Companies can be removed from CG or ESG indices for three reasons:

1. **Violating general listing rules or delisting.** Companies can be removed from the index for violating general listing rules or because of delisting. These removals occur immediately in all indices.
2. **Failure to meet market-based criteria.** Most indices specify market-based criteria, such as market capitalization, free float, or liquidity thresholds, in the index rules. Removal of companies falling below these thresholds can take place during the annual review, but can also occur during the quarterly, thrice yearly, or semi-annual rebalancing of the index.
3. **Failure to comply with CG/ESG criteria.** Two types of governance-criteria-related exclusions from an index can occur: **ordinary** and **extraordinary**.
 - **Ordinary exclusions** occur in all indices when a company does not meet the specified benchmark threshold during the annual review. The **Mexican** and **South African** indices have procedures in place that allow a

company to remedy weaknesses and remain in the index. In Mexico, the company has the period until the following year's evaluation to improve the practice(s) in question. The South African index identifies so-called Borderline Companies that, during the annual review, meet most criteria but marginally fail in one. They have three working days to respond to the issue, after which a decision is made on whether they qualify for the index.

- **Extraordinary exclusions** for a grave violation of governance criteria—extremely important for the reputation of the index—can take place at any time. All stock exchanges surveyed, with the exception of the Lima Stock Exchange, have the option for such exclusions.

3. EXCLUSIONS IN PRACTICE

In practice, virtually all removals from CGI and ESG indices are for the first two reasons listed above. Companies are delisted because of mergers, acquisitions, or bankruptcy, or because they fail to meet market-based criteria. For example:

- In **Italy**, 45 companies have been removed from the STAR tier since 2002, all for either delisting (mergers, acquisitions, or bankruptcy) or exceeding the market cap limit of €1 billion.
- In **Peru**, one company, *La Cima*, has been excluded from the BVL CGI since 2008. It no longer met the liquidity requirements of the index.
- In **China**, 17 companies have been removed from the SSE CGI since 2009. Sixteen of these removals were due to mergers and acquisitions.

The SSE CGI in **China** featured the only case in the study where a company was **removed because of violating CG criteria**. In February 2009, Chongqing Bridge and Road Company was removed from the index after it was fined by the SSE for illegal transactions. The removal took place immediately.

This case underlines the dilemma of removing companies from an index and protecting the integrity of the index as a whole. While knowledge of corporate wrongdoing might exist early, in order to exclude a company from the index a stock exchange has to wait until a case has been resolved to take action. At this point it could be too late to avoid reputational damage for the index.

IV. Growth, Performance, and Product Development

A. Growth

In several countries, the number of companies listed in corporate governance indices has grown enormously in a short time. Table 8 illustrates this growth. In the indices that are not capped (Brazil, China, Mexico, Italy, Turkey, and South Africa), listings have grown markedly since index inception. For instance, Turkey's index has grown steadily, by six companies in 2008, eleven in, in 2009, seven in 2010, and 2011, and six in 2012.

TABLE 8: NUMBER OF COMPANIES

Index	Launch Date	Original Constituents	February 2013
Brazil BM&FBOVESPA CGI	2001 (*)	12	174
China SSE CGI	2008	199	266
Italy FTSE STAR	2001	20	66
Mexico BMV IPC Sustentable	2011	23	29
Peru BVL Good CGI	2008	9	9
South Africa JSE SRI Index	2004	49	79
South Korea KRX KOGI	2003	50	50
Turkey ISE CGI	2007	7	45

Source: Stock exchange websites and responses to questionnaires

(*) The segments were launched in 2000, but the first companies joined the segments only in 2001.

Some of the listing increases in the CGI come in markets that have not seen strong growth of new listings (Figure 3). For instance, Italy, South Africa, and Turkey have not seen a significant number of new listings in the recent past, but their CG indices have thrived.

B. Performance

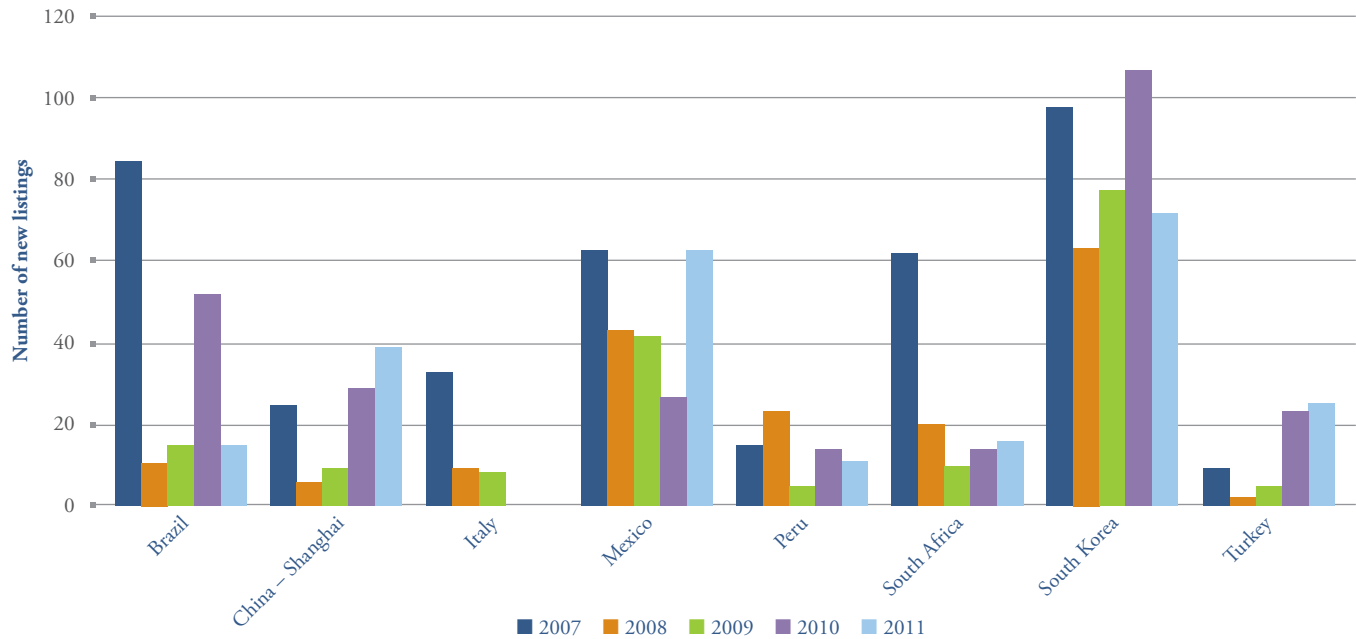
The performance of the eight indices in this study, in comparison to their respective benchmark indices, ranges from those closely tracking the benchmark to those clearly outperforming it. This study cannot control for variables other than governance that may affect the performance of the companies in the CGIs. For example, general economic circumstances may affect companies in the CGI differently than companies in the benchmark index, depending on factors such as the sectorial mix of companies in the indices. Nevertheless, outperforming the benchmark over a longer period, as is the case in Brazil, can probably be attributed to the positive impact of governance factors.

The majority of the eight CGIs, summarized in Figure 4, have closely tracked the country's broader market index. The principal reason is the high level of overlap between the portfolios of both the broader index and the CGI in many countries. For instance, **South Africa's** JSE All Share Index (ALSI) consists of 164 companies. All 79 companies in the JSE SRI Index are also part of the ALSI. Those 79 companies, however, capture nearly 80 percent of the market capitalization of the ALSI.



The performance of the eight indices in this study, in comparison to their respective benchmark indices, ranges from those closely tracking the benchmark to those clearly outperforming it.

FIGURE 3: NUMBER OF NEW LISTINGS



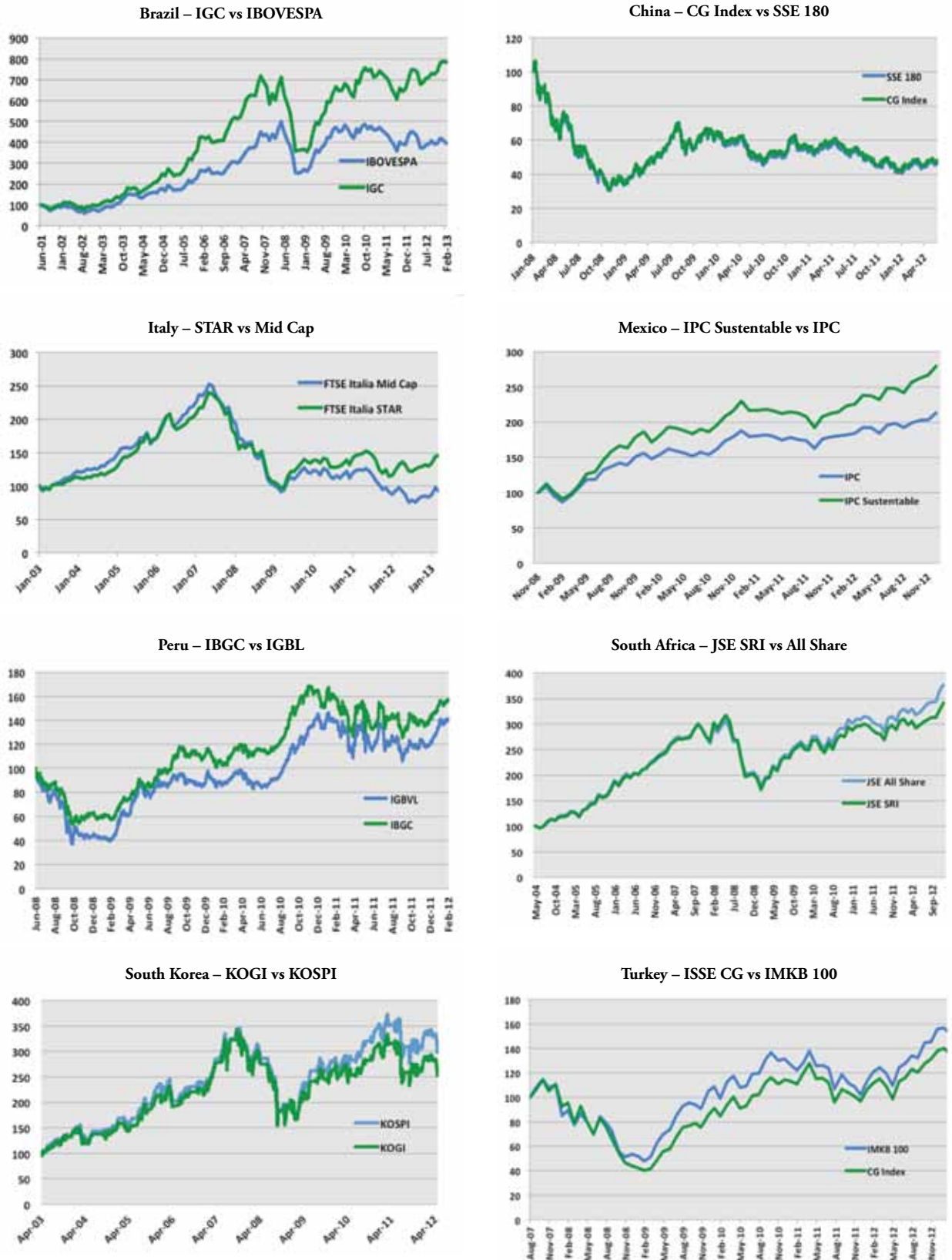
Source: World Federation of Stock Exchanges

Outperforming the benchmark over a longer period, as is the case in Brazil, can probably be attributed to the positive impact of governance factors.

Underlining the fact that the main market drivers are part of the SRI Index is that 36 of the companies in the Top 40 Index—the largest companies by market capitalization—are part of the JSE SRI Index.

China offers a similar example of the main drivers in the country's stock market dominating both the benchmark and the CGI. China's CGI and the main market index, the SSE 180, had virtually identical (negative) performance over the past few years. The only explanation for such similar performance is that the 100 companies in the SSE 180 Index are also almost exclusively driving the performance of the broader 266-company SSE CGI. The other 166 companies appear to be too thinly traded to make an impact on performance.

FIGURE 4: PERFORMANCE OF CGI AND ESG INDICES AGAINST MARKET BENCHMARK



Source: Stock exchanges



CAPE TOWN, SOUTH AFRICA

There are, however, three examples of CGIs outperforming their respective market benchmarks, Brazil, Italy, and Mexico.

In **Brazil**, the corporate governance index, IGC, has dramatically outperformed the broader IBOVESPA index since 2001. The IGC has steadily made bigger gains in strong markets, such as 2007, and has been less volatile than the broader market. The strong performance of Brazil's IGC may come from the strong relative performance of better-governed companies. The IGC weights companies by multiplying their market values by a governance factor. This factor is 2 for companies on the Novo Mercado, 1.5 for Level 2, and 1 for Level 1. Thus, companies with the best governance practices (i.e., on the Novo Mercado) get the biggest weightings relative to market value, followed by those on Levels 2 and 1, respectively. If these companies outperform others in the market, the IGC index's superior performance becomes even more accentuated.

The STAR index in **Italy** has mirrored the comparable Mid Cap index for the better part of its existence since 2003. However, since 2009, the STAR governance segment has clearly outperformed the Mid Cap index, as well as the broader FTSE Italia All-Share Index. Over the ten-years since 2003, FTSE Italia STAR has gained 40 percent, while the FTSE Italia Mid Cap lost 7 percent over the same period, and the FTSE Italia All-Share lost 28 percent.

The **Mexican** IPC Sustentable has outperformed the broader IPC index by almost 20 percent between its November 2011 inception and February 2013. Backdating the two indices to 2009 shows that the IPC Sustentable would also have outperformed the broader index prior to its launch. The Mexican example also shows that superior performance by the CGI is

possible even if there is significant overlap between the CGI and the benchmark index. 24 of the 29 constituent companies of the IPC Sustentable are also among the 35 companies listed on the IPC. But these 24 clearly outperform their 11 peers in the IPC who are not part of the IPC Sustentable.

As more companies are added to the CGIs over time, performance should diverge from the broader market in the medium to long term. Brazil and Mexico, albeit with a shorter time span, demonstrate how well-governed companies can outperform the market as a whole. Brazil's distinctive weighting of its corporate-governance levels also offers a way to differentiate CGIs meaningfully.

C. Investment Products

Only two exchange-traded funds (ETFs) have been built from the indices surveyed—in Brazil and China. It is worth noting, however, that trading volume among these products is fairly strong. China's BOCOM SSE 180 Corporate Governance Index ETF generated a volume of more than 2 million shares on days in 2012. Brazil's It Now IGCT Fundo de Indice ETF has recently posted a trading volume of about 180,000 shares, and over the past year volume has climbed as high as 400,000 shares. Also of note: two ETFs in Korea are based on KOGI's sister index, the KRX SRI index. Both have limited trading volumes, however.

Product development based on CGIs is currently limited. However, if stock exchanges can find ways to better differentiate CGIs from the broader market, they may attract more interest from investors and can lead to more fund and ETF development.

V. Main Findings

A review of the experience of the eight CGIs studied shows that they are having a strong impact in a number of areas:

Indices are growing and attracting companies across index types. All indices in the study that are not capped have shown strong growth, often in only a few years. This is particularly true for the listing tiers in Brazil and Italy, but also for the ISE CGI in Turkey and the SSE CGI in China. This shows that companies see the value in adopting more stringent governance requirements than are required in the regular market. The growth of the JSE SRI Index in South Africa, based on the automatic evaluation of the main index at the JSE, indicates that companies are improving their practices to be part of the index.

CGIs offer tangible benefits as research and policy tools. In markets where information on the governance practices of companies is scarce, companies selected to be in an index can be a useful starting point for investors choosing stocks. More importantly, raising the governance bar via the introduction of new market-driven index requirements can have an immediate effect on companies' governance practices and can offer alternative avenues to attract foreign capital.

Some indices outperform, while most indices mirror, the broader market. Almost all indices studied closely track the main benchmark index of their markets. This mainly reflects the large overlap in constituents between the main index and the CG and ESG indices. It also shows the lack of depth in capital markets in most of the countries in the study, where a few blue chip companies move the market. These blue chips are also the natural constituents of CGIs since they usually have good governance practices. Brazil's BM&FBOVESPA CGI is the only CGI that has significantly outperformed the market over time. This shows both the success of the index in differentiating itself from the main market and the greater depth of capital markets in Brazil.

Besides these observations on the impact of CGIs, this study attempts to address **three key questions**:

1. What are the key drivers for stock exchanges to launch CGIs?
2. What are the critical building blocks in the construction of a CGI?
3. What risks do investors face when investing in CGIs?

Based on the review of experience and performance of the eight CG and ESG stock exchange indices studied, a number of conclusions can be reached:

1. Key drivers for launching CGIs

Indices can elevate a country's overall corporate governance environment. Weaknesses in a country's CG framework, such as lack of shareholder protection and weak requirements for independent directors, are some of the main reasons behind the creation of CG and ESG indices. Evaluation criteria often address the most salient issues facing a country in this area.

Indices can offer companies an opportunity to differentiate themselves and can increase their access to capital. Creating an index or listing tier of excellence in corporate governance allows companies to differentiate themselves from other companies in the market. At its 10-year anniversary, the Italian STAR showed that SMEs in the index were able to increase their liquidity and access to foreign capital. Brazil's Novo Mercado not only attracts the bulk of new listings in the Brazilian market but also significantly outperforms the broader market index. This is also true for

In markets where information on the governance practices of companies is scarce, companies selected to be in an index can be a useful starting point for investors choosing stocks.

indices incorporating broader ESG issues, as the premium paid for companies in South Africa's JSE SRI Index demonstrates.

Indices based on listing tiers offer a higher degree of commitment to governance issues than indices with a rating threshold. Since adherence to all of the tier's listing rules becomes a binding contractual obligation, listing tiers offer a higher level of commitment than indices based on meeting a rating threshold, where a company is never required to score 100 percent compliance with the index criteria. The attractiveness of the listing-tier approach is highlighted by the strong growth of Brazil's Novo Mercado and Italy's STAR.

The success of Italy's STAR underlines that CGIs are also an option for segments in markets where overall corporate governance is already considered strong. By focusing on the particular governance challenges of SMEs, the Borsa Italiana created a listing tier that offers clear benefits for both companies and investors as is evident from the performance of STAR.

When indices are based on a rating threshold, automatic evaluations have a stronger potential impact on CG practices than voluntary applications. Corporate governance indices can be an efficient policy tool for improving CG practices. In this context, automatically evaluating listed companies has a stronger reputational effect than letting companies voluntarily apply. Experience with voluntary application in Peru and Turkey shows that only companies assured of qualifying for the index will apply, while companies with bad CG practices can pretend not to be interested in joining the index. Automatic evaluations, on the other hand, offer no such option. If a company in the evaluation sample is not part of the index, it is because the company's practices were not good enough to meet the index threshold. This offers a stronger incentive for companies to improve their practices.

2. Critical building blocks of an index

Stock exchanges tend to select governance criteria that are objective and measurable, and are often based on national corporate governance codes. The governance criteria used for listing-tier rules and index evaluation tend to be concrete and measurable, which is critical for supporting the evaluation process, the supervision of companies, the potential exclusion of companies that do not meet the criteria, and the overall credibility of the index. A majority of criteria focus on the role of the board of directors, such as number of independent directors, existence of committees, and separation of CEO and chairman. National corporate governance codes play an important role as source for the criteria used in the indices, and

indices contribute to better application of codes. If the index criteria are based solely on the corporate governance code, however, they can be only as strong as the underlying principles of the code. This can present a challenge, as in the case of Peru, where the Code's independence definition for directors is weak.

Market-based criteria are important for the marketability of the index but may hurt its policy impact. Ensuring the availability of a sufficient number of shares for trading is of critical importance for a CGI to be marketable, especially in markets with concentrated ownership structures. Applying free float and/or liquidity criteria in the index can achieve this goal. However, in markets where liquidity is concentrated in a few stocks and free float is limited, the number of companies eligible for inclusion in an index can be severely reduced, as is the case in Mexico. It thus diminishes the potential of an index to broadly influence corporate behavior, if companies not meeting free float and liquidity criteria are not part of the governance evaluation. On the other hand, it can motivate tightly controlled companies to make more shares available for trading. Market-based criteria can also skew the evaluation, since highly traded companies tend to be the blue chips of the index and are likely to have higher governance standards. Definitions of free float can also be problematic, since little changes can trigger big consequences, as can be seen from the recent changes in Mexico.

Stock exchanges outsource the evaluation process for indices based on a rating threshold to avoid conflicts of interests with client companies. For indices based on a rating threshold instead of compliance with special listing rules, the evaluation of companies by the stock exchange can present a potential conflict of interest, since the companies are also the clients of the exchange. All exchanges, with the exception of China's SSE, consequently outsource the evaluation to external providers. Nevertheless, with the exception of Peru and Turkey, the evaluation is paid for by the stock exchanges to ensure an independent evaluation process.

Most of the stock exchanges disclose index criteria and methodology. Transparency about index evaluation criteria and methodology is an essential building block for a CGI, and all indices, with the exception of China's SSE index, disclose both. However, effective communication goes further than mere disclosure and includes easy accessibility of information. Only the exchanges in Brazil, Peru, and South Africa link directly to criteria and methodology from the index pages on the stock exchange websites, and only Brazil and South Africa offer the information in English.

Disclosure of rating results is rare. The disclosure of rating scores and evaluation reports is important for investors, and

it also adds to the index's credibility. Nevertheless, of the six threshold-based indices, only the Korean and Turkish exchanges disclose the rating grades. Turkey discloses the full evaluation report.

Exclusion of companies from indices occurs mainly during annual reviews and rarely occurs because of a failure to meet governance criteria. Evaluation of companies against index criteria is an annual affair in all indices and listing tiers with the exception of Brazil, where compliance is monitored continuously, and exclusion for a violation of listing rules may occur immediately. To protect the index from the risk of reputational damage, stemming from a scandal at a constituent company between the evaluation cycles, all indices with the exception of Peru have an option for immediate exclusion of a company. Such an exclusion outside of the review cycle has occurred only once in the eight indices. Even during the annual review, virtually all exclusions are due to failure to meet market-based criteria or because companies have simply delisted. This pattern could suggest reluctance by stock exchanges and evaluators to exclude constituent companies for governance reasons. It could, however, also indicate the success of the indices in permanently elevating the governance practices of its constituent companies.

3. Risks for Investors

CGIs offer a unique challenge for investors' expectations, as the underlying governance criteria do not always follow international standards. For example, while all indices require the presence of independent directors on the board, the definition of independence and the required number of independent members differ substantially among the indices and vis à vis international practices.

Asymmetry of information can create false expectations. Investors may believe that they understand the CG criteria of an index based on notions from markets that they are familiar with, but the criteria employed in the indices can be very different. Equally important is the process of company evaluation and supervision of the index employed by the stock exchange. Investors need to make an effort to fully understand the intricacies of each index to ensure that their initial expectations are met.

The more transparent the index, the lower the information asymmetry investors face. Transparency about the set-up of the index, including its rating criteria, methodology, and disclosure of evaluation results, is critical in allowing investors to ensure that the index meets their expectations.



SAN ISIDRO, LIMA, PERU



Indices based on adherence to listing rules represent the highest level of commitment by constituent companies and are best suited to improving CG practices, differentiating companies and attracting investment.

VI. Eight Steps in Building a Successful Corporate Governance Index

1. Use a Wide Initial Consultation Process

Whether the initiative for the index originates from the stock exchange, the regulator, companies, or even investors, a thorough initial consultation process is critical to gauge interest from all stakeholders, anticipate obstacles, and prepare companies for the launch of the index.

2. Define the Objective(s) of the Index

A CGI's objectives can be to function as a policy tool with which to improve CG practices, to offer companies a platform for differentiation, and to tap into the pool of investments committed to good governance and sustainability. An index can pursue any combination of these three objectives, depending on circumstances in the home market. Defining the objectives is critical for selecting the index type. When attracting investment is a key objective, the introduction of market-based criteria is essential to ensure sufficient availability of shares for trading.

3. Select the Index Approach

Indices based on adherence to listing rules represent the highest level of commitment by constituent companies and are best suited to improving CG practices, differentiating companies and attracting investment. If building a listing tier is not a feasible option, an index based on a rating threshold can achieve the same objectives, if the following observations are kept in mind: An index based on automatic selection offers more credibility and has better potential to improve CG practices. Indices based on broader ESG issues are more likely to attract investment.

4. Differentiate Criteria from Standard Governance Practices

The criteria for the index should be measurable and should address issues that are of particular concern in that country. The national corporate governance code serves as a good basis for the development of evaluation criteria. However, additional criteria offer companies a greater opportunity for differentiation and can address potential weaknesses in the code.

5. Build a Transparent and Credible Evaluation Process

The evaluation methodology should be straightforward and easily accessible to all parties involved. Development of the methodology may be outsourced to avoid conflicts of interest between the stock exchange and its clients, the companies. The evaluation of companies should be outsourced for the same reason. To guarantee the objectivity of the external evaluators, the stock exchange should cover the rating costs.

6. Achieve Maximum Possible Disclosure

Information on the index, including its rating criteria and methodology, should be easily accessible on the stock exchange's website and preferably available in English as well. Evaluation results, including rating scores and detailed reports, are ideally fully disclosed on the same central webpage, but stock exchanges need to take into account that client companies are reluctant to allow disclosure of their ratings and reports. Encouraging companies to disclose evaluation reports as best practice, or gradually increasing the level of disclosure every year, may help improve overall disclosure.

7. Effectively Monitor Index Criteria

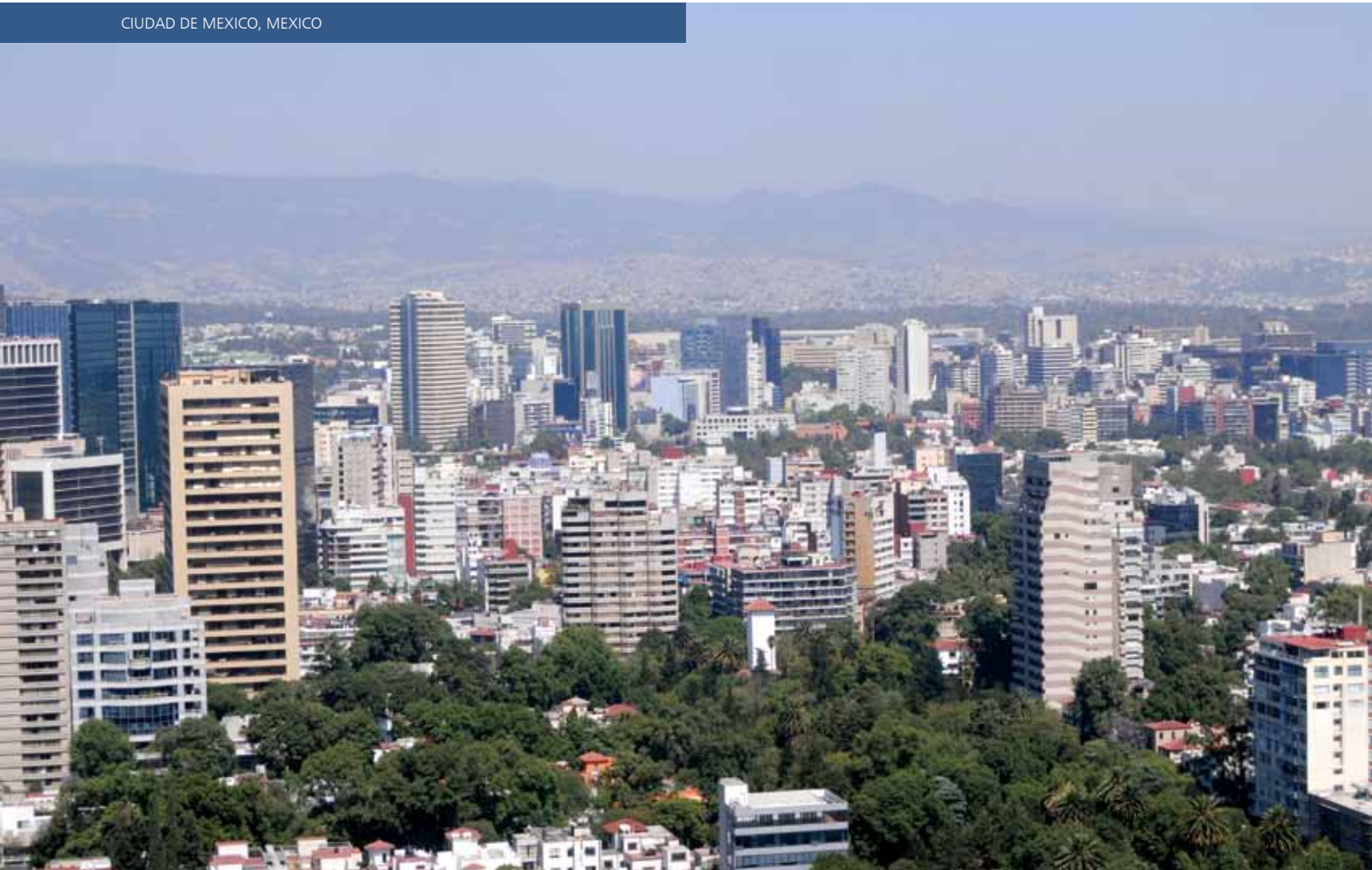
While the annual review of compliance with governance criteria is generally sufficient and cost efficient, a stock exchange should employ some form of continuous monitoring to avoid the reputational damage that can result from a scandal at a constituent

company. Dealing with such a crisis credibly includes excluding client companies from the index for the violation of governance criteria. Stock exchanges should also encourage stakeholders and the general public to participate in monitoring constituent companies, something the Johannesburg Stock Exchange has started for its environmental index criteria.

8. Develop the Index

Once an index is established, it should become more demanding over time. While companies should not be presented with ever-changing criteria, it is important to build a progressive and adaptable model that develops with the evolution of governance. This can include introducing new criteria, as the BM&FBOVESPA did in 2009 when the separation of CEO and chairman was added to the Novo Mercado listing requirements, or gradually increasing the disclosure of index results as the BMV plans in Mexico in the years to come. Making index criteria harder to meet can also help differentiate the index more meaningfully from the market's main blue chip index.

CIUDAD DE MEXICO, MEXICO



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VIII. Appendices

Appendix I: Index Profiles

BRAZIL	
Name	CORPORATE GOVERNANCE INDEX (IGC) CORPORATE GOVERNANCE TRADE INDEX (IGCT)
Launch date	June 2001 IGC January 3, 2011 IGCT
Geographic market	Brazil
Ownership structure	BM&FBOVESPA
Scope of Index	
Components, weighting	Pure CG Index. The IGC - Special Corporate Governance Stock Index, consists of all companies participating in BM&FBOVESPA Listing Tiers Novo Mercado (NM), Level 1, and Level 2. Value of shares is weighted with factor 2 for companies on the Novo Mercado, 1.5 for Level 2, and 1 for Level 1
Governance criteria/factors, origin	Companies participating in Level 1, 2, or Novo Mercado of BM&FBOVESPA are obliged to fulfill increasingly stringent corporate governance requirements going beyond the regular Brazilian corporate governance framework
Selection of companies	Automatic if member of Level 1, 2, or Novo Mercado
Exclusion of companies	If company leaves one of the special segments. If a NM, L1 or L2-listed company fails to comply with listing regulations, BM&FBOVESPA will notify the company in writing, stipulating a deadline for rectification of the irregularities. The company may also be subject to the following consequences: fines, suspension of shares from trading, and, in more serious cases, cancellation of its NM, L1 or L2 registration.
Market-based criteria	NM, L1, or L2: 25 percent free float. Additionally, IGCT companies must comply with the following criteria: a) Those included in a group of stocks whose combined negotiability indices represent 99 percent of the total value of all individual indices b) Those with trading session participation that is equal to or greater than 95 percent in the period
Methodology & Data Collection	
Type of information	Documentation of compliance with rules of listing tier
Evaluator	BM&FBOVESPA
Evaluation methodology	N/A
Index calculation	BM&FBOVESPA
Monitoring/Updates	At the end of April, August, and December, the theoretical IGC portfolio is re-evaluated to check that none of the companies surpassed the maximum participation limit. On this occasion, shares that do not meet the minimum liquidity requirements may also be excluded.
Supervision	BM&FBOVESPA
Verification/Audit of information and third-party providers	Companies in the 3 segments must meet their contractual obligations (such as 20 percent independent directors). BM&FBOVESPA verifies the companies' compliance with the listing rules mainly by monitoring the disclosure of information required by the Brazilian Securities and Exchange Commission.

BRAZIL (cont.)**Disclosure & Transparency of Index**

Level of detail of disclosure	Companies listed on NM, L1, and L2 have additional disclosure requirements towards BM&FBOVESPA who will in turn make them public.
Methodology	http://www.bmfbovespa.com.br/Indices/download/IGC_ing.pdf
Accessibility of information	Dedicated, easy-to-find page on BM&FBOVESPA site for Index offering introduction, methodology, composition, and historical statistics. http://www.bmfbovespa.com.br/Indices/ResumoIndice.aspx?Indice=IGC&Idioma=en-us

Performance

Number of companies	174 as of February 2013
Additions/Exclusions	N/A
Performance	IGC has gained over 640 percent since 2001, outperforming BOVESPA by 300 percent
Financial products	ETF: It Now IGCT Fundo de Indice (GOVE11)

MILAN, ITALY



CHINA	
Name	SSE Corporate Governance Index SSE 180 Corporate Governance Index
Launch date	January 2008
Geographic market	China, People's Republic
Ownership structure	Shanghai Stock Exchange (SSE)
Scope of Index	
Components, weighting	Pure CG Index
Governance criteria/ factors, origin	Governance criteria are based mainly on Chinese Corporate Governance Code and take into account specific Chinese issues. As part of the application process, a company conducts self-evaluation against 20 governance questions.
Selection of companies; benchmark	Companies apply to be part of the SSE Corporate Governance Board. All companies selected form the SSE Corporate Governance Index. The SSE 180 CG Index is constructed of the first 100 companies in the intersection between the CG segment and the SSE 180 Index
Exclusion of companies	Companies commonly removed during annual review but can be removed immediately for grave violations of index criteria.
Market-based criteria	None
Methodology & Data Collection	
Type of information	Self-evaluation of company and other publicly available information
Evaluators	Joint effort between SSE and China Securities Index Co., Ltd.
Evaluation methodology	A company's application is reviewed by SSE CG Board Selection Working Team and posted for public comment. A Selection Unit is formed annually to review each application. It is composed of rating agencies, fund managers, and insurance companies. Based on this review and on feedback from public disclosure, an Expert Consultation Committee (nominated for 2 years) makes the final decision on company selection.
Index calculation	China Securities Index Co., Ltd.
Monitoring/Updates	The CG segment is evaluated annually between May and June.
Supervision	SSE Corporate Governance Board Rating Expert Consultation Committee and China Securities Index Co., Ltd.
Verification/Audit of information and third- party providers	The SSE CG Segment Selection Working Team verifies the information provided by the companies, which includes posting the self-evaluation for public comment.
Disclosure & Transparency of Index	
Level of detail of disclosure	Index constituents; self-evaluation of companies for public comment
Methodology	The evaluation process and self-evaluation questions for companies are disclosed in Chinese http://www.sse.com.cn/cs/zhs/xxfw/flgz/temp/temp20071008a.pdf
Accessibility of information	Detailed evaluation methodology and qualifying thresholds not disclosed. \ Only the calculation methodology of index is available in English.
Performance	
Number of companies	SS CG Index: 266 SSE 180 CG Index: 100
Additions/Exclusions	Over 4 review cycles, 17 companies have been excluded from SSE CG Index owing to failure to meet CG Board requirements.
Performance	Very similar to main index SSE 180 because of overlap in constituents and lack of liquidity of majority of index constituents.
Financial products	ETF: BOCOM SSE 180 Corporate Governance Index

ITALY

Name	FTSE Italia STAR
Launch date	April 2001
Geographic market	Italy
Ownership structure	FTSE, Borsa Italiana

Scope of Index

Components, weighting	Based on the STAR segment of Borsa Italiana
Governance criteria/factors, origin	STAR segment market rules require companies to comply with certain normally voluntary rules of the Italian Corporate Governance Code (see Appendix III).
Selection of companies	All constituents of STAR
Exclusion of companies	At any time for violation of listing tier rules
Market-based criteria	Market capitalization between €40 million and €1 billion STAR requires entry requirement 35 percent free float, which cannot fall below 20 percent

Methodology & Data Collection

Type of information	Documentation of compliance with rules of listing tier
Evaluator	Borsa Italiana
Evaluation methodology	Annual verification process by Borsa Italiana. Company submits annual self-assessment and declaration of compliance with tier rules. Borsa reviews information and assigns internal rating, determining continuous membership of company.
Index calculation	FTSE
Monitoring/Updates	Index is reviewed on a quarterly basis in March, June, September, and December. Governance of companies is reviewed annually.
Supervision	Borsa Italiana
Verification/Audit of information and third-party providers	Governance is annually verified by Borsa Italiana to confirm Star status.

Disclosure & Transparency of Index

Level of detail of disclosure	STAR segment companies publish governance reports showing their compliance with governance criteria.
Methodology	STAR segment listing rules
Ease of disclosure	Basic tenets of STAR segment are laid out on stock exchange website.

Performance

Number of companies	66 as of February 2013 STAR launched with 20 companies in 2001
Additions/Exclusions	45 exclusions from STAR segment since 2002, mainly because of mergers and delistings
Performance	Grew by only 40 percent since December 2002, but did outperform both FTSE All-Share and FTSE Mid Cap indices.
Financial products	None

MEXICO	
Name	IPC (índice de precios y cotizaciones) Sustentable
Launch date	December 2011
Geographic market	Mexico
Ownership structure	Bolsa Mexicana de Valores – Mexican Stock Exchange (BMV)
Scope of Index	
Components, weighting	E, S, and G Corporate Governance 34 percent; Social Responsibility 33 percent; Environment 33 percent
Governance criteria/factors, origin	Framework of Index is based on 6 OECD Principles, factors derive from OECD Principles, national law and code, and investor demand. Criteria go beyond mandatory and voluntary Mexican framework.
Selection of companies; benchmark	Initially from all listed companies with a score better than the global average of EIRIS' ESG rating of a universe of 3,500 companies. Subsequently from all companies who meet market-based criteria.
Exclusion of companies	If company falls below benchmark in annual evaluation, it has a grace period until next year's evaluation to improve score.
Market-based criteria	More than 30 percent of free float liquidity and/or US\$1 billion of market capitalization
Methodology & Data Collection	
Type of information	Analysis of publicly available information
Evaluators	Two providers: Universidad Anáhuac del Sur and EIRIS (through a Mexican representative: Ecovalores)
Evaluation methodology	Anáhuac and Ecovalores evaluate publicly available information and rate companies on ESG data. Results are integrated between the results of both providers
Index calculation	Mexican Stock Exchange
Monitoring/Updates	Monitoring every 6 months, formal evaluation annually by evaluators
Supervision	Mexican Stock Exchange
Verification/Audit of information and third-party providers	Companies audited reports are considered verified information; analysis of third-party providers is exclusively based on such information
Disclosure & Transparency of Index	
Level of detail of disclosure	Index constituents Basic methodology (overall ESG criteria weight and index calculation) on Mexican Stock Exchange website.
Methodology	http://www.bmv.com.mx/wb3/wb/BMV/BMV_repositorio/_rid/223/_mto/3/NotaMetodologicaIPC SustDic2011.pdf Universidad Anáhuac evaluation methodology at: http://ols.uas.mx/cegc/doctos/CALIFICADORA_DE_SUSTENTABILIDAD_CORPORATIVA_METODOLOGIA.pdf
Ease of disclosure	Dedicated site: http://www.ipcsustentable.com/ offering background information on index. All information in Spanish
Performance	
Number of companies	29
Additions/Exclusions	Six companies were added in the first review cycle in 2012.
Performance	In 2012, the first year of the IPC Sustentable, it outperformed the benchmark IPC by almost 20 percent.
Financial products	ETFs planned, but not launched yet

PERU

Name	Índice de Buen Gobierno Corporativo (IBGC) Good Corporate Governance Index
Launch date	July 2008
Geographic market	Peru
Ownership structure	Bolsa de Valores de Lima (BVL) – Lima Stock Exchange

Scope of Index

Components, weighting	Pure CG Index.
Governance criteria/factors, origin	26 governance criteria derived from Peruvian Corporate Governance Code.
Selection of companies; benchmark	Companies need to be part of general index to ensure liquidity. Voluntary participation of companies; information provided gets verified by accredited auditors. Companies qualify if scoring at least 60 percent of maximum score of 312.
Exclusion of companies	During annual review if failing to meet benchmark or liquidity threshold
Market-based criteria	Constituents need to be in the top 80 percent liquid stocks at the BVL.

Methodology & Data Collection

Type of information	Self-evaluation of companies
Evaluators	6 auditing firms accredited by BVL to verify self-evaluation of companies
Evaluation methodology	The criteria are derived from Corporate Governance Code and receive different weights based on importance (essential, important, convenient, desirable).
Index calculation	BVL
Monitoring/Updates	Annual update of index by rating providers
Supervision	BVL
Verification/Audit of information and third-party providers	The self-evaluation of companies is verified by third-party providers; providers have to be accredited by the BVL.

Disclosure & Transparency of Index

Level of detail of disclosure	The highest-scoring company gets publicized annual award “Key to the BVL”
Methodology	http://www.bvl.com.pe/ipgc/MethodologiadeSelecciondeValores.pdf
Ease of disclosure	Dedicated page for index offering all relevant information in Spanish http://www.bvl.com.pe/acercabuengobierno.html

Performance

Number of companies	9 companies, another 8 recognized for practices but fail to meet liquidity criteria
Additions/Exclusions	Since 2008, 2 companies have been added and one excluded owing to failure to meet liquidity threshold
Performance	Slightly better but very similar to main index
Financial products	None

SOUTH AFRICA	
Name	SRI Index
Launch date	May 2004
Geographic market	South Africa
Ownership structure	Johannesburg Stock Exchange (JSE)
Scope of Index	
Components, weighting	E, S, and G
Governance criteria/factors, origin	Companies are assessed based on policy/strategy, management/performance and reporting against more than 90 indicators across each of Environment, Society, Economy, and Governance. Governance criteria taken from international best practice standards and South African Code King III.
Selection of companies; benchmark	Any company in the FTSE/JSE All Share Index is eligible. The Top 40, FTSE/JSE Mid Cap and current SRI Index constituents are automatically evaluated; others can volunteer to be assessed. Criteria are separated into core and desirable. Company must meet the majority of all indicators, at least one-third of which must be core indicators.
Exclusion of companies	So-called controversial issues can trigger investigation during annual review and lead to exclusion of company if issue not satisfactorily addressed.
Market-based criteria	All Share Ground Rules apply: turnover of at least 0.5 percent of shares in issue, after the application of any free float restrictions, per month in at least ten of the twelve months
Methodology & Data Collection	
Type of information	Analysis of publicly available information followed by feedback where necessary
Evaluator	EIRIS assisted by University of Stellenbosch Business School's Unit for Corporate Governance in Africa
Evaluation methodology	Two-fold approach: 1st phase: Data provider reviews all publicly available information regarding the company to compile a profile indicating how information compares to the criteria; 2nd phase: Following the review, companies are invited to respond to the profile by commenting on, supplementing, or clarifying information contained in the profile within three weeks from receiving the preliminary profile.
Index calculation	FTSE on behalf of JSE
Monitoring/Updates	Criteria, which are part of listing requirements, are continuously monitored, others as part of Annual Review published in November. Index reviewed quarterly to determine if still complying with the Ground Rules of the JSE All Share Index.
Supervision	JSE
Verification/Audit of information and third-party providers	JSE conducts informal quality assurance of the analysis done by EIRIS and USB.
Disclosure & Transparency of Index	
Level of detail of disclosure	Index constituents and Best Performers (companies meeting all social and governance core requirements)
Methodology	http://www.jse.co.za/About-Us/SRI/Criteria.aspx
Ease of disclosure	Very comprehensive and informative site in English http://www.jse.co.za/About-Us/SRI.aspx
Performance	
Number of companies	79 (2012)
Additions/Exclusions	Original Constituents 2004: 51; exclusions have occurred owing to violation of unlawful competition and human rights violations.
Performance	Very similar to JSE All Share Index because of overlap in constituents.
Financial products	A few funds actively track the SRI Index.
Impact/Outlook	Index is set out to become more demanding; i.e., aligning more closely with global benchmarks, converting desirable indicators into core indicators, and automatically assessing the whole core universe of companies.

SOUTH KOREA

Name	Korea Corporate Governance Stock Price Index (KOGI)
Launch date	February 2003
Geographic market	South Korea
Ownership structure	Korean Stock Exchange (KRX)

Scope of Index

Components, weighting	Pure CG Index
Governance criteria/factors, origin	95 assessment criteria, representing a blend of OECD Principles and Korean characteristics
Selection of companies; benchmark	All companies on main Index KOSPI and top 100 companies on tech index KOSDAQ get automatically evaluated. Selection according to rating and market capitalization if ESG rating same. The company score has to be above B+.
Exclusion of companies	During annual review
Market-based criteria	Value traded: average transaction volume for past 3 months within top 40 percent bracket of listed companies

Methodology & Data Collection

Type of information	Evaluation based mainly on publicly disclosed information.
Evaluator	Korea Corporate Governance Service (KCGS)
Evaluation methodology	5 ratings (A+, A, B+, B, C) are assigned, top 50 companies with minimum rating of B+ are selected
Index calculation	KRX
Monitoring/Updates	Annual regular realignment in September based on evaluation of KCGS
Supervision	KRX Index Committee
Verification/Audit of information and third-party providers	Corporate governance committee and corporate governance research committee with outside experts to audit evaluation results.

Disclosure & Transparency of Index

Level of detail of disclosure	Index constituents on KRX website, Company grades B+ and better on KCGS website
Methodology	In Korean on KCGS website
Ease of disclosure	Information dispersed between KRX and KCGS website.

Performance

Number of companies	50
Additions/Exclusions	On average 18 percent turnover of index constituents since 2007.
Performance	Slightly worse than main index KOSPI but similar because of overlap of constituents.
Financial products	None on KOGI

TURKEY	
Name	ISE Corporate Governance Index
Launch date	August 2007
Geographic market	Turkey
Ownership structure	Istanbul Stock Exchange (ISE)
Scope of Index	
Components, weighting	Pure CG index
Governance criteria/factors, origin	Based on the Corporate Governance Principles issued by Capital Markets Board of Turkey (CMB), which, in turn, are modeled after the OECD Principles. Companies are assessed against the four Chapters of the Principles addressing Shareholder Rights, Stakeholders, Transparency and Disclosure, and Board of Directors. For the calculation of the overall company score, the following weights are applied: Shareholder principles 25 percent, Stakeholders 15 percent, Disclosure 35 percent, and Board 25 percent.
Selection of companies; benchmark	Companies have to engage rating companies to be assessed. Any company on the Istanbul Stock Exchange (ISE) is eligible. Companies with a corporate-governance rating of a minimum of 7 out of 10 are selected for index.
Exclusion of companies	Company is excluded when its rating falls below 7 or when it stops contracting rating companies to be assessed.
Market-based criteria	No additional free float or market capitalization requirements
Methodology & Data Collection	
Type of information	Rating agencies base rating on public information supplemented by additional information provided by companies upon request, as well as interviews.
Evaluator	Rating institutions incorporated by CMB in its list of rating agencies
Evaluation methodology	Each rating agency has its own rating methodology within parameters (factor weighting) set by the CMB.
Index calculation	Istanbul Stock Exchange
Monitoring/Updates	Companies are required to get rated at least once a year.
Supervision	Istanbul Stock Exchange
Verification/Audit of information and third-party providers	No verification beyond accreditation of rating agencies by CMB.
Disclosure & Transparency of Index	
Level of detail of disclosure	Full rating reports of companies included in Corporate Governance Index are posted on the website of the Turkish Corporate Governance Association.
Methodology	The rating agencies disclose their rating methodologies on their websites in Turkish.
Ease of disclosure	Companies announce their CG ratings on Public Disclosure Platform (www.kap.gov.tr) in Turkish and link to their websites for the full report. All reports are also available on the website of the Turkish Corporate Governance Association.
Performance	
Number of companies	45 as of February 2013
Additions/Exclusions	No exclusions so far. Index started with 7 companies in 2007. Additions: 2008 (6); 2009 (11); 2010 (7); 2011 (7); 2012 (7)
Performance	Practically identical to main market index IMKB
Financial products	Currently none

SHANGHAI, CHINA



Appendix II: Corporate Governance Framework in Indices' Jurisdictions

Country	Type	Name	Applies to
Brazil	Law	Corporation Law, 1976	Joint Stock Companies
	Reg	CVM Rules 480, 481, 2009	Listed companies
		Novo Mercado Rules, 2011	Listing Tier
China	Law		
	Code	Code of corporate Governance for Listed Companies in China, 2001	Listed companies
Italy	Law	Law on Savings No. 262 of 2005	Listed companies
		Consolidated Law on Financial Intermediation, 1998	
	Code	Codice de Audodisciplina -Corporate Governance Code, 2011	Listed companies
Mexico	Law	Companies Law, 1996	All companies
		Securities Market Law, 2005	Listed companies
	Code	Best Practice Code, 2nd edition, 2010	Listed companies
Peru	Law	Companies Law, 1997	All companies
		Securities Market Law, 1996, amended 2002	Listed companies
	Code	Principles of Good Governance for Peruvian Companies, 2002	Listed companies
South Africa	Law	Companies Act, 2009	All companies
	Code	King Code of Corporate Governance, 2010 (King III)	All companies
South Korea	Law	Financial Investment Services and Capital Markets Act, 2009	Listed companies
	Code	Code of Best Practices for Corporate Governance, 2003	Listed companies
Turkey	Law	Commercial Code, 1956	Listed companies Listed companies
		Commercial Code, 2011 (effective July 2012)	
	Code	Corporate Governance Principles, Capital Markets Board of Turkey, 2005	Listed companies

Appendix III: Indices' Governance Criteria

Legend:

	Shareholder rights	Stakeholder Rights	Disclosure	Board	Other
	Brazil BM&FBOVESPA CG Index		Italy - FTSE Italia STAR		Mexico BMV IPC Sustentable
Source	<ul style="list-style-type: none"> • Novo Mercado Listing Regulation 		<ul style="list-style-type: none"> • Borsa Italiana Star Listing Rules • Italian CG Code 		<ul style="list-style-type: none"> • CG Evaluation criteria of Universidad de Anahuac
1	<ul style="list-style-type: none"> • Only common shares 		<ul style="list-style-type: none"> • Disclose Quart. Interim Management, Semi-Annual & Annual Report on website 		<ul style="list-style-type: none"> • Only common shares
2	<ul style="list-style-type: none"> • No voting limitations 		<ul style="list-style-type: none"> • Publish all reports and financial statements in English 		<ul style="list-style-type: none"> • Disclosure of RPTs
3	<ul style="list-style-type: none"> • Full tag-along rights 		<ul style="list-style-type: none"> • Composition of Board according to Art.2 CG Code 		<ul style="list-style-type: none"> • Sep. CEO/Chairman
4	<ul style="list-style-type: none"> • Tender offers at least at economic value of company 		<ul style="list-style-type: none"> • Min 2. Ind Directors 		<ul style="list-style-type: none"> • Ind. Nomination of Directors
5	<ul style="list-style-type: none"> • Disclosure of Code of Conduct & Securities Trading Policy 		<ul style="list-style-type: none"> • Establish Internal Committees 		<ul style="list-style-type: none"> • 25 percent Independent Directors
6	<ul style="list-style-type: none"> • English Financial Statements 		<ul style="list-style-type: none"> • Remuneration of Directors 		<ul style="list-style-type: none"> • Independent Audit Committee
7	<ul style="list-style-type: none"> • 20 percent Independent Directors 		<ul style="list-style-type: none"> • Establish Internal Control Committee 		<ul style="list-style-type: none"> • Board evaluation
8	<ul style="list-style-type: none"> • Separation of CEO/Chairman 		<ul style="list-style-type: none"> • English speaking Investor Relations Officer 		<ul style="list-style-type: none"> • At least 4 meetings a year
9	<ul style="list-style-type: none"> • Arbitration for dispute resolution 				<ul style="list-style-type: none"> • Executive and Board compensation policies
10	<ul style="list-style-type: none"> • Annual public meeting with analysts 				<ul style="list-style-type: none"> • Board's Interest in ESG Practices

	Peru BVL Good CG Index	Turkey ISE CG Index
Source	● BVL CG Index Methodology – Questionnaire on CG Principles	● Turkish CG Principles, 2005
1	● Agenda topics should facilitate discussion	● Facilitating the Exercise of Shareholders' Statutory Rights
2	● Location of AGM facilitates shareholder's participation	● Shareholders Right to Obtain and Evaluate Information
3	● Shareholder's ability to include topics on the agenda	● The Right to Participate in the General Shareholders' Meeting
4	● Shareholders' ability to be represented by others	● Voting Rights
5	● Opportunity to exchange non-voting shares for voting shares	● Minority Rights
6	● Sufficient number of independent directors	● Dividend Rights
7	● Disclosure of external audits	● Transfer of Shares
8	● Designated information channels	● Equal Treatment of Shareholders
9	● Confidentiality of information clearly defined	● Principles and Means for Public Disclosure
10	● Ind. internal audit	● Public Disclosure of Relations between the Company and Its Shareholders, the Board and Executives
11	● Board fulfills key functions (strategy, risk, etc.)	● Periodical Financial Statement and Reports in Public Disclosure
12	● Transparent nomination and election process	● Functions of External Audit
13	● Remuneration of board and executives	● The Concept of Trade Secret and Insider Trading
14	● Monitoring of conflicts of interest	● Significant Events and Developments That Must Be Disclosed to the Public
15	● Existence of Audit committee	● Company Policy Regarding Stakeholders
16	● Supervise CG policies	● Stakeholders' Participation in the Company Management
17	● Supervise disclosure policies	● Protection of Company Assets
18	● Special bodies to deal with conflicts of interest	● Company Policy on Human Resources
19	● Board is representative of all shareholders	● Relations with Customers and Suppliers
20	● Appropriate information for directors to perform their duties	● Ethical Rules
21	● Defined policies to contract external experts	● Social Responsibility
22	● Introductory policies for new board members	● Fundamental Functions of the Board of Directors
23	● Procedures to elect alternate board members	● Principles of Activity and Duties and Responsibilities of the Board of Directors
24	● Avoid duplicity of functions btw CEO and Chairman	● Formation and Election of the Board of Directors
25	● Structure of corporation should avoid concentration of power	● Remuneration of the Board of Directors
26	● Management compensation should be tied to results	● Number, Structure and Independence of the Committees ● Established by the Board of Directors
27		● Executives

	China	South Africa	South Korea
Source	<ul style="list-style-type: none"> • SSE Corporate Governance Segment Selection Methodology Brief, company self-evaluation questions, unofficial translation 	<ul style="list-style-type: none"> • Excerpted CG criteria from JSE SRI Index Background and Selection Criteria 2011 	<ul style="list-style-type: none"> • Korea Corporate Governance Services Rating Criteria
1	<ul style="list-style-type: none"> • Controlling shareholder's property titles have been transferred to company 	<ul style="list-style-type: none"> • Sep. CEO/Chairman 	<ul style="list-style-type: none"> • Protection of Shareholder Rights (27 evaluation criteria)
2	<ul style="list-style-type: none"> • Conflict of interest involving controlling shareholder 	<ul style="list-style-type: none"> • Independent Chairman 	<ul style="list-style-type: none"> • Disclosure (27 evaluation criteria)
3	<ul style="list-style-type: none"> • RPTs involving controlling shareholder 	<ul style="list-style-type: none"> • Majority non-executive & majority independent 	<ul style="list-style-type: none"> • Auditing System (13 evaluation criteria)
4	<ul style="list-style-type: none"> • Cont. shareholder vetoed dividend distribution in past 3 years 	<ul style="list-style-type: none"> • Audit and Remuneration Committee 	<ul style="list-style-type: none"> • Board of Directors (25 evaluation criteria)
5	<ul style="list-style-type: none"> • Cumulative voting allowed 	<ul style="list-style-type: none"> • Procedures to review external audit findings 	<ul style="list-style-type: none"> • Distribution of Profits (3 evaluation criteria)
6	<ul style="list-style-type: none"> • Online voting allowed 	<ul style="list-style-type: none"> • Board Charter 	
7	<ul style="list-style-type: none"> • CSR disclosed in annual report 	<ul style="list-style-type: none"> • Ind. Chairs of committees (D) 	
8	<ul style="list-style-type: none"> • Self-evaluation of board disclosed 	<ul style="list-style-type: none"> • Nomination and Risk Committees (D) 	
9	<ul style="list-style-type: none"> • Audit Report disclosed 	<ul style="list-style-type: none"> • Annual Evaluation of Board (D) 	
10	<ul style="list-style-type: none"> • Chairman and General Director are selected with due process 	<ul style="list-style-type: none"> • Internal Audit Function (D) 	
11	<ul style="list-style-type: none"> • Chairman nominated by controlling or related shareholder 	<ul style="list-style-type: none"> • Code of Ethics covering core issues of Index 	
12	<ul style="list-style-type: none"> • 50 percent of board nominated by non-controlling shareholder 	<ul style="list-style-type: none"> • Senior responsibility for ethics management 	
13	<ul style="list-style-type: none"> • Board/Chairman voices independent opinion 		
14	<ul style="list-style-type: none"> • 1/3 or more of board vote cast through long-distance communication 		
15	<ul style="list-style-type: none"> • Long-term incentive plans for senior management 		
16	<ul style="list-style-type: none"> • Sr. management violated law during duties in the past 3 years 		
17	<ul style="list-style-type: none"> • Financial reports have received reservation or negative feedback from audit in past 3 years 		

Appendix IV: Independence Definitions

*Indices in China and South Korea do not have clearly defined independence criteria as part of their evaluation criteria

Definitions of Independence					
Brazil	Mexico	Peru	Italy	Turkey	South Africa
Novo Mercado Listing Regulation	Securities Market Law	Corporate Governance Principles	Corporate Governance Code	Corporate Governance Principles	King Report on Corporate Governance
<p>"Independent Director" means a member of the board of directors that:</p> <p>(i) has no ties to the Company, other than an equity interest; (ii) is not a Controlling Shareholder, spouse or close family member (to the second degree) of a Controlling Shareholder, and neither has, nor has had in the three (3) previous years, any ties to any company or entity related to a Controlling Shareholder (excluding persons with ties to public education or government research entities); (iii) in the three (3) previous years has not been an employee or officer of the Company, or of the Controlling Shareholder or of a subsidiary of the Company; (iv) is not a direct or indirect provider, supplier or buyer of goods and/or services, to an extent that would imply loss of independence; (v) is not an employee or senior manager of any company or entity that</p>	<p>Independent directors are directors appointed based on their experience, capacity and professional prestige, and that at the time of their appointment are not: (i) relevant officers⁷, employees or statutory examiners of the PHC or of any of the entities that integrates its corporate group⁸ or group⁹, (ii) individuals with decision making authority¹⁰ or significant influence¹¹ over the corporation or any of the entities that integrates its corporate group or group, (iii) shareholders that are part of the group of persons that controls the PHC, (iv) clients, providers, debtors, creditors, partners, directors or employees of a company that is a significant client, provider, debtor or creditor¹², and (v) spouse or family members of an individual mentioned in (i) through (v) herein.</p>	<p>II. B. Independent directors are those selected for their professional prestige and who are not connected to the company management, nor to the control group of the same.</p>	<p>3. C. 1. (...) a director usually does not appear independent in the following events, to be considered merely as an example and not limited to:</p> <p>a) if he/she controls, directly or indirectly, the issuer also through subsidiaries, trustees or third parties, or is able to exercise over the issuer dominant influence, or participates in a shareholders' agreement (...);</p> <p>b) if he/she is, or has been in the preceding three fiscal years, a significant representative of the issuer, of a subsidiary having strategic relevance (...);</p> <p>c) if he/she has, or had in the preceding fiscal year, directly or indirectly (...) a significant commercial, financial or professional relationship:</p> <p>- with the issuer, one of its subsidiaries, or any of its significant representatives (...)</p>	<p>3.3.5. A member of the board who fulfill the below mentioned requirements may be qualified as an "independent member":</p> <p>a. Not to have any direct or indirect relationship of interest in terms of employment, capital or trade and commerce between the company, its subsidiaries, affiliates or any other group company and himself/herself, his/her spouse and his/her blood or affinity relatives by up to the third degree within the last two years,</p> <p>b. Not to be previously elected to the board of directors as a representative of a certain group of shareholders,</p> <p>c. Not to be employed in a company, primarily for the audit and consultant firm, which undertakes full or partial activity or organization of the company under a contract and not to be have a managing position therein within the last two years,d. Not to be previously employed by the external auditor of</p>	<p>Independence is the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company</p>

Appendix IV: Independence Definitions (cont.)

Definitions of Independence					
Brazil	Mexico	Peru	Italy	Turkey	South Africa
Novo Mercado Listing Regulation	Securities Market Law	Corporate Governance Principles	Corporate Governance Code	Corporate Governance Principles	King Report on Corporate Governance
is offering or requesting services and/or products to and from the Company to an extent that would imply loss of independence; (vi) is not a spouse or close family member (to the second degree) of any senior manager of the Company; and (vii) is not entitled to any payment by the Company other than the consideration earned as director (excluding cash distributions received in the capacity of an equity holder)			or is, or has been in the preceding three fiscal years, an employee of the above-mentioned subjects; d) if he/she receives, or has received in the preceding three fiscal years, from the issuer or a subsidiary or holding company of the issuer, a significant additional remuneration (...)	the company or not to have been included in the external audit process within the last two years, e. Not to be previously employed by a firm providing significant amounts of services and products to the company and not to have a managing position therein within the last two years, f. For his/her spouse or any of his/her relatives by blood and affinity up to the third degree, not to have a managing position or be a shareholder holding more than 5 percent of the total capital or the controlling shareholding by all means, or not to hold a managerial position or not to be effective in the control of the company, g. not to receive any compensation other than the board membership compensation and attendance fee; to hold shares of less than 1 percent if he/she is a shareholder due to his/her duty, provided that such shares are not preferred shares.	
			e) if he/she was a director of the issuer for more than nine years in the last twelve years; f) if he/she is vested with the executive director office in another company in which an executive director of the issuer holds the office of director; g) if he/she is shareholder or quotholder or director of a legal entity belonging to the same network as the company appointed for the auditing of the issuer; h) if he/she is a close relative of a person who is in any of the positions listed in the above paragraphs.		

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