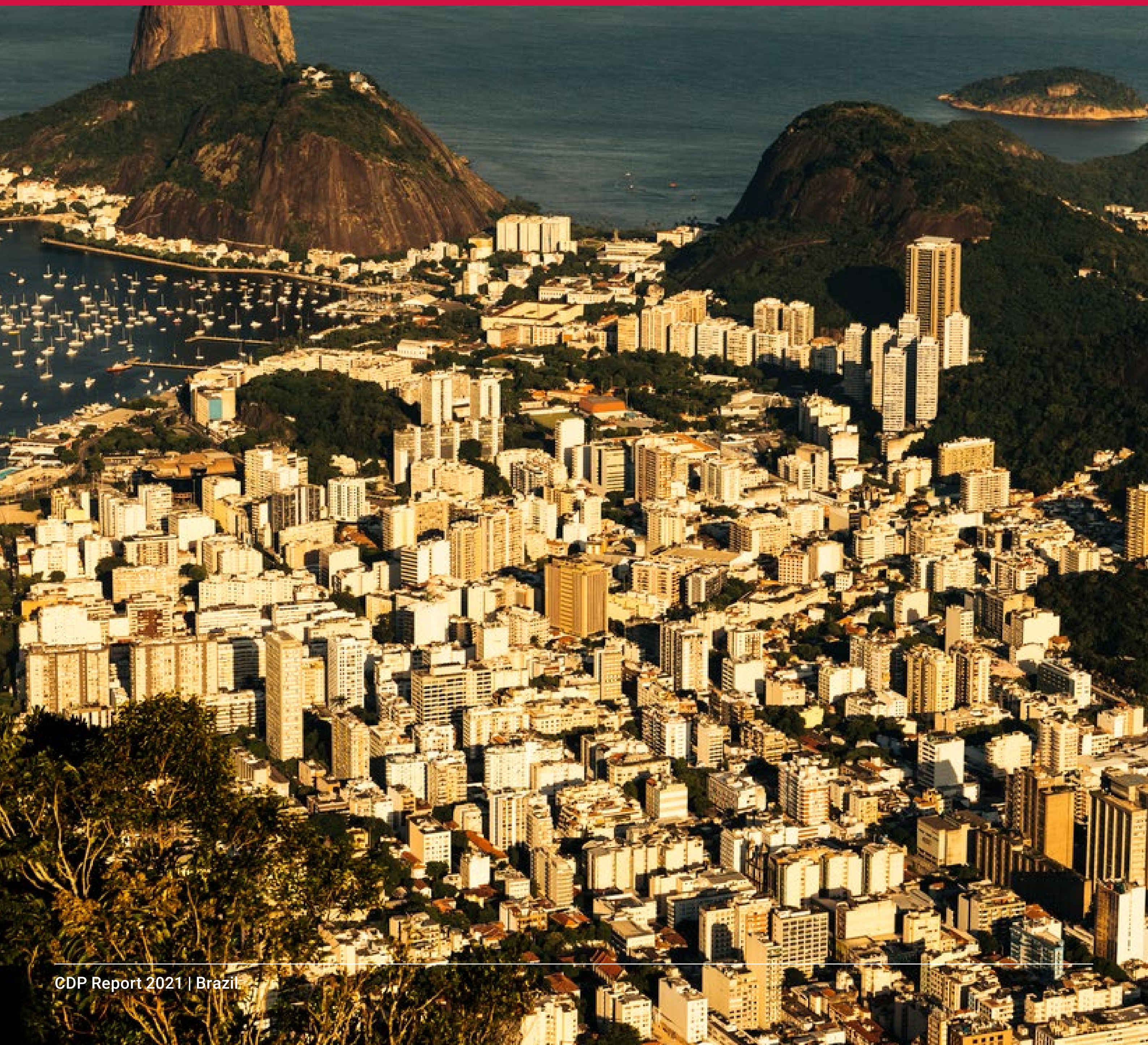
SHAPING A SUSTAINABLE FINANCIAL SYSTEM

Future-proofing global finance for a net-zero, nature-positive world

BRAZIL



INTRODUCTION

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Brazil's GDP has shrunk from US$1.84 trillion to US$1.45 trillion between 2019 and 2020. Because it has one of the currencies that lost the most value in the last year[1], the country left the list of the top ten largest economies, positioning itself in 12th place. In its turn, it was the sixth largest emitter in the world, accounting for 3.2% of global emissions[2].

One of the key drivers of emissions is deforestation, which grew 9.5% between August 2019 and July 2020 (when compared to the previous season)[3]. Data show the land-use sector represents 44% of Brazilian emissions, followed by agriculture and livestock (28%)[4]. As Greenhouse Gas (GHG) emissions in Brazil are associated with commercial agriculture and livestock, the relationship between finance and deforestation needs to be investigated further. According to a study by Forests and Finance (F&F), between 2016 and 2020 more than 50% of the total investment worldwide in forest-risk commodities (US$55 billion) was directed to Brazil[5].

Brazil's Nationally Determined Contribution (NDC) is also considered unsatisfactory to avoid irreversible losses to the environment[6]– the country committed to reduce its GHG emissions by 37% below 2005 levels by 2025 and by 43% by 2030[7]. The successful implementation of Brazilian NDC is highly dependent on deforestation reduction and the promotion of sustainable land use systems. Although the financial sector is not mentioned in Brazil's NDC, it plays a vital role in contributing to its goals. One of these includes the restoration of 15 million hectares of pasturelands by 2030[8], which will be implemented through credit lines and other economic incentives. Therefore, ambitious climate targets can generate a virtuous loop providing incentives for growing the number of climate-finance initiatives accelerating the transition to a low-carbon and resilient economy.

It is estimated that Brazil only needs to invest approximately US$1 billion per year by 2030 to meet its Paris commitment[9] but the country now has a public debt surpassing 90% of the country's GDP[10]. It is time for the financial sector to support the transition to a low carbon economy, which has the potential for bringing gains of almost R$28 trillion for the country[11]. The surge of ESG issues in the wake of the pandemic has indeed positively affected Brazil, which until August 2021 had a growth of 88% in volume of green credit, compared to the whole year of 2020[12].

1. RC Consultants. Inflation cripples, but exchange rate kills.
2. Observatório do Clima (OC). Analysis of Brazilian GHG emissions and its implications for Brazil's climate targets.
3. National Institute for Space Research of Brazil (INPE). Monitoring Deforestation of the Brazilian Amazon Forest by Satellite.
4. Climate Observatory. Greenhouse Gas Emission Estimation System (SEEG): Analysis of Brazil's GHG Emissions.
5. Forests & Finance. Materiality of ASG Risks in Commodity Sectors with Deforestation Risk
6. Climate Action Tracker (CAT). Brazil: Country Summary.
7. Government of Brazil. Intended Nationally Determined Contribution of the Federative Republic of Brazil.
8. Government of Brazil. Intended Nationally Determined Contribution of the Federative Republic of Brazil
9. VEJA. To meet its climate commitment, Brazil must invest R$ 5 billion annually.
10. Central Bank of Brazil (BCB). Economics statistics.
11. InfoMoney. Brazil can earn R$2.8 trillion with "green economy.
12. Sitawi. Sustainable Finance Trends in 2021.

KEY SUSTAINABLE FINANCE POLICY ACTORS

Actor	Responsibilities and actions taken
REGULATORS	
CENTRAL BANK OF BRAZIL (BCB OR BACEN)	BCB is a member of the Sustainable Banking Network (SBN)[13] since 2012 and of the NGFS since 2020. Its new regulation on climate risks is TCFD-aligned, although the framework is not mentioned.
THE SECURITIES AND EXCHANGE COMMISSION (CVM)	The CVM's latest bill for capital markets includes climate requirements, but they are not TCFD-aligned. Stakeholders participating in public consultations suggested TCFD is considered in the final version.
THE NATIONAL SUPERINTENDENCY OF COMPLEMENTARY WELFARE (PREVIC)	PREVIC deployed a questionnaire in March 2021 to analyze how ESG requirements could be applied to private closed-pension funds.
THE SUPERINTENDENCE OF PRIVATE INSURANCE (SUSEP)	Brazil was the first insurance market to commit to the TCFD agenda, as part of the UN Principles for Sustainable Insurance of 2018[14].
VOLUNTARY INITIATIVES	
THE LABORATORY OF FINANCIAL INNOVATION (LAB)	LAB promotes multisectoral dialogue on how the public and private sector can collaborate to support sustainable development through finance.
THE BRAZILIAN FEDERATION OF BANKS (FEBRABAN)	The Federation sets a series of guidelines and provides guidance on issues related to the ESG agenda. It is currently analyzing the sector credit portfolio based on advanced criteria (like those from the EU), in order to define a voluntary green taxonomy[15].
ASSOCIATION OF CAPITAL MARKETS INVESTORS (ANBIMA)	ANBIMA included ESG criteria in its 2016 Stewardship Code and is creating a classification for self-titled ESG funds[16].

14. United Nations Environment Programme Finance Initiative (UNEP-FI). Rio declaration on climate risk transparency by the Brazilian insurance industry.
15. FEBRABAN. 2021 Green Taxonomy.
16. Capital Reset. Anbima aims to define what is a sustainable fund.

KEY SUSTAINABLE FINANCE POLICIES AND REGULATIONS

Actor	Policy/Regulation	Supervisory/ Implementation	Sustainable Finance Positioning	Year of Implementation	Addresses Climate Change?	Addresses the Safeguarding of Forest Resources?	Addresses Safeguarding Water Resources?
1	Resolution 3.545 Resolution 3.814	BCB	These resolutions aim to prevent the financing of companies involved in illegal deforestation.	2008 and 2009, respectively	-	-	Borrowers must document how companies comply to the Forest Code
2	Instruction 480	CVM	Securities issuers **must** describe risk and costs associated with socioenvironmental issues and inform if they implement environmental policies and/or reporting. The E in ESG is addressed without further requirements.	2009	Climate would be considered in 2021, but non-aligned to TCFD	-	-
3	Amendments to Resolution 3.792	PREVIC	Investment policies from pension fund asset managers **should** indicate whether the principles of social and environmental responsibility are being observed.	2009	-	-	-
4	New Forest Code (Law 12.651)	Different federal entities	Article 78-A **urges** financial institutions to check if landowners have properties legally registered and do not operate in embargoed areas before approving credit or other incentives related to sustainable forest management.	2012	-	-	X
5	Resolution 3.896 Resolution 4008 Resolution 4267	BCB	Tax **incentives and rules** promote low-interest credit for activities aligned with climate change mitigation and adaptation.	2010, 2011 and 2013, respectively	X	-	X
6	Instruction nº 552	CVM	This builds on Instruction nº 480 to require securities issues to inform if and **how** they implement environmental policies and environmental reporting.	2014	-	-	-
7	Resolution 4327	BCB	**Requirements** for financial institutions' Socioenvironmental Responsibility Policy (PRSA)	2014	Climate would be considered as a single factor only in 2021 (PRSAC)	-	-
8	Decree 10102	Ministry of Economy	Decarbonization Credits (CBIO) that aim to **compensate** those reducing emissions in the fuel sector, including financial institutions.	2019	X	-	-
9	Resolution 4557	BCB	This Resolution inaugurated socio-environmental risks **requirements** for financial institutions.	2017	-	-	-
10	Circular 3.846	BCB	Financial institutions **must** demonstrate how they consider environmental risks exposure, including for risk-based capital requirement.	2017	-	-	-

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11	**Instruction nº 6**	**PREVIC**	Pension fund asset managers are **encouraged** to consider ESG risks as part of their investment decision making process.	2018	-	-	-
12	**Instruction nº 35**	**PREVIC**	Pension fund asset managers **must** consider ESG in details in their investments policy.	2020	-	-	-
13	**Federal Decree 10387/2020**	**Different federal entities**	A fast track for capital market investors to issue 'infrastructure debentures' with environmental benefits.	2020	X	X	X
14	**Resolution nº 4.943 (amends Resolution 4557)**	**BCB**	This resolution for financial institutions has specific climate-related requirements in line with TCFD recommendations, although TCFD is not mentioned. Now climate, social and environmental risks are treated separately and with stronger requirements. For instance, larger banks will have to carry out stress tests and consider different climate scenarios, evaluating factors such as risk concentration by regions and productive sectors. The implementation will be phased, with institutions providing quantitative data (metrics and targets) in a posterior moment.	2021	X	This mentions the importance of forests as carbon sinks and identifies forest-related risks in its lists without specific requirements	Water-related risks are mentioned without specific requirements
15	**Resolution nº 4.945 (amends resolution 4327)**	**BCB**	This resolution demands from financial institutions disclosure on risks and opportunities related to environmental, social and climate issues in their Responsibilities Policies (GRSAC Report). Along with Resolution 4.944, aimed at smaller institutions, there are stronger requirements in areas such as governance, such as requirements on the description of how goals of the boards are linked to the performance of these factors.	2021	X	Institutions could address forests in the environmental scope, but this is not required or explicitly mentioned in this Resolution	Same applies to water
16	**Instruction nº 153**	**BCB**	This innovative instruction establishes standardized tables for the elaboration of the GRSAC, expanding some TCFD criteria to the report of environmental, climate and social issues.	2021	-	-	-
17	**Resolution nº 140**	**BCB**	This resolution reinforces conditioning to rural credit by considering compliance to environmental, climate and social issues, in articulation with legislations such as the Forest Code (Article 78-A). This will be strongly allied to the 'green bureau', which was announced in July 2021 and will link operations self-titled as 'green' to geo-referencing technology. This will help financial institutions avoid granting credit to deforestation.	2021	X	Because the system will map the credit going to agriculture, credit can be redirected considering forest-related risks	-

Nb: This is not an exhaustive list of actors but key regulatory and policy initiatives in Brazil

ANALYSIS (INCLUDING GOVERNANCE CHALLENGES)

In Brazil, there has been resounding advancement on regulation, especially for the banking sector. Resolution 4327 from 2014 has created an innovative mechanism to keep record of socioenvironmental damage and, along with regulations like CVM 480 from 2009, helped to include environmental concerns in the financial system.

However, these actors might understand how environment-related risks represent more than a matter of reputation management. Brazilian actors are still learning how to explore opportunities and green financial services.

Regulators are facing their challenges as well. In Brazil, past ESG regulations are still not harmonized with international frameworks and have a short scope in all aspects of the natural capital. Water security, for example, is not explicitly addressed in the most important ESG financial regulations and there is a lack of data on how these aspects are being dealt with by institutions.

Regulation sometimes is not well-connected even to other national policies and initiatives, which compromises a broad consideration of natural capital. One example is the Environmental Rural Registry (CAR) and Environmental Regularization Program (PRA), which helps to define strategies against deforestation. Both CAR and PRA are not mentioned in the new regulation Social, Environmental and Climate Responsibility Policy (PRSA) that banks must submit.

Another complex issue is that Brazil and its intricate federative structure pose coordination challenges among Ministries, subnational governments, states, and regulators. Regulators are less susceptible to political embroil and hold higher levels of independence, which explains why they are leading on the agenda. Therefore, regulators and Ministries need to set up and run formal initiatives with non-governmental stakeholders, to promote mutual efforts.

Finally, there are issues related to implementation and oversight. Brazil has, for example, one of the most advanced Forest Codes in the world, but lower levels of law enforcement. For financial regulators, this can be seen in a lack of broad institutional strategies and initiatives to set up relatively advanced or satisfactory regulations on ESG. To this is added a lack of awareness and information on sustainable finance among institutions and other stakeholders, which is one of the main obstacles to greening financial systems in Latin America.

The way forward

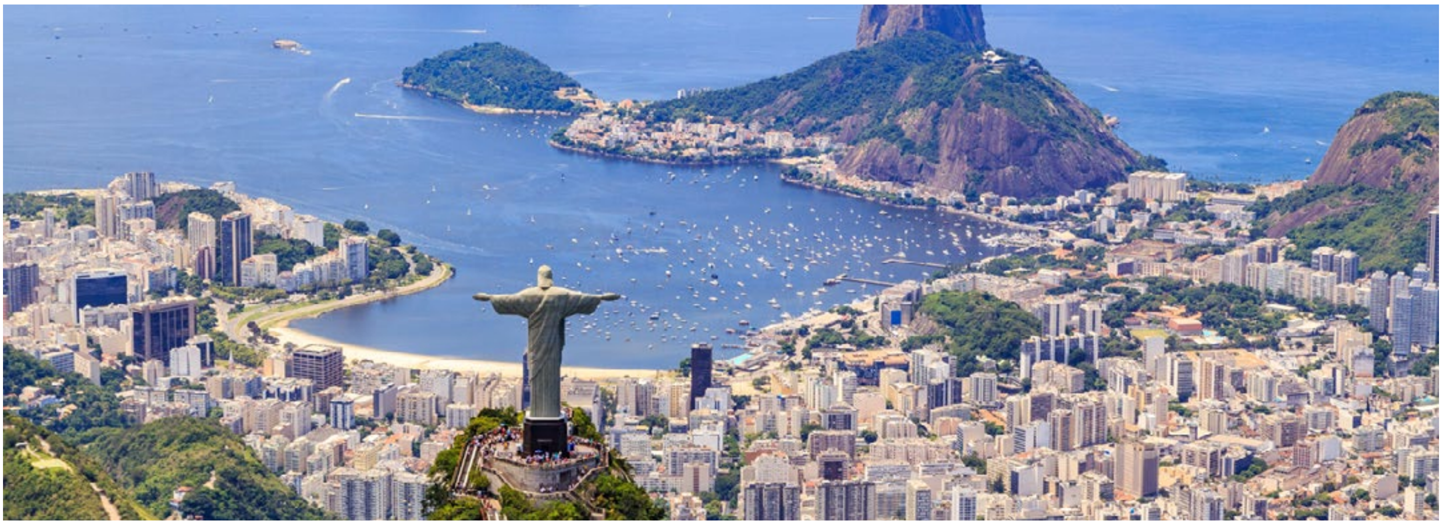
Enhance the environmental pilar in the ESG regulations

In Brazil, policies are mainly focused on broader ESG (socioenvironmental category) areas, without considering environmental issues in detail. These gaps are usually filled by voluntary guidelines providing additional information. However, regulators need to qualify all aspects of natural capital (including climate, forests and water) in their own norms and guidelines, as to promote uniformity, clarity and enable enforcement. Also, it is crucial that the enhancement of the environmental pillar should be connected with international frameworks, such as the Taskforce on Nature-related Financial Disclosures (TNFD) and the Natural Capital Protocol.

The banking sector, considering previous self- and mandatory regulations, is ready to include metrics for forests. The Brazilian Central Bank should extend environmental best practices, such as: (1) deforestation risk management in credit operations; (2) Forest Code compliance by fully monitoring the Environmental Rural Registry (CAR); (3) geographical location monitoring against indigenous population and traditional communities; and (4) environmental licensing analysis to all financial institutions.

Establish TCFD mandatory disclosure for Brazilian capital markets

Climate-related criteria are being considered with the proposed Amendments to Instruction nº 480 but this is not following all recent advances on the agenda. For example, the draft is neither TCFD-aligned nor requires institutions to detail the process used to identify, assess and manage risks related to climate change. Furthermore, institutions are not required to report their 'climate compliance policy' or the costs incurred to comply with climate-related regulations. CVM is one of the most advanced Brazilian regulators in forging partnerships, producing documents and engaging in multistakeholder forums to bring awareness of sustainable finance. Therefore, the existent network of support for capacity-building enables more ambitious regulation with a progressive approach. CVM envisions quantitative requirements but does not provide a clear timeframe, which can curb the sense of urgency.



Financial institutions can take a step further by requiring companies to set decarbonization pathways

The new normative act for non-financial risks, not yet in force, is relatively advanced. It is going to be adopted in a two-phase process in which quantitative information is not going to be required in the beginning. This should give institutions time to prepare themselves to define stronger targets and metrics for their reporting. However, the Central Bank has not yet announced any formal roadmap, multisectoral initiative or guidelines, which are precisely the strategies needed to help financial institutions to implement regulations.

From a technical perspective, this regulation leaves out important aspects for which the banking sector has preparedness, as one of the most advanced among developing countries. Although TCFD-aligned, the regulation does not mandate the assessment of opportunities, which compromises the risk-opportunity binomial of the framework. Furthermore, there is a lack of requirements on transition plans aligned to 1.5°C and other climate scenarios, in which SBT-setting methods could serve as a reference.

The draft text should also clarify on climate issues in financing portfolios, not only in operations, as to maintain a double materiality approach; and request third-party revision of climate data, as well as information on financial sector's climate externalities in PRSACs. This could be done by adopting a gradual approach, instead of being disregarded.

Promote Capacity Building and Integration in pension funds and insurance markets

Although there is already extensive material produced by the different actors regarding ESG and climate risk disclosure, there is clearly a big gap in terms of knowledge and consequent need for training on climate risks, its management and transparency among financial regulators; especially regarding the insurance market and pension funds. These subsectors need to be more exposed to international discussions on the agenda and exchange experiences with the banking and capital markets regulators. We strongly recommend PREVIC and SUSEP to be actively engaged with voluntary multistakeholder forums and build alliances to develop ESG training programs. These programs can be structured both in general and specific aspects, providing risk management tools and aligning the language, relevance and specificities of each market.

Taxonomy development and transitioning finance

Brazil has not yet formally started discussing a green taxonomy. Policy actors like the Central Bank of Brazil and the Ministry of Economy are just starting to reflect on how to 'tropicalize' best international practices to the Brazilian market, with limited participation of stakeholders and interministerial cooperation. As vountary initiatives like FEBRABAN are well-advanced in mapping criteria and defining methodologies for the country[17], it is recommended that policy actors use these as a groundwork to define a green taxonomy roadmap. FEBRABAN's taxonomy has had rounds of public consultations that strengthened its conceptualization.

CVM efforts to build a taxonomy should also be extended not only from 'credit rights fund' to all types of investment funds, but to other subsectors, in line with internationally recognized methodology. Voluntary initiatives like LAB must also capitalize from their multistakeholder coalitions to push for this agenda, as the risk of greenwashing might become a generalized governance challenge in Brazil's green market; the biggest of Latin America. Smaller markets like Chile and Colombia are ahead of Brazil in 'tropicalizing' the agenda.

17. The Brazilian Federation of Banks (FEBRABAN). Green Taxonomy.

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