SUSTAINABLE BANKING NETWORK (SBN)

COUNTRY PROGRESS REPORT

ADDENDUM TO SBN GLOBAL PROGRESS REPORT

BRAZIL

Sustainable Banking Network

International Finance Corporation
WORLD BANK GROUP

Creating Markets, Creating Opportunities

The global SBN program is supported by the government of China through the Ministry of Finance. IFC's Latin America Sustainable Finance Program is supported by the government of Canada through the Department of Foreign Affairs.

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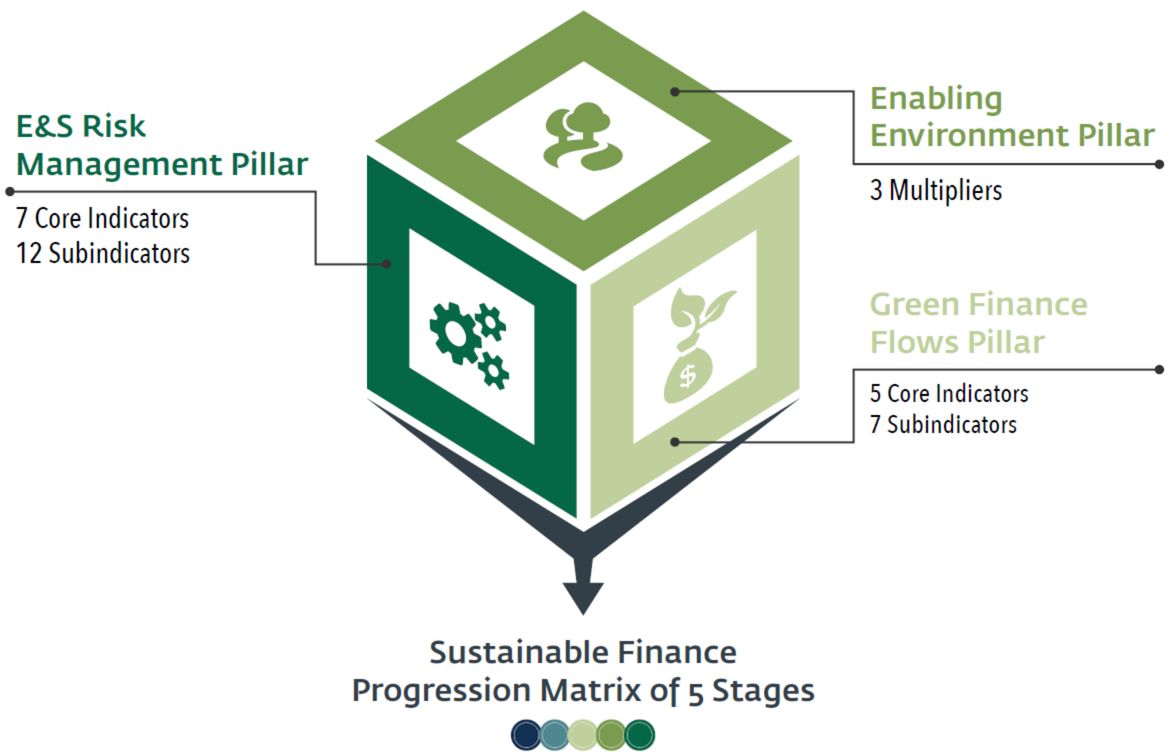
1. Introduction

Market-based sustainable finance initiatives led by members of the Sustainable Banking Network (SBN) have made significant progress in directing the financial sector toward sustainability. Established with International Finance Corporation's (IFC) support in 2012, SBN represents a community of financial sector regulators and banking associations from 34 emerging markets. SBN members now represent over US$ 42.6 trillion in banking assets, accounting for more than 85 percent of the total banking assets in emerging markets.

The SBN Global Progress Report is based on a unique measurement framework, the first of its kind to assess sustainable finance initiatives across emerging markets. The SBN Global Progress Report for the first time presents a systematic view of progress on sustainable finance among emerging economies that are represented by SBN. A rigorous measurement framework was developed and agreed on by members. The SBN Measurement Framework draws on international best practice as well as SBN members' experiences and innovations. This framework will be continuously applied to measure progress annually.



The Global Progress Report draws on the findings of **15 individual country progress reports prepared for members, including this report.** These 15 countries, with US$38.3 trillion in banking assets, account for more than 76 percent of emerging market banking assets.

Country-specific progress reports were prepared for 15 SBN members with sustainable finance initiatives. These reports contain a thorough analysis of the country's policy or principles in relation to the environmental and social (E&S) risk management and to the green finance flows, as well as a contextual analysis of the local policy landscape and the enabling environment. Country reports detail each country's good practice and highlight areas of focus in order to support and encourage members to further accelerate sustainable finance.

All SBN member countries are advancing sustainable finance at differing stages of development. Countries are mapped to five different stages of their development, from initiating to mature.

SBN Progression Matrix with Assessment Results, based on progress up to and as of June 2017

* Pakistan launched its policy in October 2017, after the cut off date of June 2017 for the report

2. Executive Summary

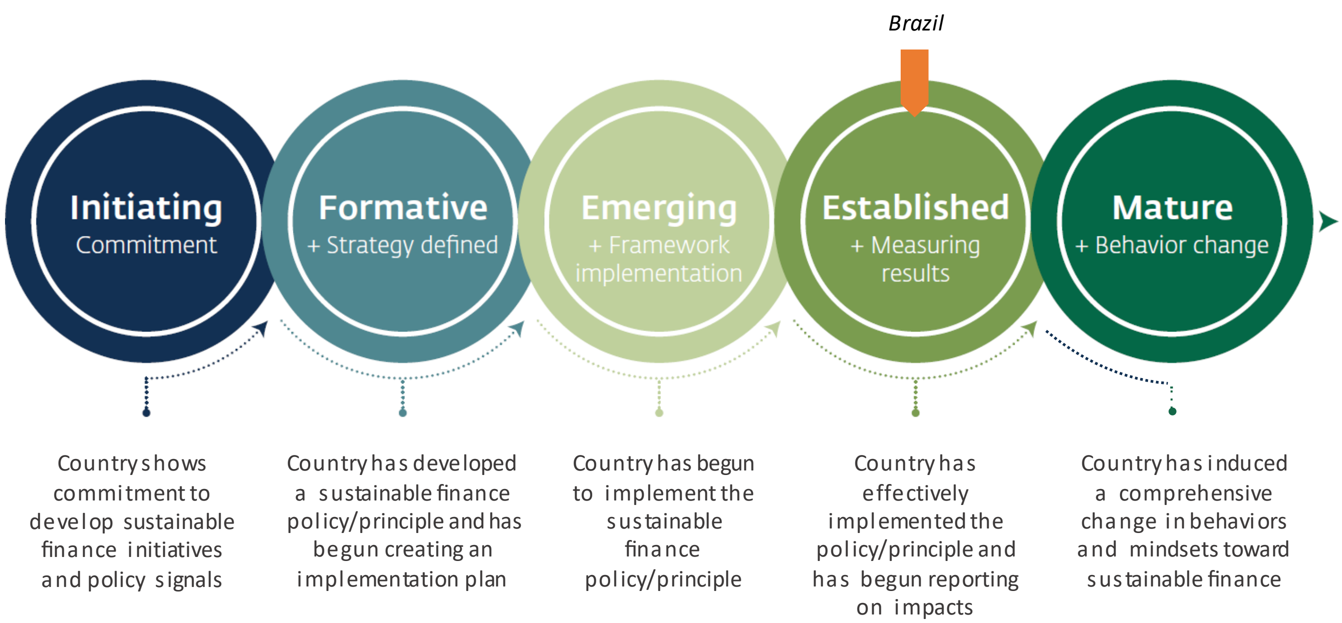
The regulatory environment supporting sustainability in Brazil is developed and ambitious, which is consistent with local circumstances, and with the country's involvement in global initiatives and commitments, such as the Earth Summit held in Rio de Janeiro in 1992 (the first major United Nations conference on sustainable development), and Rio+20 in 2012.

Sustainable finance initiatives have stemmed from voluntary industry actors, government bodies, and regulators. As early as 1995, the Ministry of the Environment facilitated and supported the commitment of five state-owned banks to voluntary guidelines entitled ***Protocolo Verde*** (Green Protocol). The Brazilian Federation of Banks (FEBRABAN), representing both state-owned and commercial banks, joined the initiative in 2009. In 2014, the Central Bank of Brazil launched the **Resolution N°4,327/2014** on Social and Environmental Responsibility (the Resolution) , which applies to all financial institutions. FEBRABAN, the Federation of Brazilian Banks, also released a protocol on Social and Environmental Responsibility (**SARB14**) in 2014.

With the support of central bank and banking association, Brazilian financial institutions (FIs) have been advancing environmental, social, and governance (ESG) risk management for almost a decade. To further advance the journey, the sustainable banking industry policy package could now help FIs by providing more practical guidance to assess their ESG risks and set up the appropriate governance of these risks in their organizations.

Brazilian banks and the stock exchange appear to be proactive in encouraging and developing green finance products. Increasing green finance flows would require more guidance regarding the types of green products to be developed or the way to identify and measure these green finance flows.

Overall Results



Good Practice

- Various actors related to the financial sector (such as the banking association, banking regulators, and Ministry of the Environment) are highly involved, which strengthens the ambition and potential impact of the E&S risk management industry guidance. Industry players have shown significant commitment to the development of green finance products and services.

- The regulatory framework regarding ESG risk management requires FIs to adapt their governance and processes in order to implement social and environmental responsibility policies.

- Finance flows to green sectors have been monitored and publicly disclosed since 2013, and a Guide for Issuing Green Bonds was released in 2016.

- The Central Bank's Resolution also requires FIs to address stakeholder concerns via consultation and dialogue, which is a good practice to reinforce FI accountability and transparency.

Areas for Improvement

- More detailed and operationally focused environmental and social risk management (ESRM) guidelines, especially on monitoring and reporting aspects, could be developed to help FIs define and apply their social and environmental responsibility policies.

- Finance flows to green sectors are publicly disclosed annually, and green sectors and green bonds are clearly defined. Going further, FIs could be required to disclose this information at a corporate level. Complementary guidance could be released to clarify reporting requirements, define other green financial products, and outline the methodology to be used to assess environmental and social benefits.

CONTEXT:

3. Enabling Environment

Country Profile

Brazil's economy is the largest in Latin America. It is mainly driven by services (including banking and telecommunications), which account for two-thirds of the country's gross domestic product (GDP), followed by industry (automobile, steel, and petrochemicals) and agriculture.

Because of its geographical location and economic development, Brazil faces increasing environmental and social issues, which primarily include deforestation, but also biodiversity destruction, air pollution, waste disposal, poverty, social inequalities, and social tensions. In Amazonia in particular, climate change and deforestation threaten both natural and indigenous inhabitants.

ESG regulations have been developed in Brazil to address these issues. As early as 1981, Brazil established an **Environmental Policy** that introduced corporate liability for industrial pollution. However, there have been challenges to enforce these environmental regulations. The country's involvement in global sustainability initiatives and agreements, such as the Rio+20 summit in 2012 and the Paris Agreement in 2016 is promising, as this may help to strengthen Brazil's ESG regulatory environment. In its Nationally Determined Contribution, Brazil committed to reducing its 2030 greenhouse gas emissions to 43 percent below 2005 levels. The country is currently elaborating a climate strategy to define how to achieve this commitment.

The Brazilian banking sector is doing relatively well, benefiting from improvements in asset quality and lower interest rates. Business models vary significantly among the 1,500 financial intermediaries operating in Brazil. The Brazilian financial sector is highly concentrated, with the top six banks—which also operate internationally—accounting for almost 70 percent of total assets. Seven other locally focused banks account for nearly 20 percent of total assets.

Background and Strategy of the Sustainable Banking Framework

The development of a sustainable finance framework in Brazil was triggered by the increase of environmental and social issues, and by the commitment from industry actors, government bodies, and the banking regulator to promote and develop sustainable practices within the Brazilian financial sector.

The framework is constituted of two core initiatives. The first core initiative is the ***Protocolo Verde*** (Green Protocol, or the Protocol), set up voluntarily by five Brazilian state-owned banks and the Ministry of the Environment in 1995 (revised in 2008) and updated in 2009 by the Brazilian banking federation FEBRABAN. FEBRABAN has also developed a set of indicators to assess the Protocol´s impact on banks.

Following this initiative, the Brazilian Central Bank released four regulations to address specific ESG issues in the financial industry: on the environmental side, **Regulation N°3,545** on the protection of Amazon Biome (2008) and **Regulation N°3,813** on sugar cane investment (2009); on the social side, **Regulation N°3,876** on slave labor (2010); and **Regulation N°3,547** on the internal capital adequacy assessment process (ICAAP, 2011) to ensure that firms have suitable governance in place to manage the risks they face.

The second core initiative came in 2014 with the **Resolution N°4,327** on Social and Environmental Responsibility for Financial Institutions, which institutionalized the initial requirements of the Green Protocol. It details the principles that FIs must take into account when developing their social and environmental responsibility policies. The regulation is flexible, and the level of ambition of the policies and action plans required are chosen by the banks themselves, according to their E&S risk exposure. Consequently, the policy focuses more on the governance of E&S risk than on specific E&S risks. FEBRABAN also released a self-regulation on Social and Environmental Responsibility (SARB14) in 2014 for the implementation of the policy framework.

More recently, **Resolution N°4,557** (2017) requires FIs to implement a structure for continuous and integrated risk management, which includes E&S risks, as defined in **Resolution N°4,327**.

Support from Regulators

The Central Bank had to address many market failures in the past. Its strategy toward sustainable banking is to familiarize the market with E&S principles, particularly as the current political context makes long-term planning difficult. The Central Bank has improved its supervisory capacity by setting up a team. It has started to compare, through questionnaires, banks' E&S risk evaluation and action plans with its own views and evaluations. Once this database becomes more comprehensive and is further consolidated, it will be used for comprehensive supervision of bank E&S action plans. The Central Bank plans to set up a committee on credit and E&S risk by 2018.

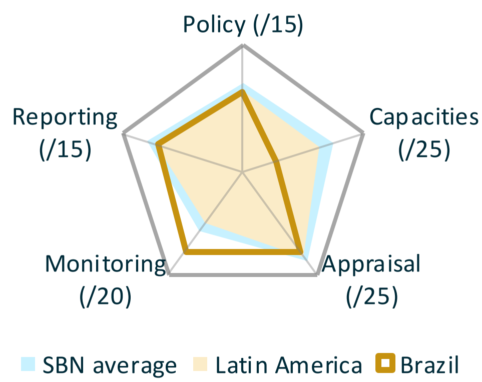
RISK:

4. Environmental and Social Risk Management

The current policy framework is composed of Regulation N°4,327 and FEBRABAN self-regulation SARB14, which provides a minimum level of procedures and practices to be adopted by FIs when developing and implementing the resolution. Not all banks are signatories, but 18 banks currently participate in FEBRABAN´s self-regulation system, representing 90 percent of the retail banking market.

The evaluation matrix indicates that the Brazilian policy framework mainly lacks guidance for FIs on how to design E&S policies and related governance.

The level of commitment to sustainable practices is quite high in the Brazilian financial sector: 37 FIs have signed the UN Global Compact, five of the largest banks have signed the Equator Principles, and 48 financial institutions have signed the UN Principles for Responsible Investing (PRI), which is the second largest number of FIs to have signed this among Sustainable Banking Network (SBN) countries, after South Africa.



Subpillars	Comments on good practice and areas for improvement
Policy	- The Central Bank's Resolution N°3,547 requires FIs to assess their activities' exposure to E&S risks and demonstrate their capacity to address these risks, in order to maintain internal capital adequacy. Resolution N°4,327 increased the Central Bank's requirements by requiring financial institutions to formalize an E&S responsibility policy for all their activities and issue guidelines on how to implement the policy. - Currently, banks are not required to formalize a climate risk management policy or develop a climate strategy aligned with Brazil's climate commitment or with a 2°C trajectory.
Capacities	- Both Resolution N°4,327 and SARB14 state the need to provide staff with the skills required to implement E&S policies and guidelines. - Both documents highlight the need for proper governance, but they do not define roles, responsibilities, or the competencies needed.
Appraisal	- Resolution N°4,327 and SARB14 demand that FIs include E&S criteria in their risk assessment processes and that they categorize projects accordingly, in order to enable efficient monitoring of the E&S risks identified. - Requiring FIs to incorporate E&S provisions and investment conditions into their legal agreements would further reinforce the impact of the E&S risk assessment process already in place.
Monitoring	- The Central Bank requires FIs to assess and quantitatively record E&S risks and impacts downstream, through its Resolution N°4,327. - This process could be further strengthened by including regular onsite visits of high-risk projects, as well as by taking into account climate risk in lending decisions.
Reporting	- The Central Bank's Resolution N°3,547 and SARB14 both require public reporting on E&S risks. - The Green Protocol encourages FIs to develop mechanisms for stakeholder consultation and dialogue. However, the current policy framework is not as explicit as the Protocol for this requirement.

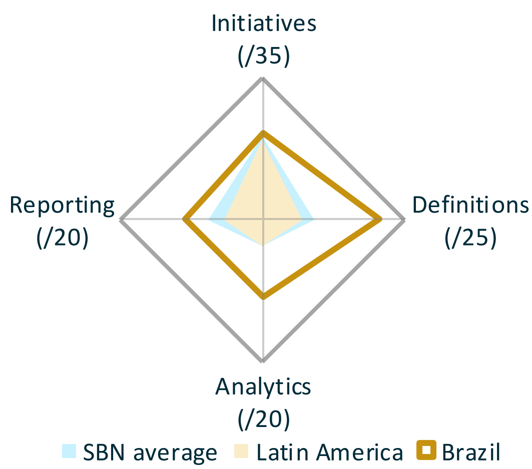
OPPORTUNITY:

5. Green Finance Flows

The first principle of the Green Protocol is the development of a portfolio dedicated to products or services with environmental or social added value, showing a strong commitment from the banking industry to the development of green finance to address the country's E&S issues. While Resolution N°4,327 and SARB14 focus more on E&S risk management, the Brazilian banking sector is also measuring annual finance flows going to the green economy, namely 12 sectors that "*result in improvements in well-being and social equality, while significantly reducing environmental risks and ecological scarcity, and have the following main pillars: low carbon emissions, efficient use of resources and social inclusion.*"

With regard to capital markets, the Brazilian BOVESPA stock exchange remains proactive regarding sustainable development, despite a strong decrease in market capitalization, as well as a reduction in the number of listed companies since the beginning of the economic crisis and recession in 2013. It has been promoting greater transparency from listed companies regarding sustainability through the Corporate Sustainability Index (ISE) created in 2005.

In 2016, FEBRABAN and the Brazilian Business Council for Sustainable Development (CEBDS) released their **Guidelines for Issuing Green Bonds in Brazil**. Green bonds have been issued in Brazilian realms since 2010, and the Brazilian National Bank for Economic and Social Development (BNDES) was the first Brazilian bank to issue a green bond in 2017 (US$1 billion). None of the private banks have issued green bonds to date.



Subpillars	Comments on good practice and areas for improvement
Initiatives	- Regulation N°4,327 and SARB14 do explicitly promote the growth of green finance flows, following the Green Protocol. The implementation of financial incentives, such as differentiated financing conditions for green finance projects, was recommended in the Green Protocol. - Industry associations are acting on this issue by measuring the annual financial resources allocated to the green economy and by releasing Guidelines for Issuing Green Bonds in Brazil. - To further promote green finance, FEBRABAN could develop awards for green products or initiatives, and take part in additional voluntary initiatives (for example, 2°C strategy or involvement in think tanks).
Definitions	- Green sectors and green bonds are properly defined in Brazil, with the latter defined in accordance with international standards (Green Bond Principles and Climate Bonds Standard). Going further, other green financial assets or services could be defined.
Analytics	- 14 FIs are currently measuring their finance flows toward green sectors, and an online template is provided. Going forward, reporting templates, methodologies, and tools could be expanded to include impacts (such as environmental benefits) and could be shared with the whole industry.
Reporting	- The measurement of financial resources allocated to the green economy at the the aggregated level is sufficiently transparent. However, FIs could be required to disclose these figures at the company level (and not only at an aggregated level), and to communicate investment impact.