BANKING, INSURANCE AND FINANCE

CENTRAL BANK OF BRAZIL WEARS ESG

21 JULY 2021

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The Climate-Related Financial Disclosures Task Force (TCFD), an institution created in 2015 at the G20 request to promote recommendations for disclosures related to climate change, issued in 2017 recommendations to financial and non-financial companies seeking to make consistent, comparable, clear and efficient some voluntary disclosure information.

TCFD's work aims to provide more transparency to risks and opportunities related to climate change to enable better investment, credit and insurance procurement decisions, and to improve understanding of the concentration of carbon-related assets in the financial sector.

After becoming a supporting institution of TCFD in September 2020, the Central Bank of Brazil launched its sustainability agenda, with even greater scope than the recommendations of the task force, because, in addition to contemplating the management of climate risks, it addresses the management of social and environmental risks, the promotion of sustainable finance and the integration of sustainable variables in the decision-making process of the Central Bank.

The initiative of the federal authority is very welcome, for integrating in its strategy rules of risk management and social and environmental responsibility. In this sense, Central Bank's policy also seems to embrace the acronym of order at the moment: ESG (Environmental, Social and Governance), which reflects the need for an analysis capable of integrating, in addition to financial return, issues of environmental, social and governance character.

For example, the Central Bank has put proposals in public this year on:

- sustainability criteria applicable in the granting of rural credit and ban access to rural credit for socio-environmental issues (Rural Credit Consultation);
- definitions of social risk, environmental risk and climate risk and requirements for its management (Risk Management Consultation); and
- disclosure of social, environmental and climate risk and opportunity reporting by financial institutions (Consultation Risk and Opportunity Report).

With regard to the Rural Credit Consultation, the proposed standards divide transaction into three segments:

- those that can be considered sustainable according to the list (pointed out as very comprehensive because it can include practices far from sustainability);
- those that cannot receive rural credit (which includes only areas enbared in the Amazon biome); and
- intermediaries, who can receive rural credit, but with warning to financial institutions that the transaction represents environmental risk (easing past restrictions and generating legal uncertainty for the financier).

A novelty already expected by the market in the proposal of the Rural Credit Consultation is the integration of government databases and the creation of the Bureau of Sustainable Rural Credit, whose information can be provided by authorization of the borrower, within the principles of *open banking*.

The Risk Management Consultation provides that social, environmental and climate risks should be considered in the risk management structure of financial institutions and updates the Social and Environmental Responsibility Policy.

Social risk includes the possibility of losses generated, directly or indirectly, by events associated with practices of violations of fundamental rights and guarantees or acts harmful to collective interests, such as acts of harassment, prejudice, discrimination, child labor, work in conditions analogous to slavery, among others.

Environmental risk includes the possibility of losses to institutions caused, directly or indirectly, by events associated with environmental degradation acts or activities, including excessive use of natural resources, or environmental disasters resulting from human intervention – including air, water or soil pollution, large-scale environmental destruction , deforestation, forest fire or forest fire.

In turn, climate risk is divided into:

- resulting from the possibility of losses to the institution caused, directly or indirectly, by events linked to the transition process to a low-carbon economy, in which greenhouse gas emissions are reduced or offset (changes in legislation, technological innovations, negative perceptions of any *Stakeholder* on the institution's contribution to a low-carbon economy); and

physical, possibility of losses by events associated with extreme environmental conditions caused by changes in weather patterns (weather, long-term environmental changes, human migration by such events).

The Risk and Opportunity Report Consultation proposes mandatory disclosure of the report by financial institutions addressing qualitative aspects of TCFD's recommendations with a focus on governance, institutions' strategies and social, environmental and climate risk management. In a second moment, Central Bank intends to require quantitative aspects focused on goals and metrics.

Even if some of the proposals contained in the public consultations can be improved, it is certain that the standards that may be implemented should contribute to the financial market in general to take more environmentally, socially and governance-responsible practices. This applies both to the granting of credit and to the channeling of investments and is another important step in addressing the great socio-environmental and climate challenges of the coming years.