

The Sustainability agenda in the National Financial System

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Over the last two decades, the financial sector's ability to influence the development of a sustainable economy has been observed; more recently, the sector itself has woken up to the need to take a stand on sustainability. Banks, development agencies and credit rating agencies are increasingly turning their attention to clients' and borrowers' adoption and achievement of ESG-related goals. By imposing such requirements, they end up inducing and disseminating adoption of ESG factors. After all, if the financial "taps" are turned off for a certain sector or company, the chances of growth and expansion, or even stability, in business rapidly diminish.

Sustainability is not a new issue in the Brazilian financial market. In 2014, the National Monetary Council's Resolution 4.327/2014 established guidelines for financial institutions' social and environmental responsibility in transactions with their clients. In 2020, Brazil's Central Bank (BCB – *Banco Central do Brasil*), as part of its sustainability agenda under Agenda BC#, expressly recognized the existence of potential climate risks for the financial system and imposed stress tests related to climactic risk under its regulations. This measure follows the direction taken by regulators in other jurisdictions, such as the United Kingdom, France, Australia and Japan.

To advance the sustainability agenda, the National Monetary Council (CMN – *Conselho Monetário Nacional*) and the BCB have issued new rules and regulations aimed at:

- **strengthening management of risks** linked to ESG questions by institutions within the National Financial System (SFN – Sistema Financeiro Nacional),
- **transparency**, by regulating disclosure of information on ESG-related risks by those institutions,
- **rural credit**, with legal and regulatory requirements related to social, environmental and climate issues.

The main rules that will come into force in 2022 are:

- **CMN Resolution 4.943**, which reflects innovations in the structure for financial institutions' risk management, capital management and information disclosure policies.
The new Resolution includes identification of social, environmental and climactic risks among the elements to be incorporated into the risk management structure established by all banks and major financial institutions. **Social risk** is defined as risk associated with the violation of fundamental rights and guarantee; **environmental risks** are events associated with degradation of the environment, including excessive use of natural resources and non-compliance with the conditions of

environmental licenses; and **climate risk** involves events associated with the process of transition to a low-carbon economy, frequent and severe storms, and long-term environmental changes.

The new risk management structure must be compatible with the institution's Social, Environmental and Climate Responsibility Policy (see CMN Resolution 4.945 below), and must provide for mechanisms to identify and monitor the social, environmental and climate risks incurred by the institution by reason of its products, services, activities or processes, or by reason of activities performed by its borrowers, controlled entities, suppliers or third party service providers.

Institutions must also perform scenario analysis under the stress test program that considers possible changes in climate patterns and scenarios for transition to a low-carbon economy.

- **CMN Resolution 4.944**, which improves the rules on the simplified social, environmental and climate risk management structure that credit cooperatives and non-banking financial institutions can opt for.
- **CMN Resolution 4.945**, which establishes new rules on the Social, Environmental and Climate Risk Policy and actions to ensure that the policy is effectively implemented by institutions within the National Financial System.

This Resolution provides that financial institutions must establish a Social, Environmental and Climate Risk Policy, consisting of the set of principles and guidelines related to social, environmental and climate matters that the institution will abide by in conducting its business, activities and processes, and in its relationships with "parties interested in the institution's activities" – which is a type of stakeholder defined in the Resolution.

The BCB has also issued

- **BCB Resolution 139**, which establishes requirements for annual release of a Social, Environmental and Climate Risks and Opportunities Report by banks and major financial institutions, and
- **BCB Resolution 140**, which determines which enterprises are subject to restrictions in their access to rural credit by reason of legal and regulatory provisions related to social, environmental and climate issues.

The BCB's sustainability agenda contemplates internal and external actions, regulatory and supervisory activities, and significant partnerships to improve monitoring of data related to ESG risks and factors, such as joining the Network for Greening the Financial System (NGFS), and signing a memorandum of understanding with the Climate Bonds Initiative (CBI).

The growing concern of regulators, banks, and other agents in the National Financial System over greater transparency, uniform disclosure, and compliance with ESG criteria by market players will certainly make a significant contribution to the transition to a clean, decarbonized economy by 2050, in line with the goals for reduction of global warming established by the Paris Agreement and now being revised at COP26.

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