Recommendations of the Task Force on Climate-related Financial Disclosures – review of local relevance

BRAZIL

1. Background - why this review?

Without better climate disclosure, investors cannot manage risks and opportunities associated with an energy transition. In December 2016, the industry-led FSB Task Force on Climate-related Financial Disclosures (TCFD) released draft recommendations for climate-related financial disclosures. The Principles for Responsible Investment (PRI) and global law firm Baker McKenzie have together produced a series of country reviews examining how these voluntary recommendations integrate into existing regulation and soft law in specific markets, and how investors and companies in those markets can apply them. The country reviews cover Brazil, Canada, the EU, Japan, and the United Kingdom (UK).

This review of Brazil's existing regulation describes Brazil's existing climate change-related commitments, and then considers existing regulation and policy on climate-related disclosure for companies, and investors/pension funds. Its analysis builds on the findings of the Fiduciary Duty in the 21st Century Brazil Roadmap developed by the PRI, UNEP FI and The Generation Foundation to overcome barriers to integrating ESG throughout the investment chain. It also draws on the regulatory analysis from PRI and MSCI's Global Guide to Responsible Investment Regulation, which examined the breadth of responsible investment-related public policy initiatives across 50 economies, including Brazil.

The PRI's response to Baker McKenzie's findings

The TCFD's recommendations are voluntary and do not supersede national disclosure requirements. They will assist in implementing existing Brazilian regulation and soft law instruments. Implementation of the TCFD will also support meeting Brazil's national climate change commitments under The Paris Agreement (see Appendix 1).

Three practical actions for better climate disclosure in Brazil

1. Government: The Federative Republic of Brazil should endorse the TCFD's final recommendations, as should bodies such as the Brazilian Securities Exchange Commission and the Brazilian Superintendence of Complementary Pension Plan.
2. Stock exchanges: B3 should consider referencing the TCFD's recommendations in reporting guidance.
3. Companies and investors should adopt the TCFD's recommendations as a useful voluntary framework for climate-related disclosures. Collaboration on implementation challenges: Sharing of good practice could assist in overcoming initial challenges, with convergence in reporting frameworks needed in the longer-term.

Action the PRI will take

The PRI has over 1,700 signatories in 50 countries, representing over US$65 trillion in assets under management. In 2017-18, the PRI will support Brazilian PRI signatories in:

- Active ownership: We will convene collaborative global investor engagement with companies to adopt the TCFD's final recommendations.
- Investor disclosure: We will evolve the PRI's Reporting Framework with the TCFD's guidance for asset owners and asset managers.
- Investment practices: We will advance investment practices in assessment and management of climate-related risks and opportunities.
- Collaboration with policymakers: We will draw on our expertise in investment practices and ESG-relevant policy in several capital markets to encourage G20 policymakers to implement the TCFD.
- Addressing barriers around responsibility investment: The PRI has set out its priorities for the next 10 years in its Responsible Investment Blueprint, published in May 2017. The PRI's work will include climate change, fiduciary duty, ESG disclosure and a sustainable global financial system.

Building on these findings, this review concludes that there is scope for Brazil to work towards a stronger disclosure regime, such as that identified by the TCFD under its recommendations. This would assist materially in ensuring climate risk mitigation in Brazil, facilitating better investment decisions and assisting with the maintenance of financial stability, as Brazil and its global trading partners seek to transition to a lower carbon economy. In particular, existing regulation would benefit from a greater recognition of the material *financial* risks to a company's strategy (in the medium and long term) that may be posed by climate change, and integration of such risk analysis into general financial analysis and disclosure.

2. Private sector regulation

2.1 Disclosure requirements for companies

In the early part of 2016, the PRI mapped out all existing responsible investment policy - almost 300 individual policy tools or market-led initiatives, covering the relationship between finance and ESG issues. These measures can be broadly grouped into three main categories which relate to different parts of the investment chain: pension fund regulations, stewardship codes and corporate disclosure requirements.

The Brazilian regulations applicable to corporate disclosure establish general guidelines and obligations, and are mainly directed towards listed companies. Privately held (non-listed) corporations are incentivised to *voluntarily* disclose their corporate information.

Listed companies

Federal Law No. 6.404/1976 (Brazilian Corporation Act) sets out the main disclosure and reporting obligations and Ruling No. 358/02 of the Brazilian Securities Exchange Commission (CVM) sets out the rules for the use and disclosure of material information, for listed companies. Overall, the controlling shareholders, managers and the statutory audit committee are responsible for the disclosure of their companies' material information, and can be held liable in case of misinformation or non-compliance.

Ruling CVM No. 358/02 establishes that a material act, fact or information is generally characterized when it can (i) affect the value of the company's securities or (ii) change or influence an investor's decision. Some examples listed in the ruling, amongst many others, are: (i) change of control; (ii) mergers or spin-offs; (iii) change in the company's assets; (iv) change in accounting criteria; (v) renegotiation of debts and (vi) bankruptcy.

> To view Brazil's complete responsible investment framework, visit the PRI’s Regulation Map.
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> For each measure, it indicates the nature of the rule, the year of implementation, the authority responsible, whether the measure is voluntary or mandatory, and if it addresses ESG issues in isolation or in combination. It also provides commentary on the key clauses relating to ESG factors and investment.
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> To view the map and download the full methodology, visit the PRI website.
>
> For further information, email policy@unpri.org

Further, pursuant to Ruling CVM No. 480/2009, listed companies are required to periodically provide to CVM (electronically), and make available on their website, certain corporate and financial information on the company (such as corporate and management structure, change of control or management, financial statements and relevant audit report, etc.). Following similar guidelines and requirements, Ruling CVM No. 578/2016 also requires investment funds to provide periodical information.

Climate change risks are increasingly appreciated by investors globally as risks having material financial implications, rather than merely non-financial implications which are relevant only in the context of the company's particular policy positions on environmental or social matters. There does not appear to be any regulation aiming to integrate analysis and disclosure of climate change-related risks into the required financial disclosure by listed companies, despite the need to consider issues which may affect the value of the company's securities or alter investor's decisions regarding the company.

This is where the adoption of reporting standards such as those envisaged by the TCFD can assist significantly, e.g. by helping:

- corporate entities understand the real financial implications of climate-related risks and their potential impacts on business models, strategy and cash flows;
- investors understand if, and how well, companies are conducting this analysis; and
- normalise this analysis as part of good corporate governance in Brazil.

The detailed and forward-facing risk assessment proposed by the TCFD may also reveal opportunities for companies, which would not have been easily identifiable where climate risks are not considered in detail or in relation to their financial implications.

State-owned entities

Additionally, B3's State-Owned Enterprise Governance Program (*Programa de Destaque em Governança de Estatais*) (Program) was created with the aim of encouraging companies controlled, or directly or indirectly owned by the State (Union, States, the Federal District and municipalities), to implement best practice in corporate governance, stimulating the implementation of annual corporate governance report and an annual integrated report or sustainability report, in accordance with the Global Reporting Initiative (GRI).

Stock exchanges and indices

B3, a Brazilian stock exchange previously known as BM&F BOVESPA , has different listing segments, which each have different access requirements. The highest rank segment is called "Novo Mercado". The listing regulations for this segment require that companies must fully comply with all corporate governance principles. They require, in accordance with the national regulation standards, that listed companies provide regular (usually every trimester) and detailed information through the release of public balance sheets and other official information. These listing standards have been applied since 2000, and have demonstrated that good corporate governance practices attract a wider range of investments for Brazilian companies and also lower the costs of capital. This aligns with the findings of the TCFD regarding risk management outcomes, and the improved outcomes that detailed medium and long term analysis of risks, and strategic planning based on the results of that analysis, can lead to.

Currently, there are also two environment-related indices based on companies listed with B3. One of these is the Corporate Sustainability Index (ISE), which was a pioneer initiative in Latin America, introduced in 2005. This index measures the performance of the assets of companies listed with B3 which are known for their engagement with sustainable enterprising. The other one is the Carbon Efficient Index (ICO2). This index comprises shares of participating companies that voluntarily agreed to join the initiative by adopting transparent practices with respect to their greenhouse gas (GHG) emissions. It takes into consideration, amongst other things, the efficiency levels of GHG emissions. According to B3 and BNDES (which jointly created the index), their main objective is to encourage companies to disclose and monitor their GHG emissions, stimulating the shift to a lower carbon economy.

B3 also contributed to the Model Guidance on Reporting ESG Information to Investors: A Voluntary Tool For Stock Exchanges to Guide Issuers released by the Sustainable Stock Exchanges Initiative in 2015.

Brazilian National Monetary council's Resolution No. 4,327/2014 sets forth guidelines for the implementation of social and environmental responsibility policies in financial institutions regulated by the Central Bank, particularly regarding management of social and environmental risks.

Brazilian regulators are already pursuing the TCFD's recommendations regarding best practice corporate climate-related analysis and disclosure, by giving decision-makers informative and concise information and embracing public financial market transparency. By adopting the TCFD framework more comprehensively companies will also be able to analyze how well their disclosure policies align with their governance and risk management.

More specifically focused on environmental matters, *Instituto BVRio* (the national environmental stock exchange) has a mission of promoting and facilitating the use of market mechanisms as a means of implementing environmental policies, sustainable development and the green economy. *Instituto BVRio* has created the *Bolsa de Valores Ambientais BVRio* (environmental assets exchange), which is a for-profit entity which aims to support Instituto BVRio in its mission and is a trading platform for certain products relevant to the environment. By providing a specific forum for companies to deal with these assets, BVRio stimulates companies to realize the financial impacts and benefits of friendly and responsible environmental practices. For a company to trade in BVRio, the company must have regular and detailed information - with a specific focus on environmental matters – publicly available on its website. Unlike BM&F, there is no need to provide the material information directly to BVRio; when the company wants to start trading, it must show that its practices are in compliance with the global standards. One way to do so is by having a CDP (Driving Sustainable Economies) certificate.

CDP is a global disclosure system that enables companies, cities, states and regions to measure and manage their environmental impacts. In Brazil, in addition to BVRio requiring a CDP certificate, some class/industries entities, such as ABRAPP – Brazilian Association of Pension Funds and ABRASCA – Brazilian Association of Listed Companies also support the CDP and advocate for Brazilian entities to participate in the CDP's programs.

Manuals/guidance

Finally, non-governmental industry associations have issued best practice manuals and orientations for the disclosure of environmental, social and governance policies and actions in companies in Brazil.
The primary manuals and orientations are:

- the Brazilian Corporate Governance Code, produced by a group of organizations including the Brazilian Institute of Corporate Governance (*Instituto Brasileiro de Governança Corporativa - IBGC*), B3, ANBIMA - Brazilian Association of Financial and Capital Market Entities, ABRAPP, ABRASCA and IBRI - Investor Relations Brazilian Institute. The Code applies to listed companies on a "comply or explain" basis, supervised by the CVM. It also includes reference to ESG issues as part of the risks to be considered and reported on by Brazilian corporations. In June 2017, CVM modified Rule No. 480/09 to introduce a new corporate governance report required to be disclosed periodically by Brazilian listed companies, whereby such companies will publicly disclose whether or not they adopt each corporate governance practice recommended under the Brazilian Corporate Governance Code and, if not, why; and
- the Committee of Orientation for Information Disclosure to the Market (*Comitê de Orientação para Divulgação de Informações ao Mercado* - (CODIM), which issued the Pronouncement No. 14/2012 orienting on best practices related to disclosure of information on sustainability issues (social and environmental responsibility of companies).

Overall, there are few express ESG disclosure requirements in Brazil both for listed and non-listed companies. Though there are manuals and guidelines provided by non-governmental organizations based on international standards regarding corporate governance and environmental/social responsibilities, there is no specific climate-related risk regulation or guidance. The TCFD framework may assist in that it provides for more specific and clear standards on how climate risk analysis should be conducted in order to, amongst other things, enable formulation of a clear, forward-looking view of the potential financial implications of those risks in an organization, as well as any opportunities.

2.2 Climate change-related aspects of pension fund/investor regulation

When it comes to pension funds regulations, the Brazilian National Monetary council's Resolution No. 3,792/2009, which sets forth guidelines for the investment of funds managed by closely held pension funds, provides that each pension plan should disclose whether or not its investment policy observes principles of social and environmental responsibility.

Although the Brazilian government and industry associations such as ABRAPP and *Instituto* Ethos are creating policies to stimulate transparency in accordance with the best corporate governance practices, the applicable law and regulations only require very general transparency and disclosure of information to investors, and they do not particularly regulate ESG and disclosure obligations.

The Brazilian Superintendence of Complementary Pension Plan (*Superintendência Nacional de Previdência Complementar* – PREVIC) provides for Corporate Governance and Pension Funds Best Practices Guidelines, which, however are not enforceable as laws. Also, every year, ABRAPP develops a questionnaire for its registered funds to evaluate their performance and provide information that can help all parties involved to make better investment decisions. The completion of the form is not mandatory, but most of the major pension funds in Brazil are complying with it. Also, large pension funds are voluntarily adopting as a practice to take into consideration environmental aspects in order to value their assets.

For a complete analysis of the evolving landscape of fiduciary duty in the Brazilian market, download the Fiduciary Duty in the 21st Century Brazil Roadmap developed by the PRI, UNEP FI and The Generation Foundation.

The roadmap builds on conversations with over thirty key market stakeholders and makes recommendations to implement clear and accountable policy and practice that embraces the modern interpretation of fiduciary duty.

The project team is engaging market stakeholders to implement these recommendations.

The Brazil roadmap is part of a larger work programme on fiduciary duty, for more information, visit www.fiduciaryduty21.org.

Evidently, while pensions funds and other investors are encouraged to consider the social and environmental aspects of climate change-related risks to investments, there is currently limited incentive to evaluate such risks from a financial perspective. There appears to be no specific guidance or precedent for the integration of climate-related risks into pension fund investment decisions, which leaves it open to individual funds to decide on the extent to which such integration is required in order to discharge their broader statutory duties. This means it may be difficult to meaningfully compare investments by these funds, as they are not necessarily considering climate-related risks to potential or existing investments in a uniform way, or required to be open and transparent about the nature of that consideration (and particularly the extent of its integration into *financial* risk analysis).

The TCFD's recommended approach to analysis and disclosure of climate change-related risks would be likely to materially assist pension funds in understanding the rationale for integration of this analysis into general financial assessments and decision-making by investee companies.

3. Conclusion

Brazil has relatively comprehensive general financial reporting regulations, and a clear focus in some sectors on incorporating ESG considerations into business strategy assessment and decision-making. However, there is currently limited motivation for companies to consider climate change and other ESG risks in a financial context, as part of general financial analysis and reporting required of listed companies.

Listed and other company regulation in particular in Brazil may benefit from the adoption of a broader framework of the kind envisaged by the TCFD, and particularly more express prescription of, and guidance in relation to, climate and other ESG risks, as financial risks, where applicable. This would compel companies to engage in medium and longer term consideration of risks and opportunities presented by decarbonisation, and disclose this thinking to the market in a way that is reliable and able to be understood (and effectively compared with relevant disclosures by other companies) by investors.

Climate-related disclosures made as part of mainstream financial filings will not only ensure the quality of information disclosed, but also promote and normalise the inclusion and importance of this information within the corporate and investor communities in Brazil. This in turn may assist in maintaining market stability, improving investor confidence in disclosures by enabling investors to understand and assess financial climate change-related risks to investments and how they are being integrated into corporate strategy.

Appendix 1: Summary of Brazil's climate change commitments

Over 146 parties have ratified the Paris Agreement. Its central aim is to strengthen the global response to climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius. The goal is feasible, but only if emissions peak by 2020 at the latest. The Paris Agreement requires all parties to put forward "nationally determined contributions" (NDCs), including a requirement to report regularly on their emissions, and on their implementation efforts. In 2018, parties will take stock of the collective efforts to progress towards the goal set in the Paris Agreement.

Brazil confirmed its high-level intended nationally determined contribution (first established in 2010 when the National Policy on Climate Change (NPCC) was enacted), which commits to reduce GHG emissions by 37% below 2005 levels by 2025, and 43% by 2030. The country reserves its position in relation to the possible use of any market mechanisms that may be established under the Paris Climate Change Agreement (PCCA). It proposes to achieve its goals mainly through:

- the increase of renewables in the energy sector; and
- actions related to the forestry sector. Brazil is the largest developing country to set an economy-wide absolute mitigation target in its NDC.

Specifically concerning the forestry sector, Brazil's nationally determined contribution (NDC) is in line with the PCCA, under which parties are encouraged to take action to implement and support activities relating to reducing emissions from deforestation, forest degradation, conservation, sustainable management of forests, and enhancement of forest carbon stocks in developing countries (REDD+).

Brazil is well advanced in its efforts to consolidate a legal framework to provide support to REDD+ projects. In this sense, federal Bill of Law 212/2011 proposed by the Senate has been widely discussed in the country. This Bill, in general terms, foresees the implementation of a National System of REDD+ in line with the National Policy on Climate Change, through an integrated approach including the Federal Government, States and Municipalities, in order to avoid double counting of emission reductions. In the House of Representatives, Deputy Tripoli has also proposed an initiative to implement a REDD+ system (Bill of Law No. 225/2015), which is very similar to the project submitted by the Senate. This Bill is yet to be discussed by the commissions of the Congress.

Despite the lack of a robust legal framework on the matter, Federal Decree No. 8,576/2015 established an Environmental Commission to coordinate and monitor the implementation of the so-called National Strategy on REDD+. The major objective of this Strategy is to enhance the monitoring and the analysis of the impacts of public policies for the achievement of REDD+ results and to contribute with the mobilization of resources for compliance with the National Policy on Climate Change, among others.

It should be noted that the successful efforts related to REDD+ in Brazil have mainly been financed through public finance, and mainly by countries such as Norway and Germany. Proper and adequate financing is a critical feature for the long-term sustainability and development of REDD+. Therefore, one of the challenges facing REDD+ in countries like Brazil is the need to create opportunities for the development of projects prior to 2020 through governmental and private investment. In this sense, the National Fund on Climate Change and the Brazilian Carbon Market established by the NPCC could increase the amount of funds available for the control of deforestation, in addition to contributing to the modernization and competitiveness of industry. In order to encourage finance to flow on a larger scale, remaining legal uncertainties connected to REDD+ will have to be addressed.

As for the energy sector, the need to increase renewables in the energy sector is also a focus of public and private companies in Brazil. The increasing demand on the government to reduce its emissions, at the same time power demand is growing, means that renewables have become a key consideration among policymakers.

In this sense, Brazilian environmental authorities have reinforced, through environmental licensing proceedings, the need to upgrade several industrial plants so that they emit fewer or no GHG emissions. For some areas of the state of São Paulo – known as "saturated areas" – there is even an absolute prohibition to emit certain types of pollutants, including GHG emissions. Clear enforcement initiatives like this one will certainly push several sectors to adapt their energy matrix as the only possible path to enable the enlargement of their industrial capacity, opening space for solar, wind and biomass energy generation, such as those produced from sugar cane and eucalyptus pulp.

With respect to biomass, for example, it is also notable how such enforcement initiatives may impact the whole supply chain, whereas technological development is one of the key factors to ensure high level of productivity of the plantations and the superior quality of the pulp produced.

The issuance of further policies and rules prohibiting or discouraging the commercialization/use of carbon-intensive products constitute a long-term impact of the PCCA on the business transactions conducted by companies located in Brazil. One example of this trend is a technical understanding recently issued by the state of São Paulo's environmental protection agency (CETESB) within the discussion of a bill of law that is contrary to the commercialization of diesel vehicles in Brazil, on the grounds that GHG emissions would increase and contribute to global warming.

Connected to the enforcement of more stringent rules addressing climate change, the number of large companies placing an internal price on GHG emissions has been growing at high rates in countries such as the United States and Canada, and, in view of the provisions of the PCCA and the NDC proposed by Brazil, this is certainly one of the impacts in the long term for companies located there. It is relevant to mention that the advantages related to the implementation of internal price on GHG emissions by Brazilian companies could be two-fold:

1. They could be key to complying with the federal and state rules on climate change; and
2. they could constitute a tool for financing emissions reductions projects (such as REDD+) and incorporating policies to make them more efficient and more resilient to climate change.

The PCCA has changed the business environment around the globe, and in Brazil specifically. Companies that succeed in contemplating the policy measures that are proposed in Brazil's NDC and implementing their own strategies accordingly will be at an advantage. Not only will they be able to stay ahead of the increasing regulatory frameworks that regulate emission reductions, they may also be able to find new opportunities for business development.

Between 2005 to 2012, Brazil was able to curtail its emissions by 41.1% due to the decrease in deforestation rates. Though their submission seems ambitious, there remains optimism in achieving its targets, due to the comprehensive level of mitigation actions proposed.[1]

[1] Secretariat for Social Communication of the Presidency of the Federative Republic of Brazil, 'Fact Sheet - Brazil at COP22', November 2016 http://www.brazilgovnews.gov.br/news/fact-sheet-cop22_en_nov16_final.pdf.

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About the Principles for Responsible Investment

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. The Principles have over 1,700 signatories globally, representing over US$72 trillion in assets under management.

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