

AN INTRODUCTION TO THE BRAZILIAN BANKING SECTOR AND ITS SUSTAINABILITY PRACTICES



BANKTRACK

SÃO PAULO, BRAZIL

DECEMBER 2012

2012 AMIGOS DA TERRA – AMAZÔNIA BRASILEIRA

PROGRAMA ECO-FINANÇAS

(www.eco-financas.org.br)

CONTENT

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SUPPORT

Bank Track

Adessium Foundation - Netherlands

An Introduction to the Brazilian Banking Sector and its Sustainability Practices / Amigos da Terra – Amazônia Brasileira. São Paulo, 2012

1. Sustainability 2. Banks 3. Economics 4. Environment

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INDEX

1.	FOREWORD.....	4
2.	THE BRAZILIAN NATIONAL FINANCIAL SYSTEM (SFN).....	5
3.	BRAZILIAN BANKING SECTOR OVERVIEW	8
4.	THE ROLE OF FOREIGN BANKS IN THE BRAZILIAN MARKET.....	15
5.	CREDIT POLICIES AND SUSTAINABILITY RELATED INITIATIVES	17
6.	REGULATION, BANKING SUPERVISION AND SUSTAINABILITY.....	21
7.	REFERENCES.....	24

1. FOREWORD

This report is a part of a major project financed by the Adessium Foundation and coordinated by BankTrack, the global network of civil society organisations and individuals which tracks the operations of the private financial sector and its effect on people and the planet.

The project has aimed to strengthen the capacity of civil society groups based in the 'BRIC countries' (Brazil, Russia, India and China), to monitor the activities and investments of the banking sector in these countries, and to ensure strong coverage of these countries within the BankTrack network.

In the Brazilian context, the project has included developing greatly improved links with Brazilian civil society organisations, not least the report's authors, Amigos da Terra Amazônia Brasileira, as well as the delivery of a training course for campaigners in Guararema, São Paulo in October 2012, developed from BankTrack's decade-long experience in tracking banks' least sustainable activities and campaigning to put a stop to them.

This report provides a basic introduction to the Brazilian finance sector. It describes how it is regulated, its main participants, and the steps taken to date towards developing a sustainable finance sector. Detailing the projects financed by Brazilian banks with severe negative impacts on the environment, people's livelihoods and human rights is outside of the report's scope (although more information on such 'dodgy deals' can be found on the BankTrack website). However, we hope that making this report widely available will contribute to an improved understanding of the Brazilian banking sector, and that this understanding will equip civil society organisations and other campaigners to pressure Brazilian banks towards acting, with full accountability and transparency, in the best interests of people and planet.

Johan Frijns
Director, BankTrack

2. THE BRAZILIAN NATIONAL FINANCIAL SYSTEM (SFN)

2.1 SFN's history

The main roles of the Brazilian National Financial System (the *Sistema Financeiro Nacional*, or SFN) are to regulate, to supervise and to put into practice the operations necessary for currency circulation and credit availability in the Brazilian economy. The SFN is composed of many different entities with distinct and complementary functions. According to the Brazilian Federation of Banks (FEBRABAN), these entities can be divided in two groups, depending on their main duties:

- i. **Entities with law enforcement and supervision duties** – As its name suggests, this group is composed of institutions that can elaborate operational rules and financial intermediation parameters, as well as supervise and enforce their use by operational entities. Components: Brazilian Monetary Council (CMN), Brazilian Central Bank (Bacen), Securities Commission (CVM), and also the special state-controlled entities with critical functions for the Government within the SFN, such as Banco do Brasil, the Brazilian National Development Bank (BNDES) and Caixa Econômica Federal.
- ii. **Entities with operational duties** – This second group is formed by institutions with a direct role in financial intermediation. Their function is to enable the flow of financial resources between lenders and borrowers in accordance with the rules established by the first group. This group is composed of banks and non-banking financial institutions such as credit unions, investment promotion agencies, finance and investment companies, leasing companies; the Brazilian Savings and Loans System (SBPE); and non-financial institutions, such as stock exchanges and over-the-counter markets.

Below is a summary, in chronological order, of the history of the SFN:

- **1808:** the Portuguese Royal Family arrives in Brazil and creates the first Brazilian bank, Banco do Brasil. Afterwards, new public institutions were created, including the first Caixa Econômica
- **1836:** foundation of the first Brazilian private bank, Banco do Ceará, which was closed in 1839
- **1863:** foundation of the first foreign banks in Brazil, the London & Brazilian Bank and the Brazilian and Portuguese Bank
- **1920:** the Bank Inspectorate was created
- **1921:** the Cheque Clearing House of Rio de Janeiro was founded
- **1932:** Cheque Clearing House of São Paulo inauguration
- **1945:** the Money and Credit Superintendence (SUMOC) was created
- **1947:** the first credit, financing and investment company was created
- **1952:** foundation of two development banks - BNDE, which, in 1971, would become BNDES, and Banco do Nordeste do Brasil (BNB)
- **1964:** foundation of the Brazilian Central Bank, which substituted the SUMOC. The Brazilian Monetary Council, the Housing Financing System (SFH) and the Housing National Bank (BNH) were also created
- **1969:** the Regional Integrated Cheque Clearing System (SIRC) was created
- **1970:** Caixa Econômica Federal was founded
- **1976:** Securities Commission (CVM) was created

- **1983:** Implementation of the Check Compensation National System substituting the regional systems
- **1988:** the check compensation processes begin to be managed electronically
- **1996:** creation of the Monetary Policy Committee (COPOM), responsible for defining Brazilian monetary policy guidelines, setting the interest rate and compiling inflation reports
- **1997:** the Mortgage System (SFI) and the Credit Risk Central, run by Bacen, were created
- **1999:** the Brazilian Monetary Council (CMN) establishes nine risk levels to indicate creditworthiness
- **2002:** the new Brazilian Payment System (SPB), the Financial Reserves Transference System (STR) and the Electronic Transference System (TED) start operating
- **2003:** creation of simplified current accounts (checking accounts) and saving accounts to promote financial inclusion
- **2006:** creation of salary accounts which can be used to receive salaries, proceeds and pensions and are exempt from any maintenance fees
- **2012:** Bacen creates a rule, starting in 2013, which obliges all financial institutions to have and implement a social and environmental responsibility policy.

2.2 Main types of financial institutions in the SFN, with operational duties

Commercial banks

Commercial banks are public or private financial institutions whose main objective is to provide short and mid-term finance to retail, industrial and service clients as well as individuals. Another typical activity of commercial banks is receiving deposits that can be withdrawn by the client at any time, as well as fixed-term deposits.

The process of integrating social and environmental risks into commercial banks' risk management has been gradual, since most of them are medium sized companies and the larger financial institutions, with more diversified portfolios, are the ones that have a higher capacity to implement this kind of tool.

Commercial banks play a major role in financing the supply chain of large companies since the biggest part of their operations is guaranteed by receivables. However, they also finance small and medium sized enterprises with short and medium-term products.

Development banks

The major purpose of these state-controlled financial institutions is to offer the necessary financial resources, in the medium or the long term, to the programs and projects established by the country's economic and development policy.

Their funding typically comes from fixed-term deposits, external loans, issues or endorsement of mortgage certificates, issue of bonds and Economic Development Titles. Development banks provide mid and long term loans mainly to the private sector but also to state-controlled companies and sub-sovereign entities such as states and municipalities.

There are four development banks in Brazil:

- Minas Gerais Development Bank (BDMG)
- Extreme South of Brazil Regional Development Bank (BRDE)
- Northeastern Brazil Bank (BNB)
- The National Bank for Economic and Social Development (BNDES)¹

Investment banks

These institutions specialise in operations involving temporary equity stakes, financing productive activities by providing fixed and working capital loans, and managing third party assets through investment funds. All investment banks in Brazil must be established as corporations (SA – Sociedade Anônima) and use the term “Banco de Investimento” in its name.

Investment banks cannot create current (checking) accounts. They raise money through fixed-term deposits, transference of internal and external financial resources and by selling shares of investment funds they manage. Their main active operations are: provision of fixed and working capital, acquisition or underwriting of bonds and securities, inter-bank deposits and foreign loans.

Multiple banks

These are state controlled or private financial institutions that perform active, passive and accessory activities. They execute these functions through their commercial, investment and/or development, mortgage, leasing and financing portfolios.

The activities performed by the multiple banks are under the same rules and guidelines applicable to those financial institutions with only one kind of portfolio. The development portfolio can only be operated through a State-controlled bank, such as Banco do Brasil or Banco da Amazônia. This latter bank is also responsible for transferring federal resources related to the implementation of specific policies directed to Northern Brazil.

A multiple bank must be established as a corporation (SA – Sociedade Anônima) and have at least two portfolios, with one of them being, mandatorily, a commercial or investment portfolio. Institutions with commercial portfolios are able to manage current (checking) accounts. In Brazil, the top 10 multiple banks have a social and environmental risk management policy.

In this category, there are also the mixed capital banks or, more precisely, the *mixed capital societies*. In these institutions the state acts as a controlling equity-holder, although the mixed capital society is a private entity and does not benefit from tax exemptions or special jurisdictions. Usually, these societies' shares are traded on the stock exchange, as with, for example, Banco do Brasil.

Credit unions

A credit union is a member-owned financial co-operative, controlled by its members who are, at the same time, partners and beneficiaries. They are non-profit private entities created to provide services for their own members under specific regulations, and are not covered by the federal legislation on bankruptcy.

¹ Even though BNDES is categorized as a development bank, it also has law enforcement and supervision duties, since BNDES is one of the special institutions with highly important functions to the Federal Government, such as executing certain policies and financing key activities.

The main goal of a credit union is to provide credit and other banking services to their members with more favourable conditions. In Brazil, credit unions are considered financial institutions (Law 4.595/64) and their operations are authorized and regulated by the Central Bank.

Investment promotion agencies

Investment promotion agencies are non-banking financial institutions with the objective of supplying long term and working capital loans in the state they are based. Each state in Brazil may only have one investment promotion agency, which must be a non-tradable corporation.

As a non-banking institution, it cannot receive fixed-term deposits, have investments in other financial institutions, use the Central Bank rediscount operations nor have a reserve account at the Central Bank. Every investment promotion agency must have a liquidity fund equivalent to, at least, 10% of its liabilities. This value must be fully invested in federal bonds.

Finance and investment companies

Finance and investment companies are financial institutions specialised in financing goods, services and working capital. Generally, the objective of a finance and investment company is to finance the purchase of durable goods by consumers through instalments.

The finance and investment companies cannot operate current (checking) accounts. They raise funds via private bond issues and fixed-term deposits.

Leasing companies

A leasing operation has two parties involved: the lessor and the lessee. The lessor buys the asset chosen by the lessee, who will benefit from it. Thus, the lessor is the owner of the asset but, during effectiveness of the leasing contract, the lessee will be the user. The leasing contract can also establish the purchasing option of the lessor's asset by the lessee.

Leasing companies specialise in operations with minimum terms of 24 months for goods with expected useful life of less than 5 years, and 36 months for other goods. There are also operating leases that include a service-providing clause attached to the tenancy contract. The costs of the service can be the responsibility of the lessor or the lessee, and the lease will have a minimum term of 90 days.

3. BRAZILIAN BANKING SECTOR OVERVIEW

3.1 Brazilian banking sector evolution

A lot has changed in the Brazilian economy since the first financial institution was created in the country (Banco do Brasil, in 1808). The Brazilian financial system, obviously, had to follow these transformations. Especially in the last two decades, the banking sector in Brazil suffered major changes: during this period, the country faced a hyperinflation problem, which was solved through the introduction of the new currency, the Real, in 1994. Another very important change was the entrance of foreign banks into the Brazilian market, from 1997.

In the past twenty years, there has been a concentration process in the banking sector caused by mergers and acquisitions. The latest large merger was between Itaú and Unibanco. A reduction in importance of the public banks, both in number and in market share, has also been noted.

In 1997, Brazil had 230 operating banks, among them national private and state-controlled banks, partly or wholly foreign-owned private banks, and branches of international banks. This number reduced to 165 in December 2003 and, in the same month in 2010, it was already 157. During this period, the number of foreign controlled banks almost doubled and the amount of state controlled banks has been reduced by two-thirds.

Type of bank ²	1997	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
State controlled ³	27	15	15	14	14	13	13	12	10	9	9
Private	190	152	150	150	147	146	143	147	148	148	151
National	118	76	78	82	77	78	77	83	82	77	73
National with foreign capital ⁴	23	11	10	10	13	12	10	2	6	11	16
Foreign controlled ⁵	33	56	53	49	49	48	49	56	54	54	56
Foreign branches ⁶	16	9	9	9	8	8	7	6	6	6	6
Total	217	167	165	164	161	159	156	159	158	157	160

Source: Bacen, 2012

With the State being less present in the banking sector and the rising number of international banks in the country, there were expectations of great benefits for bank customers. However, the results of the banking sector consolidation process in Brazil were below expectation and, sometimes, even negative regarding the credit/GDP ratio and the costs of financial intermediation. An article written by CORREA et al., in 2010, demonstrates that, on one hand, there was a huge reduction in the banking spread (the difference between borrowing and lending rates) from 120% p.a. in 1994 to 40% p.a. in the early 2000s (and relatively sustained until today), but on the other hand, there was a deterioration in the credit-to-GDP ratio from 35% in 1994 to 22% in 2002.

In 2003, the credit/GDP ratio started an upward trajectory that reached 45% in 2009, remaining at this level until January 2011. In the same month of the following year, the ratio was already over 48.8%. Regarding the structure of the banking sector, the process of reduction of the importance of state controlled banks moved backwards and the state controlled banks enlarged their market share in the sector. Between January 2003 and February 2010, the total amount of credit provided by state-controlled financial institutions rose 416%, compared to a 348% increase in the credit provided by the private sector. Specifically in the industrial sector, the credit grew 297% among the state-controlled financial institutions and only 240% for private entities.

The expansion of credit supply by private financial institutions outperformed that of state controlled entities only in rural credit for individuals. Even so, in 2009, state controlled banks were responsible for more than 50% of the rural financing operations (33% performed by Banco do Brasil and 9% by BNDES), while the private banks held 36% of this kind of operation.

² Include multiple banks, commercial banks and Caixa Econômica Federal.

³ Include Caixa Econômica Federal and similar regional institutions which existed until 1999.

⁴ Banks with foreign participation higher than 10% and less of 50% of the total capital.

⁵ Diversified and commercial banks controlled by foreign entities (except subsidiaries)

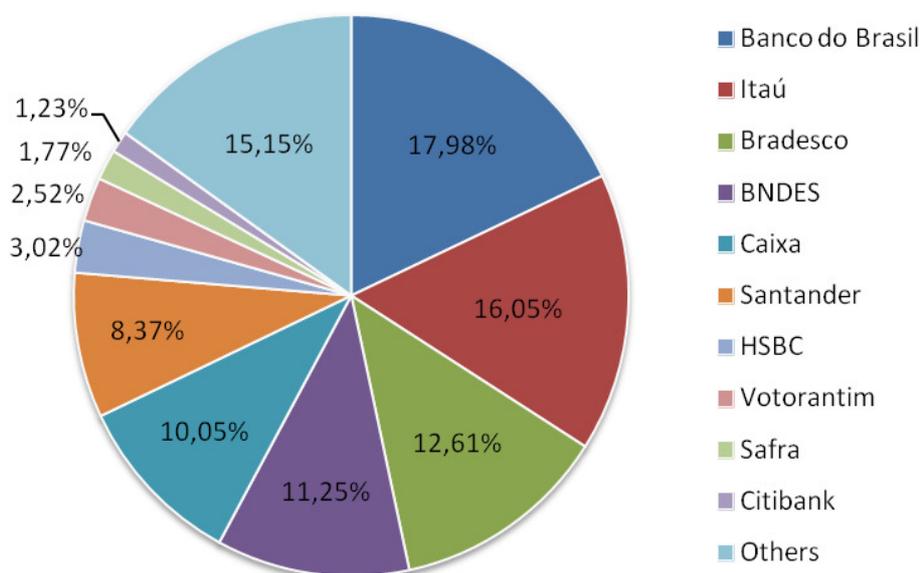
⁶ Subsidiaries of foreign banks

The trend towards sector consolidation could be seen during this entire period. In September 2011, just 10 banks held almost 85% of banking sector assets, and state controlled banks controlled more than 40% of the sector's total assets.

3.2 Main players in the Brazilian banking sector

The Brazilian banking sector is relatively concentrated and the 6 larger banks have more than 75% of the sector's total assets. This characteristic is the result of an ongoing process initiated in the 1990s. The trend has stabilized in the last few years after two major transactions: the acquisition of Banco Real by Santander (2007) and the merger of Itaú and Unibanco (2008). Since then, only minor acquisitions have occurred, affecting banking sector concentration in a less significant way and not changing each bank's position in the ranking.

Brazilian 10 largest banks market share in September 2011 (total assets)

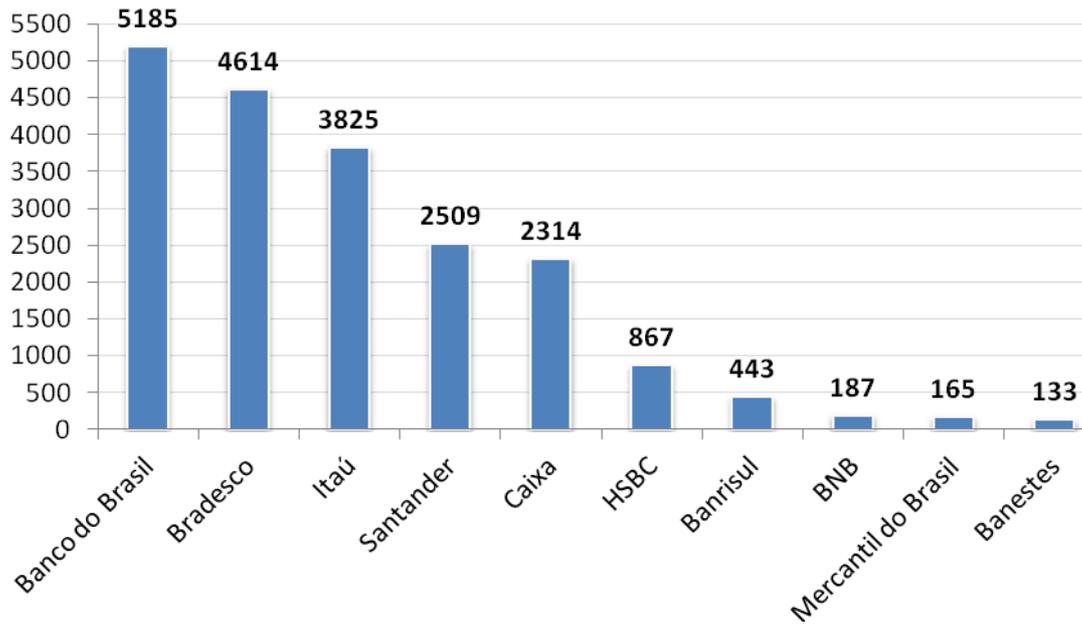


Source: Bacen (2012)

All the top 6 banks, except BNDES, perform a great amount of retail banking operations both for individuals and companies. To be able to do so, they need to have an extensive branch network. With the rise in the income of the Brazilian population, the number of people demanding banking services has also grown, obliging the banks to create new branches, in both the large and small cities.

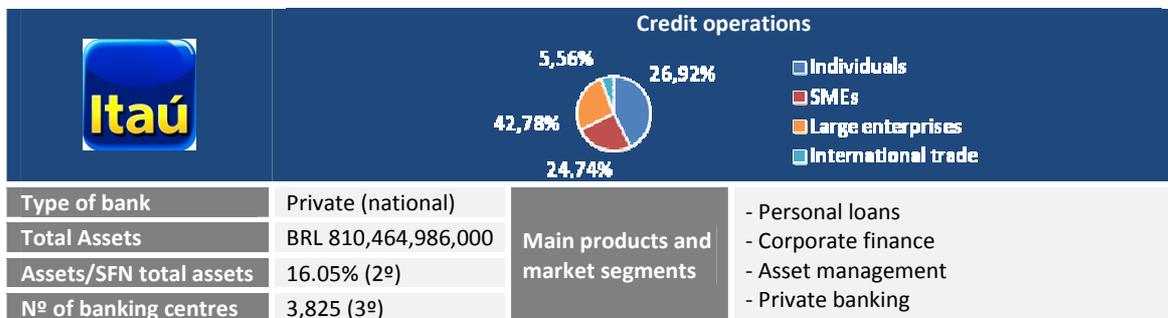
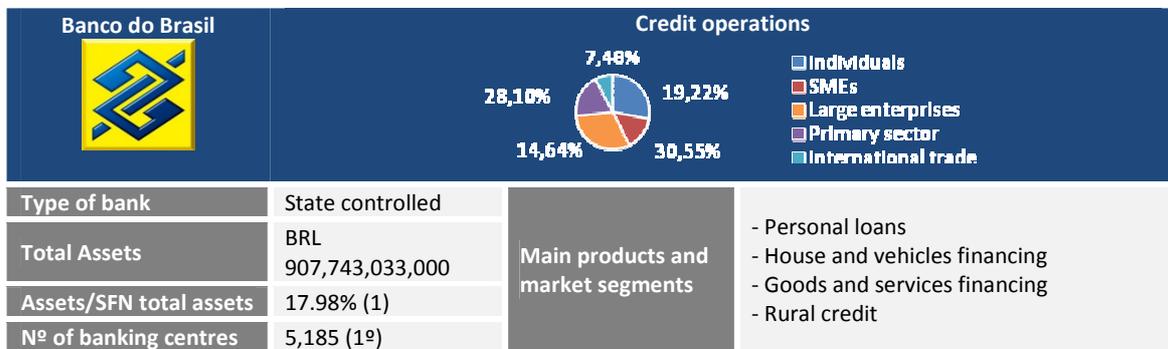
Along with the expansion on the number of branches, the last 10 years can be characterised by a segmentation of clients by the banks. They have created different structures designed to answer their customers' demands according to the financial returns they can provide. Thus, they created the *preferred* segment for individuals, including special branches and VIP areas within conventional branches. Similarly, small and medium enterprises had their services transferred to platforms outside the traditional high street bank branches, which, nowadays, focus on servicing individual and micro enterprises.

Institutions with the highest number of branches in January 2012



Source: Banco Central do Brasil (2012)

Another interesting trend with deep implications has been the larger banks' interest in banking products and niches usually dominated by small or medium sized financial institutions, such as payroll deduction loans for individuals and working capital financing and receivables for small and medium sized companies. This trend has been making the smaller banks take more and more risks and search for gradually more specific niches.



		Credit operations  <ul style="list-style-type: none"> □ Individuals ■ Enterprises ■ Public sector ■ Primary sector 	
Type of bank	Private (national)	Main products and market segments	- Personal loans
Total Assets	BRL 636,399,735,000		- Corporate finance
Assets/SFN total assets	12.61% (3º)		- Private pension
Nº of banking centres	4,614 (2º)		- Insurance

		Credit operations  <ul style="list-style-type: none"> □ Individuals ■ SMEs ■ Large enterprises ■ Public sector 	
Type of bank	State controlled	Main products and market segments	- Brazil largest long term lender
Total Assets	BRL 567,894,785,000		- Local and regional development
Assets/SFN total assets	11.25% (4º)		- Financing Programs
Nº of banking centres	-		- Specific sector funds

		Credit operations  <ul style="list-style-type: none"> □ Individuals ■ Enterprises ■ Public sector 	
Type of bank	State controlled	Main products and market segments	- Microcredit
Total Assets	BRL 507,306,734,000		- Social Funds (INSS, PIS, Bolsa Família)
Assets/SFN total assets	10.05% (5º)		- Largest mortgage portfolio
Nº of banking centres	2,314 (5º)		- SME credit

		Credit operations  <ul style="list-style-type: none"> □ Individuals ■ Enterprises ■ Primary sector 	
Type of bank	Private (foreign) ⁷	Main products and market niches	- Personal loans
Total Assets	BRL 422,407,010,000		- Corporate finance
Assets/SFN total assets	8.32% (6º)		- SMEs solutions
Nº of banking centres	2,509 (4º)		- Private banking

		Credit operations  <ul style="list-style-type: none"> □ Individuals ■ Enterprises ■ Primary sector 	
Type of bank	Private (foreign)	Main products and market niches	- Personal loans
Total Assets	BRL 152,265,999,000		- Asset management
Assets/SFN total assets	3.02% (7º)		- Financial solutions for enterprises
Nº of banking centres	867 (6º)		- Private banking

⁷ In this report, when a bank is categorized as private with foreign control it means it has more than 50% of its total capital controlled by an entity outside Brazil. It does not mean, therefore, it is a branch – unless otherwise specified.

		Credit operations 		<ul style="list-style-type: none"> ■ Individuals ■ Enterprises ■ Primary sector
Type of bank	Private (national)	Main products and market niches	- Corporate banking	
Total Assets	BRL 127,354,340,000		- Middle market	
Assets/SFN total assets	2.52% (8 ^o)		- Asset management	
Nº of banking centres	35 (18 ^o)		- Private banking	
		Credit operations 		<ul style="list-style-type: none"> ■ Individuals ■ Enterprises ■ Primary sector
Type of bank	Private (national)	Main products and market niches	- Personal loans	
Total Assets	BRL 89,106,267,000		- Brokerage	
Assets/SFN total assets	1.77% (9 ^o)		- SMEs solutions	
Nº of banking centres	101 (13 ^o)		- Private banking	
		Citibank		
Type of bank	Private (foreign)	Main products and market niches	- Personal loans	
Total Assets	BRL 62,329,592,000		- Corporate finance	
Assets/SFN total assets	1.23% (10 ^o)		- SMEs solutions	
Nº of banking centres	126 (11 ^o)		- Private banking	

Source: Bacen (2012); banks' websites; 2011 banks' annual reports

3.3 Relation between private and development banks

Among the Brazilian top 5 financial institutions there are two state controlled banks, Banco do Brasil and Caixa Econômica Federal, two private banks with national capital, Itaú and Bradesco, and the largest development bank, BNDES. The first four have a major role in the on-lending of BNDES' credit to borrowers. BNDES classifies this kind of intermediation as 'indirect operations'.

In 2011, Banco do Brasil, for example, provided more than BRL 6.7 billion (US\$ 3.2 billion) through BNDES' Machinery and Equipment Financing Program (FINAME) and BRL 2.2 billion (US\$ 1.06 billion) through BNDES' Program for the Strengthening of Income and Employment Generation Capacity (Progeren). Overall, Banco do Brasil is the financial institution that intermediates the largest amount of BNDES' resources. Last year, Banco do Brasil provided more than BRL 18 billion (US\$ 8.7 billion) in credit via BNDES' indirect operations.

Bradesco, the second largest private bank in Brazil and the third among all financial institutions in the SFN, intermediated more than BRL 15 billion (US\$ 7.2 billion) of BNDES' resources in 2011 alone. Itaú Unibanco, another private bank, and its investment branch, Itaú BBA, also offers some of BNDES' programs and is the leader in FINAME's funds intermediation. In 2011, Itaú and Itaú BBA performed 48,000 of BNDES' indirect operations, mobilizing BRL 9.3 billion (US\$ 4.5 billion).

Top 10 intermediaries of BNDES' resources in 2011

#	Financial institution	Total BNDES' resources intermediated 2011 (BRL)
1	Banco do Brasil	18,117,100,532
2	Bradesco Banco Múltiplo	15,403,743,009
3	Itaú Unibanco Banco Múltiplo	7,583,574,800
4	Itaú BBA	5,924,991,814
5	Volkswagen Banco Múltiplo	4,206,674,376
6	Safra Banco Múltiplo	3,873,871,196
7	Mercedes Banco Múltiplo	3,027,221,387
8	Caixa Econômica Federal	2,835,181,407
9	Santander Banco Múltiplo	2,776,047,518
10	Votorantim Banco Múltiplo	2,431,493,536

Source: BNDES (2012)

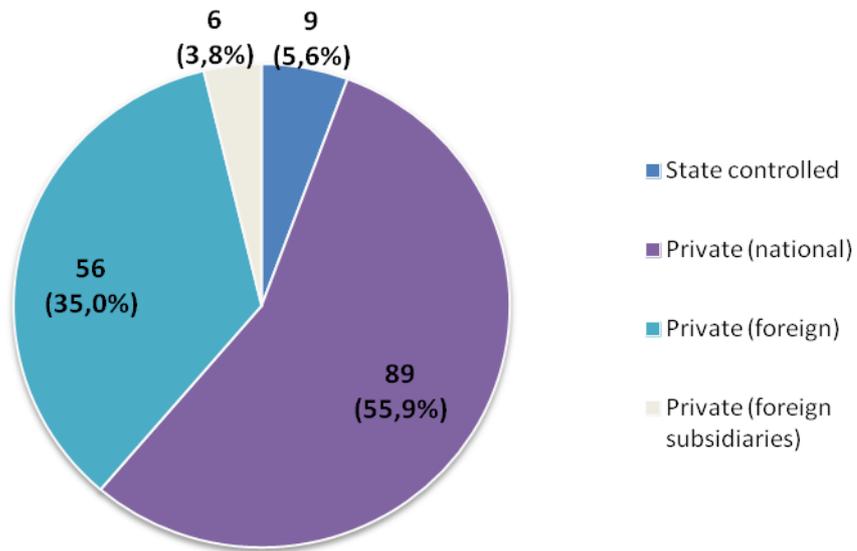
One of BNDES' main instruments for providing credit to micro and small enterprises is the BNDES Card. Issued by five different banks, Banco do Brasil, Bradesco, Caixa, Itaú and Banrisul, the Card is responsible for around 60% of BNDES' total transactions in 2011, which corresponds to BRL 7.6 billion (US\$ 3.6 billion), or 5% of BNDES' total disbursement.

BNDES' indirect operations (IO) are divided in 5 different types: automatic IO, rural IO, export support IO, IO via BNDES' Investment Guarantor Fund and non-automatic IO. Even though this last type of indirect operation is performed by other financial institutions, it must be approved by BNDES itself.

In its indirect operations, BNDES' intermediary financial institutions take all the risk of the loan. However, in larger operations, such as project finance for infrastructure development, it is usual that BNDES provides 50% of the credit itself and the other part via indirect operations. Thus, the credit risk is divided among the financial institutions involved.

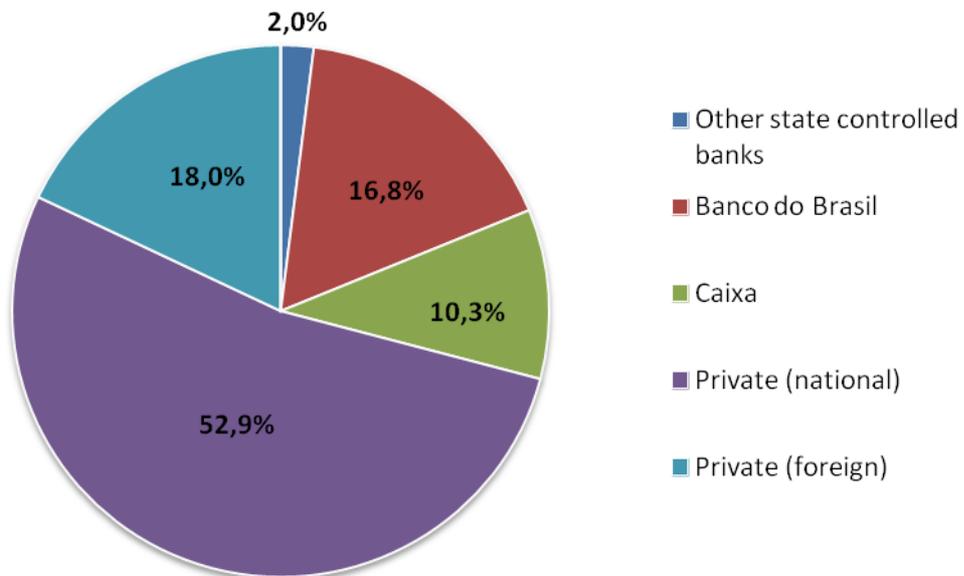
4. THE ROLE OF FOREIGN BANKS IN THE BRAZILIAN MARKET

Number of banks per capital structure - December 2011



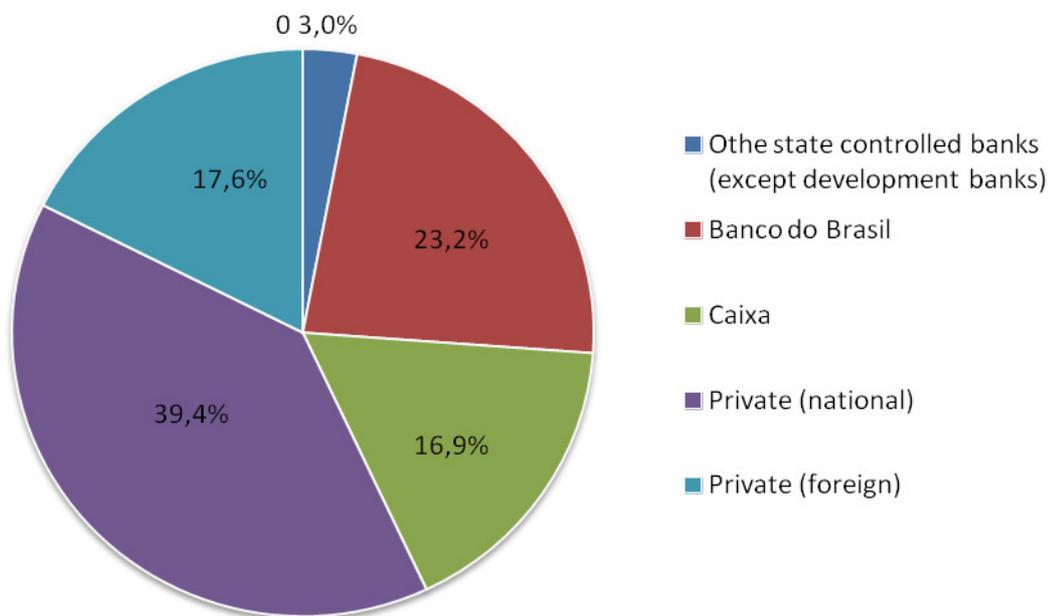
Source: Bacen (2012)

Participation (%) of each type of institution in banking sector's total assets - December 2011 (only multiple and commercial banks)



Source: Bacen (2012)

Participation (%) of each type of institution in banking sector's total credit operations - December 2011 (only multiple and commercial banks)



Source: Bacen (2012)

Even though the foreign banks represent an considerable part of the total number of financial institutions in the Brazilian banking sector (34%), their share in the sector's total assets and credit supply operations is significantly smaller (17.9% and 17.8%, respectively).

Private banks represent, by number of institutions, more than half of the total SFN (56%). Their share of the total amount of assets is similar (52.9%). On the other hand, just like the foreign banks, their participation in the total amount of credit supply operations is smaller than their share of the number of institutions would suggest. National private banks account for 39.4% of credit supply operations.

On the other hand, state-controlled banks face a completely different situation. Even though there are only nine of them (excluding development banks), corresponding to only 5.6% of the total banking sector, together they have more than 29% of sector's total assets and account for 43% of the total amount of credit supply operations. This indicates the government's huge level of participation in Brazil's banking sector. Although the number of state controlled banks has dropped sharply in recent years, they remain very relevant. Banco do Brasil and Caixa, for example, provided 23% and 14%, respectively, of the total amount of credit provided in the banking sector in 2011. These numbers are much higher than any other individual bank.

5. CREDIT POLICIES AND SUSTAINABILITY RELATED INITIATIVES

This section is dedicated to an analysis of Brazilian sustainability practices: policies, reports and participation in initiatives and forums.

An assessment made by the Central Bank of Brazil, in 2011, showed how many financial institutions have sustainability policies and publish sustainability reports. The results are shown below:

Sustainability incorporation by financial institutions in Brazil

Type of institution	Total Number	Number of institutions with a sustainability policies	Number of institutions publishing sustainability reports
Large banks	10	8 (80%)	8 (80%)
Medium and small banks	128	16 (12,5%)	9 (7%)
Development banks	4	3 (75%)	2 (50%)
Investment banks	14	5 (35,7%)	3 (21,4%)
Investment promotion agencies	16	0 (0%)	0 (0%)
Credit unions	38	0 (0%)	0 (0%)
Total	210	32 (15,2%)	22 (10,5%)

Source: Bacen (2011)

In Brazil, almost all of the top 10 multiple banks (80%) have sustainability policies and publish a sustainability report. This number is greatly lower for the small and medium sized banks. Only 12.5% of these have a sustainability policy and even fewer (7%) publish some kind of document with this information.

Among the investment banks, sustainability issues are not well embedded. Only 35% of these financial institutions have a specific policy on the subject and around 20% publish a sustainability report. None of the investment promotion agencies and credit unions has policies or publishes reports on sustainability issues.

Regarding the development banks, only one of them (BRDE) does not have a sustainability policy. Half of these financial institutions publish a report. Overall, only 15% of the total Brazilian Financial System's financial institutions have sustainability policies and 10% prepare a report.

5.1 National initiatives

Green Protocol

The "Protocolo Verde" is a letter of intentions in which the signatories commit to cooperate to create social and environmental policies to promote sustainable development in Brazil.

According to FEBRABAN, which signed the document in 2009, the Protocolo Verde ("Green Protocol") has 3 basic principles and different guidelines to stimulate the banks:

- To offer financing lines of credit to promote the population's quality of life and the sustainable use of natural resources;
- To consider social and environmental impacts and costs in their asset management practices and project risks analysis;
- To promote the sustainable use of natural resources internally and externally;

The Letter of Principles for Sustainable Development, which preceded the Protocol, was signed, at first, by state controlled banks: BNDES, Banco do Brasil, Caixa, BNB and Banco da Amazônia. These five institutions committed to incorporate environmental issues into their project analysis and assessment systems and to prioritize actions to support sustainable development. Other banks adhered to the Protocol afterwards: Bradesco, Cacique, Citibank, HSBC, Itaú, Safra and Santander.

Café com Sustentabilidade (“Breakfast with Sustainability”)

This initiative was created by FEBRABAN in 2007, and consists in a series of breakfasts followed by lectures and panels to discuss themes related to sustainability, which affect banks and their stakeholders. The participants are usually representatives from banks associated to FEBRABAN, civil society and government organizations, other trade associations and opinion makers.

Café com Sustentabilidade aims to create a network and to promote a critical point of view about sustainability, helping to bring about a convergence of the objectives of the Brazilian banking sector. Since 2007, FEBRABAN has organized 25 lectures and panels, all available to the general public on FEBRABAN’s website. The highlight was the launching of BankTrack’s report “Mind the Gap” in December 2007.

Corporate Sustainability Index (ISE-Bovespa)

BM&F BOVESPA’s Corporate Sustainability Index (ISE) measures the return of a hypothetical portfolio composed by share of companies (40 or less) committed to environmental, social and corporate governance issues. The shares are selected among those most frequently traded on the BM&F BOVESPA stock exchange. They are weighted according to the market capitalization of the company.

The table below shows the banks listed on ISE’s most recent portfolio, when they first appeared on the list and their weighting:

Bank	Ticker	Type	First time in ISE	ISE participation – Adjusted (%)	ISE participation - Market Cap(%)
Banco do Brasil	BBAS3	ON NM	2005	1,443	3,955
Bradesco	BBDC3	ON ED N1	2005	0,854	2,341
	BBDC4	PN ED N1	2005	3,650	10,004
Bicbanco	BICB4	PN EJ N1	2011	0,030	0,081
Itaú Unibanco	ITUB3	ON N1	2005	0,418	1,146
	ITUB4	PN N1	2005	4,959	13,591
Santander	SANB11	UNT N2	2011	0,702	1,924

Source: BM&F Bovespa (3/23/2012)

CEBDS – Sustainable Finance Technical Forum

The Sustainable Finance Technical Forum (CTFin) is part of the Brazilian Business Council for Sustainable Development (CEBDS), whose main goal is to incentivize financial institutions to play their role in the promotion of sustainable development, promoting discussions and best practices. This forum has four objectives, according to CEBDS:

- i. To provide information and to develop financial products which can help financial institutions to identify opportunities in sustainable finance and to reiterate the importance of the participation of the financial sector in sustainable development;

- ii. To represent the financial institutions' view of sustainable finance and to debate and elaborate policies with governments and stakeholders;
- iii. To disseminate best practices, showing society the contribution of financial institutions to sustainable development;
- iv. To stimulate sustainability in associate institutions through projects and partnerships focused on sustainable finance which can provide concrete results.

In the last few years, CTFin has focused on the implementation of the Equator Principles by Brazilian banks. Thus, it has already organized two training sessions with IFC instructors and market consultants for the banks, one in 2007 and another in 2011. Amigos da Terra – Amazônia Brasileira has been invited to join these training sessions. At CTFin's meetings, the participants discuss specific projects financed by the banks under the Equator Principles' rules. Civil society cannot attend these meetings.

Empresas pelo Clima (EPC)

The "Companies for Climate" initiative has two main objectives:

- i. To mobilize, to generate awareness and to articulate business leaders to the management and reductions of GHG emissions;
- ii. To manage climate risks and to propose public policy and incentives in the context of climate change.

EPC also comprises a thematic area for adaptation to climate change.

In 2010, the Sustainability Centre at Fundação Getúlio Vargas (GVces), founder of the Empresas pelo Clima platform, launched a study entitled *Public Finance and Climate Change*, analysing strategies and practices of Brazilian state controlled banks and sovereign funds towards climate management.

The goal of this publication was to compare the policies and practice of these banks and funds in respect of their operational actions on climate impact mitigation. In 2011, GVces released a new study, this time focusing on private finance.

5.2 Adherence to international initiatives

Equator Principles

The Equator Principles were launched in 2003, after a series of meetings between the International Finance Corporation (IFC) and important project finance providers, including ABN Amro (The Netherlands), Barclays (United Kingdom) and Citigroup (United States). These institutions saw as urgent the need for social and environmental risk assessment in large projects in emerging countries.

The IFC defines the Equator Principles as a series of social and environmental requirements which are applied to the financial contracts of major projects above a certain loan value. In July 2010, new governance rules were announced to the signatories of the Equator Principles, emphasizing the transparency they should demonstrate, defining rules for the exclusion of financial institutions that do not fully comply with the Principles and creating the 'associate' category for entities that do not finance projects, but do use the Principles for other transactions.

The first Brazilian bank to become a signatory to the Equator Principles was Unibanco, in June, 2004. Itaú, Bradesco, Banco do Brasil, and, more recently, Caixa Econômica Federal have also

become signatories. Among the international banks which operate in Brazil, Citi, HSBC and Santander are also signatories.

Natural Capital Declaration

The Natural Capital Declaration was born after discussions at several events around the world about how financial institutions could benefit from the integration of sustainability issues into their risk management and operational activities, such as credit and insurance. The Declaration encourages all these entities to assimilate environmental, social and corporate governance issues in their activities and disseminate them among companies they work with, so they could understand their impact on the environment.

The initiative is coordinated by UNEP-FI, Global Canopy Programme (GCP) and the Centre of Sustainability Studies at FGV (GVces). It involves 35 CEOs of different financial institutions, including banks, pension funds and investment managers in 12 countries. In Brazil, the first signatory was Infraprev. Later, Caixa Econômica Federal signed the Declaration, and remains the only Brazilian bank engaged in this initiative so far.

5.3 Summary of Sustainability Practices at the largest Brazilian banks

Initiative								
Sustainability policy	✓	✓	✓	✓	✓	✓	✓	✗
Sustainability report	✓	✓	✓	✗	✓	✓	✓	✗
Equator principles	✓	✓	✓	✗	✓	✓	✓	✗
Protocolo Verde	✓	✓	✓	✓	✓	✓	✓	✗
CEBDS CTFin	✓	✓	✓	✓	✓	✓	✗	✓
CEBDS CTClima	✓	✓	✓	✓	✓	✓	✗	✓
Empresas pelo Clima	✓	✓	✓	✗	✗	✓	✗	✓

Source: banks' website; initiatives' websites; 2011 banks' sustainability report (when available)

5.4 Sector-Based Credit Policies

A factor that is intimately related with the financing of controversial activities and sectors, and that can possibly generate negative social and environmental externalities, is the existence (or non-existence) of a social and environmental policy for each sector. In general, what we observe among the largest Brazilian banks is that, even if they have considerable credit exposure to specific sectors, they seldom have sector-based policies that determine under which conditions and to what type of project credit can be offered.

Although most of the top 10 financial institutions in the country are signatories of the Equator Principles, these criteria only apply to project finance operations, therefore leaving an important gap in the integration of social and environmental issues into the credit and investment analysis for several sectors.

Banco do Brasil has sector policies for agribusiness, water, energy (hydropower included), forests and biodiversity, and climate change. It does not have any guidelines for the mining sector, although this accounts for 4.5% of its corporate credit portfolio.

Itaú has a social and environmental policy that defines criteria and tools for the identification of social and environmental risks. Among the tools, there is an Exclusion List, which contains sectors where the bank does not provide credit, and a Restrict List, containing high risk sectors and specific guidelines for pig iron, sugar and alcohol, for instance.

Similarly, Santander has an exclusion list and an attention list. The latter contains 14 sectors which are subject to specific analysis, including mining, metallurgy and agribusiness.

Caixa's Corporate Environmental Policy focuses on actions to be developed in eco-efficiency, technological innovation and environmental management in sectors in which the bank has major investments: housing, sanitation and infrastructure.

HSBC has specific rules for the financing of forestry, forest-based products, mining, metals and water infrastructure.

Among the remaining multiple banks, Bradesco has a credit policy that considers social and environmental risks, including the slave labour exclusion list disclosed by the Ministry of Labour, areas that are prohibited by IBAMA (the Brazilian Institute of Environment and Renewable Natural Resources), and contaminated areas according to the state environmental agencies Cetesb (Sao Paulo), Inea (Rio de Janeiro) and Feam (Minas Gerais). However, it does not have sector-specific policies for those sectors with strong social and environmental externalities.

5.5 Civil society assessments

Guide for Responsible Banking (GBR)

Organized by the Brazilian Consumer Defence Institute (Idec), GBR is an evaluation tool that aims to promote social and environmental responsibility among banks, with the support and mobilization of their customers.

GBR benchmarks the performance of the six largest multiple banks in the country across three themes: consumer issues, financing and labour; each with different evaluation criteria, and gives a rating of very bad, bad, average, good or very good.

The philosophy behind GBR is that competition among banks will be increased as consumers demand more responsible policies and practices from a social and environmental perspective, therefore prompting a change of behaviour in financial sector as a whole.

6. REGULATION, BANKING SUPERVISION AND SUSTAINABILITY

6.1 Brazil and the Basel Accords

The Basel Committee on Banking Supervision, responsible for a range of standards and guidelines for the world's banking sector, is especially famous for the Basel Accords, which determine several rules and guidelines for the banking sector worldwide. The first Accord was developed in the last years of the 1980s, and introduced in 1988. Basel II was written in

2004, a few years before the latest worldwide financial crisis. The third Accord, in 2010, was a response to this crisis.

The main point of Basel II was the determination of an 8% minimum capital requirement. This means that every investment made by the banks should be financed from, at least, 8% of the bank's own reserve capital. But this minimum capital requirement was actually weighted by a risk factor of between 0% and 150%, depending on the risk level associated with each investment.

Such risk level should be defined by international rating agencies. And this is already a big issue, because these agencies are private entities, with private interests. However, the larger financial institutions had the prerogative of elaborating their own risk factor evaluation methods, without being obliged to follow the agencies. Brazil, in a December 2004 communiqué by the Central Bank, has withdrawn the rating agencies mandate and has established a risk assessment method for its financial institutions.

In general, considering the financial crisis of the latest years, the inefficiency of Basel II became clear. The banks are not obliged to disclose the risk assessments of their individual clients and the authorities do not have the competencies that are required to perform an adequate supervision. However, this issue was not reviewed in Basel III, when the minimum capital requirement was increased from 8% to 9%, but the banks' autonomy to measure risks on their own was kept, at least for the large financial conglomerates.

In the beginning of 2012, the Brazilian Central Bank started a public hearing process in order to discuss the application of the guidelines and rules of the latest Basel Accord. The process will begin in January 2013 and shall be concluded by January 2019.

Concerning sustainability, social, environmental and corporate governance issues would be treated indirectly, which means they would be considered simply as variables in the risk factor assessment that determines the minimum capital required. It could be said that the Basel Accords, especially the second and third, have wasted a great opportunity to develop the integration of social and environmental themes in banking and other financial activities.

6.2 The role of the Brazilian Central Bank – actions and perspectives

In several other countries, central banks have already started to act as advocates for the integration of sustainability-related issues in the financial systems of their respective nations, besides taking a regulatory role. An active role of the central bank, as the most important institution of a country's financial system, is one of the strongest ways of incentivizing and consolidating the principles of sustainability. The central bank could contribute, for instance:

- Incentivizing socially and environmentally responsible initiatives by financial institutions, and helping to promote these initiatives;
- Producing guides for the integration of sustainability by financial institutions;
- Promoting events, workshops, debates and lectures about these themes;
- Rewarding best practice;
- Creating tax incentives for banks that adopt products with social and environmental features;
- Elaborating new norms for social and environmental responsibility within the national financial system, making sure the issue is not only a possibility for market differentiation, but also a legal requirement.

In the case of Brazil, after the enactment of regulations by the National Monetary Council, including Resolution 3545, in 2008, which determines that public and private banks that provide rural credit must request documentation about the environmental compliance for their clients in the Amazon region, the Central Bank took the first step towards becoming a key pillar in the incorporation of sustainability into the national financial system, by guiding financial institutions to promote discussion and learning around sustainable development-related questions and their integration across the whole financial system.

In 2010, a specific department was created to manage social and environmental responsibility and financial inclusion issues. By the end of that year, the Brazilian Central Bank and the Brazilian Environment Ministry signed a technical cooperation agreement, which aimed to develop mechanisms to track the social and environmental initiatives undertaken by the signatories of Protocolo Verde (Green Protocol).

Also in 2010, the Social and Environmental Responsibility for the Financial System project was implemented. This project established good practice standards for social and environmental responsibility among the financial institutions regulated by the Central Bank. One of the first activities of the project was the development of a study to establish social and environmental practices within the domestic and international financial systems, in order to identify best practice among those institutions surveyed.

It was only in 2012 when the Central Bank had positioned itself as a regulator of the sustainability integration process into the national financial system, when it published the public hearing call (41/2012) in order to discuss the mandatory implementation of social and environmental responsibility policies by all the financial institutions and other entities supervised by the Central Bank. This measure will also oblige the publicly listed companies to publish sustainability reports.

In short, the proposal determines that financial institutions must have a social and environmental responsibility policy that comprises the following items:

- Social and environmental impacts of products and services;
- Specific products and services for each type of client;
- Client relations;
- Risks and opportunities related to climate change and biodiversity;
- Stakeholder engagement.

Financial institutions are now obliged not only to perform the actions contained in their social and environmental responsibility policy, but also to monitor and evaluate them. If any gap is detected, they should also present a schedule to remedy this.

Another important point that is strongly emphasised in the proposal is the question of social and environmental risk management. The Central Bank's new norm indicates that each institution must have tools to measure these risks, creating a social and environmental responsibility evaluation system for its operations with consistent criteria. Moreover, they must also keep a database of their social and environmental activity in the last five years.

For the Central Bank, each of these companies must establish criteria and impact mitigation mechanisms for the sectors with greater environmental externalities, as well as making a prior evaluation of the social and environmental impacts of new products and services that they intend to include in their portfolios.

Lastly, the norm determines that publicly listed financial institutions must disclose information about their social and environmental responsibility policies internally and externally, as well as a public report on their performance on these issues.

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