Guide to Sustainable Debt in Brazil

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Introduction

Bonds and Credit Granting Operations Labeled by ESG (Environmental, Social and Governance) characteristics finance an economy that is more sustainable and resilient to climate change, given that the funds obtained are directed to projects/assets with social, environmental and/or climate benefits or to companies that commit to implement more sustainable practices.

Estimates of the United Nations Conference on Trade and Development (UNCTAD) indicate that US$ 5 trillion to US$ 7 trillion in investments would be needed[1] between 2015 and 2030, to support projects and activities aimed at meeting the Sustainable Development Goals (SDGs[2]). Only in developing countries[3], this amount varies from US$ 3.3 trillion to US$ 4.5 trillion[4], which illustrates the challenge, but also represents an opportunity scenario for the Brazilian financial system to play a leading role in this agenda.

Given that banks are institutions specialized in intermediating between those who save and those who demand funds, they play an active role in mobilizing capital for a positive social and environmental impact. Specific debt financial instruments can be targeted to generate this impact. The Brazilian Federation of Banks (Febraban), through this Guide and other sector initiatives aimed at disseminating information on sustainable finance, works to strengthen the Sustainable Debt Market in Brazil.

Since the first Green Bond issue in Brazil, in 2015, until December 2022, the Sustainable Debt Market in the country totaled more than R$ 195 billion[5]. In addition to the growth in volume of funds, the market has also diversified, both in terms of the profile of borrowers and types of operations. In 2016, when FEBRABAN published, in partnership with the Brazilian Business Council for Sustainable Development (CEBDS), the Guide for Issuing Green Bonds in Brazil[6], this market only contemplated Green Debt Bonds and which totaled R$ 5.2 billion, in four issues carried out.

1 Content available at: https://news.un.org/pt/story/2015/09/1525211. Accessed in June 2022.

2 Content available at: https://sdgs.un.org/goals. Accessed in June 2022.

3 They are low and middle income countries, according to the classification of the World Bank. Available at: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups. Accessed in February 2023

4 Content available at: https://cebds.org/vem-ai-financa-sustentavel/. Accessed in June 2022.

5 In this report, we chose to use the NINT database https://docs.google.com/spreadsheets/u/1/d/e/2PACX-1vTWJD33KHwRWNc0O3OD3Zt50oJjvrA-X5zcXWO4FLI9-BCKqK3LYoOT04oOcnDgmA/pubhtml?gid=1075 464847&single=true&pli=1), since it is a public reference database (which feeds on other databases – public and private). It was considered the data in the month in which this report was finalized. Note that there may be divergences between the results of other existing sources."

6 Content available at: https://cmsarquivos.Febraban.org.br/Arquivos/documentos/PDF/Guia_emissa%CC%83o_ti%CC%81tulos_verdes_PORT.pdf. Accessed in May 2022.

Currently, the market also has the so-called Social, Sustainable, Sustainability-Linked and Transition Bonds. Furthermore, as of 2019, in addition to Bonds, bank credit operations have also received these labels.

In this way, the Sustainable Debt Market is understood to be the set of operations, also called Labeled Operations with ESG characteristics or, as we will discuss in this guide, **ESG Labeled Operations:**

i. **Green, Social, Sustainable, Transition or Sustainability-Linked Bonds** (the latter also called ESG Performance), that follow voluntary market benchmarks[7];

ii. **Green, Social, Sustainable, Transitional or Sustainability-Linked Loans** (ESG Performance), which follow voluntary market benchmarks.[8]

The role of financial institutions in the Sustainable Debt Market in Brazil has been growing. If at the beginning, their role was limited to coordinating the issue of Labeled Bonds, today they are also responsible for issuing and granting Loans and Financing of this type.

Since the first issue by a private Brazilian bank – Banco BV, in 2020, through a Bond – financial institutions have raised more than R$ 24 billion through Labeled Operations, up to December 2022. These funds have been directed towards its clients, ensuring that capital is allocated to activities that bring benefits from an environmental, social or climate point of view, in a transparent manner and in line with the best market practices. In the first semester of 2022, Labeled Bonds raised by banks, accounted for more than a third of total Labeled Operations in Brazil.

The Guide to Issuing Green Bonds in Brazil[9] ("Guia Para Emissão De Títulos Verdes No Brasil" – CEBDS and FEBRABAN, 2016) has been a reference for market participants for the structuring of Green Bond Operations, along with international guidelines. Furthermore, the Guide also served as a relevant source of information and concepts, as at the time of its publication the market was incipient in the country.

7 Voluntary benchmarks are frameworks with guidelines established by market associations that are not mandatory to be followed, but are used as best market practices.

8 In this Guide, the term "Loans" is used to refer to "Financing and Loans", based on the understanding that "financing" is a type of loan in which the structure of the operation provides that the fund is used to acquire defined goods or services.

9 Content available at: https://cmsarquivos.febraban.org.br/Arquivos/documentos/PDF/2016_Guidelines%20for%20Issuing%20Green%20Bonds%20in%20Brazil_ING.pdf. Accessed in August 2022.

From then on, it is possible to mention some milestones that point to the revolution that occurred in the Sustainable Debt theme, described in Figure 1. In June 2020, Decree 10,387/20 defined a simpler and faster process for issuing debentures for infrastructure projects, with relevant environmental and social contributions, including tax incentives, considering these priority projects. In the same year, the International Capital Market Association (ICMA) published the Sustainability-Linked Bond Principles (SLBP). In February 2021, the LMA (Loan Market Association) published the updated version of the Green Loan Principles (GLP), originally published in 2018. In June 2021, ICMA published the updated editions of the Green Bonds Principles (GBP), Social Bonds Principles (SBP) and Sustainability Bond Guidelines (SBG), whose initial versions were released from 2014 onwards.

Figure 1 – Milestones in the theme of sustainable debt until 2022.

2020
- Publication of Decree 10387/20, in Brazil

2021
- Brazilian sustainable debt market reaches R$ 100 billion
- Launch of the Green Bond Transparency Platform (GBTP) by the IDB

2014
Publication of the initial version of the Green Bond Principles (GBP) by ICMA

2016
Publication of the "Guide for Issuing Green Bonds in Brazil" by Febraban

2017
Publication of the first version of the Social Bond Principles (SBP) and Sustainability Bond Guidelines (SBG) by ICMA

2018
Publication of the first version of the Green Loan Principles (GLP), by LMA

2019
Publication of Sustainability-Linked Loan Principles (SLLP) by LMA

2020
Sustainability-Linked Bond Principles (SLBP) published by ICMA

2021
- Publication of the updated version of the Green Bond Principles (GBP), Social Bond Principles (SBP) and Sustainability Bond Guidelines (SBG), by ICMA
- Publication of the Green Loan Principles (GLP) and the first version of the Social Loan Principles (SLP), by the LMA

2022
- Publication of Guidelines for Blue Finance by IFC

2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022

2015
First Brazilian issue of a Green Bond, by BRF

2018
First Brazilian issue of a Social Bond, by Vivenda

2019
First Brazilian issue of a Transition Bond, by Marfrig

2019
First Sustainability-linked loan by Alunorte

2020
First Green Loan in Brazil, by CBA

2020
First credit Sustainability-linked Bond by FS Bioenergia, in the capital market by Boticário and a Sustainable Bond, by Iguá Sanitation

2021
First Sustainable Loan in Brazil, by Banco do Brasil

2022
First Brazilian issue of a Blue Bond by BRK Ambiental

Source: Developed by NINT.

Introduction

With a view to improving the ESG Labeled Operations Market in the country, Febraban launches this **Sustainable Debt Guide in Brazil**, contemplating different available instruments, types of operation and the current market context. In this sense, three elements were highlighted for the elaboration of this publication:

i. **Role of Labeled Operations in promoting the ESG agenda:** they are used to finance sustainable assets and projects and/or adoption of sustainable practices by companies.

ii. **Opportunities and challenges associated with the growth of the Sustainable Debt Market:** requires consistency, transparency and adoption of best practices to prevent greenwashing[10]. The market should continue to grow, but without compromising quality.

iii. **Need to reinforce voluntary guidelines:** although there is no specific regulation regarding the aspects to be followed for a debt operation to be labeled, the market recognizes that its participants must follow the voluntary guidelines defined by ICMA and LMA.

The purpose of the Febraban's Sustainable Debt Guide is to disseminate concepts and key aspects of this market to: (i) accelerate the mobilization of capital for sustainable activities and (ii) contribute to the integrity of the market, promoting the adoption of best practices. The material, however, is not intended to be prescriptive as to the practices to be followed.

Febraban recommends that this Guide is considered together with other benchmarks from the national and international market, produced by associations and representative entities, when in line with the international guidelines of ICMA and LMA.

10 Greenwashing refers to the practice of falsely promoting an organization's environmental efforts or spending more funds to promote the organization as "green" than to actually engage in environmentally sound practices. Thus, greenwashing is the dissemination of false or misleading information about an organization's strategies, objectives, motivations and environmental actions. Adapted from Encyclopedia of Corporate Social Responsibility. Available at: https://link.springer.com/referenceworkentry/10.1007/978-3-642-28036-8_104 Accessed in February 2023.

2. Understanding sustainable debt instruments

2.1 Context

Sustainable Finance encompasses different types of banking and Capital Market products, such as Fixed-Income Securities, Investment Funds, among others, which may vary according to the use and purpose of using the funds.

The use of such instruments has been increasing. The publication "O Mercado de Finanças Sustentáveis no Brasil em 2022" (The Sustainable Finance Market in Brazil in 2022)[11] (GIZ and Green and Sustainable Finance Project – FiBraS, 2022), suggests that the growth of this market can be explained by six factors:

i. Market innovations in order to create and offer sustainable financial products;
ii. Consolidation of market standardization initiatives through recurring publications of principles, such as the GBP and SBP, to be followed for each instrument;
iii. Development of legislation favorable to the ESG agenda in different parts of the world, resulting from sustainable finance strategies and commitments made by governments and companies;
iv. Pressure from stakeholders and multiplication of corporate commitments, such as those to neutralize Greenhouse Gas (GHG) emissions, known as Net Zero;
v. Demand greater than supply, on the part of large institutional investors, with long-term vision, for the Labeled Bonds;
vi. Advantages of Labeled Bonds for companies: lower cost of capital, diversification of the investor base, reputational benefits, among others.

It can be said that such factors contribute to the leading role of **ESG Labeled Operations**, whether in the Credit Market (Loans) or in the Capital Market (Bonds).

Several instruments associated with Loans and/or Bonds can be labeled. Examples include Project Finance, Corporate Credit, Agribusiness Receivables Certificates (CRA), Real Estate Receivables Certificates (CRI), Debentures (including Infrastructure Incentivized Debentures), Financial Bills, Promissory Notes, among others.

11 Content available at: FiBraS-Mercado-FinSustentaveis_2022.pdf (labinovacaofinanceira.com). Accessed in May 2022.

The only requirement is that such operations follow the framework of the financial product and its ESG formatting, in addition to the agreed standards agreed by the market as fundamental to ensure that the operation has characteristics that guarantee the adequate generation and management of a positive social and/or environmental impact (also called "social and environmental additionality"[12]).

2.2 Modalities and labels

ESG Labeled Operations have two modalities regarding fund allocation possibilities:

1. **Use of Proceeds:** funds are allocated to specific projects, assets and/or investments that bring environmental and/or social benefits. In this case, the labels are related to the allocation of funds. Currently, these operations receive 4 possible labels (or classifications), according to the form of impact:
    - **Green Operations:** aimed at financing projects with an environmental contribution and whose guidelines are in the Green Bond Principles (published by ICMA) and Green Loan Principles (LMA).
    - **Social Operations:** aimed at financing projects with social contribution and whose guidelines are in the Social Bond Principles (published by ICMA) and Social Loan Principles (LMA).
    - **Sustainable Operations:** directed to finance projects that have environmental and social contribution simultaneously. It is also possible to finance a set of projects that contemplate environmental and social contributions separately. The guidelines must follow both benchmarks mentioned above, and for Bonds, there is also the Sustainability Bond Guidelines (ICMA) reference.
    - **Transition Operations:** aimed at financing projects that mitigate negative impacts typically on the climate, and are normally carried out by borrowers from sectors that, due to the nature of the activities, generate negative environmental/climate

12 Additionality refers to the positive impact generated by that asset or project that would not be generated if that asset or project did not exist.

impacts, but that are committed to the transition to more sustainable models. For these operations, there are no guidelines published by ICMA or LMA similar to those mentioned above.

2. **Sustainability-linked:** use funds flexibly and include variations in financial or structural conditions (e.g. in the interest rate), linked to the achievement (or not) of predefined target(s) in a given time frame, in relation to the borrower's ESG performance. The targets are linked to Key Performance Indicators (KPIs), which can be environmental and/or social in nature. In this sense, it is a single label: Operations Linked to ESG Targets, to which the Sustainability-Linked Bond Principles (SLBP) and Sustainability-Linked Loan Principles (SLLP) guidelines apply.

These two types of operations share some fundamental characteristics, despite having specific ones for each of the modalities.

Table 1 – Comparison between operations with Use of Proceeds and Linked to ESG Targets

	Types of ESG Labeled Operations	
	Use of Proceeds	**Linked to ESG Targets (Performance)**
Use of the resources	Exclusively intended for projects, assets and/or investments with a positive and pre-defined social and/ or environmental impact.	General corporate use. Issuers are free to use the funds as they intend, including to refinance other debts.
Labels with international principles of ICMA and LMA	**Three possible labels,** depending on the theme: – Green – Social – Sustainable	There is **only one theme**: ESG Performance. However, the goals can be linked to environmental issues, social issues or a combination of the two.
	NOTE: there is also the label of "Transition Operations", used in Operations of Use of Proceeds and Linked to Goals, however, without international standardization.	
Changes in the conditions of financial operations for the borrower	**Greater attraction of capital for specific projects, assets and/ or investments** with social and environmental additionality. Rate advantages may or may not be obtained, depending on the demand for the Security.	**Changes in the conditions of financial operations based on the improvement of ESG performance and better impacts** on society and/or the environment. Rate adjustments or other financial characteristics (such as term, required guarantees and frequency of payment of installments) is due to the achievement of social and/or environmental targets.
Benefit to borrower's ESG Strategy	Fundraising to **enable specific projects** that are part of the ESG strategy.	**Signal investors the company's commitment** to its ESG strategy.
Operation complexity	**Less complexity (on average)** Ease for companies that do not yet have a robust ESG agenda, with defined targets. Categorization of projects, assets and/or investments based on categories previously defined by ICMA and LMA.	**Greater complexity (on average)** Borrowers must have an ESG strategy capable of achieving well-defined targets. Operations must be structured and customized, which requires careful analysis of indicators and targets, for which there is no prior definition, as it depends on the context of each company.
Time and funds required for structuring	**On average, it takes less time and funds to structure the transaction and obtain** an independent valuation opinion.	**On average, it takes more time and funds to structure the transaction and obtain** an independent valuation opinion.
Sectorial Profile	Any sector, at first, can carry out a performance issue.	Any sector, at first, can carry out a performance issue.
Goals and Targets	Goals related to project/asset impacts, but no targets.	**Indicators and targets are necessary,** and they affect the financial and structural characteristics of the operation.

2.3 Definitions

A. Guidelines

As mentioned in section 2.1, the International Capital Market Association (ICMA) and the Loan Market Association (LMA) present guidelines that make up the most used standards in the Sustainable Debt Market.

In Use of Proceeds – whether Loans or Bonds – the borrower or issuer follows four main pillars in its structuring:

- Use of the Resources
- Process for Evaluation and Selection of Projects
- Asset Management
- Reporting

In Sustainability-linked operations – whether Loans or Bonds – there are five usual pillars:

- Selection of Key Performance Indicators (KPIs)
- Calibration of Performance Targets (Sustainability Performance Targets – SPTs)
- Characteristics of financial instrument
- Reporting
- Verification

These pillars are covered in more detail in Chapters 5 and 6.

Even though they are pillars intended to be implemented by borrowers (borrowers in Loans or issuers of Bonds), it is important that the others involved in the operations contribute to the adoption of these good practices. In Chapter 4, guidelines are presented on how banks can contribute, according to the role played in the operation.

It is recommended that the borrower's commitment to follow the ICMA and LMA pillars be added to the documentation that formalizes the operation, which is typically already done, either in the credit agreement (in the case of a Loan) or in the documentation of the offering (in the case of a Bond).

B. Sustainable Finance Framework

The Sustainable Finance Framework is a document in which the borrower explains and details the alignment of the Labeled Operation with the best market practices. The structure of the Framework, as shown in the table below, must follow, therefore, the pillars of the ICMA (when directed to Bonds) and/or the LMA (when directed to Loans), according to the modality and label that the borrower intends to include.

This Framework can be:

- At the operation level: developed for a specific operation, therefore being used only once; or
- Corporate, as a policy: designed as an umbrella framework for future sustainable debt fundraising operations. That is, borrowers define in advance the practices that they will follow for any future Labeled Operations.

The Sustainable Finance Framework may be known by alternative names, depending on its scope. For example, when only targeted to Green Bonds, it may be referred to as the Green Bond Framework.

Table 2 – Characteristics of the Sustainable Finance Framework

Sustainable Finance Framework		
	In terms of the operation:	**Corporate:**
Purpose	Provide transparency about the alignment of the operation with the ICMA and/or LMA principles, according to the type of operation. It is recommended that the borrower also includes relevant information in the context of its sustainable finance strategy.	Provide transparency about the alignment of the operations program with the ICMA and/or LMA principles, according to the type of operation. It is recommended that the borrower also includes relevant information in the context of its sustainable finance strategy.
Typical structure:	**For Use of Proceeds:** 1. Use of the resources; 2. Project evaluation and selection process; 3. Reports; 4. Asset management. **For Operations Linked to ESG Targets:** 1. Selection of indicators (KPIs); 2. Target calibration[13]; 3. Characteristics; 4. Report; 5. Verification. In Chapters 5 and 6 the nine mentioned structures are described. NOTE: The framework can also mention alignment to other international benchmarks, if applicable, such as the Climate Bonds Standards and the Sustainable Development Goals (SDGs).	
Usage	**In a single fundraising**	**In all fundraisings under the umbrella of the framework**
Person in charge of the preparation	**Borrower, who may have the support of may have the support of banks, specialized consultancies and other agents.**	

13 The issuer that opts for an umbrella Framework in Sustainability-linked operations must pay attention to the robustness of the targets at the time of each issue. Target recalibration should occur with new issue or if the SFF has been published for a relevant time. There is no set maximum time. The relevance of this time must be evaluated by the issuer.

C. Independent Evaluation

It is recommended that the characteristics of Labeled Operations is verified by a specialized and independent entity, since the Independent Evaluation Report guarantees alignment with good market practices.

In Brazil, the most common types of independent valuation are the Second Opinion (applicable to both Use of Proceeds and those Linked to ESG Targets and used to assess compliance with the issue characteristics) and Verification (more common for Sustainability-linked Operations, and used to audit the baseline of the indicators and verify the fulfillment of the ESG Targets according to concepts presented in Chapter 6).

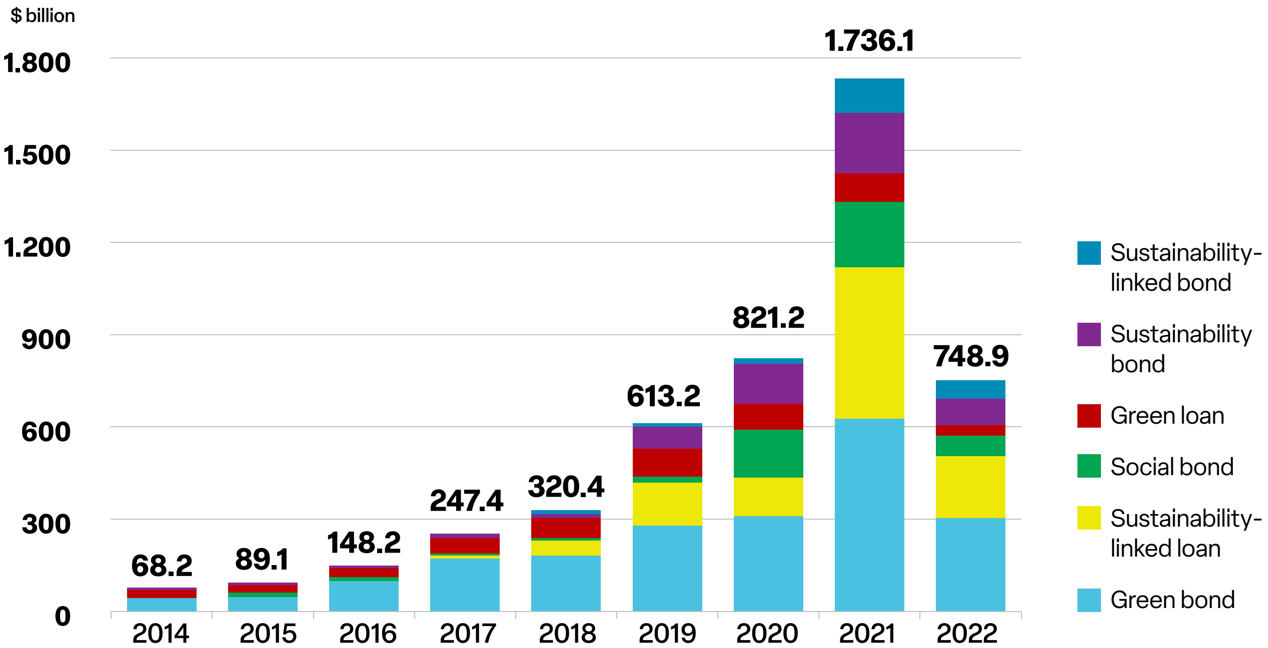
If the borrower has a Sustainable Finance Framework, an independent valuation of the Framework can also be carried out, in order to ensure that future operations are in line with the pillars of the ICMA and/or LMA.

3. Knowing the market

3.1 Global outlook

Market estimates indicate that the volume of global Sustainable Debt reached an accumulated value of US$ 4.8 trillion by the first semester of 2022. Although the growth in 2021 of Labeled Operations exceeded US$ 1.6 trillion, double compared to the previous year, for 2022 the expectation is for a slowdown, with estimates that point to a total issue of US$ 1.5 trillion[14] in the year. The first semester of 2021, for example, ended with US$ 900 billion of Sustainable Debt issued, while the first semester of 2022 reached almost US$ 750 billion. The main causes pointed out are the market's concern in relation to greenwashing, and thus the greater scrutiny for these operations, and the world macroeconomic outlook of high interest rates and geopolitical scenario.[15]

Figure 2 – Evolution in the global volume of Labeled Bonds and Loans, in billions of dollars (2013 – 1st semester of 2022).



Source: Sustainable Debt Issuance Dips as Scrutiny Increases (BloombergNEF, Bloomberg LP)

14 Content available at: https://www.bloomberg.com/news/articles/2022-12-15/sustainable-debt-esg-markets-turn-frosty-in-2022?leadSource=uverify%20wall. Accessed in March 2023

15 Content available at: https://about.bnef.com/blog/sustainable-debt-issuance-dips-as-scrutiny-increases/. Accessed in March 2023.

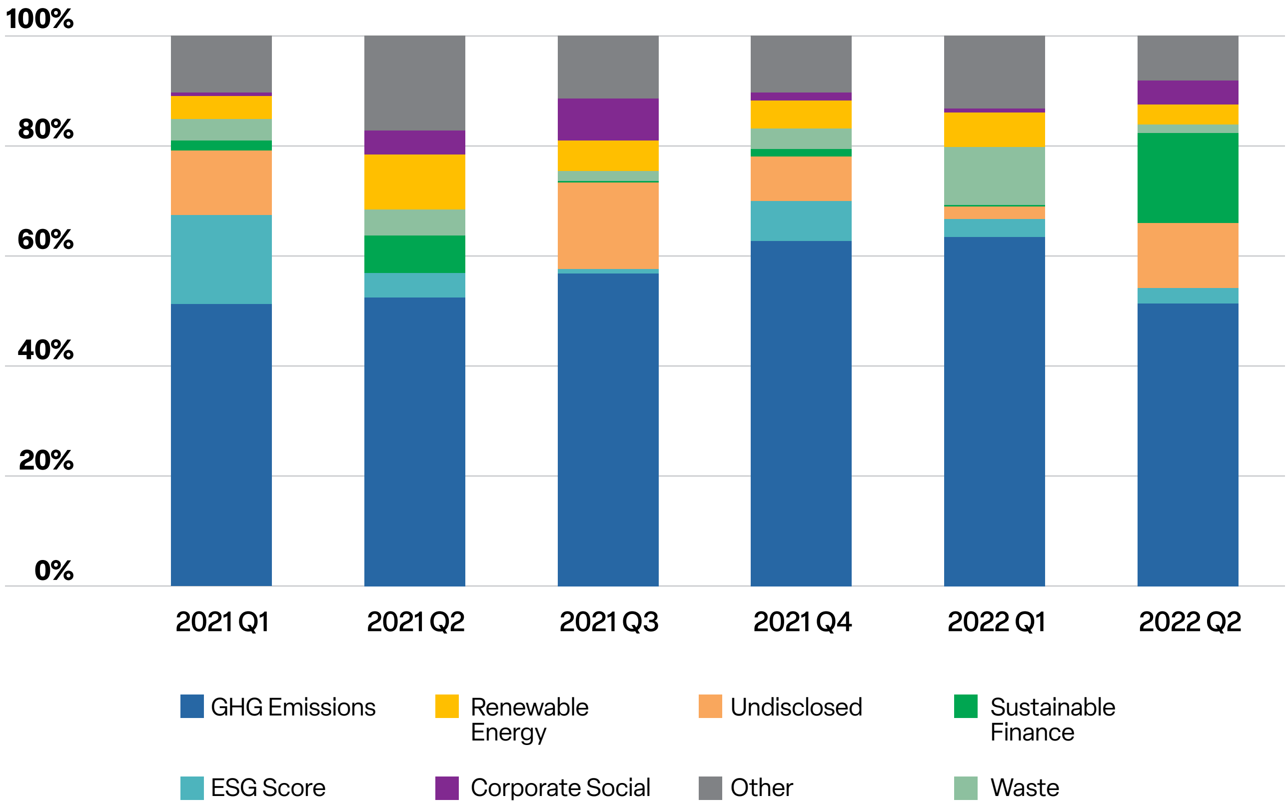
There is a strong concentration of Green Bond issues. Considering the volume issued from January 2022 to the third quarter of this year, Green Bonds had more relevant weight when compared to other labels, reaching US$ 332.4 billion, 52% of the total for the period. Together, Sustainable and Social Bonds had a share of US$ 236 billion (37%), with a greater share of Sustainable Bonds, representing 22%, while Social Bonds had a share of 15%. The Sustainability-Linked Bonds, despite presenting advantages such as flexibility in the use of funds, reached US$ 63.5 billion, around 10% of the total. The main issuing organizations for these operations are supra-national organizations, such as the World Bank, followed by entities in the U.S., France, China and other countries in Europe.

Lastly, Transition Operations still have an incipient share, reaching a value of US$ 3.4 billion in the period, and have mainly taken place in Asian and European countries. This reflects the lack of a set of robust standards to be adopted by the industry for transition instruments, which leads to a potential risk of greenwashing, at the same time that several sectors, including the most polluting ones, have been directly using Sustainability-linked operations, as there is no need to allocate resources to specific projects.

Specifically on the Sustainability-linked Bonds achieved, it can be noted that, of the volume of US$ 46 billion issued by mid-2022, 58% of this had targets linked to GHG emissions, representing an increase compared to 2021. Another important factor is that there is a gradual increase in targets related to GHG emissions that encompass the three scopes of emissions, scopes 1, 2 and 3[16]. This indicates the growing concern of companies to reduce their carbon emissions in response to increasing pressure from stakeholders such as investors, governments, and civil society.

16 Scope 1, Scope 2 and Scope 3 Emissions: “Scope 1” indicates direct greenhouse gas (GHG) emissions from sources owned or controlled by the reporting entity. “Scope 2” indicates indirect GHG emissions associated with the production of electricity, heat or steam purchased by the reporting entity. “Scope 3” denotes all other indirect emissions, i.e. emissions associated with the extraction and production of purchased materials, fuels and services, including transportation in vehicles not owned or controlled by the reporting entity, outsourced activities, waste disposal, etc. Available in: https://www.ipcc.ch/site/assets/uploads/2018/02/ipcc_wg3_ar5_annex-i.pdf . Accessed in March 2023.

Figure 3 – Global distribution of themes of Sustainability-linked Bonds, in % of financial volume (2021 – 1st semester of 2022).



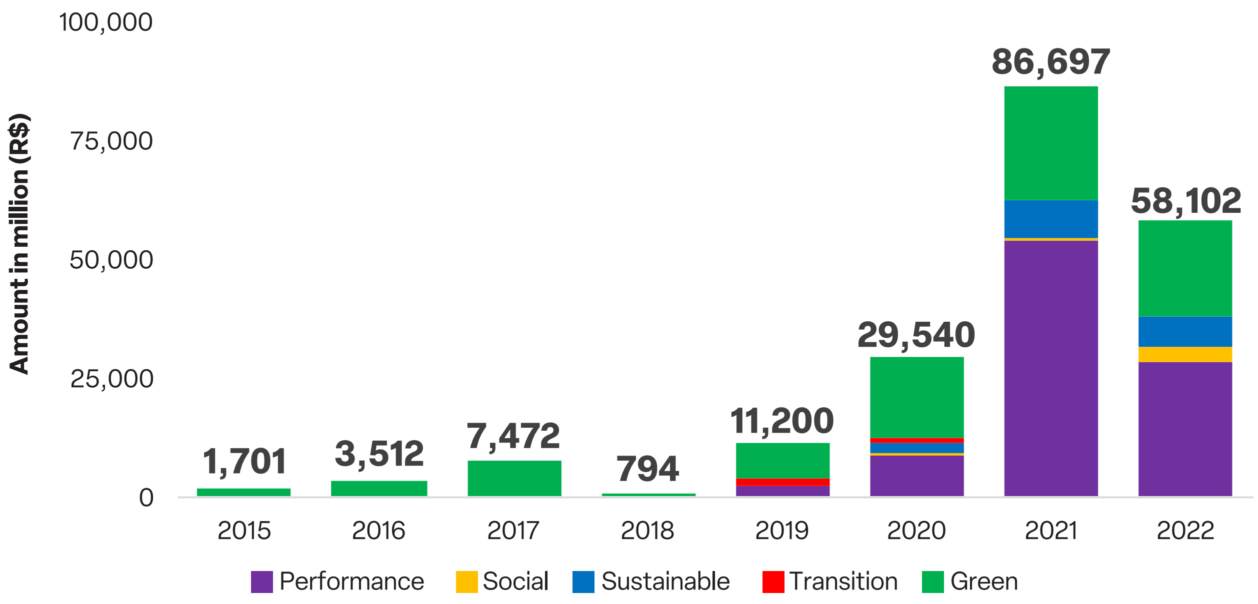
Source: Sustainable Debt Market Summary H1 2022 (CBI)

These operations considered ideal for borrowers and who are looking for funding to improve their ESG performance, have also been frequently used by sectors prone to issuing Use of Proceeds, either for corporate purposes or to refinance existing debt.

3.2 Brazilian outlook

The period between 2019 and 2022 was marked by a significant evolution of Labeled Operations in Brazil, with emphasis on the year 2021. In addition to the growth in volume, there was also the diversification of the labels of the operations, which were initially predominantly Green, and gradually also began to cover other themes. The most significant growth was in Performance Operations ("Sustainability-linked"), following the international trend: in 2021 they reached 62% of the total, in volume.

Figure 4 – National evolution of the volume of Labeled Operations (Bonds and Loans), by topic, in R$ million.



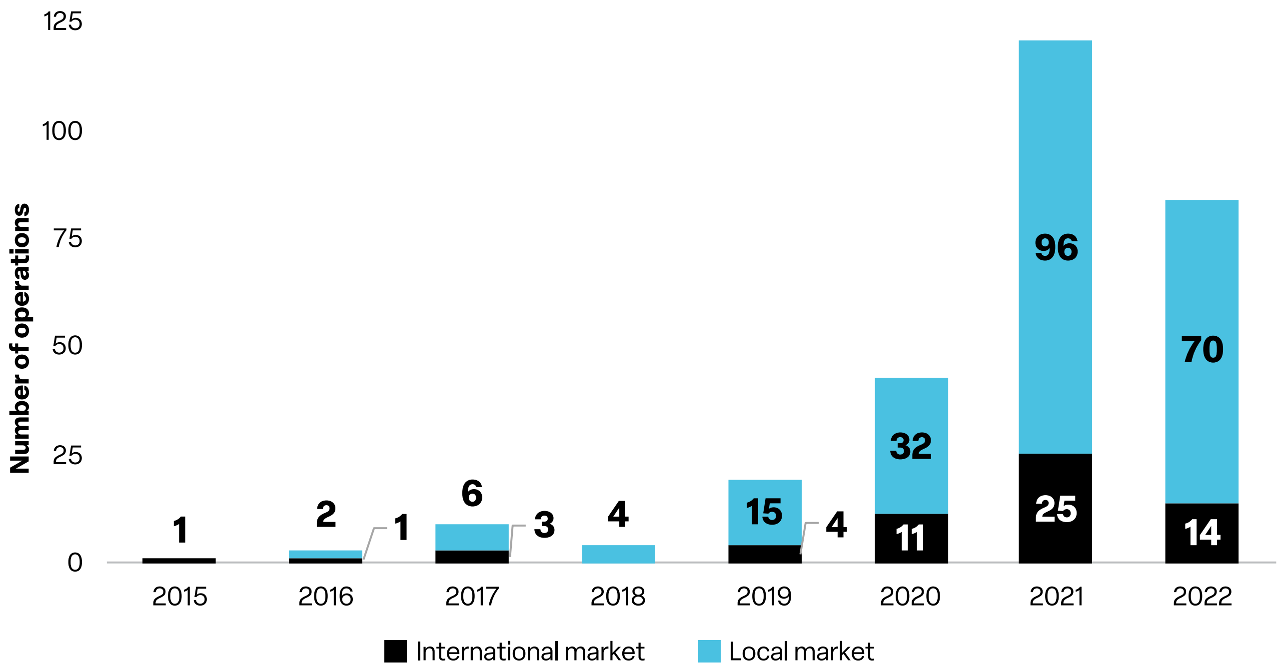
Source: NINT database.

The number of Use of Proceeds and Performance Operations issued in the international market during the entire period was practically the same, 29 and 30 respectively, however with a strong acceleration of Performance Operations in 2021, given their more recent "popularization".

This acceleration pattern also occurred in the local market, with 37 Performance Operations in the period, but with emissions concentrated from 2021. Use of Proceeds reached around 192 operations during the entire period. Performance Operations showed acceleration precisely because of their characteristics that allow them to cover more sectors and give more freedom in the use of funds raised, as will be discussed in the next sections.

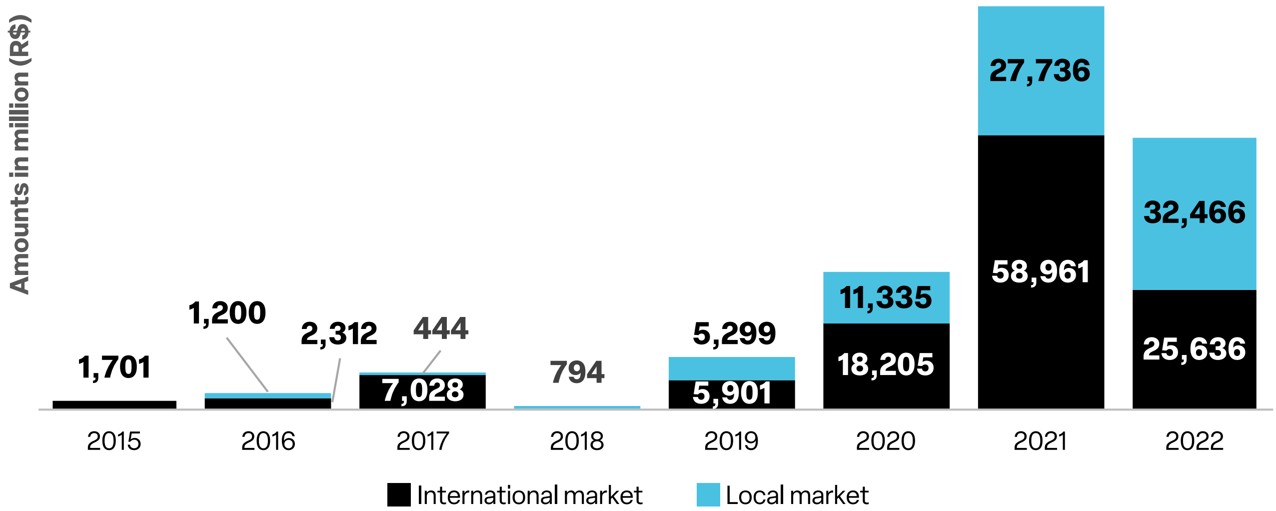
Most of these Labeled Operations occurred at the local level (Figure 5). However, in financial terms, 60% of the volume of Brazilian operations took place via the international market (Figure 6). This behavior reinforces the appetite of international investors for Labeled Operations.

Figure 5 – National distribution of Labeled Operations (Bonds and Loans).



Source: NINT database.

Figure 6 – National distribution of the financial volume of Labeled Operations (Bonds and Loans).



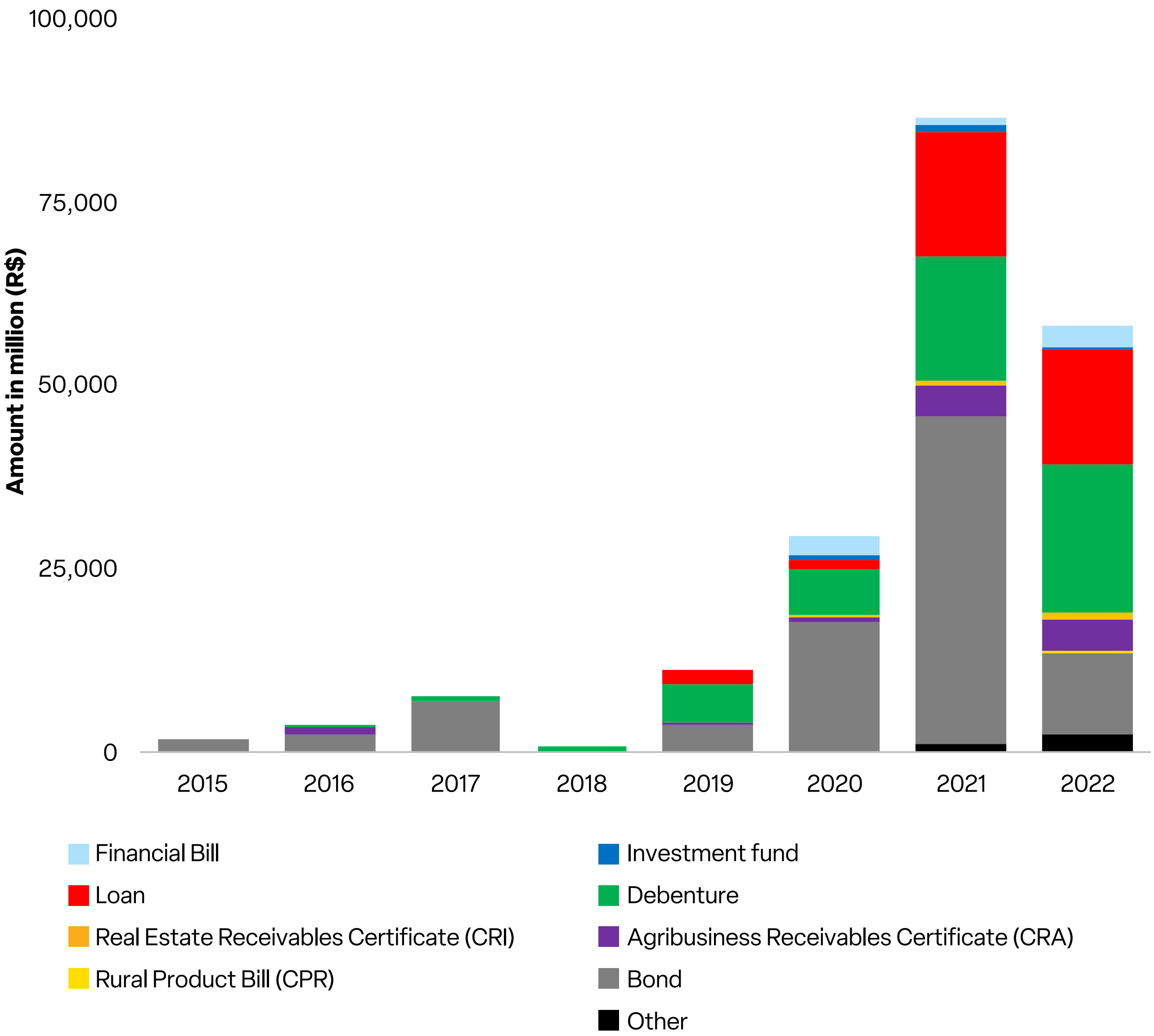
Source: NINT database.

Labeled Operations may use different financial instruments (Figure 7), however there is a predominance of international Bond issuance volume, followed by Debentures and Loans operations (Figure 7). Bonds accounted for 45% of the financial instruments issued since 2015. This volume can be explained by the issue of Bonds by larger companies in the international market and because they are made in currencies more valued than the Real, such as the Dollar.

Debentures also had a relevant share, reaching 25% of operations in the country (Figure 8). The financial volume of the Debentures reached R$ 16 billion in 2021 and more than R$ 20 billion in 2022.

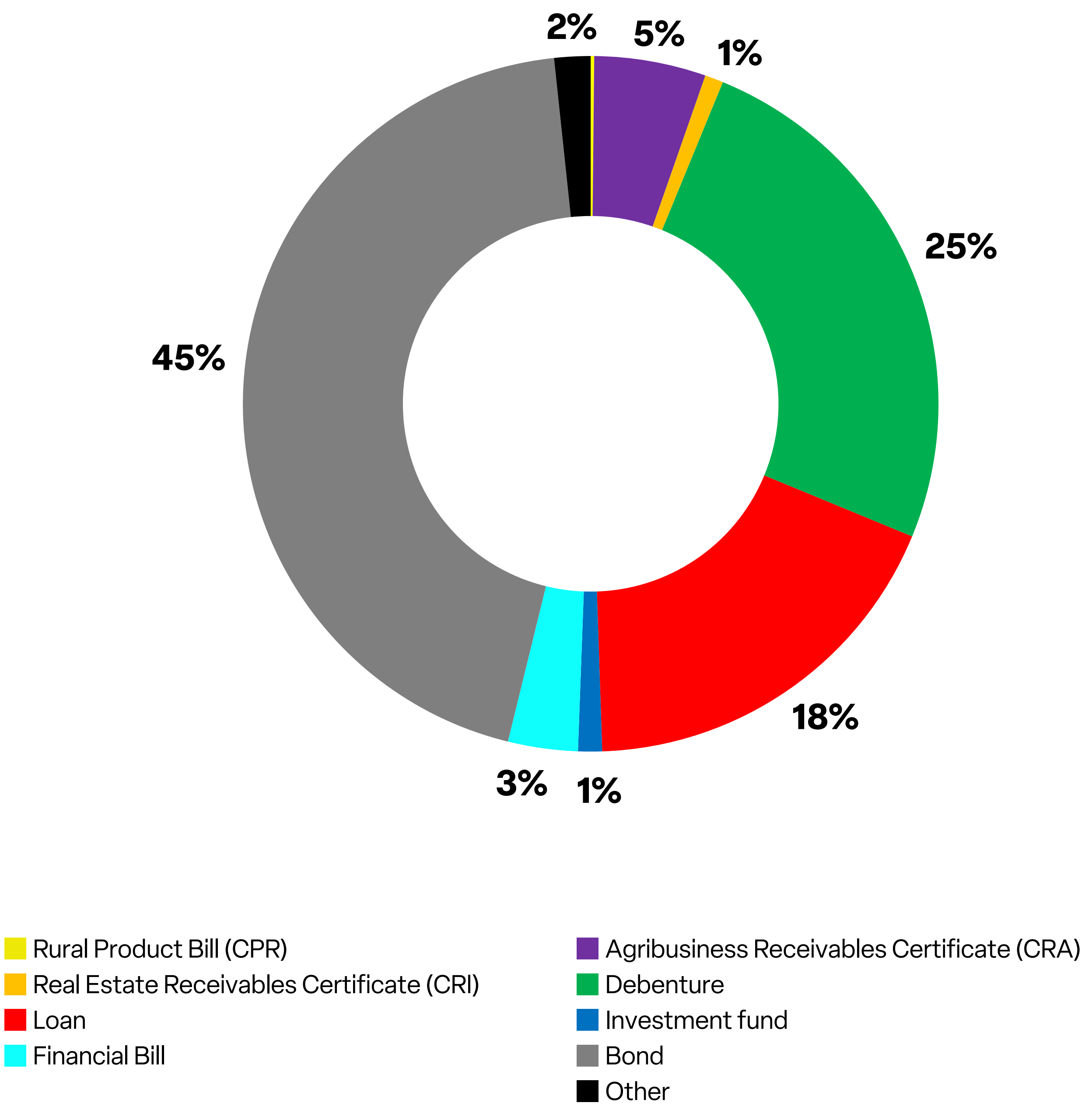
Loans, in turn, reached a lower value when compared to Debentures, but showed strong growth, from R$ 1.5 billion to R$ 15.7 billion, between 2020 and 2022.

Figure 7 – National evolution of the volume of Labeled Operations (Bonds and Loans), by financial instrument, in R$ million



Source: NINT database.

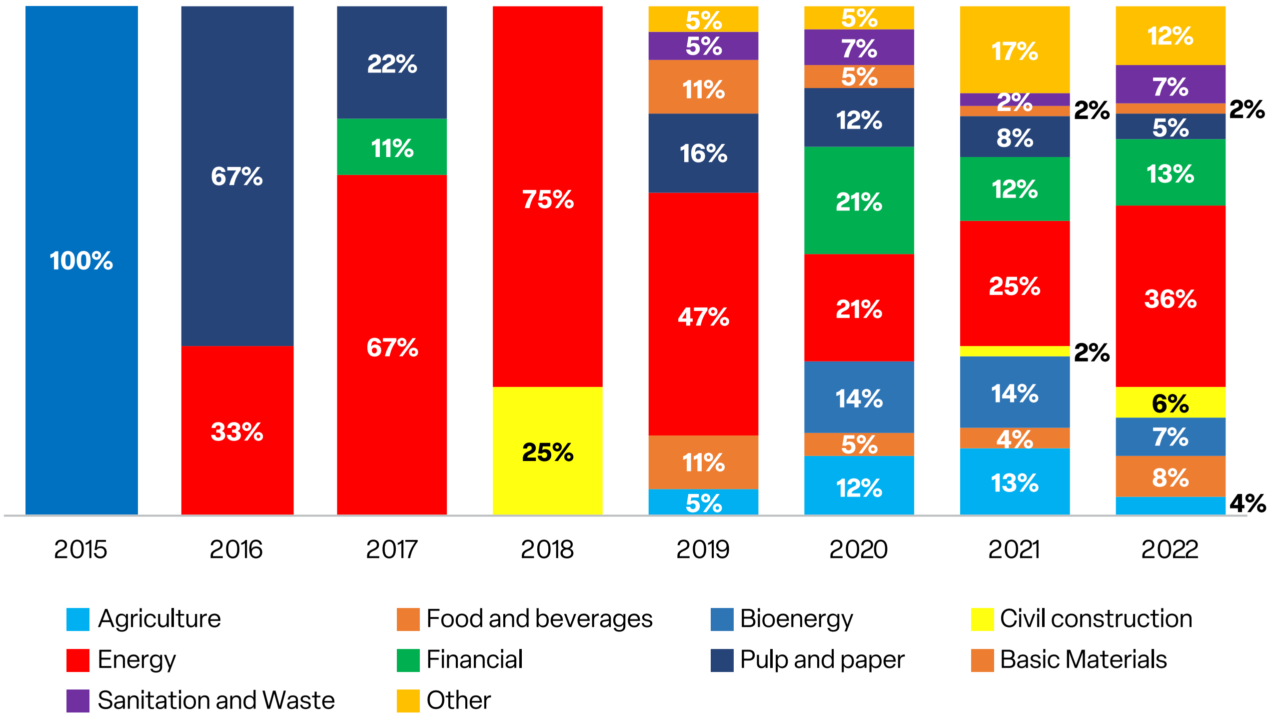
Figure 8 – Percentage share of the financial instrument in the total historical volume of national Labeled Operations (2015-2022).



Source: NINT database.

When analyzing from a sectorial perspective, there has also been, in recent years, diversification in the Sustainable Debt Market (Figure 9). The sectors with the most Labeled Operations were: Energy, Finance, Bioenergy, Pulp and Paper and Agriculture.

Figure 9 – National evolution of the percentage share of sectors in Labeled Operations.

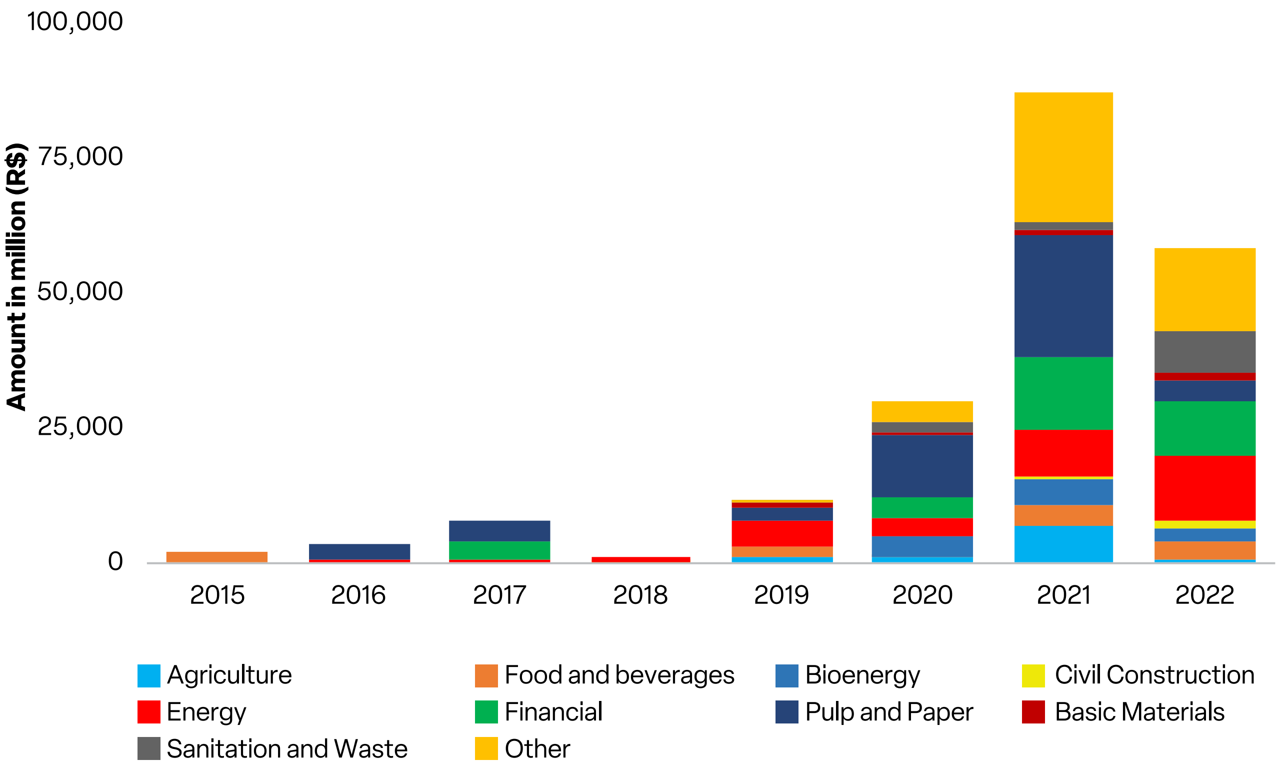


Source: NINT database.

In financial volume, the Pulp and Paper sector leads with 24% of Labeled Operations, followed by the Financial and Energy sector, as shown in Figure 10. This relevant share of Pulp and Paper is the result of the actions of some large companies in the sector that are more mature in terms of sustainability and for being able to issue debt internationally, that is, in another currency.

Moreover, the relevant share of the Financial Sector is an indication of its ability to act through financing in various sectors with positive impacts on the economy. And finally, the relevant share of the Energy sector can be explained by the availability of sustainable projects, such as solar and wind energy.

Figure 10 – National evolution of the volume of Labeled Operations (Bonds and Loans), by sector, in R$ million.



Source: NINT database.

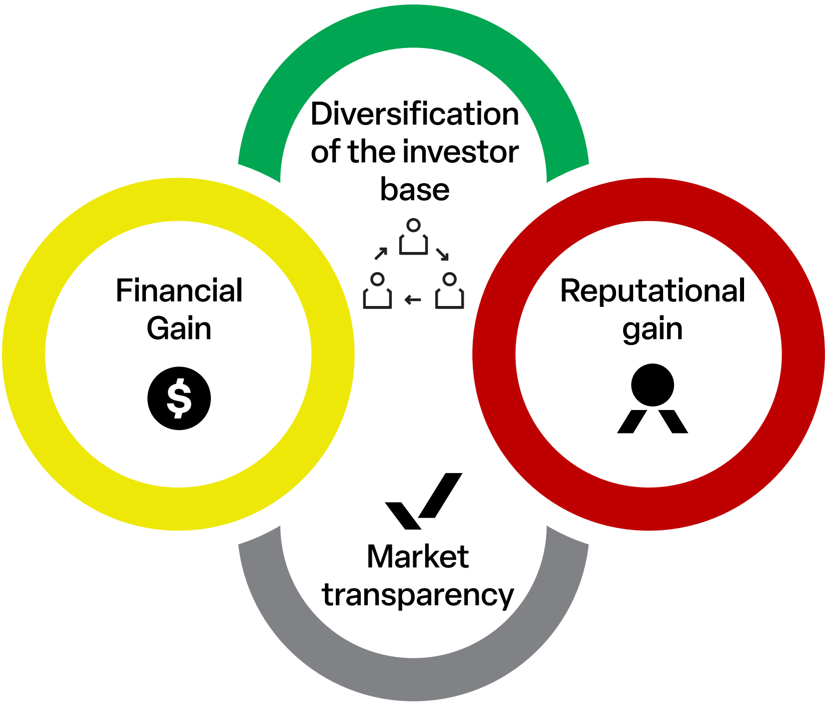
The representativeness of the financial sector, with 17% of Labeled Operations in 2022, including banks, fintechs, credit unions and insurance companies, both in terms of the number of Labeled Operations and in financial volume, should follow this dynamic, growing, even with the less expressive results of the Market of Labeled Debt, given the international macroeconomic context and because 2022 was an election year. These factors mainly affect the Bonds Market, whether they are Labeled Operations or not.

Between 2020 and 2022, fundraising of the financial sector through Labeled Operations grew from R$ 4.1 billion to R$ 10 billion, an increase of 143%. This result indicates that the sector has embraced the opportunity to obtain funds in this way, as shown in the examples presented in the next chapter.

3.3 Advantages for borrowers

Based on the experience of borrowers in the national and international market, some benefits were observed, which can be categorized into four types of comparative advantages in relation to an operation without an ESG label:

Figure 11 – Advantages of Labeled Operations



1. **Diversification of the investor base**
   Borrowers of ESG Labeled Operations can expand their investor base by accessing those with specific sustainability mandates, especially in view of the growth of ESG Funds or Sustainable Investments. For these investors, the existence of assets or projects with an ESG Label reduces efforts to assess the ESG characteristics of the operation and brings greater credibility.
2. **Market transparency**
   The main guidelines used in structuring Labeled Operations require periodic monitoring and reporting of the use of the funds and impacts obtained. Thus, in addition to greater

control over these operations, which can mitigate risks, there is greater transparency and availability of information to the market. Therefore, borrowers who seek to increase the transparency of their activities can also benefit from using these ESG Labeled Instruments.

3. **Reputational gain**
   Labeled Operations generate greater visibility for a project or company by differentiating them from conventional operations due to their positive social and environmental contribution (positive externalities), also serving as an instrument of institutional positioning with investors, customers and other stakeholders. Moreover, especially in the case of Sustainability-Linked Operations, these may signal a greater degree of commitment by the borrower to the ESG agenda, since it links its funding strategy to the achievement of targets of this nature.
4. **Financial Gain**
   Despite being incipient, international experiences have shown some differentiation in the pricing of securities[17]. One of the main empirical evidences is the so-called “Greenium” effect (that is, obtaining a premium price from the green characteristic) or Sustainability Premium for Bonds, which occurs when the interest rate obtained in the transaction of the Bond is lower than that obtained in conventional operations with similar characteristics, but without the ESG label. One of the reasons for this result is the greater demand for Labeled Operations in relation to supply, in specific market classes, as in cases of greater investor appetite for these types of instruments, favorable credit rating of issuing companies and low interest rate. However, specifically for funding in the Brazilian market, there is still no robust evidence to indicate the Greenium effect. In the case of Sustainability-linked operations, whether Bonds or Loans, the potential financial differential can be verified more directly, since the variation in the interest rate (or other financial and structural conditions) agreed in the operation can reward and/or penalize the borrower according to its ESG performance.

17 Content available at: https://www.climatebonds.net/files/reports/cbi_pricing_h1_2021_03b.pdf. Accessed in April 2022.

Study published in January 2022, in the Social Science Research Network (SSRN) entitled "Who Pays for Sustainability?"[18], showed that there is a yield differential of 29 bps[19], on average, between issues of Sustainability-Linked and Conventional Bonds. Issuers of Labeled Operations benefit from a lower cost of capital, while investors bear the burden of advancing social and environmental issues.

18 Content available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4007629 Accessed in February 2023.

19 BPS or Basis Points is used to present changes smaller than 1% in percentage points of the rates of indicators and financial assets.

4. What is the role of banks?

4.1 Possible ways to participate

As mobilizers and intermediaries of funds, banks play an important role in the growth and consolidation of the Sustainable Debt Market. They operate mainly through three roles:

i. Service provider/facilitator: offer of financial services to support customers' Labeled Debt Operations:
   - Structuring of Labeled Bonds – typically performed by banks that carry out activities such as investment banking; or
   - Advice on adapting to ESG requirements – whether in Bonds that go on the market or in Labeled Loans, in which the bank itself is also the financier.

ii. Lender: financing to companies through Labeled Operations, which may be:
   - Loans and financing
   - Availability of guarantees and acquisition of Bonds. In Brazil, this occurs especially in Bonds in which a bank, in addition to exercising the structuring function, also provides a firm guarantee to the issuer, that is, it undertakes to subscribe the securities, in case the total amount is not acquired by the market.

iii. Borrower: fundraising through Sustainable Debt, either through the issue of Securities (such as CDBs or Financial Bills) or through Bilateral Loans. The funds raised by the institution are then used to support its credit portfolio, increasing the availability of capital to finance customers and sustainable projects.

Table 3 breaks down the different roles that banks can play, considering the two types of debt that can be labeled: Bonds and Loans.

Table 3 – Performance of banks in Labeled Operations (Bonds and Loans)

		BONDS	LOANS
Types of financial instruments that can be used		– Debenture, Agribusiness Letter of Credit (LCA), Real Estate Letter of Credit (LCI), Bank Deposit Certificate (CDB), Financial Bill (LF), among others	– Project finance, corporate credit, among others
BANKS' PERFORMANCE	[Facilitator] **Rendering of financial services to clients**	– Structuring and placement of Bonds on the market – ESG guidelines for the client to follow good market practices in their fundraising	– Financial structuring of Loans, when necessary – ESG guidelines for the client to follow good market practices in their fundraising
	[Lender] **Credit Granting/ allocation of funds to customers**	– Acquisition of Bonds (typically for firm guarantee operations)	– Credit Granting to its customers
	[Borrower] **Fundraising by banks**	– Issue of Labeled Bonds in the domestic or international Capital Market, to finance a certain sustainable portfolio	– Funding through Labeled Loans with investors, especially international development financial institutions, to finance a certain sustainable portfolio
Recommendation on hiring an independent valuation		– Recommended for all cases	– Recommended whenever possible, especially for larger operations, for cases where the bank advises on ESG issues, and/or for more complex cases from an ESG point of view (e.g.: Sustainability-Linked)

4.2 General guidelines for facilitating banks/service providers or financiers of Sustainable Debt Operations

To ensure the integrity of the Sustainable Debt Market, some good practices are recommended for financial institutions. General guidelines are described below and other specific guidelines, for the different modalities, are presented in the next sections:

Debt restructuring service

The banks provide financial structuring services and issue Labeled Bonds in the market, mainly through their Debt Capital Markets (DCM) areas and/or other Product areas.

The main steps for structuring these Operations are:

1. Identify which clients have projects with social and environmental additionality (for Use of Proceeds) and/or have an ESG strategy aligned with the definition of targets (for Operations Linked to ESG Targets);
2. Introduce the customer to the possibility of carrying out a Labeled Operation and the potential benefits of the modality; and
3. Support the client in applying the principles that guide these operations, including:
    i. Construction of a Sustainable Finance Framework, in which the customer undertakes to follow the standards of the ICMA and/or the LMA. This Framework can be structured for the operation in question or to be applicable to any future Labeled Funding;
    ii. Obtaining an Independent Evaluation Report, when applicable.

As they are Capital Market operations, it is recommended to obtain an independent valuation that certifies that their characteristics are in line with good market practices. The optional hiring of an independent evaluator can be carried out by the issuers themselves, but the bank can support them in this process (for example, participating in discussions with the independent evaluator).

Credit granting

It is the direct way for the bank to allocate funds to its clients' projects, assets or activities. The granting of bank credit, through Labeled Loans, usually follows the following steps:

1. Identify which clients have projects with social and environmental additionality and/or have an ESG strategy capable of defining material targets;
2. Assess whether it is possible to classify operations as labeled, i.e., whether they follow the principles and guidelines of best market practices as defined by the LMA;
3. Structure labeled operations with customers and support obtaining an independent opinion, when applicable.

Because they are predominantly Bilateral Operations (between the creditor bank and the borrowing customer), it is understood that the independent evaluation for Use of Proceeds may be waived in cases where the projects/assets financed and their socio-environmental contribution are easily identified, and whose contracted amount is small[20]. However, for these cases, it is recommended that the bank have well-defined criteria and processes in order to identify, manage and report on these operations.

It is recommended that independent assessments be carried out for large operations[21], Sustainability-linked operations and operations with the use of defined funds, but whose social and environmental contribution is not so clear, avoiding potential questions about greenwashing.

In all cases, hiring an independent evaluation typically takes place through borrowers themselves, and the bank can support them in this process.

It is important that the banks' commercial and credit areas involve specialists in social, environmental and climate risks and/or in sustainable business in these operations. There are banks that include these specialists in their business area teams, while others promote dialogue between areas dedicated to ESG topics and their business areas, to make these operations feasible.

20 The amount considered as "small amount" varies for each financial institution.

21 The amount considered for "large operations" varies for each financial institution.

4.3 General guidelines for banks as sustainable debt raisers

Fundraising, through the issue of Labeled Bonds or Loans, can support funding diversification strategies from the treasury and banks to expand their ability to allocate funds to clients, projects, assets and/or investments with capital demands related to ESG issues. For this, it is necessary to have a credit portfolio with social, environmental and climate additionality that can be used as a backing for raising sustainable funds in the market, through Labeled Operations. In addition, banks must ensure that the funds raised will be properly managed and allocated, generating the desired impact.

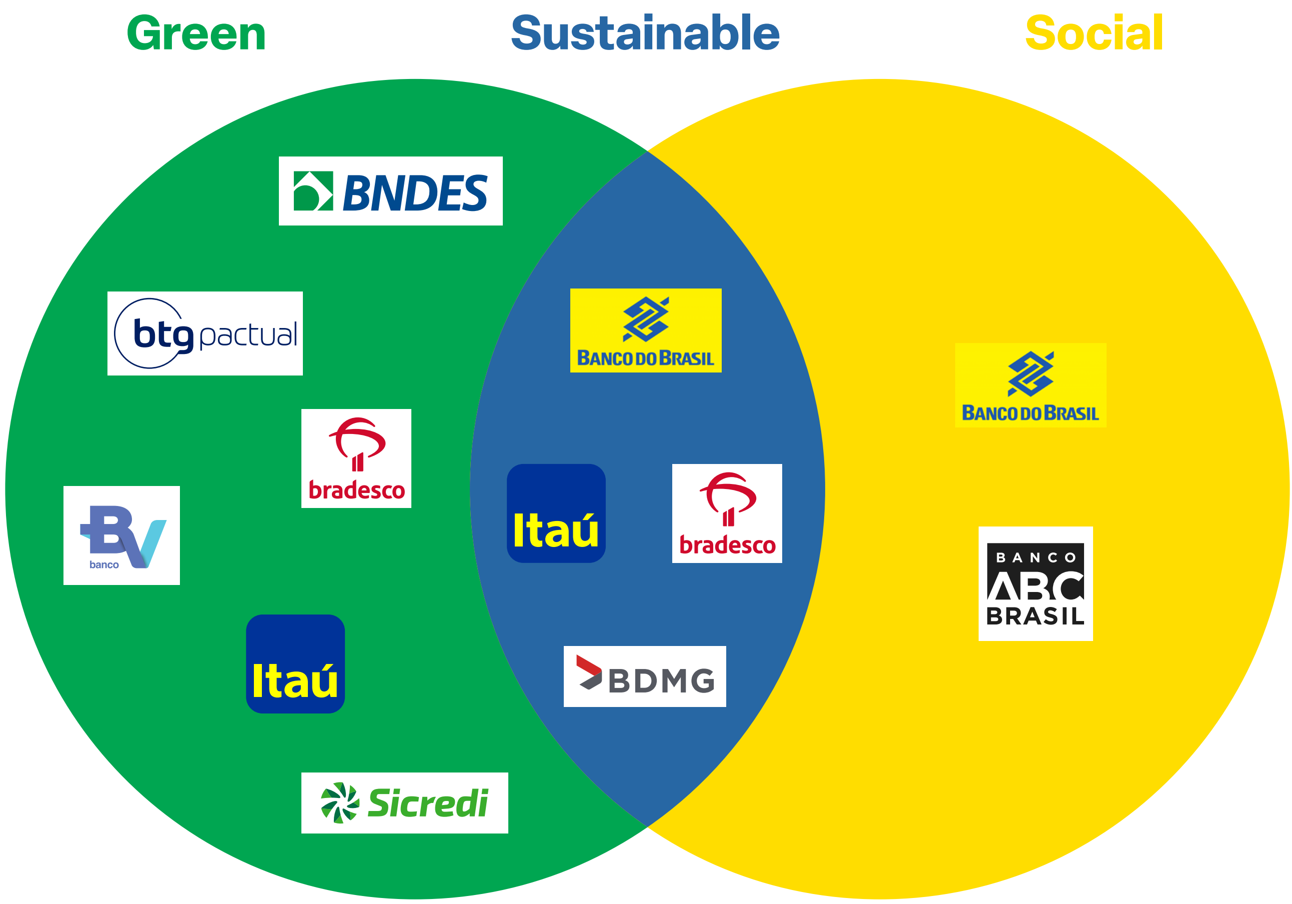
It is therefore recommended that the bank:

1. Develop a Sustainable Finance Framework where it commits to following ICMA and/or LMA standards. This Framework, as described above, can be targeted at a specific operation or serve as a policy applicable to future sustainable funding. Several banks in Brazil use their Sustainable Finance Frameworks on a recurring basis.
2. Have processes and adequate governance in place to implement the Sustainable Finance Frameworks, including:
   a. Mark operations potentially eligible for the categories of projects/assets defined by ICMA and LMA (according to Chapter 5), in the case of Use of Proceeds. Example: Credit operations for replacing equipment with more efficient ones (retrofit) fall under the “Energy efficiency” category.
   b. Assessment of operations, in order to guarantee the foreseen eligibility and adequate management of social, environmental and climate risks.
   c. Asset management to ensure proper use of those funds raised for book projects.
   d. Periodic monitoring and reporting of operations, including fund allocation and impact indicators.

3. Get independent valuation opinions on the Framework and/or operations.

In Brazil, several banks have already raised funds in the Sustainable Debt Market[22], according to Figure 12.

Figure 12 – Banks operating in the Labeled Debt Market in Brazil.



Source: NINT database.

22 Cut-off date used: April 2022.

When analyzing the operations already carried out, the following characteristics are observed:

- All operations have defined fund use;
- The themes were mostly Green or Sustainable (few operations and few banks operated with the Social label);
- Most of the operations were through Capital Market instruments (issue of Bonds);
- Several banks performed more than one operation;
- In terms of financial volume, more than 50% of funding took place in the international market.

Table 4 presents the main categories of use of funds in Labeled Operations of Brazilian banks and carried out until June 2022:

Table 4 – Use of funds from banking sector operations, by theme

Green	• Renewable energy financing • Energy efficiency • Sanitation • Clean transportation • Green buildings
Social	• Financing for Small and Medium Enterprises (SMEs) and businesses related to the Health area • Popular Housing • Financing and microfinance for SMEs • Social and economic development • Access to essential services (health, transportation, education, among others)

5. How to classify Green, Social and Sustainable Operations?

5.1 Borrower profiles

Borrowers, whether in Loan operations or Bonds for the Use of Proceeds, may have the following profiles:

- Companies allocating funds to specific projects, assets and/or investments with a positive social and/or environmental impact (social and environmental additionality).
- Companies allocating funds to a set and/or program of projects with social and environmental additionality.
- Pure player companies[23], allocating funds to its operation, characterized by social and environmental additionality.
- Financial institutions allocating funds to their credit portfolio which, in turn, will be directed to credit operations with social and environmental additionality.
- Sovereign issuers, i.e., national governments, whose issues are coordinated by national institutions with this responsibility (such as the National Treasury in Brazil), allocating funds to government projects with social and environmental additionality[24].

5.2 Key aspects to be followed

Regardless of the financial instrument, it is essential that Use of Proceeds follow the four pillars of suggested guidelines to be followed:

1. Use of the resources
2. Process for Evaluation and Selection of Projects
3. Asset management
4. Reporting

These guidelines are set out in the Green Bond Principles (GBP) and Social Bond Principles (SBP) of the ICMA, and the Green Loan Principles (GLP) and Social Loan Principles (SLP) of the LMA.

23 Term commonly used to refer to companies whose nature of all their economic activity is already considered Green or Social. For example, companies in the renewable energy sector, sanitation sector, education sector.

24 As of the date this Guide was prepared, there had been no sustainable sovereign issue in Brazil.

1. Use of the resources

This pillar refers to the definition of which projects, assets and/or investments or type(s) of project(s)[25] the funds raised will be directed to. It is recommended that each project or type of project be categorized into one of the Green or Social categories, in line with ICMA and LMA principles.

In the event that a bank is the borrower, they may be allocated to future credit granting operations or even to refinance contracted operations projects, that is, carried out before the issue. Borrowers of corporate and sovereign funds can also use the funds to cover already executed disbursements or to refinance projects. In the latter case, it is recommended that:

(i) the look-back period[26] for refinanced projects and repayments already made to be defined;
(ii) an estimate of the ratio of financing versus refinancing is presented and, where appropriate, indicate which types of projects may be refinanced.

Furthermore, a good practice is to indicate which SDGs the listed projects contribute to. In this case, the connection can be made through SDG Goals, allowing for a more precise identification. Tables 5 and 6 below present the Green and Social categories defined by ICMA and LMA, and an example of SDGs to which some types of projects typically contribute.

25 In this context, project refers to any investment in a specific project or asset, already named. Project type can include more than one project or asset. Example: installation of solar panels is a type of project.

26 Maximum period between: (i) date of disbursements already made and intended to be included as funding support; and (ii) date of completion of the funding operation.

Table 5 – Eligible green projects categories under the Green Bond Principles

Project categories (GBP)	Description	Examples of potentially benefiting SDGs
Renewable Energy	Generation, transmission, distribution, associated facilities and products related to renewable energy projects;	7 AFFORDABLE AND CLEAN ENERGY; 13 CLIMATE ACTION
Energy efficiency	New and renovated buildings that meet known standards for energy efficiency, energy storage, smart grids and efficient equipment;	7 AFFORDABLE AND CLEAN ENERGY; 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 13 CLIMATE ACTION
Prevention and control of pollution	Projects to reduce emissions, control of Greenhouse Gases (GHG), soil remediation, prevention or reduction of waste generation, waste recycling and energy generation through waste with efficiency in GHG emissions;	6 CLEAN WATER AND SANITATION; 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 12 RESPONSIBLE CONSUMPTION AND PRODUCTION
Environmentally sustainable management of living natural resources and land use	Sustainable agriculture projects; sustainable animal husbandry; sustainable agricultural inputs such as biological crop protection or drip irrigation; environmentally sustainable fisheries and aquaculture; environmentally sustainable forestry, such as afforestation or reforestation; and preservation or restoration of natural landscapes;	2 ZERO HUNGER; 13 CLIMATE ACTION; 14 LIFE BELOW WATER; 15 LIFE ON LAND
Conservation of terrestrial and aquatic biodiversity	Projects for the protection of terrestrial fauna and flora, protection of coastal, marine and watershed environments;	13 CLIMATE ACTION; 14 LIFE BELOW WATER; 15 LIFE ON LAND
Clean transportation	Projects or acquisition of electric, hybrid, public, rail, non-motorized, multimodal transportation, as well as infrastructure for vehicles powered by clean energy and reduction of pollutant and GHG emissions;	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 11 SUSTAINABLE CITIES AND COMMUNITIES; 13 CLIMATE ACTION
Sustainable management of water and wastewater	Sustainable infrastructure projects for clean and/or potable water, sewage treatment, sustainable urban drainage systems and other forms of flood mitigation;	6 CLEAN WATER AND SANITATION; 11 SUSTAINABLE CITIES AND COMMUNITIES

Adaptation to climate changes	Projects to make infrastructure more resilient to the impacts of climate change, as well as for information support systems such as climate observation and warning systems;	9 Industry, innovation and infrastructure; 13 Climate action
Eco-efficient products, technologies and production processes and/or those adapted to the circular economy	Design and introduction of reusable, recyclable and refurbished materials, components and products; circular products and services and/or certified eco-efficient products;	9 Industry, innovation and infrastructure; 11 Sustainable cities and communities; 12 Responsible consumption and production
Green buildings	Buildings that meet regionally, nationally or internationally recognized standards or certifications for environmental performance, including matters such as energy, water, use of construction materials and waste management;	9 Industry, innovation and infrastructure; 11 Sustainable cities and communities; 13 Climate action

Table 6 – Categories of eligible social projects according to the Social Bond Principles

Project categories (SBP)	Description	Potentially benefited SDGs
Access to essential services	Access to health, education and professional training, financing and financial services;	1 No poverty; 3 Good health and well-being; 4 Quality education
Socio-economic advancement and empowerment	Equitable access and control over assets, services, funds and opportunities, equitable participation and integration in the market and society, including reducing income inequality;	1 No poverty; 5 Gender equality; 8 Decent work and economic growth; 10 Reduced inequalities; 12 Responsible consumption and production
Generation of employments	Programs aimed at generating new jobs, preventing and/or alleviating unemployment resulting from socio-economic crises, including through financing micro, small and medium-sized enterprises (MSMEs);	1 No poverty; 5 Gender equality; 8 Decent work and economic growth; 10 Reduced inequalities

5. How to classify Green, Social and Sustainable Operations?

Affordable housing	Housing projects for people without access, and at affordable prices;	8 DECENT WORK AND ECONOMIC GROWTH; 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 10 REDUCED INEQUALITIES; 11 SUSTAINABLE CITIES AND COMMUNITIES
Accessible basic infrastructure	Projects related to sanitation, energy, transportation;	6 CLEAN WATER AND SANITATION; 7 AFFORDABLE AND CLEAN ENERGY; 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 11 SUSTAINABLE CITIES AND COMMUNITIES
Food security and sustainable food systems.	Physical, social and economic access to safe, nutritious and sufficient food to meet dietary needs;	1 NO POVERTY; 2 ZERO HUNGER; 3 GOOD HEALTH AND WELL-BEING

In the case of Social Operations, it is essential that the projects aim to cover areas of interest to society in order to reduce inequalities and seek to reach a target public classified as vulnerable or a collective need of the society or community affected. Few examples of target audience include, but are not limited to:

- People who live below the poverty line[27];
- Excluded or marginalized populations;
- Disabled people;
- Migrants or displaced persons;
- Other disadvantaged publics, due to lack of access to essential goods and services (e.g.: microenterprises);
- Unemployed;
- Women or sexual and gender minorities;
- Aging populations;
- Vulnerable young people (who are unable to afford study-related expenses);
- Other vulnerable groups, including because of health emergencies and natural disasters.

27 There is no official definition of the poverty line in Brazil, which may have different concepts and understandings based on the government's social program. Given the international context of the Sustainable Debt Market, the World Bank definition can be used as an internationally recognized financial institution: people below the poverty line in Brazil are people with per capita monthly income of up to US$ 5.5 per day in Purchasing Power Parity/2011. In 2020, this amount corresponded to approximately R$ 450 per month. Content available at: https://biblioteca.ibge.gov.br/visualizacao/livros/liv101892.pdf. Accessed in October 2022

The use of taxonomies for sustainable projects – such as, the Climate Bonds Standards (from the Climate Bonds Initiative – CBI), the Taxonomy of Sustainable Activities of the European Union and the Febraban's Green Taxonomy[28] – can also support this pillar, making it clear which projects or types of projects are eligible.

2. Process for evaluation and selection of Projects

This pillar aims to guide borrowers to be able to assess and select projects that fall into the eligible categories applicable to their own operations.

The borrower must be able to identify the characteristics of the project that are classified as Green, Social or Sustainable (the latter, when it simultaneously encompasses the Green and Social categories). Additionally, definition of criteria for inclusion and exclusion of projects should be in it, in addition to indicating the process of identifying and managing social, environmental and climate risks potentially related to projects.

3. Asset management

The funds raised must be managed in order to ensure their proper application in Green, Social and/or Sustainable projects, ensuring that they are not used for other purposes.

For that, it is necessary that borrowers define internal processes that allow the traceability of this fund, which may be allocated to an account, portfolio or other specific accounting structure (for example, in a Special Purpose Entity). When a structure of this type is not appropriate, the borrower must establish internal processes that guarantee that the amount raised is fully directed to the projects defined for the generation of the desired results.

4. Reporting

Borrowers must monitor fund allocation and provide, annually, updated reports that present information about their use, the results and the description of the projects invested, as well

28 Content available at: https://cmsarquivos.Febraban.org.br/Arquivos/documentos/PDF/Guia%20Explicativo%20da%20Taxonomia%20Verde%20da%20FEBRABAN_DEZ2021.pdf. Accessed in July 2022.

as the impact achieved. For greater transparency, impact performance indicators should be used, both qualitative and quantitative, clearly presenting the assumptions or reference methodologies for quantifying results.

Examples of indicators used:

- Number of beneficiaries;
- Number of Labeled Operations;
- Average Ticket of Sustainable Loans;
- Volume of funds not yet allocated;
- Percentage of funds allocated to refinancing;
- Renewable energy generated annually;
- Reduced or avoided annual GHG emissions;
- Annual reduction in energy consumption;
- Annual consumption of avoided fossil fuels;
- Estimated number of jobs created or maintained;

The indicators must be aligned with the expected impacts for each project or type of project. The definition of SDG Goals – as mentioned in the Use of Proceeds pillar – can contribute to the definition process, in addition to being frequently used to report the impacts achieved throughout the project in question.

5.3 Non-compliance of guidelines

In the event that the borrower does not appropriately allocate the funds raised to Green, Social or Sustainable projects, as established in the issue process, the operation should no longer have the label that differentiates it from a conventional operation. As there is no regulation on the subject in the country, there is no definition of who should “remove” this label. Borrowers themselves can make public information about this situation, especially to investors.

Although no sanctions are foreseen in the regulation, non-compliance with guidelines can lead to loss of credibility of the borrowers in the market and damage to their reputation and image. To avoid cases of non-compliance, it is possible that, in the case of Labeled Bonds, issuers include clauses in the issue documents, and that, in the case of Labeled Loans, banks and borrowers agree to clauses in the credit agreements.

6. How to classify Sustainability-linked operations?

6.1 Borrower profiles

Borrowers can choose to link funding to ESG performance targets, without necessarily determining the use of the funds raised.

6.2 Key aspects to be followed

As shown in Chapter 2, Sustentability-linked Bonds and Loans differ from Use of Proceeds, especially as they do not predetermine the destination of the funds raised. Thus, the borrower can use them for general corporate purposes. However, it is necessary to define at least one goal, and it will be measured by ESG performance indicators that allow borrowers to demonstrate the contribution in matters associated with their scope of action.

The Sustainability-Linked Bond Principles (ICMA) and the Sustainability-Linked Loan Principles (LMA) define guidelines in five pillars, detailed below:

a. Selection of Key Performance Indicators (KPI);
b. Calibration of Sustainability Performance Targets (SPT);
c. Characteristics of the financial instrument;
d. Reports;
e. Verification.

A. Selection of KPIs

Bearing in mind that the conditions of the financial operation will depend on the ESG performance of the borrower, defining one or more goals is the first step in structuring an operation of this type.

It is necessary to prepare material KPIs for the business and sustainability strategies (materiality matrix), as well as to establish the main social and environmental challenges of the borrower's performance context. In this sense, it is recommended to double materiality[29], with the KPI being relevant for both, both for the borrower's business and for society and/or the environment impacted by it.

In addition, KPIs should be:

(i) Measurable, based on a methodology that adheres to what is intended to be measured;
(ii) Externally verifiable and;
(iii) Comparable through benchmarks, so that it is possible to have benchmarks that show what would be a good performance in that KPI.

B. Target Calibration

It is necessary to define one or more targets/SPTs to be achieved, which must be ambitious, in the sense of contributing to significant changes. Each KPI typically has a target associated with it. However, a KPI can have more than one target when there are different degrees of ambition over time. As a hypothetical example, borrowers using the Greenhouse Gas (GHG) KPI of their operations may have a 30% GHG reduction target within a given year and another 50% GHG reduction target within one year later.

The target calibration process should consider:

(i) Comparison to a baseline proposed by the company, so that material improvement and performance can be measured against performance;
(ii) Comparison with an external benchmark, whenever possible, so that it can be demonstrated that the target(s) is/are ambitious because it is/are above the performance of similar companies or aligned with the same sustainability standards (e.g., Science-based Targets Initiative[30]);

29 Double materiality: As defined by the European Union, it uses the view that a company must evaluate and disclose relevant information from financial and non-financial aspects, that is, how sustainability issues affect its business and how its activities impact the environment and society.

30 Content available at: https://sciencebasedtargets.org/. Accessed in May 2022.

(iii) Consistency with the borrower's ESG strategy, so that the target(s) is(are) adherent to the implementation of their strategy.

Each target must be linked to a specific schedule, defined in the structuring of the operation, which may serve as a trigger for any changes (e.g.: reduction of the interest rate, reduction of the necessary guarantees, alteration of the payment schedule), as will be presented in the pillar below.

C. Characteristics of financial instrument

Due to the definition of Sustainability-linked operations, the Bond or Loan may undergo financial alteration associated with the achievement of the target(s). The most common is the change in interest rate of the operation, which can receive a step-up (when the rate increases due to the non-achievement of one or more targets) or a step-down (when the rate is reduced by achieving one or more targets).

Other changes, such as the periodicity of payments, collateral or grace periods, can also be adopted.

The link between the borrower's ESG performance and the financial and/or structural alteration of the operation must be clearly defined at the time of structuring the operation, especially the way to assess how the target(s) will be achieved.

In case the targets cannot be evaluated at a given time, the reason must be communicated, which may or may not be sufficient to justify such an occurrence. It is also recommended to anticipate potential impacts of exceptional events, such as changes in the regulatory environment or organizational restructurings, which may impact both the KPI assessment and progress towards the target(s).

D. Reports

The reports must present periodic monitoring of the targets and be disclosed at least annually, in order to show the progress and transparency of the actions taken. Furthermore, it is recommended to indicate in the reports the moment of achievement of each target, which may lead to new adjustments in the financial and/or structural characteristics of the operation in the following stages.

For Bonds, reports must be public and available. In relation to Loan Operations, issues such as the confidentiality of the operation must be considered, however it is advisable to make efforts to increase the transparency of operations.

The report must also present information that allows the financer (bank lending the Loan or investor in Bonds) to monitor performance and the level(s) of ambition of the target(s).

E. Verification

Targets must be verifiable and the baseline used must be audited prior to issuance. Thus, it is necessary that when structuring the operation, a Second Party Opinion (SPO) verifies the conformity of the characteristics of the operation with the pillars of ICMA and LMA, previously presented.

Furthermore, it is necessary that an independent evaluation be subsequently contracted, responsible for verifying performance in relation to previously established targets. In this way, it will be transparent to all parties whether or not the targets are met.

6.3 Non-compliance of guidelines

In cases where borrowers do not meet the necessary efforts to comply with the SPTs, the expected consequence is the adjustment of the operating conditions", provided for in the contract.

Failure to comply with other guidelines of the five pillars can lead to penalties such as the early maturity of the operation, increase in the required collaterals and alteration of the payment periodicity, however, this is something uncommon. An important type of non-compliance to be considered is the non-availability or incomplete provision of ESG performance and/or external assurance results (where contractually defined) to the funder without adequate justification.

7. Keeping an eye on trends

In addition to the growth and diversification of Labeled Operations in the Brazilian market, which showed significant evolution in the last three years (2020, 2021, 2022), new movements and/or international trends may impact market participants in Brazil.

7.1 Specific thematic labels

A. Transition operations

As discussed in Chapter 3, Transition Operations are still in an evolutionary stage compared to other Labeled Operations. Currently, it is more common to use this label for Bonds. Although they do not represent a significant amount in the total financial volume of global issues of Labeled Operations, historically reaching little more than US$ 12.7 billion[31] until the third quarter of 2022, there is great growth potential for Transition Bonds in the world and in Latin America.

This potential stems from the possibility of use by companies that, due to the very nature of their operations, of being large emitters of greenhouse gases. These companies can finance a transition strategy, through operations using resources or Sustainabilily-linked, aiming to improve their operations and mitigate their negative impacts. For example, coal-fired power plants can use the funds raised to change their processes and start using natural gas, significantly reducing their GHG emissions.

In order to guide emissions with a Transition label, in December 2020, ICMA published the Climate Transition Finance Handbook, a document that it does not provide definitions or a Taxonomy for this type of project, but it presents recommendations to support the issuer in the transition from sectors that require greater technological and/or financial efforts towards Net Zero. The recommendations are based on four core elements:

31 Content available at: https://www.climatebonds.net/files/reports/cbi_susdebtsum_highlq32022_final.pdf. Accessed in March 2023.

a. Management and strategy for the issuer's climate transition

The "Transition" label, when applied to a financial debt instrument, serves to inform the issuers' corporate implementation strategy in order to transform their business model and effectively address climate-related risks, contributing to compliance with the objectives of the Paris Agreement.

b. Environmental materiality of the business model

The planned climate transition trajectory should be material to the issuers' business model, considering future scenarios. In other words, it must consider the relevance of the issuers' climate impacts on the environment and society and seek to mitigate negative externalities.

c. Science-based climate transition strategy, including targets and actions.

When basing its climate strategy on science, issuers should set targets and actions that are:

i. Quantitatively measurable (consider measurement methodology that is consistent over the period);
ii. Aligned with benchmarks that allow recognizing and comparing that the trajectory is based on science;
iii. Publicly available, preferably in funding-related archival databases, including intermediate milestones;
iv. Supported by independent assessments.

d. Transparency in the implementation process

When offering an instrument that aims to finance the issuers' climate transition strategy, communication with the market must be clear and transparent, providing information on investments, such as capital (CAPEX) and operating (OPEX) expenses, Research and Development (R&D) expenses, operating expenses considered additional (non-business-as-usual), in addition to other pertinent information on the implementation of the transition strategy, such as details of divestments and changes in processes and management.

B. Gender operations

Gender Bonds belong to the category of Social Bonds, but with a clear objective of promoting diversity, equity and gender inclusion in the market. As they are part of the Social Bonds group, they must follow the standards established by ICMA, through the Social Bond Principles (SBP). These operations are characterized as "Gender" due to the raising and use of funds exclusively for activities and/or projects related to the theme. Similarly, the label is also applicable to Loans, which must follow the LMA's Social Loan Principles (SLP).

Funds can finance, for example, companies led by women that promote gender equality in the workplace, or that develop products and services that improve the quality of life of this population, among other possibilities.

In Brazil, although we have operations with part of the funds focused on gender, until the end of 2022 there was no operation exclusively with this focus. However, Latin America has stood out in this regard. According to the Inter-American Development Bank (IDB), the region became a leader in the issue of Gender Bonds, totaling 14 operations up to April 2022, a number that grew even with the pandemic and the worsening of the economic crisis. The issuing countries were Colombia, Mexico, Chile, Peru and Ecuador[32].

32 Content available at: https://www.idbinvest.org/en/blog/gender/latin-america-world-leader-gender-bonds. Accessed in February 2023.

In 2020, the IDB acquired US$ 100 million in Colombian Gender Bonds, issued by the Banco Davidenda, and two-thirds of the proceeds were allocated to Loans to women who buy homes in the low-income segment. The remainder will be loaned to small and medium-sized enterprises (SMEs), also led by women. An additional incentive was set forth in the same agreement, in which Banco Davivienda would receive a payment of up to US$ 300,000 for increasing its SME Loan portfolio belonging to women[33].

C. Blue operations

The Blue Bonds aim to preserve water resources and ecosystems (such as rivers and oceans), include projects that promote and create business opportunities in the so-called "Blue Economy" and the responsible management of water funds. The characteristics mentioned above for Use of Proceeds also apply to "Blue" operations. Furthermore:

a. A relevant reference for the topic is the Guidelines for Blue Finance, by IFC. It is also recommended to use complementary references as the Green Bond Principles and UN Global Compact. In this case, it is also recommended to use complementary benchmarks, such as the UN Global Compact Sustainable Ocean Principles, which can support the identification of projects or assets that meet the "Blue"[34] objectives;
b. Loans can also earn the "Blue" label (Blue Loans).

Companies that can benefit from this type of instrument are typically of two types:

- Companies operating in water ecosystems ("In or By the water"), whose projects are carried out directly in oceans, seas or fresh water, such as ports, maritime transportation, infrastructure, tourism, fishing and aquaculture, and offshore renewable energy;
- Companies that contribute to a relevant direct impact on oceans, seas and freshwater, such as water-intensive industries, agriculture, water and sanitation.

33 Content available at: https://www.idbinvest.org/es/medios-y-prensa/bid-invest-estructura-el-primer-bono-social-de-genero-del-mundo-con-incentivos-vinculados. Accessed in June 2022.

34 Content available at: https://www.unglobalcompact.org/take-action/practical-guidances-for-the-un-global-compact-sustainable-ocean-principles. Accessed in June 2022.

Most Blue Bond issues focused on investments in marine conservation and restoration or in water-related infrastructure. The first Blue Bond was issued through a sovereign operation, in October 2018, made by the Republic of Seychelles, and raised US$ 15 million from international investors. Funds were directed towards marine management and sustainable fisheries in the archipelago[35].

In Brazil, the first operation of this type was a Blue Loan, made in July 2022, by the International Finance Corporation (IFC), member of the World Bank Group, for the Basic Sanitation Company of the State of São Paulo (Sabesp). The funds were destined especially for improving the water quality of the Pinheiros River, integration with the communities along its course and the expansion of access to water and basic sanitation in São Paulo[36].

7.2 Emerging standards of good practice

A. EU Green Bond Standard

Within the European Commission, the EU Green Bond Standard is a voluntary standard that seeks to expand the environmental ambitions of the Green Bond Market in that continent. It was created from the 2018 action plan on financing sustainable growth and is part of the European Green Deal[37]. These standards are guided by four requirements:

1. Taxonomy alignment

Funds raised through the security must be fully allocated to projects aligned with the Taxonomy of the European Union;

35 Content available at: https://www.worldbank.org/en/news/press-release/2018/10/29/seychelles-launches-worlds-first-sovereign-blue-bond. Accessed in June 2022.

36 Content available at: https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=27106. Accessed in June 2022.

37 Content available at: https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_pt. Accessed in June 2022.

The Taxonomy of the European Union (EU)[38] was published in 2020 and is considered the main pillar of the block's green finance package. The instrument covers a catalog of more than 70 activities, including forestry, industrial and energy sectors, and is anchored in scientific data, serving as a guide for companies and investors. Additionally, the Taxonomy provides a set of technical evaluation criteria that support the identification of whether a given activity is environmentally sustainable and consistent with agreed internal or external political commitments, such as the Paris Agreement.

Activities must contribute to one of the following objectives:

- Mitigation of climate change;
- Adaptation to climate change;
- Water use and protection;
- Circular Economy;
- Pollution control and prevention;
- Protection and restoration of biodiversity and ecosystem.

The Taxonomy intends to simplify and standardize communication, reports and disclosure of information, avoiding inconsistencies in standards and reports on sustainability. It is constantly being developed and updated, such as the discussion of a proposed social Taxonomy in 2022.

2. Transparency

Accountability on how the funds raised through the security will be allocated. The EU believes that the Taxonomy will contribute to greater transparency in operations;

3. External evaluation

All European Green Bonds must be verified by an independent evaluator to ensure compliance of funded projects with the Taxonomy; and

38 Content available at: https://ec.europa.eu/commission/presscorner/detail/PT/ip_21_1804. Accessed in June 2022.

4. Supervision of independent valuers by the European Securities and Markets Authority (ESMA)

Independent valuers providing services to European Green Bond issuers must be ESMA registered. The aim is to guarantee the quality of services and reliability of valuations in order to protect investors and ensure market integrity.

B. SDG Impact Standards for Bond Issuers

The SDG Impact Standards for Bond Issuers[39], developed by the United Nations Development Program (UNDP), in April 2021, seeks to support Bond issuers in the application of standards and management, increasing the likelihood that the issuer will have a positive impact and adhere to the SDGs.

Although still little used, the initiative has the potential to facilitate the identification and management of funds in Use of Proceeds or those Sustainability-linked and how they can contribute to the SDG agenda.

The SDG Impact Standards for Bond Issuers contribute to defining and identifying positive impacts, through the materiality of operations and are structured in four perspectives:

1. **Strategy:** guide issuers to have an SDG Bond program, develop an impact strategy and define the objectives to be achieved.
2. **Management approach:** guide issuers in the processes of evaluating and maximizing the impacts to be generated by the Bonds.
3. **Transparency:** establish transparency criteria, essentially to demonstrate how the Bond issued contribute to the SDGs.
4. **Governance**: indicate good governance practices, with the definition of mechanisms, processes and policies that reinforce the issuer's commitment and in the SDG Bonds program.

39 Content available at: https://sdgimpact.undp.org/sdg-bonds.html. Accessed in June 2022.

8. Final considerations

8. Final considerations

Operations labeled with ESG characteristics, in line with international standards, in addition to promoting direct positive impacts on society and/or the environment, can also generate tangible benefits for borrowers, such as lower cost of capital and image gains, among others.

The ESG label has been increasingly sought after by market players from different sectors in order to raise capital for their projects and investments. Furthermore, this market is expected to gain more and more prominence, given the pressing need for financing for the transition to a sustainable, low-carbon economy. In this context, Brazilian banks can contribute even more with their customers and partners in order to mobilize sustainable capital, through three ways: acting as structurers, issuers and creditors of Labeled Operations.

For the Sustainable Debt market to evolve and consolidate over time, attention is needed to the specificities that differentiate it from the conventional market. As shown in this Guide, for operations to be successful, it is recommended that banks follow the general guidelines for operating in the Sustainable Debt Market (Chapter 4), the ICMA and LMA guidelines for Use of Proceeds and Operations (Chapter 5) and Sustainability-linked operations (Chapter 6).

FEBRABAN will continue to monitor the evolution of the topic at the national and international level, and reinforces the recommendation that banks and other players in this market be aware of any updates.

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