

Social Environmentalism and Corporate Capture

Corporate Governance and Sustainability in Brazil

Luciana Dias

1 INTRODUCTION

Discussing sustainability and how corporate law and corporate governance mechanisms have been influencing and promoting the development of this agenda in Brazil is not an easy task. Contrary to what appears to be the case in other parts of the world, the two issues have evolved in parallel in Brazil, almost without connections. The efforts of corporate governance professionals to include sustainability themes in the debates on the organizational structure of companies are relatively recent and cooperative relationships among non-governmental organizations advocating sustainability and Brazilian companies are even younger. Most of those efforts focus on the environmental component of the three-fold concept of sustainability and far less on its social and economic dimensions. This chapter presents a number of initiatives and regulations connecting the sustainability and corporate governance agendas in Brazil, particularly in the securities market and banking sector where most progress is found. Although these initiatives are testimony to a trend in the right direction, the advancements observed in this area aim primarily at improving the management and mitigation of socio-environmental-related financial and reputational risks and attracting investors.

Further progress is not expected in the near future because the significant agro-exporting sector makes the debate on sustainability in Brazil a challenge. The sustainability agenda has been seen by many, but especially by the main agents in this sector, as an obstacle to growth, because it would allegedly create excessive requirements and limits to the use of land in Brazilian agricultural areas.

This clash is even more evident in the Brazilian political context. There is a large, powerful and significant group of Brazilian parliament members representing agribusiness interests, the so-called "ruralist caucus,"¹ which explicitly or implicitly assumes positions contrary to the implementation of laws and initiatives intended to strengthen the commitment of the agribusiness environment to the sustainability agenda.

Rafael Vieira de Andrade de Sá and Bruno Fiaschetti provided research assistance for this chapter, and Maria Alice Guedes Travaglia provided translation assistance.

¹ The Ruralist Caucus, which represents the Brazilian rural producers, is a group of parliament members from several political parties. In 2016, the Caucus had 207 out of a total of 513 federal representatives, allowing them to dispute control over State policies outlined by the Legislative Branch. More information about the different Brazilian caucuses in federal representation may be found in the following article from *A Pública*, a news website, <https://apublica.org/2016/02/truco-as-bancadas-da-camara/>.

In order to provide a more concrete picture of how this political clash has unfolded in Brazil, the discussions around the draft and implementation of article 78-A of Brazil's Forest Code² will be used as an example. This provision has still not taken effect, more than six years after its approval.

The Forest Code was approved in 2012 after a 14-year discussion in the National Congress. Its main purpose is to regulate the protection of forests and vegetation in private rural properties in Brazil. In other words, the Forest Code regulates the productive activities in Brazilian rural properties.

The original wording of article 78-A established that, five years after the approval of the Code, financial institutions could only provide credit, in any of its forms, to landowners that: (i) were enrolled in the Environmental Rural Registry (*Cadastro Ambiental Rural* – “CAR”);³ and (ii) proved to be compliant with the Forest Code.⁴ The aim of this provision was to:

Harmoniz[e] the rural credit extension policies and the environment by establishing a five-year term as of which financial institutions will extend credit only to rural properties and possessions environmentally compliant. This represents a powerful mechanism to encourage compliance with the rules on regularisation, preservation and vegetation recovery that, in line with the adjustment of the inspection and monitoring capacity that will follow, shall secure the effectiveness of the new legislation.⁵

However, there is a fierce resistance to the implementation of said provision. In the very year of its enactment, the original wording of article 78-A was amended to eliminate the second requirement, until then imposed to obtain credit, that is, proof of compliance with the Forest Code.⁶ As a result of said amendment, the current wording of article 78-A left it to each of the financial institutions to decide the level of compliance with the Code that it wanted to adopt as a requirement to extend credit to rural producers. The amendment does not render the rule totally without concrete effects, considering that the National Environmental Policy⁷ provides for the liability of institutions that finance polluting business activities, regardless of determination of fault.⁸ Hence, the establishment of the obligation for rural producers to enter their properties in the CAR ends up rendering each property's deforestation level and its compliance with environmental laws transparent to the financial institutions. Each institution will have to decide whether or not, and to what extent, to finance non-compliant properties based on the risk of their civil liability for the polluting activities of their clients.

Another clear reflection of the existence of political forces opposing the implementation, even if in an indirect manner, of the sustainability agenda in the country, is the fact that article 78-A

² Law No. 12.651/2012.

³ The CAR is a public, electronic registry of rural properties that aims to integrate environmental information with the purposes of controlling, monitoring, and supporting environmental management, and combating deforestation. It reflects each property's structure, soil conditions, water source, the areas of permanent preservation, areas for agricultural and livestock use, degraded areas, native vegetation, and obligatory reserves.

⁴ To be technically prepared to comply with article 78-A of the Forest Code in May 2017, financial institutions, by means of a partnership between the government and the Brazilian Federation of Banks (*Federação Nacional de Bancos* – “FEBRABAN”), financed the satellite mapping of Brazilian biomes in order to build a database to feed the CAR.

⁵ Article 78-A was not approved in the original text of the Forest Code. Its inclusion in the Code resulted from an individual act of the President of the Republic, Executive Decree 571 of May 25, 2012, issued on the same day the Forest Code was approved, later passed into Law No. 12,727 of 2012. The quote is from the Preamble of the Executive Decree.

⁶ In the process of passing the Executive Decree (see footnote 5) into Law, which requires the National Congress' approval, the final part of the provision was eliminated.

⁷ Law No. 6,938/1981.

⁸ Articles 3, IV; 12 and 14, Par.1 of the National Environmental Policy (Law No. 6,938 of 1981).

has not taken effect until now. Through a series of presidential acts, article 78-A's effectiveness was postponed to 31 December 2018.⁹ Further postponements of the obligation to enroll rural properties in the CAR by means of presidential decrees are no longer possible, and new delays would depend on a legislative amendment, but at a higher political cost. However, a legislative amendment might not be improbable and, if it happened, would not surprise anyone acquainted with Brazilian politics.

Finally, Article 78-A was also judicially challenged. The Progressive Party (*Partido Progressista*), which has the second largest number of parliamentary members in the "ruralist caucus,"¹⁰ brought an Action for Declaration of Constitutionality¹¹ seeking to dissociate the CAR from credit extension policies. At that time, the Brazilian Supreme Court (*Supremo Tribunal Federal*) acknowledged by unanimous vote the constitutionality of the provision, re-asserted the right to the ecologically balanced environment as secured by the Constitution, and rectified the initial five-year term for the provision to take effect.

This brief exposition shows that the discussion on sustainability in Brazil is closely bound up with powerful political forces, a fact that must always be considered. Against that backdrop, this chapter will describe progress in the use of corporate governance mechanisms for the promotion of sustainable development in Brazil. An effort has been made on the part of the author to canvass and analyze intersections between the corporate governance and sustainability agendas in the Brazilian environment, and the consequent effects on the market and on society.

To write this chapter, in addition to reviewing Brazilian literature and regulation, the author interviewed Sonia Aparecida Consiglio Favaretto, Director of Press, Sustainability, Communication and Social Investments of the Brazilian Stock Exchange (*B3 S.A. - Brasil, Bolsa, Balcão*), Mario Sérgio Fernandes de Vasconcelos, Institutional Relations Director of the Brazilian Federation of Banks (*Federação Nacional de Bancos - "FEBRABAN"*); and Claudio Maes, analyst at the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários - "CVM"*). Their experiences and thoughts are reflected in various parts of this chapter.¹²

Section 2 provides a brief overview of how the agendas of sustainability have evolved in Brazil. Section 3 explores the origins of the corporate governance agenda and identifies the main securities market initiatives associated with sustainability. In Section 4, the chapter provides an analysis of the main initiatives of the Brazilian financial system, which were, and still are, responsible for the inclusion of sustainability issues in financial institutions. Finally, Section 5 concludes with reflections on the scope and significance of sustainability initiatives as a value to be pursued by corporations and financial institutions.

⁹ Despite said provision having been approved with an already quite extended term of five years as of the date of publication of the Forest Code for it to take effect, the President issued an Executive Decree in December 2015 – hence, 18 months before the date on which the provision was to take effect – postponing the term for rural properties to enroll in the CAR to December 31, 2017, thereby delaying article 78-A's effectiveness. This same Executive Decree already provided that the President of the Republic might postpone for another year the date at which landowners had to enroll their rural properties in the CAR. Based on that provision, two presidential decrees were enacted (Decree No. 9,257, of 2017 and Decree No. 9,395, of 2018). While the first extended the term for the rural properties' enrolment in the CAR until May 31, 2018, the second postponed once more the enrolment obligation to December 31, 2018.

¹⁰ See footnote 1.

¹¹ The Action for Declaration of Constitutionality (*Ação Declaratória de Constitucionalidade*) is a remedy provided for in the Brazilian Federal Constitution, whereby the Supreme Court is requested to examine the constitutionality of a legal provision that has proven controversial in the courts.

¹² The author is extremely grateful for their contribution and bears full responsibility for any errors contained in this chapter.

2 THE DEVELOPMENT OF SOCIAL ENVIRONMENTALISM IN BRAZIL

Political discussions on social and environmental issues in Brazil have a very clear starting point: the Federal Constitution of 1988. Between the 1920s and the 1980s, Brazilian history was dominated by regimes which, each in its own way, had the purpose of integrating the country in the global capitalist economy. In light of that purpose, social and environmental issues were considered obstacles to the country's development.

Until 1964, governments pursuing economic growth by means of a protectionist and interventionist agenda predominated in Brazil. A main feature was the establishment of several State-owned enterprises (SOEs) that conducted the basic industrial activities in Brazil. It was in this period that the federal government established companies such as Petrobras, which operates in the oil and gas sector; Companhia Vale do Rio Doce, one of the largest mining companies in the world; and Companhia Siderurgica Nacional, an important Brazilian steel-producing company. All such companies are still very important to the Brazilian economy and their activities have a direct impact on the environment.¹³ Despite the relative success of the developmentalist governments in expanding the Brazilian industrial base, Brazil's economy remained quite unstable and closed.

In 1964, there was a military coup and a dictatorial regime was established. It implemented an economic regime that allegedly intended to secure the country's economic stability and growth, as well as open the economy up to the international market.

Although the developmentalist regime and military dictatorship were quite different, both governments were quite unresponsive to international pressures and also disinclined to assume any commitment to social or environmental goals or policies. Developing Brazil's economy was the primary goal and socio-environmental issues were seen as problems to be overcome.

Particularly in the period of military dictatorship, environmental policies were practically reduced to the establishment of legal instruments for the creation of protected areas and national parks. Protection of the environment occurred by means of the preservation of the fauna and flora within such areas. Outside these areas, the priority was to develop the Brazilian economy.¹⁴

Another consequence of the military government that had a deep impact on the socio-environmental agenda debate in Brazil was the demobilization of civil society.¹⁵ The military government set up in 1964 lasted for more than twenty years and, during that period, repression, quite often violent, prevented civil society from organizing itself to claim rights or defend other values different from those of the government. Consequently, the regime undercut social movements, including those that were linked to environmental issues.

Thus, throughout the period of military government, the State lacked any political will to pursue best environmental practices discussed by the international community at the time or any commitment to social issues. Meanwhile, civil society was completely disorganized and, for that reason, unable to put pressure on the government.

¹³ For a history of the state-owned enterprises in Brazil, see M. Pargendler, *Evolução do Direito Societário – lições do Brasil* (São Paulo: Editora Saraiva, 2013), pp. 174–201; and M. E. Pinto Jr., *Empresa Estatal: função econômica e dilemas societários* (São Paulo: Atlas, 2010), pp. 17–55.

¹⁴ H. Fürstenau-Togashi and V. de Souza-Hacon, *A evolução do debate socioambiental no Brasil: Legislação, etnoconservação e racionalidade ambiental* (The Evolution of the Socio-Environmental Debate in Brazil: Legislation, Ethnoconservation and Environmental Rationality), www.scielo.org.mx/scielo.php?script=sci_arttext&pid=S1405-84212012000200005.

¹⁵ A. Priori, L. R. Pomari, S. M. Amâncio and V. K. Ipólito, *A Ditadura Militar e a violência contra movimentos sociais, políticos e culturais* (Maringá: Eduem, 2012).

This situation of civil fragmentation changed only after the enactment of the 1988 Constitution, which represented a landmark in the democratic resurgence in Brazil. The Federal Constitution of 1988 sought to make the transition from an authoritarian, intolerant and quite often violent State to a democratic and social regime. This way, further to ensuring the right to social mobilization and, as a consequence, civil society's ability to organize itself to put pressure on the State in several areas, the 1988 Brazilian Constitution also specifically addressed socio-environmental issues in several of its articles, thereby ensuring the enjoyment of both individual and collective human rights by Brazilian citizens.¹⁶

Article 225 of the Constitution gives all citizens the right "to an ecologically balanced environment, as well as the common use thereof by the people and essential to the healthful quality of life, whereas the Government and the people have the right to defend and preserve it for the present and future generations."

Encouraged by the new regime, civil society at the end of the 1980s and, especially, during the 1990s reorganized itself into many social movements, and non-governmental organizations (NGOs) proliferated, many of them dedicated to socio-environmental issues.

The democratic re-opening ensured that international debates on the environment flooded into the country. In 1992 Brazil hosted the United Nations Conference on Environment and Development (Rio-92). Rio-92 was the birthplace of three important documents: the Convention on Biological Diversity; the Convention on Climate Change; and Agenda 21, a global action plan promoting sustainable development. Agenda 21 is a response to one of the major points of consensus reached during the Summit, which is that the most developed nations were primarily responsible for environmental degradation. It also recognized that developing countries needed financial and technological support to achieve a sustainable growth model.

At the national level, the country's mobilization in the run-up to the Rio-92 Summit drew attention to the discussion of environmental issues for a part of the population never before exposed to this subject. In particular, it reminded Brazilians of the importance of the richness of the country's biomes such as the Atlantic Rainforest and the Amazon Rainforest.

3 DEVELOPMENT OF THE CORPORATE GOVERNANCE AGENDA IN BRAZIL AND SUSTAINABILITY

The existence of sound and clear corporate governance rules is one of the cornerstones of the Brazilian capital market. Brazil is noted in the international literature as an example of a country in which self-regulation has been able to promote a healthy and vigorous evolution of corporate governance patterns.¹⁷

In 2000, the Brazilian Stock Exchange created special listing segments with governance requirements stricter than those required by Brazilian Corporate Law.¹⁸ The New Market (*Novo Mercado*), Level 2 and Level 1, are segments that help investors to screen and select the

¹⁶ Fürstenau-Togashi and Souza-Hacon, *The Evolution of the Socio-Environmental Debate in Brazil*.

¹⁷ Cf. the article discussed in the *Latin American Round Table* promoted by the Organisation for Economic Co-operation and Development: OECD, *Trends and Factors Impacting on Latin American Equity Market Development*, June 2013, where it is stated that: "[i]n the case of Brazil, it is interesting to note that the percentage of firms listed both at BM&FBOVESPA and on the New York Stock Exchange with ADR programmes at Level 2 or 3 has dropped from 14.3% in 2007 to 10.6% in 2011. During this same period, the percentage of BM&FBOVESPA firms listed on the Novo Mercado has risen from 30% in 2007 to 43% in 2011, suggesting that Novo Mercado may be acting as a substitute mechanism for Brazilian companies to signal better investor protection," p. 11, www.oecd.org/daf/ca/2013LatinAmericaCGRoundtableEquityMarketReport.pdf.

¹⁸ Law No. 6,404/197.

companies that are willing to provide further information, respect certain rules with the purpose of bringing quality to a company's management and ensuring minority shareholders are treated in a more balanced way than the remainder of the issuers.¹⁹

The special listing segments were created in the context of the deterioration of the Brazilian capital market,²⁰ as a solution to a long-held perception among capital market professionals that the legal system then in effect failed to provide investors with appropriate protections and guarantees.²¹ In view of a continuous degradation process, in the 1990s, the Brazilian stock exchange, fearing for the viability of the local stock market and, in this regard, its own existence, conducted studies intending to diagnose the major problems that doomed the market to a gradual and constant shrinking.²²

Solving most of these issues would require legislative changes at a time when there was not sufficient support in Congress for the new legislation. Therefore, the stock exchange, acting as a private agent with the encouragement of capital market authorities, drafted its own listing rules for voluntary compliance in the hope that requiring enhanced corporate governance would make the Brazilian market more attractive for investors. Companies join these listing segments voluntarily, under a contract, and undertake to comply with certain governance and transparency rules that are stricter than those determined by law or the sector's regulation.

Many other factors had to be combined for the Novo Mercado's success, especially the resumption of economic stability and growth from the second half of the 1990s to 2009. However, the meeting between investors and companies in the Brazilian market would probably not have happened through the capital market had the Novo Mercado not developed itself as a mechanism of screening and selection of companies with better corporate governance, which made investors' choices easier. Since the Novo Mercado was implemented, virtually all companies that made initial public offerings in Brazil did so in one of the special listing segments.

The Novo Mercado is the subject of periodic reviews in order to prevent their rules from becoming outdated. Since it was launched, three such reviews have taken place, in 2006, 2011 and 2017. Considering the contractual and voluntary character of the listing segments, the changes proposed by the stock exchange must be submitted for approval to the companies included in each one of the segments. Hence, any significant change in the regulation can only

¹⁹ "The basic premise guiding the creation of the Novo Mercado was that a reduction in investor perceptions of risk would improve share values and liquidity. Specifically, BOVESPA believed that investors would perceive the risks to be lower if they were granted additional rights and guarantees as shareholders, and if the asymmetry of access to information between controlling shareholders/company management and market participants was narrowed, if not eliminated." SANTANA, Maria Helena, *Novo Mercado and Its Followers in Focus 5, Global Corporate Governance Forum*, IFC, 2008, p. 11.

²⁰ Between July 1997 and December 2000, the value of the shares traded on the Brazilian stock exchange fell by 46.76%; in the same period, the share prices reflected by the variation of the IBOVESPA index, which measures the performance of the most liquid shares and is the main exchange index, had dropped by 34.32%. During that period, very few companies registered with the Brazilian Securities and Exchange Commission and the stock exchange to make initial public offerings of shares – between 1995 and 2000, only eight companies went public in the Brazilian market.

²¹ This perception of permanent expropriation of minority shareholders was reinforced by the 1997 reform, introduced by Law 9,457, the purpose of which was to facilitate the privatization process and maximize the gains of the State, as the controlling shareholder, in processes related to the telecommunications and electric sector. The 1997 reform thus deprived the minority shareholders of rights and protections associated with corporate transactions and corporate concentrations. For a discussion of the 1997 reform, see M. Pargendler, "State Ownership and Corporate Governance" (2012) 80(6) *Fordham Law Review*, <http://ssrn.com/abstract=1854452>.

²² The results of these studies and the proposals that gave rise to the Novo Mercado were summarized in J. R. M. Barros, J. A. Scheinkman, et al., *Desafios e oportunidades para o mercado de capitais brasileiro* (Bovespa, 2000), p. 10 (Challenges and Opportunities for the Brazilian Capital Market), www2.bmf.com.br/cimConteudo/W_Livros/mercado_capitais_desafios.pdf.

be implemented after a hearing with Novo Mercado's companies in which no more than one third of the companies of each specific segment opposes such change.²³

Discussions on sustainability were not included in the original proposal for the Novo Mercado or the 2006 and 2011 reviews. In the process of surveys and negotiations that preceded the 2017 reform, the stock exchange proposed for the first time that the companies in the segment showing a higher corporate governance level should publish an externally verified report containing social and environmental information, prepared according to an internationally accepted standard, such as the Global Reporting Initiative (GRI) or the International Integrated Reporting Council (IIRC).

During this round of negotiations, the stock exchange itself believed the proposal for the obligation to publish the social and environmental report would have higher chances of being accepted if there were no obligation to have the social and environmental report assured by an audit firm. It therefore submitted for voting by each one of the segments only the proposal that rendered mandatory the publication of a social and environmental report prepared according to an internationally accepted standard. Of 129 companies forming the Novo Mercado, 50 rejected the proposal, 49 backed it and 29 abstained from voting. With more than one third in opposition, the proposal was rejected. The same occurred in the other listing segments.

In the current Novo Mercado regulation, the sole reference to the sustainability agenda is in the rule on the Code of Conduct. Companies in the segment are required to prepare and disclose a Code of Conduct, approved by the board of directors and applicable to all of a company's employees and its management. Among other issues, it has to address the company's and its management's duties vis-à-vis civil society, such as socio-environmental responsibility, respect for human rights, and respect for labor relations.

The foregoing shows that socio-environmental themes still face strong resistance even among Brazilian listed companies that otherwise are willing to adopt governance rules stricter than the legal rule.

According to the specialists interviewed for this chapter, this resistance is lower or less pronounced among companies whose activities have a direct impact on the environment. Two factors ensure that socio-environmental matters are treated by these companies with greater care. The first is the pressure exerted by foreign investors, which are extremely important in the Brazilian capital market, representing approximately 50 percent of the volume traded on Brazilian stock exchanges.²⁴ The community of international investors demands a responsible posture from those companies whose activities have a direct impact on the environment. The second factor leading these companies to tackle socio-environmental themes is the perception that actions associated with commercial operations that damage the environment represent risks that effectively need to be addressed at these companies, as well as many others. For this very reason, they are now considered as corporate matters, they are handled by the compliance and risk divisions, and their strategic definitions are made by the top management.

²³ Article 76 of the Novo Mercado Regulation.

²⁴ According to B3's data, between July 2 and 31, 2018, foreign investors accounted for 48.5 percent of the daily volume of transactions on the spot market. Further information regarding the participation of foreign investors in the Brazilian capital market may be found in B3's website, www.b3.com.br.

3.1 State Regulation of Corporations and Sustainability

The legal framework for the majority of Brazilian companies is set forth in two main Acts: the Brazilian Civil Code²⁵ that regulates limited liability firms and the Brazilian Corporate Act²⁶ that regulates corporations. Only corporations can be listed, in which case they are also subject to the Brazilian Securities Act.²⁷

Article 154 of the Brazilian Corporate Act establishes that an officer shall use the powers conferred “upon him by the law and the bylaws to achieve the corporation’s purposes and to support the corporations’ interests, including the requirements of the public at large and of the social role of the corporation.” A similar command, in the sole paragraph of article 116 of the Brazilian Corporate Act, orders that “the controlling shareholder shall use its power to make the corporation accomplish its corporate purpose and perform its social role.” Except for those general principles and a few minimum requirements related to corporate governance, none of these Acts deal with sustainability issues.

In practice, the two principles are hardly ever directly associated with sustainability.²⁸ Most of the scholarship related to Article 154 focuses on the duties of the directors and officers toward the companies and shareholders as a whole, as opposed to some sort of loyalty toward the group of shareholders that appointed them.²⁹ This Article is also used as a starting point to discuss the need for officers and directors to conduct business in strict observance of the law, even when not complying with the regulations could be more profitable.³⁰ Similarly, the sole paragraph of article 116 of the Brazilian Corporate Act is used as a starting point to discuss the controlling shareholder’s duties to the company and to other shareholders as opposed to its own interests.³¹

In practice, although the wording of Articles 154 and 116 of the Brazilian Corporate Act could facilitate a much broader debate, these duties have not been explored by public prosecutors and administrative bodies to hold officers, directors and controlling shareholders to account for sustainability issues.

Only in very dramatic cases are corporate law duties interpreted as prescriptions of compliance with sustainability obligations. An example is the case of the environmental disaster that occurred in November 2015, with the collapse of the iron ore tailings dam, property of the mining company Samarco Mineração S.A., in the city of Mariana, State of Minas Gerais – considered the largest in Brazilian history. On the petition of civil action (*ação civil pública*) against Samarco and its controllers, Companhia Vale do Rio Doce and BHP Billiton Brasil Ltda., the government prosecutors expressly referred to the corporate law provisions concerning the liability of the defendants.³² Even in this case, Article 116 of the Brazilian Corporate Act was used as part of the argument of the public prosecutors, not as the legal basis to find the controlling shareholders liable for the environmental accident.

²⁵ Law No. 10.406/2002.

²⁶ Law No. 6.404/1976.

²⁷ Law No. 6.385/1976.

²⁸ See C. Salomão Filho, *O Novo Direito Societário*, 4th ed. (São Paulo: Malheiros, 2011), p. 201.

²⁹ See M. Carvalhosa, *Comentários à Lei das Sociedades Anônimas*, 5th ed. 3rd vol. I (São Paulo: Saraiva, 2011), p. 327.

³⁰ CVM Administrative Proceeding No. RJ2015/1760, www.cvm.gov.br/export/sites/cvm/noticias/anexos/2018/20180911_PAS_2015_1760_Embracer_Voto_DPR.pdf.

³¹ See M. Carvalhosa, *Comentários à Lei das Sociedades Anônimas*, 5th ed. 2nd vol. I (São Paulo: Saraiva, 2011), p. 562.

³² The full pleading for the civil action on this case is available at www.brasil.gov.br/noticias/meio-ambiente/2015/12/confira-documentos-sobre-o-desastre-do-rio-doce/acao_inicial_agu_es_mg_samarco.pdf.

In 2016, the State-Owned Enterprise Act was enacted.³³ Paragraph 2 of Article 27 of this law sets forth that SOEs “shall adopt environmental sustainability practices and corporate social responsibility policies compatible with the market in which they develop their activities.” Further, this Act commands SOEs to respect the principle of sustainable development when contracting with third parties.

SOEs had a 24-month period to comply with the duties of the State-Owned Enterprise Act and most of the efforts in this adaptation period were concentrated on objective rules, such as having independent directors on boards and forming audit committees. If there was some effort by SOEs on evaluating and improving sustainability practices as a result of the State-Owned Enterprise Act, this could not be noted by outsiders, even the ones following such companies closely.

The CVM requires Brazilian listed companies to produce and disclose annual, qualitative and periodic information at least since 1979.³⁴ Nonetheless, it was not until 2009 that the CVM, by means of the enactment of CVM Instruction no. 480, effective as of January 1, 2010, tackled socio-environmental issues.

CVM Instruction no. 480/2009 created the Reference Form, a document that listed companies must submit annually and that had among its main purposes to deepen the information provided by the issuers, especially those related to their internal organizational structures, policies and practices adopted in the process of deciding on sensitive issues, such as management’s remuneration and transactions with related parties.

The new rule substantially changed not only the quantity of information, but also the methodology for its provision. Instead of factual data, most of the new rules started to demand that the company reflected over its internal processes and governance structures. This change brought the Brazilian rules and standards much closer to those recommended by international institutions specialized in the securities market,³⁵ placing the organizational structure and the governance rules of the Brazilian securities issuers in the spotlight.

For the first time, listed companies were required to disclose their internal policies, practices and structures used in the process of formation of the corporate policy, that is, their decision-making processes, especially in regard to matters of greater sensitivity to the company’s operations. The purpose of these reforms of 2009 was to enlighten the organizational structures, many of them aiming for deeper discussions in Brazil, simply because of the lack of information.

In this context, the CVM started to request listed companies to submit annually a description of the significant effects of the State regulation on said companies, with specific comments on their environmental policies and the costs incurred for compliance with the environmental regulation, such as other environmental practices, including compliance with international environmental protection standards, in case they were adopted by the company.³⁶

In 2014, the Reference Form was updated and since then the document includes socio-environmental issues in the risk factors that may influence the investment decision.³⁷ Furthermore, as of said reform, securities issuers were required to disclose, in regard to their socio-environmental policies, the following information: (i) whether the issuer discloses corporate and environmental information; (ii) the methodology followed in the preparation of the

³³ Law No. 13.303/2016.

³⁴ Article 17 of CVM Instruction No. 9.

³⁵ Cf. IOSCO, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, September 1998, www.sec.gov/about/offices/oia/oia_corpin/crossborder.pdf.

³⁶ Item 7.5 b of the Reference Form.

³⁷ Item 4.1 j of the Reference Form.

information; (iii) whether the information is audited or reviewed by an independent entity; and (iv) the webpage on which the information can be found.³⁸

Finally, CVM is in the process of making it mandatory for companies to disclose, in the “comply or explain” format, their adherence to the Brazilian Corporate Governance Code – Listed Companies (*Código Brasileiro de Governança Corporativa*). While for the more liquid companies this obligation took effect in 2018,³⁹ it will take effect for the other listed companies in 2019. This Code was prepared during 2015 and 2016 by a working group formed by eleven entities related to the capital market and coordinated by the Brazilian Institute of Corporate Governance (*Instituto Brasileiro de Governança Corporativa*). The Code establishes a series of principles, and the companies are required to disclose if and how they adopt and comply with these principles.

Socio-environmental issues are mentioned in four of the Governance Code principles. The first principle is addressed to the board of directors which, according to the Governance Code, must perform their duties considering the long-term interests of the company and the impacts resulting from its activities on society and the environment. The second principle is addressed to the officers who are required to implement and maintain mechanisms for monitoring the company’s impacts on society and the environment. The Governance Code also establishes that the company’s CEO and board of executive officers are required to be assessed regarding performance, financial and non-financial targets, including environmental, social and governance aspects. Finally, the Governance Code recognizes that businesses are subject to risks, including socio-environmental risks, and that such risks have to be considered in managements’ decisions.

Therefore, CVM has been taking significant measures aimed at improving transparency relating to said policies and how companies deal with socio-environmental concerns within their governance structures.

3.2 SOEs Governance Program

Launched in 2015 by B3,⁴⁰ the SOEs Governance Program (*Programa Destaque em Governança de Estatais*) draws its inspiration from the Novo Mercado, but aims at publicly held SOEs and SOEs in the process of listing their shares. It was developed to encourage these enterprises to improve their corporate governance practices and structures in those areas where they differ from other listed companies. In order to voluntarily obtain the certification, the enterprises are required to fulfill the corporate governance measures set forth in the Program. This way, a Brazilian SOE may participate in the Novo Mercado’s listing segment and, at the same time, bear the Program’s certification.

The initiative had the purpose of contributing to the restoration of trust between investors and SOEs after the numerous corruption scandals since 2012 in Brazil, and it presented measures intended to assist in the reduction of uncertainties related to the conduct of business transactions and disclosure of information, as well as to mitigate the political component inherent in these enterprises’ governance, for example by setting forth a series of requirements for board members and directors.

³⁸ Item 7.8 of the Reference Form.

³⁹ Companies that belong to the IBX-100 Index of the Brazilian Stock Exchange (B3 S.A. – Brasil, Bolsa, Balcão).

⁴⁰ Press, Sustainability, Communication and Social Investments of the Brazilian Stock Exchange (B3 S.A. – Brasil, Bolsa, Balcão).

One of the items analyzed by the Program is whether the SOE's code of conduct or integrity encompasses its duties vis-à-vis civil society such as socio-environmental responsibilities, respect for human rights and employment relations. In addition, the Program analyses whether the SOE publishes an annual report containing environmental, social and corporate governance information, prepared according to any of the internationally accepted standards, such as the GRI or that of the international structure for integrated reporting of the IIRC. None of these items is mandatory; the certification is provided based on the scoring of a comprehensive number of corporate governance factors, and failure to comply with some of them does not prevent the SOE from obtaining the Program's certification.

3.3 Corporate Sustainability Index

In a pioneering initiative in Latin America, in 2005, Brazil's stock exchange, with the assistance of, and financial support from, the International Finance Corporation (IFC), a financial arm of the World Bank, created the Corporate Sustainability Index (*Índice de Sustentabilidade Empresarial* – "ISE") – the fourth index of the kind in the world – to identify and assess the performance of corporations that conduct their activities in a manner consistent with sustainable development demands.

The ISE is composed of approximately 40 companies chosen by a decision-making committee among the 200 more liquid stocks in B3. These companies are chosen according to answers given to a questionnaire intended to assess their sustainability performance. This questionnaire is quite comprehensive and investigates the companies' performance in seven dimensions that assess, in an integrated manner, among other aspects, environmental, social, economic and financial elements.

The ISE is a tool for the comparative analysis of companies' performance relating to corporate sustainability, and helps in identifying companies and groups committed to sustainability.

3.4 Financial Innovation Laboratory

Launched in 2017, the Financial Innovation Laboratory (*Laboratório de Inovações Financeiras* – "LAB") is another result of multilateral entities' influence on the debate on sustainability themes in Brazil. On an initiative of the Inter-American Development Bank, the CVM coordinates the LAB. It is a forum to discuss international experiences and build up an intersectoral dialog to encourage the creation of investment instruments and sustainable financial structures.⁴¹

The LAB aims at identifying bottlenecks to private investment in sustainable solutions in sectors such as energy, transport, agriculture, and water, as well as design of financial instruments to leverage innovative investments. The LAB has working groups on green finance, green securities, FinTechs, and financial and investment instruments of impact.

4 THE BANKING SYSTEM AND SUSTAINABILITY

The banking system in Brazil is large, sophisticated and concentrated in the hands of a small number of large institutions. Another important feature of the Brazilian financial system is the existence of a significant number of banks owned by federal and state governments, some of

⁴¹ The LAB's website, www.labinovacaofinanceira.com.

which, especially the federal State banks, are quite significant in the agribusiness financing market.

The Central Bank of Brazil (*Banco Central do Brasil* – “Bacen”) is a federal entity responsible for overseeing and inspecting institutions in the national financial system including those controlled by governmental entities. The Bacen, very much due to its significance in the Brazilian economy, has been assuming a prominent role in international debates on banking regulation and financial stability. In view of this active participation in such forums, since 2008, the Bacen has been contemplating socio-environmental issues in the regulation of the Brazilian financial institutions.

Until 2011, despite the pioneering approach on the national stage, all of Bacen’s initiatives related to the sustainability agenda focused on financing made with public resources or with resources managed by public banks.

The first mention of the environment in financial system regulation was in Resolution no. 3,545/2008 enacted by the National Monetary Council (*Conselho Monetário Nacional* – “CMN”), the purpose of which was to amend the Rural Credit Manual, a document containing general rules about rural credit that applies to both the beneficiaries of the credit and the financial institutions operating in the National System of Rural Credit (*Sistema Nacional de Crédito Rural*), which is exclusively formed by State banks actively operating in the agricultural sector, whose financing, in general, is with funds subsidized by the National Treasury. The first socio-environmental measure taken up by the Bacen was to insert in the Rural Credit Manual the requirement for documentation evidencing compliance with environmental regulations in order to obtain financing in the Amazon Biome.

In 2009, CMN banned the financing of sugarcane farming in the Amazon and Pantanal Biomes and in the Upper Paraguay River Basin, among other areas.⁴² In 2010, CMN Resolution no. 3,896/2010 aimed at reducing gas emissions related to agribusiness by financing the recovery of degraded pasture and other areas in connection with programs using resources from the BNDES. Finally, CMN also regulated the use of funds of the National Fund on Climate Change (*Fundo Nacional sobre Mudança do Clima*) to finance projects, studies and undertakings aiming at the reduction of greenhouse gas emissions and adaptation to climate change effects.⁴³

In 2011, Bacen started to question private financial institutions about sustainability-related issues. Both documents regulate the Internal Capital Adequacy Assessment Process (*Processo Interno de Avaliação de Adequação de Capital* – “Incaap”).⁴⁴ They determine that the sufficiency of capital to be maintained by financial institutions should depend upon their strategic purposes and the risks to which they are subject over certain time horizons. In the first version of this rule, the Bacen requested the financial institutions to show, in the assessment and *Incaap* calculation process, whether they had the required level of capital for the risks resulting from exposure to socio-environmental damages. The second version of the Bacen Circular addresses socio-environmental risk as a category of ordinary risks to which financial institutions are exposed, and consequently determines that the *Incaap* has to cover the assessment and measurement of the need of capital for the socio-environmental risk. Hence, in relation to private financial institutions, the Bacen chose to address sustainability issues as part of the risks to be identified and managed or mitigated.

⁴² CMN Resolution No. 3,813/2009.

⁴³ CMN Resolution No. 4,008/2011 and CMN Resolution No. 4,267/2013.

⁴⁴ Circular No. 3,547, later replaced by Circular No. 3,846/2017.

Finally, in April 2014, the Bacen compelled financial institutions to adopt a Socio-Environmental Responsibility Policy (*Política de Responsabilidade Socioambiental*).⁴⁵ Bacen rules are not very prescriptive in regard to the content of such policies. Its focus is, on the one hand, on the governance structures implemented to assess, monitor, and improve the policy itself, and, on the other, on the management of the socio-environmental risks that were identified.

Thus, each institution's policy should contain principles and guidelines to direct socio-environmental actions in the institution's business transactions and in its relationship with its clients and users of its products and services, as well as with other persons who, in the institution's judgment, are impacted by its activities. Said policies must be approved by the officers and board of directors, where it exists, and be re-assessed every five years.

In order to ensure the policies are properly adopted, financial institutions are required to maintain a governance structure, procedures and systems to monitor the policy's implementation, assess its effectiveness, assess socio-environmental risk management within this policy as well as identify any deficiencies.

Finally, the Bacen determines that the preparation of social-environmental policies must take into account the principles of significance and proportionality. Resolution no. 4,327 of 2017 defines significance as the level of exposure to socio-environmental risks of each institution's activities and transactions, and proportionality as to the consistency between the policy and the institution's nature and the complexity of its activities and its financial services and products.

Concerning the self-regulation of financial institutions, there are two initiatives that should be mentioned. First, in the attempt to assist private financial institutions in the preparation of their social-environmental policies, the FEBRABAN enacted Normative Act SARB no. 14 of 2014 that established a self-regulation program for the development and implementation of socio-environmental responsibility policies. Said program aims at formalizing fundamental guidelines and procedures for the assessment and management of socio-environmental risks into business transactions and the relationship with clients and other stakeholders.

The second initiative concerning the self-regulation of financial institutions is enforced by the Brazilian stock exchange. B3 has an Operational Qualification Program (*Programa de Qualificação Operacional*) to assess and attest to the quality of the services provided by banks and brokerage firms. Such a program operates as a quality certification; indeed, certain institutional investors only do business with brokerage firms and banks bearing said qualification.

Based on the analysis of a series of requirements and indicators, B3 prepared two sets of requirements to be followed by the participants: the first concerns conformity to the market regulation, and the second the nuances of the specific strategy for each business. The first set of requirements contains two items that are related to the socio-environmental agenda, namely, the obligation delegated to the board of executive officers to monitor the implementation of the social-environmental policy, which is mandatory under Bacen's regulation, and the participants' duty to establish and disclose their socio-environmental actions to their clients.

In view of these facts, the Bacen opted for regulating socio-environmental issues in private financial institutions by means of the identifying and monitoring risks associated with environmental impact of commercial practices and how those risks are acknowledged and managed within the governance of the financial institution. On the one side, this option fills the need for a regulation that can be applied to both small institutions and the powerful financial

⁴⁵ Resolution No. 4,327/2014.

conglomerates existing in Brazil. On the other, it reinforces the regulator's option to deal with socio-environmental issues, at least in regard to private institutions, primarily from the perspective of its potential financial and reputational impact.

The self-regulation of financial institutions has limited itself to, on the one hand, assisting financial institutions by providing more concrete parameters on which to prepare their social-environmental policy, and, on the other, making the granting of a quality certification conditional on that policy being in place and appropriately treated from the perspective of each institution's governance.

5 CONCLUSION

This chapter has provided a survey of the initiatives and regulations connecting the sustainability and corporate governance agendas in Brazil, concentrating on the securities market and banking sector, where most progress is found. This chapter shows that, although corporate governance has evolved considerably in Brazil over the past decades, neither State regulation nor self-regulation provide for the institutions' obligation to adopt social-environmental policies or disclose socio-environmental information according to the international standards generally adopted for such reports.

The information on these issues is limited to what needs to be disclosed on the financial and qualitative information forms required by the capital market regulator, such as the risk of labor or environmental contingencies and the companies' internal policies.

The few companies that voluntarily adopt clear policies to deal with socio-environmental themes and disclose such information in a more integrated manner are those whose activities have a direct impact on the environment. The risks inherent in this impact combined with the pressure from international investors encourage these companies to develop voluntary socio-environmental policies and disclose such information based on internationally accepted standards.

The banking sector has advanced a bit further in this regard. Since 2014, the Bacen has required financial institutions to adopt social-environmental policies that also cover their relationship with their clients. Although the regulation does not establish a minimum content for such policies, it seems to encourage the institutions to think of socio-environmental matters by means of the identifying and monitoring risks associated with environmental impact of commercial practices and how those risks should be acknowledged and managed within the governance of the financial institution.

Large, non-financial listed companies and financial institutions are less resistant agents to socio-environmental issues than other significant sectors of the Brazilian economy, such as the agribusiness sector. At least, it seems as if these sectors do not have organized entities engaged in fighting against the development of the sustainability agenda.

Nevertheless, Brazilian financial and non-financial companies are still not aware that the overarching purpose of the sustainability agenda is to ensure a safe operating space for humanity. There is nothing in the State or self-regulation rules and regulations aimed at effectuating, even if gradually, a change in how socio-environmental issues are integrated into the governance of Brazilian companies. With rare exceptions, the advancements observed in this area seek to improve the management and mitigation of socio-environmentally related financial and reputational risks; attracting investors, especially international investors; and leveraging their economic and financial performance.

We see little possibility for improvement in the near future. In January 2019, Jair Bolsonaro initiated his term as President of Brazil. His main campaign promise in the environmental area is to merge the Ministry of Environment with the Ministry of Agriculture, since there are likely synergies between these two areas. Because of the reaction of the international and national press, soon after being elected Mr. Bolsonaro announced that the two ministries would remain separate. In selecting the new Minister of Environment, however, he indicated that he would be looking for a person who is not too radical and would be sensitive to the needs of the Brazilian agribusiness industry.