Addressing SESG: aligning words and actions

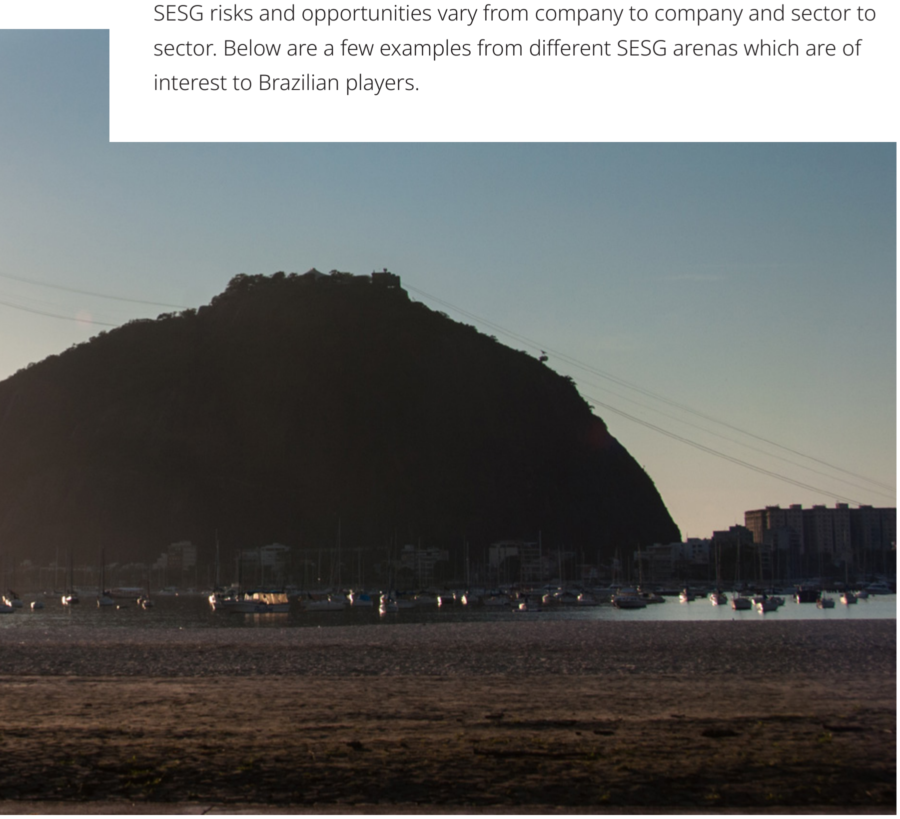
DLA PIPER

CAMPOS MELLO ADVOGADOS
IN COOPERATION WITH DLA PIPER

4) What is happening in Brazil around SESG?

A recent publication by DLA Piper brought to light the current “departure from the Friedman Doctrine of maximizing shareholder value” to “SESG strategies showing how they are addressing SESG risk and distinguish themselves from the pack as well.” This is based on a growing understanding that companies’ responsibility to serve all stakeholders is increasingly becoming a norm in international business. Of course, major geopolitical and social issues undergird this change. But businesses are already moving to the fore of this discussion, with many seeing SESG as a way to disrupt “business as usual” and obtain competitive economic advantages along the way. is definitely following this trend.[7]

SESG risks and opportunities vary from company to company and sector to sector. Below are a few examples from different SESG arenas which are of interest to Brazilian players.



Energy

The energy industry has been at the forefront of SESG for some time. SESG principles align with several challenges the power sector will face in the near future. One of these challenges arises from the tension between energy demand and the need to decarbonize energy generation. Renewable sources are key to addressing this task and Brazil has some promising numbers:

- Brazil has some of the highest shares of renewable energy use in the world, and solar generation is definitely on the rise, with at least 5.3 GW of new photovoltaic solar power expected in 2021, an increase of 65.6 percent over last year
- With over 80 percent of our power matrix already supplied from renewable sources, Brazil has natural characteristics that make us a world leader in renewable power.

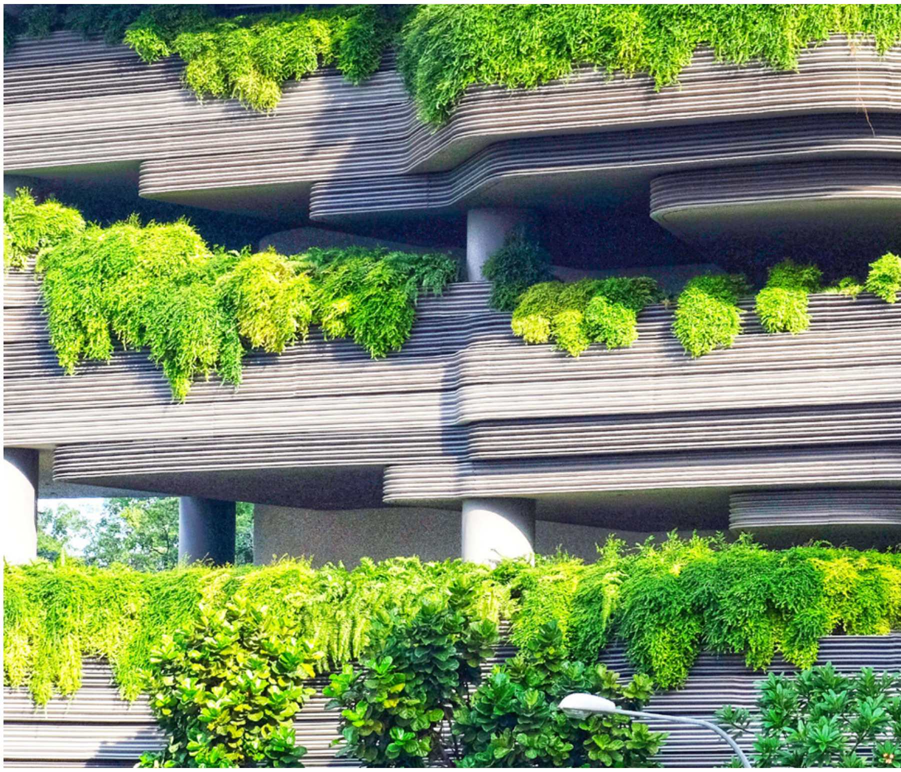
For companies pursuing renewable energy as part of their SESG strategies, bioenergy (that is, energy from organic matter from plants and animals, such as biomass, biomethane and biogas) may be an important component. As a result, we have seen a growing number of laws aimed at encouraging and regulating bioenergy generation at both the federal and state levels in Brazil.

The incorporation of SESG principles in companies’ business plans is also leading to growth in other areas in the Brazilian energy market:

- **The market for International Renewable Energy Certificates (I-REC).** The number of Brazilian I-RECs nearly doubled from 2.5 million in 2019 to around 5 million in 2020
- **The energy efficiency market.** The use of renewable distributed generation and smart grid technologies combines the “Three Ds” of modern power generation: decarbonization, decentralization and digitalization.

Financial services

- The Brazilian Securities and Exchange Commission (CVM) is currently in the process of improving the standards of reference forms released by publicly held companies to include information related to SESG issues and promote a broader disclosure of the social, environmental and climatic risk factors to which companies are exposed and how to mitigate these risks. CVM will also require companies to (i) publicly report on their commitment to the Sustainable Development Goals relevant to each business individually; (ii) adopt SESG-performance indicators; and (iii) provide information on gender and racial diversity in staff and management positions, as well as differences in pay between different positions and between genders and races.
- A new SESG index emerged in September 2020 when S&P Dow Jones Indices (S&P DJI) and the Brazilian Stock Exchange (Brasil Bolsa Balcão – B3) jointly developed the S&P/B3 Brazil SESG Index. The Index is designed to measure the performance of securities in meeting sustainability criteria. Companies involved in the weapons, tobacco, or thermal coal businesses and companies with disqualifying United Nations Global Compact scores are excluded. Remaining eligible companies are then weighted in the index by their S&P DJI SESG Score resulting from a corporate sustainability assessment. The S&P/B3 Brazil SESG Index currently has 96 companies in its portfolio.
- In the past year, the Brazilian government has been focusing on creating opportunities for green investments. At the start of 2021, the government launched the following program as a strategy to protect the country's forests and avoid deforestation, especially in the Amazon region:
  - *Increase in forest concessions* addresses private management of public forests through their sustainable forestry management practices.
  - *Adote um Parque (adopt a park)* seeks to attract resources to fund the conservation and maintenance of federal conservation units throughout the country.
  - *National Program of Environmental Services (Floresta+). Floresta+* is intended to promote and consolidate the environmental services market so that the economic value of activities such as conservation and monitoring in native forests are properly valued through financing from individuals, NGOs, private companies, and international cooperation agencies.



- FEBRABAN (Federação Brasileira de Bancos) has also presented a proposal to create a green taxonomy in the Brazilian banking system to establish criteria for banks to analyze how their portfolios address exposure to socioenvironmental risks.

Real estate

The real estate sector has long sought to adopt sustainable practices, both through environmental certifications (such as the LEED certifications offered by the Green Building Council) and through the adoption of environmental management systems, such as the International Organization for Standardization's ISO 14001.

According to a survey conducted by GBC, civil construction is responsible for about 75 percent of Brazil's annual natural resource consumption, 44 percent of the country's energy production, and 39 percent of Brazil's net carbon emissions related to energy. The GBC also indicates that projects with sustainability certifications consume 40 percent less water and 30 percent less energy, and they generate 65 percent for

waste. In addition to these benefits, these projects are also more flexible, have lower raw-material consumption and costs, and often higher resale values.

Below are only a few of the many examples of how policies aiming to making civil construction more sustainable are benefiting people and the environment:

- Some Brazilian municipalities have instituted projects granting discounts in the value of the real estate property tax (IPTU) for taxpayers who adopt environmentally beneficial practices, such as the use of renewable energy, rainwater collection and use, improved waste handling, and building features like green roofs and permeable paving.
- Brazilian regulators are beginning to require more sustainable practices in the development of real estate projects. In Rio de Janeiro, for example, new regulations require some new buildings to have water reservoirs for rainwater storage and meet energy efficiency criteria.
- Real estate investment funds are also beginning to adopt sustainability principles. A fund structured by Integral Brei has helped raise funds to create a "smart city" in Brasília/DF. This smart city will be developed in a 1 million square meter area and will house several construction projects. It is intended to be a district of innovation and a home for technology companies and startups.
- The National Development Bank (BNDES) has signaled the importance of sustainability and governance by developing financial instruments (such as green bonds) to raise capital for sustainable economic activities.
- These new instruments bring a fresh approach to project finance for residential, commercial, and other real estate projects developed under the BNDES guidelines, such as compliance with Brazilian legislation and environmental licensing.

Life sciences and healthcare

- Life sciences and healthcare companies must demonstrate the environmental integrity of their manufacturing processes and their philosophy on patient access and (as seen in the current developments around COVID-19 vaccines) their readiness to collaborate with competitors in service of the greater good.[8] This includes a range of issues, such as transparency in access to clinical trials, the ethical use of data, and affordability of access.
- Disruptive technologies have gained considerable market share in most of the crucial industry sectors, and the life sciences and healthcare sectors are no exception. The greater focus on patient experience (preventive care and wellness), new disease diagnosis and management techniques, product-life cycles, and the use of AI, machine learning, automation, robotics, and other disruptive technologies will all play an important role in future.
- Boards of life sciences and healthcare companies should also be aware of the impact of their manufacturing, production and supply chain processes. These include considerations of how raw materials are sourced; how products are designed, manufactured, packaged, sold, reused or recycled; how waste and hazardous materials are treated; and how to manage wider environmental and social impacts related to issues like emissions, plastics, water use, biodiversity loss, labor conditions and local communities. All this takes place in the context of an evolving regulatory landscape and a growing need to translate SESG "authenticity."
  - For example, in terms of environment, manufacturers, importers, and distributors of medicines are required to adopt all measures to ensure the implementation and operation of the reverse logistics system (take-back system – *this is not a novel initiative but has been more than ever put in the spotlight due to SESG rising demand*). Under that system, distributors must collect and return products and packaging to the manufacturers or importers, which are in turn responsible for returned products' environmentally appropriate disposal. Since the enactment of a federal law covering such takebacks, new rules have also been enacted at the federal and state levels to regulate this obligation, contributing to the adoption of sustainable measures regarding product life cycles. As major companies address takebacks and waste management, their approaches will become templates for the industry at large.
- The way in which businesses respond to these expectations can have a direct impact upon their reputation and ultimately upon their license to operate.

Insurance

- Because of SESG's relevance to risk management, the Brazilian insurance sector has been at the fore in adopting SESG principles. In 2016, the Brazilian Private Insurance Superintendence (Superintendencia de Seguros Privados, SUSEP) issued a letter to inform the market of an initiative to support the Principles for Sustainable Insurance (PSI)[9] of the Financial Initiative of the United Nations Environment Program (UNEP FI) and with support from the International Association of Insurance Supervisors (IAIS).
- SUSEP's initiative followed the steps of the Brazilian Federation of Insurers (Confederação Nacional das Empresas de Seguros Gerais, Previdência Privada e Vida, Saúde Suplementar e Caitalização, CNSEG), which has 170 supervised entities as members and has supported PSI since 2012. Many Brazilian insurers were already following PSI's principles and guidance.
- As part of its commitment to PSI, SUSEP begun monitoring SESG in the Brazilian insurance market. Its first step was to identify sustainable practices within the industry with a questionnaire asking members to comment on sustainable initiatives in their operations. The questionnaire was inspired by the initiatives of the UK's Prudential Regulatory Authority and Bank of England, as well as the National Association of Insurance Commissioners in the US.
- In June 2016, SUSEP issued a report aggregating information gathered from the market and noting that sustainability was high on the agenda for most insurers, even though effective steps to put sustainable principles in practice were still in development. The report also noted SUSEP's own commitment to its own sustainability, evinced by its developing awareness on sustainable practices internally.
- In May 2018, the leadership of CNSEG, SUSEP and UNEP-FI signed the "Rio Declaration on the transparency of climate risk for the Brazilian insurance sector."[10] The Rio Declaration affirms the commitment of the Brazilian insurance industry to meeting the temperature goals of the Paris Agreement on Climate Change and establishing dialogue on practical and effective measures to comply with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).
- The Rio Declaration also shows the Brazilian insurance sector's commitment to the PSI and SUSEP's engagement with Brazilian supervised entities in implementing the TCFD's recommendations.
- Since then, although no enforceable regulations yet require supervised entities to implement sustainable measures in their operations, SUSEP has been issuing regulations encouraging the supervised entities to invest in sustainable portfolios and promoting increased awareness of the importance of sustainability to the industry. This year, SUSEP expressly committed in its annual regulatory plan to enact specific regulation covering SESG.

Apart from these industry sectors, but highly relevant to all…

Brazil's Labor Public Prosecutor Office recently issued new guidance for employers on LGBTQIA+ rights. And in late 2020, the Committee for the Promotion of Equal Opportunities and Elimination of Discrimination at Work produced a Technical Note with guidelines for protecting of rights of members of the LGBTQIA+ community in the workplace. The Technical Note contains seven recommendations for employers. Although these recommendations are not legally binding, compliance is important for ensuring a healthy working environment for all employees and for avoiding labor claims and other adverse consequences for the employer. Among other points, the Technical Note recommends the following:

- Employers should use an employee's social name for all purposes, regardless of whether the employee has obtained a legal name change.
- The employer is responsible for ensuring a healthy working environment that promotes all employees' physical and psychosocial health.[11] Employers should thus help to resolve psychosocial risks, adopting measures to prevent violence, harassment, and other acts of prejudice and intolerance against LGBTQIA+ employees.
- Transgender employees should have access to gender-restricted spaces in the workplace (such as bathrooms) according to the employees' gender identity, as opposed to their biological sex.
- LGBTQIA+ employees' right to parental leave should be honored as established by law.
- During the COVID-19 pandemic, employees living with people who are part of a risk group should be offered the possibility of performing their activities remotely, since it is the company's responsibility to ensure the compatibility of employees' professional and family responsibilities.
- Employers should be aware of signs of domestic violence against their LGBTQIA+ employees and take appropriate action if signs are identified, such as by warning the competent authorities and prioritizing the victim's safety.

A growing number of employers are focusing on D&I policies and devising new recruitment processes to avoid workplace discrimination, including in the selection of candidates and the admissions process.

To clarify: SESG is good for the world and good for the company

Harvard Business School has published a study of global firms suggesting that those paying consistent attention to material SESG issues perform better than their competitors:

> *"[…] Firms performing better on material sustainability issues experience relatively more positive changes in profitability margins. Specifically, we find that changes in return-on-sales (ROS) and sales growth are more positive for the portfolio of firms performing better on material issues. […]*
>
> *"We find that firms with superior performance on material sustainability issues outperform firms with inferior performance on material sustainability issues in the future"* [12]

Key SESG Contacts

Fabio Perrone Campos Mello
Managing Partner
T +55 21 3262 3027
fcamposmello@cmalaw.com

Marcella Hill
Head of Insurance Sector Group, member of DLA Piper International Insurance Task Force
T +55 11 3077 3507
marcella.hill@cmalaw.com

Natasha Najman
Senior Associate
T +55 11 3077 5637
natasha.najman@cmalaw.com

Marcus Bitencourt
Head of Financial Services Sector, Co-Head of Corporate, M&A and Capital Markets practice
T +55 21 3262 3008
mbitencourt@cmalaw.com

Fabiano Gallo
Head of Energy and Natural Resources Sector, Co-Head of Corporate, M&A and Capital Markets practice
T +55 11 3077 3574
fabiano.gallo@cmalaw.com

Rafael Bussière
Head of Real Estate and ICT Sectors, Head of Environmental, Real Estate, Hospitality and Leisure practices
T +55 21 3262-3048
rbussiere@cmalaw.com

Aline Brayner
Financial Services Sector
T +55 21 2217-2012
aline.brayner@cmalaw.com

Flávia Cerutti
Energy and Natural Resources Sector
T +55 11 3077-3527
flavia.cerutti@cmalaw.com

Gabriela Mello
Industrial Sector
T +55 11 3077-3568
gabriela.mello@cmalaw.com

Juliana Nunes
Industrial Sector
T +55 11 3077-3558
juliana.nunes@cmalaw.com

Bruna Rocha
Life Sciences and Healthcare Sector
T +55 11 3077-3525
bruna.rocha@cmalaw.com

Carla Steinberg
Energy and Natural Resources Sector
T +55 11 3077-3542
carla.steinberg@cmalaw.com

Endnotes

1 https://www.dlapiper.com/en/uk/insights/publications/2021/01/beyond-woke-acting-now-sesg/

2 https://www.forbes.com/sites/tinethygesen/2017/01/24/innovation-isnt-created-the-way-people-think/?sh=6a266ffe5a8c

3 https://www.dlapiper.com/en/us/news/2020/11/dla-piper-launches-sustainability-and-esg-portal-to-help-clients-thrive-in-a-sustainable-future/

4 https://www.dlapiper.com/en/us/insights/publications/2021/01/biden-administrations-ambitious-climate-agenda-starts-now

5 https://www.dlapiper.com/en/uk/insights/publications/2021/02/sfdr-are-you-ready/

6 Ibid.

7 https://lifesciences.dlapiper.com/post/102grik/the-importance-of-an-sesg-strategy-for-life-sciences-companies

8 https://www.dlapiper.com/en/uk/insights/publications/2021/01/beyond-woke-acting-now-sesg/

9 SUSEP 2016 Sustainability Report: http://www.susep.gov.br/setores-susep/seger/codin/Ryou elatorio%20de%20Sustentabilidade%202016%20v%20final.%20docx.pdf

10 https://midias.cnseg.org.br/data/files/53/F2/D1/15/B8A6361019FF6136F98AA8A8/Declara__o%20do%20Rio.pdf

11 The rights of members of the LGBTQIA+ community are based on the principles of human dignity, equality and non-discrimination, as set out in the Federal Constitution.

12 https://dash.harvard.edu/bitstream/handle/1/14369106/15-073.pdf?sequence=1

13 https://www.dlapiper.com/en/us/news/2020/11/dla-piper-launches-sustainability-and-esg-portal-to-help-clients-thrive-in-a-sustainable-future/

14 https://treediversidade.com.br/