Appraisal Environmental and Social Review Summary

Appraisal Stage

(ESRS Appraisal Stage)

Date Prepared/Updated: 11/29/2022 | Report No: ESRSA02359

BASIC INFORMATION

A. Basic Project Data

Country	Region	Project ID	Parent Project ID (if any)
Brazil		P178888	
Project Name	Brazil Climate Finance Project		
Practice Area (Lead)	Financing Instrument	Estimated Appraisal Date	Estimated Board Date
Finance, Competitiveness and Innovation	Investment Project Financing	8/23/2022	12/22/2022
Borrower(s)	Implementing Agency(ies)		
Banco do Brasil	Banco do Brasil		

Proposed Development Objective

To support the expansion of sustainability-linked finance for climate mitigation and strengthen capacity to access high quality carbon credit markets in Brazil.

Financing (in USD Million)	Amount
Total Project Cost	1896.00

B. Is the project being prepared in a Situation of Urgent Need of Assistance or Capacity Constraints, as per Bank IPF Policy, para. 12?

No

C. Summary Description of Proposed Project [including overview of Country, Sectoral & Institutional Contexts and Relationship to CPF]

The proposed project seeks to support the expansion of sustainability-linked finance for climate mitigation and strengthen capacity to access high quality carbon credit markets in partnership with Banco do Brasil (BB), a large commercial bank with significant strength in financing key sectors linked to Brazil’s carbon footprint. This is a financial intermediary (FI) project where the Bank is supporting a credit entity (BB) to fund clearly defined FI subprojects. It seeks to offer an integrated package of financing and TA to attract investors and firms committed to achieve mitigation outcomes through sustainability-linked finance and carbon markets. The project comprises two components:

Component 1: Expanding access to sustainability-linked finance for mitigation. This component aims to support Brazil's climate mitigation outcomes through the expansion of sustainability-linked finance through a sustainability-linked credit line and a climate debt fund.

Component 2: Technical assistance. This component would provide technical assistance to Banco do Brasil to develop solutions that support beneficiaries in adopting credible mitigation plans and targets, reducing the high transaction costs of creating high-quality carbon credits, and increasing access to carbon credit markets.

D. Environmental and Social Overview

D.1. Detailed project location(s) and salient physical characteristics relevant to the E&S assessment [geographic, environmental, social]

The project will have a national scope. BB holds 800,000 clients in the SMES segment and 269,000 clients in the agribusiness segment spread all over the country. The project has the target of financing 25,000 subprojects for infrastructure projects and for the agricultural sector with the potential to generate carbon credits or reduce GHGs. Brazil is a critical player for mitigating global climate change in view of its size and potential for carbon sink and removal. Brazil carbon footprint has been growing over the past ten years, with GHG emissions rising by 2.3 percent annually on average, making it one of the top ten global emitters by virtue of its size. In 2018, it contributed 2.9 percent of global net Green House Gas (GHG) emissions. By 2020, Brazil accounted 2.16 billion tCO2e gross emissions. Its emissions growth is dominated by land use change and forestry (LUCF) and it is ranked second in the world in terms of net emissions from these sectors as Brazil's institutional framework for environmental sustainability faces important difficulties in implementing and enforcing measures against deforestation. Much of this LUCF emission is coming from the Amazon, a globally important carbon sink of which 60 percent is in Brazil as well as from the deforestation of the Cerrado biome (an agricultural powerhouse). In 2020, LUCF were the largest emitters, accounting for 998 million tCO2e (or 46 percent of the total country emissions). In the same year, agriculture and cattle raising accounted for 577 million tCO2e (27 percent). Brazil's energy sector came in third place (nearly 394 tCO2e and 18 percent) largely because of the significant share of renewables in the country's energy matrix (18 percent), whereas industrial processes and wastes were relatively smaller gross emitters (100 and 92 million tCO2e, respectively). Brazil's NDC program target of a 50 percent reduction in GHG emission reductions from 2005 levels by 2030 translates into 1.28 GtCO2e. Also, the Country has committed to become net-carbon neutral by 2050. However, to meet its NDC and realize its potential for carbon removal, Brazil needs an acceleration in market-based financing. Brazil's participation in voluntary carbon credit markets amounted to only 3.6 percent of the global voluntary marketing (equivalent to $ 1.2 billion) by the end-2021. The country has the potential to increase this share to 10 percent by 2030, driven by the forest sector. These levels of generation of carbon credits could generate revenues close to at least US$ 100 billion or higher. This revenue generation potential could be harnessed by the strengthening of a robust carbon finance market in Brazil, and its linkages to the global carbon markets.

Brazil is also pointed out as one of the countries with the greatest potential for the development of the Voluntary Carbon Market in view of its rich biodiversity, conserved areas, and potential for renewable energy. This market is dominated by Energy projects (63%), followed by projects in Agriculture, Forestry and Other Land Uses (25%). But the regulatory framework for carbon markets is still under development, posing risks around the integrity of its carbon credits in the absence of well-defined domestic standards and regulatory uncertainty that could affect demand in the market. The Central Bank has put a strong focus on reducing Brazil's carbon footprint and the momentum it has built in adopting strong regulations for making the financial sector more environmentally and socially sustainable through, for e.g., tighter reporting and more systemic climate risk assessment. A proposed Bill for establishing the Brazilian Emissions Reduction Market and regulating carbon credits transactions is currently under discussion by the Chamber of Deputies and listed as a priority legislation for this calendar year. It would regulate critical aspects of the voluntary market, including its standards, and propose the introduction of a compliance market.

D. 2. Borrower's Institutional Capacity

The BB was founded in 1808 and is the first financial institution listed in the Brazilian Stock Exchange. The Federal Government controls just above half of the total shares but BB operates commercially. There is no other investor with more than 5 percent of the shares. BB has 3,977 branches and is present in 96.6 percent of the Brazilian municipalities. It has 75.3 million customers (including 21.9 million digital customers). The expanded loan portfolio (including private securities and guarantees) reached 814.2 billion Brazilian reais (circa of USD 162 billion), split between individuals (31 percent), agribusiness (28 percent), small and medium size companies (11 percent), corporations (18 percent) and Government (7 percent). BB's sustainable loan portfolio reached 282.1 billion Brazilian Reais (35 percent) distributed between social loans (48 percent), socioenvironmental best practices (26 percent), low carbon agriculture (15 percent) and companies (11 percent). Loans to renewable energy reached 7.4 billion Brazilian Reais; investments in environmental, social and governance funds equaled 4.4 billion Brazilian Reais; and Green Commercial Papers captured 158 million reais in three months.

BB's policies and processes incorporate the increasingly demanding regulations of the Brazil Central Bank (BCB), the National Monetary Council (CMN) and Banking Self-Regulation System of the Brazilian Federation of Banks – (SARB/FEBRABAN) that apply to financial institutions operating in Brazil on responsible social, environmental and climate policies (Resolution 4,327/14, Ordinance 3,846/2017 and Resolution BCB 139/2021).

BB's operations also incorporate a range of voluntary practices. BB has been a signatory to the Equator Principles since 2005. Illustratively, BB also adheres to the IFC's Performance Standards on Environmental and Social Sustainability and the World Bank Group's General Environmental, Health and Safety (EHS) Guidelines, and is a signatory of the Green Protocol Program and the Principles for Responsible Investment (PRI).

Since 2005, BB has enacted policies and plans to reduce negative environmental and social impact of its lending portfolio. Now in its eighth version, BB's Sustainability Plan (Agenda 30 BB 2021-2023), that was approved by the Executive Sustainability Committee, contains 10 Long-Term Commitments to 2030 under three blocks: Sustainable Businesses, Responsible Investment and ESG and comprises 40 actions for the period 2021-23. BB's Board of Directors approved a Socio-Environmental Responsibility Policy (the "Policy") in December 19th, 2019 and BB has developed Sustainability Credit Guidelines for Loans (the "Guidelines") that comprises a set of 52 guidelines and applies to the concession of loans to ten sectors – Agrobusiness, Irrigated Agriculture, Civil Construction, Cement, Energy, Mining, Oil & Gas, Transportation, Pulp & Paper, and Steel. These Guidelines focus on four key thematic areas and call attention to 14 relevant socio-environmental issues. They list Excluded Activities, Restricted Activities, and Alert Activities.

BB's organizational structure encompasses:

- The Risk and Capital Committee approved in 2017 by the Board of Directors and responsible for advising the Board of Directors on the approach to risk management (including environmental and social risks).
- Two units directly related with sustainability issues: one directly linked to the CFO for dealing with corporate sustainability issues and another for environmental and social risk management in its credit operations under the Risk Management Board. The latter is responsible for the implementation of BB Socioenvironmental Responsibility Policy.
- A Strategic Sustainability Forum composed of BB executives and responsible for (a) supporting the process of incorporation, alignment and dissemination of BB's sustainability principles and practices and (b) monitor the

environmental and social initiatives and the implementation of the actions provided for in Agenda 30 BB. The Forum reports to the Business Executive Committee.
BB's Risk Management Department (DIRIS) is responsible for the global management of risks, including environmental and social risk management, for classifying the risk by sectors and for assigning the socio-environmental rating to clients. The customized assessment is the responsibility of the Credit Department. The screening and assessment of Environmental, Social and Governance (ESG) risks are made internally by a specialized team which is independent and segregated from the commercial area. This procedure aims to assure an unbiased analysis. Thus, the socio-environmental risk assessments of customers and loans are exclusively carried out in BB by 3,493 analysts working at the Headquarter Operation Center, so separate from the teams that carry out the prospecting and negotiation of credit in order to avoid any conflicts of interest when reviewing different risk aspects and, thereafter, making decisions that are duly informed by environmental and social considerations prior to approving prospective investments.
With a long and solid track record in the field on ES risk management in its credit corporations, as well as a corporate commitment to sustainability practices, BB has been continuously recognized by rankings and indices that select financial institutions and companies with the best sustainable practices.

II. SUMMARY OF ENVIRONMENTAL AND SOCIAL (ES) RISKS AND IMPACTS

A. Environmental and Social Risk Classification (ESRC) — Substantial

Environmental Risk Rating — Substantial

As the Eligible Companies and the sectors they operate will remain unknown until Project implementation, the FI-2 categorization of the environmental and social risks of the project is based on an assessment that took in consideration the relevant international literature of investments on common goods (in general) and aiming at the reduction of GHG emissions and climate change mitigation (in particular). The sub-loans aim to support the implementation of credible carbon footprint and GHG emissions Mitigation Plans by Eligible Companies, contributing to the expansion of the Voluntary Carbon Market in the country and the achievement of Brazil's NDC. Overall, the potential direct environmental and social risks and impacts of these Mitigation Plans will not be unprecedent. They are expected to be few in number, generally site-specific and largely reversible and readily addressed through mitigation measures. In the international literature, investments dealing with common goods (in general) and aiming at the reduction of GHG emissions and climate change mitigation (in particular) have been associated with a variety of environmental co-benefits and a few potential adverse side-effects on ecosystems, economic activity, society, health, air pollution, and resource efficiency - such as: reductions in biodiversity losses and soil erosion through an increase in forest-based carbon sequestration, increases in resource efficiency through water and other natural resources conservation, improved energy efficiency and increased resources reutilization, reduction of air pollution (which is often associated to improvements in public health outcomes: reduced mortality, morbidity, prevalence of diseases, and/or health expenditures). When these investments are made in the AFOLU sector and properly managed on its environmental and social risks, they may: a) contribute to conservation of biological diversity and save endangered animals both by reducing deforestation, or by using reforestation/afforestation to restore biodiverse communities on previously developed farmland, as the implementation of low carbon production systems; b) have positive impacts on water resources (water yields and water quality) as various measures contribute to prevent the contamination of local drinking water sources and to reduce flood peaks, erosion and efflux of silt. The international literature also highlights that when these investments are inadequately managed on its environmental and social risks, they can be associated with: i) reduction of biodiversity due to increased risks of attacks of forest plantations based on the establishment of monocultures over large areas of the landscapes by pests, which could compromise the entire plantation and would be exacerbated where the plantations advance into sensitive sites (e.g., wetlands or high-slope sites); ii) degradation of water sources (through the losses of pesticides and nutrients to water) as well as water shortages (where, for instance, irrigation water is used to produce bioenergy crops or in some forest plantations); iii) temporary and excessive use of pesticides and herbicides for pest control with inappropriate levels of toxicity and following non-recommended procedures at the initial stage of implementation of low carbon production systems (such as cattle raising-forestry, cultivation-cattle raising-forestry integration systems, the implementation, maintenance and management of planted forests, and the appropriate disposal of waste); and iv) intentional or accidental introduction of alien, or non-native, species of flora and fauna into areas where they are not normally found that can be a significant threat to biodiversity, since some alien species can become invasive, spreading rapidly and destroying or out-competing native species.

Social Risk Rating Substantial

As the Eligible Companies and the sectors they operate will remain unknown until Project implementation, the FI-2 categorization of the environmental and social risks of the project is based on an assessment that took in consideration the relevant international literature of investments on common goods (in general) and aiming at the reduction of GHG emissions and climate change mitigation (in particular). The sub-loans aim to support the implementation of credible carbon footprint and GHG emissions Mitigation Plans by Eligible Companies, contributing to the expansion of the Voluntary Carbon Market in the country and the achievement of Brazil's NDC. Overall, the potential direct environmental and social risks and impacts of these Mitigation Plans will not be unprecedent. They are expected to be few in number, generally site-specific and largely reversible and readily addressed through mitigation measures. They are not expected to lead to adverse impacts related with labor and working conditions, resource efficiency and pollution, community health, safety and security, land acquisition and involuntary resettlement, biodiversity, natural habitats and living natural resources, Indigenous Peoples or disadvantaged and vulnerable social groups, and cultural heritage. In the international literature, investments dealing with common goods (in general) and aiming at the reduction of GHG emissions and climate change mitigation (in particular) have been associated with a variety of social co-benefits related with improvements in public health outcomes: reduced mortality, morbidity, prevalence of diseases, and/or health expenditures), increased food and energy security among low-income people who depend on agriculture and weather patterns to earn a living and are the most vulnerable to climate change impacts (in consequence of a more effective land use in impoverished areas and the expansion of the energy portfolio through low-carbon technologies and energy-efficiency improvements), on land tenure arrangements; increase food production and availability (e. g., agroforestry, intensification of agricultural production, or integrated systems); and improve the livelihoods and food security of several disadvantaged and vulnerable social groups (including Indigenous Peoples, Forest-dependent communities, and other social groups). The international literature also highlights that when these investments are inadequately managed on its environmental and social risks, they can be associated with the remote possibility that the capitalization of the rural MSMEs producers – due to the increased productivity and profitability of its production – leads to the opening of new areas or to indirect impacts on adjacent permanent protection areas with potentially negative impacts on habitats natural and forests as well as the weakening of the already fragile land tenure and possession rights, food security and involuntary displacement of Indigenous Peoples, forest-dependent and other disadvantaged and vulnerable social groups.

B. Environment and Social Standards (ESSs) that Apply to the Activities Being Considered

B.1. General Assessment

ESS1 Assessment and Management of Environmental and Social Risks and Impacts

Overview of the relevance of the Standard for the Project:

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS10 Stakeholder Engagement and Information Disclosure

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

B.2. Specific Risks and Impacts

A brief description of the potential environmental and social risks and impacts relevant to the Project.

ESS2 Labor and Working Conditions

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS3 Resource Efficiency and Pollution Prevention and Management

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS4 Community Health and Safety

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS5 Land Acquisition, Restrictions on Land Use and Involuntary Resettlement

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS6 Biodiversity Conservation and Sustainable Management of Living Natural Resources

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS7 Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS8 Cultural Heritage

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

ESS9 Financial Intermediaries

OP 4.03 ESRS is prepared and cleared as a separate document due to the system deficiencies.

C. Legal Operational Policies that Apply

OP 7.50 Projects on International Waterways	No
OP 7.60 Projects in Disputed Areas	No

B.3. Reliance on Borrower's policy, legal and institutional framework, relevant to the Project risks and impacts

Is this project being prepared for use of Borrower Framework?	No

Areas where "Use of Borrower Framework" is being considered:

None.

IV. CONTACT POINTS

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Borrower/Client/Recipient

Borrower: Banco do Brasil

Implementing Agency(ies)

Implementing Agency: Banco do Brasil

V. FOR MORE INFORMATION CONTACT

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VI. APPROVAL

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