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GUIDELINES FOR SUSTAINABLE FINANCE

DISCLOSURE REGULATION IN THE LAC REGION

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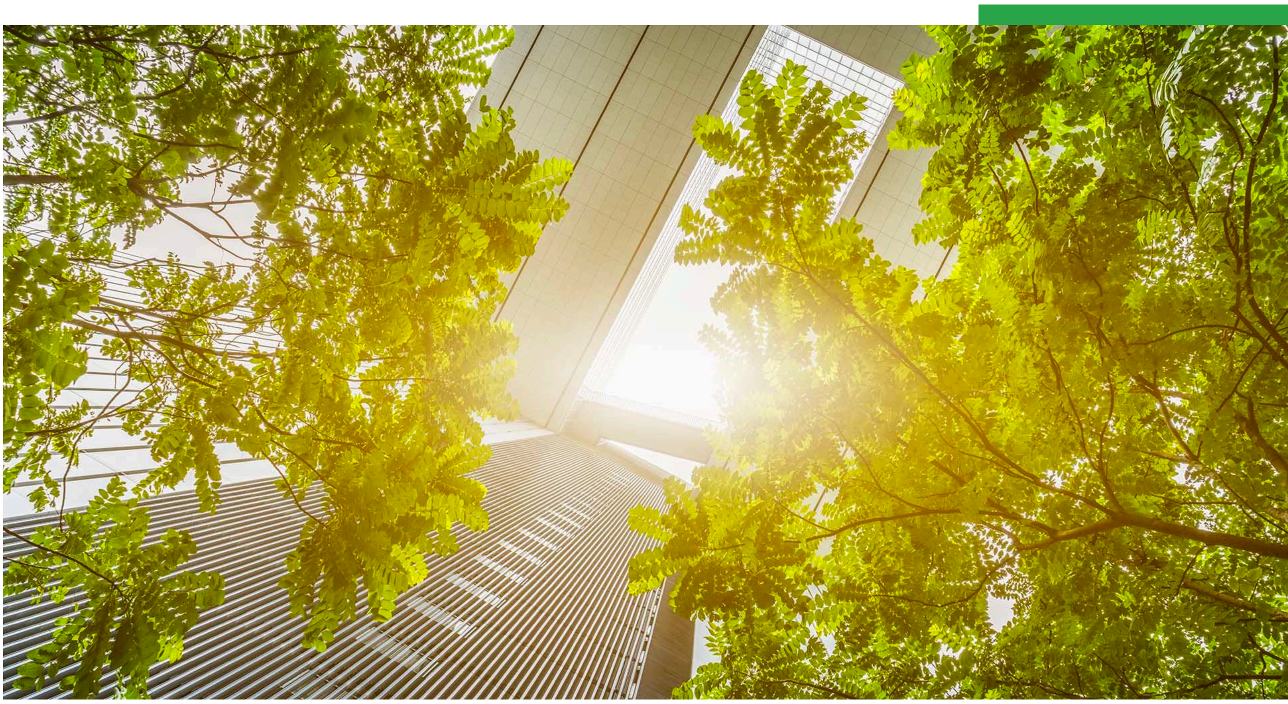
INTRODUCTION



In recent years, there has been an increasing awareness of the significant economic and financial impacts of environmental, social, and governance (ESG) and climate change risks. A global agenda has grown over the past years, and a range of governments and private institutions are now working to create and apply a structured approach to this topic.

Most financial institutions understand the magnitude of ESG impacts and recognize the need to devote more attention in response to the regulatory pressure. There is a growing demand for decision-useful information by many participants in the financial markets, requiring access to risk data that is consistent, comparable, and relevant, which could therefore generate a successful materiality assessment.

This increasing demand for decision-useful information has resulted in the development of several ESG and climate-related frameworks and standards. Regulators, investors, and policy makers have stepped up their efforts to address sustainability-related risks and opportunities by proposing ESG-related policies and commitments. However, many struggle to apply an integrated approach to this matter, and few have met the standards of ESG financial disclosures.

In the absence of any global agreement on harmonized regulations and disclosures, a broad range of standards have been developed that financial institutions may be required to comply with depending on their jurisdiction. These standards and recommendations include: (1) The Global Reporting Initiative (GRI) standards that have advanced sustainability reporting; (2) The Sustainability Accounting Standards Board (SASB) that provides detailed industry-specific guidance and recommendations; and (3) The Task Force on Climate Financial Disclosures (TCFD), focused on climate change, which is currently used as reference by several firms and key regulatory agencies.

Currently at the forefront of mandatory ESG disclosure, the European Union (EU) has established a set of comprehensive sustainability disclosure requirements covering a broad range of ESG metrics at entity and product level for financial institutions. The Sustainable Finance Disclosure Regulation (SFDR) is a fundamental pillar of the EU Sustainable Finance agenda, which also includes the Taxonomy Regulation and the Low Carbon Benchmarks Regulation, to improve transparency for investment products in the financial market.

In this sense, this paper aims to assess how the Latin American and Caribbean (LAC) countries have been addressing ESG assessment and recommend guidelines for sustainable finance disclosure regulation in banking institutions of the region, by using as reference the above mentioned standards and frameworks to provide harmonized rules for LAC financial markets.

Hence, the paper focuses on examining the latest developments in three representative countries in the LAC region: Brazil, Chile, and Colombia, and it is structured as follows.

1 Methodology

2 Literature Review

3 Benchmark Analysis

4 Gap Analysis

5 Recommendation

6 Conclusion

1 METHODOLOGY

This capstone research project investigates the current practices of the sovereign nations in the LAC region on ESG regulation and recommends a robust set of guidelines for sustainable finance disclosure. The study mainly focuses on credit institutions (mostly banks) in the financial sector, and the team used a mixed research method.

First, team members conducted extensive surveys and interviews. The team developed an inclusive question list, one comparative analysis table, one institutional-design checklist, and organized interviews with eight experts on ESG disclosure and sustainable finance. Specifically, the team carried out interviews with experts from multilateral organizations (the IDB and the International Monetary Fund, IMF), four local experts from the destination countries, and two external consultants. Due to the ground-breaking nature of the research topic, primary research, including surveys and interviews, is of great significance as it provides the latest expertise from industry and academia throughout the process. Another advantage of surveys and interviews is that the research team can directly reach out to the target stakeholders for research results after identifying them. Furthermore, surveys and interviews create both quantitative and qualitative data to facilitate the research. One advantage of interviews with experts is that they will almost certainly provide inspiration to the team while talking, albeit in most cases unconsciously.However, primary research might indeed be constrained by time and cost constraints. Similar studies in the future could be improved by having extended expertise and more industry-academia knowledge sharing.

Second, the team performed comparative case studies on three countries with satisfactory representativeness, namely Brazil, Chile, and Colombia. The financial markets of the three economies are examined and benchmarked with global counterparts (e.g., Europe and European Banking Authority, the United Kingdom and Bank of England, Singapore, and China) to identify gaps between them. Simultaneously, there are obvious gaps between the countries within the LAC region. As a result, recommendations are both customized and harmonized.

Third, secondary research (desk research) was adopted to supplement data collection. Both qualitative and quantitative methods were used, while qualitative data was the main focus, considering the nature of the topic. The team summarized existing literature to obtain the current status of development in various regions. For example, the latest reports from banks on ESG, CSR, and green finance were also critically reviewed. On the other hand, the project team was careful about the timeliness and credibility of the desk research results. Cross checks were employed to ensure that the research produced valid and reliable evidence.

Overall, the mixed research methodology produced a favorable degree of validity and reliability for the study. Primary research in the form of surveys and interviews generated insights to benchmark and establish the regulatory systems of the financial markets in the LAC region, facilitated by extensive desk research. By replicating the logic of this study, consultants from other emerging markets can also effectively push the boundaries of requirements on ESG disclosure.

2 LITERATURE REVIEW

2.1 LAC regional overview

Latin American and Caribbean countries face disparities related to the levels of economic growth and development within the region. Therefore, it is important to evaluate the current macroeconomic conditions, which cover the existing economic performance and growth rates in the main countries analyzed in this report. However, the coronavirus pandemic had widespread economic, social, and political effects in the region, generating a massive shrink in GDP and growth rates in 2020.

As the largest economy in Latin America and the thirteenth largest in the world, Brazil's Gross Domestic Product (GDP) was US $1.4 trillion in 2020 and had a significant GDP growth rate of -4.06% in the same year as a result of the recession generated by the coronavirus pandemic. Colombia, the fourth largest economy in Latin America, had a GDP of US $271 billion in 2020 with a decline of -6.8% in its growth rate, and Chile, which follows it as the fifth largest economy in the region, had a GDP of US $252 billion and a decline of -5.77% in its GDP growth rate in 2020.

The poverty index increased from 30.5% in 2019 to 33.7% in 2020, and to cope with the economic crisis, governments across the region implemented expansionary monetary and fiscal policies, raising public debt from about 68% of GDP in 2019 to 77% in 2020. On the other hand, according to estimates, the region experienced higher than expected growth in 2021, averaging 6.2%, mainly due to the low baseline established in 2020, and eleven countries actually managed to regain the GDP levels seen prior to the crisis. This expansion, however, will not be able to ensure sustained growth because of the deepening of already present structural problems in the region as a result of the crisis generated by the pandemic, as well as changing the low growth dynamic prior to 2020, which will have negative repercussions on the economic and labor market recovery despite the uptick in growth in 2021.

The 2021 macroeconomic scenario was marked by rising inflation. In some of the largest economies in the region (Brazil, Chile, Colombia, Mexico, and Peru), prices increased by 8.3% in 2021—the largest jump in 15 years. However, given the region's history of high inflation, the central banks reacted quickly and decisively to the sharp rise in consumer prices. In Brazil, Chile, Colombia, Mexico, and Peru, policy rates rose between 1.25% and 7.25% over the course of 2021. These were often combined with forward guidance that signaled further rate increases in the coming months.

The Economic Commission for Latin America and the Caribbean (ECLAC) emphasizes that 2022 will be a year of major challenges for growth and tackling the pandemic's social issues since there is a lot of uncertainty regarding the pandemic's evolution, low investment and productivity, and a slow recovery in employment, as well as reduced fiscal space, increased inflationary pressures, and financial imbalances. Furthermore, the crisis came at a moment when the regional economy was already stagnating, unable to tackle the long-term investment crisis, employment, and sustainable productive diversification.

In that sense, the creation of a multilateral forum can be useful to debate the macroeconomic conditions for the region, regarding issuing new and restructuring current debt, as well as creating relief initiatives. This can also be seen as an opportunity to rethink the system of cooperation to achieve a multidimensional form of thinking about sustainable finance disclosure and mechanisms that could help the region attract investments as well as simulate innovative financing instruments, such as green and SDG bonds.

2.2 Credit institutions and supervision of this region overview

The banking industry is developing vastly in the Latin American region. In 2010, the average percentage of GDP for the LAC region was 39.78%; a decade later, the average percentage of GDP almost doubled, growing to 62.72%. However, compared to other regions like Europe and Asia, the banking industry in the Latin American region still has room for growth. As the data from the International Monetary Fund shows, the world's average bank assets as a percentage of GDP for 2020 was 73.31%. Asia has an average of 96.87%; Europe has an average of 86.18%. (International Monetary Fund, 2020). As the above data shows, credit institutions in these two regions play huge roles in the economy. In the next section, we will show the mature banking regulation and disclosure practices in the regions from which we take lessons for our LAC study.

Within the Latin American region, there are also huge gaps between countries regarding banking development. As S&P Global stated in 2021, Brazil's top five banks were the largest lenders in the Latin American and Caribbean region. Itau Unibanco Holding SA, the largest bank in the region, held over $370 billion in assets

by the end of March 2021. (S & P Global, 2021). Besides Brazilian banks, Colombia's Grupo Aval Acciones y Valores SA and Chile's Banco de Credito e Inversiones are also among the ten biggest banks in this region. Based on these statistics, the relatively more advanced stages of development of banking in Brazil, Chile, and Colombia let us select these three countries for our assessment of the stage of development towards a robust sustainable finance regulatory disclosure framework.

In terms of banking regulation and supervision, the countries in the Latin American and Caribbean regions have some common features and some differences. Most of the countries in the region have started to adopt Basel III for their banking sectors, though they are at different stages. As the Fitch Rating report states, Brazil and Argentina, as the official members of the Basel Committee on Banking Supervision, have fully implemented the Basel III requirements. Chile, Colombia, and some other LAC countries are still at earlier stages. (Fitch Ratings, 2022). Details of the Basel III regulations will be discussed in the next section of the report.

Financial supervision systems also diverge within the Latin American region. Both integrated and specialized supervision institutions can be found in LAC countries. For instance, Banco Central do Brasil, the central bank of Brazil, is not only responsible for making monetary policies like targeting full employment or targeting inflation, but also for regulating and supervising the domestic financial market and financial institutions.

On the other hand, countries like Colombia have independent institutions in charge of supervising and regulating financial institutions, including banks. For instance, Superintendencia Financiera de Colombia (SFC) is Colombia's government agency that regulates and supervises financial institutions. Separated from the Central Bank, this institution specializes in regulation and supervision activities. In this report, we will not discuss which of the two types (integrated vs. specialized) is better. However, in our recommendations later in this report, we will notice this difference and discuss the potential risks and remedies related to it.

2.3 Current Disclosure Framework and Standards

In the last two decades, the context in which businesses operate has changed radically – economically, socially, and environmentally. As business has benefited from economic growth, globalization, increased consumption and fossil fuel supplies, it has reinforced and expanded its role as the major provider of goods, jobs and infrastructure worldwide. As such, its contribution to critical sustainability topics like climate change, biodiversity, access to medicine, wages, and skills has also grown. Simultaneously, the advancement of technology has ensured that stakeholders, not just shareholders, are now able to challenge businesses on their behavior. As a result, transparent measurement and disclosure of sustainability performance is now considered to be a fundamental part of effective business management and essential for preserving trust in business as a force for good.

Reporting of information about businesses' performance on sustainability topics started as a stakeholder-driven accountability initiative just over 30 years ago. Today, sustainability disclosure (also called ESG disclosure – environmental, social, and governance disclosure, or non-financial reporting) is more relevant than ever for a wide range of audiences, including policymakers, consumers, employees, investors, and civil society organizations. Leading companies and their boards, who carry the responsibility for all corporate reporting, are now aiming not just to be accountable to shareholders, but also to define their purpose and benefit to all stakeholders.

Our research focuses on credit institutions, which are primarily banks, out of all the businesses discussed. The Basel Committee, formerly known as the Committee on Banking Regulations and Supervisory Practices, sets major policies and regulations for the banking industry. It was established to improve the quality of banking supervision around the world in order to improve financial stability. There have been three Accords established along the way. Basel One was founded in 1988 to focus on financial institutions' capital adequacy. The capital adequacy risk refers to the possibility that a financial institution will be harmed by an unexpected loss. Banks that operate internationally must maintain capital of at least 8% of their risk-weighted assets under Basel One, which ensures that banks have enough capital to meet their obligations. The second Basel Accord, formally known as the Revised Capital Framework but more commonly known as Basel Two, was a follow-up to the first. Minimum capital requirements, supervisory review of an institution's capital adequacy and internal assessment process, and the effective use of disclosure as a lever to strengthen market discipline and encourage sound banking practices, including supervisory review, were the three main areas covered. The three pillars refer to these three areas of focus as a whole. Finally, following the 2008 collapse of Lehman Brothers and the subsequent financial crisis, the Basel Committee decided to update and strengthen the Accords. Basel Three builds on the previous three pillars by adding new requirements and safeguards. One thing to note is that since the Basel Three Accord, there has been a growing awareness of ESG risk disclosure being integrated into the supervisory system, leading to the development of industry standards and voluntary ESG disclosure frameworks.

Among all industry standards for business sustainability disclosure, the Sustainability Accounting Standards Board (SASB) Standard is in the lead for guiding companies' disclosure of financially material sustainability information to their investors. The SASB standards are designed to identify a minimum set of sustainability issues most likely to impact the operating performance or financial condition of the typical company in an industry, regardless of location. They are also intended to enable cost-effective and decision-useful communication on corporate performance on industry-level sustainability issues through existing disclosure and reporting mechanisms.SASB has developed a set of 77 industry-specific sustainability accounting standards, each of which describes the industry that is the subject of the standard, including any assumptions about the predominant business model and industry segments that are included. For their banking standards, SASB identifies the industry as having an essential role in the functioning of global economies and in facilitating the transfer of financial resources to its most productive capacity. Following the SASB Standard, the main sustainability disclosure topics and accounting metrics in the banking industry include data security, financial inclusion and capacity building, incorporation of environmental, social, and governance factors in credit analysis, business ethics, and systemic risk management.

The Task Force on Climate-Related Financial Disclosures (TCFD) has been introduced into the picture as well, to correspond with the research focus on climate change risk. The framework emphasizes voluntary and consistent climate-related financial disclosure standards, requires institutions to assess and price climate risk, and examines the resilience of firm strategies under various scenarios. Some of the major financial institutions, such as JPMC and BOA, have followed the guidelines and published TCFD reports in addition to their annual sustainability reports. Overall, the framework is divided into four sections. The first section, Governance, asks firms to provide their board's oversight and management's role in addressing climate-related issues. The second section, Strategy, is primarily concerned with the firm's actual and potential impacts of climate-related risks and opportunities. The third risk management component primarily consists of risk identification, assessment, and management for the firm. Credit risk, market risk, liquidity risk, compliance risk, and so on are the most commonly assessed risks. The final section is about metrics and targets, which are usually adjusted to fit the business focus of different organizations. Water, energy, land use, waste management, and greenhouse gas emissions will be considered by institutions where relevant and applicable.

What has recently piqued our interest is that the European Banking Authority (EBA) published a specific ESG disclosure framework for European banks in January 2022. The EBA is an EU authority in charge of prudential regulation and supervision, with a European Single Rulebook that coordinates banking regulation. The book contains updated and harmonized rules for financial institutions throughout the EU. The EBA mandates disclosure regulation, capital requirements, and corporate governance when it comes to sustainable finance and ESG disclosure, and publishes detailed action plans for implementation. The EBA is asking banks to disclose information on: 1) Climate risks: how climate change may exacerbate other risks within banks' balance sheets, whether it be the risk of stranded carbon-intensive assets or loans to property within a flood plain. 2) Mitigating actions: What mitigating actions do banks have in place to address those risks, including financing activities that reduce carbon emissions? 3) Green Asset and Banking Book Taxonomy Alignment Ratios: to understand how institutions are financing activities that will meet the publicly agreed Paris Agreement objectives of climate change mitigation and adaptation based on the EU taxonomy of green activities. The EBA is also asking banks to describe their ESG strategies, governance and risk management arrangements with regard to ESG risks. When developing these standards, the EBA has built on the Financial Stability Board Task Force on Climate-related Financial Disclosures (FSB-TCFD) recommendations, the Commission's non-binding guidelines on climate-change reporting, and the EU Taxonomy.

2.4 History and current disclosure practices of this region overview

Since 2015, climate-related risks and their economic impacts have been considered a relevant topic on the global public agenda. By linking ESG to financial stability, this moment marked a transformation in how financial regulators, supervisors, and central banks perceived the threat of global warming to financial stability.

In LAC, regional supervisors and regulators have not yet established climate-related risk disclosure in binding regulations and/or supervisory measures for the financial sector, and most of the initiatives have been initiated by a public-private effort of voluntary disclosure agreements. However, there is a current effort by several countries' financial regulators to create self-regulatory and supervisory measures for the disclosure in the financial sector, adopting and developing voluntary frameworks and guidelines that aim to identify, assess, measure, and manage climate-related risks in financial systems, which can be considered a first step towards more explicit regulation on ESG disclosure.

An article by the IDB (2019) categorizes the countries in the region under three major, not-mutually exclusive groups for the development of regulatory and supervisory efforts:

i) countries with ESG risk regulation in place,

ii) countries where supervisory measures have been put in place or initiated, and

iii) countries where private sector initiatives (or self-regulatory) practices are being implemented or have led the efforts of the financial system.

In conclusion, there is significant work ahead for the LAC at the national and regional levels to develop effective and complete frameworks to identify, assess, manage, and disclose ESG risks and be aligned with the global tendency of sustainable finance. At the same time, the countries in this region, and their financial systems as well, are at very different stages of development regarding the tools to support financial system resilience to climate-related risks, and the IDB is playing a key role in the piloting of innovative and regional approaches, as well as the exchange of experiences and transmission of knowledge between countries.

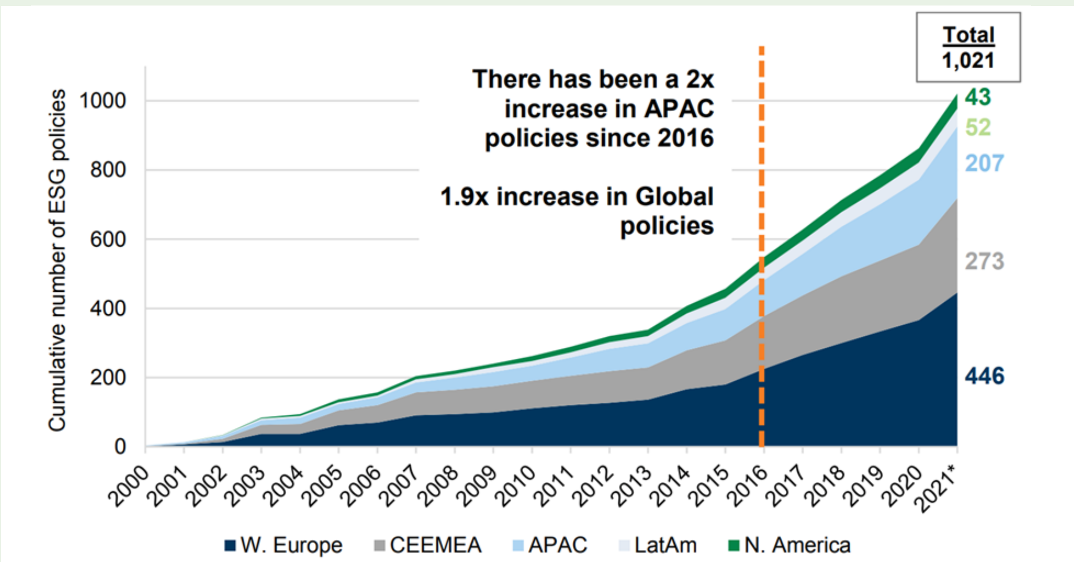
2.5 Global overview

Policies and other regulatory requirements designed for ESG disclosure are accelerating globally, albeit with repetitive disruptions brought on by the COVID-19 pandemic. The increasing regulatory expectations and requirements have become an "imminent" reality that all stakeholders in the financial market must face, including the focus of the project—credit institutions. However, it is possible to seize the initiative during the evolution towards finer ESG standards, although creditors have to make new cost considerations and critical updates to their skill sets.

The reasons for the burgeoning interest in ESG development are manifold. On the one hand, there is a growing demand for ESG disclosure from regulatory authorities, investors, and consumers. From the supply-side perspective, potential debtors with better sustainability-related practices could also streamline the process of indirect finance, thereby effectively reducing the cost, mostly in risk management (Lashitew, 2021).

The stages of development vary greatly across the world, despite an initial consensus on performing sustainable financial practices. The picture from one global region to another can differ vastly. For example, by the end of 2021, the number of ESG reporting policies in Western Europe will have accounted for 44% of global ESG policies, and the number has been 20% in the Asia-Pacific, with a matchless growth rate of 200% over the past five years (Murphy, 2022). However, the proportion of ESG policies in North America is merely 4%, with a considerable part of those policies implemented in Canada.

Cumulative capital market ESG regulations and amendments, Jan 2000 to Aug 2021*



Source: PRI, Goldman Sachs (2022)

US: Starting actions after noticing itself being outpaced

American regulators have been reluctant to mandate sustainability disclosure. The United States, as the world's largest economy, has long been a leader in developing technology to combat climate-related threats, while it lacks momentum and lags behind its European and Asian counterparts regarding reporting standards. Within the US, politics and hesitancy continue to slow advancement, despite recent efforts to make some progress. The burden of absent or inconsistent disclosure requirements continues to fall heavily on credit institutions. The downside of low domestic demand for ESG standards is that the US-originated financial intermediaries could be forgotten regarding opportunities in Europe, Asia, and other regions that have structured ESG regimes in place. Having businesses in these markets will force those banks, regardless of their scale, to confront a patchwork of domestic and global metrics and disclosure requirements, raising the complexity level and causing inefficiencies in the process.

EU: Continuing to lead the ground-breaking effort in exploring ESG disclosure

In contrast, Europe is leading the global community by building a regime for sustainable financial reporting at the forefront of its agenda. It is following a systematic and centralized approach toward climate transition and sustainability disclosure (Baines and Burdulia, 2021). Its regulatory regime is underpinned by the European Climate Law that legally endorses the EU's commitment to meet the Paris agreement. To achieve climate neutrality by 2050, the European continental body, along with the United Kingdom (the Bank of England, working closely with the UK Sustainable Investment and Finance Association), has gone through the difficult process of establishing SFDR and the EU taxonomy, putting themselves further ahead in terms of reporting and further widening the existing disclosure gap between EU-based and US-based corporations.

Asia-Pacific: Following EU and facilitating the transition from 'factory Asia' to a clean, green and inclusive growth pattern

The Asia-Pacific region appears to follow in Europe's footsteps, and the current trend is likely to resume, following a similar policy path to Europe, albeit with regional nuances.

The difference is that the Asia-Pacific credit institutions focus more on environmental and social factors than governance, probably because of organizational cultures. The reason for the change in the growth model is the change in people's mindsets. In particular, mainstream attitudes have shifted favorably from growth at any cost to recognizing and prioritizing sustainable and equitable growth, from fighting as a "lonely warrior" to working collaboratively in policymaking.

The reporting of credit institutions has improved substantially. The average ESG disclosure levels of most economies in the Asia-Pacific region are equal to or above the US level. For example, the Development Bank of Singapore (DBS) and the four largest state-owned banks in China have all constituted Committees on CSR and ESG Affairs. The banks have been publishing dedicated reports according to the EU taxonomy and TCFD (Pan, 2021; Dawson, 2022). In the next step, the institutional designers will produce an Asia-Pacific green taxonomy, a TCFD-aligned inclusive reporting structure, and a carbon pricing mechanism across the region. Moreover, the regulatory authorities are also expected to guide the stakeholders in the financial markets to measure performance using the entity's ESG data, rather than simply rewarding the action of disclosing.

Overall, the different ESG regulatory routes and status quos have implications for the LAC region as a large emerging market with great potential to integrate and prosper. As the economies look ahead, the trend for credit institutions and the whole financial market is clear: to make the move toward meaningful and accurate global ESG reporting, every country and region must participate actively or be left behind. Inaction or belated actions, however, will have detrimental consequences for the global competitiveness of the credit institutions in the country and even more for the whole financial market.

3 BENCHMARK ANALYSIS

3.1 Country Analysis: Brazil

In this section, we will discuss financial institutions, historic ESG policy in Brazil, the current rules and frameworks proposed and the implementation in the Brazilian financial institutions, focused on the banking sector.

Regulation/Supervision System in Brazil

The legal framework for the financial system in Brazil was created in 1964. It established the National Monetary Council (CMN) as the highest macroeconomic and financial regulatory authority and the Brazilian Central Bank (BACEN), the authority in charge of supervising financial institutions and issuing currency. Both institutions, CMN and BACEN, regulate banks and other financial institutions through the issuance of resolutions and circulars related to capital requirements, accounting procedures, corporate governance and functioning procedures. And the Securities and Exchange Commission of Brazil (CVM, founded in 1976) is the government agency responsible for regulation and supervision of the securities markets.

The Brazilian Central Bank (BACEN) is a federal self-governing institution that is responsible for the maintenance, regulation, and supervision of the financial market to ensure its financial and economic stability. Financial institutions cannot operate in Brazil without approval from the Central Bank and are subject to supervision and banking regulations.

ESG Policies in Brazil

Over the past few years, the Brazilian Central Bank has been acting proactively on measures related to social and environmental issues, standing out in the creation of regulations regarding risk management and socio-environmental responsibility.

Since the publication of Resolution CMN 4,327 in 2014 that approved the guidelines that should be considered in the implementation of the Social and Environmental Responsibility Policy (PRSA) by financial institutions, debates on sustainability have been gaining position, focusing mainly on the impacts of climate change on the financial sector.

Recently, the Brazilian Central Bank (BCB) opened some public consultations (Public Consultation 85/2021 and Public Consultation 86/2021) to improve rules related to the management of environmental, social, and climate-related risks in the institutional agenda—Agenda BC #.

Regarding Public Consultation 85/2021, the set of regulatory improvements is anchored on three main objectives:

1. Maintaining Brazilian initiatives in the establishment of risk management and responsibility policies

2. Explicit inclusion of issues related to climate change in the Brazilian regulatory framework

3. Improvement of definitions related to risks and responsibilities for social and environmental issues

Also, the framework considers a proportional application according to the segment in which institutions are allocated. For instance, the Social, Environmental, and Climate Responsibility Policy (PRSAC) should be established for all financial institutions (from Segment 1 (S1) to Segment 5 (S5)).

Mandatory ESG disclosure Framework

The Public Consultation 86/2021 is directly linked to the Public Consultation 85, which involves disclosure rules for social, environmental, and climate-related risk management being subject to being applied to Segment 1 (S1), Segment 2 (S2), Segment 3 (S3), and Segment 4 (S4).

This disclosure proposal is inspired by the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) but is not limited to a climate perspective, including social and environmental aspects. The Report on Social, Environmental, and Climate-related Risks and Opportunities (GRSAC Report) will be released using standardized tables built on the experience of Pillar 3 of the Basel Framework.

The disclosure requirements will be in force in two phases: the first phase will address qualitative aspects related to governance, strategy, and

risk management; and the second phase will address quantitative terms, such as metrics and targets.

Recently, the Brazilian Central Bank (BCB) published a set of regulations following public consultations (85/2021 and 86/2021). The latest resolutions are:

- CMN Resolution No. 4,945, which established new rules on the Social, Environmental, and Climate Responsibility Policy (PRSAC) and on actions for its effective implementation. The provision will be in force in July 2022 for institutions classified under S1 and S2, and in December 2022 for S3, S4, and S5.

- BCB Resolution No. 139, which established requirements for disclosure of information in the GRSAC report. This Resolution will enter into force on December 1, 2022.

Implementation of the main non-mandatory framework

While the regulatory/mandatory framework for Brazilian financial institutions is still an ongoing process, there are a few non-mandatory frameworks that have been used by large public companies, including banks, to improve disclosures and enhance clarity in reporting.

Standards such as the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) have been adopted to ensure high-quality information for disclosing sustainability information to stakeholders. The GRI standards focus on the firm's ESG impacts and each set of standards complements the other, while SASB focuses on environmental, social, and corporate governance issues that are expected to have a material financial impact on the company.

Implementation of other frameworks

As mentioned in the Brazil Financial Sector Assessment elaborated by the International Monetary Fund (IMF), the BCB implemented Basel III with effect from October 2013, covering Pillar 3 (Market Discipline) that requires banks to release periodic disclosures about their risk management frameworks, including liquidity risk management.

According to Circulars 3,930/19 and 3,936/19, which comply with the Basel Committee on Banking Supervision's recommendations, banks should disclose their risk management, presenting detailed information of the procedures and controls that firms are exposed to, allowing market agents to appraise companies' capital adequacy.

3.2 Country Analysis: Chile

In this section, we will discuss financial institutions, historic ESG policy in Chile, the current rule for bank disclosure on ESG and its implementation.

Regulation/Supervision System in Chile

The Commission for the Financial Market (CMF) of Chile was recently consolidated as the financial supervisor of the banking sector, with a legal mandate comprising financial stability, market development, and market conduct. CMF is the legal successor of the Superintendence of Banks and Financial Institutions (since 2019) and of the Superintendence of Securities and Insurance (since 2017).

In 2019, the CMF issued a decision to include in the annual regulation plan the development of an ESG reporting regulation. The goal was to promote transparency in the financial market, to increase the availability of ESG information as well as products, and, in general, to enhance market development.

ESG Policies in Chile

In 2019, the Ministry of Finance, with the support of the IDB, the British Embassy and UNEP FI, the Central Bank, the Commission for the Financial Market (CMF), and the Superintendent of Pensions, promoted a coordinated effort among the regulators and supervisors of the Chilean financial system, including banking, asset management, pension funds, and insurance companies, to improve the understanding of climate-related risks and opportunities. This effort led to the creation of the Public-Private Dialogue on Green Finance, which had as its main objective the agreement by the end of 2019 of a formal Green Agreement between regulators and the private sector, and the release of a joint-declaration on the importance of climate issues for the financial system. It also aimed to establish a Road Map for Climate Finance 2020–2024 to support the integration of climate factors into the decision-making processes of financial institutions in the country (IDB, 2019).

One of the first activities of the Public-Private Dialogue on Green Finance was launching a survey on the adoption of climate-related risks within financial institutions in Chile in the summer of 2019. The initial conclusions of the survey highlight that there is strength in establishing governance, strategy, and opportunity pillars for climate-related risks in organizations (IDB 2019). At the same time, most financial institutions already identify climate risk as a source of risk for their companies.

However, on the implementation of solutions for these risks, there is still a low level of knowledge and capacity to adopt and apply methodologies to address them, with only a small percentage of the interviewed financial institutions already using instruments for the management of climate-related risks. Therefore, one of the greatest barriers to mobilizing stakeholders is the lack of cross-sectional knowledge, understanding, and training in the economic and financial sectors related to the risks and opportunities of the climate and sustainable development phenomenon (IFC, 2019).

The Chilean government signed the Paris Agreement on Climate Change in 2016, and in 2020 the President reaffirmed that Chile, together with the United Nations Framework Convention on Climate Change and the United Nations Development Program (UNDP), has strongly promoted the Alliance for Climate Ambition to achieve carbon neutrality before 2050.

However, it was only in November 2021 that the CMF published General Rule No. 461 (NCG 461) that modified the content of the annual reports that supervised entities elaborate. Incorporating the duty to report their policies, practices, and goals adopted in environmental, social, and governance matters, this gives greater visibility to investors and the general population on the adoption of ESG practices by companies.

● *Mandatory ESG disclosure Framework*

In the social and governance pillars, the NGC 461 represents a very strong regulation. For example, it requires the disclosure of the structure and operation of corporate governance, reports on the diversity of the organization's staff, and possible gender gaps in salary and behavior of employees. However, in the environmental pillar, the rules still lack some structure.

At the same time, the regulation requires a report on the detection and management of physical and transition risks. There is still a gap in how this disclosure should be done and more specific topics to have a broader vision of this type of risk. In that sense, there is also no specific mandatory framework defined for most of the report, except for the sustainability metrics defined by the Sustainability Accounting Standards Board (SASB) according to the entity's industrial sector and determined according to the classification of industries in the Sustainable Industry Classification System (SICS).

The implementation of the rule will be mandatory for entities subject to supervision by the CMF and will come into force for the annual reports in December of 2024 for banking institutions, with the possibility of voluntarily adapting their annual reports to the new requirements prior to the dates indicated.

● *Implementation of other frameworks*

Banks in Chile should transition to Basel III to lower downside risks, as climate stress tests do not show current vulnerabilities but suggest transition risks merit further monitoring. In that sense, the Chilean regulators have already issued regulations related to the implementation of Basel III and the banks with the largest gaps were already taking steps, which started to be implemented in December 2021.

3.3 Country Analysis: Colombia

In this section, we will discuss financial institutions, historic ESG policy in Colombia, the current rules and frameworks proposed, and the implementation in its banking sector.

Regulation/Supervision System in Colombia

Before analyzing Colombia's ESG progress, it is important to introduce its regulation and supervision system. Unlike other countries that have an integrated central bank that is responsible for both monetary policies as well as regulations, Colombia has an independent regulator/supervisor other than Banco de la Republica (the Central Bank of Colombia). As the IMF's financial system sustainability assessment report suggests, Superintendencia Financiera de Colombia (SFC), which was born from the merger between the Superintendence for Banks and the Superintendence for Securities in 2005, oversees the whole financial market, including banks, finance companies, insurance companies, securities, etc. It plays an important role in setting capital, disclosure, and other requirements for financial institutions and monitoring the implementation of rules like Basel III for the banking sector specifically. (International Monetary Fund, 2022)

ESG Policies in Colombia

Colombia is quite active in terms of proposing ESG policies. As the International Finance Corporation states in its report, Colombia started environmental and social regulations in the early 1990s to protect the environment and manage natural resource usage. In 2015, in collaboration with the Inter-American Development Bank, the Colombian government started an initiative called the Sustainable Colombia Initiative to further tackle E & S issues based on the UN Sustainable Goals.

Colombia also signed the Paris Agreement on Climate Change in 2016, agreeing to reduce greenhouse gas emissions by 20 to 30 percent by 2030.These collaborative gestures show the country's determination to tackle E&S-related issues. (International Finance Corporation, 2018)

As mentioned above, Colombia has a specialized, instead of an integrated, regulatory or supervisory institution. The central bank plays little role in regulations. According to an IFC report in 2015, the central bank has historically placed little emphasis on green finance and disclosure, though green finance might be on the bank's schedule as time moves on. (International Finance Corporation, 2015)

Another important ESG policy is proposing green financial products, including green bonds. As the IFC report on sustainability banking suggests, the government has put forward a roadmap for creating a green bond market in Colombia even though the bond market is at its early stage in this country. In September 2021, Colombia issued the first sovereign green bond domestically for a total amount of around $200 million. (Climate Bonds Initiative, 2021)

As the historic ESG policies in Colombia suggest, Colombia is an active player in tackling ESG, especially environmental issues.

Mandatory ESG disclosure Framework

Besides the policies mentioned above, Colombia also has several mandatory and non-mandatory frameworks for ESG disclosure. The mandatory guidelines for ESG disclosure come from Superintendencia Financiera de Colombia (SFC), the regulatory and supervisory branch of the Ministry of Finance. The current guideline is Circular Externa 007 de 2021, which sets up the risk disclosing and reporting requirements, including those for ESG-related risks. However, this guideline does not include banking authorities but instead focuses on pension funds, insurance companies, and capitalization and saving associations. Also, there are no independent requirements for "E," "S," and "G" separately. The requirements for ESG-related risks are not separated into quantitative and qualitative sections, and transition risks are not incorporated into this mandatory framework. (Superintendencia Financiera de Colombia, 2021)

In summary, the mandatory Circular Externa 007 de 2021 regulates financial institutions other than banking authorities, and it covers all types of financial risks instead of solely ESG risks. It is a broad guideline, but lacks detailed requirements or rules for the ESG topic.

Implementation of the main non-mandatory framework

As shown in the previous section, the mandatory ESG disclosure framework does not cover banking authorities in Colombia. Colombian banks have developed their own framework to address ESG risks and issues. In 2012, Asobancaria, the association of banks in Colombia, started voluntary guidelines called the "Green Protocol," which were signed by 12 banks. In 2016, Asobancaria issued the General Guidelines for the Implementation of Environmental and Social Risk Analysis, explaining the details needed for applying the Protocol.

As the General Guidelines state, banks that sign the protocol are required to set up a clear E&S policy, E&S performance standards, the capacity to manage E&S risks (through training sessions, for instance), annual monitoring reports, periodic reporting of the implementation, etc. Relevant international standards are provided, but not required. (International Finance Corporation, 2018)

Clearly, the General Guidelines include many more detailed requirements and specialize in E & S related risks for banking authorities. However, transition risks are still not included, and "G" is not included in this sustainability framework. Also, this framework is not mandatory for those banks that have not signed the protocol.

The SFC, the country's regulator and supervisor of the financial market, does not directly get involved in the draft of the guidelines. The Ministry of Finance offered recommendations, but this framework should still be considered as an initiative of non-government institutions.

Implementation of other frameworks

Last but not least, we want to discuss the implementation of other related frameworks in this country.

To begin with, we will discuss the implementation of Basel III in the country. As the IMF report states, the Colombian authorities have made progress towards adopting Basel III since 2012 by converging regulations on capital solvency, liquidity, and operational risks. However, unlike Brazil and Argentina, Basel III has not yet been fully implemented in Colombia, as the Fitch Ratings report suggests. (International Monetary Fund, 2022)

Other international ESG-related frameworks followed by some of the Colombian banks include but are not limited to: the TCFD framework (by Bancolombia in 2020), the Equator Principles, the Principles for Responsible Investment and UNEP-FI. As mentioned in earlier sections, there are currently no required international guidelines and related implementation schedules for banks in Colombia.

4 GAP ANALYSIS

Two tables were created to identify gaps in the EU Sustainable Finance Disclosure Regulation (SRDR) developed by the European Supervisory Authority (EBA), which aims to strengthen end-investor protection by increasing transparency in disclosure. Table 1 breaks down the EU taxonomy of ESG disclosure and applies the metrics to the three countries under analysis: Brazil, Chile, and Colombia. The Regulation (EU) 2020/852, initiated by the EBA, aims to establish a framework to facilitate sustainable investment (Taxonomy Regulations) and requires that credit institutions and investment firms disclose information, both qualitative and quantitative, with metrics and targets. Under those two routes, each category specifies three pillars. For qualitative measures, the framework examines the existence of disclosure on sustainability considerations in the risk management and business models toward the Paris Agreement goals. As for quantitative measures, credit institutions are required to disclose comparable KPIs, including a green asset ratio (GAR) and a banking book taxonomy alignment ratio (BTAR). In Table 2, the team proposed a flowchart checklist to scrutinize the current institutional design, guideline alignment, and policy implementation for the three countries. The significance of the table is to identify discrepancies in each stage of the ESG disclosure. That is, unlike the EBA, which provides a relatively advanced framework and a unified (Western) European model, Table 2 will be a process breakdown analysis that evaluates the ESG reporting process from the beginning (designing institutions and directives, aligning objectives) to the end (implementing policies, collecting data, providing feedback).

TABLE 1 EBA and three countries' banking regulations

	Brazil	Chile	Colombia
Qualitative Metric on Environmental Risk Include but are not limited to business strategy integrated environmental factors, policy and procedures, management body and its responsibilities, and risk management framework.	Check	Check	Check
Qualitative Metric on Social Risk Include but are not limited to business strategy, integrated social factors, policy and procedures, management body and its responsibilities (with special attention to community, employee, customer and human rights), and risk management framework.	Check	Check	Check
Qualitative Metric on Governance Risk Include but are not limited to governance integration of counterparty (with special attention to ethical considerations, inclusiveness, transparency, etcs), and risk management framework.	Check	Check	Not Included
Banking Book - Climate Change Transition Risk I Credit quality of exposure by sector, emissions and residual maturity following EU Paris-aligned Benchmarks of Article 12.1-2, and GHG Financed Emissions Scope 1-3.	Check	Check	Not Included
Banking Book - Climate Change Transition Risk II Energy efficiency (EPC label) of the collateral underlying loans collateralized by immovable poverty.	Not Included	Not Included	Not Included

	Brazil	Chile	Colombia
Banking Book - Climate Change Transition Risk III Alignment metrics of PiT distance to 2030 NZE2050 scenario in % by sector.	Not Included	Not Included	Not Included
Banking Book - Climate Change Transition Risk IV Risk exposure to top 20 carbon-intensive firms on carrying amount, average maturity, and number of firms included.	Not Included	Not Included	Not Included
Banking Book - Climate Change Physical Risk I Credit exposure subject to physical risk (acute and chronic events) by sector and residual maturity following EU Paris-aligned Benchmarks of Article 12.1-2.	Check	Check	Not sure
Summary of GAR KPIs Include GAR stock and flow variables corresponding to climate change mitigation and adaptation.	Not Included	Not Included	Not Included
Mitigating Actions - GAR Underlying assets for the calculation of GAR, include absolute numbers and percentage numbers.	Not Included	Not Included	Not Included
Mitigating Actions - BTAR Underlying assets for the calculation of BTAR, include absolute numbers and percentage numbers.	Not Included	Not Included	Not Included
Other climate change mitigating actions that are not covered in the EU Taxonomy	Not Included	Not Included	Not Included

TABLE 2 Institution - Rules - Implementation of three countries

	Questions	Brazil	Chile	Colombia
Institution	Is there a regulator/supervisor in the country?	Yes	Yes	Yes
	If yes, then who is the regulator?	Banco Central do Brasil (BACEN)	Financial Market Commission (CMF)	Superintendencia Financiera de Colombia (SFC)
	If yes, then who is the supervisor?	Banco Central do Brasil (BACEN)	Financial Market Commission (CMF)	Superintendencia Financiera de Colombia (SFC)
Policies	Is there any outstanding policy for ESG disclosure?	Yes	No	No
	If yes, what is the “name” of the policy?	Sustainability Dimension under the Agenda BC	N/A	N/A
Rules	What is the resolution/ norm that states the mandatory framework?	CMN Resolution No. 4,945	General Rule No. 461	Circular Externa 007 de 2021
	Is the framework divided by E, S and G or is it all combined?	Yes	Yes	No
	Is there a quantitative and a qualitative matrix within the rules?	No	No	No
	Are transition risks incorporated into current rules?	Yes	Yes	No
Implementation	Is the Basel III Pillar III implemented in your country?	Yes	Yes	Yes
	Are all banks obliged to implement rules in the same timeline?	Yes	Yes	Yes
	Are the banks following the same framework for ESG reporting?	No	No	Yes

	Questions	Brazil	Chile	Colombia
	Is there a determined schedule for reporting on disclosure?	Yes	Yes	Yes
	Is the country following the EBA framework?	No	No	No
	If not, what other ESG regulatory frameworks are they using?	SASB, GRI, TCFD	SASB, COSO, COBIT, TCFD, ISO	Green Protocol; General Guidelines for the Implementation of Environmental and Social Risk Analysis

The countries' matrix analysis reveals the gaps in ESG disclosure between EBA and chosen practices. This comparison shows that these countries already have technical standards that aim to ensure that stakeholders, including end-investors, are well-informed about institutions' ESG exposures, risks, and strategies and can make informed decisions and exercise market discipline.

However, one of the main gaps we see between the LAC countries and the EBA framework is related to the quantitative measures related to transition and physical risks. While all three countries have established how to disclose qualitatively about ESG risks, they are still missing a clear way of disclosing the numbers regarding the most affected economic sectors related to climate-risks.

Unlike the EBA, the LAC countries are not putting forward comparable disclosures and KPIs for ESG disclosure, which could be used as a tool to show how institutions are embedding sustainability considerations in their risk management, business models, and strategy and their pathway towards the Paris Agreement goals in quantitative metrics.

As for the EBA disclosure, the countries highlighted had built their frameworks on the recommendations of existing initiatives, like those of the TCFD, SASB, and GRI, although they missed the definition of templates, tables, and instructions to ensure enhanced consistency, comparability, and meaningfulness of institutions' disclosures.

As a comparison between the analyzed countries, it is possible to see that Brazil has the most robust framework for ESG risk disclosure inspired by the TCFD, having already established policies and some of the main companies already disclosing their ESG risks in voluntary internal frameworks. However, in the analysis, it was possible to see that the Chilean rule has more robust social and governance pillars, which can be knowledge to be shared with other countries.

5 RECOMMENDATION

In this section, we will propose recommendations based on previous analysis and discussions.

5.1 IDB can be a facilitator throughout the process

The Latin American and Caribbean region (LAC), compared with Europe, does not have a supranational institution for the banking industry such as the European Banking Authority (EBA). At the same time, the economic systems and institutions are less mature in LAC countries compared to their peers in Europe and Asia.

Based on these facts, we suggest that the IDB act proactively in the development of ESG regulatory technical standards for banks in the LAC region. By taking on itself the mission of acting as a facilitator for sound ESG promotion and implementation, the IDB will be further enhancing its role as a key agent for best financial practices throughout the region.

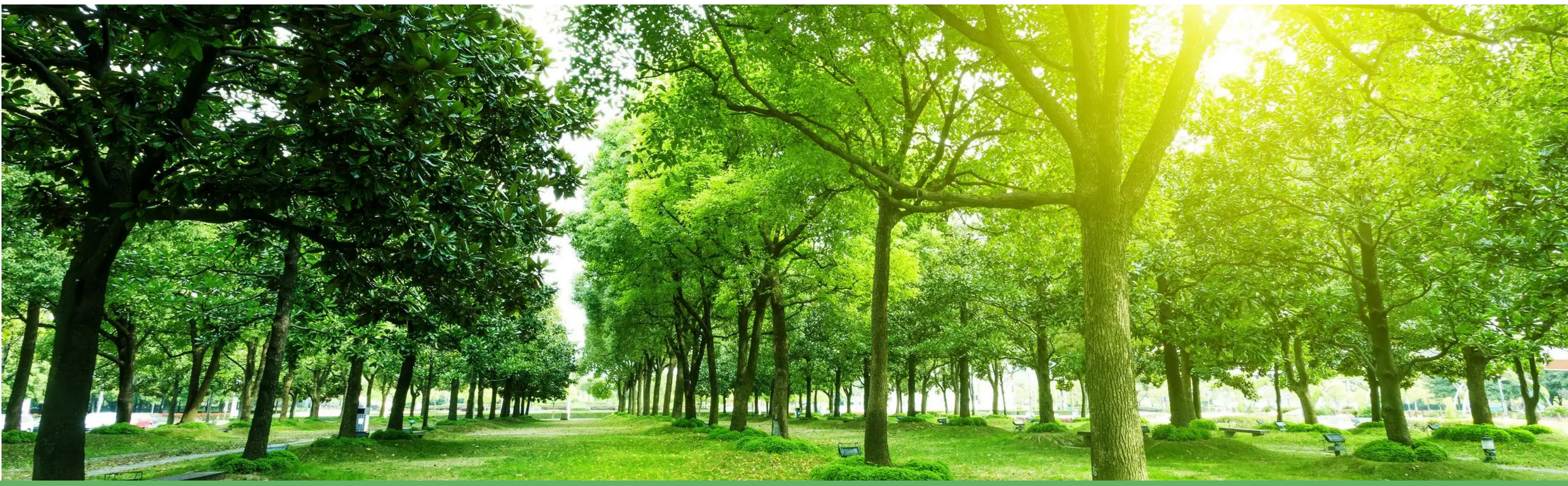
5.2 A Regional ESG Framework should be implemented at different speed for different countries

As previous analyses and tables show, the implementation of ESG disclosure frameworks in the banking industry is at different levels across the Latin American and Caribbean countries. Countries like Brazil are leading in setting up and adopting mandatory frameworks; countries like Colombia do not have regulator-initiated frameworks but have non-mandatory frameworks initiated by banks themselves; other countries are more behind and even at an early stage of adopting Basel III requirements. As the current situation suggests, it will be impossible and inappropriate to require all countries in the region to adopt a general mandatory framework like the EBA guidelines in Europe.

Our suggestion is to create independent schedules for different groups of countries. For countries like Brazil, we suggest they adopt the mandatory regional framework first. Modifications and improvements can be enabled during the implementation phase in these countries, so that the framework is more prepared, and the experience can be lessons for those less prepared countries.

We suggest countries like Colombia increase regulators' (like SFC) involvement in the banking ESG disclosure framework first, and then gradually propose the regional framework to replace the current non-mandatory framework at home.

We suggest countries that are far behind use the framework as recommendations first to help prepare related policies and the frameworks meet their current development phase for banking sectors. As the framework proves to be successful and mature in other leading countries, it is then proper to gradually introduce the regional framework as the mandatory guidelines for ESG disclosure in banks.

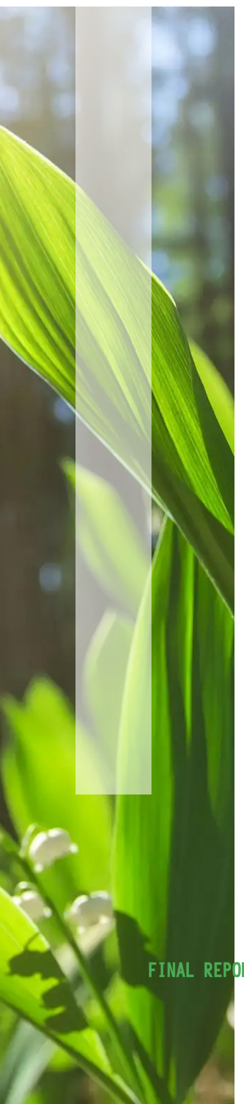


5.3 LAC regional framework may target EBA guidelines as the next step

As previous sections show, there is still a huge gap between EBA guidelines and the current ESG disclosure frameworks in LAC countries. However, we believe the EBA guidelines, as one of the most mature and comprehensive ESG disclosure frameworks for banks, should be the "future" version of the LAC regional ESG standards. Right now, as mentioned in the previous paragraph, the main focus is to start a regional ESG framework and help countries that are behind catch up. As the ESG standards start to mature in all LAC countries, taxonomy and transition risk are the two topics included in EBA that we find important for regulators and supervisors to include in the final version of the regional ESG disclosure framework.

6 CONCLUSION

The increasing awareness of ESG and climate-related risks, frameworks, and standards has propelled financial institutions to greater transparency of these risks. Regulators, investors, and policymakers have stepped up to propose ESG-related policies and commitments. However, many jurisdictions, including those in the LAC, are on the way to designing a comprehensive institutional framework regarding this matter.



Currently at the forefront of mandatory ESG disclosure, the European Banking Authority (EBA) has established the most complete set of sustainability disclosure requirements, covering a broad range of ESG metrics at entity and product level for financial institutions. However, the LAC countries are at very different stages of developing regulations and frameworks for ESG risk reporting. Also, our analysis shows that there is more progress in ESG disclosure for securities than in the banking sectors in most LAC countries, so there is still a lot of space for creating and implementing ESG disclosure measures for banks. At the same time, regulators and supervisors might need to play a bigger role in the region as the current banking regulations are mostly initiated by private institutions.

Therefore, our suggestion is that the IDB could act more proactively by cooperating with regulators and supervisors and developing ESG regulatory technical standards and frameworks for banks in the LAC region, flexible to each country's reality. In the long run, the goal is to create a regional framework that mirrors what has been done by the EBA, incorporating the realities of Latin American and Caribbean countries at the same time.

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