

FIDUCIARY DUTY IN THE 21ST CENTURY

BRAZIL ROADMAP

THE PROJECT

[Fiduciary duty in the 21st century](#) concluded that failing to consider long-term investment value drivers, which include environmental, social and governance (ESG) issues, in investment practice is a failure of fiduciary duty. Despite significant progress, many investors have yet to fully integrate ESG issues into their investment decision-making processes.

In January 2016, the PRI, UNEP FI and The Generation Foundation launched a three-year project to implement the report's recommendations, including the preparation of country roadmaps. These roadmaps enable the PRI and UNEP FI to work with national stakeholders to implement clear and accountable policy and practice that embraces the modern interpretation of fiduciary duty.

The Brazil roadmap was developed through extensive industry consultation and sets out recommendations in five categories: regulatory action, investor education, corporate reporting, stewardship and engagement and industry guidance.

1. Regulatory action:

- a. The Superintendence of Private Pension Funds (PREVIC) should recommend a revision to Resolution 3.792 which governs investment practices and disclosures by closed pension schemes¹.
- b. Oversight and monitoring by the Central Bank of Brazil (the Central Bank) of the impact of Resolution 4.327 on the investment activities of relevant regulated entities.

2. Investor education:

- Industry associations and accreditation agencies to collaborate on raising ESG awareness and practical training provision.

3. Corporate reporting:

- The securities regulator (CVM) should review the effectiveness of reporting of material ESG factors by Brazilian corporations.

4. Stewardship and engagement:

- CVM should adopt the Brazilian Association of Capital Market Investors' (AMEC) stewardship code.

5. Guidance:

- Regulatory and industry associations to provide guidance for asset managers and private pension providers on the scope and content of their fiduciary duties.

This work also sets the Brazilian capital market in a broader international context, as regulators and investors respond to a rapidly-changing investing environment. Following assessment of seven further markets (Australia, Canada, Germany, Japan, South Africa, UK and US), the PRI, UNEP FI and The Generation Foundation will prioritise the areas to which we will contribute.

ESG integration is defined as the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions.

PROJECT STEERING COMMITTEE

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¹ Closed pensions schemes are private pensions delivered through non-profit organisations that can be established on a single or multi-employer basis and by labour unions: <http://www.oecd.org/finance/private-pensions/43920149.pdf>

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This roadmap is prepared by the PRI, UNEP FI and The Generation Foundation and does not necessarily represent the views of interviewees and reviewers.

We would particularly like to thank the Central Bank for hosting our stakeholder roundtable on 6 October 2016.

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STAKEHOLDER FEEDBACK

This roadmap draws on events and interviews with more than 25 stakeholders at different points in the Brazilian capital market (see list above). Common themes in the feedback provided by stakeholders have formed the basis for the analysis and recommendations that follow.

Brazil is going through a period of political uncertainty and instability caused by the impeachment crisis. The “Lava Jato” corruption scandal and its economic impacts were identified by stakeholders as having far-reaching implications for the political economy of Brazil. In the context of ESG factors, it was considered that this scandal had significantly elevated the level of investor focus on corporate governance and stewardship in Brazil. The scale and extent of the scandal has created a window of opportunity for new regulation and market norms to be established.

Several stakeholders noted that there was often a significant disconnect between the language set out in regulation and statements of policy and the practical investment behaviour of Brazilian institutional investors. Our stakeholders sought interventions in policy and process that would make ESG integration an operational reality rather than an addition to an investor’s compliance or reporting burden.

The modal asset allocation of a Brazilian portfolio was comparatively skewed towards government debt, given the attractive nominal rates of return it has offered in recent years. In that context, our stakeholders were keen to see an increase in domestic listing activity and expected asset allocations overtime to rebalance towards equities.

As we have observed in the US, there was an increased focus on shareholder engagement in Brazil. Both development investors, such as The Brazilian Development Bank (BNDES), and leading asset owners were using similar approaches to ESG analysis in questionnaires presented to their asset managers and project

companies. There was an increasing volume of requests for ESG information from Brazilian corporations. However, stakeholders considered that there remained knowledge gaps and a lack of awareness of ESG issues scattered throughout the market.

Pension scheme trustees and their advisers needed knowledge of the rationale for ESG integration and an understanding of the techniques and products available to them. This required supporting data and case studies (including in relation to quantitative approaches) regarding ESG investment analysis. With many funds facing capacity constraints, tool-kits were required to simplify the implementation of ESG analysis.

The relevant regulators, industry associations and stock exchanges, such as the Central Bank, PREVIC, the Securities, Commodities and Futures Exchange (BM&FBOVESPA), AMEC, The National Association of Capital Market Analysts and Professionals (APIMEC), The Pension Fund Association (ABRAPP) and the Brazilian Association of Financial and Capital Markets (ANBIMA)² were engaged and supportive of ESG integration and sustainability issues and were critical to raising market awareness. It was proposed that engaging the entities regulated by the Superintendence of Private Insurance (SUSEP) was particularly important to advance ESG practice in Brazil. It was highlighted that the assets under management in “open” pensions had recently exceeded those managed within “closed” pensions, reflecting similar trajectories in markets such as the UK and the US.

² See Appendix for details of each organisation

THE BRAZILIAN CONTEXT FOR ESG INTEGRATION AND FIDUCIARY DUTY

ESG integration and national economic priorities

Sustainability and corporate governance issues have taken on renewed urgency in Brazil. The “Lava Jato” scandal has damaged Brazil’s reputation, reduced economic output and caused international investors significant concern regarding Brazilian equities. In addition, the Mariana dam collapse has directly caused many fatalities, polluted rivers and agricultural land and contaminated a water basin that serves 500,000 people³. It has also brought about huge fines⁴ and write-downs⁵ for Samarco (BHP and Vale). Both these events, which destroyed investment value and generated national outcry, have causes located in poor management of ESG issues. Engagement by investors and policymakers on ESG factors, sustainability and corporate governance has become a national, economic and political priority.

The analysis of ESG factors can help reorient companies towards long-term investment horizons, enabling investors to understand the quality of a firm’s management and the sustainability of its business model⁶. This can help asset owners to reorient investment strategies such that long-term liabilities are matched against long-term investments.

Our stakeholders noted that investment opportunities critical to Brazil’s national development would be in unlisted products and that an analysis of ESG factors could help direct more capital into domestic infrastructure (such as transport, and energy generation and transmission) as well as sustainability-themed investments (such as green bonds).

For a country with significant dependence on extractives and carbon-intensive industries, it is worth stating that ESG integration does not involve a narrowing of the available investment universe (unlike negative screening). Neither does it involve relegating the pursuit of a financial return to unrelated objectives (social or ethical). We define ESG integration as “the systematic and explicit inclusion of material ESG factors into investment analysis and investment decisions”. This tells us that ESG integration provides investors with an expanded set of tools for evaluating the operational performance and financial prospects of investee companies⁷. This is vital information for investors in the context of complex regulations and high-profile corporate governance failures.

As a result, ESG factors can be regarded as a significant business opportunity for Brazilian companies and investors, particularly those seeking to attract international liquidity to the Brazilian capital market.

An enabling environment for ESG factors

Brazil presents an enabling context for engagement on ESG integration. In both regulation and practice, Brazil has been actively engaged on ESG issues for over a decade. Its corporate law recognises duties to an array of stakeholders, rather than only shareholders⁸. Resolution 4.327⁹ implemented by the National Monetary Council establishes that financial institutions regulated by the Central Bank should adopt a social-environmental-responsibility policy relevant and compatible with its business model. BM&FBOVESPA was one of the first stock exchanges to engage

3 Samarco Dam collapse: <https://www.theguardian.com/sustainable-business/2016/oct/15/samarco-dam-collapse-brazil-worst-environmental-disaster-bhp-billiton-vale-mining>

4 <http://www.ibtimes.co.uk/bhp-vale-reach-settlement-brazilian-authorities-over-samarco-dam-disaster-1547251>

5 <https://www.bloomberg.com/news/articles/2016-07-27/bhp-says-to-book-provision-of-as-much-as-1-3-billion-on-samarco>

6 Turning a Profit While Doing Good: <https://www.brookings.edu/research/turning-a-profit-while-doing-good-aligning-sustainability-with-corporate-performance/>

7 ESG Research Works: <https://www.ft.com/content/b22c49c8-06e8-11e2-92ef-00144feabdc0>

8 http://www.hbs.edu/faculty/Publication%20Files/16-023_f29dce5d-cbac-4840-8d5f-32b21e6f644e.pdf

9 Released by the Central Bank on 25 April, 2014

with sustainability reporting¹⁰. Additionally, Brazilian consumers are increasingly aware of sustainability issues and are seeking to incorporate them into their buying decisions¹¹. There are also local examples of Brazilian corporations adopting sustainability¹² and integrated reporting practices¹³.

Several of Brazil's major asset owners and strategically important development institutions, such as BNDES, have good awareness of ESG issues. Resolution 3.792 requires "closed" pension schemes to disclose whether they take account of environmental and social matters. There is local evidence of the performance benefits of ESG analysis (such as the trend, performance and low volatility of the BM&FBOVESPA sustainability index (ISE))¹⁴. Brazilian investors have also indicated their interest in the enhanced reporting of material ESG issues as shown in the PRI report, Materiality of ESG KPIs: a perspective from Brazil¹⁵.

Recent regulatory advances in Brazil

Proxy voting has been the subject of regulatory focus by CVM. It has been an expensive and bureaucratic process in Brazil. In order to vote, investors have been required to attend in-person at annual general meetings or through an annually reviewed power of attorney. This was particularly onerous for international investors¹⁶. Through Instruction 561 (amending Instruction 481), CVM have confirmed the introduction of electronic voting. Through phased implementation,¹⁷ electronic voting will be fully adopted for the 2018 proxy season. This is a positive development in Brazilian capital markets regulation, removing an unnecessary procedural obstacle to shareholder engagement.

BM&FBOVESPA's special listing segment, the Novo Mercado corporate governance listing requirements, were open to consultation through to early 2017. Since their introduction in 2000, these listing standards have demonstrated that good governance can lower the cost of capital, and attract international investment for Brazilian companies.

A draft stewardship code for Brazilian investors was released for consultation by AMEC and subsequently launched on 27 October 2016¹⁸. We welcome this code particularly as it seeks to address ESG incorporation as an explicit part of investor stewardship activities.

PREVIC also announced and have begun a review of Resolution 3.792 applicable to closed pension schemes. Such a review was recommended in [Fiduciary duty in the 21st century](#).

A working group of organisations including the Brazilian Institute of Corporate Governance (IBGC), BM&FBOVESPA and AMEC have produced Brazil's first corporate governance code¹⁹. The code will apply to listed companies on a "comply or explain" basis overseen by the CVM. The code includes reference to ESG issues as part of the risks to be considered and reported on by Brazilian corporations (item 4.5 of the code).

We address these developments further in our recommendations below.

International clarification of fiduciary duty

Regulators and government agencies across mature capital markets have confirmed interpretations relevant to fiduciary investment practice.

In Canada, the Financial Services Commission of Ontario noted that the decision to incorporate ESG factors in investment processes of pension funds is in line with pension administrators' fiduciary duty to monitor and mitigate risk²⁰. In the UK, the Law Commission, in its report *Fiduciary Duties of Investment Intermediaries*, stated that "there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material"²¹. This clarifies that it is not the origin of the factor (or the label ascribed to it), but rather its financial materiality that is relevant to whether it should be considered²².

10 BM&FBOVESPA Report or Explain for Sustainability or Integrated Report: http://www.bmfbovespa.com.br/en_us/about/sustainability/at-companies/report-or-explain/

11 GreenDex survey: <http://environment.nationalgeographic.com/environment/greendex/>

12 Forbes Sustainability Top 100: <http://www.forbes.com/2010/01/26/most-sustainable-companies-leadership-citizenship-100.html>

13 GRI Business Transparency Project: https://www.globalreporting.org/services/preparation/Business_Transparency_Program/Pages/Natura.aspx

14 BM&FBOVESPA Corporate Sustainability Index (ISE): http://www.bmfbovespa.com.br/en_us/products/indices/sustainability-indices/corporate-sustainability-index-ise.htm

15 <https://www.unpri.org/page/materiality-of-esg-kpis-a-perspective-from-brazil>

16 <http://www.glasslewis.com/brazil-foreign-investors-voting-parity-mutually-exclusive/>

17 Implementation phased under CVM Instruction 570

18 Stewardship code http://www.amecbrasil.org.br/en/wp-content/uploads/2016/06/Brazilian_Stewardship_Code_Draft_for_Public_Consultation.pdf

19 New corporate governance code: <http://www.ibgc.org.br/index.php/noticias/19843/GT-Interagentes-lanca-Codigo-Brasileiro-de-Governanca-Corporativa-Companhias-Abertas>

20 Financial Services Commission of Ontario, Investment Guidance Notes: IGN-004: Environmental Social and Governance (ESG) Factors, <https://www.fscso.gov.on.ca/en/pensions/policies/active/Documents/IGN-004.pdf>

21 *Fiduciary Duties of Investment Intermediaries*, UK Law Commission 2014: <https://www.gov.uk/government/publications/fiduciary-duties-of-investment-intermediaries>

22 The evaluation of financial materiality is at the well-reasoned discretion of pension scheme trustees having taken appropriate advice.

RECOMMENDATIONS

1. Regulatory action:

a. **The Superintendence of Private Pension Funds (PREVIC) should recommend a revision to Resolution 3.792 which governs investment practices and disclosures by closed pension schemes.**

The resolution, which came into force in 2009, requires closed pension funds to use due diligence, comply with the law and adopt high ethical standards in investment processes and decision making. It also requires closed pension funds to comply with several governance requirements, one of which is that they must state whether they take account of environmental and social issues in their investment practices. PREVIC requires pension funds to explicitly state in their annual policy statements whether they comply with environmental and social principles.

Regulators outside Brazil have increasingly required statements explaining ESG investment practices. The Financial Services Commission of Ontario requires that pension funds disclose the extent to which they take account of ESG factors in investment processes²³. It is worth noting that such disclosures have been a feature of UK pensions regulation for over a decade²⁴, and have recently been strengthened with supporting guidance²⁵ and public commentary from The Pensions Regulator in the UK on the importance of ESG factors to prudent scheme practice²⁶. These requirements give regulators and industry bodies a basis of information to analyse and understand scheme practice in relation to environmental and social factors in investment processes.

The resolution review process is now underway. PREVIC has made significant progress and engaged with national stakeholders. It has been suggested that the revised resolution will have an increased focus on risks, internal organisational controls and governance of investments and will also contain an expanded set of requirements

relating to ESG integration and sustainability²⁷. In addition to this, additional prudential supervision of closed pension funds may be added to the scope of regulation.

Recommendation and next steps: As part of PREVIC's proposal to the National Monetary Council following its review of Resolution 3.792, it should request that the resolution be updated to clarify that the consideration of material ESG factors are part of the primary analysis of a prudent investment process. The resolution should enable ESG factors, which are commonly referenced in investment policies, to be reflected in the investment processes and decisions of closed pension schemes.

PREVIC should also strengthen its oversight and implementation of the revised resolution through analysing and reporting on the implementation of its environmental and social requirements. In connection with the review of Resolution 3.792, both the Guide to Best Practices in Investments and the Guide to Best Practices in Risk Management issued by PREVIC should be updated to incorporate equivalent ESG language²⁸.

b. **Oversight and monitoring by the Central Bank of Brazil (the Central Bank) of the impact of Resolution 4.327 on the investment activities of relevant regulated entities.**

Resolution 4.327²⁹ establishes that financial institutions regulated by the Central Bank should adopt a social-environmental-responsibility policy. The resolution acknowledges that the relevance of an environmental or social factor will not be the same across sectors. For example, what is a material environmental or social issue for a bank will not be the same for an extractives firm. Consequently, the resolution proposes that such policy should be relevant and compatible with the regulated entities' business model.

23 <https://www.fsc.gov.on.ca/en/pensions/legislative/Pages/sipp.aspx#ESG>

24 The Occupational Pension Schemes (Investment) Regulations 2005: <http://www.legislation.gov.uk/uksi/2005/3378/regulation/2/made>

25 Guide to Investment Governance – The Pensions Regulator: <http://www.thepensionsregulator.gov.uk/docs/dc-investment-guide.pdf>

26 <http://www.professionalpensions.com/professional-pensions/news/2470190/tpr-trustees-must-wake-up-and-smell-the-coffee-on-esg>

27 Update on Resolution 3.792: <http://diario.abrapp.org.br/Paginas/Detalhes.aspx?nId=39634>

28 PREVIC best practice guide: <http://www.previc.gov.br/menu-de-apoio/guia-de-melhores-praticas-1/best-practices-for-pension-funds.pdf>

29 Released by the Central Bank on 25 April, 2014

That guidance also encourages firms to construct an effective policy that relates to the operational aspects of the business rather than producing boilerplate language with limited practical effect.

As with any new regulation, it is subject to implementation gaps. Our stakeholders indicated that regulated entities seeking to interpret the resolution were often unsure of the scope of their responsibility. This reflects concerns that often arise with novel sustainability regulation, namely identifying the boundary within which the regulation applies. This may be hard to uniformly resolve when reporting on activities. It was also noted that the universe of regulated entities to which the resolution applies was diverse, meaning that implementation would be uneven. This would partly reflect the differences in capacity and scale across the sector.

The resolution was highlighted as being strategically significant for the development of the Brazilian capital market. Several stakeholders indicated that they wanted to see further guidance developed on the implementation of the resolution, and an attempt to account for its effect in practice – acknowledging that it was both new, and had only recently come into force.

Recommendation and next steps: As part of the Central Bank's continuing review of regulatory effectiveness, it should report on the impact of Resolution 4.327, the policies that have been produced in response to it and the gaps in implementation. Industry organisations were supportive of assisting the Central Bank in this work.

2. Investor education: Industry associations and accreditation agencies to collaborate on raising ESG awareness and practical training provision.

Brazil has comparatively high market awareness of ESG issues and practices, driven to an extent by regulatory requirements. Research released last year on closed pension funds indicated that 94% of the top 50 pension funds (by net asset value) mention ESG issues in investment policies, up from 67% in 2014³⁰. These policies tended to reference negative screening or purely aspirational statements on ESG issues and reflected Resolution 3.792. The same research estimated that under 30% of assets of the top 50 funds were subject to 'effective integration', notwithstanding the content set out in investment policies.

There is however, less awareness of the methods and processes by which ESG factors can be implemented in practice. There is a significant role for industry associations to promote understanding and best practice of integrating ESG factors into investment processes and decision making. Such associations can also help to adjust guidance to reflect the scale and maturity of the market actors that they represent.

Industry associations can leverage the existing knowledge of organisations such as the PRI, which have produced practical guides to enable ESG integration, including:

- A practical guide to ESG integration in equity investing³¹
- How asset owners can drive responsible investment: beliefs, strategies and mandates³²
- Investment policy: process and practice³³.

30 Responsible Investment in Brazil 2016: ESG incorporation by pension funds., Sitawi (May 2016)

31 <https://www.unpri.org/news/pri-launches-esg-integration-guide-for-equity-investors>

32 <http://globalsustain.org/en/story/11009>

33 <https://www.unpri.org/about/pri-teams/investment-practices>

34 CFA exam going green: <http://www.bloomberg.com/news/articles/2016-10-20/the-cfa-exam-is-going-green>

This can supplement existing training initiatives in Brazil, such as by BM&FBOVESPA's Educational Institute, which has built ESG content into its core investment curriculum, reflecting recent developments in CFA's training programme.³⁴

Underlying our recommended approach is the analysis that voluntary codes of conduct have been widely adopted and proved effective in driving and consolidating industry practice (in a range of sectors and product areas). Examples of these include certifications and standards such as ISO 9000³⁵ regarding a range of quality management standards and ISO 26000³⁶ which addresses the social responsibility of business practices.

Recommendation: ABRAPP, APIMEC and ANBIMA³⁷ should continue to engage their membership on ESG factors and identify specific areas of training and awareness-raising required for ESG issues. These organisations can partner with the PRI through the PRI Academy and the PRI's ESG integration roadshows to spread the knowledge of ESG integration approaches among their respective memberships. ESG awareness and training should then be incorporated into the core competencies and relevant certifications for the professionals represented by these industry bodies. This could be coordinated through COREMEC³⁸ to ensure broad adoption and consistency of approach.

3. Corporate reporting: The securities regulator (CVM) should review the effectiveness of reporting of material ESG factors by Brazilian corporations.

Significant initiatives are underway, at both domestic and international level, to improve the quality and comparability of corporate reporting of material ESG information. The most recent intervention is by the Financial Stability Board (FSB), which established a Task Force on Climate-related Financial Disclosures (TCFD) to undertake an assessment of what constitutes efficient, consistent and effective climate-risk financial disclosures³⁹. In the US, the Securities and Exchange Commission (SEC) conducted a

comprehensive review of its disclosure framework for reporting companies, including the disclosure of material ESG information⁴⁰. We also note that the SEC has begun a review of the reporting practices of carbon intensive corporations, relating to the valuation of assets exposed to climate change regulation⁴¹. The Global Reporting Initiative⁴² and the International Integrated Reporting Council⁴³ have seen companies continue to adopt their standards. Third party data providers have also seen demand for ESG information continue to grow, though the corporate information they are able to collect is often poor and hard to compare.

In Brazil, regulation has played a significant role in improving corporate transparency. CVM's expanded reference form was regarded as having driven improved governance disclosures by listed Brazilian entities⁴⁴. Sections four and five of the reference form had encouraged listed entities to focus on and disclose against risk factors and market risks, and section seven (at question 7.8) requests listed companies to disclose sustainability policies. Several companies have used the form as an opportunity to draw attention to their sustainability and stakeholder reporting practices, the BM&FBOVESPA's voluntary initiative, the Report or Explain Sustainability or Integrated Report.

Disclosures of "social" policies, such as business ethics and anti-corruption⁴⁵ have often been driven by industry guidance, such as that provided by the Brazilian Institute for Corporate Governance⁴⁶. Disclosure of greenhouse gas emissions has been partially driven by regulatory mandates, in addition to voluntary disclosure initiatives (such as the Carbon Disclosure Project and the UN Global Compact).⁴⁷ However, corporate disclosure as a compliance response to regulation will only produce a limited set of disclosures material to investors.

Reviewing corporate disclosures would require close coordination with BM&FBOVESPA. Good corporate governance requires corporations to be aware of and manage environmental and social risks and opportunities. We welcome BM&FBOVESPA's revisions of the Novo Mercado, expanding on BM&FBOVESPA's significant engagement on ESG reporting and sustainability.

35 http://www.iso.org/iso/iso_9000

36 <http://www.iso.org/iso/home/standards/iso26000.htm>

37 Working through the ANBIMA Sustainability Working Group

38 Brazil regulatory structure: http://www.cvm.gov.br/subportal_inlgles/menu/about/jurisdiction.html

39 The Task Force was convened in December 2015

40 Securities and Exchange Commission, Business and Financial Disclosure Required by Regulation S-K <https://www.sec.gov/rules/concept.shtml>

41 <http://www.wsj.com/articles/sec-investigating-exxon-on-valuing-of-assets-accounting-practices-1474393593>

42 GRI: <https://www.globalreporting.org/Pages/default.aspx>

43 IIRC: <http://integratedreporting.org/the-iirc-2/>

44 Set out in CVM Instruction 480, 2009

45 IBGC code: <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/1824495.pdf>

46 Report – ESG Disclosure in Brazil: State of the Market. Bloomberg & Sitawi (2016)

47 Such as that set out by the Electricity Regulatory Agency ANEEL – Agência Nacional de Energia Elétrica

Given this national and international context, we expect Brazilian regulators and standard setters to review the quality and comparability of ESG disclosures by Brazilian companies. An underlying premise for such a review is that material ESG information is a key contextualising element of financial analysis and should be available at the same time as, and in a comparable format with, financial data.

Recommendation and next steps: We propose that CVM conduct a review of the effectiveness of ESG disclosures by Brazilian corporations and consult widely with investors and their representatives regarding their expanded expectations for enhanced reporting of climate risks and material ESG information. CVM can engage with this issue in connection with the TCFD's principles-based recommendations launched in December 2016⁴⁸.

4. Stewardship and engagement: CVM to adopt the Brazilian Association of Capital Market Investors' (AMEC) stewardship code.

Brazil has a mixed but increasingly enabling landscape for stewardship activities. Corporate governance has become a particular point of focus in Brazil following the "Lava Jato" and other major national corporate scandals. Shareholders are increasingly engaging with corporations across a range of themes and in response to near-term issues (such as the drought of 2014/15). It is often noted that many large Brazilian companies are controlled companies, meaning that opportunities for shareholder engagement have been more limited than in other developed markets. We understand that this trend is changing.

Attitudes to environmental and social issues within the ESG spectrum have adjusted, increasingly being seen as material to operational performance and financial prospects. Brazil's large pension funds tend to manage assets in-house⁴⁹. This can be advantageous in terms of conducting engagement with investee companies, as smaller pension schemes face capacity constraints and have to out-source engagement practices to investment managers. Comparatively, large Brazilian pension funds have low exposure to equities, with significant investments in government bonds. We expect this to adjust over time.

We welcome AMEC's code⁵⁰ setting a framework for investors to strategically engage with their investee companies on ESG issues. Our stakeholders noted that AMEC's code and Resolution 3.792 complemented each other.

International examples suggest that codes are only effective where they have market-wide adoption. Following such adoption, reporting and accountability mechanisms should be built in to the monitoring and oversight of the code. In the UK, the FRC, which oversees the UK Stewardship Code, has undertaken a review of the quality of reporting against the code. Such an exercise enhances the credibility of the code and enables it as a tool to drive best practice.

Over time, a code should assist the quality and resources committed to engagement activities to become a tool for competitive differentiation, particularly among asset managers. We do accept that a new code for engagement in a market where engagement practices are largely new will take time to gain acceptance – as institutions consider how to apply the code and the resources required to do so.

Recommendation and next steps: To ensure broad uptake and impact of the code, we suggest that a national regulator, such as CVM and PREVIC, should adopt AMEC's stewardship code and provide oversight and monitoring or reporting against it. Prior to this, AMEC should provide a market signal that its members are expected to sign the code and meaningfully report against it. Following the publication of AMEC's Implementation Guide regarding the code, AMEC should establish a transition to monitoring the code as the first reporting cycles against the code are completed.

⁴⁸ TCFD report and recommendations: <https://www.fsb-tcfd.org/publications/>

⁴⁹ Sustainable investment in key emerging markets: http://www.ifc.org/wps/wcm/connect/f0dd0c8048855cd88cfcde6a6515bb18/IFC_Brief_DoingSL.pdf?MOD=AJPERES&CACHEID=f0dd0c8048855cd88cfcde6a6515bb18

⁵⁰ Amec's code: http://www.amecbrasil.org.br/en/wp-content/uploads/2016/06/Brazilian_Stewardship_Code_Draft_for_Public_Consultation.pdf

5. Guidance: Regulatory and industry associations to provide guidance for asset managers and private pension providers on the scope and content of their fiduciary duties.

Well-framed regulatory guidance can be a catalyst for fiduciaries and their advisers to revisit governance structures and investment processes. Guidance should not be prescriptive but rather should set out a framework of expectations against which asset owners, investment managers and service providers are to be held. As we have described earlier in this report, guidance has been issued in the UK and Canada which stakeholders in those markets indicate is having an impact on expectations of investor behaviour and filtering into investment practice.

We note that in addition to the large asset owner pension plans, the insurance industry, as a major supplier of private pensions, is a subject of renewed regulatory focus in other developed markets, particularly in the context of climate risk. In California, the Insurance Commissioner has implemented disclosure requirements for insurance companies linked to climate-related risks⁵¹. The UK's Prudential Regulatory Authority, part of the Bank of England, also conducted an insurance sector survey on climate adaptation⁵².

The report [Fiduciary duty in the 21st century](#) recommended that clarifying guidance on the content of fiduciary duty be provided by CVM and ANBIMA. This would apply to asset owners and investment managers. It would complement existing regulation, such as Resolutions 3.792 and 4.327 (discussed above). Following commentary from our stakeholders, we now extend that analysis and propose that similar guidance should be issued by SUSEP in reference to open pension funds.

Recommendation: Regulators and industry associations should, for their respective regulated entities and members:

- clarify that fiduciary duty requires them to pay attention to long term factors (including ESG factors) in their decision making, and in the decision making of their agents;
- clarify that they are expected to take account of ESG issues in their investment processes and decision making, and to proactively engage with the companies and other entities in which they are invested.

As regulators, CVM and SUSEP can provide such guidance through rule writing. Industry associations such as ANBIMA can provide guidance in the form of best practice notes to their membership.

51 Insurance Commissioner letter to SEC: <https://www.sec.gov/comments/s7-06-16/s70616-222.pdf>

52 PRA report on insurance industry: <http://www.bankofengland.co.uk/prs/Documents/supervision/activities/pradefra0915.pdf>

APPENDIX: REGULATORS AND INDUSTRY ASSOCIATIONS

PREVIC - Superintendência Nacional de Previdência Complementar
(Superintendence of Private Pension Funds)

BM&FBOVESPA S.A. - Bolsa de Valores Mercadorias e Futuros
(BM&FBOVESPA S.A. - Securities, Commodities and Futures Exchange)

AMEC - Associação de Investidores no Mercado de Capitais (The
Brazilian Association of Capital Market Investors)

APIMEC - Associação dos Analistas e Profissionais de Investimentos
do Mercado de Capitais (National Association of Capital Market
Analysts and Professionals)

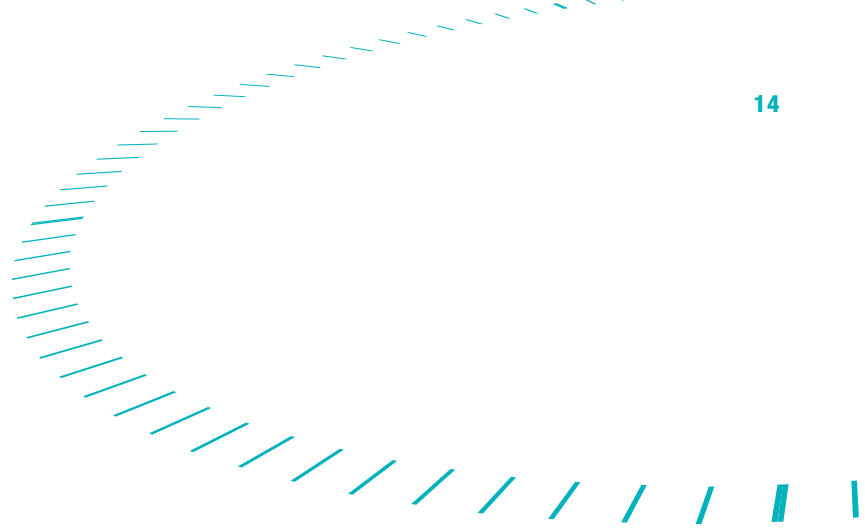
ABRAPP - Associação Brasileira das Entidades Fechadas de
Previdência Complementar (The Pension Fund Association)

ANBIMA - Associação Brasileira das Entidades dos Mercados
Financeiro e de Capitais (Brazilian Association of Financial and
Capital Markets)

SUSEP - Superintendência de Seguros Privados (Superintendency
of Private Insurance)

CVM - Comissão de Valores Mobiliários (The Brazilian Securities
Regulator)

CMN - Conselho Monetário Nacional (The National Monetary
Council)



About the PRI

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions. The six Principles were developed by investors and are supported by the UN. They have more than 1,500 signatories from over 50 countries representing US\$62 trillion of assets. They are voluntary and aspirational, offering a menu of possible actions for incorporating ESG issues into investment practices. In implementing the Principles, signatories contribute to developing a more sustainable global financial system. For more information, see www.unpri.org.

About UNEP FI

The United Nations Environment Programme Finance Initiative (UNEP FI) is a unique global partnership between the United Nations Environment Programme (UNEP) and the global financial sector founded in 1992. UNEP FI works closely with over 200 financial institutions who have signed the UNEP FI Statements as well as a range of partner organizations to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realize the adoption of best environmental and sustainability practice at all levels of financial institution operations. For more information, see www.unepfi.org.

About The Generation Foundation

The Generation Foundation ('The Foundation') is the advocacy initiative of Generation Investment Management ('Generation'), a boutique investment manager founded in 2004. The Foundation was established alongside Generation in order to strengthen the case for Sustainable Capitalism. Its strategy in pursuit of this vision is to mobilise asset owners, asset managers, companies and other key participants in financial markets in support of the business case for Sustainable Capitalism, and to persuade them to allocate capital accordingly. For more information, see www.genfound.org.

CREDITS

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