DRSAC Brazil
Banco Central Do Brasil ESG Reporting Framework

The environmental, social, and governance (ESG) trend – supporting corporate and individual demand to better quantify and understand the impacts of our actions on the planet – continues its march around the globe. Each region (EMEA/EU Taxonomy, APAC/ASEAN Taxonomy) or country (Australia, Canada, Hong Kong) with its own standards and good practices – albeit with some overlap – defining whether institutions in their respective jurisdictions are socially aware, sustainable, and correctly managed.

In other words, ESG provides a way of determining an organization's sustainability performance in terms of actions it takes around:

- **Care for the environment:** Preserving nature, combatting global warming, pollution, etc.
- **Social responsibility:** Addressing labor relations, human rights, diversity, safety, etc.
- **Governance:** Ensuring that its practices have a positive effect via transparent policies, and the monitoring, evaluation, and improvement of implemented actions.

The DRSAC aims to capture information about social, environmental, and climate risk-related drivers of an institution's credit and securities exposures at the industry (CNAE), counterparty, and individual-transaction level.

Next Stop, Brazil

The *Documento de Riscos Social, Ambiental e Climático* (DRSAC) was created by the Central Bank of Brazil to support its sustainability agenda, based on the Taskforce on Climate-Related Financial Disclosures (TCFD). There are also similarities between the DRSAC and the EU's EBA Pillar3 regulation, which is based on TCFD requirements. The use of categorization of exposures by industry – the National Classification of Economic Activities (CNAE) for DRSAC, the NACE (Nomenclature of Economic Activities) for Pillar 3, and even the Global Industry Classification Standard (GICS) for the International Sustainability Standards Board's (ISSB) climate-related disclosures – is another example of similarities between the DRSAC and other global frameworks. The growing global importance of identifying possible climate-risk related transmission channels is, therefore, becoming increasingly clear.

The DRSAC helps institutions assess the likelihood of event-driven losses caused by exposure to the following:

- **Social risk:** The violation of fundamental rights or acts harmful to the common interest, including harassment, discrimination, or prejudice based on personal attributes
- **Environmental risk:** The degradation of the environment (deforestation, animal cruelty, etc.)
- **Climate risk:**
  - Transition risk: The process of adapting to new regulations/restrictions with the aim of becoming a low-carbon economy
  - Physical risk: Acute and chronic weather events (floods, drought, wildfires, etc.) becoming more frequent and more severe due to climate change

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Which market participants are impacted by DRSAC?

DRSAC reporting is mandatory for all financial institutions licensed by Brazil's Central Bank. Furthermore, regulators such as Comissão de Valores Mobiliários (CVM) and Banco Central Do Brasil continue to review and establish new practices and rules. Other financial institutions, such as Brasil, Bolsa, Balcão (B3), also play an important role in fostering the ESG agenda by recognizing the most sustainable companies, including banks listed on the Brazilian stock exchange via its ISE B3 index.

And because the financial sector has a key role to play in achieving ESG goals, all five banking segments are affected by the DRSAC's regulatory requirements.

DRSAC must be filed twice a year, as depicted below. Regulatory in-force dates vary by segment.

Segment	Regulatory In-Force Date	Initial DRSAC Submission – 10th business day
1	December 2022	February 2023
2	June 2023	August 2023
3	December 2023	February 2024
4	June 2024	August 2024
5	Must present a simplified risk management structure.	

Why is the DRSAC important?

The introduction of the DRSAC into the regulatory landscape signifies a drastic change in Brazilian financial institutions' operational priorities. The type of data and information now needed to satisfy regulatory requirements is vastly different from traditional regulations, necessitating a fresh outlook in terms of data sourcing (through market data providers vs directly from counterparties) and an overhaul of the institutions' internal operations. Questions abound.

- *How do institutions sourcing data from market-data providers assess their accuracy?*
- *How do they choose between the results of multiple providers for a singular counterparty when market-data providers use different methods of estimation?*
- *How would institutions manage their exposures to private companies or households when market-data providers only have publicly-available information?*

There are no fewer questions for institutions obtaining data directly from counterparties.

- *Are their current KYC systems still suitable?*
- *Can their KYC systems link to their monitoring and reporting systems/departments?*
- *How do they assess the responses they receive from the counterparties?*

The DRSAC is expected to be just the first step for Brazil. Like other regional trends in the ESG regulatory landscape, further regulatory developments via new green taxonomies or expanded sustainability-related disclosures are expected.

What are some of the functional challenges created by the DRSAC framework?

A New Take On Risk Management

In 2021, the Central Bank of Brazil released the *Política de responsabilidade social, ambiental e climática* (PRSAC). It is a set of social, environmental, and climate principles and guidelines institutions must observe in business activities and processes, as well as relationships with interested parties. Today, in addition to observing the principles and guidelines, institutions are required to implement effective actions, strengthen their governance structure, and publicly disclose their activities.

Because sustainability is fundamental to ESG, DRSAC requirements include disclosing exposure to a variety of non-financial risks and their related components, as defined above. This produces a distinct challenge for institutions as they must now look beyond the traditional financial risks – such as credit, market, operational, and liquidity risk – and perform risk assessment through a new lens.

Evolving Market Practices

Emerging global trends and regulatory developments is another challenge facing institutions. The ISSB has recently finalized requirements for entities to disclose information about climate-related risks and opportunities. This would require a more advanced view of the information disclosed under DRSAC with the introduction of climate-related scenario analysis.

Because the EU's EBA Pillar 3 regulation has many synergies with the DRSAC's disclosure requirements, in terms of the type of information requested, taking a strategic approach i.e., a singular platform to manage ESG regulations, is the best way to mitigate these challenges.

These regulations are a prime opportunity for institutions to collect and analyze non-financial information from their counterparties, paving the way for more sustainable operations and investment. It also allows them to gain a more holistic understanding of their processes, which in turn, may inspire better roadmaps to climate-friendly/neutral economies.

What are the technical challenges created by DRSAC ?

- **Data collection and credibility** top the list of ESG regulatory reporting challenges. Data required for calculations and reporting, such as ESG-risk ratings and greenhouse gas (GHG) emissions, is broadly unavailable, uncollected, and/or not measured by state or market-data institutions. This is a worldwide challenge as the demand for ESG data sources is relatively new.
- **Technology and tools** for measuring and evaluating risk factors are another key challenge for Brazilian banks. The requirement to report in a machine-readable format adds an extra layer of complexity to be addressed. Therefore, institutions need a system that easily links the infrastructure used to evaluate exposures and generates the final reports as an XML file.
- **Risk reporting and reconciliation**: To further demonstrate the interconnectedness of global financial markets, there is a growing recognition and trend towards aligning ESG and other risk reporting (e.g., DLO). A lot of source data aligns. Effectively reconciling the current set of risk reports with DRSAC would enable banks to have a more complete view of their underlying exposures
- **Climate-risk models**: In addition to a lack of ESG data, the DRSAC does not provide a standard method or taxonomy for the assessment and definition of ESG risk ratings; it is up to financial institutions to define their own models. Therefore, banks must decide how to model their ESG risks, as well as estimate or create proxies for GHG calculations.

What's next for Brazilian banks?

The DRSAC impacts all banking segments. And since no facet of a bank – investments, data collection, technology, risk and credibility reporting, reconciliation and climate-risk models – goes untouched from a technical perspective, it is better to formulate efficient, holistic organizational processes around data sourcing and strategy now, rather than addressing each regulation in silos.

With that in mind, the correct solution:

- Incorporates ESG data from different sources (internal/external) from one or multiple data providers, including the client's proprietary ESG data models, and performs data-quality checks and adjustments on ESG risk ratings, as needed.
- Delivers an intuitive UI view into the final report for trend, variance, and other analytics; and enables workflow automation for the issuance of management reports that support strategic ESG and business decisions.
- Provides reconciliation capabilities and implementation, including multiple reporting solutions, direct mapping from SCR transactions (IPOCs), or COSIF accounts to the DRSAC report.

Adenza has been developing regulatory ESG solutions for many jurisdictions around the globe and can support client initiatives for data integration across different frameworks (multiple data providers, PCAF, etc.), while continuing to perform relevant KPI calculations, and end-to-end ESG reporting.

Contact Adenza to start a conversation about how we can help you adapt any data source and input format for your ESG solution.

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