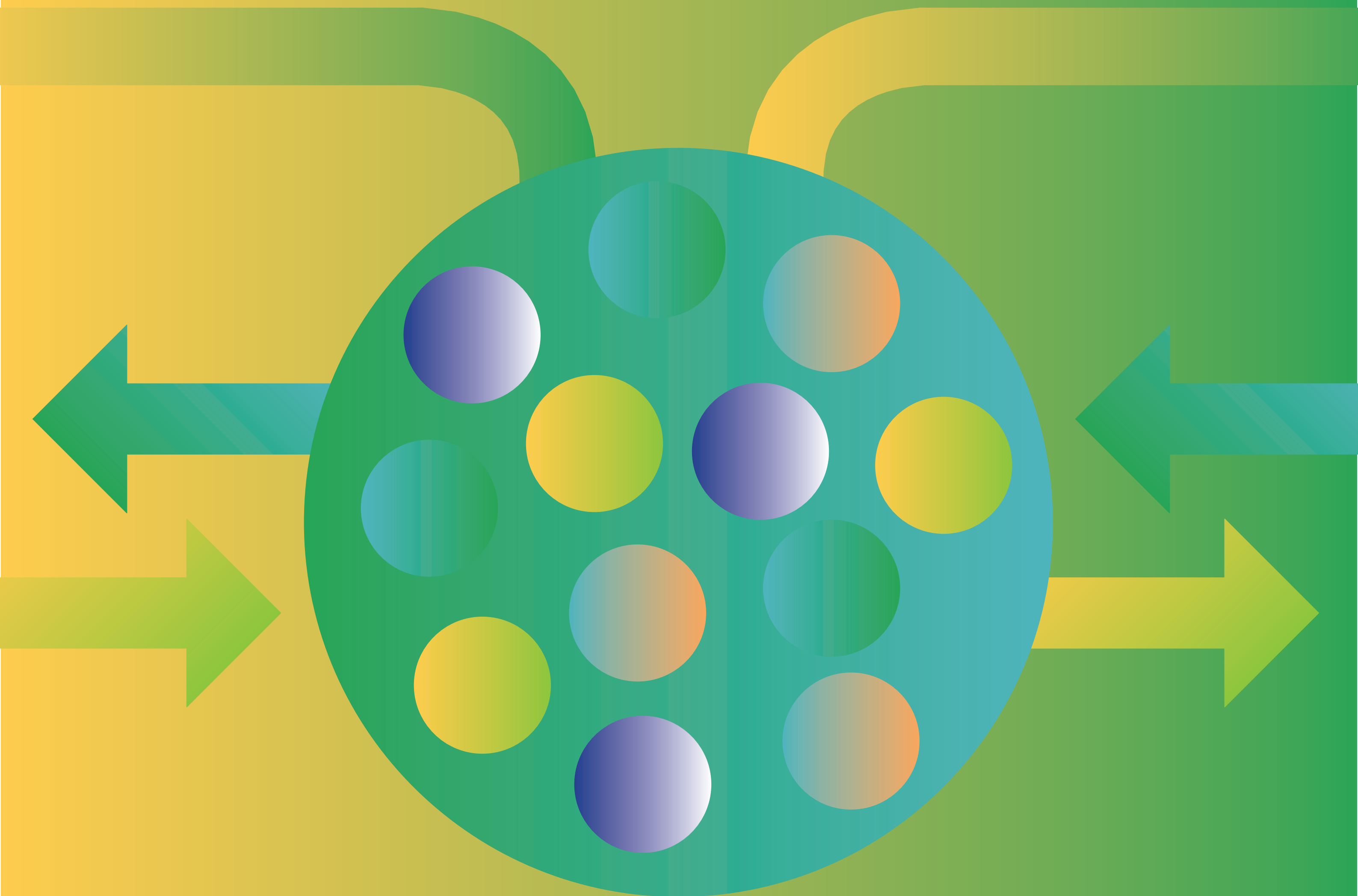
Brazil sustainable securitisation

State of the market Q3 2022

CLIMATE BONDS INITIATIVE



Prepared by the
Climate Bonds Initiative

Contributions from
VBSO Advogados

Contributions from
VERT Securitizadora

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Introduction

Asset-backed securities (ABS) are one of Brazil's most important and well-established debt instrument types, allowing the financing of smaller projects and assets through deals of meaningful size via the capital market. They have attracted investment to key sectors of the Brazilian economy, such as agriculture, forestry, and bioenergy. More recently, advances in regulatory frameworks have extended the application of these instruments further to include infrastructure. Brazil's sustainable (labelled) securitisation market is unique within the Latin American and Caribbean (LAC) region and market analysis could encourage issuers in other emerging markets (EM) to explore the format. This report aims to provide an overview of the Brazilian sustainable ABS market, its regulatory foundations and case studies, as well as highlighting opportunities to channel investment into sustainable activities, projects, and assets in the country.

Contents

Climate Bonds has identified five issuer benefits of securitisation

1. Access to debt capital markets: Raising capital through debt markets comes with additional structuring costs and time. Brazilian securitisation companies can supply financing at reasonable prices, offering an alternative to the prevalent banking and credit institutions. Moreover, securitisation structures can match the financing needs of small issuers to the investment preferences of institutional investors. For example, small projects can be aggregated, combining different maturities and credit ratings, and the resulting instruments can meet demands for longer tenors and improved creditworthiness.

2. Lower cost of capital for the issuer: ABS can offer an alternative for companies and businesses looking to finance their operations without having to pay higher costs through lending or financial operations with multiple intermediaries. Additionally, securitisation stimulates competition between funding sources and capital suppliers due to the replacement of bank intermediation with a securitisation company that reduces the tax burden for its retail clients.

3. Fostering market competitiveness: Companies can ease their balance sheets and cash flows by wrapping their credit rights and other contract receivables into a securitised instrument sold in the debt capital market, generating investing capital in advance to foster innovation and technology. The income flow from those receivables is then reverted to pay the investors.

4. Scalability of local GSS+ debt market: ABS instruments are well-understood by local corporate issuers and growing as funding alternatives. Adding a thematic label could encourage issuers to adhere to sustainable practices and diminish investors' risk perception, thus generating a positive snowball effect. International investors are keen to buy sustainable debt instruments from a variety of sources. Combining securitised structures with climate-aligned and social benefits could attract external capital to fund various small-scale activities of the Brazilian economy while expanding the local GSS+ market.

5. Leveraging financial entities' lending capacity: Financial entities can use securitised debt to offload exhausted lending portfolios and recycle the proceeds into new loans. Brazilian lenders can grow financing for small-scale green and social activities by aggregating agriculture, energy, and real estate related portfolios into sustainability-labelled Agribusiness Credit Letters (LCA) and Real Estate Credit Letters (LCI). These ABS can combine credit letters of different tenors and sizes to suit capital market investors' appetite for longer maturities and larger ticket sizes.

Green	Social	Sustainability	Sustainability-linked	Transition
Use-of-proceeds instrument with all net proceeds allocated to eligible green projects/assets with environmental benefits.	All net proceeds are allocated to projects/assets with positive social outcomes, such as healthcare, gender equality, access to infrastructure, livelihoods, education, and income equality.	Net proceeds are allocated to projects, assets, expenditures, and activities with both environmental and social benefits.	General purpose instruments tied to a time-bound performance of predefined sustainability indicators. These structures can trigger coupon changes according to whether the issuer meets its stated goals.	'Transition' instruments may refer to both general purpose and use-of-proceeds formats that finance Paris-aligned entities, activities, projects, or assets from hard-to-abate sectors to enable a transition to a low-carbon economy.

Disclaimer: Climate Bonds Initiative screens green-labelled deals for inclusion in its Green Bond Database by referencing the Climate Bonds Taxonomy and overarching prerequisites. The labelled data contained in this study is exclusively based on the Climate Bonds Database. To check the methodology, please refer to: https://www.climatebonds.net/market/green-bond-database-methodology. Climate Bonds Social, Sustainability, and Sustainability-linked bonds (SSSLB) database was launched in April 2022. SSSLB data published prior to April 2022 was provisional and subject to change. The methodology is available here (not including SLBs): https://www.climatebonds.net/market/social-sustainability-bond-database-methodology. Sustainable linked bonds and loans are collected by the organization but do not go through a screening methodology.

Brazil has a rich environment that enables securitisation. Below we have summarised and defined some key relevant mechanisms that exist in the local market and which are exploredthroughout this report.

Brazilian securitisation instruments glossary (Supplied by VBSO Advogados)

Real Estate Receivables Certificates (CRI)

- An ABS that connects real estate credit to the capital market.[1] CRIs are exclusively issued for real estate receivables by securitisation companies that acquire the credits, securitise them, and issue the instrument to the market.
- The structuring of a CRI can occur in different formats, always backed by real estate credits assigned to the securitisation company who, then, elaborates a Securitisation Credit Term establishing the link between the credits and the CRI.

Agribusiness Receivables Certificates (CRA)

- Inspired by CRIs, CRAs were introduced in 2004 to allow credit receivables generated from businesses in agro-industrial chains to be grouped into a security and offered to the capital market.[2]
- A CRA is a nominative credit instrument. It represents the promise of a cash payment exclusively issued by a securitisation company. The payment is linked to credit rights originating from financial transactions related to the production, commercialisation, improvement or industrialisation of products, agricultural inputs or machines, between rural producers (or rural cooperatives) and third parties.

Agribusiness Credit Rights Certificates (CDCA)

- CDCAs[3] are a type of credit instrument that can be issued by rural cooperatives, producers or agriculture producing companies, to raise medium and short-term credit to invest in their activities in the off-season.
- The issuance is backed by credit receivables carried out by agents in the agribusiness production chain. The credit rights to which this security is linked must be held in custody (held by a financial institution) and registered on the stock exchange.

Receivables Certificates (CR)

- CRs are credit securities issued by a securitisation company that represent a promise of payment in cash from a business on its credit rights. It is an opportunity for industries to access better guarantee and risk structures through securitisation.[4]
- The structure represents an alternative to the Receivables Certificates specific to the Real Estate (CRI) and Agriculture (CRA) sectors. It promotes greater access to the capital market for a variety of sectors that lack legal similarity to pre-established CRI and CRA. Greater use of this instrument is expected, especially within infrastructure and sanitation projects looking for competitive rates.
- The benefits provided are mainly in terms of operational costs as the structuring process is cheaper and requires fewer service providers, compared to more traditional financing models, in especial those which collects funding via FIDCs (explained below). The absence of any fiscal benefit – unlike CRAs and CRIs – may alienate individual investors, but the possibility of better rates can attract other audiences. Still, as investment funds regulations limit portfolio exposure to a single issuer or asset type , this can represent a bottleneck in the distribution of CRs and needs to be further addressed.

Credit Rights

- Credit rights are an essential part of securitisation instruments. They are acquired by the securitisation company to back the issuance of securities placed to investors, whose payment is primarily conditional on the receipt of funds from those credit rights. Other assets, rights, and guarantees can also back the issuance of securitisations.
- Credit rights are defined by the Brazilian Securities Commission (CVM) as securities that represents credit originated from operations in any economic segment.[5]

Financial backing revolving

- CVM also defined the concept of 'revolving financial backing', which refers to the acquisition of new credit rights with resources from matured credit rights/goods/other backing rights within a securitised instrument.[6] This mechanism was implemented to adjust the tenor of the backing credit rights to longer maturities from their ABS. The term of the issuance stems from the so-called 'revolving credit' or revolving financial backing, a system in which, when a specific credit ceases, another is acquired with the transferred payment resources, creating a revolving mechanism.
- The Securities Commission allows revolving structures for situations in which the crop cycle, harvesting, and marketing of products and agricultural inputs linked to the CRA do not allow credit rights with timeframes compatible with the maturity of the CRA.[7] The above-mentioned case is based on the idea that the securitised financing model is one of the pathways for companies to gain access to the capital market, without resorting to an Initial Public Offering (IPO) for raising funds or borrowing from a bank.

Rural Product Note (CPR)

- CPR is a credit instrument, registered on the stock exchange, representing a promise of future delivery of agricultural products.[8] It can be issued by rural producers or associations, including cooperatives.
- It can be used as an underlying asset for ABS and issued in two different modalities: physical, where settlement takes place through delivery of the product by the issuer; and financial, when the payment is made through cash settlement on the due date.

Credit Rights Investment Fund (FIDC)

- The legal framework for investment in receivables allowed the creation of FIDCs, a structured debt instrument backed by a pool of underlying assets, of which at least 50% are credit rights from service provision or financial, industrial, commercial, and real-estate activities.[9]

Agribusiness Investment Fund (FIAgro)

- FIAgro is a type of fund instrument dedicated to investing in agribusiness assets such as credit rights and securities shared from CRAs and FIDCs.[10]
- The purpose of this fund is to increase financial resources raising access for agriculture and livestock beyond institutional investors. The fund can be turned to liquid investments in the agribusiness sector, as well as for private equity investment vehicles in limited companies.

Agribusiness Credit Letters (LCA)

- LCA is a fixed income instrument to support agricultural credit in the country.[11] The securities are issued by financial entities with the aim of raising financial resources for loans, in this case within the agriculture sector.
- LCAs are available in three modalities: prefixed (with interest defined before purchase); post-fixed with redemption (linked to the interbank deposit rate variation); and post-fixed without redemption (also linked to the interbank deposit rate). They do not have an administration fee nor any other form of income taxation.

Real Estate Credit Letters (LCI)

- LCI is a fixed income instrument issued by financial entities to source funds for loans across the real estate sector, as it uses real estate credits as collateral.[12]
- It is available in the post-fixed modality (linked to the interbank deposit rate variation). Like its peer in the agriculture sector, it has no administration fee and is free of income tax and other forms of taxation.

1. Overview of Brazil's sustainable finance market

At the end of the third quarter of 2022 (Q3 2022), cumulative labelled debt originating from Brazil had reached USD32.6bn. Green, social, sustainability, sustainability-linked bonds and loans (SLBs and SLLs) and transition bonds (collectively, GSS+) from Brazil constituted 22.7% of the LAC market. Brazil is the second largest source of GSS+ debt in the region behind Chile, which has experienced exponential growth since 2019, largely due to the issuance of 25 GSS+ sovereign bonds which have contributed 77% of the country's thematic debt market. Brazil leads the LAC market in sustainability-linked and transition instruments, with a 60.7% share.

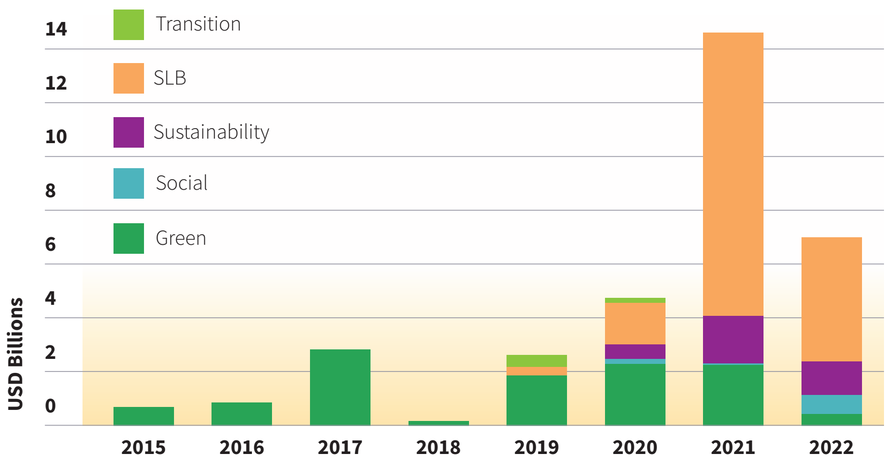
The green label represents 35% of the thematic market in Brazil, with cumulative volumes of USD11.6bn. BRF SA priced the first deal, a EUR500m deal in 2015, and the market has steadily grown to 102 deals from 58 issuers. 2017 was an important year with USD2.7bn issued, and except for the atypical 2018, the following years continued the momentum.

The private sector dominates the country's issuer type profile, with non-financial corporates contributing the largest share (76%), followed by development banks (10%), financial corporates (9%), and government-backed entities (4%). So far, green asset-backed structures were only issued by private corporate entities and corresponds to 7% of the amount issued in the country.

The predominance of green deals was superseded by the emergence of the sustainability-linked structure in mid-2019 through both loans and bonds. Three loans from Alunorte, Votorantim Cimentos, and LDC Sucos were completed, together worth USD268m. In 2020, social, sustainability, and sustainability-linked bonds debuted in the Brazilian market. Iguá SA priced two sustainability bonds (BRL621m/USD120m and BRL260m/USD50.3m) with the green portions obtaining Climate Bonds Certification under the Water Infrastructure criteria, followed by Suzano's USD1.3bn SLB and Banco ABC Brasil's USD99.5m social bond.

Sustainability bonds contributed 9.8% to the Brazilian GSS+ market, with USD3.2bn divided among 16 deals. Between 2020 and 2021, this market quadrupled from USD418m to USD1.6bn. 2022 was a strong year for the label, with USD1.2bn priced within the first three quarters. Most deals (56%) came from non-financial corporates, followed by financial entities (37%). ABS deals represented 1% with two CRAs (Tanac's USD37.3m and the not-for-profit Taboa's USD195k), and development banks share the same percentage with one USD50m bond from the Minas Gerais Development Bank (BDMG).

2021: a record year for Brazil's GSS+ market



Source: Climate Bonds Initiative 2022

The social label represents 2% of the local GSS+ market, through nine deals. Similar to the sustainability label, 2022 was a record year for social deals, with USD692m issued by the end of Q3. The two previous years had accumulated USD107m and USD25.9m respectively. Financial institutions contributed 91% to total issuance volumes, the remaining 9% coming from ABS deals (two CRIs).

As of Q3 2022, the sustainability-linked format represented the largest share of thematic deals originating from Brazil (50.6%), with USD16.5bn of volume across SLBs and SLLs. In 2021, the rapidly growing label multiplied from USD1.8bn to an impressive USD 10.4bn. In 2022, the market slowed, with USD4.2bn issued by the end of Q3 2022.

There were 60 sustainability-linked deals in the local market by the end of Q3 2022. Bonds represent a little more than half, with 33 deals (USD11.5bn); the remaining 27 deals are loans (USD5bn). Corporate deals dominate this market segment. 91% of the amount issued came from non-financial institutions, while 9% was from financial corporate institutions (namely Simpar and B3).

Furthermore, sustainability-linked asset-backed securities made an entrance to the market, in 2021, through two JBS S.A. CRAs worth USD 95.7m and USD 114.5m. They were followed by Dori Alimentos' USD42.6m CRA. Together, these three deals represent 1% of the amount issued in sustainability-linked deals in the country.

Brazil is the only country in the LAC region from which transition bonds have originated. The three non-financial corporate transition bonds were issued between 2019 and 2020 and represent 2% of the Brazilian GSS+ market. Marfrig's USD500m bond earmarked proceeds for sustainable livestock while two consecutive deals from Eneva (USD102.3m and USD66.5m) supported energy efficiency. Although the use-of-proceeds transition label has the smallest share of the GSS+ market by far, transitioning high-emitting sectors of the economy will be essential to achieve net-zero goals, and there are numerous opportunities for Brazil to grow transition finance. Most of this is in the form SLBs rather than use-of-proceeds instruments. Climate Bonds recognizes that, given their forward-looking targets, SLBs are inherently about transition, and represent an excellent opportunity for companies to access sustainable finance to support the achievement of their net-zero (and potentially other) targets. With further guidelines and metrics for credible sectorial transitions being developed, the expectation is for the market to evolve and issuance to scale up.

Thematic ABS market in Brazil

ABS deals represent a small share of the Brazilian GSS+ market (3.5%), but present a unique opportunity to scale up investments in smaller projects via securitisation. ABS have been widely used in sectors such as agriculture and bioenergy. Non-labelled ABS deals in Brazil have grown over the past years with CRAs increasing from BRL12bn (USD 2.3bn) in 2019 to BRL25bn (USD 4.9bn) in 2021.[13] Climate Bonds has identified huge potential to scale up the use of thematic ABS instruments in Brazil.

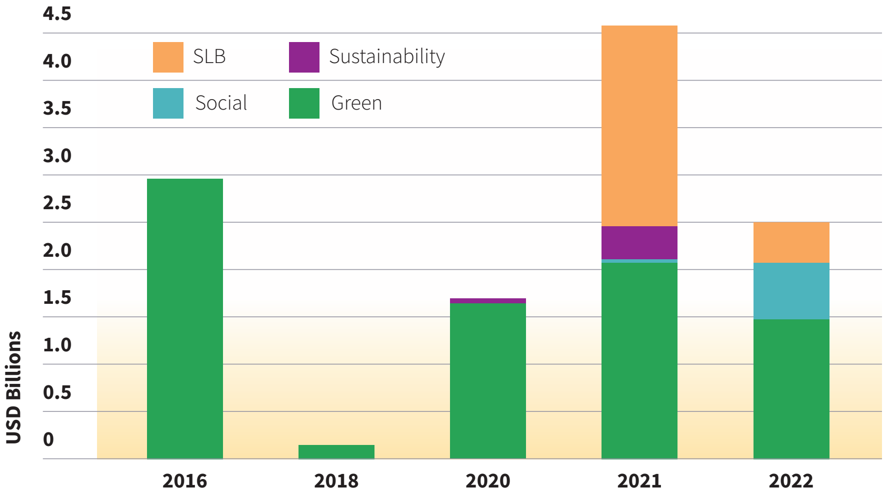
The labelled securitisation market debuted in 2016 with Suzano Papel e Celulose's USD295m green CRA to finance low-carbon agriculture and forestry. After three dormant years, 2019 saw a revival with two new, albeit small, deals. Burger King partnered with H2 Energy on a USD4.5m CRI to finance distributed solar energy supplying its restaurants, while Forest Company do Brasil issued a USD9.6m CRA to fund forestry projects and assets. For the initial few years, forestry and renewable energy were the only sectors funded via GSS+ ABS in Brazil.

In 2020, after the launch of Climate Bonds' Bioenergy (2019) and Agriculture (2020) Criteria, the market gained traction with four green CRAs issued by FS Bioenergia, Rizoma Agro, Bioenergética Aroeira and SLC Agrícola, totalling USD166m.[14,15] This same year, Taboa, a not-for-profit organization, issued a USD195k sustainability CRA through Gaia Agro Securitizadora to finance family farming within cocoa bean value chain.

2021 was a record year with significant benchmarks. Among the 11 green deals issued in the year, Órigo Energy, through Albion Capital securitisation, launched the first green FIDC. Proceeds from the USD32.9m deal were earmarked for the construction of 12 solar farms. The first social ABS was issued by Magik JC, through Gaia Securitizadora: a USD2.8m CRI financing social housing. Finally, JBS issued the first two sustainability-linked CRAs through securitisation company Virgo, worth USD96m and USD115m.

2022 was a slower year, with four GSS+ ABS deals worth a combined USD251m, slightly more than half of the total amount issued in 2021.

GSS+ ABS deals originating from Brazil



Source: Climate Bonds Initiative 2022

Green bonds

Securitisation Vehicle	Issuer name	Amount issued	Issuance date	Local instrument	External review type	External reviewer	Use of proceeds
Ecoagro	**Suzano Papel e Celulose ABS**	BRL 1,000.0m	Nov-16	CRA	SPO	NINT	Agriculture and Forestry
True Securitizadora	**H2 Energy**	BRL 18.6m	Sep-19	CRI	SPO	Resultante	Solar Energy
n/a	**Forest Company do Brasil Participacoes SA**	BRL 39.4m	Sep-19	CRA	SPO	NINT	Forestry
Vórtix	**FS Bioenergia**	BRL 210.3m	Jul-20	CRA	SPO	NINT	Bioenergy
Ecoagro	**Rizoma Agro**	BRL 25.0m	Aug-20	CRA	Certification	Bureau Veritas	Agriculture
ISEC Securitizadora	**Bioenergetica Aroeira**	BRL 150.0m	Dec-20	CRA	SPO	NINT	Bioenergy
ISEC Securitizadora	**SLC Agricola**	BRL 480.0m	Dec-20	CRA	SPO	Resultante	Agriculture
True Securitizadora	**The Origo Energy**	BRL 80.1m	Feb-21	CRI	Certification	Bureau Veritas	Solar Energy
Ecoagro	**Usina Rio Amambai**	BRL 60.0m	Feb-21	CRA	SPO	NINT	Bioenergy
Gaia Securitizadora	**Produzindo Certo**	BRL 63.3m	Feb-21	CRA	Certification	Bureau Veritas	Agriculture
Ecoagro	**Colombo AgroIndústria**	BRL 358.4m	Mar-21	CRA	SPO	NINT	Bioenergy
Albion Capital	**The Origo Energy**	BRL 184.0m	Apr-21	FIDC	Certification	Bureau Veritas	Solar Energy
Ecoagro	**Ferrari Agroindustria**	BRL 80.0m	Apr-21	CRA	SPO	NINT	Bioenergy
Ecoagro	**Fazenda da Toca**	BRL 25.0m	May-21	CRA	SPO	NINT	Agriculture and Forestry
Gaia Securitizadora	**Solinftec**	BRL 140.0m	May-21	CRA	Certification	NINT	Agriculture
True Securitizadora	**Athon Energia S.A.**	BRL 82.0m	Aug-21	CRI	Certification	NINT	Solar Energy
Ecoagro	**Umgrauemeio**	BRL 8.0m	Sep-21	CRA	SPO	Bureau Veritas	Agriculture
Virgo	**RZK Energia**	BRL 56.0m	Dec-21	CRI	SPO	NINT	Solar Energy
Ecoagro	**FS Bioenergia**	BRL 375.0m	May-22	CRA	Certification	Sustainalytics	Bioenergy
Ecoagro	**FS Bioenergia**	BRL 375.0m	May-22	CRA	Certification	Sustainalytics	Bioenergy

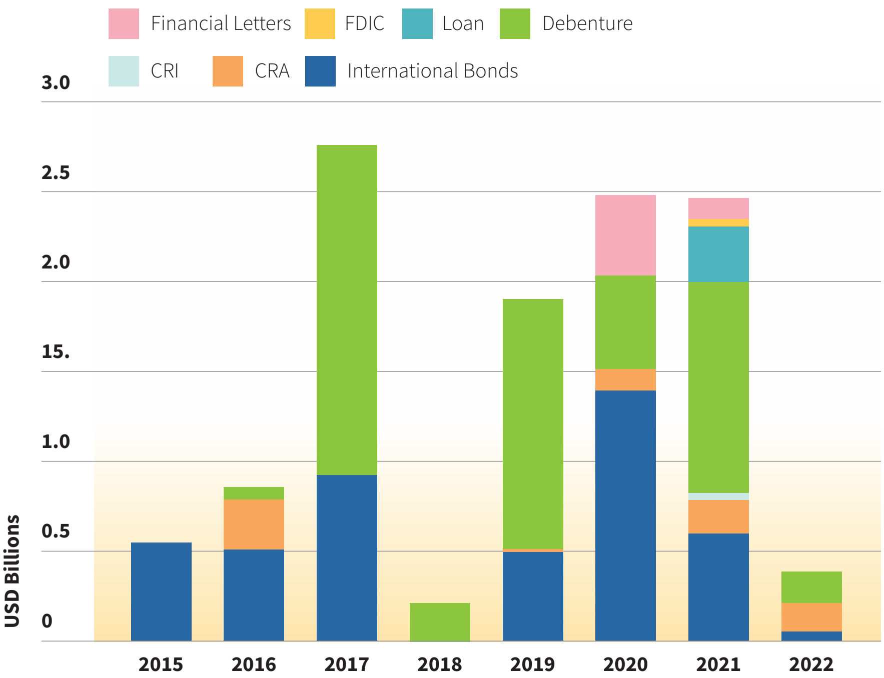
Securitisation Vehicle	Issuer name	Amount issued	Issuance date	Local instrument	External review type	External reviewer	Use of proceeds
Social bonds							
Gaia Securitizadora	**Magik JC Empreendimentos Imobiliários Ltda.**	BRL 14.8 m	Sep-21	CRI	None/ undisclosed	None/ undisclosed	Affordable infrastructure
True Securitizadora	**Direcional Engenharia S.A.**	BRL 300.0 m	Jun-22	CRI	SPO	NINT	Affordable infrastructure and Equality
Sustainability bonds							
Gaia Securitizadora	**Tabôa**	BRL 1.0 m	Dec-20	CRA	SPO	WayCarbon	Microfinance, food security, and land use
Ecoagro	**Tanac**	BRL 195.0 m	Sep-21	CRA	SPO	Bureau Veritas	Education, food security, and land use
Sustainability-linked bonds							
Virgo Companhia de Securitização	**JBS S.A.**	BRL 522.8 m	Dec-21	CRA	SPO	ISS ESG	Livestock
Virgo Companhia de Securitização	**JBS S.A.**	BRL 626.0 m	Dec-21	CRA	SPO	ISS ESG	Livestock
Opea Capital	**Dori Alimentos S.A.**	BRL 200.0 m	Apr-22	CRA	SPO	Resultante	Water efficiency and waste management

Brazil's green securitisation market

The green label leads Brazil's sustainable securitisation market, with 70% of the volumes (USD868m). This niche market also represents 7% of Brazil's total green market, with CRAs, CRIs, and FIDCs the most frequently issued instruments. There are not yet green securitised debentures in the country.

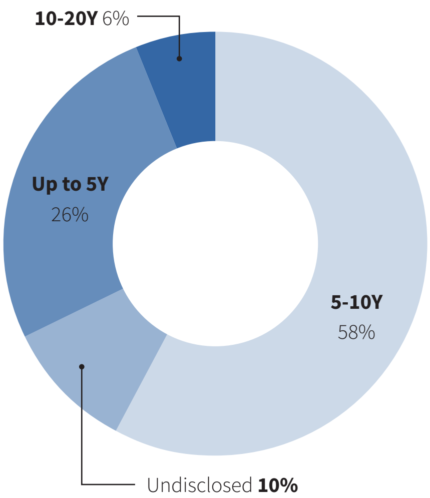
CRAs currently account for 91% of Brazil's green ABS volumes and finance agriculture, forestry, and biofuel production, while CRIs and FIDC represent the remaining share and mainly finance solar energy. By late 2022, green securitisations had only financed renewable energy and land use, but there is potential for diversification. Other sectors, such as buildings and transport, could also be funded via securitised instruments. Furthermore, other securitisation instruments available in Brazil, such as CPRs (Rural Product Bills) and CRs, could be mobilised.

Brazil green finance market per local instrument



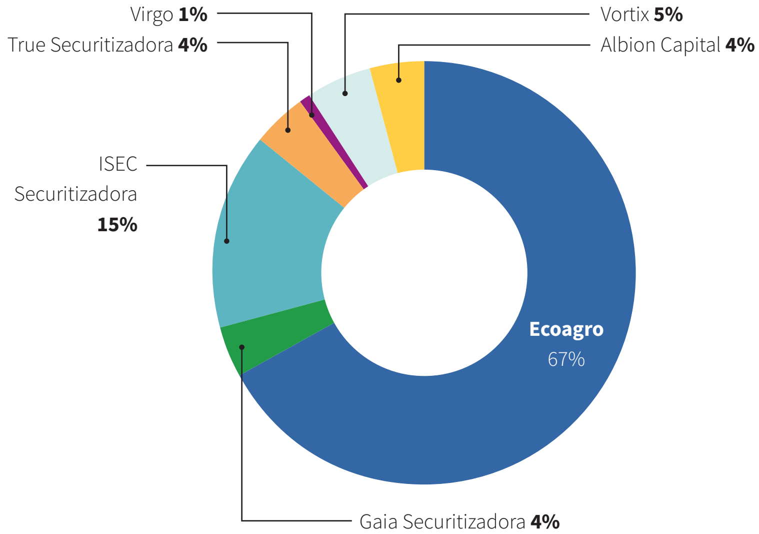
Source: Climate Bonds Initiative 2022

Shorter tenors dominate



Source: Climate Bonds Initiative

Ecoagro leads the green securitised market



Source: Climate Bonds Initiative

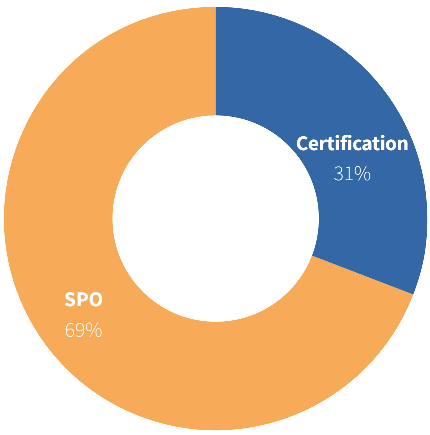
More than half (58%) of green ABS volume has tenors ranging between five to ten years. The three deals with the longest term – ten to 20 years – are the FIDC from Órigo Energy and the two CRIs issued by H2 Energy (Burger King) and Órigo Energy; all had proceeds earmarked for solar projects.

All the green securitisations were issued in BRL, although recent regulatory changes permit the issuance of USD-denominated CRAs. The primary green securitisation vehicle in the country is Ecoagro, with 67% of the market share. The company has issued ten green CRAs to finance bioenergy, agriculture, and forestry. Gaia Securitizadora, the third largest in the country, has also issued three green CRAs to finance sustainable agriculture, all Certified under the Climate Bonds Standard.

All green ABS deals in Brazil obtained an external review, following market best practice.

The Second-Party Opinion (SPO) is the preferred type of external review. NINT was responsible for 83% of SPOs by volume. Other providers include Bureau Veritas and Resultante. Most of the verification as part of Climate Bonds' Certification scheme were provided by Sustainalytics (59%), followed by Bureau Veritas (25%) and NINT (16%).

SPOs are the most common review type



Source: Climate Bonds Initiative

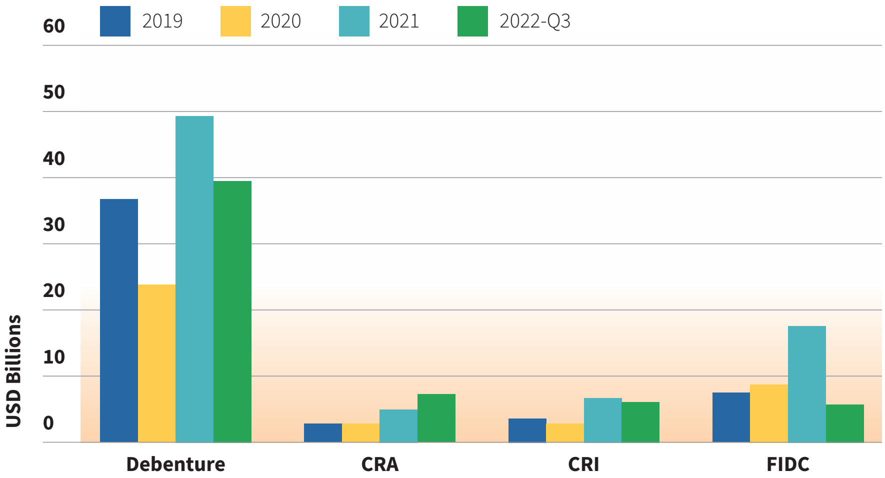
2. Brazil's securitisation market in expansion

Securitisation is one of the most traditional types of debt funding in Brazil. It has emerged as one of the most relevant alternatives for smaller entities looking for financing options at potentially lower costs in the debt market. The growth of securitisation deals also increased the diversification of external financing options for companies and investment portfolios for their investors. These structures stimulate competition between sources of funds and suppliers. They provide companies with broader access to capital markets, reduce costs from banking intermediaries and tax burdens, and allow small projects or SMEs (small and medium-sized enterprises) to enter the debt market and attract a broader range of investors.

The first sector in Brazil to benefit from these instruments was real estate, instituting CRIs and establishing legal security for investors (see page 3).[16] Since then, most receivables certificates have originated from entities operating in the real estate sector, with recent expansion into other sectors, most notably agribusiness where CRAs are being used as an alternative to bank lending.

In 2021, the total volume of corporate debt securities issued in the Brazilian capital market reached USD147.4bn (BRL752bn), the largest annual amount to date.[17] ABS (CRI, CRA, and FIDC) account for the second largest share of the Brazilian corporate debt market (following debentures), and their share is growing. Notably, the agriculture sector is mobilising these instruments to increase its external funding opportunities, creating accessible investment options and bringing economic dynamism to the industry.

The overall Brazilian debt capital market



Source: : Boletim Econômico CVM, 2022

Furthermore, given recent changes in the regulation of CRs, a broader source of securitised investment for various sectors of the Brazilian economy is now included, described on page 3.[18] This development opens new opportunities and alternatives for non-real estate and agribusiness companies seeking financing via FIDCs, noting that CRs are less expensive and require fewer service providers. The use of CRs is expected to grow substantially among banking, sanitation, infrastructure, and education companies.

CRs have the potential to further attract long-term institutional investments because they do not provide an exclusive fiscal benefit for retail investors. Unlike CRAs and CRIs that because of this feature have a higher level of engagement with a non-sophisticated investor base. CRs could also attract more foreign investment due to their similarity to international securitisation instruments. Finally, the possibility of a tax exemption for non-residents in purchasing corporate debt could make this instrument even more appealing to these buyers.[19]

Securitisation structures to finance Brazilian Agriculture

Agribusiness is the source of 27.5% of Brazilian GDP, requiring very substantial funding volume.[20] 77% of the sector comprises small producers, for whom it can be difficult to access mainstream financing.[21]

Although agriculture is traditionally primarily funded by public capital through credit lines supported by Plano Safra, capital markets can offer an alternative source of funding, especially given prevailing market conditions and associated inflation-driven increases in production costs.

The federal government legislated to leverage private investments in the sector in 2020.[22] This not only broadens guarantee mechanisms but also allows competitive interest rates for capital market agriculture deals.

CRAs are being used as a debt facility to finance corporate operations, working capital, and flow agreements within the sector to supplement and diversify financing sources.

CRAs can offer stakeholders an alternative source of financing off their balance sheets and at equal or lower interest rates compared to traditional sources, including banking lending sourced by the federal government.

Interestingly, CRAs can be structured as both 'corporate' and 'dispersed'. Within the former, the debt capital is directly invested into the issuing company/debt owner (e.g., trading, chemical, seed, and resale companies; cooperatives and producer associations), which will eventually finance agricultural producers. In the latter, investments are made directly into a credit portfolio aggregating multiple borrowers (e.g., producers) who transfer their risks directly to investors through an intermediary, such as a producer's association.

While corporate CRAs account for 90% of the structured agribusiness debt, the remaining 10% are dispersed instruments, which shows that CRAs still have an untapped potential to provide financing at scale to small producers.[23]

Likewise, within the local sustainable securitisation market, corporate CRAs have been the favoured structure (see page 6). Fostering securitisation to finance small-scale agriculture could help producers to outsource financing and leverage the sector's economic growth and development.

Brazilian agriculture offers vast opportunity for climate-related investments and a significant role in growing the green securitisation market.[24] Identifying green assets according to international green standards helps investors to understand the sustainable practices already employed by local producers. Finally, considering the growing volume of vanilla CRAs (see above) and the type of projects and assets being funded, there is considerably potential to attract larger pools of investors to help grow local sustainable agriculture and bring further investments to smaller projects.

3. The appetite for securitisation

Compiled by Renato Buranello, Phillipe Käfer, and Barbara Breda, VBSO Advogados

Securitisation has made an essential contribution to the development of the agribusiness sector, as well as other sectors of the Brazilian economy, enabling companies to raise financing while promising greater profitability for investors.

Securitisation originated in the mid-1970s in the United States and involves transforming a less liquid asset into a marketable security. A securitisation takes cash flows linked to specific assets or pools of assets, and packages them to sell on in the capital market.

The operation is based on three fundamental pillars: (i) **the transferor**, that is, the creditor to whom the accounts receivable are due; (ii) **the securitisation company**, an institution that will convert these accounts receivable into securities that can be traded in the capital market; and (iii) **the investor**, who will take its stakes and effectively buy the securities for the economic yield.

The securitisation company operates as the intermediary between the creditor and investor, guaranteeing the convergence of their interests. It reinforces the capacity of the securitisation mechanism in mobilising wealth, mitigating risks, and financial disintermediation.

From a legal standpoint, it is possible to define securitisation as a structure composed of a *set of legal transactions – or indirect legal transactions – that involve the assignment and segregation of assets of a company or an investment fund issuing securities guaranteed by these segregated assets.*

Consequently, these securities are structured to be sold to investors whose funds will pay for the assigned assets. The assets are disconnected from the originator's equity by transferring ownership, and later by the issuance of the representative securities. Securitisation is essentially a set of contracts aimed at issuing securities guaranteed by a specific asset, usually segregated from the beneficiary's equity, through an independent entity known as a special purpose vehicle (SPV).

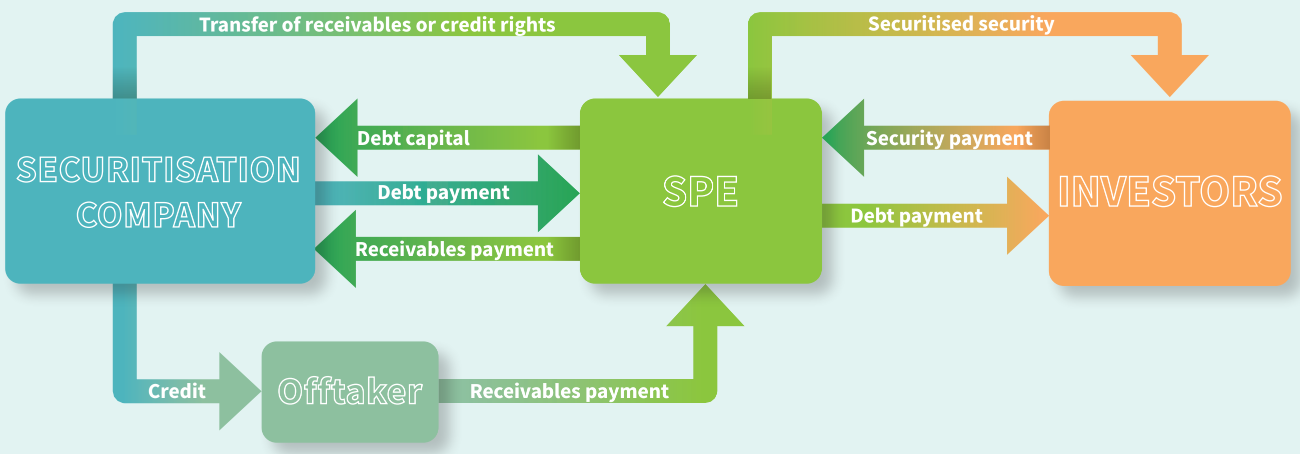
Securitisation mechanisms underwent extensive legislative changes in 2022, with emphasis on Law n. 14,430/22 (also known as the Brazilian Securitisation Framework), which resulted from the conversion of Provisional Measure n. 1,103 – the fundamental legal framework for securitisation in Brazil – and the Brazilian Securities and Exchange Commission Resolution n. 60, of December 23, 2021 – that has brought specific regulatory rules to this mechanism.[25]

The growing need for diversified financing and agile capital injection followed the consolidation of capital markets as the primary source of funding for various sectors of the Brazilian economy. The *Brazilian Securitisation Framework* contributes to this by establishing rules for the securitisation of credit rights and the issuance of the CR. It creates the legal definition of securitisation transactions with broad applicability in accordance with what has been previously established by international regulations on the subject.

The Framework also replicates CRI and CRA standards, and it expands the variety of securitised assets beyond the real estate and agribusiness sectors. CRs have wider applicability among sectors, which is determined by the use of proceeds description in the securitisation term and the indication of the backed credit rights.

Furthermore, a recent regulation for public offerings simplified the process for issuing deals under the CVM instruction n. 476, such as CRs, CRIs and CRAs.[26] It brought a more systemic approach by including an automatic registration mechanism for deals destined to institutional investors and revoking provisions that used to hamper some negotiations. Therefore, this innovation provided a cheaper and faster process to companies issuing credit rights.

Recievables Securitisation



4. How to structure a securitisation

Compiled by Marlana Zanatta, Paula Peirão, and Bianca Souza Soares, VERT Securitizadora

FIDCs, CRAs, CRIs, and debentures are the most common ABS in Brazil. CRs joined this list most recently. These instruments can be labelled as GSS+ following best market practice, such as the relevant Green Bond or Social Bond Principles developed by the International Capital Market Association (ICMA), or the Climate Bonds Standard and Certification Scheme.[27] However, it is important to understand the step-by-step process of structuring these securities, regardless of the financial instrument, to better grasp the opportunities they present to issuers.

The choice of instrument depends on the characteristics of the credit originator, assets backing the operation, investor appetite, market maturity, macroeconomic scenario, and other variables. Each issuer should consider these topics, identify the best path, and in partnership with the securitisation company (sometimes also called sponsor or mistakenly the issuer) select the most appropriate instrument. To illustrate this, an entity with receivables linked to rural producers could issue CRAs backed by agribusiness transactions. However, an FIDC could be strategically more interesting.

How? In Brazil, FIDC is a traditional instrument and, therefore, better known by investors and well consolidated in the market, while CRAs were not established in regulation until 2018.[28] Prior to that, issuance of the instrument was based on the CRI regulation (see page 3). Therefore, a conservative investor may feel more confident buying a FIDC share rather than a CRA. On the other hand, the structure of an FIDC requires multiple service providers and therefore greater structuring costs compared to CRAs. Finally, FIDCs are only intended for professional and qualified investors, while the CRAs can be purchased by any type of investor.

Labelling GSS+

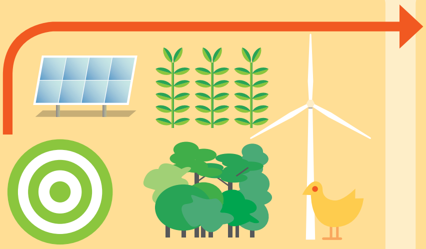
Obtaining an external review can strengthen the credibility of a GSS+ bond. There are several types of review, among which the SPO is the most popular.

All types of external review have the same advantage: providing greater transparency and security to investors that the product in which they are investing complies with the criteria and objectives set out in the documentation. The difference between the types of review is in the assessment processes. Certification, for example has higher evaluation parameters, requiring more documentation than other options.

A thematic label can be applied by an issuer regardless of whether the framework has been externally reviewed. However, investors, assignors, and issuers prefer the additional transparency a review provides.

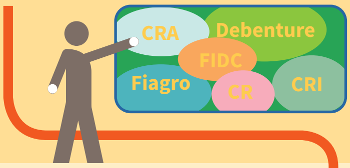
How can you label securitisation?

Structuring a GSS+ securitisation is similar to a vanilla operation. There are five steps:

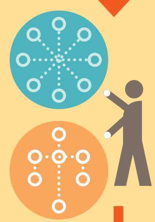


1. The capital need and the use of proceeds: the eligibility criteria for the underlying assets are defined; assets or projects are selected, and resource management is planned.

2. The type of financing: in the case of securitisation, the best instrument for raising funds is defined according to the nature of the credit and considering the product that best suits the needs of the company and the appetite of investors; it could be a debenture, CRA, CRI, CR, Fiagro or FIDC.



3. The structure: different financing methods or structures can be combined, depending on the characteristics of the asset/project and macroeconomic factors. The securitisation company structuring service prepares the documentation: due diligence reports, cash flow projections and evaluations, financial accounts, historical reports, potential social impact of the project and, where necessary, is also responsible for ensuring that the transaction is in line with the labeling criteria or objectives specified in the documentation. In addition, the securitisation company is responsible for converting the company's assets into securities and acting as an intermediary in the transaction between the assignor and the investor.



4. The issuance: involves all parties that supported the structuring and execution of the transaction: issuer, structurers, external reviewers, legal advisors, auditors, and coordinators.

5. The disclosure: annual reporting confirms the allocation of proceeds to environmental projects/assets and the management of unallocated resources. To comply with best market practice, issuers should also disclose the impacts of the financed projects through appropriate metrics and methodologies.

Types of External Review

Second Party Opinion: The institution must be independent from the issuer or present appropriate procedures, such as information barriers, to guarantee the independence of the SPO. This typically involves an assessment of alignment against the ICMA Green Bond Principles (GBP). It may include an assessment of the issuer's scope, objectives, strategy, policy or processes related to sustainability, and an assessment of the environmental characteristics of the project type.

Certification: the environmental credibility of resources can be confirmed through a certificate issued by qualified and accredited third-party companies (Climate Bonds being the most common and well known). These companies analyse and verify the consistency of the certification criteria. They are typically aligned with the ICMA GBP.

5. Case studies

Securitisation instruments bearing the green, social, or sustainability labels are debt securities backed by cash flows from underlying green or social assets; or have proceeds earmarked for eligible green or social activities (or both). The proceeds of sustainability-linked structures are typically general purpose, but the coupon payments are linked to the achievement of the sustainability performance targets (SPTs) specified in key performance indicators (KPIs) described in the financing framework. Below are selected examples of thematic securitised deals issued in the Brazilian debt market.

CRA Solinftec - Green

Solinftec is an agricultural technology company that deploys automation services for sustainable crop production. The company developed a one-of-a-kind platform combining artificial intelligence, algorithms, and hardware that allows the real-time connection of machinery and equipment to coordinate production and reduce input and fuel intake. This technology also includes a direct link with weather stations. The company guides clients on effectively applying agrochemicals to avoid over-use and spill-over.

Issuer: Solinfitec

Securitisation vehicle: Gaia Securitizadora

Instrument type: CRA

Underlying assets: Agribusiness Credit Rights Certificates (CDCA) from contracts between Solinftec and its clients, who hire the company's smart automated solution.

Use of proceeds: Sustainable agriculture

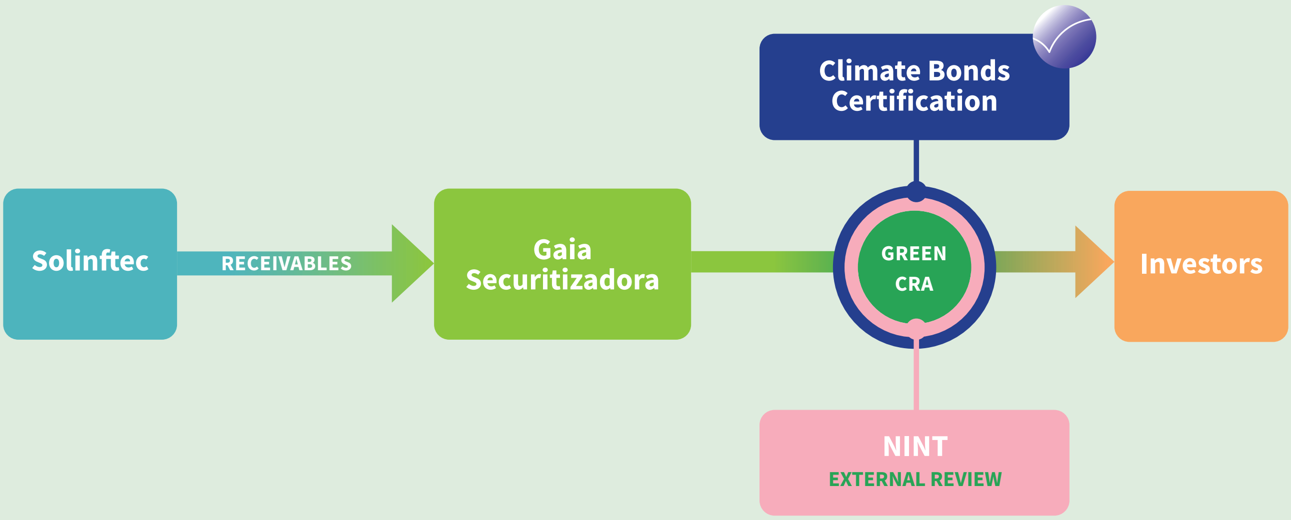
External reviewer: NINT

External review type: Climate Bonds Certification

Underwriter: Itaú BBA

Legal advice: VBSO Advogados

Solinftec raised approximately USD27m (BRL140m) through Gaia Securitizadora's CRA to finance its activities and meet growing capital market demands. The deal was backed by Solinftec's Agribusiness Credit Rights Certificates (CDCA) originated from contracts with clients. The proceeds were earmarked for operational expenses and smart solutions to increase agriculture production and promote environmental preservation.



CRA Produzindo Certo – Green

In March 2021, Gaia Securitizadora, in partnership with Traive Finance, issued the first dispersed green CRA from **Produzindo Certo**, a company that provides environmental and social solutions for agrifood companies, producers and their supply chain. The USD12m (BRL63.3m) deal was backed by 17 CPRs issued by small rural producers. This innovative aggregation mechanism enabled small rural producers to access large investors directly.

Issuer: Produzindo Certo

Securitisation vehicle: Gaia Securitizadora

Instrument type: CRA

Underlying assets: 17 CPRs from small rural producers

Use of proceeds: Sustainable agriculture

External reviewer: Bureau Veritas

External review type: Climate Bonds Certification

Legal advice: VBSO Advogados

In addition to having their financial and productivity obligations monitored, the 17 producers have to qualify the environmental aspects of their crops by meeting Climate Bonds' Criteria as well as Produzindo Certo requirements. They are responsible for preserving and restoring environmentally sensitive areas, while Produzindo Certo monitors them and provides environmental advisory services.

CRI Órigo Energia – Green

Órigo Energia is one of the largest Brazilian energy companies operating distributed generation solar farms in Brazil, active in the states of Minas Gerais, São Paulo, and Pernambuco.

Issuer: Órigo Energia

Securitisation vehicle: True Securitizadora

Instrument type: CRI

Underlying assets: Property lease agreements and fiduciary sale of equipment, quotas, and surface rights

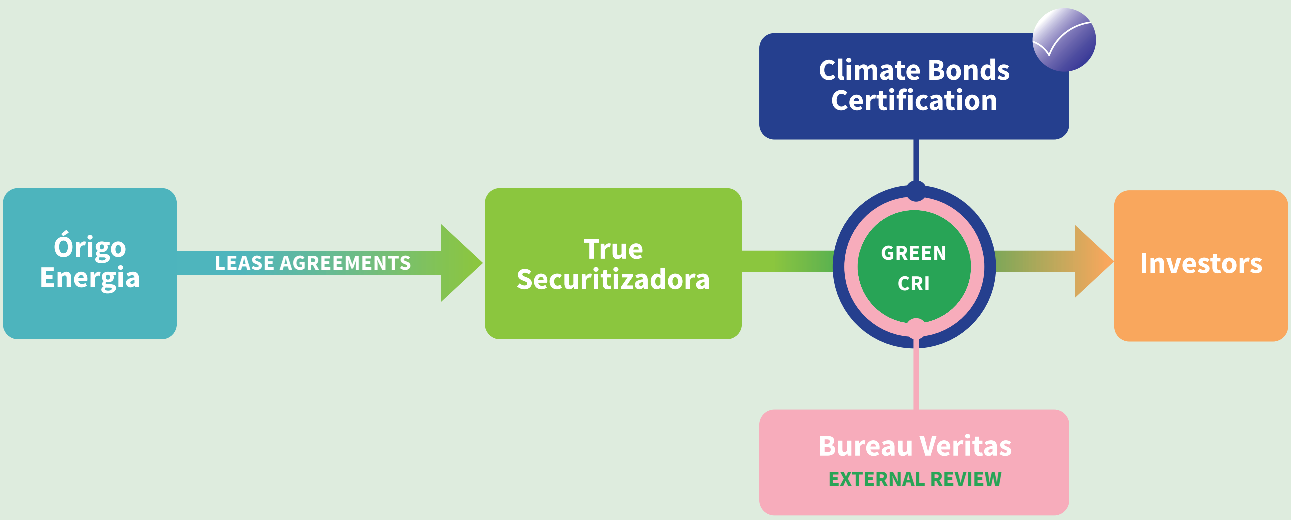
Use of proceeds: Solar energy generation

External reviewer: Bureau Veritas

External review type: Climate Bonds Certification

Underwriter: Itaú BBA

In February 2021, True Securitizadora issued a two-tranche USD14.7m (BRL80m) green-labelled CRI on behalf of Órigo Energia to finance the development of four photovoltaic solar energy generation facilities in Latin America, mainly in Brazil. The ten-year green ABS tranches had interesting features for both originator and investors, such as a longer-than-average maturity and an 18-month grace period for repayment. Furthermore, the subordinated debt structure offered de-risking for senior investors.



FIDC Órigo Energia – Green

Órigo Energia raised USD32.9m (BRL184m) through a Green FIDC. Albion Capital structured the innovative instrument with a maturity term of 12 years. The proceeds were invested in the construction of 12 solar farms in the Brazilian state of Minas Gerais, where the company holds most of its operations, adding 30MW of generation capacity.

The deal was Certified against the Climate Bonds Solar Criteria and had initially received a second-party opinion from Bureau Veritas.

Issuer: Órigo Energia

Securitisation vehicle: Albion Capital

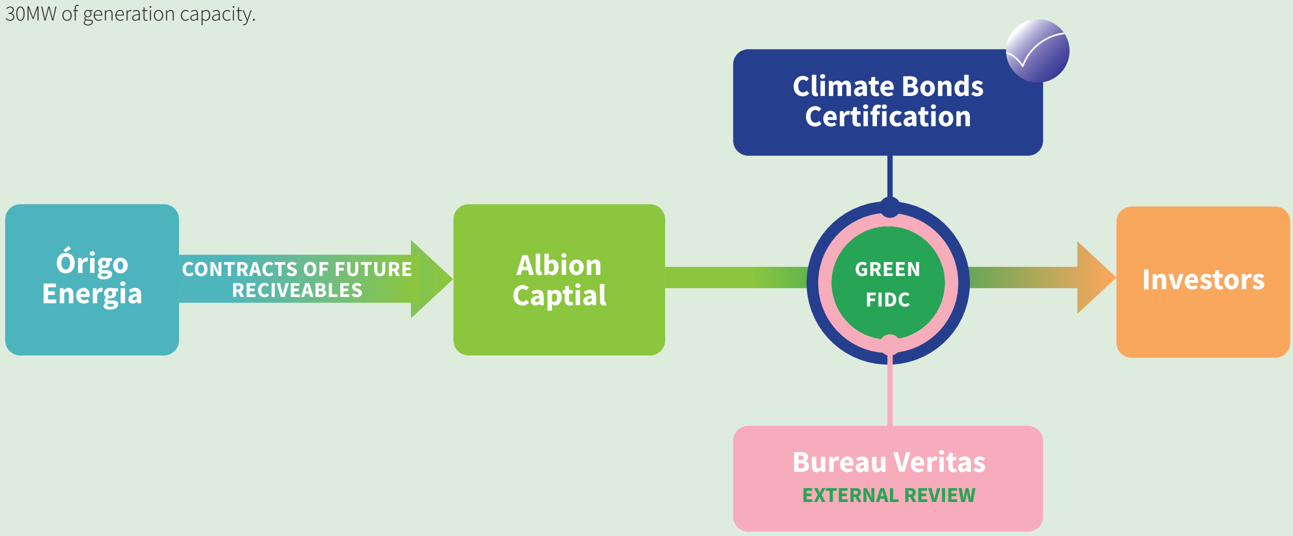
Instrument type: FIDC

Underlying assets: Contracts of future receivables from Órigo Energia

Use of proceeds: Solar energy generation

External reviewer: Bureau Veritas

External review type: Climate Bonds Certification



CRI Direcional Engenharia – Social

Direcional Engenharia is a Brazilian real estate company that aims to provide accessible and affordable sustainable housing. In June 2022, Direcional issued a USD59.4m (BRL300m) social CRI through True Securitizadora. The ten-year securitisation was backed by Direcional's debentures, which financed the construction of social housing for families with a monthly income of approximately USD800.

Issuer: Direcional Engenharia

Securitisation vehicle: True Securitizadora

Instrument type: CRI

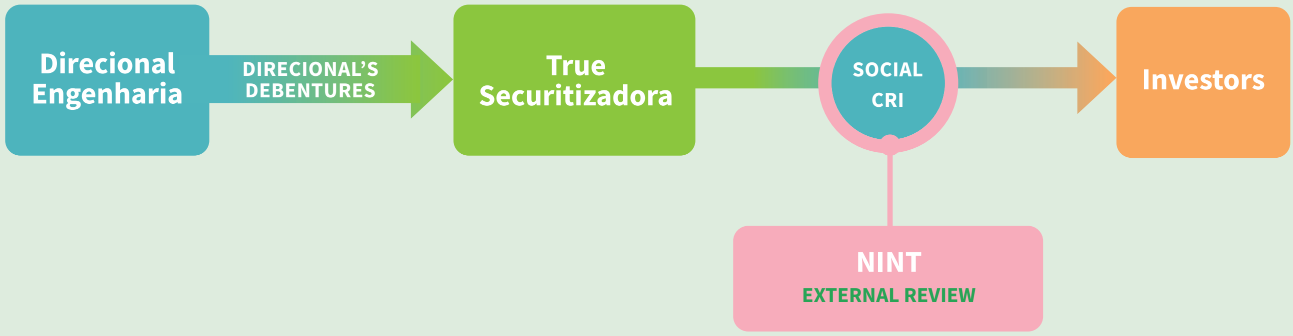
Underlying assets: Debentures from Direcional

Use of proceeds: Social Housing

External reviewer: NINT

External review type: Second-Party Opinion

The operation was 1.2x oversubscribed, reached institutional and retail investors, and followed ICMA's Social Bond Principles while obtaining an SPO from NINT.



CRA Tabôa – Sustainability

Tabôa Fortalecimento Comunitário is a not-for-profit organisation that aims to strengthen local communities by supporting community initiatives and socioeconomic enterprises in Bahia.

In October 2020, Gaia Securitizadora issued a sustainability-labelled securitisation backed by contracts from Tabôa to finance family farmers, totalling USD195,000 (BRL1m). The proceeds are being used to (re)finance activities and projects undertaken by those small producers until 2025.

Issuer: Tabôa Fortalecimento Comunitário

Securitisation vehicle: Gaia Securitizadora

Instrument type: CRA

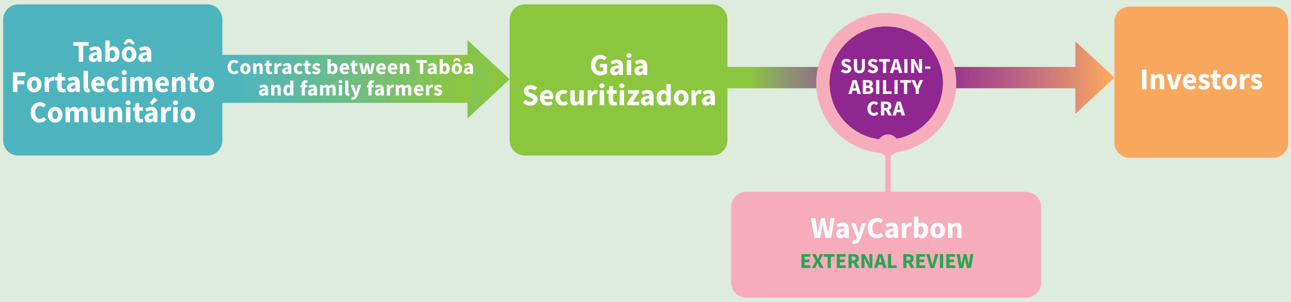
Underlying assets: Contracts from Tabôa

Use of proceeds: Finance and refinance small producers' activities

External reviewer: WayCarbon

External review type: Second-Party Opinion

The social and green UoP included sustainable management of living natural resources and land use, agroecological/organic agriculture, agroforestry systems (SAFs), food security and sustainable food systems, and socioeconomic empowerment – including women, young people, settlers, and quilombolas. The issuance followed ICMA's Sustainability Bond Guidelines and received a second-party opinion from WayCarbon.



CRA JBS S.A. – SLB

JBS is a Brazilian multinational meat processing company and the largest protein producer in the world. The company operates in 15 countries over 400 production units and has commercial offices on five continents. In recent years, land-use change activities increased due to global food production and market pressure on agriculture and livestock companies, leading JBS to develop its 2030 net zero strategy.

Issuer: JBS S.A.

Securitisation vehicle: Virgo Companhia de Securitização

Instrument type: CRA

Underlying assets: Debentures from JBS

External reviewer: ISS ESG

External review type: Second-Party Opinion

KPIs: Cattle origin control

SPT: 100% of Brazilian cattle from direct suppliers registered by 2025.

In December 2021, the company priced two CRA tranches worth USD210m (BRL1.15bn) linked to the group's target of registering all its direct cattle suppliers in the *JBS Transparent Livestock Platform* to monitor deforestation activities. Although the KPI chosen is relevant to deforestation issues and overarching ESG goals, the deal is not linked to GHG emissions reductions and, therefore, not Paris-aligned. Moreover, while JBS' SLB framework does refer to its 2030 target to reduce Scope 1 & 2 emissions by 30%, Climate Bonds recognises that Scope 3 emissions represent some 91% of the entity's total emission footprint.[29] Climate Bonds encourages JBS to raise the level of ambition and materiality in future SLB issuance in order to demonstrate clearly to investors and other stakeholders its commitment to aligning with a 1.5 degree-aligned pathway.

6. The growing role of GSS+ securitisation

Currently, all economies around the world are being pressured by the post-COVID-19 recovery, energy price shock, and resultant high inflation. Traditional financial institutions increasingly concentrate their credit portfolios on large companies to avoid credit risk, forcing the market to seek alternatives to finance smaller activities. Meanwhile, debt originating from the private sector remains a small proportion of the overall Brazilian debt market. According to the Brazilian Central Bank, public sector debt is equivalent to 88% of the country's GDP, while private sector debt represents only 47%, including the lion's share of private banking participation.[30] Securitised instruments can contribute to the diversity and growth of an inclusive and broad-based debt capital market in Brazil by facilitating increased corporate participation.

Financial entities, in turn, play a prominent role in the local economy and are also large issuers of two types of securitised instruments, LCA and LCI. The rising Brazilian interest rate enhances the appeal of these financial debt instruments. For instance, LCA and LCI portfolios of financial entities grew 38% and 25% respectively between 2021 and 2022.[31] Securitisation, in the case of financial entities, can contribute to expanded credit lines and increased lending capacity by decoupling from the balance sheet.

GSS+ instruments can help to attract a larger pool of investors to grow the local capital market, contribute to the costs of averting climate change risks, and potentially reduce transition costs/risks.[32] Estimates suggest that 8% of the Brazilian financial system's credit portfolio is exposed to transition risks, 70% of which comes from cattle, freight transport, and steel activities. The financial institutions exposed to the greatest risk are the smaller ones, such as credit cooperatives which are primarily responsible for providing credit to agribusinesses.[33]

Fostering small-scale sustainable projects and assets that could be financed through securitised instruments across the Brazilian market can contribute to safeguarding the country's economy against future economic distress caused by climate change. While the international and domestic contexts are challenging, sustainable investments can support a green recovery and fund important sectors for resilient growth.

GSS+ securitisation could also sharpen the competitive position of the Brazilian market by expanding the availability of credit and funding options. It could be the tool of choice to grow the local capital market by providing robust conditions to support the aggregation of projects that may otherwise lack resources. This could further attract institutional investors in support of the country's economic and climate resilience targets.

Finally, Brazil is positioned to lead this market. The country has the largest financial sector and capital market in LAC, and plays a major role in the GSS+ universe as the region's second-largest market. The Brazilian GSS+ ABS market is the pioneer in Latin America. This exposure can be leveraged to grow the market and further finance sectors already reached by securitisation and benefit new ones, given the most recent legislative updates (see page 9).

7. Recommendations for leveraging sustainable securitisation in Brazil

The Brazilian securitisation market can be attractive to both investors and issuers by offering a lower cost of capital to the latter and longer maturities, larger ticket sizes, and risk exposure to the former. The country boasts a comprehensive regulatory framework that supports an array of instruments. Regulations can be applied either to specific sectors (i.e., CRAs and CRIs) or multiple (i.e., FIDCs and CRs); they can have a more complex structure (i.e., FIDCs) or simplified; offer tax exemption to individual investors (i.e., CRAs and CRIs); and even exchange rate fluctuation protection (i.e., CRs and CRAs). The GSS+ securitisation market in Brazil has a unique potential to attract institutional investments at scale towards smaller climate-aligned projects.

Climate Bonds identifies three actions to boost the GSS+ securitisation market in Brazil.

1. Leverage the role of securitisation in the local market

Securitised instruments are one of the most traditional sources of financing in the Brazilian market. Nevertheless, recent developments in the regulatory framework can propel the market to even greater prominence offering greater transparency, accountability, and standardisation. Key stakeholders including securities commissions, capital markets associations, and stock exchanges must amplify this message and educate both issuers and investors to allow them to leverage securitisation.

Governments can foster securitised issuances by facilitating the availability of data on financial performance, and social and environmental impacts of small projects that can eventually underly securitised deals. Centralizing data through digital solutions and standardisation can help project developers meet investors' demand and increase the potential for securitised structures. In Brazil, the platform *Monitor de Investimentos*,[34] launched in 2022, can be further explored to centralize data on small projects across multiple sectors of the economy.

2. Identifying sustainable portfolios

Identifying green and social lending portfolios can help leverage the Brazilian securitisation market. Brazil has a massive untapped pipeline of small-scale, sustainable projects and assets, especially in agriculture, green buildings, waste management, distributed renewable energy, and urban mobility. The aggregation of smaller projects into GSS+ securitisations can unlock private capital to support these sectors. Collaboration with securitisation companies is essential to build a robust pipeline of projects in compliance with international guidance and best practice.

3. Accelerate supportive policies

Policymakers play an important role in the net-zero agenda. The availability of market guidelines and data can attract investment flows and enable the identification of a pipeline of sustainable projects. While the green label currently represents the largest share of the Brazilian securitisation market, the expansion of social, sustainability, and sustainability-linked instruments is vital to ensure a just transition. GSS+ deals can be leveraged by adopting fast-track mechanisms to facilitate the approval of projects and securitised deals with social and environmental benefits.

Governments must act today to prevent higher costs of transitioning at a later stage. They can invest in research and development to incorporate climate into long-term pipeline planning to support and guarantee the future bankability of assets/projects. Policies such as green procurement prioritise green development and support the growth of the private sector. Finally, in partnership with development financial institutions, governments can work to absorb higher risks of sustainability-labelled deals by providing guarantees, leveraging blended finance, creating a GSS+ bond de-risking facility and engaging in innovative demonstration transactions.

Endnotes

1. Federal Law n. 9,514/ 1997
2. Federal Law n. 11,076/2004
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4. Established by article 20 in Law n. 14,430/2022
5. CVM Resolution n. 60, from December 2021
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Supported by the Gordon and Betty Moore Foundation

Authors: Julia Ambrosano and Sofia Borges

Collaborators: Leisa Souza, Sheila Alves, Phillipe Käfer, Barbara Breda, Renato Buranello, Marlana Zanatta, Paula Peirão, and Bianca Souza Soares

Design: Godfrey Design and Joel Milstead