Emerging Issues at Banco do Brasil

Emerging risks may be defined as the possibility of occurrence of events the information on which are still not sufficiently understood, and which indicate future perspectives of significant impact on the Bank's results. These risks may become relevant if their potential impact is expanded and affects the company's strategic objectives, thus requiring the adoption of specific management processes.

In this context, we count on a process to identify relevant risks, risk policies, rules, procedures, structure, governance, Information Technology (IT) infrastructure, and risk and capital management processes that provide the safety required for the development of our business.

At Banco do Brasil, the purpose of the risk management is to identify, measure, assess, control, monitor, mitigate, and report on the risks of the aggregate positions of the Prudential Conglomerate, as well as to identify and monitor the risks associated to the other companies controlled by the Conglomerate's enterprises and improve the risk management globally.

In 2021/2022, we reviewed the Risk Relevance Identification and Definition Model. We are continuously acting to improve this model to capture the risks, factors, and emerging issues, and the potential impacts thereof on the organization. The process contemplates observations and actions for the adoption of preventive measures to avoid materialization of the risk factors and, at the same time, seize the opportunities that may arise.

The Model counts on quantitative and qualitative criteria to define the relevance of the risks. The relevance matrix is the instrument that consolidates the results of the quantitative and qualitative assessments, balancing them to demonstrate the most accurate degree of final relevance for the risk.

Within the context of emerging issues, the factors that may generate or increase exposure to risk are qualitatively encompassed, considering matters that are the subject of discussions in the analysis of markets to formulate the corporate strategy, external publications, and inputs of the Market Intelligence Management. Such information is translated into risk factors and assessed regarding to their possible materialization, within the scope of the relevant risks of the Bank. For that purpose, different weights defined according to the management feasibility are applied, which may vary according its complexity. The result of the general exposure of risks in relation to the assessed factors is classified according to the degree of criticality, used to define and prioritize the relevant issues to which the Bank is exposed.

Risk of entry of non-banking competitors and changes in banking consumer behavior – Technology at the service of the client

This risk stems from the intensification of competition, which is directly affected by the performance of fintechs, bigtechs, and the emergence of new disruptive technologies such as, for example, the blockchain and the metaverse, and the evolution of the digital consumer, which is more informed, more connected and demanding, intensifying real-time transactions, raising expectations around speed, availability, security, and efficiency from banking services. The new players, digital natives, position themselves in the market quickly and offer creative, innovative solutions built based on the experience of different client profiles.

The economic scenarios indicate lower gains in financial intermediation, increasing the need of asset portfolio reposition and greater increase in other sources of income, such as income from services rendered.

The banking sector is in continuous technological evolution. Clients are increasingly demanding and banks continue to push the boundaries of technological applications. Consumers have intensified carrying out real-time transactions, such as PIX (instant payment) and online service, especially through bank applications or instant messaging. This dynamic has heightened expectations around speed, availability, security, and efficiency of banking services.

We note that the industry standard has been to provide the best experience for clients on digital channels and increase efficiency through the digitization of transactions, leading the industry to explore a number of themes that complement technology investment strategies. A good part of this resources prioritization seeks to further leverage digital channels and their ability to create relationships and generate business.

The industry's competitiveness requires financial institutions to make increasingly faster and more efficient decisions. Given the high volume of industry data, the adoption of strategies and practices that make the capture and use of this data more effectively is latent. Open Finance is the reality that makes it possible to increase the interoperability of the financial ecosystem as it creates a secure environment for sharing data that opens new opportunities and brings new threats to the company's business. The challenge focuses on accelerating the digital transformation process, with a continuous increase in productivity and diffusion of the digital mindset, to gain more efficiency and improve user experience and client satisfaction.

We envision that competition will change: from specific arenas, with specialized players, to the confrontation between ecosystems containing large arrangements of companies of different sizes, collaborating and complementing each other in the construction of solutions to meet consumer needs. This "platformization" of the economy will result in new arrangements among companies, such as retail companies acquiring communication companies and fintechs.

We are attentive to innovations in the financial industry, especially the emergence of new business models and technologies, and we seek to anticipate trends, with investments in digital transformation and the creation of new relationship models. We have revisited our service models and channels, intensifying digital solutions capable of improving customer experience. We have also optimized our strategic committees, accelerating decision-making and ensuring greater assertiveness in the digital transformation process. We have invested in Analytical Platform and Artificial Intelligence, essential for the shared creation of prospective models capable of anticipating consumer behavior trends. We have also advanced in strategies such as Open Finance and Marketplace, in addition to seeking strategic positioning in the digital ecosystem.

We also seek to mitigate this risk by focusing on banking consumer behavior and investing in the quality and convenience of service, mainly through the development of products and services suited to consumer demands and multichannel technologies, i.e., in which clients can choose the channel that best serves them and can keep their banking relationship, even in a scenario of restrictions imposed by the pandemic.

Since 2019, we have increased investments in operational efficiency, focused on reducing expenses and optimizing processes. We have intensified the optimized allocation of capital, prioritizing credit portfolios with the best risk-return ratio, and joined the International Credit Portfolio Association - IACPM, ensuring our leading role in the global debate on the subject and keeping us alert to changes in the scenario.

In 2021, the progress in the construction of APIs (Application Programming Interfaces) allowed the formalization and implementation of more than 100 partnerships with technology companies, which develop diverse solutions, promote the Bank's services and increase business opportunities. Almost half of the more than 5,000 clients who consume our APIs use cash financial services through our partners' platforms. Altogether, five APIs are published on BB Portal Developers and several others are in the pilot process, undergoing various preparations before mass dissemination.

Risk of not transitioning to a low carbon economy

This risk arises from the possibility that Banco do Brasil clients do not develop strategies to adapt and mitigate climate risks, hindering or delaying their transition to an inclusive and low-carbon economy.

The effects of climate change may influence different Market segments. Since the COP26 negotiations, with the global commitment to reduce methane emissions by 30% by 2030, challenges and opportunities arise for companies, driving them to adapt to reducing their emissions.

Achieving the COP 26's climate ambition will require major changes and additional investments. The Intergovernmental Panel on Climate Change (IPCC) estimates that between US$1.6 and US$3.8 trillion a year will be needed to prevent warming from exceeding 1.5°C. The World Bank, in turn, calculates that developing countries will need to invest around 4.5% of their GDP to face the effects of climate change.

As part of the financial industry, we assume responsibility for directing the investment of funds and assisting our clients in the transition from a high-impact economy to a sustainable economy, less intensive in carbon emissions and more inclusive, with correct risk management and preparation of Innovative investment models. However, we see potential impacts on the Bank's business arising from the challenges faced by companies in this transition process to a green economy, which could result in the devaluation of assets of these companies, with effects on credit and market risks.

The profitability of the Bank's business may be affected due to potential impacts on loans, financing, and Bonds and Securities, especially when considering that climate risk could represent financial losses for clients that have not been able to adapt to this movement. Also, regulatory changes or carbon taxation could alter the economic and financial balance of companies, and the reduction in demand for carbon-intensive products or products originated from production processes that imply increased emissions could also lead to financial losses.

As with physical risks, transition risk could affect the clients' ability to pay and, therefore, lead to potential default.

Aware of the impact of the risk of non-transition to a low carbon economy by our clients and potential clients on our business results, we seek to mitigate it through the development and offer of financial solutions with social and environmental aspects, in line with our Credit Sustainability Guidelines, which are in synergy with the international commitments assumed by the Federal Government, including those related to mitigation and adaptation to the effects of climate change.

With national prominence in the development of financial solutions and business models that promote the transition to a sustainable and inclusive economy, we consider climate change in planning and catch business opportunities for a low carbon economy, especially to meet the needs of reducing emissions assumed by Brazil under the Paris Agreement.

The adoption of sustainable assumptions is in line with our strategy by directing the investment of funds in activities and/or production systems characterized by low environmental impact, low carbon, and inclusiveness, throughout the value chain. As main lines of financing, we can highlight the National Program for Strengthening Family Agriculture (Pronaf) and the Low-Carbon Agriculture Program (ABC).

In 2021, we disbursed R$18.4 billion credit through Pronaf. In terms of volume, BB is the market leader with 46.5%. Business reached 84.7% of Brazilian municipalities, which demonstrates the width of the program. In terms of portfolio, we serve more than 613 thousand Pronaf producers.

During the year, we also maintained our financing leadership in the Low-Carbon Agriculture Program (ABC), reaching 61.4% of the market with a portfolio of R$7.43 billion. Considering the total portfolio, ABC covers 45.7% of Brazilian municipalities, benefiting more than 12,400 rural producers.

We also invest in sustainable technologies for the agribusiness portfolio, thus contributing to gains in efficiency, use of waste and reduction of environmental impacts, enabling the expansion of the rural properties productive capacity. The offer of credit to support these technologies thus becomes an opportunity for financial institutions. Credit for low GHG production chains, in addition to encouraging the adoption of sustainable technologies and the generation of renewable energy sources, allows financial institutions to balance their portfolio, mitigating the risks of the transition to a low-carbon economy.

In addition, clients have at their disposal a product portfolio that includes Agricultural Insurance, Invoicing Agricultural Insurance, Proagro, Proagro Mais, all with coverage that mitigates the adverse effects of climate risk. In 2021, 60.8% of all agricultural funding, in the amount of R$52.7 billion, was covered by the Agricultural Insurance or Proagro to mitigate the risk of production loss due to extreme weather events.