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LatAm ESG debt issuance surges in 1H21; unifying standards, UOP transparency pose challenges

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LatAm borrowers' issuance of environmental, social, and governance (ESG) debt in 1H21 surpassed the 2020 full-year total, supported by increased demand from domestic and international investors and supportive regulatory frameworks, four sources told *Debtwire*.

Investor appetite for sustainability-linked bonds has opened the door to the region's less-eligible issuers, but concerns about transparency in use of proceeds remain. Continued growth of the region's sustainable bond market will be a question of having consistency for standards reporting and support from governments' legal frameworks, the four sources said.

Mexico's and Nemak's EUR-denominated issuances in early July kicked off LatAm's 2H21 ESG bond issuance after a record first half. ESG bond issuance from LatAm borrowers reached USD 21.87bn-equivalent in 1H21, compared to USD 5.6bn in full-year 2020 according to *Debtwire*'s Primary Issuance Database, including both cross-border and domestic market transactions. Taking both bonds and loans into consideration, total LatAm issuance was USD 22.96bn in 1H21, compared to USD 10.76bn in all of 2020.

"We expect that issuance of ESG-labelled debt will continue to increase in LatAm," Michael Gaynor, Senior Credit Research Analyst, European Financials and ESG at BBVA, told *Debtwire*. "Further issuance will be supported by increasing demand from domestic and international investors, and growing support from regulators on the ESG topic."

As the nature of many LatAm companies cannot justify the issuance of a green bond due to insufficient eligible projects, sustainability-linked bonds (SLB) have become a common solution in LatAm. These instruments have a more flexible structure and allow issuers to set forward-looking goals based on performance instead while not being constrained by a specific use of proceeds.

Nearly USD 10bn of this year's LatAm ESG transactions have been SLBs, representing 14 of 23 deals in 1H21, according to *Debtwire* data.

"The market for green and sustainable debt is still relatively small in LatAm, largely because investors are more focused on analyzing the ESG credentials at the issuer level currently, rather than at an asset level as with green bonds, hence, there is more focus on buying bonds of 'greener names' rather than explicitly buying green bonds," Gaynor said.

This is why there has been such a strong issuance of SLB from the region, as corporates are seeking to access the growing pool of ESG investors and using entity-level targets to do so, Gaynor added.

PROPRIETARY

Latin America

Consumer: Foods

Issuer
Federal Government Of Mexico

Issuer
Grupo Maggi

Issuer
Itau Unibanco Holding S.A.

Issuer
Klabin S.A.

Issuer
MercadoLibre Inc

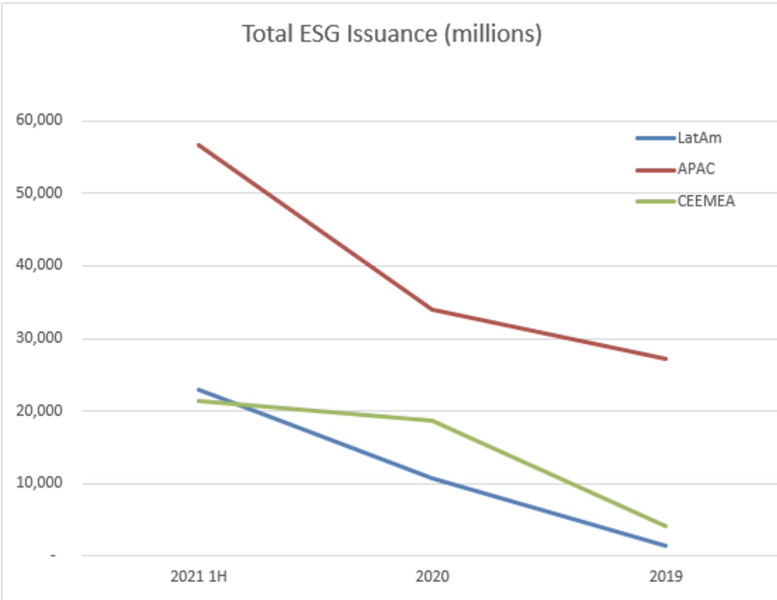
Issuer
Metalsa, S.A. De C.V.

Issuer
Movida Participacoes S.A.

Issuer
Suzano S.A.

Issuer
Tenedora Nemak, SA De CV

LatAm's USD 21.87bn total ESG issuance in 1H21 compared to USD 56.70bn-equivalent from Asia-Pacific and USD 21.14 from CEEMEA, according to *Debtwire* data. It appears to be closing a gap with the other EM regions from 2020, when LatAm's USD 10.76bn total represented a smaller portion of Asia's (USD 34.01bn) and was smaller than CEEMEA's (USD 18.64bn).



Source: Debtwire Primary Issuance Database

"Investor interest is drawn into LatAm ESG bonds, but it's not expected to overtake APAC for the time being," a private banker said. "This is a new development for the region, compared to Asia and Europe, and the level of growth after the current boost will depend on the establishment of guidelines and standards that will inspire investors' confidence to the region's commitment to sustainable investments."

Gaynor said he does not expect LatAm issuance to increase above what he has seen from Asian issuers, particularly South Korean and Chinese issuers. "We have only seen very limited social bond issuance from LatAm to date and much of the focus for investors is still on green financing."

Meanwhile, a buyside analyst said the pandemic slowed not just ESG bonds, but all bonds. "Ironically, there is a natural flow back and forth between the different markets and how they operate" he said. For example, in Brazil there was a buoyant equity market, so if a company was in fact selling equity, it is flush with cash and has no need to issue an ESG, or any, bond for that matter, he added.

There is huge appetite for ESG debt, and as the market expanded and grew comfortable with high-yield issuers, that opened the door for LatAm, according to the buyside analyst. Investors need to find ways to diversify, and in Latin America there are multiple companies with multiple currencies, and multiple types of industries.

Looking ahead, there is a lot of potential in Latin America when it comes to environmentally friendly projects, according to all four of the sources.

“Brazil, particularly, is a dormant giant. It's an environmental powerhouse that at the moment with the current administration, it is actually going towards the wrong direction of the environmental trend, but it has a strong regulatory framework to protect the environment,” a research analyst said. “Latin America should be a place where a lot of investors should be looking at environmentally friendly projects. From our perspective, Latin American green bonds should be as good as green bonds from anywhere in the world, as long as it makes sense.”

Skepticism about standards, transparency in UOP

Regulators continue to make progress on providing financial market participants with guidance and rules on ESG investing, including in Colombia, Chile, and Mexico, according to BBVA’s Gaynor. Colombia is developing its own classification of green activities, or taxonomy, while Chile and Mexico are also said to be doing the same, using the framework of the EU's taxonomy as a basis. The purpose is to encourage issuers to make consistent disclosures on social and environmental issues, and provide the market with comparative information.

However, while analysts and investors discuss how big ESG debt can get, concerns about the lack of standards in the green bond market and about use of proceeds still make some investors anxious.

“I think the green bond trend will remain, but I am a bit skeptical about the ESG market, because I don’t see a point in how a car rental company could come with an ESG bond,” the private banker said. “I don’t see any value in such bonds by such issuers.”

Brazil’s Movida sold a USD 500m 5.25% 2031 sustainability-linked bond in January. It traded 9 July at 100.473. The list of SLB issuers in 1H21 included Klabin, Suzano and Amaggi, but also non-agricultural or forestry companies like Itau, Metalsa and Mercado Libre.

Issuers know what to expect in terms of yields when they classify an issuance as sustainable and they will try to find a way to do this, the private banker said.

“From the moment a company gets the cash, money can be used for whatever reason, so companies use this as an excuse to come to market,” the private banker said.

However, this banker said he believes that in the future, the market might realize there's an abuse of the ESG, sustainability-linked instruments and that it has become "too much.”

At the same time, suggesting that the green or social credentials of ESG labelled issuance from LatAm is secondary to the possible yield pickup does not seem entirely accurate, according to Gaynor.

Investors scrutinise frameworks of green and social bonds from LatAm issuers with the same degree of attention as they would with issuances from developed markets, Gaynor said.

Managers of green bond portfolios are keen to further the diversification of the market, however, as it is still relatively concentrated in terms of jurisdiction, sector and currency denomination – typically low-yield, developed market, investment grade bonds from utilities, SSAs and FIG issuers – Gaynor added. So, LatAm issuance is eagerly received by many green bond investors to provide some diversification and possible greater yields.

The ESG trend is most likely a multiyear trend, the research analyst said, “to the extent that you can raise money more cheaply, because investors are perceiving these kinds of investments to be less risky and they're likely to pay a premium.”

There is a huge number of portfolios that are committed to sustainability that will raise issuers by environmental society and governance scores and pledge or will pledge to build a portfolio that is very much biased towards good actors or ESG terms or sectors, according to the research analyst. "The challenge is to get all the corporations and the sovereigns to report appropriately on the emissions and to also find eligible projects."

With sovereigns, it’s “very complicated” because of the limited data and well-audited control, and the corporate sector is developing faster, the research analyst added. Mexico became only the second sovereign LatAm ESG bond issuer this year. Chile’s four deals for USD 9.8bn equivalent represented the sovereign ESG bond issuance for 1H21.

The question of what exactly constitutes an ESG bond remains, according to the buyside analyst, because as of right now the servicing and maintenance of an ESG is not unique versus a non-ESG bond.

"When it comes to lookback provisions within the ESG market, there's been huge growth within sustainability-linked as opposed to ESG, sustainable bonds,” the buyside analyst said.

SLBs have a more flexible structure and allow issuers to set forward-looking goals based on performance instead whilst not being constrained by a specific use of proceeds and roughly about 60% of the pipeline that the banks have is trending toward SLB, according to the buyside analyst.

The barrier to entry for issuers when issuing SLB is lower than for green bonds, according to Gaynor. In addition, domestic investors are focused largely on engaging corporates on issuer level concerns, such as ESG disclosures and improving governance, which could make key performance indicator (KPI)-linked bonds more of an accessible type of ESG financing than use of proceeds bonds.

“If you don’t have a commitment in USD, your target is going to be a KPI and then you simply have to meet whatever is demonstrated in the offering memorandum for the KPI to meet the threshold. If you fail to meet their threshold then typically that creates a step-up in the coupon, and that becomes a benefit to the investor,” the buyside analyst said.

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