Reports

Sustainable finance to boom in Latin America following COP26

Sources suggest that the UN's flagship event will drive sovereign green bonds in the region as government taxonomies pave the way for new types of issuances and asset classes

By **Noah Zuss**

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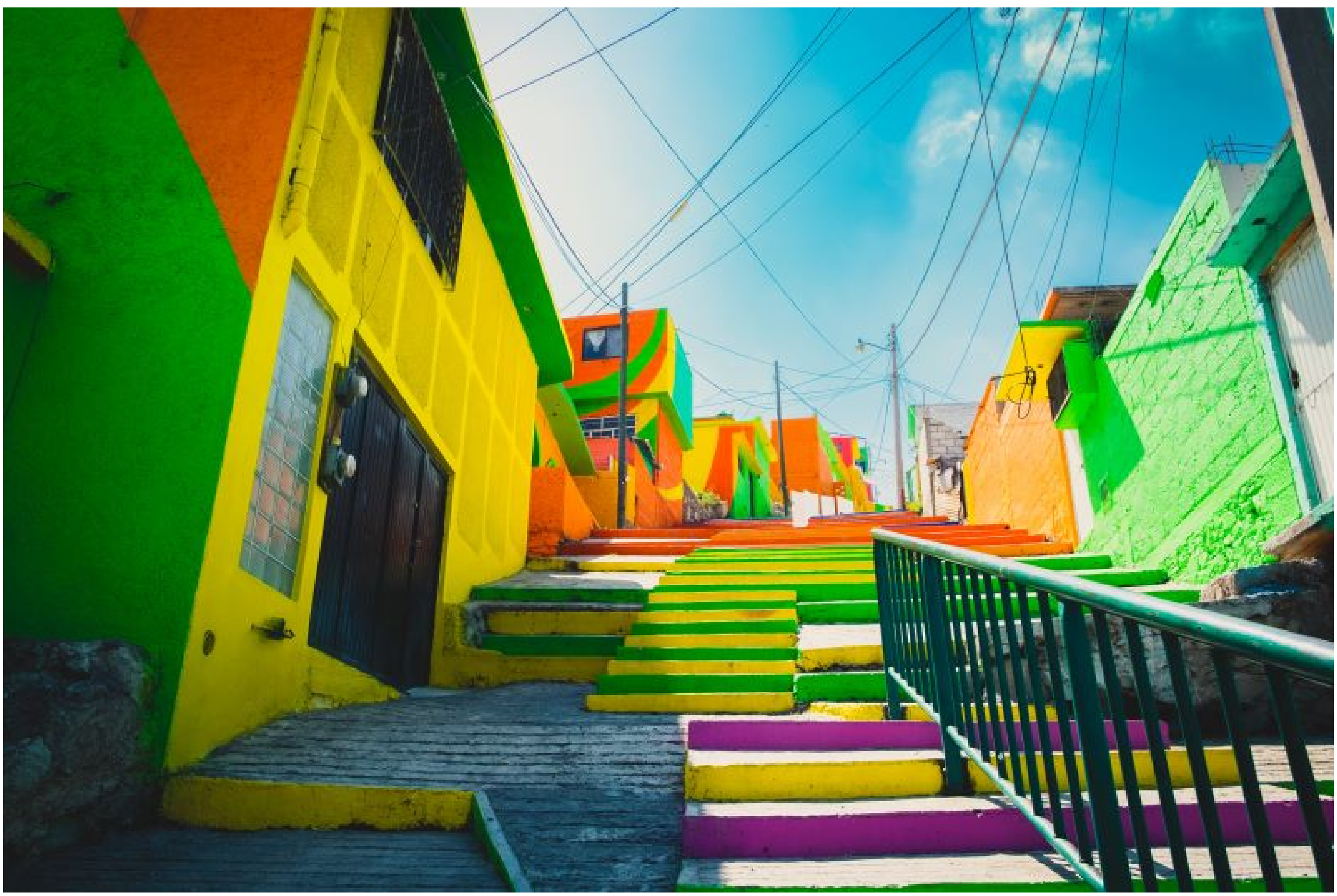

Green and sustainable bond issuances have increased in Latin America as developing nations in the region look to use financial capital injections to ramp up the climate transition and bolster long-term sustainability.

Greater choice of green, climate, and sustainable-linked bonds show that the market is expanding quickly, sources suggest. The use of sovereign bonds, including those issued in local currency – still small compared to the US and Europe – is also expanding, explained Edward Kempson, counsel with Latham & Watkins.

"Relatively, the market is still much smaller than Europe or North America, but there has been significant growth across 2020 and into 2021," he said.

The Latin America and Caribbean (LAC) region is rich with opportunities to tackle high-carbon emitting industries and extractive sectors through climate finance, he added.

"It is certainly a region that needs a significant injection of sustainable finance to help with the transition," said Kempson. "There's a fair level of reliance on high carbon emitting industries and extractive sectors that do need to facilitate their transition trajectory and sustainability profile."

See also: At COP26, IFRS new international sustainability disclosure standards broadly welcomed

Latin American markets for green bonds are now over $30 billion, from $13.2 billion in 2019, figures show

"The market has seen explosive growth in the last two years in particular," said Kempson, the firm's global sustainable finance practice coordinator. "We've seen that across a range of different products, green bonds, loans, and sustainability-linked products."

COP26-lications

Bonds for scaling energy and sustainable infrastructure are likely to further accelerate after the COP26 climate summit.

"Further focus at the regulatory, supranational, and at the corporate financial institution level is going to help to further mobilise the market," said Kempson. "Expect markets to continue to grow both in Latin America and globally, because this is one of, if not the most, important trends around ESG."

Simone Utermarck, sustainable finance director at the International Capital Market Association (ICMA), expects the conference to give further impetus to the surging sustainable bonds market.

"Some of the announcements that have already been made during COP, especially on finance day, will directly or indirectly impact the green and sustainable bonds market, which has proven very well suited to raising the investment needed to achieve the goals of the Paris Agreement," she said. "Sustainability-linked bonds especially have emerged as an ideal instrument to finance the transition required to getting there."

See also:* *International cooperation needed to enact Biden's climate push

Christopher Flensborg, head of climate and sustainable finance at Swedish Investment bank and insurer SEB, said that the Latin American climate finance market could be reenergised after COP26.

Innovation nations: Colombia and Mexico

Two countries that exemplify the increase in sustainable issuances in recent times are Colombia and Mexico, who's recent domestic green bond issuances signal a maturing market.

Sovereign bonds issued in local currency indicate that investors are hungry for debt beyond dollars or euros, explained Leisa de Souza, head of Latin America at the Climate Bonds Initiative (CBI).

"This is a developing trend and a very positive sign of what is happening in the market," said de Souza, responsible at CBI for developing the green bond market.

Bryan Carter, head of emerging markets debt with HSBC, agreed that Latin America sustainable funds will continue to grow and said that the emerging market debt fund at the bank holds sovereign green bonds from both Chile and Colombia.

Sovereign bonds in local currency are not a novelty or "one hit wonder," he explained, they are here to stay.

"This is now something that we can think about as being a fixture of the asset class," Carter said. "If that sets a standard for other countries, then we can start to think about green bonds being a staple of the asset class and being a dedicated part of the benchmark."

Developing a robust taxonomy classification system for the investments gives investors greater comfortability and has led to increased investment, de Souza added.

"This shows the appetite for other currencies and is a positive sign for market maturity in what investors are looking for," said de Souza. "Previously, if you didn't have hard currency it would be harder for issuers to come in and invest."

Colombia's sovereign green bond issuance was able to be issued following the government's work to create a green taxonomy for the country's decarbonisation investments, which was developed with the CBI's assistance. Colombia has recognised that these investments are critical to tackle climate risks, explained Carolina Barreto, CBI's programme manager for Latin America.

"The regulator is very interested and active in signalling that financing a low carbon economy is important, not for branding or for reputational purposes, but to correctly manage the financial risks arising from climate change," she said.

Mexico offerings have also expanded as the nation issued the first unsecured sustainable bonds by a Real Estate Investment Trust (REIT), last month. In Mexico, corporates rather than sovereigns have driven innovations, said Rogelio Gonzalez, director at Fitch Ratings.

See also: First sustainable loan in LatAm shows region's commitment to ESG

Innovative issues can drive investment by creating a virtuous investment cycle, he said.

"Besides companies being more proactive in achieving ESG goals in their operations, portfolio managers need to invest in green or sustainability bonds," said Gonzalez. "That is going to continue and we'll probably we'll see more issuance in the near future."

Matured markets

Latin American labelled bond issuances increased during the Covid-19 pandemic when markets were impacted by shutdowns.

Issues across developing markets in general increased throughout the pandemic, amidst investors' deep appetite for sustainable investments. The Latin American markets matured during the pandemic in order to target the region's economic recovery, said Nneka Chike-Obi, director for ESG research and sustainable finance at Fitch Ratings.

For example, the entire green, social, sustainability, and sustainability-linked (GSSS) bond market has increased in the region. Sustainability-linked bonds represented 81% of total GSSS bonds issued by July 2021, Fitch figures show.

This indicates a lasting trend, not a market blip, Chike-Obi explained.

"Quite quickly from the middle to the end of 2020 there were a lot more sustainable bond issuances, including pure green bonds that had nothing to do with Covid-19 at all," Chike-Obi said.

Sustainability-linked bonds that use key performance indicator (KPI)-linked or sustainable development goal (SDG)-linked bonds that adhere to climate or other goals have also increased, Utermarck explained. Latin American markets have seen further growth in social and sustainability – a mix of green and social bonds – which raise finance for affordable housing, basic infrastructure, employment generation, and socioeconomic advancement in the last two years, she added.

There have been an increase in green bonds and a natural evolution to sustainability-linked bonds, which seem to have proven more suitable for some sectors that need to transition, added Chike-Obe.