New EIG/Aramco bonds in ESG indices: EOM flow risks

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The recent EIGPRL Aramco oil pipeline financing bonds appear to have been included in the JPMorgan ESG CEMBI as well as the Bloomberg MSCI ESG indices. Some investors, such as the Danish Medical Association's Pension Fund[1] and various ESG ETFs have initiated large lending positions to EIGPRL as they mechanically follow the bond index rules.[2] Those loans will, in our opinion, effectively provide financing to an entity which MSCI indicates as "over 4C implied temperature rise." We recommend a reassessment of the ESG status of EIGPRL bonds – aligning them with Aramco bonds - which could potentially lead to divestments. Add to this a possibly poor technical as we expect an elevated bond supply pipeline due to Aramco lease-lease-back bridges needing to refinance, and there is plenty reason for investors to be cautious solely on flow factors.

As a background on the structure,[3] the EIGPRL bonds (EIGPRL 3.545 08/2036 and 4.837 11/2046) come from an SPV issuer that owns a minority stake in the Saudi Arabian Pipeline Company. Aramco own the remaining 51% of that company and is the ultimate controlling owner of the actual pipelines, as well as having a permanent full operational responsibility for them. To our knowledge, EIGPRL does not have any other investments or activities. The bond proceeds from EIGPRL sale will be used to pay the upfront to Aramco for the Pipeline Company's 25 year lease of Aramco's oil pipeline network, via bank bridge loans. We opine that this makes EIGPRL effectively an Aramco subsidiary for aspects of credit exposure and financing relationships, cf. Fitch: "the ratings are linked to Saudi Aramco's rating."

ESG rating agencies have not, as far as we can see, analyzed and scored EIGPR, likely as the bonds came to market as late as mid-January. This lack of data opens a potential loophole in terms of index construction. Many indices allocate a sector or country average score to non-scored entities, which obviously creates an incentive to generate new issuance vehicles without ESG scores for issuers that otherwise would be excluded. It appears that Aramco bonds are excluded from the aforementioned indices. Sustainalytics score Aramco at 45.6 on ESG risk rating indicating "Severe Risk", with a rank of 13678 out of 14530 in a global universe; MSCI indicates an "over 4C implied temperature rise" and projects that Aramco emissions will rise from 2.2Gt CO2e today to 3.0Gt in 2050. [4]

Given this, we believe there is an elevated risk that over time – not least toward end-of-month – that some investors need to decrease their positions in the EIGPRL bonds. Combined with an elevated supply pipeline, investors should consider the potentially weak technicals in the bond(s) at the same time as evaluating whether EIGPRL as an issuer exposure is compliant with internal climate commitments or not.

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[1] "Investeringsforeningen Laegernes Pensionsinvestering", the declaration on the most important negative sustainability effects here (Danish), including their investment policy based on the JPM ESG CEMBI index.
[2] Data from Bloomberg, accessed 11 Feb 2022.
[3] "Oil, gas and bond pipelines: the case of Aramco/EIG/BLK", AFII, 5 Feb 2022, for details on the deal structure and bond curve.
[4] Sustainanalytics report here, and MSCI report here, both accessed on 11 Feb 2022.

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