No green ePIFany

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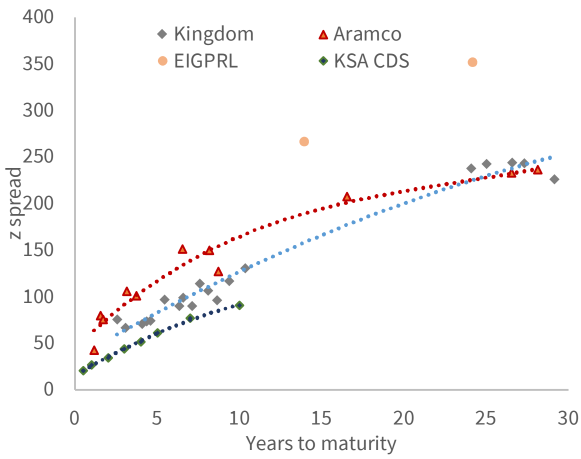
The Saudi sovereign wealth fund PIF is looking to place a green bond deal in the market, presumably a multi-tranche dollar benchmark 5y, 10y and potentially longer maturity.[1] The optics of climate aligned Saudi government issuance are challenging to begin with, and at closer examination, it is even more difficult to consider this issuance as genuinely 'green.'

Investors are increasingly setting requirements that a green bond issuer strategically aligns with climate goals, in order to allow to qualify the bond as 'green.' One practical way of doing this is to investigate pari passu assets of the green bond(s): in case of default, which other type of assets would be in the recovery pool that the green investor would share with ordinary investors?

Figure 1. Saudi bond curves: the sovereign, Aramco and EIG Pearl, a pipeline financing vehicle. Source: Bloomberg, AFII.



Looking at PIF, various sources indicate the sovereign (ticker: KSA) as aligned to 3 to 4 degrees of warming,[2] and PIF is clearly a direct subsidiary of KSA. Looking at a potential PIF green bond, it would sit pari passu with the issuer' newly acquired stake in Saudi Aramco (4%)[3], its NEOM city giga-project[4] and Newcastle United.[5] We would be especially concerned with exposure to Saudi Aramco coming directly onto the balance sheet for a green bond investor in case of a credit event.

An important question is why is PIF funding through the bond markets? With high oil prices and revenues and a strong cash position, it seems questionable why one would want to go through with a relatively expensive process to issue a bond. We opine that likely what is sought is signalling value and nominal support from banks and investors rather than actual monetary funding.

Indeed, we opine that this 'green' bond deal provides zero additionality and should be viewed as a marketing exercise.[6]

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[1] "Saudi Arabia opens wealth fund's books ahead of debut bond", Financial Times, 28 Sep 2022.
[2] See, for example, Climat Action Tracker here.
[3] "Saudi government transfers 4% Aramco stake to sovereign wealth fund", Financial Times , 13 Feb 2022
[4] We opine that the NEOM project is consistent, even consequential planning, considering the issuer's current climate alignment.
[5] "PIF have used Newcastle United as 'leverage' as £653m deal agreed", Football Insider, 26 Jul 2022.
[6] For purposes of AFII's work, we will exclude PIF "green" bonds from our labelled bond universe.

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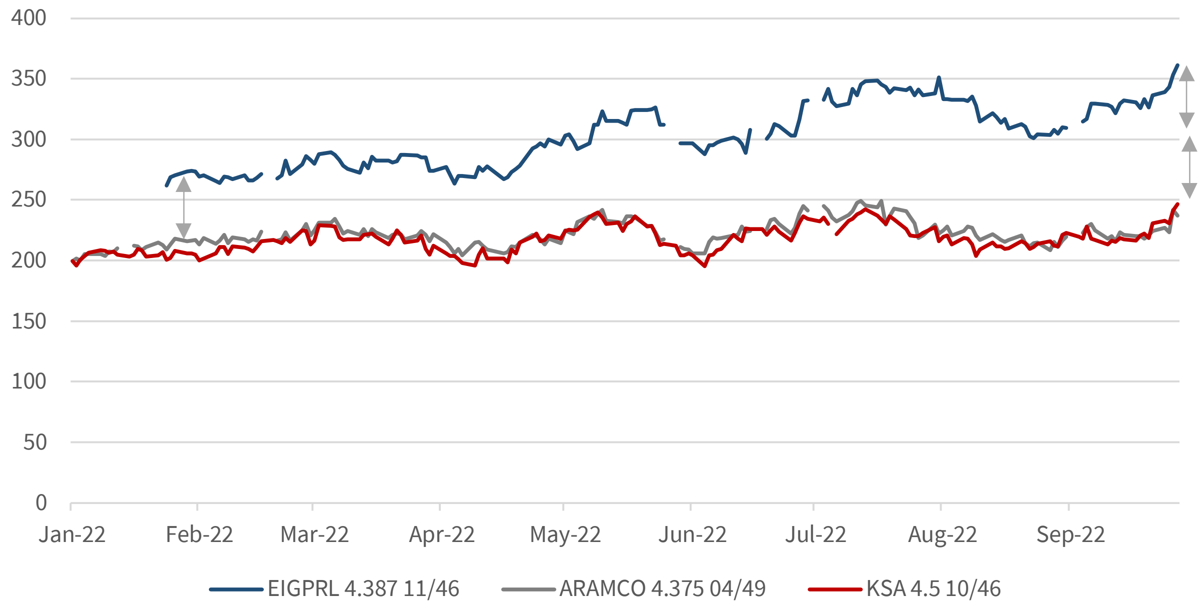
What if we considered an alternative structure? Given the breadth of PIF's balance sheet, a more natural approach would be to consider a bond format which applies climate alignment across all assets rather than soft-separated pool of 'good' assets.

This suggest that a deal could be structured as a sustainability-linked bond deal of the type "if the portfolio of assets of PIF are Paris-aligned by 202*X* then the coupon steps/down by *Y*bps for the remainder of the life of the bond." Some inspiration on structuring of SPTs, if not on coupon steps or ambition level, for an asset manager could be found in EQT's SLBs issued in 2022H1 (EQTSS 0.875 05/31, XS2338570331, and the EQTSS 2.375 04/28 and EQTSS 2.875 04/32s).

However, at the current time and in our opinion, the prospect of a balance sheet-general structure with relevant climate alignment targets for this issuer seems distant.

Perhaps one should even call it a pipe dream.

Figure 2. EIGPRL spread differential to KSA/ARAMCO has roughly doubled since issuance in January. Source: Bloomberg.



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