

Deforestation exposure: Q1 2024 bond issuance review and bank syndication fees

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Deforestation causes often-irreversible changes in land-use that reduce biodiversity and harm climate mitigation efforts. It is therefore coming under increased scrutiny from regulators and investors. In December 2023, AFII introduced its Representative Deforestation Credit Portfolio (RDCP), a universe of credits with potential exposure to deforestation,[1] to support investors in achieving their sustainability objectives.

In this note we review issuance from this universe in Q1 2024. Our purpose is to show how benchmark exposure may have changed over the last quarter and provide insights that may help investors concerned about deforestation better target their sustainability engagements with banks.

Our conclusions:

- **In Q1 2024 there was $19bn of bonds issued within this universe**. Compared to overall market activity, issuance in USD was average, whereas issuance in EUR was above average. **This suggests benchmark EUR investors may have increased exposure.**
- Tracking syndication fees from these transactions offers an opportunity to identify engagement targets amongst banks. With this data, Investors can direct their business to institutions more aligned with their sustainability objectives.[2]
- Among large institutions, Citi and HSBC receive the highest proportion of their fees from in-scope issuers, and are therefore key targets for engagement. The most significant deals conducted by these lenders involved Kraft Heinz, Compass, and Nestle.

[1] For full details please see "RDCP: Deforestation exposure in liquid credit portfolios", AFII, 22 Dec 2023.
[2] For full details please see our white paper at "The Box: a tool for bank influence", AFII, 20 Dec 2023.

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Deforestation risk

Nature exposures in investment portfolios are becoming increasingly important across the fixed income space.[3] Deforestation is one aspect of nature loss being focused on by both regulators and investors.

On the regulatory front, a key driver of this increased scrutiny is the Kunming-Montreal agreements regarding the Global Biodiversity Framework, which was adopted in December 2022. This commits signatory countries to achieve certain biodiversity loss and natural ecosystems restoration targets by 2030.[4] To reach these targets, countries must ramp up sovereign investment in nature conservation and enhance oversight of corporate activities under their jurisdiction.

Furthermore, in April 2023 the EU adopted the EU Deforestation Regulation (EUDR), which effectively bars companies that sell products in Europe from sourcing commodities such as soy, palm oil, beef, and timber from lands transformed by deforestation. Companies that fail to comply may have to pay a fine of at least 4% of their total annual EU turnover.[5] Similar legislation is in development in the UK, and being considered in the US.[6]

These regulatory initiatives have turned deforestation into a key business risk for thousands of companies, one that has material financial implications.

On the investor side, certain institutions are innovating with the anti-deforestation theme. Storebrand, a Nordic financial group, has developed a portfolio specifically focused on deforestation risk.[7] In the US, Federated Hermes has reported that "*contributing to efforts to eliminate deforestation […] is fundamentally in the long-term financial interests of our clients, and therefore part of our fiduciary duty*", and so is integrated into its investment process.[8]

Investor appetite for deforestation-free portfolios has the potential to drive capital toward certain issuers and away from others, thereby impacting investment returns.

RDCP Universe

To improve transparency for fixed income investors, AFII have developed the RDCP universe, to highlight potential sources of deforestation exposure.

The RDCP universe is a portfolio of 35 companies, all issuers of fixed income securities, that are relevant for credit portfolio managers seeking to control their deforestation exposures. A full list of the current universe is shown in Table 1, alongside their respective AFII Deforestation Scores (ADS). For full details on this scoring, please refer to our December 2023 paper.[1]

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[3] "Biodiversity quickly rises up the ESG investing agenda", FT, 20 Sep 2022.
[4] For an analysis of sovereign bond portfolios please see "Kunming-Montreal agreements: A bond perspective", AFII, 5 April 2023.
[5] To show the potential impact of this regulation on bond spreads for soy traders please see "EU deforestation law: fire on the horizon for soy traders", AFII, 13 Sep 2023.
[6] "Recent developments in deforestation legislations – the UK, U.S. and EU", Ropes & Gray, 29 Feb 2024.
[7] For example "Storebrand: Creating deforestation-free investment portfolios", Climate Champions, 7 Aug 2022.
[8] "Policy Statement on Deforestation", Federated Hermes, Dec 2023.

Table 1. RDCP universe based on ADS score and AFII's liquidity review. Source: Bloomberg, AFII.

Issuer name	Ticker	Sub-sector	Country of Risk	Agg. rating	ADS
Ahold Delhaize	ADNA	Food & Drug Stores	NL	BBB	10
Aramark	ARMK	Food Services	US	B+	7
Archer-Daniels	ADM	Agri. Prod. Whslrs	US	A	12
Brands Int/Burger King	BCULC	Food Services	CA	BB	8
Cargill	CARGIL	Agri. Producers	US	A	11
Carrefour	CAFP	Food & Drug Stores	FR	BBB+	9
Cencosud	CENSUD	Food & Drug Stores	CL	BBB-	8
Colgate-Palmolive	CL	Personal care	US	AA-	6
Compass	CPGLN	Food Services	GB	A-	9
Danone	BNFP	Packaged Food	FR	BBB+	7
ELO / Auchan	ELOFR	Food & Bev. Whslrs	FR	BBB-	9
Frigorifico Concepcion	FRICON	Agri. Producers	PY	B	10
General Mills	GIS	Packaged Food	US	BBB	9
Glencore	GLENLN	Base Metals	AU	BBB+	10
JBS	JBSSBZ	Packaged Food	US	BBB-	8
Kering	KERFP	Apparel, Footwear	FR	A	8
Klabin	KLAB	Paper	BR	BB+	14
Kraft Heinz	KHC	Packaged Food	US	BBB-	8
Kroger	KR	Food & Drug Stores	US	BBB	10
Louis Dreyfus	LOUDRE	Agri. Prod. Whslrs	NL	BBB-	14
Mars	MARS	Packaged Food	US	A	7
Marubeni	MARUB	Food & Bev. Whslrs	JP	BBB	7
McDonald's	MCD	Restaurants	US	BBB+	7
Minerva	BEEFBZ	Packaged Food	BR	BB	9
Nestle	NESNVX	Packaged Food	US	AA-	7
Nike	NKE	Apparel, Footwear	US	A+	7
Reckitt Benckiser	RKTLN	Home Products	GB	A-	7
Sodexo	SWFP	Food Services	FR	BBB+	7
Sysco	SYY	Food & Bev. Whslrs	US	BBB	6
Target	TGT	Mass Merchants	US	A	10
Tesco	TSCOLN	Food & Drug Stores	GB	BBB-	11
Tyson Foods	TSN	Packaged Food	US	BBB	10
Unilever	UNANA	Personal care	GB	A+	5
Walmart	WMT	Food & Drug Stores	US	AA	11
Yum!	YUM	Restaurants	US	BB-	7

Q1 2024 issuance

Eleven RDCP issuers brought a combined $19bn of new debt to the market in Q1. Full details are below in Table 2.

Table 2. RDCP issuance in Q1 2024. Source: Bloomberg, accessed 19 Apr 2024.

Issuer	ISIN	Pricing Date	Maturity	Currency	Size (bn)	Rating	ESG Label
ATACADAO SA	BRCRFBDBS079	02-Jan-24	12-Jan-26	BRL	0.65	N.A.	
ATACADAO SA	BRCRFBDBS087	02-Jan-24	11-Jan-27	BRL	0.85	N.A.	
COMPASS GROUP PLC	XS2758114321	30-Jan-24	06-Feb-31	EUR	0.75	A	Sustainable
GENERAL MILLS INC	US370334CX03	16-Jan-24	30-Jan-27	USD	0.5	BBB	
GLENCORE CAP FIN DAC	CH1305916889	08-Jan-24	18-Jan-30	CHF	0.15	BBB+	
GLENCORE FUNDING LLC	US378272BR82	26-Mar-24	04-Apr-27	USD	0.8	BBB+	
GLENCORE FUNDING LLC	US378272BW77	26-Mar-24	04-Apr-27	USD	0.35	BBB+	
GLENCORE FUNDING LLC	US378272BS65	26-Mar-24	04-Apr-29	USD	1.1	BBB+	
GLENCORE FUNDING LLC	US378272BU12	26-Mar-24	04-Apr-34	USD	1.25	BBB+	
GLENCORE FUNDING LLC	US378272BV94	26-Mar-24	04-Apr-54	USD	0.5	BBB+	
KERING	FR001400OM10	05-Mar-24	11-Mar-32	EUR	1	NR	
KERING	FR001400OM28	05-Mar-24	11-Mar-36	EUR	0.75	NR	
KONINKIJKE AHOLD DLHAIZE	XS2780024977	04-Mar-24	11-Mar-26	EUR	0.4	BBB+	
KONINKIJKE AHOLD DLHAIZE	XS2780025271	04-Mar-24	11-Mar-31	EUR	0.5	BBB+	Green
KONINKIJKE AHOLD DLHAIZE	XS2780025511	04-Mar-24	11-Mar-36	EUR	0.7	BBB+	SLB
KRAFT HEINZ FOODS CO	XS2776793965	27-Feb-24	15-Mar-29	EUR	0.55	BBB	
MARUBENI CORP	JP387760AQ25	16-Feb-24	22-Feb-34	JPY	18	N.A.	
NESTLE CAPITAL CORP	US64105MAA99	05-Mar-24	12-Mar-29	USD	0.6	AA-	
NESTLE CAPITAL CORP	US64105MAB72	05-Mar-24	12-Mar-31	USD	0.45	AA-	
NESTLE CAPITAL CORP	US64105MAC55	05-Mar-24	12-Mar-34	USD	0.8	AA-	
NESTLE CAPITAL CORP	US64105MAD39	05-Mar-24	12-Mar-54	USD	0.65	AA-	
NESTLE CAPITAL CORP	XS2787862346	13-Mar-24	22-Mar-29	GBP	0.4	AA-	
NESTLE CAPITAL CORP	XS2787862429	13-Mar-24	22-Mar-36	GBP	0.4	AA-	
NESTLE CAPITAL CORP	AU3CB0308229	26-Mar-24	04-Apr-29	AUD	0.6	AA-	
NESTLE CAPITAL CORP	AU3CB0308211	26-Mar-24	04-Apr-34	AUD	0.6	AA-	
NESTLE FINANCE INTL LTD	XS2752872882	16-Jan-24	23-Jan-31	EUR	0.75	AA-	
NESTLE FINANCE INTL LTD	XS2752873005	16-Jan-24	23-Jan-37	EUR	0.75	AA-	
TYSON FOODS INC	US902494BL61	28-Feb-24	15-Mar-29	USD	0.6	BBB	
TYSON FOODS INC	US902494BM45	28-Feb-24	15-Mar-34	USD	0.9	BBB	
UNILEVER FINANCE	XS2767489474	12-Feb-24	15-Feb-32	EUR	0.7	A+	
UNILEVER FINANCE	XS2767489391	12-Feb-24	15-Feb-37	EUR	0.6	A+	

There were transactions in seven currencies (EUR, USD, BRL, CHF, JPY, GPB, AUD). We will focus on EUR and USD issuances, and compare to overall market issuance.

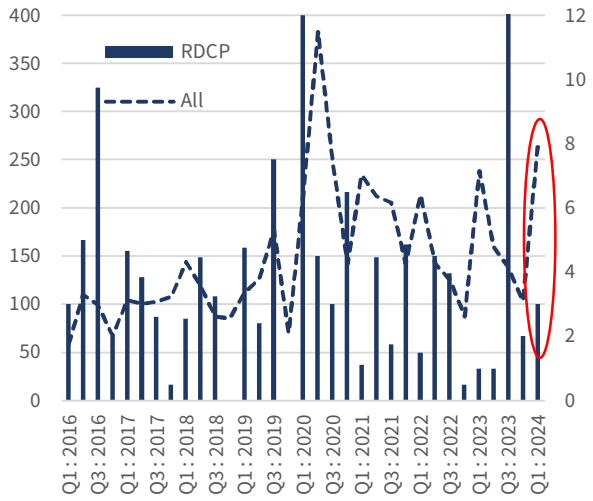
USD issuance

Figure 1 compares total market issuance by the RDCP universe to all USD BBB bonds.[9] Q2 2024 was a good quarter for overall market issuance, the second highest quarter in our sample, but this was not mirrored by the RDCP universe, which saw below average issuance.

RDCP issuance was dominated by a $4bn five-tranche deal from Glencore,[10] a Swiss commodity trader and miner. There was also a $1.5bn two-tranche deal from Tyson foods, a US food company.

At other ratings, the most significant USD issuance was from AA-rated Nestle, a Swiss food manufacturer, which priced ten bonds in the quarter, of which four were in USD.

Figure 1. USD BBB issuance in $bn by pricing date. Source: Bloomberg, accessed 19 Apr 2024.



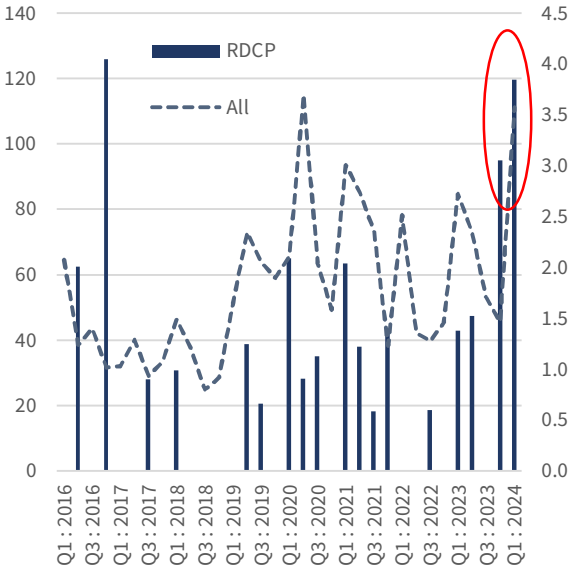
EUR issuance

Figure 2 compares total market issuance by the RDCP universe to all EUR BBB bonds. This presents a study in contrasts.[9]

Overall market issuance was again high, but RDCP issuance was also well above average. Indeed, issuance volumes were the highest since Q2 2016.

The most significant BBB-rated issuance was a three-tranche deal from Dutch-Belgian supermarket Ahold (rated BBB+), which combined vanilla, green and sustainability-linked structures.[11] Kraft Heinz, a US food company, also chose to tap the EUR market with a €0.55bn 5yr bond.

Figure 2. EUR BBB issuance in $bn. Source: Bloomberg, accessed 17 Apr 2024.



Conclusions

Q1 issuance across the market was high. Among RDCP issuers a greater number tapped the EUR market than the USD. This means EUR benchmark investors may have increased exposure to deforestation, whereas USD investors may need to prepare engagement strategies for future deals.

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[9] Using a minimum size of $0.01bn for RDCP and $0.1bn for the total market, and the Bloomberg composite rating.

[10] This deal was issued only a few days before a ruling from the European Court of Human Rights against the Swiss Government on 8th April 2024, which may also put Swiss companies under pressure to address their emissions more quickly, as reported in "Europe's landmark climate change ruling may force companies to reduce 'emissions as quickly as you can'", Fortune, 10 Apr 2024.

[11] This deal is covered in more detail in "Relative value is in the eye of the Ahold-er", AFII, 18 Mar 2024.

Bank engagement

Banks are key links in the chain of transactions that enable deforestation. While regulator and investor focus on their actions is growing, it has been reported that banks are yet to fully consider the consequences of deforestation.[12]

This makes banks key engagement targets for investors, which can apply pressure to specific lenders to reduce their involvement with companies contributing to deforestation.

The Box – a tool for influence

AFII has developed The Box, a tool for investors to engage with banks on their sustainability objectives. AFII monitors syndication fees; the income that banks receive for issuing bonds and loans linked to activities that do not align with climate and/or deforestation goals. tables can be used by investors to adjust bank business such as trading counterparties, to promote more aligned activity by banks.[2]

By linking using a measure of revenue rather than balance sheet usage to track bank activity, we can more closely monitor the value to each deal being offered by each lender (clients pay more when they are receiving more value). Our approach also captures data often omitted from banks' own sustainability reporting.

Method for Deforestation risk

Looking at the RDCP universe, we calculate syndication fees for deals with those issuers. As the population is small, we group data over the past three years, and calculate the ratio compared to total fees. This rolling ratio can be updated on a quarterly basis to identify trends.

$$RDCP/Total\ fee\ ratio\ for\ bank_i = \frac{\sum_{r=1}^{n} RDCP\ fees_r}{\sum_{r=1}^{p} Total\ fees_r}$$

where *n, p* are the total number of relevant deals for bank in the specified rolling window.

The resulting table identifies key targets for engagement. It is important to note that the banks with the highest fee revenues are not necessarily major contributors to deforestation, but rather that they are facilitating capital market access for companies that have a recorded potential impact on deforestation.

Forest 500

For the banks in question, we have also considered an external data source, the Forest 500 score, to understand their respective commitments to deforestation.

The Forest 500 ranking offers a comprehensive overview of financial institutions' policies and actions related to critical commodities associated with deforestation.[13] Those ranked are assessed on their efforts in addressing deforestation risks within their portfolios and the degree of transparency and accountability they bring to this task.

[12] "Report shows banks may be failing to recognise the risks of deforestation", The Banker, 23 Feb 2023.
[13] For further details, see Forest 500 Ranking Institutions, Forest 500, accessed 12 Apr 2024.

The score ranges between 0-100%. The higher the score, the stronger the commitment to combating deforestation. Among banks the current highest score is 58.5%, whereas the top corporates stand at 72.5%.

Key targets – large banks

Table 3 shows syndication fees for banks considered Tier-1 based on their global DCM activities and trading volumes over the past 3 years.[14]

Citi and HSBC are the two Tier-1 banks with the highest percentage of fee revenue from clients who are potentially exposed to deforestation in the RDCP.

Table 3. RDCP fees vs total fees for Tier-1 banks: Source: AFII, Bloomberg, effective date 11 Apr 2024.

Bank	RDCP/Total fees ratio	RDCP fees USDmn	Total fees USDmn
Credit Agricole CIB	0.4%	14.2	3,661
MUFG	0.6%	17.4	3,056
SMBC	0.6%	17.2	2,695
Goldman Sachs	0.7%	32.1	4,904
Morgan Stanley	0.9%	37.1	4,108
UBS & Credit Suisse	0.9%	43.0	4,615
BNP Paribas	1.2%	60.1	5,207
RBC Capital Markets	1.2%	41.4	3,338
Deutsche Bank	1.3%	59.5	4,759
Societe Generale	1.3%	32.0	2,403
Barclays	1.4%	66.8	4,785
BofA Securities	1.4%	123.2	8,687
Wells Fargo	1.5%	65.7	4,299
JP Morgan	1.5%	143.0	9,273
Mizuho Financial	1.7%	50.5	3,022
HSBC	1.8%	79.4	4,424
Citi	2.2%	152.2	6,934

RDCP/Total fees ratio: Percentage of total fees from RDCP
RDCP Fees: All fees from eligible RDCP deals in the period
Total Fees: All fees from eligible deals in the period

Citi has both the highest fee share as well as the highest absolute amount of deforestation-related fees. We see no overarching commitment from Citi around deforestation, although it has been monitoring and analysing risks in the agribusiness sector, which includes deforestation. When coupled with a Forest 500 score of 26.3% (which is low in absolute, but in the top quartile of bank scores),[15] Citi makes a strong candidate for deforestation-related engagement.

In this quarter Citi was joint lead manager for the Kraft Heinz, Compass, Nestle's EUR deals and Unilever EUR and USD issuances as laid out in Table 2.

[14] The population of banks is split between large and intermediate based on total fee size but using subjectivity relating to the relevance of the bank as a counterparty in terms of secondary trading activity in hard-currencies. The list is subject to change and updates. This aligns with our broader fossil/green rankings as determined in earlier work.
[15] "Company rankings: Citigroup", Forest 500, accessed 11 Apr 2024.

HSBC has the second-highest relative fees. Its forestry policy[16] states that it uses certification to check that its customers meet its deforestation standards. This covers clients that are involved in both production and supply chain. All logging sites in high-risk countries, as well as all facilities sourcing wood or pulp from or originating from high-risk countries, are required to have FSC or PEFC certification.[17] Furthermore, the policy states that HSBC has committed not to provide financial services to customers that are involved in illegal logging. Its Forest 500 score is 34.1%.[18]

Notable deals for HSBC last quarter include their joint lead manager role in the Nestle USD and EUR deals.

Key targets – intermediate banks

Table 4 shows syndication fees for intermediate-sized institutions, as determined by their global DCM activities and trading volumes.[14]

Table 4. The Deforestation Box for intermediate-sized institutions: Source: AFII, Bloomberg, effective date 11 Apr 2024.

Bank	RDCP/Total fees ratio	RDCP fees USDmn	Total fees USDmn
Swedbank	0.0%	0.0	406
Nordea	0.0%	0.0	1,038
DNB ASA	0.0%	0.0	1,396
Jefferies	0.0%	0.0	1,075
SEB	0.0%	0.2	817
Nomura	0.0%	0.5	1,328
Danske bank	0.1%	0.6	938
National Australia Bank	0.1%	0.5	709
Industrial & Comm Bank of China	0.1%	1.8	2,175
Westpac Banking	0.2%	1.3	627
ABN Amro Bank NV	0.3%	0.8	269
Lloyds Bank	0.3%	1.7	546
Intesa Sanpaolo	0.3%	3.5	1,135
Scotiabank	0.4%	9.2	2,158
UniCredit	0.5%	8.3	1,685
Commerzbank	0.5%	5.0	906
BMO Capital Markets	0.6%	13.6	2,334
Natixis	0.7%	10.9	1,638
Commonwealth Bank	0.8%	4.8	611
TD Securities	0.9%	20.9	2,272
ANZ Group Holdings Ltd	1.0%	9.6	943
Truist Securities Inc	1.1%	15.9	1,481
US Bancorp	1.1%	15.4	1,404
NatWest Markets	1.3%	14.7	1,164
Standard Chartered Bank	1.4%	22.7	1,679
ING Groep	1.5%	27.7	1,852
BBVA	1.5%	14.8	965
Banco Santander	1.7%	37.0	2,162
Rabobank	3.0%	15.8	521
Zuercher Kantonalbank	4.8%	13.5	281

[16] "Sustainability risk", HSBC, accessed 11 Apr 2024.
[17] The Forest Stewardship Council (FSC) or national schemes endorsed by the Programme for the Endorsement of Forest Certification (PEFC).
[18] "Company rankings: HSBC", Forest 500, accessed 11 Apr 2024.

Zuercher Kantonalbank has the highest relative share of RDCP fees among intermediate-sized banks, followed by Rabobank. Zuercher Kantonalbank is not assessed by Forest 500, and its fees mainly relate to bonds and loans concerning Nestle, with which it seems to have a relatively exclusive banking relationship.

Rabobank, which has the second-highest relative fee figure, has a Forest 500 score of 54.7% – one of the highest among financial institutions, suggesting its policies are relatively strong. Its position in this quarter's table highlights the challenges ranking the deforestation strategies of financial institutions on a systematic basis. According to a joint report from Greenpeace and Profundo, Rabobank's financing to Brazil-based companies may have direct or indirect links to 387,700 hectares of deforestation.[19] This in turn suggests that banks with superficially strong biodiversity policies can still finance companies connected to severe deforestation. Specifically, in Q1 2024, it was joint lead manager in the Ahold and Tyson Foods issuances identified in Table 2.

Banco Santander (Forest 500 score: 16.5%) is the intermediate-sized bank with the highest absolute fee revenue from facilitating capital market access for companies exposed to deforestation in the RDCP.

In an effort to tackle deforestation in the Amazon, Santander Brazil requires their lumber company clients hold Forest Stewardship Certification. The bank also conducts annual reviews of large companies involved in agribusiness.[20] Furthermore, they signed a protocol that commits them to require beef processing clients with slaughterhouses to end illegal deforestation by December 2025. However, according to Forest 500 Santander has no overarching commitments on deforestation.[21]

Conclusions

Deforestation is a key source of nature loss and biodiversity reduction. There is increasing focus from regulators and investors on this risk, which in turn can drive investment performance. To support fixed income investors, AFII has developed an issuer universe to identify potential sources of deforestation exposure.

In Q1 2024 there was $19bn of bonds issued within this universe. When comparing to overall market activity, we conclude an average level of activity in USD, but a relatively higher level of activity in EUR. This suggests benchmark EUR investors may have increased exposure.

Tracking syndication fees from these transactions also offers an opportunity to identify engagement targets amongst banks. Amongst large institutions, Citi and HSBC receive the highest proportion of their fees from in-scope issuers, and so are key targets.

[19] "€ 0.7 billion in profits, € 66 billion in damages. Rabobank's destructive financing of deforestation in Brazil" Profundo, 5 July 2023.
[20] "Santander and the Brazilian Amazon", accessed 11 Apr 2024.
[21] "Company rankings: Santander", Forest 500, accessed 12 Apr 2024.

This publication is funded by the Gordon and Betty Moore Foundation through The Finance Hub, which was created to advance sustainable finance.

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