

Fall 2021

Latin America Focus

Opportunities and challenges
in post-COVID-19 Latin America



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Cover: Inhotim is home to one of the largest foundations of contemporary art in Brazil and one of the largest outdoor art centers in Latin America.

Pink modern sculpture, Mexico City

Opportunities and challenges in post-COVID-19 Latin America

We are delighted to introduce the first edition of *Latin America Focus*, a publication produced by the Latin America Interest Group at White & Case. Our intent with this publication is to provide market insights from our practices and proprietary research that could be valuable to senior decision-makers who have an interest in the region.

COVID-19 hit Latin America's economies more heavily than it hit any other region around the world. The region's economies contracted by nearly 7 percent in 2020, compared to a global average of only 3 percent. Current projections indicate a healthy recovery through the end of 2021, perhaps by as much as 6.9 percent according to S&P Global,¹ and thereafter steady growth of about 2.5 percent per annum.

As we look forward to 2022 – 2023, Latin America, in very significant part, will likely continue to face the ebbs and flows of populism, resource nationalism and weak institutions that seem to take turns at flooding some of the countries in the region from time to time. Yet, we also see Latin America propelled away from the COVID-19 swamp by the powerful global engines of economic, social and technological evolution that will push heavy foreign investment into the region: unprecedented global liquidity and the search for yields in emerging markets, the energy transition, the commitments to mitigate climate change by global natural resources and energy companies, and the technology-driven push to digitize and automate the increasingly global world economy. We saw these global drivers, and foreign investors' net-net belief that Latin America will resurge in the medium term, supporting our cross-border business in the region through a 2020 – 2021 period that we expected at the outset could be cataclysmic for foreign investment in view of the region's endemic challenges.

In this edition of *Latin America Focus*, partners in our Latin America Interest Group have written articles based on their personal experiences in the trenches and market research that go to the very heart of both the latest sequel in the Latin American saga of transitions, and the current global forces of growth, the interplay of which will likely shape what is to come in post-COVID-19 Latin America.

Times of transition are frequently associated with greater incidences of disputes, notably investor-state disputes, but also commercial disputes, especially in times of supply-chain disruption. In "Latin American arbitration in transition," our team outlines the past and present of commercial arbitration in Latin America, and its prospects for the future.

Latin America has experienced many sovereign debt defaults over the past century. The most recent installment of these usually long-brewing crises played out as COVID-19 partly disabled the region, involving Ecuador, Argentina, Belize and Suriname. Meanwhile, Venezuela continues mired in default for more than three years as of the time of publication. In the article "Sovereign debt restructurings in Latin America: A new chapter," our team explores some of the lessons learned and innovations employed in these recent sovereign debt restructuring exercises, providing insights into the implications for the future of sovereign and sub-sovereign international finance and, more broadly, cross-border restructurings, in the region.



Carlos Viana
Partner, White & Case LLP
Latin America Interest Group
Leader and Editor of *Latin America Focus*



We are delighted to introduce the first edition of *Latin America Focus*, a publication produced by the Latin American team of partners at White & Case. Our intent with this publication is, as a service to our clients, to provide insights that are fascinating and valuable to senior decision-makers across the region, or who have an interest in the region.

Aerial view on the colorful old town of Guanajuato, Mexico

With the COP26 conference being held in Glasgow in November 2021 and concerns about climate change at an all-time high, it is unsurprising that environmental, social and governance (ESG) trends are a recurring sub-theme through several of the articles in this inaugural edition of *Latin America Focus*. In “Sustainable finance in Latin America,” our team focuses directly on green, social and sustainability-linked (GSS) bonds. This article also covers other kinds of sustainable finance, and international environmental agreements in this area to which Latin American countries are signatories.

Our world is being transformed by what the World Economic Forum calls the 4th Industrial Revolution, and Latin America is no exception. Over the next few years, the region is expected to experience faster growth in interconnection bandwidth capacity than any other region in the world. This is especially important for Latin America given the role that connectivity and digital capacity play in driving inclusive economic growth and prosperity. In “Bridging Latin America’s digital divide,” our team takes a detailed look at investments in digital infrastructure across the region. We focus especially on mobile networks (including 5G), data centers and sub-sea cables, exploring also how these investments are being (and might be) funded.

Latin American equity markets proved remarkably resilient to COVID-19, in terms both of growth in their major indexes and in new initial public offerings (IPOs), and other stock and rights issuances. Brazil, in particular, saw a large number of new publicly listed companies emerge in 2020 – 2021. “Equity capital markets in Latin America” provides a current overview of the state of equity capital markets in Latin America, emphasizing key growth opportunities.

Finally, the first half of 2020 saw a sharp contraction in M&A in Latin America, but deal flow has rebounded strongly in 2021. In “M&A in post-COVID-19 Latin America,” our team explores some of the factors that international investors need to take into account when investing in the region’s growing markets in view of the current environment. Data drawn from White & Case’s global M&A Explorer tool is used to show current trends among various cross-sections of deals.

We do hope that you enjoy reading these insights, and find them valuable. Please do not hesitate to let me know if there are any topics that you would like us to cover in future editions.



¹ <https://www.spglobal.com/ratings/en/research/article/s/210624-economic-outlook-latin-america-q3-2021-despite-a-stronger-2021-long-term-growth-obstacles-abound-12013558>.



Latin American arbitration in transition

A disruptive era portends a new wave of disputes using well-established frameworks for commercial and investment arbitration

By Jonathan C. Hamilton, Ank Santens, Viviana Mendez and Estefania San Juan

Latin America faces disruption on a scale not seen in three decades due to the confluence of the global pandemic, the fallout of years of scandals and shifting political perspectives on globalization. While the particular circumstances differ by jurisdiction, arbitration will continue to be the preferred mechanism to resolve resulting disputes. Arbitration institutions and market stakeholders should be prepared for these new changes. Arbitral institutions in Latin America should continue to strengthen their rules and their practices. Market stakeholders who may face arbitrations in the years to come should consider taking steps to avoid or best prepare for these coming disputes, including, for instance: (i) reviewing the dispute resolution clauses in their contracts with commercial actors and state agencies; and (ii) assessing, securing and protecting international investment protections.

Latin America is once again in a state of transition. The disproportionate impact of the global pandemic on Latin American economies, coupled with complex domestic politics and global trends related to globalization, reflects a new and complex turn of the wheel of history in a region historically marked by cycles of nationalization and privatization. This confluence of factors is already triggering new trends in disputes in the region, including commercial and investment disputes. Whereas arbitration was an emergent dispute mechanism at the time of the political and macroeconomic transitions of the 1990s, it is not deeply embedded in the region for the resolution of both private and public sector disputes.

WORLD IN TRANSITION: LATIN AMERICAN PERSPECTIVE

Latin American history was shaped over time by cycles of political and economic regimes that embraced or rejected cross-border investment. Authoritarian regimes rose in the 1970s, and fell in the 1980s. In the 1990s, the end of the Cold War and emergence of the “Washington Consensus” favoring free markets shaped a sea change in the region. Latin American countries overwhelmingly liberalized their economies and embraced globalization in an effort to bolster trade and attract foreign investment. In line with the Washington Consensus, most countries adopted structural adjustment reforms centered on fiscal discipline, tax reform, deregulation of the market, and financial and trade liberalization, among others.¹

This turn of the historical cycle was marked by a critical additional element: arbitration. As a component of sweeping reforms, most countries adopted new domestic arbitration laws and ratified international treaties providing for investment protections and access to arbitration. Critically, sovereigns in the region broadly signed on to arbitration, largely abandoning deeply rooted historical resistance to submission to arbitration. As a result, as disputes emerged, they both were handled in new fora and also had the effect of reinforcing the macroeconomic models of the era.²

Some countries went their own way in the 2000s, prompted by a range of ideological and economic factors.³ Argentina, Venezuela, Bolivia and Ecuador turned against pro-investment policies, and against investment arbitration, signaling a backlash against the Washington



Arbitration is now deeply entrenched in the private and public sectors in Latin America, and will be the key mechanism for international disputes arising out of unfolding transitions in the region.

Consensus.⁴ The result was not merely political; waves of arbitrations centered on those jurisdictions followed. Meanwhile, until more recent years, many countries largely maintained the underpinnings of the Washington Consensus, at least in principle—including for instance the Pacific Alliance countries of Chile, Colombia, Mexico and Peru. But cracks began emerging over time.

Over recent years, a confluence of factors have impacted the relative continuity of the historical cycle in the region that persisted over the past quarter-century and, mostly, through the global recession of more than a decade ago.

First, the assumptions of the post-Cold War era of globalization have been shaken. The Brexit vote in the United Kingdom in 2016 is the most blatant symbol of this shift, but for the Americas, there is another example that marked a turning point in 2016: the demise of the participation of the US in the Trans-Pacific Partnership (TPP). The US was an architect and champion of the Washington Consensus, and developed the TPP



as a broad alliance of like-minded countries. The TPP also constituted the realization of a form of the long-imagined free trade agreement of the Americas, including the NAFTA countries plus Chile and Peru. It promised to consolidate the Washington Consensus at a time when contrarian countries like Ecuador and Venezuela were faltering. Instead, the US exited the TPP, and support for free trade and investment agreements deteriorated significantly in the US.⁵ The replacement of NAFTA with the US-Mexico-Canada agreement reflected the complex mix of continuity and change.

In the context of a broad debate over globalization, Latin American countries were impacted by a series of complex corruption issues that impacted established political order and assumptions.

As a further addition to this complex confluence of factors, the COVID-19 pandemic hit the region hard, exacerbating existing economic and political fault lines. As a region, Latin America experienced the sharpest contraction in gross domestic product (GDP), namely 7 percent, compared to a global average of 3 percent. Peru experienced an especially severe contraction, with GDP shrinking by 11 percent in 2020.⁶

The impact of the pandemic reverberated through Latin American politics, reflecting especially in countries where general elections took place. In April 2021, for example, Peruvian citizens elected a leftist former schoolteacher and union leader, Pedro Castillo,⁷ who spoke against globalization during his campaign. In Colombia, violent protests broke out after the government announced a new tax reform that purported to shrink deficits that grew during 2020. Following sustained blowback, the reform was withdrawn, but protests have continued with expanded demands.⁸ Other countries with traditionally economically open economies, such as Chile, have also begun taking measures that may signal a return to more nationalist economies.⁹ Policies instituted in Brazil under President Jair Bolsonaro and in Mexico under President López Obrador seem to confirm how deeply

nationalist movements are linked to anti-globalization sentiments.

Time will demonstrate whether the disruption of recent years, and the pandemic, is a sign of permanent disruption of core components of the Washington Consensus, or merely a detour. Despite broad political drama, many core tenants of the prescriptions for economic growth in the 1990s, such as a focus on fiscal responsibility, have persisted, and there are mixed political developments. For instance, Ecuador is returning to a model friendlier to foreign direct investment (FDI) under recently elected President Guillermo Lasso, proclaiming that he wants “more Ecuador in the world and more of the world in Ecuador.”¹⁰ In his inaugural presidential speech, Lasso promised to put an end to former President Rafael Correa’s caudillo era, and to restore fair economic trade for the country.¹¹ Two months into his presidency, Lasso enacted a new hydrocarbon policy that had immediate effects.¹² Under the new hydrocarbon policy, Ecuador will once again allow foreign companies to exploit petroleum resources in its oil fields.¹³

These diverse factors impacting policies in Latin America present challenges and opportunities for trade and investment in the region, as countries’ different leaders focus on closing, opening or expanding certain markets. This shifting historical and political context must be assessed carefully with respect to the particulars of any particular deal or dispute, and caution is required in this regard. What is certain is that factors portend future disputes, and have implications for commercial and investment arbitrations.

DISRUPTION AND COMMERCIAL ARBITRATION

Building on historical examples of the use of arbitration in the region,¹⁴ the framework for commercial arbitration across the region was consolidated during and after the 1980s and 1990s.¹⁵ Over the past quarter-century, Latin America has broadly embraced commercial arbitration as an alternative to domestic courts to resolve disputes. Over the past 30 years, commercial arbitration has consequently become far more ubiquitous in



Latin American legal frameworks for commercial arbitration mostly have been solidified, and regional arbitral institutions have emerged as robust leaders for the continued growth of the field as new types of disputes emerge.

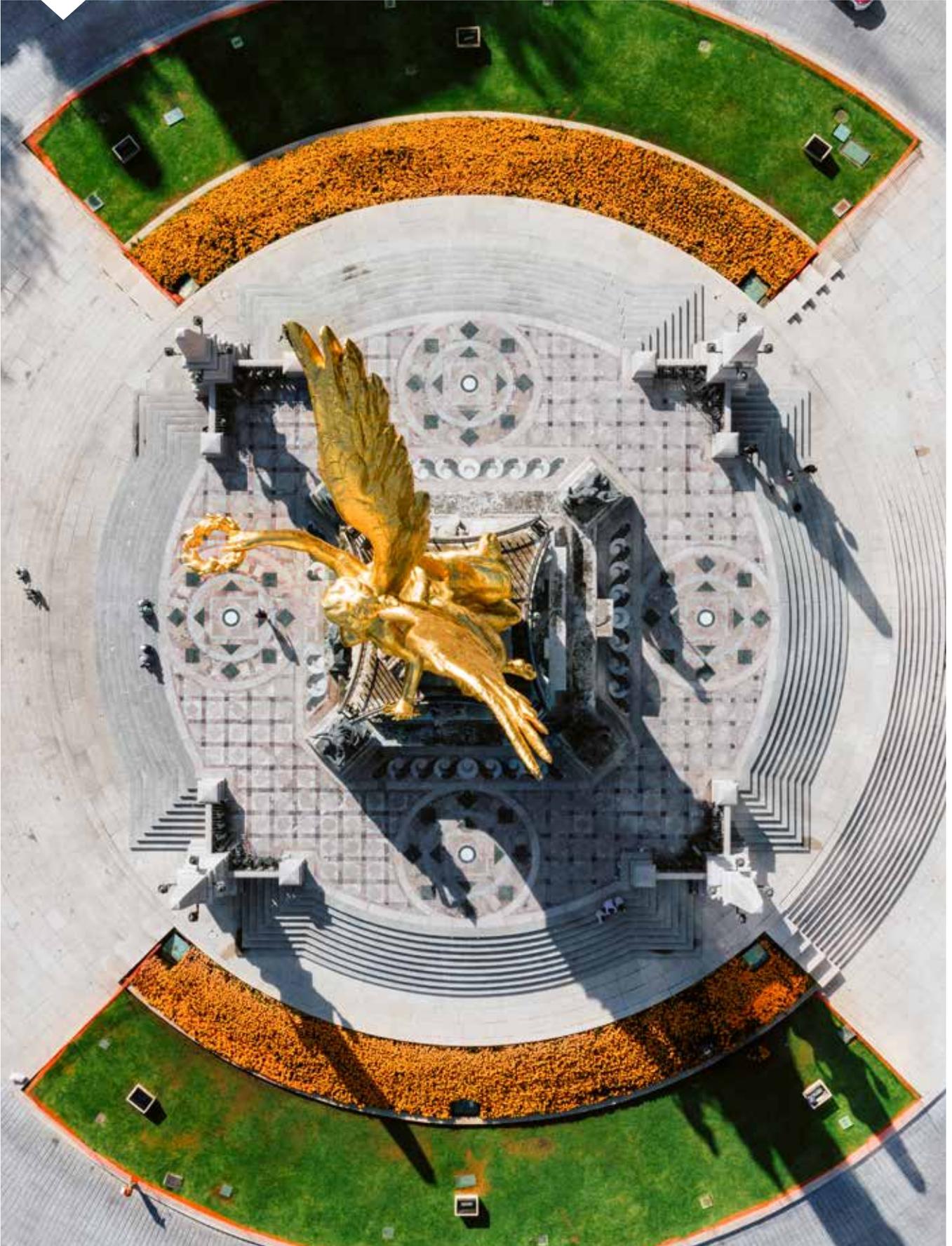
the region’s jurisdictions. Strong arbitral institutions have emerged and grown, and national legal frameworks have been enhanced to support arbitration in the region.¹⁶ In short, arbitration is now deeply entrenched in the private and public sectors in Latin America, and will be the key mechanism for international disputes arising out of unfolding transitions in the region.

The trends described above are likely to increase the range and number of disputes and hence commercial arbitrations stemming from international business transactions involving Latin America.

Latin American arbitral institutions: Continuity and growth in the face of change

Latin American legal frameworks for commercial arbitration mostly have been solidified, and regional arbitral institutions have emerged as robust leaders for the continued growth of the field as new types of disputes emerge. With the support of global arbitral institutions, Latin American jurisdictions began, toward the end of the 20th century, to create legal infrastructure to accommodate commercial arbitrations. As regulatory frameworks, they adopted the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), which provides a regime for the enforcement and recognition of arbitral awards within its 157 contracting states, and the 1975 Inter-American Convention on International Commercial Arbitration (Panama Convention). National laws were also enacted that follow the United Nations

The Angel of Independence with cityscape in background, Mexico City



Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration.

In 2011, the Institute for Transnational Arbitration (ITA), with White & Case LLP, undertook an unprecedented survey, to better understand the landscape of arbitration in Latin America. It focused on legal frameworks and institutions in the region. This survey discovered that regulatory and policy shifts toward globalization and free trade in the 1990s in Latin America¹⁷ were accompanied by an increase in arbitral institutions.¹⁸ More than half of Latin America's arbitral institutions were established between 1997 and 2002.¹⁹

While most of these arbitral institutions resolve disputes between local parties, a significant and increasing number settle disputes involving foreign parties.²⁰ In some, such as the International Center for Conciliation and Arbitration in Costa Rica and the Arbitration Center of the Peruvian American Chamber of Commerce Peru, cases involving foreign parties now make up a significant percentage of their caseload. In the same vein, while the majority of cases involve private parties, the percentage of public parties represented is growing steadily.²¹

As disputes become more complex, they also tend to involve multiple parties. While most disputes in Latin America still involve only two parties, this is changing. Again, Brazil's Market Arbitration Chamber leads the region, with 80 percent of its caseload involving more than two parties.²² Overall, the trends uncovered in the ITA's study indicate that the rest of Latin America will soon see more complex disputes, as the nature of arbitration in the region becomes more multifaceted. Overall, the data in the inaugural study confirmed that Latin American arbitral institutions were becoming increasingly sophisticated and reliable.²³

Latin American "seats" of arbitration

As in the rest of the world, in Latin America international arbitration is the preferred method to resolve cross-border disputes.²⁴ In recent years, Latin American countries have worked to modernize their

legal frameworks to accommodate international arbitration and the arbitration of cross-border disputes.

The "seat of the arbitration" is critical to maximizing the efficacy of arbitration and avoiding the risk of jurisdictions with newer laws or less reliable enforcement. A party may be limited to seek to set aside an arbitration award at the domestic courts of the seat of arbitration. Accordingly, the law and practice governing how the courts of the seat handle set-aside proceedings is critical. In addition, the choice of the seat may affect other important considerations, such as confidentiality, the degree of judicial intervention in an arbitration proceeding, and whether an arbitral tribunal may issue or enforce interim measures.²⁵ Choosing an appropriate seat of arbitration is therefore critical.

The most recent White & Case and Queen Mary University Survey confirmed that the preferred seats to arbitrate Latin American disputes in 2021 were Paris, New York, São Paulo, Singapore and Geneva.²⁶ The Survey also showed that other seats were growing in reputation and popularity. For example, 2 percent to 4 percent of respondents named other cities in terms of arbitral seat appointments, including Washington, DC and Miami.²⁷ Among those surveyed in Latin America, Paris (64 percent), New York (54 percent), and São Paulo (21 percent) were ranked as the three preferred seats. Miami (15 percent), Lima (6 percent) and Madrid (5 percent) were also among the eight preferred seats.

These Survey results show the continued trend of Miami as a preferred seat for Latin American arbitration.²⁸ This can be attributed to the efforts of the local legal community to develop both the legal and institutional infrastructure to support the locale as a seat. For instance, in 2010, Florida implemented the Florida International Commercial Arbitration Act, a state law based on the UNCITRAL Model Law.²⁹ Further, in 2013, the state created the International Commercial Arbitration Court, within the civil division of state courts—one of the few specialized courts in international arbitration in the US. The Florida Bar has also supported these



Investment protections and arbitration remain critical to doing business across borders, and the rise of environmental, social and governance (ESG) issues portends future battlegrounds for investment disputes.

developments, allowing foreign lawyers to practice arbitration hearings without being members of the Florida Bar.³⁰

Disruption provokes a new wave of arbitrations in Latin America, particularly in targeted sectors

In recent years, Latin American countries have attracted the interest of foreign companies that have begun developing very significant construction projects in the region. For example, Spanish construction companies are involved in the construction of new airports, highways, ports and railways throughout the continent including in Colombia, Peru, Chile, Mexico and Panama.³¹ China's involvement in the infrastructure development in Latin America is also prominent, with the country investing a total of US\$86 billion in 59 construction projects in 2019.³²

While foreign construction projects are advancing full steam ahead, Latin American regulations of construction projects have lagged. Unsurprisingly, construction and commercial disputes are on the rise. In 2021, a Spanish newspaper article reported that more than €4 billion is at stake in commercial arbitrations in the region, arising between Spanish construction companies and Latin American entities.³³

Investment protections and arbitration remain critical to doing business across borders, and the rise of environmental, social and governance (ESG) issues portends future battlegrounds for investment disputes. ESG reporting and regulatory requirements are evolving rapidly and frequently differ

significantly across jurisdictions and industries. This can lead to the disruption of existing commercial contracts, in turn giving rise to disputes. For example, the International Maritime Organization (IMO) (the specialized unit of the United Nations responsible for global shipping regulation) agreed at its last meeting in June 2021 to re-open discussions on putting a price on shipping companies' emissions.³⁴ At least in its most ambitious forms, this proposal could radically overhaul the way in which ships operate.³⁵ It is foreseeable that disputes will arise to determine who should shoulder the cost of innovation, policy implementation or even liability for non-compliance—for instance among shippers, fuel providers and other actors in the supply chain.

This is just one example of a raft of ESG policies with which organizations are expected to comply. This trend will draw further attention following the United Nations 2021 Climate Change Conference (COP26) in Glasgow in November.

DISRUPTION AND INVESTMENT ARBITRATION

Investor-state dispute settlement (ISDS) is a system to resolve disputes between foreign investors

and host states. Consent to investment arbitration is given by the host state in an international investment agreement (IIA), which takes shape as a bilateral investment treaty (BIT) with another state, a free trade agreement (FTA), or a multilateral agreement such as the Energy Charter Treaty (ECT). Consent to investment arbitration may also be found in investment agreements concluded directly between the host state and the investor. International investment arbitration allows a foreign investor to seek redress for state conduct that has harmed it before a neutral forum, thereby bypassing national courts that might be biased toward their respective states and result in significant delays.³⁶

While the substantive protections in each IIA may differ, the most common protections afforded to foreign investors are:

- Protections of investments from expropriation
- Fair and equitable treatment (FET)
- National treatment, which ensures that foreign investors/investments will be treated no less favorably than their domestic counterparts

- Most favored nation (MFN), which ensures that all foreign investors are treated equally

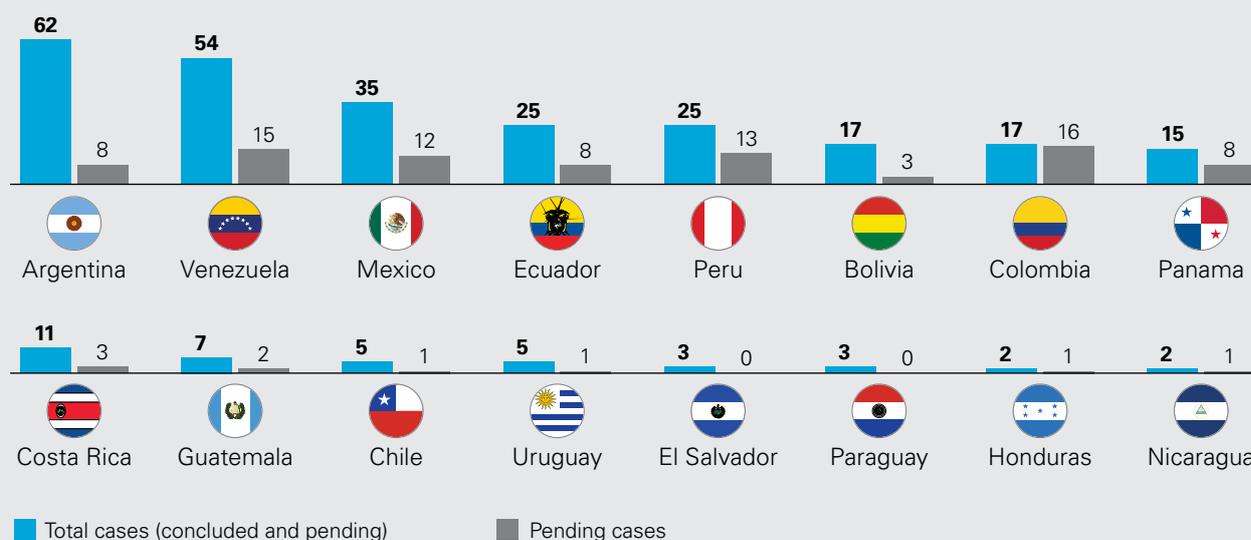
- The freedom to transfer funds

- Full protection and security of the investment

An investor can take advantage of treaty protections in various ways, for instance by structuring the investment in a manner that provides the best coverage. In many cases, company incorporation in a state that is party to an IIA suffices to establish corporate nationality that attracts the desired treaty protection.³⁷

Latin American countries are parties to hundreds of IIAs, which provide for investor-state dispute settlement proceedings, often at the International Centre for the Settlement of Investment Disputes (ICSID) established under the auspices of the World Bank in Washington, DC. Given the continent's history of changing political economies, it is unsurprising that Latin American countries have been among the states that have faced the most claims at ICSID since it began operating in the 1980s. A 2017 report prepared by the Transnational Institute indicates, for example, that by 2017, 28 percent

Table 1: Latin American investment arbitration cases



Source: UNCTAD, *Investment Dispute Settlement Navigator*, 2021, available at: <https://investmentpolicy.unctad.org/investment-dispute-settlement> (Includes ICSID and Non-ICSID cases, does not include Caribbean states)

Aerial view of traffic circle
in Ciudad de Mexico



of respondents in ICSID cases were from Latin America.³⁹ It further notes that the states facing the most claims in the region include Argentina, Venezuela, Mexico, Bolivia, Peru and Ecuador; and that in fact, taken together, “the number of claims against these countries accounts for 77.3 percent of the total number of claims against [Latin American] countries.”³⁹ In the past ten years, four of the 13 most frequent respondent states are Latin American.⁴⁰

Disruptions in Latin America have not meaningfully undermined access to investor-state arbitration, and they will likely generate more investment disputes in Latin America, as described below.

Access to international investment arbitration appears to be here to stay

During the 1990s, Latin American states entered into an array of IIAs as part of their policies of economic liberalization and deregulation.

When several of these countries traded open-market economies for nationalist ones in the 2000s, countries like Argentina, Ecuador and Bolivia threatened to terminate IIAs. This caused some at the time to cast doubt on the future of investment treaties and investment arbitration in Latin America.

Bolivia, Ecuador and Venezuela did eventually terminate their investment treaties and withdrew from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) in 2007, 2010 and 2012 respectively. Investment arbitration however, and international investment agreements in Latin America, have persistently stood the test of time.⁴¹ Latin American countries continued signing new investment arbitration agreements, even recently. Even those countries that favor anti-globalization participate in investment arbitration proceedings and generally comply with arbitral awards.⁴² Furthermore,

given the presence of “survival clauses” or “sunset clauses” in the investment treaties of Ecuador, Bolivia and Venezuela, those countries continued facing investment-arbitration proceedings for years after they terminated certain agreements. (Survival clauses allow the BIT to continue to have a legal effect even after the BIT itself has been terminated, usually ranging from ten to 20 years.)⁴³

At the same time, the moves years ago by a trio of countries did not lead to a trend of disruption of access to investment arbitration. Indeed, Mexico itself became a party to the ICSID Convention in 2018 in the context of re-negotiations of the North America Free Trade Agreement (NAFTA)⁴⁴ (whereas Mexico disputes previously were conducted under the ICSID Additional Facility Rules).⁴⁵ Similarly, in 2021 Mexico conditioned any economic deal with Ecuador to that country’s

joining of the ICSID.⁴⁶ For its part, Ecuador, which for the past decade embraced a state-centric model and denounced the ICSID Convention, recently re-joined the instrument, by signing the ICSID Convention in June of 2021. In summary, continuity of access to investment arbitration is likely.

Disruption provokes disputes and opportunities for investment arbitration

Given that Latin America's economies are not homogeneous, it is difficult to predict how current socio-political and economic trends are likely to influence challenges and opportunities to investment arbitration in the region. Some patterns can be identified, though, that might characterize the years to come.

Expropriation of private assets and nationalization of private industries is a recurring element of Latin American disputes over history, including with respect to states that effectively rejected globalization in the early 2000s.⁴⁷ Some states, such as Bolivia, Ecuador and Venezuela, nationalized foreign investments, particularly in the oil & gas sector. In other countries and sectors, state conduct to the detriment of foreign investors has been more subtle and incremental. For instance, governments might promulgate measures purporting to protect the environment or some other public policy objective that, in effect, harm or discriminate against foreign investors.

With the return of many Latin American countries to nationalist economies and populist policies, threats to foreign investor assets loom on the horizon. While any particular country, or case, requires careful and particularized analysis, some trend lines are evident.

– **Chile:** In May 2021, Chileans voted for a reform to end neoliberalism, which has been cited as the “left’s biggest victory” since the end of Augusto Pinochet’s dictatorship in 1973.⁴⁸ Left-leaning parties won the elections on May 15 and 16, 2021 for local and regional offices, and won majority representation in the assembly that will draft Chile’s new constitution.⁴⁹ Such

developments are possible signals of future state measures that impact foreign investment.⁵⁰

– **Colombia:** Concerns over high unemployment, inequality and lack of police accountability prompted protests in 2021. Observers cite growing political polarization ahead of presidential elections scheduled in 2022. Some commentators note that Gustavo Petro is the “clearest candidate on the left without serious competitors on that side of the spectrum.”⁵¹ Disruption of the Colombian macroeconomic model is in the range of possibilities.⁵²

– **Argentina:** The cyclical nature of Latin America’s political economies has played out starkly in Argentina. Current president Alberto Fernández previously served as Chief of Staff to both President Néstor Kirchner and his wife who succeeded him, President Cristina Fernández de Kirchner, and their populist left-wing brand of “Kirchnerism.” When President Mauricio Macri succeeded Fernández de Kirchner as president and brought in a center-right government, Fernández and Fernández de Kirchner teamed up in 2019, with Fernández re-taking the presidency with the goal of returning a leftist agenda to office.⁵³ In June 2020, President Fernández took a page from Vice-President Fernández de Kirchner’s playbook when he expropriated crop trader Vicentin SAIC.⁵⁴ The move provoked concerns of investors in the market, as Fernández had previously voiced his support for an increase of foreign direct investment in the country.⁵⁵

– **Peru:** After relative continuity of, at least, macro-level support for pro-investment policies over many years, Peru has become a more complex jurisdiction and market. President Pedro Castillo suggested during his campaign that he would nationalize Peru’s mines and concessions, and consider withdrawing from the World Bank arbitration system. The early days of his government have not definitively resolved these risk factors.⁵⁶

Mexico:

By Rafael Llano, Ismael Reyes Retana and Francisco de Rosenzweig

President López Obrador’s government has taken steps that have impacted investment in key sectors of the economy. Among other examples, the National Center for Energy Control and the Mexican Energy Secretariat have cancelled bids and introduced changes to the regulations governing the issuance of Clean Energy Certificates. On March 9, 2021, Mexico published an amendment to the Electric Power Industry Law (*Ley de la Industria Eléctrica*), which seeks to benefit the Federal Commission of Electricity and the power generation plants owned by its subsidiaries, displacing clean and renewable energy plants, as well as more efficient and privately owned thermal power plants. President López Obrador has appeared to justify his views on the pretext that the energy private sector has “failed” Mexico.

More recent developments go further. On September 30, 2021, President López Obrador sent to Congress a bill to amend the Constitution with respect to the electricity sector (the “Initiative”). The Initiative proposes to dismantle the current legal framework and give full control of the national electricity sector to the state. In particular, the Initiative provides that, among other things: (i) the state, through the Federal Electricity Commission (CFE), will exclusively carry out all activities in the electricity industry, including dispatch procedures; (ii) existing power generation permits, power purchase agreements (PPAs), and energy certificates be cancelled; (iii) pending requests related to permits and contracts be rejected; and (iv) limitations capping private sector power plants’ dispatch to up to 46 percent of the power that the country requires. The Initiative also includes changes to the hydrocarbons and mining sectors, particularly with respect to the regulation of “strategic” minerals, such as lithium. The political fate of the Initiative is uncertain. The country is currently facing 12 investment-arbitration cases, some related to alleged government takings.

These developments are likely to lead to more investment disputes involving respondent states, such as Chile, Colombia and Peru, that faced comparatively fewer cases in the past than countries like Argentina and Venezuela.⁵⁷

This trend is already playing out. Indeed, as of January 2021, Peru rose to the top of the list of Latin American countries with the most pending ICSID cases, and there were 17 investor-state cases pending against Colombia.⁵⁸

The coronavirus pandemic may leave a footprint in the ISDS setting

Finally, as the coronavirus pandemic has adversely affected Latin American economies, governments are looking for ways to recover their economies, at times by taking steps that will impact the private sector and investment. It is plausible that a fresh wave of investor-state arbitration cases against Latin American sovereigns will arise in response to these measures. Although it may be too early to conclude whether or to what extent pandemic-related claims will emerge in the coming years, the measures taken by certain Latin American countries in response to the pandemic may be in breach of investment-treaty protections and guarantees.

Indeed, already one state—Chile—is facing arbitration before the ICSID for claims related to the pandemic. On August 13, 2021, the ICSID registered a claim initiated by a French consortium against Chile claiming US\$37 million in losses due to the COVID-19 pandemic.⁵⁹ According to the French investors, the consortium saw profits fall by 90 percent in 2020, as Chile lost 19 routes and 630 weekly frequencies since the pandemic broke out.⁶⁰ In June 2020, a road concessionaire notified Peru of a potential claim related to certain emergency measures taken during the pandemic affecting toll roads.⁶¹

On balance, disruption in Latin America is likely to provoke new disputes, while maintaining the robust commercial and investment arbitration frameworks that did not exist decades ago, but are now firmly established in the region.

- 1 Prateek Agarwal, *Washington Consensus*, *Intelligent Economist*, April 30, 2018, available at: <https://www.intelligenteconomist.com/washington-consensus/>.
- 2 Hamilton, Jonathan C., et al., "Latin American Arbitration and Investment Protection," in *Latin American Investment Protections: Comparative Perspectives on Laws, Treaties, and Disputes for Investors, States, and Counsel* (Jonathan C. Hamilton, et al., eds.) (Brill, 2012).
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Sovereign debt restructurings in Latin America: A new chapter

Sovereign debt restructuring solutions developed in Latin America during 2020 and 2021 create a new paradigm for sovereign debt restructurings in the region and globally

By Ian Clark, Thomas MacWright, Brian Pfeiffer, Dimitrios Lyratzakis and Amanda Parra Criste

Over the past 50 years, the Latin American and Caribbean region has experienced at least 50 sovereign debt crises and sovereign debt restructurings (see figure 1).¹ Domestic macroeconomic mismanagement, currency crises and commodity price shocks are just some of the drivers that have led countries into distress, rendering governments unable to repay their foreign creditors according to the original terms of the underlying debt contracts. In response, sovereign borrowers have engaged in multiple and complex sovereign debt restructuring transactions—with varying degrees of success.

During 2020 and 2021, the region faced yet another shock as a result of the COVID-19 pandemic, which for some countries created new liquidity constraints, while for others exacerbated existing macroeconomic imbalances and fiscal pressures. As a result, several Latin American and Caribbean countries and Argentine provinces sought to comprehensively restructure their external debt: Among others, Argentina restructured approximately US\$65 billion of external debt owed to private creditors, Ecuador restructured US\$17.4 billion of external private debt, more than ten Argentine provinces collectively restructured in excess of US\$10 billion of external private debt, including the Province of Buenos Aires (PBA), which restructured US\$7.1 billion of its external private debt, while Suriname is in the process of restructuring US\$675 million of external private debt (and a total of US\$1.4 billion of external debt).

In the absence of a sovereign bankruptcy regime, the resolution

of debt crises is ultimately a matter of ad hoc negotiation between a sovereign and its creditors. In this article, we provide an overview of the resolution of sovereign debt crises in Latin America in the COVID-19 era. In particular, we discuss (1) the evolution of debt and creditor compositions and the corresponding restructuring challenges, (2) the role of the International Monetary Fund (IMF) in the restructuring process and in the provision of financing, and (3) the adopted restructuring mechanisms that have provided substantial debt relief to several sovereign and sub-sovereign debtors.

By drawing comparisons to pre-COVID-19 debt crisis resolutions in the region, we conclude that the solutions found during 2020 and 2021 create a new paradigm for sovereign debt restructurings in the region and globally, where good-faith negotiations between sovereign debtors and organized creditor groups, together with targeted use of contractual mechanisms to reduce holdout risks, can lead to orderly restructuring transactions that provide debtors substantial debt relief, preserve value for investors, and minimize the risk of chronic and acrimonious litigation.

THE LANDSCAPE OF SOVEREIGN DEBT: DEBT AND CREDITOR COMPOSITION AND RESTRUCTURING CHALLENGES

Historical evolution

The landscape of sovereign borrowing has evolved considerably over the past 40 years. Before the 1970s, many Latin American countries borrowed proportionately more from multilateral lenders, including the IMF, the World Bank



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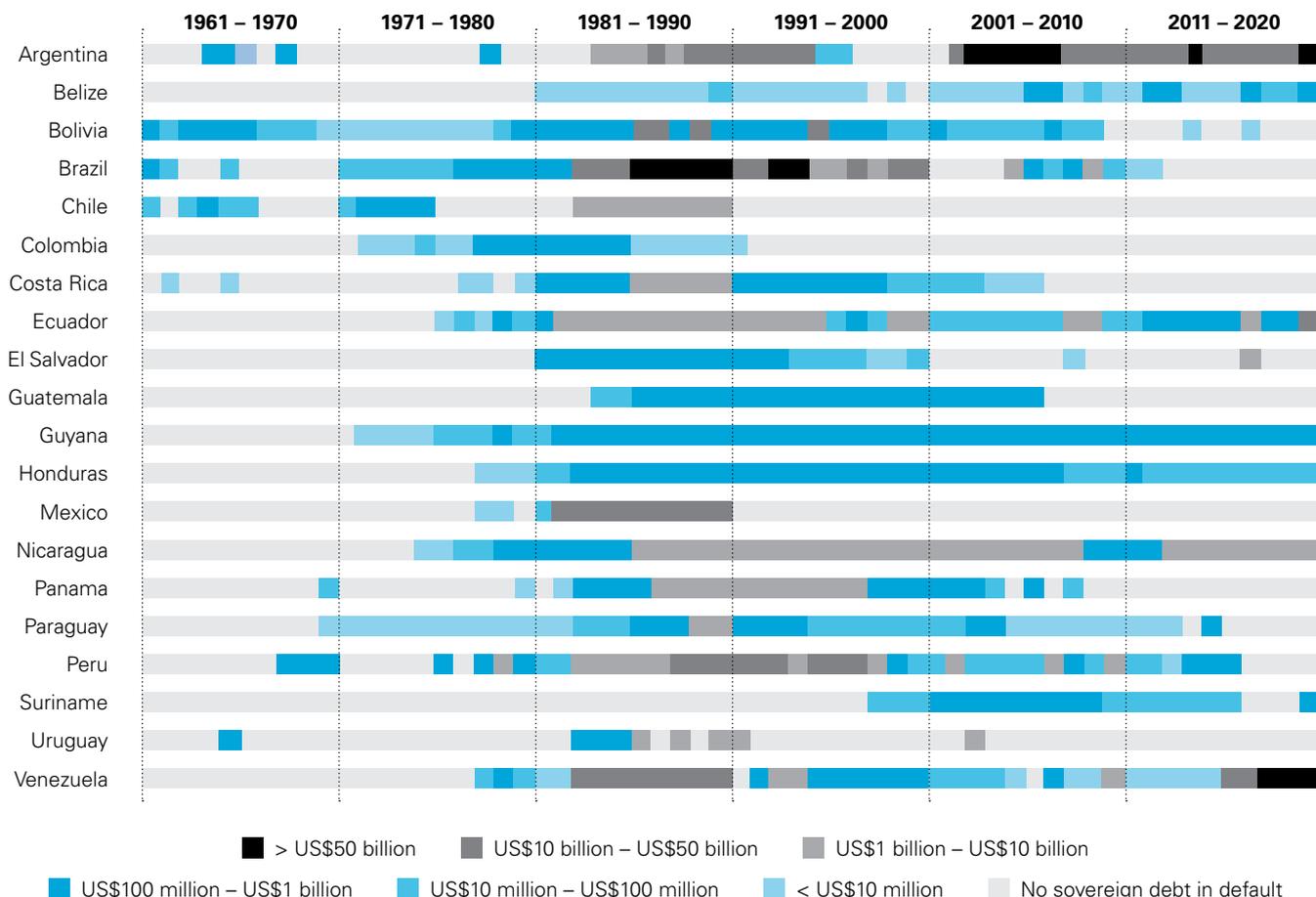
and the Inter-American Development Bank, and “official” lenders, including the US and other developed economies. The source of credit fundamentally shifted in the 1970s, however, when, as a result of oil price shocks, Organization of Petroleum Producing Countries (OPEC) countries experienced sudden massive trade surpluses and deposited oil earnings and receipts in commercial banks. The banks, in turn, extended relatively cheap credit to Latin American countries to finance their fiscal and current account deficits, amounting in many cases to more than two-thirds of external financing.

The debt and creditor composition again changed drastically during the Brady bond restructuring era in the late 1980s. Increased debt levels following the borrowing splurge of the 1970s and early 1980s made many countries in the region highly vulnerable to refinancing and interest rate risk. Rising interest rates in the US soon led borrowers such as Mexico, Brazil, Venezuela and Argentina to conclude that their debt burdens had become unsustainable. After a “lost decade” of economic stagnation, and superficial and



Figure 1: Latin America has experienced more than 50 sovereign debt defaults in the past half-century.

Historical sovereign debt defaults in Latin America (US\$)



Source: Bank of Canada + Bank of England Sovereign Default Database, 2021 update¹

inadequate debt re-profiling efforts, Latin American countries embraced the Brady initiative, persuading their commercial bank lenders to exchange their non-performing loans into tradable instruments that were issued with a principal haircut but were backed by US treasury notes as collateral. This allowed banks to free up capital by substituting non-performing assets on their balance sheets with collateralized, performing obligations of the same debtor. The large-scale Brady bond restructurings of the 1980s and 1990s led to the widespread replacement of syndicated loans by tradable bonds as the primary source of sovereign borrowing and financing in Latin America. From that point onward, the domestic and international bond markets became the principal source of finance for Latin American sovereign issuers.

Private creditor composition

As the source of credit shifted, the composition of sovereign creditors changed as well. Bank lenders, often with decades of on-the-ground experience and a profound understanding of local political and economic trends, were replaced by anonymous and dispersed holders of interests in global bonds lodged in the international clearing systems.

From the sovereign’s perspective, a dispersed and heterogenous private creditor base makes a potential debt restructuring operation particularly complicated: Not only is it hard to locate and negotiate with creditors, but a sovereign also has to negotiate with creditors that have different business models and economic preferences, and therefore, respond to different incentives. Specialist distressed debt investors behave differently than “real money” institutional investors, retail

investors behave differently than local banks, and so on. In the absence of a sovereign debt restructuring regime, or sufficiently robust contractual mechanisms embedded in the terms of the debt instruments, this landscape creates opportunities for holdout behavior that can debilitate a restructuring process, as illustrated by the Argentine restructuring saga between 2001 and 2014 discussed further below.

Lack of creditor coordination can create risks from the creditor perspective as well: A dispersed and uncoordinated creditor base may tempt a sovereign to launch a unilateral, non-negotiated transaction or play creditors against one another in an effort to extract outsized value from the creditor claims. Take, for example, Ecuador’s debt buyback in 2008: Ecuador publicly defaulted on two series of bonds,

Total debt in default by country in 2020 (US\$)



Source: Bank of England Sovereign Debt Default Database

depressing their prices, and then proceeded to buy them back in a Dutch auction using financial intermediaries. Lack of creditor coordination arguably contributed to the success of this effort, as creditors were not able to set forth a unified response to the default.

Creditor committees

The establishment of representative creditor (particularly bondholder) committees provides an answer to the creditor coordination problem. Creditor committees facilitate information flow between the debtor and the creditors, reduce information asymmetry and facilitate constructive dialogue between the parties. Indeed, a key characteristic of the Latin America debt restructurings in the COVID-19 era has been the presence of well-organized creditor committees.

In each of the COVID-19-era restructuring cases, the composition of the creditor committee has been critical. In every case, committees have been composed of either large institutional investors who had purchased debt in the primary market, or hedge funds that had been long-term active investors in the secondary market. Such committees have been widely perceived to represent the interests of the broad class of bondholders, giving credibility to the negotiating process and facilitating relatively quick resolutions.

In the case of Argentina, Ecuador, Suriname and several Argentine provinces in 2020/2021, bondholder committees have proven successful in reaching consensual restructuring deals with the debtor that provide needed debt relief while preserving bondholder value. In the case of Ecuador and Suriname, creditor



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committees first negotiated temporary deferral of payment obligations to provide breathing space until a longer-term debt restructuring solution could be found. Ultimately, Ecuador reached a comprehensive restructuring agreement with its bondholder committee in September 2020, while Suriname remains in debt restructuring talks with its bondholder committee.

Equally notable, creditor committees have been effective in rejecting lowball and unilateral “take-it-or-leave-it” offers designed to extract maximum debt relief from external creditors, as in the case of Argentina in 2020 and the Province of Buenos Aires in 2020 – 2021. Argentina launched an exchange offer in early 2020 with subsequent unilateral amendments that were all quickly and publicly rejected by Argentina’s largest bondholder groups. Such public rejection continued until successive counteroffers led to a mutually acceptable deal. At that stage, the public endorsement of the deal by the largest bondholder groups led to overwhelming support for the deal.

Beyond private credit: The evolving complexity of the debt stock

In addition to private commercial debt, either in the form of bank loans or bonded debt, and to traditional official and multilateral loans, the external liabilities of many Latin American countries today include exposures to repurchase obligations, supplier credits, secured debts, guaranteed debt of state-owned enterprises and, on many occasions, court judgments or arbitral awards. If such other categories of debts are denominated in foreign currency or governed by foreign law, then they often need to be taken into account when assessing the sustainability of the sovereign’s debt stock. Having a highly heterogenous debt stock creates additional challenges for sovereign debtors in a restructuring scenario, as creditors holding different categories of claims often have differing expectations as to the relative seniority or priority that should be accorded such claims. Nowhere is this complexity more evident than in the ongoing case of Venezuela’s debt restructuring, where the perimeter of an external debt restructuring, if and

when that becomes politically feasible, may include debt of the sovereign, debt of the state-owned oil company PDVSA, various promissory notes, arbitral awards and other liabilities.

THE ROLE OF THE IMF

IMF has played a central role in sovereign debt restructurings in Latin America and globally. Often seen as the lender of last resort, member countries approach the IMF when faced with significant balance-of-payment problems. Under the IMF’s Articles of Association, the IMF may only provide its general resources to assist in the resolution of balance-of-payment problems if there are “adequate safeguards” for the IMF resources. This requires that the IMF concludes the debt of the sovereign is sustainable and that it be satisfied with the policy adjustments being undertaken by the debtor country to overcome the problems that led it to seek financial aid (such required policy adjustments are known as conditionality). If, following a debt sustainability analysis, the IMF determines that a country’s debt is not sustainable, it is precluded from lending (including emergency financing) unless the member country takes steps to restore sustainability, which often requires seeking debt relief from its creditors. IMF lending has a tumultuous history in Latin America as a result of strict conditionality and austerity programs that were seen as impediments to growth and development, prohibited popular social spending programs, and thus became politically toxic.

Since the outset of the COVID-19 pandemic, the IMF has become more flexible in extending concessional financing: Notably, the IMF doubled the access to its emergency facilities—the Rapid Credit Facility and the Rapid Financing Instrument (RFI)—to accommodate increased demand for emergency financing. Borrowing from these facilities does not require the adoption of a full-fledged program or strict conditionality, unlike when the IMF extends balance-of-payment support (although it does require an assessment of debt sustainability as discussed above). By the end of 2020, more than 60 percent of the IMF emergency financing went to Latin America and the Caribbean, the regions hit hardest by the crisis. Bolivia, Costa Rica, Dominican

60%

By the end of 2020, more than 60 percent of the IMF emergency financing went to Latin America and the Caribbean, the regions hit hardest by the COVID-19 crisis

Republic, El Salvador, Grenada and Ecuador are some of the countries that received RFI financing.

By contrast, few countries in Latin America qualified for the IMF’s Flexible Credit Line (FCL). The FCL provides flexibility to draw on the credit line at any time during the period of the arrangement (one or two years). This large, upfront access to IMF resources with no conditionality has only been granted to countries with very strong macroeconomic records, such as Colombia, Chile and Peru.

While sovereigns in Latin America have historically been reluctant to request financial support from the IMF as part of a fully fledged program, such programs are not only welcomed by creditors, but sometimes required as a pre-condition to a debt restructuring. The reasoning is simple: The conditionality of an IMF program ensures a certain degree of macroeconomic and fiscal discipline, and the adoption of a credible policy framework for the country’s return to debt sustainability.

This was clearly the case in Ecuador’s 2020 restructuring, where bondholders conditioned the consummation of the restructuring transaction and the provision of debt relief on the adoption of an IMF program by a certain date. Argentine bondholders did not require a similar condition in connection with the consummation of that country’s 2020 debt restructuring, in part because the IMF was a recent and large creditor, which presented additional complications. However the subsequent (and unanticipated) fall in Argentine bond prices, which many market participants attributed to the absence of an IMF-supported adjustment program and policy framework, may be seen as a cautionary tale by investors in future regional restructurings.

RESTRUCTURING TOOLS

Pre-COVID-19 era

In the absence of an internationally recognized bankruptcy regime for sovereigns, a distressed sovereign debtor can only restructure its debts through negotiation with its creditors—requiring good faith and realism on both sides. With the prevalence of bonded debt across Latin America following the Brady bond restructurings of the 1980s

Colombian peso bills of different values close up



and 1990s, the risk of strategic holdout behavior from anonymous bondholders increased substantially. No longer were sovereigns able to work out the terms of their debt restructuring within the relatively predictable and reliable framework of the “London Club” of major commercial bank creditors, where they could have a high degree of confidence that the negotiated terms would be widely accepted within the international financial community. Instead, sovereign debtors faced the risk of disruption posed by individual bondholders seeking to capitalize on the sacrifices made by other creditors. The source of this problem lies in the terms of sovereign bond contracts themselves, specifically in the requirement (virtually universal prior to 2003) that changes to bond payment terms must attract unanimous creditor support. In other words, there was no contractual mechanism for a supermajority of bond investors who favored a debt restructuring proposal to bind a minority of holdout investors to the terms of the restructuring.

In the absence of an alternative, sovereigns conducted debt restructurings by way of voluntary

exchange offers, inviting creditors to exchange their existing bonds for new bonds with reduced payment terms that included lower principal, lower coupons, an extension of maturities, or all three. A use of specific incentives and disincentives would accompany each offer to maximize participation and minimize holdout risk.

Ecuador in 2000, for example, was the first sovereign to use an “exit consent” technique to restructure its debt. While New York law-governed bonds required unanimity to amend payment terms, they only required a simple majority to amend various non-payment terms of each bond series. Ecuador, therefore, invited bondholders to exchange their bonds and, in the process, amend various terms of their existing bonds to make them less attractive to holdout creditors. The proposed modified terms removed the cross-default clause, the negative pledge clause and the requirement to list the bonds on the Luxembourg Stock Exchange.

In 2003, Uruguay also utilized an exit consent technique to restructure its New York law-governed bonds, albeit narrower than Ecuador’s. There the proposed modification—

which narrowed the sovereign immunity waiver—was intended to limit the ability of holdouts to attach payments made by the sovereign to service the new bonds offered on the exchange. The exit consent was supplemented by an explicit threat that Uruguay would prefer the servicing of exchanged debt over non-exchanged debt.

While the use of exit consents and other restructuring mechanisms worked well in these early cases of Ecuador and Uruguay, leading to bondholder participation in excess of 90 percent, the shortcomings of these techniques in remedying the collective action problem were revealed in Argentina’s 2001 – 2014 restructuring saga. At that time, Argentina’s outstanding bonds did not include collective action clauses that would allow payment terms to be amended with supermajority support, and because creditors had allegedly amassed more than 50 percent in some individual series, a comprehensive exit consent strategy was not an option. Argentina’s strategy relied on the use of “value recovery instruments” (in particular GDP-linked warrants that would

Aerial view of Puerto Madero, Buenos Aires, Argentina

provide creditors who participated in the restructuring additional value to compensate for their losses if Argentina's GDP exceeded certain targets)—and the explicit threat of non-payment of non-exchanged debt. The threat of non-payment was carried through via the introduction of the Lock Law in 2005, which made it illegal, as a matter of Argentine law, for the sovereign to service defaulted debt or settle with holdout creditors. Notwithstanding those elements, Argentina's exchange offer was only accepted by approximately 75 percent of its creditors. Holdout creditors sought to enforce their claims in court and arbitral tribunals for years, some for nearly a decade, before Argentina was forced to settle them. During this time, Argentina was shut off from the international capital markets. International arbitration under investment treaties in particular was used to facilitate the initial settlement agreement with the government of President Mauricio Macri that proved to be the beginning of the end of the Argentine debt saga, although the use of arbitration in the sovereign debt restructuring context is highly dependent on particular facts and treaties, and has been marked by significant debate.

COVID-19-era resolutions

Prompted by the difficulties in restructuring Argentina's debt, the international community decided that the collective-action problem would be best remedied by re-drafting New York law-governed debt contracts to allow a bondholder supermajority to bind a minority to the terms of a debt restructuring. Collective action clauses (CACs) did just that and were included widely in New York law-governed bonds following Mexico's debt issuance in 2003. Following the approach that had been accepted in English law-governed bonds for many years, Mexico-style CACs permitted a qualified bondholder supermajority, usually 75 percent per bond series (the "series-by-series" CAC), that approved modifications to the payment terms of the bonds to bind a dissenting minority into the modifications. That design, however, was not immune from the risk of creditors amassing over a quarter of a series in order to pursue a holdout strategy.



The design of CACs evolved over time in response to the evolving strategies and increased financial resources of potential holdout creditors. The CACs drafted and endorsed by the International Capital Markets Association (ICMA) in 2014 represent the latest and most widely accepted iteration of the clauses. ICMA CACs provide three options for modifying the payment and other key terms of sovereign bonds: (1) a single-series option, which requires a 75 percent supermajority of each relevant series; (2) a "two-limb" option, which requires a 66 2/3 percent supermajority across all series of bonds voting in a designated pool *and* a 50 percent majority of each bond series within the pool; and (3) a "single-limb" option, which requires a 75 percent supermajority across all series of bonds voting in a designated pool as long as all holders are offered the same instrument or a choice from the same menu of instruments.

The COVID-19-era Latin America restructurings provided the first occasion for the new ICMA CACs to be tested in practice, though on several occasions the debt to be

restructured included debt issued pre-2014 that did not include the enhanced CACs or included CACs with different, usually higher, voting thresholds.

Notwithstanding such heterogeneity, the CACs operated to facilitate consensual restructuring outcomes for Argentina, Ecuador and a number of Argentine provinces in 2020/2021. While each debtor tailored its restructuring proposal to its particular characteristics, the availability of CACs, coupled with the endorsement of large creditors and well-organized creditor committees, ultimately catalyzed a holistic restructuring for these debtors.

Ecuador was the first sovereign to consummate a restructuring transaction in September 2020. In July 2020, after constructive consultation with its largest creditor group, Ecuador launched a consent solicitation and exchange offer inviting holders of ten series of bonds to consent to the amendment of those bonds and exchange them for new bonds in three series maturing in 2030, 2035 and 2040. Holders who chose to participate in the exchange offer and receive the package of new

bonds also consented to modify the payment terms of the outstanding existing bonds (held by holdout creditors) to replicate the terms of the least attractive, longer-dated new bond. Concurrently, Ecuador solicited the consent of holders to delete a contractual provision (dubbed the “No Less Favorable Treatment” clause) restricting Ecuador’s ability to leave non-consenting holders financially impaired vis-à-vis consenting holders. After prevailing in a New York lawsuit brought by an investor seeking to enjoin the restructuring, Ecuador reached the requisite CAC thresholds in all series and achieved a 98 percent creditor participation in the process.

While Argentina was pursuing its restructuring concurrently with Ecuador, it initially took a more confrontational approach toward its creditors, launching a unilateral exchange offer where it attempted to take advantage of certain deficiencies in the drafting of the ICMA CACs to consummate a restructuring that was not supported by a bondholder supermajority. Following months of failed negotiations and a series of rejected offers, Argentina agreed to the terms of a debt restructuring with its largest creditor groups. The terms of the restructuring would provide Argentina with US\$39 billion of debt relief over the following nine years, via a combination of maturity extensions and coupon reductions, and would also enhance the legal terms of the bonds to rectify the observed deficiencies in the ICMA CACs.²

In August 2020, Argentina proposed these terms to its bondholders via a structure combining the use of the two-limb CACs with the use of exit consents, in a combined exchange offer and consent solicitation. Under this structure, holders who agreed to participate in the exchange offer and tender their bonds for a new bond chosen from a menu of options would also be deemed to consent pursuant to the two-limb CACs to substitute any outstanding existing bonds (which would thereafter be held only by holdout creditors) for new bonds with the least favorable maturity structure.

Similarly to the Argentine sovereign, the province of Buenos Aires launched a unilateral offer in 2020 that was repeatedly extended for over a year due to lack of participation. Following months of

lack of engagement and progress in the negotiations, members of the organized creditor committee filed a lawsuit in New York courts to recover defaulted principal and interest amounts. Ultimately, PBA reached a deal with its largest creditor and committee member in July 2021 and subsequently launched an amended offer. The amended offer provided that while participating holders were entitled to receive new “A” or “B” bonds, non-participating holders would receive new “C” bonds that have materially worse terms compared to A and B bonds, if the CAC thresholds were met under each series. Because certain of PBA’s bonds issued under its “old” 2006 indenture contained higher CAC thresholds than bonds issued under its more recent 2015 indenture (which contained ICMA CACs), PBA incorporated additional exit consents in the restructuring proposal for those series to disincentivize holdout behavior. Although PBA launched the offer after negotiating and agreeing to the terms with its largest bondholder, it had not obtained the support of the entire committee. In the absence of such support, the offer and the associated mechanics were not well received by many in the investor community, who deemed that PBA had launched a coercive offer designed to force bondholders into a deal. Notwithstanding such opposition, PBA’s restructuring ultimately obtained the support of 93 percent of its existing bondholders.

The novelty in the combined use of CACs and exit consents in COVID-19-era restructurings in Latin America is that, in contrast to the use of exit consents by Ecuador and Uruguay in the early 2000s, creditors who tender or “exit” their existing instruments also consent to modifications of payment terms (as opposed to legal terms) of bonds held by holdout creditors. This threat of imposing on non-consenting creditors less favorable financial treatment is a stronger incentive to participate than had been the case with the prior generation of exit consents, where bondholders were left with impaired legal terms, but were still entitled to their original claim for principal and interest. Furthermore, in all the COVID-19-era restructurings in Latin America, accrued interest on debt instruments being restructured

was only paid to consenting, or participating, bondholders—further heightening the financial penalty for a failed holdout strategy.

This use of CACs and exit consents was only effective after the debtor in each case had built prior consensus and obtained the support of its main bondholder groups (or in the case of PBA, its largest creditor). In the presence of well-organized creditor groups with significant holdings across the yield curve, it has proven impossible for a sovereign to successfully use CACs with exit consents to force a hostile, unilateral offer upon the market. The COVID-era experience in sovereign debt restructuring has, thus, proven that well-organized creditor groups can effectively resist sovereign debtors’ opportunistic and coercive use of these powerful restructuring techniques. Accordingly, good-faith negotiation between debtors and their creditor committees remains the lynchpin to successful sovereign and sub-sovereign restructurings.

CONCLUSION

The experience of Latin American sovereigns and sub-sovereigns in COVID-19-era debt restructurings bodes well for the future of sovereign restructurings. After the unruly debt restructuring episodes of the past, the evolution of the contractual architecture, the increased appetite for strong creditor coordination early in the restructuring process, and the willingness of debtors and creditors alike to engage in good-faith negotiations have proven to be catalysts for (relatively) orderly and consensual restructuring outcomes.

As the restructuring techniques employed in Latin American situations effectively addressed holdout and collective action problems (although not without controversy), we can expect to see these same techniques employed in future sovereign restructuring cases in Latin America and beyond.

1 D. Beers, Z. Quiviger and J. F. Walsh (2021), *BoC-BoE Sovereign Default Database: What’s New in 2021?* Bank of England.

2 For a detailed discussion of the restructuring mechanisms of the 2020 Argentine restructuring, the controversial use of CACs and the negotiated legal enhancements to the terms of the bonds, see Ian Clark and Dimitrios Lyratzakis, *Towards a More Robust Sovereign Debt Restructuring Architecture: Innovations from Ecuador and Argentina*, *Capital Markets Law Journal*, Volume 16, Issue 1, January 2021, pp. 31–44.

Sustainable finance in Latin America

GSS bonds and other forms of sustainable finance have become a mainstream feature of Latin American debt capital markets

By John Anderson, Jessica Chen, Thomas Pate and Tallat Hussain

Sustainability issues in Latin America have long been closely linked to finance, but never more so than today. Latin America's tropical forests are among the most biodiverse ecosystems on earth—and highly vulnerable to the increasingly significant effects of climate change. The region's economies are heavily reliant on extractive industries and other sectors that depend on those natural resources and ecosystems. This has the potential to cause tensions between short-term profit priorities and longer-term sustainability goals. It is therefore unsurprising that environmental, social and governance (ESG) considerations have become more important in relevant sectors like mining, oil & gas, power, forestry, agriculture, fisheries and industry in general.

This article focuses on the state of sustainable finance in Latin America (including green, social, sustainability and sustainability-linked instruments) and the opportunities to use sustainable finance to address development priorities in the region.

SUSTAINABLE FINANCE

The European Commission defines sustainable finance as: "the process of taking ESG considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects"¹ Since 2015, sustainability in the context of finance has come to be viewed largely in terms of the UN Sustainable Development Goals (SDGs)² and the Paris Agreement commitments on climate change. Today, no industry or market exists

that is insulated from the concern of shareholders, investors, lenders, employees, consumers or society-at-large when it comes to ESG-related performance or the risks and impacts of climate change. This increased concern has led to greater motivation for developing financing products to facilitate achieving the goals, protecting against the impacts or adapting to the changes, whether social, environmental or economic.

Mechanisms such as blended finance, ESG-linked loans, green or social bonds, ESG considerations in foreign direct investment (FDI) and even some aspects of equity capital markets and trade, demonstrate how the field of sustainable finance is as diverse as the issues it seeks to address.

Latin American countries are also well aware of the interdependencies between sustainability and economic development, trade and investment, all of which are the subject of numerous international and regional trade and investment agreements, including the United States-Mexico-Canada Trade Agreement (USMCA). Like its predecessor, the North American Free Trade Agreement (NAFTA), USMCA contains several environmental provisions and a side agreement on environmental and other sustainability safeguards.

FINANCING CLIMATE ADAPTATION AND PROTECTION AGAINST GLOBAL WARMING

Under the Kyoto Protocol, which preceded the Paris Agreement by almost 20 years, Latin American countries were not considered major contributors to global greenhouse gas (GHG) emissions. They were therefore not subject to binding



Latin America's tropical forests are among the most biodiverse ecosystems on earth—and highly vulnerable to the increasingly significant effects of climate change.



targets to reduce GHG emissions. Brazil, for example, was classified as a “carbon sink” due to the potential of the Amazon rainforest to sequester GHGs to reduce global warming. Under the Paris Agreement, on the other hand, all ratifying countries have been required to present their national targets, known as Nationally Determined Contributions (NDCs). Article 6 of the Paris Agreement establishes mechanisms that contribute to the mitigation of GHG emissions and support sustainable development³ including the Kyoto Protocol’s clean development mechanism (CDM), which allows emission-reduction projects in developing countries to earn certified emission-reduction (CER) credits, each equivalent to one metric tonne of CO₂. Although not a direct form of funding, these CERs can be traded and sold. Industrialized countries can and do use them to meet a part of their emission-reduction targets under the Kyoto Protocol. While China and India have accounted for the majority of CDM projects over the years, Latin American countries

have also made extensive use of the CDM to create CERs.⁴

By the end of July 2021, 8,222 projects had been registered globally under the CDM, representing a reduction of just over 1 billion metric tonnes of CO₂-equivalent GHG emissions. Latin American projects accounted for 12.6 percent of that reduction (see figure 1).

GREEN, SOCIAL, SUSTAINABILITY AND SUSTAINABILITY-LINKED BONDS

The first-ever green bond (labeled a “Climate Awareness Bond”) was issued on July 4, 2007 by the European Investment Bank. Since then, across the world, total ESG debt including GSS bond issuances have reached US\$3 trillion, with US\$1 trillion being added in eight months during late 2020 and early 2021 alone⁵ (see figure 2). By comparison, the Organization for Economic Co-operation and Development (OECD) estimated in 2017 that annual green investment required to limit global warming to a two-degree rise will exceed

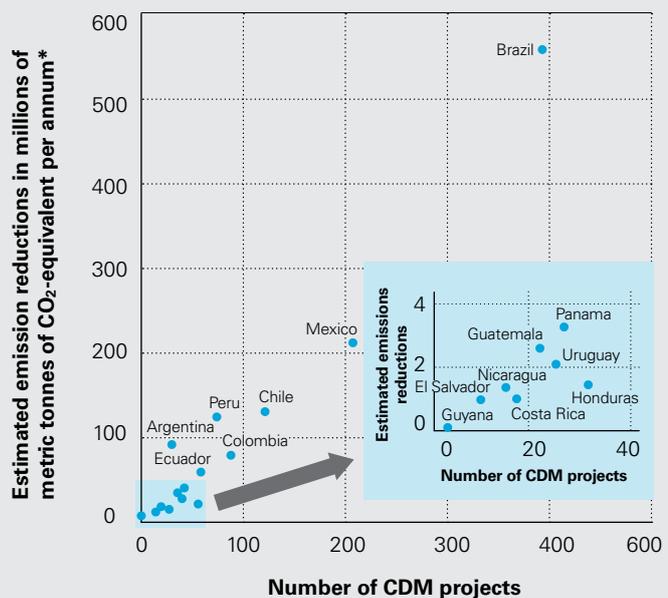
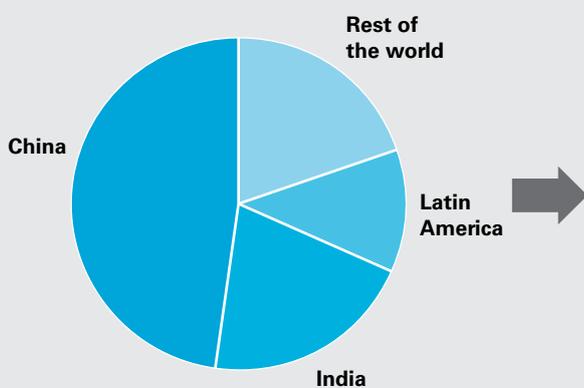


Although not a direct form of funding, these CERs can be traded and sold, and used by industrialized countries to meet a part of their emission reduction targets under the Kyoto Protocol.

Figure 1: Breakdown of CDM projects globally (pie chart) and by country in Latin America (scatter chart)

Target location: Latin America and Caribbean **Bidder location:** Global **Sectors:** All sectors

By August 2021, Latin American CDM projects accounted for 12.6 percent of the global total to date



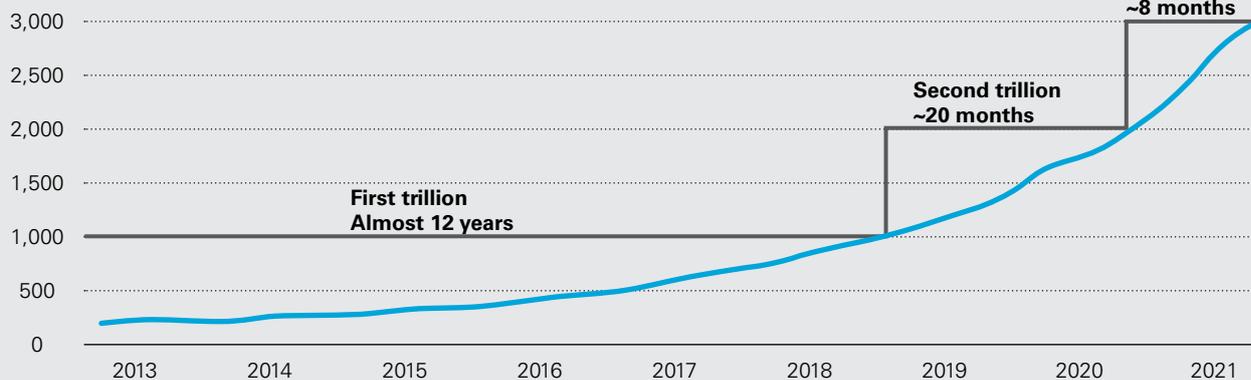
Source: UNFCCC

*as stated by the project participants

Figure 2: Cumulative debt issuance of ESG debt worldwide

Cumulative GSS debt issuance reached US\$3 trillion globally in June 2021, a third of which was added in the previous eight months

Cumulative issuance (US\$ billion)



Source: Bloomberg⁷

US\$4.3 trillion.⁶ By late July 2021, GSS issuances in Latin America had reached US\$45 billion for the year—roughly 1.7 times the total GSS issuances for the region in 2020 (see figure 3). Clearly, GSS bonds are becoming a more important feature in Latin American finance.

USING SUSTAINABILITY-LINKED BONDS IN LATIN AMERICA

While green bonds are the most established and well developed of the ESG debt instruments, and they account for the lion's share of GSS bond issuances worldwide, sustainability-linked bonds (SLBs) are becoming increasingly popular as an alternative. Since the International Capital Market Association (ICMA) published principles for SLBs in mid-2020, they have become the fastest-growing kind of issuance in Latin America (see infographic in figure 3). The essential difference between green, social and sustainability bonds, and sustainability-linked bonds, is that the former are intended to fund specific ESG-related projects, while the latter are linked to achieving defined ESG performance objectives.

Latin American GSS bonds have been issued both in international

and local capital markets, and in a variety of currencies. In 2020, for instance, Banco del Estado de Chile issued a social bond termed a “women's bond” denominated in Japanese yen, raising the equivalent of US\$95 million to improve women entrepreneurs' access to financial and non-financial services in Chile and to support the economic empowerment of women in the country.⁸ The Chilean government has also issued sovereign GSS bonds denominated in euros. The most common denominations, however, are local Latin American currencies and the US dollar.

THE LATIN AMERICAN GSS BOND MARKET IN MORE DETAIL

GSS issuance in Latin America is led by the private sector, with corporate issuers responsible for 62 percent of the total GSS issuances. Sovereign and supranational issuers represented 35 percent and 3 percent of the total GSS bond issuance, respectively. In terms of volume, the sovereign issuances have been far larger, and they account for 44 percent of the volume to date. This mix varies widely across Latin American countries, however. The private sector (especially forestry and paper companies) has been far more

dominant in Brazil, for instance, than in Chile (see infographic in figure 3).

Energy has been the most funded sector, with half of Latin America's green proceeds dedicated to renewable energy projects (mainly solar and wind) excepting Chile, where transport ranks first. However, land use and industry, which are considerably under-funded globally, represent almost a quarter of the issuance in Latin America. In contrast, green buildings and water, which are both commonly funded globally, are among the least funded sectors in Latin America.

Similar to elsewhere in the world, Latin America's financial sector has also begun to promote green finance initiatives in recent years. Mexico's Central Bank and Colombia's financial system regulator are members of the global Network for Greening the Financial System. Mexico's Climate Financial Advisory Board joined the Financial Centers for Sustainability network, announcing plans to turn the country into a regional leader in green finance (although such comment was made prior to the current pandemic). Several private sector Latin American banks have issued GSS bonds in order to use the proceeds to lend to customers to fund projects that are aligned with ESG objectives.

Figure 3: GSS bond issuances in a range of currencies and by a variety of issuer types have become an important feature of Latin American capital markets

GSS bonds have become a key feature in financing Latin American environmental and social projects, including related to GHG reduction

Green bond

A bond for which the proceeds are exclusively applied to fund defined “green” projects

Sustainability bond

A bond for which the proceeds are exclusively applied to fund projects that significantly combine environmental and social priorities

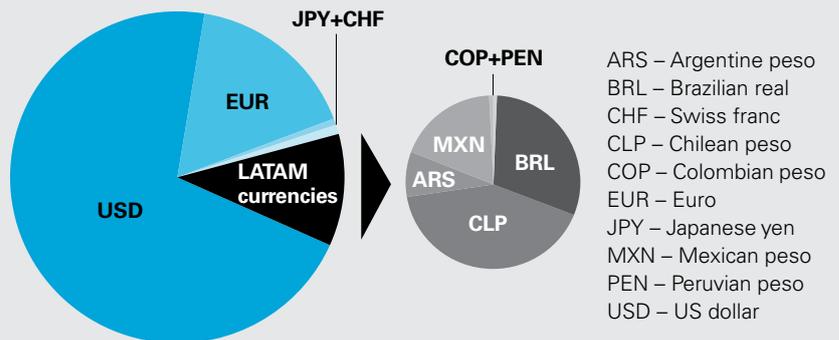
Social bond

A bond for which the proceeds are exclusively applied to fund defined “social” projects

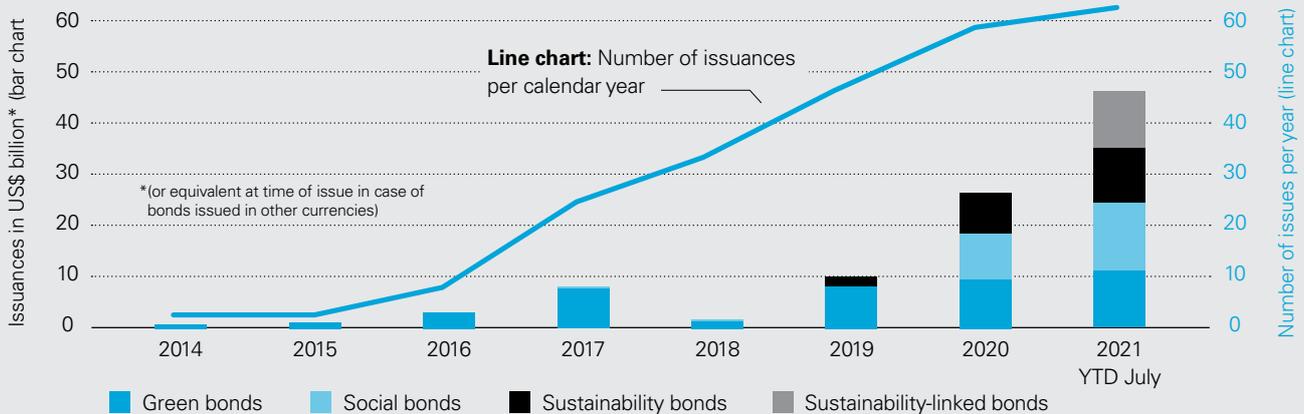
Sustainability-linked bond

A bond for which the proceed fund initiatives generally (not defined projects) aimed at achieving green and social objectives

Breakdown of LatAm GSS bonds by currency of issue 2014 – YTD 2021 (22 July)



Latin American GSS bond issuances from the first issuances in 2014 to early July 2021, by bond type



SELECT GSS BOND ISSUANCES DURING THE PAST FIVE YEARS IN THE MAJOR LATIN AMERICAN MARKETS

Brazil

- In September 2021, Rumo S.A., Brazil’s largest logistics operator in terms of total volume transported, providing rail transport logistics, port handling and warehousing services through its Luxembourg subsidiary, issued US\$500 million of 4.200% sustainability-linked notes due 2032. The interest rate and redemption price for the bonds are tied to

certain specified “sustainability performance targets” Rumo established to limit its greenhouse gas emissions to the equivalent of 11.82 gigatonnes of CO₂ per annum by the end of 2026

- In June 2021, JBS S.A., the world’s largest protein company and second-largest food company based on net revenue, through its Luxembourg subsidiary, issued US\$1 billion in aggregate principal amount of 3.625% sustainability-linked senior notes due 2032. The interest rate for the bonds is tied to certain specified “sustainability

performance targets” JBS established to reduce its global greenhouse gas emissions intensity by approximately 16 percent by the end of 2025 and 30 percent by the end of 2030

- In May 2021, lochpe-Maxion S.A., a world leader in the production of automotive steel wheels and among the world leaders in the production of aluminum wheels for light vehicles, through its Austrian and Mexican subsidiaries, issued US\$400 million of inaugural 5.000% sustainability-linked notes due 2028. The interest rate for the

GSS bonds by number of issuances
2014 – YTD 2021 (22 July)



GSS bonds by total deal size (in US\$)
2014 – YTD 2021 (22 July)



Supranational/Multilateral issuances: Number: 9; total value: US\$12.3 billion

Sources: Bloomberg, Bond Data, Latin Finance, Thomson Eikon, ICMA, Climate Bonds Initiative and several other sources, collated and cross-referenced for accuracy

bonds is tied to certain specified “sustainability performance targets” lochpe established to reduce its greenhouse gas emissions by approximately 30 percent by the end of 2025

- In April 2021, a seven-year US\$1 billion bond issued by Brazil’s Natura Cosméticos S.A. was, as of its date, the largest-ever single sustainability-linked issuance in the region. Under the terms of the new sustainability-linked bond, Natura aims to reduce greenhouse gas emissions by 13 percent and increase the use of

post-consumer recycled plastic in packaging to 25 percent by 2026⁹

Chile

- In 2019, Chile issued the first sovereign green bond in Latin America for US\$950 million; the use of the proceeds is for projects related to metro lines, electromobility, installation of solar panels, sustainable buildings and water monitoring systems
- In June and July 2019, the Republic of Chile issued two sovereign Certified Climate Bonds, the first green sovereign

bonds in the Americas. One was issued in the US market (US\$1.4 billion), the other was a Eurobond (€861million). The proceeds will be used primarily to finance low-carbon transport, but also sustainable buildings, renewable energy and water management projects

- In June of 2020, Atlas Renewable Energy issued US\$253 million of notes in the form of a private placement, the proceeds of which were used to develop two solar power projects in Chile. The transaction was the largest solar

Solar panel farm, Brazil



photovoltaic (PV) green private placement in Latin America to date. The transaction also marked the first time that noteholders took on construction risk as part of a structure to finance a greenfield solar project in Latin America

Colombia

– In December 2016, Bancolombia, Colombia's largest commercial bank, issued its first green bond for 3.5 billion Colombian pesos (US\$115 million), the proceeds of which will be used to expand financial services for private sector investments that help address climate change. It was the first green bond issued by a commercial bank in Latin America

Ecuador

– The first sovereign social bond in the world was issued in the international market by Ecuador in 2020, for US\$400 million, to develop the public program Casa para Todos, intended to provide access to decent, affordable housing to more than 24,000 families. This issuance was backed by a US\$300 million guarantee of the Inter-American Development Bank (IDB), allowing the operation to be more attractive for international investors and reducing financial costs to the government of Ecuador

Mexico

– In December 2016, Mexico City issued its inaugural MXN 1 billion (approximately US\$50 million) green bond, the proceeds of which will be used to develop projects related to efficient use of energy, improvement in the supply and quality of drinking water, as well as sustainable transport. Mexico is one of the only countries in Latin America with local government green bond issuances

– In October 2018, Fondo Especial para Financiamientos Agropecuarios (FEFA), a Mexican governmental development trust dedicated to agriculture, issued its inaugural MXN 2.5 billion (US\$130 million) green bond, the proceeds of which will be used to finance its loan to the agricultural

sector. It was the first Certified Climate Bond under the Protected Agriculture Criteria, which was developed under the Climate Bond Initiative (CBI) with the support of the IDB and FEFA

GSS BOND CERTIFICATION AND RATING

How GSS and similar bonds should be certified and rated remains an evolving field. GSS bonds fund such a wide range of projects that a degree of flexibility is required, but this must be balanced with investor need for assurance that their investment really is going to contribute to achievement of the SDGs. While consensus exists generally about what constitutes a green bond or investment, external review processes and standards can vary widely. Two approaches appear to be gathering more momentum than others, however. The first is that of ICMA, which has published principles for green bonds, social bonds, sustainability bonds and sustainability-linked bonds. The second is that of the Climate Bonds Initiative, namely the Climate Bonds Standard and Certification Scheme. The certification process for the latter is conducted through clearly defined procedures, whereas the former relies on external verifiers applying their own methodologies.

A number of indices have also emerged, with varying criteria applying for inclusion. These include:

- The Bloomberg Barclays MSCI Green Bond Index, which is a multi-currency benchmark that includes local currency debt markets tracked by the Barclays Global Aggregate Index
- The Bank of America Merrill Lynch (BAML) Green Bond Index, which tracks performance of debt issued by quasi-governments and corporations where the proceeds of the issue are to be used solely for projects and activities that promote climate or other environmental sustainability purposes
- The Standard & Poor's (S&P) Green Bond Index and the S&P Green Bond Select Index (which are multi-currency benchmarks that include bonds issued by multilateral, government and corporate issuers, the former



Investors have always been concerned with “greenwashing,” but never more so than today, with the stakes being viewed with as much concern as they are.

of which was developed collaboratively by S&P Dow Jones Indices and Infrastructure Credit Alpha Group LLC)

– The Solactive Green Bond Index, which is a rules-based, market value-weighted index engineered to mirror the green bond market

While third-party certification is important, concerns frequently arise about whether GSS bonds always end up being used for their stated purposes and have a meaningful impact on SDGs or mitigating climate change more generally. Investors have always been concerned with “greenwashing,” but never more so than today, with concerns about climate change and other ESG issues being viewed with as much concern as they are. The value of assets under management by managers applying ESG data to investment decisions has risen sharply over the past decade, to US\$38 trillion in 2020.¹⁰ Furthermore, what asset managers in Latin America might require in terms of ESG reporting differs sometimes from that required in the US, Europe and Asia-Pacific.

Perhaps as a result of the rapid development in GSS finance, ESG data in the market is emerging that is unstructured, opaque and non-standard in format. For this reason, some investors and asset managers are shifting from relying upon third-party certifiers to assembling their own data on the ESG credentials of the assets in which they choose to invest. A healthy market for raw ESG data

Table 1: International environmental agreements to which Latin American countries are parties

	 Argentina	 Bolivia	 Brazil	 Chile	 Colombia	 Costa Rica
Escazú Agreement, 2018 (access to information, public participation and justice in environmental matters)	2021	2019	2018		2019	2018
Minamata Convention on Mercury, 2013	2017	2016	2017	2018	2019	2017
International Treaty on Plant Genetic Resources for Food and Agriculture, 2001	2016	2016	2006	2016	2002	2006
Stockholm Convention on Persistent Organic Pollutants, 2001	2005	2003	2004	2005	2008	2007
Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade, 1998	2004	2003	2004	2005	2008	2009
United Nations Convention to Combat Desertification in Those Countries Experiencing Drought and/or Desertification, Particularly in Africa, 1994	1997	1996	1997	1997	1999	1998
Convention on Biological Diversity, 1992	1994	1994	1994	1994	1994	1994
Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising from the Utilization, 2010	2016	2016	2021		2011	2011
Nagoya- Kuala Lumpur Supplementary Protocol on Liability and Redress to the Cartagena Protocol on Biosafety, 2010			2012		2020	
Cartagena Protocol on Biosafety, 2000	2000	2002	2003	2000	2003	2007
United Nations Framework Convention on Climate Change, 1992	1994	1994	1994	1994	1995	1994
Kyoto Protocol, 1997 (reduction of greenhouse gas emissions)	2001	1999	2002	2002	2001	2002
Paris Agreement, 2015 (reduction of greenhouse gas emissions)	2016	2016	2016	2017	2018	2016
Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, 1989	1991	1996	1992	1992	1996	1995
Vienna Convention for the Protection of the Ozone Layer, 1985	1990	1994	1990	1990	1990	1991
Montreal Protocol on Substances that Deplete the Ozone Layer, 1987	1990	1994	1990	1990	1993	1991
Convention on the Conservation of Migratory Species of Wild Animals, 1979	1992	2003	2015	1983		2007
Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), 1973	1981	1979	1975	1975	1981	1975
Convention on Wetlands (Ramsar Convention), 1971	1992	1990	1993	1981	1998	1992

■ Signed but not yet ratified

■ Signed and ratified

 Ecuador	 El Salvador	 Guatemala	 Honduras	 Mexico	 Nicaragua	 Panama	 Paraguay	 Peru	 Uruguay	 Venezuela
2020		2018		2021	2020	2020	2018	2018	2019	
2016	2017	2013	2017	2015	2014	2015	2018	2016	2014	2013
2004	2003	2006	2004		2002	2006	2003	2003	2006	2005
2004	2008	2008	2005	2003	2005	2003	2004	2005	2004	2005
2004	1999	2010	2011	2005	2008	2000	2003	2005	2003	2005
1995	1997	1998	1997	1995	1998	1996	1997	1995	1999	1998
1993	1994	1995	1995	1993	1995	1995	1994	1993	1993	1994
2017	2012	2014	2013	2012	2020	2012		2014	2014	2018
				2012		2011		2011		2018
2003	2003	2004	2008	2002	2002	2002	2004	2004	2011	2002
1993	1995	1995	1995	1993	1995	1995	1994	1993	1994	1994
2000	1998	1999	2000	2000	1999	1999	1999	2002	2001	2005
2017	2017	2017	2016	2016	2017	2016	2016	2016	2016	2017
1993	1991	1995	1995	1991	1997	1991	1995	1993	1991	1998
1990	1992	1987	1993	1987	1993	1989	1992	1989	1989	1988
1990	1992	1989	1993	1988	1993	1989	1992	1993	1991	1989
2004			2007			1989	1999	1997	1990	
1975	1987	1979	1985	1991	1977	1978	1976	1975	1975	1977
1991	1999	1990	1993	1986	1997	1990	1995	1992	1984	1988

Source: Economic commission for Latin America and the Caribbean (ECLAC). On the basis of treaties.un.org / for all treaties deposited with the secretary-general; www.planttreaty.org for the International Treaty on Plant Genetic resources for food and agriculture; www.cms.int / for convention on the conservation of migratory species of wild animals; www.cites.org / for convention on international trade in endangered species of wild fauna and flora; www.ramsar.org / for convention on wetlands. Updated 5 April 2021

has emerged as a result. Bloomberg, for instance, now supplies its customers with reported ESG data for almost 12,000 companies and more than 410,000 securities in more than 100 countries, covering more than 15 years of historical data.¹¹ The newly launched Sustainable Fitch suite of ESG products also includes tools to help investors to evaluate the relative ESG credentials of financial instruments and entities.

When considered together with other transparency drivers, such as bank disclosure requirements for ESG risks, and also increasing regulatory requirements, it follows that entities using any source of sustainable finance would do well to ensure that their own ESG reporting is clear, unambiguous and comprehensive.

ESG REGULATORY AND POLICY FRAMEWORKS ARE EVOLVING

Latin American countries have collectively ratified roughly 20 international environmental agreements (table 1). Some of these create obligations on the part of developed nations to provide funding and other resources to developing nations, including those in Latin America, to encourage sustainable economic development. In practice, however, such funding compromise has proved insufficient to fulfill its purpose, and additional resources have been sought through different mechanisms. In recent years, the ESG safeguards built into those mechanisms have become more common and explicit.

As is usual in international law, ratifying states take steps necessary to ensure that their domestic legislation aligns with their obligations under these agreements and treaties, in some cases promulgating new law for this purpose. Regarding GSS bonds in particular, the following current and recent developments should be noted:

Colombia

The Financial Superintendency of Colombia (SFC) became the first banking regulator in Latin America to publish a regulatory framework for green bonds, on September 7, 2020, incorporating international standards and including voluntary process

guidelines that had been established by the International Capital Market Association, as well as taxonomies issued by the European Union and the Climate Bonds Initiative.

Costa Rica

The local Bolsa Nacional de Valores has a green bond standard that follows the ICMA Green Bond Principles (GBPs) and applies to both private and public issues. The guidelines allow bonds that comply with ICMA or CBI principles to be considered as “green” in the local market. External reviews must be performed, by CBI-accredited verifiers or others who can provide acceptable evidence of experience in environmental and sustainability assessment.

Chile

The Bolsa de Santiago opened a Green and Social Bond Market Segment, following collaboration with local non-governmental organizations (NGOs) in order to increase market transparency and prevent greenwashing. The exchange organized activities related to these instruments through a series of requirements stated in such Green and Social Bond Market Segment. The purpose of such framework is to simplify the issuance framework and make their authorization and supervision easier and more efficient. Guidelines supplied are similar to ICMA principles and the CBI Climate Bond Standard. An external verification report is also required.

A raft of new ESG-related legislation is under consideration in Congress in Chile, including a proposal to ban coal-fired power plants from 2025, and a Framework Law on Climate Change.

Other Latin American countries are undertaking similar initiatives, and these will likely gather momentum later in 2021 and into 2022, as the COP26 Conference in Glasgow unfolds and yields new agreements.

COMMITTING TO CARBON REDUCTION IN LATIN AMERICA

The NDCs published under the Paris Agreement require ratifying governments to take action to achieve the SDGs, especially to minimize global warming. These will

no doubt be reinforced at COP26. In turn, this will likely increase demand for GSS bonds and the kinds of projects and other activities that they fund. Although this should present opportunities that lead to more issuances, it will likely also result in closer scrutiny. Issuers and investors should be aware of and willing to accommodate not only the commitments that have been made in the region, but also the priorities, in the context of sustainable development.

NDCs vary widely across Latin America in terms of the urgency they apply to address climate change impacts and in the scale of the targets. Heavily forested countries benefit from offsetting some of their GHG emissions through oxygen produced by their forests, in the quest for net-zero carbon, but sociopolitical considerations also play a role. The energy sector in particular faces a clear divide between countries that are actively pursuing transition from fossil fuels to renewables, and those that are still prioritizing fossil fuel-based technologies. In Mexico, the Inter-Ministerial Climate Change Commission (Comisión Intersectorial de Cambio Climático or CICC) approved the country’s updated NDC in December 2020, but instead of setting progressively more ambitious targets, it merely “reaffirmed” the targets established five years ago, and which have been widely criticized as being inadequate.

BLENDED FINANCE MECHANISMS FOR SUSTAINABLE DEVELOPMENT

Blended finance is an approach to structuring funding arrangements in ways that allow investors with different objectives (e.g., financial return versus positive environmental or social impact) to invest alongside each other. According to the International Finance Corporation (IFC), blended finance is “the use of relatively small amounts of concessional donor funds to mitigate specific investment risks and help rebalance risk-reward profiles of pioneering investments that are unable to proceed on strictly commercial terms.”¹²

Blended finance is now a

Group of wind turbines, Chile



City gardens, Brazil



well-known structuring approach in financing essential projects, including in pursuit of the SDGs. The IFC, for instance, frequently applies blended finance — crowding in private finance to deliver sustainable impact in emerging and frontier markets.

For private investors, it can mitigate risk and poor returns for that risk, compared to other investment options available. For investors prioritizing ethical considerations, it can leverage available funding to create a greater level of investment than would have been possible on its own.

As a strategy, blended finance arrangements can be very flexible. Financing can be structured as debt, equity, risk-sharing, or guarantee products with different rates, tenor, security or rank. Under select facilities, they can also be performance-based incentive structures. Solutions depend, among other things, on the market barriers and failures that need to be addressed and the requirements of donors.

From fiscal year 2010 to 2020, the IFC deployed US\$1.6 billion of concessional donor funds to support 266 high-impact projects in more than 50 countries, leveraging US\$5.8 billion in IFC financing and more than US\$6.8 billion from other private sources.¹³

Other multilateral banks (MDBs) that are actively funding GSS projects in Latin America, either through subscribing to GSS bonds or through structured finance or otherwise, include the IDB and the Corporación Andina de Fomento – Banco de Desarrollo de América Latina (CAF) the central American (Banco Centroamericano de Integración Económica, CABEL) and FONPLATA, as well as country-specific development banks such as BNDES in Brazil.¹⁴

THE FUTURE OF SUSTAINABLE FINANCE IN LATIN AMERICA

Investor demand for GSS bonds and other sustainable finance instruments is unlikely to subside anytime soon. This can be seen in the degree to which such issuances are over-subscribed, and the low coupon rates achieved. A sympathetic administration in

Table 2: Status of Latin American countries regarding carbon-neutrality targets

Country	Signature	Ratification	Carbon-neutrality target date	Status
Argentina	22-April-16	21-September-16	2050	Policy document issued
Belize	22-April-16	22-April-16	2050	Target under discussion
Bolivia	22-April-16	5-October-16	Not stated	-
Brazil	22-April-16	21-September-16	2050	Policy document issued
Chile	20-April-16	10-February-17	2050	Legislation proposed
Colombia	22-April-16	12-July-18	2050	Policy document issued
Costa Rica	22-April-16	13-October-16	2050	Policy document issued
Ecuador	26-July-16	20-September-17	2050	Target under discussion
El Salvador	22-April-16	27-March-17	Not stated	-
Guyana	22-April-16	20-May-16	2050	Target under discussion
Guatemala	22-April-16	25-January-17	Not stated	Target under discussion
Honduras	22-April-16	21-September-16	Not stated	-
Mexico	22-April-16	21-September-16	2050	Target under discussion
Nicaragua	-	23-October-17	2050	Target under discussion
Panama	22-April-16	21-September-16	2050	Policy document issued
Paraguay	22-April-16	14-October-16	Not stated	-
Peru	22-April-16	25-July-16	2050	Target under discussion
Suriname	22-April-16	13-February-19	N/A	Carbon-neutrality achieved
Uruguay	22-April-16	19-October-16	2050	Policy document issued
Venezuela	22-April-16	21-July-17	Not stated	-

Source: *Climate Change News*, updated to July 7, 2021, available at: <https://www.climatechangenews.com/2019/06/14/countries-net-zero-climate-goal/>

the US, the prospect of a green bond standard in the EU, general ESG concern as the effects of climate change become more visible, and ESG drivers in Asia-Pacific all converge to assure us that these instruments will be with us for a long time, and will continue to develop and become more sophisticated. COP26 will, if anything, likely accelerate this process. In the coming years, we expect to see the criteria for sustainable finance become more stringent and more uniform standards emerge, as investors demand greater transparency. As demand for ESG transparency increases, and regulatory and policy frameworks become better developed, so ESG standards will also increasingly be included in funding arrangements more generally. In the interim, properly designed GSS bonds and other

sustainable finance instruments are likely to remain popular with investors and issuers alike.

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Bridging Latin America's digital divide

COVID-19 has created strong incentives for investment in digital infrastructure in Latin America, especially in 5G, private networks, data centers and fiberoptic cables

By Amaury de Feydeau, Martin Menski, Ismael Reyes Retana, Suzanne Perry and Pedro Hendel

While the headline-grabbing responses to COVID-19 in emerging markets have been the production and dissemination of accessible and affordable vaccines,¹ the post-pandemic reality of increased remote working and importance of virtual connectivity has prompted and accelerated investments in digital infrastructure. In Latin America and the Caribbean (LAC), following the coronavirus pandemic in particular, adopting digital solutions has been promoted as a unique opportunity to increase productivity and unlock solutions to sustainable development goals by facilitating access to finance, education and health.² Notable examples such as Brazil's Clinical Telemonitoring Center, which provides integrated digital health services to facilitate the tracking of COVID-19, and Jamaica's digital platform for climate risk management developed by the Climate Innovation Center illustrate the unique role digital technologies can play in tackling development needs. The World Bank estimates the digital economy is equivalent to 15.5 percent of global gross domestic product (GDP), growing two-and-a-half times faster than global GDP over the past 15 years, and that in certain emerging markets a 10 percent increase in mobile internet penetration may translate to a 2.5 percent increase in GDP.³

Considerable investments are needed, though, to build the infrastructure necessary in LAC to enable faster and more affordable access to mobile services and the internet. Government and multilateral efforts in the region have focused on connecting the

unconnected, especially in rural areas, and improving data access through investments in backhaul infrastructure such as optical fiber. This article examines the particular challenges for financing digital infrastructure in LAC and the current key trends and opportunities for investment and financing.

CHALLENGES OF THE DIGITAL DIVIDE

The LAC region is not unique in facing supply-and-demand-side constraints to digital transformation. As of 2019, just under half of the world's population was still without internet access, the vast majority concentrated in emerging markets and principally in rural areas. This digital divide is particularly stark in LAC, however. A handful of countries such as Chile, Uruguay, the Dominican Republic, and Costa Rica have more than 90 subscriptions per 100 inhabitants for mobile broadband, while the majority of Latin American countries are around 50 to 77 per 100 inhabitants and as low as 20 per 100 inhabitants in countries such as Cuba, Nicaragua and Guatemala. This divide is even more pronounced for fixed broadband connectivity.⁴

Several countries in LAC do not currently possess the necessary tools and environments to bridge the digital divide. Investment in basic, standard and advanced information and communication technology (ICT) skills is especially crucial. Such skills are severely lacking in most LAC countries, Chile being a notable exception. Cybersecurity skills are similarly in short supply, with the absence of regulatory frameworks posing additional constraints. Broadband



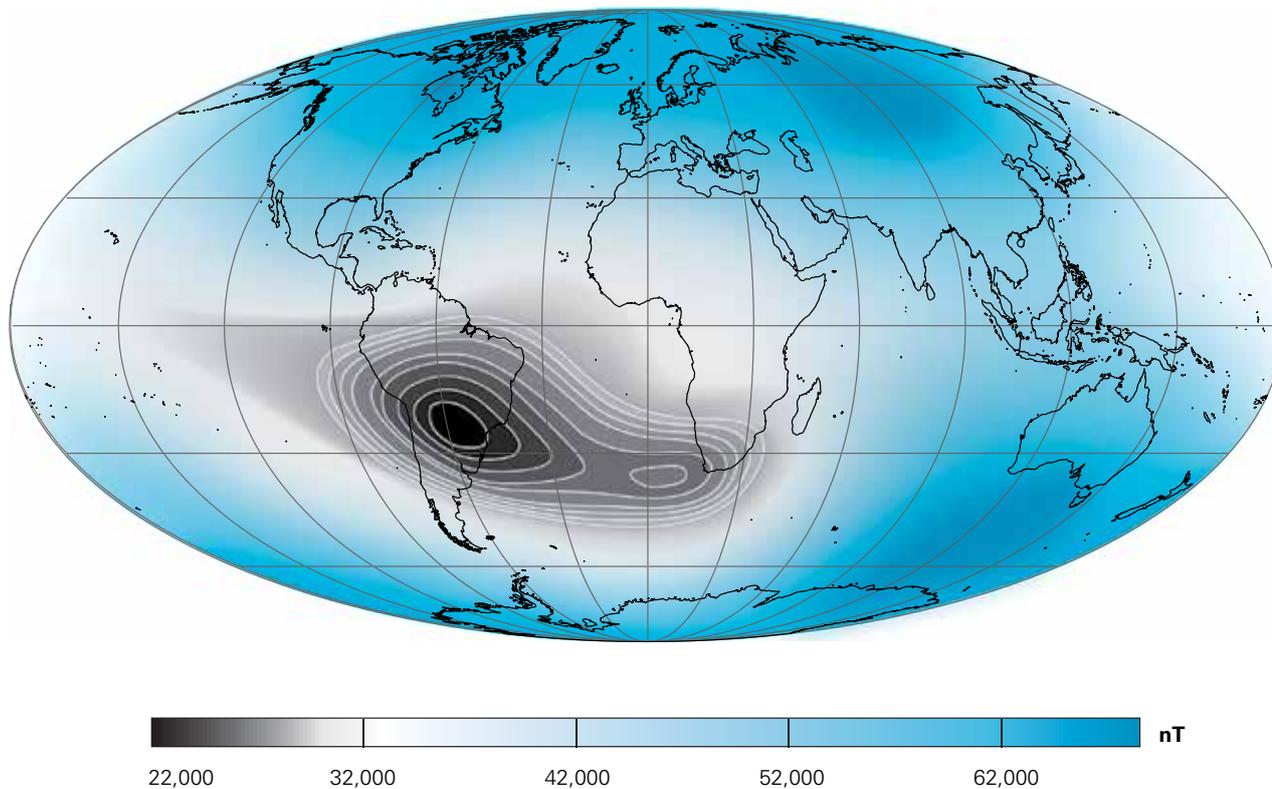
In Latin America and the Caribbean, adopting digital solutions has been promoted as a unique opportunity to increase productivity and unlock solutions to sustainable development goals.

connections in rural areas are a particular challenge, and one that cannot be easily addressed through deploying geostationary satellites due to the so-called "South Atlantic Anomaly." As an unusually weak spot in the Earth's magnetic field, which doses orbiting satellites with high levels of radiation, degrading their electronic components,⁵ this affects much of southern Latin America (see figure 1). Expanding connectivity into rural areas through fixed infrastructure (fiber or copper) requires high upfront capital costs, especially where challenging geographical terrains are involved (e.g., the Andean mountains, rainforests), while expanding mobile connectivity requires awarding and managing more spectrum. While most network operators in LAC were able to cope with the increased demand on their networks during the COVID-19 pandemic, these infrastructure gaps will hamper digital integration and accessibility in the region in the long-term if not addressed through large and sustained investments from private and public sector players.



Figure 1: South Atlantic Anomaly⁶

Image demonstrates the strength of Earth's magnetic field, with (grey) showing lower strength than lighter colors (blue). The dark grey region shows the position of the South Atlantic Anomaly in 2020.



Source: NASA

INVESTMENT OPPORTUNITIES

Paradoxically, the realities of the post-COVID-19 environment have created strong incentives to accelerate investment in digitalization efforts. While LAC is one of the smallest regions, it is expected to have the fastest growth of interconnection bandwidth capacity anywhere in the world. By the end of 2021, the region expects a compound annual growth rate of 59 percent, which would mean more than 755 terabits per second (Tbps) of installed capacity (from a current level of 118 Tbps), though this will be largely concentrated in São Paulo, Rio de Janeiro, Buenos Aires and Mexico City.⁷ It is estimated that operators in Latin America will invest more than US\$70 billion in capex between 2021 and 2025, of which the lion's share will be 5G-specific.⁸ According to a study published in 2020 by IDC Latin America, 40 percent of the region's

GDP will consist of digital businesses by 2022. This will require IT spending of up to US\$460 billion. Of this total, 35 percent will be invested in cloud computing solutions. Four main regional trends appear to be driving investments in this space:

- First, several LAC countries have made strenuous efforts to expand spectrum to accommodate 5G. In Brazil, auctions in the 3.5 gigahertz (GHz) and the 26 GHz spectrum bands are slated for 2021. The regulator, Anatel, plans also to award spectrum in the 700 megahertz (MHz) that remains unsold from 2015 in the 2.3 GHz bands. Governments in Mexico, Chile, Colombia and the Dominican Republic have also announced their intention to assign 5G spectrum in 2021. Given the geopolitical significance of 5G

for the digital economy, US-based finance and export credit institutions and other like-minded agencies in Europe and Asia-Pacific have taken steps to make concessional funding more easily available, including by revising outdated content policies to make them more suitable for digital technologies, whose supply chains are global and virtual

- Second, mining and utilities companies across the region have increasingly sought to deploy private networks in view of the need to accommodate remote working. In July 2020, Nokia and Telefónica partnered with mining firm Vale to provide a private LTE network to the Carajás mine, the world's largest iron ore mine, in northern Brazil. In Chile, the 5G consultation held by the Department

Telecom antennas above
the city of Quito, Ecuador



of Telecommunications targeted expanding private networks for the mining, manufacturing, port, agricultural and transport industries

- Thirdly, the need for data processing capabilities, combined with the expansion of 5G, and the regulatory requirement of several countries for data localization, has created incentives for the construction of major data centers (hyperscalers), especially around metropolises such as São Paulo, Rio de Janeiro, Buenos Aires and the City of Mexico, whose data centers process 90 percent of the data in the region.⁹ A data center offers clients an exclusive space with all the infrastructure to receive the hosting racks with servers, routers and others from the user company, and includes energy solutions, thermal systems and environmental monitoring software, which are vital technologies for the continuity of data center operations. According to Data Center Map, there are more than 150 colocation data centers in operation today. According to the American Association of Data Center Professionals (AFCOM), hyperscale data centers can occupy anywhere from 5,000 to up to 22,000 square meters. In Latin America, hyperscale colocation data centers began in Brazil and, throughout 2020, progressed toward Chile, Colombia and Argentina, and have continued with the construction of units in other Latin American countries, such as Mexico
- Finally, along with the expansion of the global subsea cable market, which is expected to grow by multiples to more than US\$30 billion by 2027, it is anticipated that a major portion of this will occur in integrating Latin America with the rest of the world, with several new cable systems planned for connectivity to Europe in particular. A Chilean telecom agency is leading development of the Asia-South America Digital Gateway, a proposed subsea cable of approx. 22,000 kilometers in length,

while private investors have been pursuing subsea cable projects to connect Brazil with other parts of Latin America, Europe and Africa, notably Seaborn Networks' SABR cable (which was ready for service in 2019), the first subsea cable between South Africa and Brazil, the EllaLink project, a subsea cable connecting Brazil and Portugal (due to go live in October 2021), and GuyaLink cable, between Kourou in French Guiana on the northeastern coast of South America to Fortaleza, Brazil

CURRENT AND POTENTIAL FINANCING TRENDS

The majority of investments in the digital infrastructure space have been private, and this is likely to continue to be so. In addition, it seems highly likely that they will, increasingly, involve commercial or development bank financing. The high upfront costs of constructing large capital assets such as data centers, combined with long-term revenue streams, could lend themselves to potentially limited or non-recourse financing structures, or a hybrid of those with leverage or real estate financing principles, depending on the type of lender involved.¹⁰

To date, however, most digital infrastructure projects have tended to be on a corporate or lease finance basis. Cable projects, for instance, have tended to be developed and financed by sponsors bringing their own debt financing on their balance sheet or an equity issuance. For instance, the US\$461 million expansion of the Brazilian telecom Oi's fiber-optic network, which closed in April 2021, was funded through a private placement of convertible bonds. Cable companies typically contract for long-term capacity commitments or "indefeasible rights of use" (IRU). As this results in a lump-sum up-front payment for a right to use part of the capacity on the cable along with operation and maintenance payments over time, the need for long-term financing has been minimal. Further, cable companies tend to not fully contract cable capacity to maximize revenue streams, leaving the project exposed to merchant risk. For large intercontinental subsea cable projects in particular, the challenges



inherent in securing the necessary rights to the cable's route across multiple jurisdictions, combined with the long-term risks of competitors or technological advancements (accentuated when the cable is not fully contracted with long-term commitments) typically deter project finance approaches.

Similarly, limited recourse or non-recourse financings for data centers in Latin America have yet to be seen on a major scale. In general, Latin American data centers are owned or developed by large investors such as Google, Oracle and HP. These companies tend to invest equity instead of approaching debt markets for funding. Nevertheless, encouraging signs exist that debt financing may become more prominent. The most recent deal to have closed in July 2021, the €320 million financing of Asterion Industrial Partners' data center business Nabiax, which owns a network of data centers in Spain and Latin America, was one of the first environmental, social and governance (ESG)-linked project financings in the sector, albeit with short (five-year) tenors on its term, capex and revolving credit facilities. Earlier in 2021, Odata, which is majority-owned by Brazilian private equity firm Patria Investments, received a US\$30 million loan from the International Finance Corporation (IFC) to expand its colocation data center operations in Brazil and Colombia, though this was based on the balance sheet of the company. Significantly, this was the first-ever data center financing by the IFC, and upcoming projects in LAC and other emerging markets suggest that IFC and other agencies will be stepping up financing in this space in the near term.

The need for more structured financing solutions may grow as digital infrastructure assets necessitate large capital expenditures. Due to the high cost involved in the construction and operation of mega-data centers, the importance of deploying capital more efficiently may encourage a shift toward alternative funding sources. There is a growing demand for prefabricated data centers as they reduce the time between design and implementation by several months, which improves the return on



As the so-called 4th Industrial Revolution unfolds, digital infrastructure will fundamentally enable and drive economic growth and productivity in all regions across the globe.



20 billion

The "Internet of Things" could be made up of 20 billion devices or more worldwide by 2022—more than three objects per person

OECD

investment of these projects. In Latin America, Brazil has become a regional export center for prefabricated data centers, including their design, assembly and testing. Financing prefabrication manufacturing facilities or exports could become an important growth area as the demand for data centers increases.

Further, the expansion of colocation data centers and competitive pricing of services depends increasingly on the optimization of energy consumption, which can account for up to 40 percent or more of a data center's operating expenses. Investment in advanced critical infrastructure and thermal systems (e.g., evaporative coolers and solutions that use water or air cooling) are increasingly adopted by colocation data centers in Brazil, Chile and Colombia, and may create opportunities for green financing techniques. For instance, the Nabiax project financing mentioned above linked pricing to the achievement of specific ESG targets, whereby an increased use of renewable electricity, reduced water consumption per megawatt, and hiring of more women would result in a lower interest rate (and conversely, penalties if such goals were not met).

As the so-called 4th Industrial Revolution unfolds, digital infrastructure will fundamentally enable and drive economic growth and productivity in all regions across the globe. Digital transformation can only be fully realized if high-quality access to communication networks and services is made available at affordable prices. The importance of these investments into digital infrastructure in Latin America and the Caribbean therefore cannot be overstated. Their impact on the growth of Latin American and Caribbean economies and on the livelihood of their people will be felt

in years to come across all industry sectors. It will also be essential for ensuring that the LAC region does not fall behind in the "Internet of Things" (IoT), which is poised to transform the way in which data drives economies and societies. According to the OECD, the IoT could be made up of 20 billion devices or more worldwide by 2022—more than three objects per person. Without the necessary infrastructure being installed at scale, these transformational trends could make bridging the digital divide even harder to achieve in the future.

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Equity capital markets in Latin America

Strong pandemic-era performance and a look around the corner

By John Guzman, Bibiana Jaimes, Carlos Mainero and John Vetterli

During the first eight months of 2021, Latin America recorded its strongest initial public offering (IPO) activity of the past six years. In total, 55 IPOs took place up to the end of August. That compared to 36 new issues for the whole of 2020. All this in a year that saw the region's economy contract by 6.9 percent due to the COVID-19 pandemic¹—the sharpest contraction in the world.²

Moreover, first-half deal volume (32 in H1) also accelerated compared to the second half of last year, when 27 companies came to market for the first time. Value and volume have already outstripped every year since 2015, and, with more companies unveiling plans to come to market, records may continue to be smashed (see figure 1).

This stands in sharp contrast to the general trend over the past decade, which saw domestic Latin American markets struggling to attract new companies to go public, with capital from US and European markets shifting toward emerging markets in Asia-Pacific.³ This meant

that Latin American markets remained concentrated around a relatively low number of listed companies largely dominated by company groups. The recent uptick in Latin American IPO activity injects new life into the global IPO scene.

In value terms, the region also posted strong figures: The 55 IPOs to the end of August raised US\$15.17 billion, an increase of 41 percent compared to the whole of 2020, when US\$10.8 billion was raised.

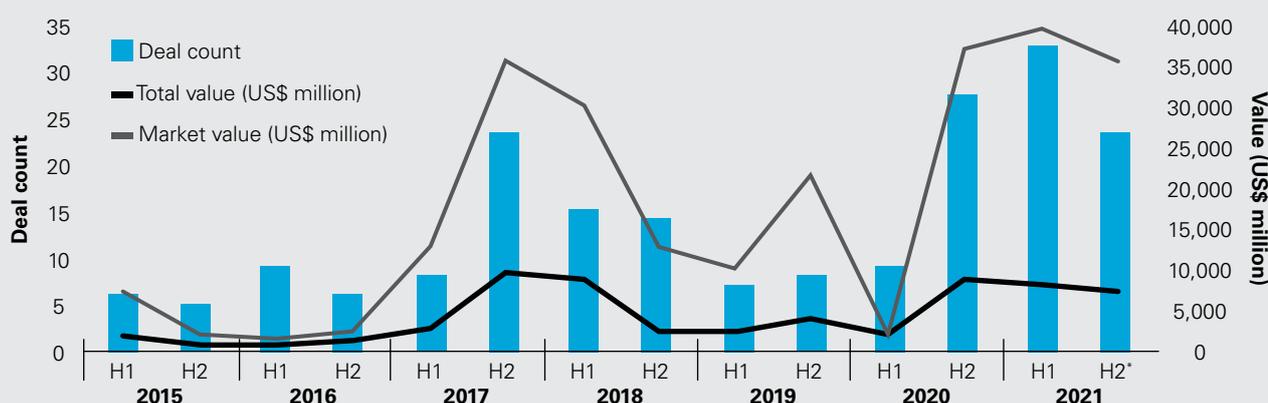
The broad range of sectors that saw significant IPO activity is also noteworthy. Since January 2021 in Brazil, there has been a steady stream of IPOs in more traditional industries such as oil & gas, financial services and transport and retail. However, we have also seen activity in sectors such as healthcare with the IPO of Hospital Care Caledonia; mining with Companhia Brasileira de Alumínio coming to market; technology as TC Traders Club S.A. floated on the São Paulo exchange in July; and in telecoms with Unifique Telecomunicações S.A. coming to market in the same month.

IPO CARNIVAL IN BRAZIL

The Brazilian market dominated Latin American dealmaking during the first half of 2021, with the country accounting for all but five of the IPOs that came to market. The strength of the country's new issue market reflects the broader bounce-back of the Brazilian economy in 2021. The International Monetary Fund (IMF) expects economic growth of 3.7 percent in Brazil this year, followed by 2.6 percent growth in 2022; that compares to an estimated decline of 4.1 percent over the whole of 2021.

Market analysts also point to the strength of Brazilian equities during the first half of the year, with the Bovespa stock market index rising 8.4 percent over the six months to June 30. That has seen both domestic and international investors take increasing interest in the country.

Figure 1: Latin America IPO activity (deal count, value, market value 2015 – 2021 – Sept 1)



Source: Dealogic

*Year to date (data correct as of 2 September 2021)





MEXICO MAKES A COMEBACK

Mexico's IPO market has been slow over the past few years. There have been a number of factors behind this, including the implementation of several regulatory policies that limit private investment in the energy sector, and the slowdown from the COVID-19 pandemic. This has resulted in Mexican companies struggling to find adequate incentives to make offerings. However, the deals that are being done demonstrate that investors (particularly institutional investors, such as AFORES, the Mexican pension funds) have the appetite to invest in the equities market.

In 2020, BlackRock Inc. launched its iShares ESG MSCI Mexico ETF (ESGMEX), on the Mexican Stock Exchange (Bolsa Mexicana de Valores), which is the first ETF that tracks a Mexican market-based sustainable index (the ESG Mexico ESG Select Focus Index). Within the first few months of its launch, this ETF reached US\$500 million in assets under management, primarily through investments by AFORES.⁴

In May 2021, Sempra Energy, the California-based company with energy infrastructure investments in North America (including Mexico, through its subsidiary IEnova) conducted an exchange offer on the Mexican Stock Exchange for shares of IEnova. As a result of this US\$1.8 billion deal, Sempra Energy now has its common stock listed on the Mexican Stock Exchange, trading as one of the few foreign issuers there.

In addition, the past few years have seen Mexico becoming a hub for fintech companies, in a country where much of the population has no formal access to banking and

financial services. This trend has been supported by the 2018 enactment of the Mexican Fintech Law, the first statute of its kind in the region. It is likely that the technology sector, and fintech in particular, will drive IPO activity in Mexico in the years ahead.

THE ELECTION EFFECT

Notwithstanding the recent track record, it makes sense to observe the geopolitical drivers in the region, which will accelerate or hamper IPO activity in the coming years. Recent research of roughly 9,500 IPOs that occurred across 33 countries between 1995 and 2017 showed that IPO underpricing is significantly more prevalent just before the general elections.⁵ This underpricing effect tends to be less pronounced in developed democracies that are characterized by effective corporate governance.⁶ It has also been shown that IPOs tend to be fewer in number during election years.⁷

General elections are scheduled to take place in Brazil and Costa Rica in 2022, as well as a presidential election in Colombia that year. General elections are also due to take place in November 2021 in Nicaragua and Chile, with a legislative election scheduled in Argentina during the same month, and a general election in Honduras in December. Venezuela is also scheduled to hold municipal elections in the coming months.

Political uncertainty can have a general depressing effect on IPOs for other reasons, too. If uncertainty causes the country's currency to weaken, that can lead to divestment—in turn making it more difficult to achieve successful IPOs. Similarly, if uncertainty causes interest rates to rise, stock markets



IPO activity in Latin America has hit record levels in 2021, with the region's largest economy taking the lion's share of the bounty.

will be negatively impacted and IPOs more challenging. In addition, if central banks curb liquidity, economic growth will be depressed.

The fact that Brazil's central bank felt it necessary to hike interest rates three times between February and June illustrates growing nervousness about Brazilian inflation, which reached 8 percent in May, and further interventions may occur.

THE PANDEMIC IMPACT

More broadly, the uncertainties of the pandemic inevitably mean that further lockdown restrictions cannot be ruled out across Latin America. The World Health Organization (WHO) has warned that case numbers are once again surging in the region. However, dealmakers have rapidly evolved to overcome the logistical challenges posed by the pandemic, becoming adept at running IPO processes and roadshows virtually, without face-to-face engagement.

In general, though, the short-term factors in Latin America appear to make cautious optimism the most appropriate sentiment regarding the prospect for the flow of IPOs through the remainder of 2021 and into 2022. Equity capital markets (ECM) in Latin America are relatively

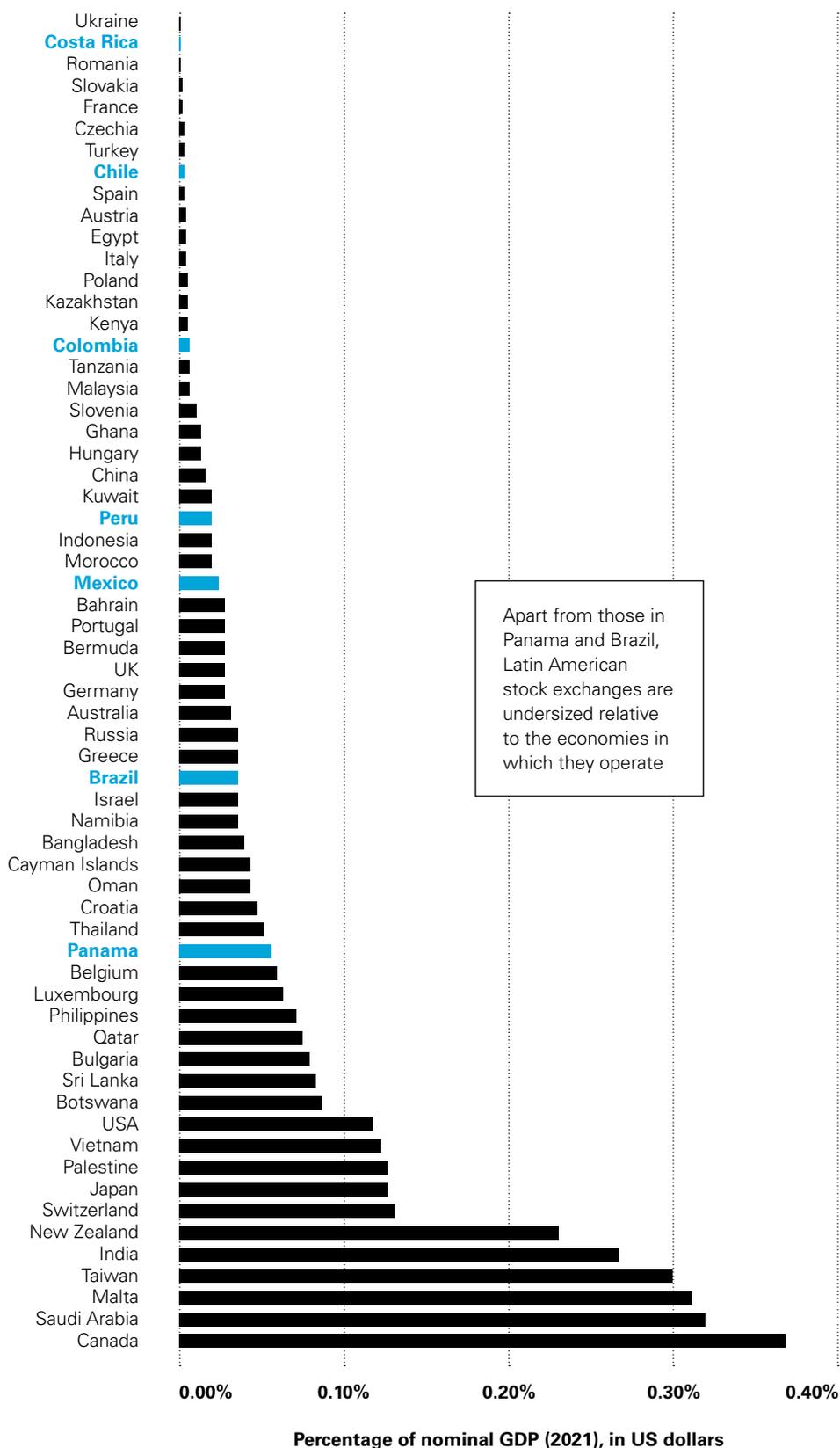
small when compared to developed economies, indicating significant scope for growth as the region's economies mature. Figure 2 shows this clearly, comparing stock market capitalization to gross domestic product (GDP) in a range of countries worldwide.

A BRIGHT, IF UNCERTAIN, OUTLOOK

Latin America's IPO bonanza over the past year or so is in line with the global equity capital markets generally. More than 6,100 equity capital markets offerings were brought to market globally during 2020, a 33 percent increase compared to a year ago and an all-time record. ECM activity totaled US\$1.1 trillion during 2020, a 56 percent increase compared to a year ago and the strongest annual period for global ECM activity since records began in 1980.⁸

Despite institutional, geopolitical and other challenges to overcome, the outlook for ECM activity in Latin America—including further IPOs—appears bright.

Figure 2: Market capitalization of stock exchanges expressed as a percentage of nominal GDP (2021), in US dollars



Apart from those in Panama and Brazil, Latin American stock exchanges are undersized relative to the economies in which they operate

1 World Bank (2021), *World Economic Outlook: Latin America and the Caribbean*.
 2 International Monetary Fund (IMF) (2021), *Short-Term Shot and Long-Term Healing for Latin America and the Caribbean*, available at: <https://blogs.imf.org/2021/04/15/short-term-shot-and-long-term-healing-for-latin-america-and-the-caribbean/>.
 3 Organisation for Economic Co-operation and Development (OECD) (2019), *Equity Market Development in Latin America: Enhancing Access to Corporate Finance*.
 4 <https://www.fundssociety.com/es/noticias/etf/cinco-afores-invierten-en-el-etf-esg-con-exposicion-a-mexico-de-blackrock>.
 5 G. Marcato and C. Zheng (2021). *Political Uncertainty and Cross-Country IPO Underpricing*. Paper presented at the 2021 annual meeting of the European Financial Management Association, Leeds, England, June 30 – July 3, 2021.
 6 H. N. Duong, A. Goyal, V. Kallinterakis and M. Veeraraghavan (2021), *Democracy and the Pricing of Initial Public Offerings Around the World*. Journal of Financial Economics, available at: <https://doi.org/10.1016/j.jfineco.2021.07.010>.
 7 G. Çolak, A. Durnev and Y. Qian (2017), *Political Uncertainty and IPO Activity: Evidence from U.S. Gubernatorial Elections*. Cambridge University Press. Published online on December 4, 2017, available at: <https://www.cambridge.org/core/journals/journal-of-financial-and-quantitative-analysis/article/political-uncertainty-and-ipo-activity-evidence-from-us-gubernatorial-elections/8F2EE62C6038B166F009987127269210>.
 8 Refinitiv (2021), *Global Equity Capital Markets Review 2020*.
 9 World Bank website, accessed on 19 September 19, 2021, available at: <https://data.worldbank.org/indicator/CM.MKTLCAPGD.ZS?>

Source: World Bank⁹

M&A in post-COVID-19 Latin America

Established trends driving M&A globally are also reflected in Latin American deal flow

By Jeannine Acevedo, Rodrigo Dominguez Sotomayor and Álvaro E. Garza-Galván

With disruptions from 2020 behind us, M&A practitioners have much to reflect upon relating to deals in Latin America. The first half of 2020 saw a steep slowdown in transactions, increased political uncertainty and uneven responses to the pandemic across the region. An eventful presidential election was held in the US, and presidential, mid-term and mayoral elections also took place in some of the largest Latin American economies, including Brazil, Argentina and Mexico. A general election also took place in Peru in April 2021. Dealflow ended 2020 strongly, with the region seeing a significant recovery in M&A transactions. Although the COVID-19 pandemic resurfaced some historical sociopolitical challenges endemic to the region, M&A activity in Latin America appears to be on a path to pre-pandemic levels, driven by the resurgence of its strongest economies.

APPROACHING LATIN AMERICA AS AN INVESTMENT DESTINATION

For bidders, confusing geo-economic and sociopolitical landscapes require careful review of political risk in the acquisition or merger target's host country. Such risk presents itself in many different forms. Examples include changes in public policy, tax laws, governmental approvals proceedings, and legislative or regulatory requirements. Changes in the terms that apply in contracts with government counterparties and to foreign exchange rules or cash repatriation laws can have especially important impacts. Political uncertainty might even trigger a downgrade of the sovereign credit

rating of the host country and, consequently, on the credit ratings of local issuers. Tough times sometimes force governments to take drastic measures. Wise investors know that within limits of investment protection treaties, and agreements and norms of international law, any country (not just in Latin America) is at liberty to pass new laws as their legislatures see fit, to address the most pressing needs of their people.

As in other emerging markets, successful investors in Latin America understand these risk factors and the unique characteristics of the region. They carefully study the region's nuances, both from a cultural and business perspective, the efficacy and limitations of the host country's legal system in enforcing the rule of law, and the investment protection framework afforded by any applicable investment treaties. Once the savvy investor identifies the aforementioned factors, she anticipates market competitors in order to have the upper hand in her investment. All of these factors can have a direct impact on the return achieved on investment (ROI) and even the success or failure of the merger or acquisition. Investors need also to be familiar with the political and legislative cycle of the host country, not least because that can provide a valuable edge during negotiations. Understanding the differences between legal systems and the protections that they afford allows investors to price assets more accurately. It is no coincidence that those who put the right level of emphasis on these factors from the outset of a transaction usually achieve the best outcomes, both in the transaction itself and in the subsequent post-merger integration and operations. Deep understanding of drivers of a deal's success can yield good dividends.



Despite these risks, there is much reason for investors to be optimistic about their prospects in Latin America.

Investors should always base long-term investment decisions on the reality that new administrations following elections might have different views on policies and social issues. They might make changes that impact the investor and the potential ROI that the transaction might yield, or even its overall feasibility. Populist, nationalist policies adopted by several governments in Latin America during the pandemic emphasized the need for investors to pay close attention to all investment protections at hand—both in terms of the efficiency of the host country's court system in enforcing the rule of law or under the country's multilateral and bilateral treaty networks.

Despite these risks, there is much reason for investors to be optimistic about their prospects in Latin America. Resilience and growth became evident in the largest economies in the region during the second half of last year, and this has maintained momentum into the first half of 2021. The current year commenced with a year-on-year increase in M&A, with a healthy pipeline especially from the middle-market to the larger players. As the year progressed, M&A activity has been inching toward the levels that existed prior to the pandemic (see figure 1).



This trend is not accidental. Continued growth of the region's consumer base makes Latin America a promising investment prospect. Its young population is eager for high-quality urbanization and infrastructure, better and more efficient services, and faster and more effective technologies. The MSCI Emerging Markets Latin America Index, which captures large- and mid-cap representation across the six largest economies in Latin America, shows that year-to-date returns for the first half of 2021 in those markets outperform the returns shown in other emerging markets.

On the procedural front, the willingness of local counterparties to run acquisition processes more institutionally through investment bankers or international financial advisors, as well as to rely on more conventional international M&A structures, such as stock-for-stock acquisitions, reverse triangular mergers and similar business combinations that are popular in the US and Europe, have added much needed comfort to market participants in the region and is certainly resulting in increased deal activity. Similarly, the propagation of representation and warranties insurance in Latin American deals is making acquisition processes

more efficient, as it offers sellers the chance to achieve a cleaner exit and buyers a more expedited remedy against insurance companies in US courts. These factors, together with the fundamental drivers in the local economies summarized above, are making the region more attractive and giving dealmakers a more leveled playing field to pursue regional M&A opportunities more aggressively.

COVID-19 RESILIENCY HIGHLY UNEVEN ACROSS LATIN AMERICA

Some economies and industry sectors proved more resilient than others during the COVID-19 pandemic. Brazil, for instance, contributed to almost 60 percent of the regional announced M&A transactions, followed by Mexico, Chile, Peru and Colombia (see figure 2). Brazil also pushed through its long-anticipated privatization agenda and implemented several structural changes that boosted economic activity in the country prior to the pandemic. The devaluation of the Brazilian real, coupled with very low interest rates in some of the major developed economies, also created a significant volume of M&A transactions that continues to feed deal activity in the region.

Countries such as Mexico, on the other hand, adopted a more antagonistic approach toward foreign investors. The country's government pursued a more nationalistic agenda in its energy sector that, for much of 2020 and so far in 2021, has significantly slowed down foreign direct investment (FDI) into that sector.

Because of the outcome of its recent general election, Peru is currently an enigma in the region. The country has good fundamentals and a solid track record of M&A transactions. However, many investors are wary of the risk of regulatory and policy changes. Some investment decisions are being delayed until greater clarity exists about the direction that the new administration intends for the country.

Latin American M&A is generally known for its large number of cross-border transactions, both incoming and by Latin American bidders into other regional markets and beyond. Over the past two years, Brazilian acquirers have been the regional leaders, with almost US\$85 billion reported cross-border acquisitions. This amount is almost twice as much as FDI from the US, which is historically the most active acquirer in the region. Acquirers

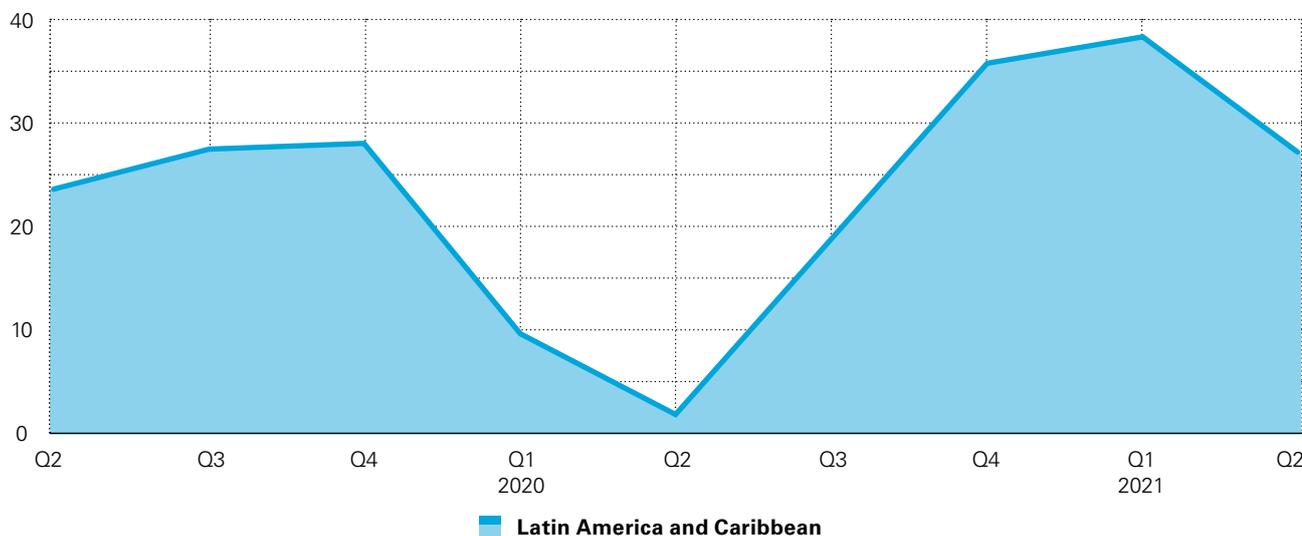
Figure 1: M&A activity by value Q2 2019 – Q2 2021

Target location: Latin America and Caribbean

Bidder location: Global

Sectors: All sectors

Deal value (US\$ billion)



Source: White & Case M&A Explorer, in partnership with Mergermarket

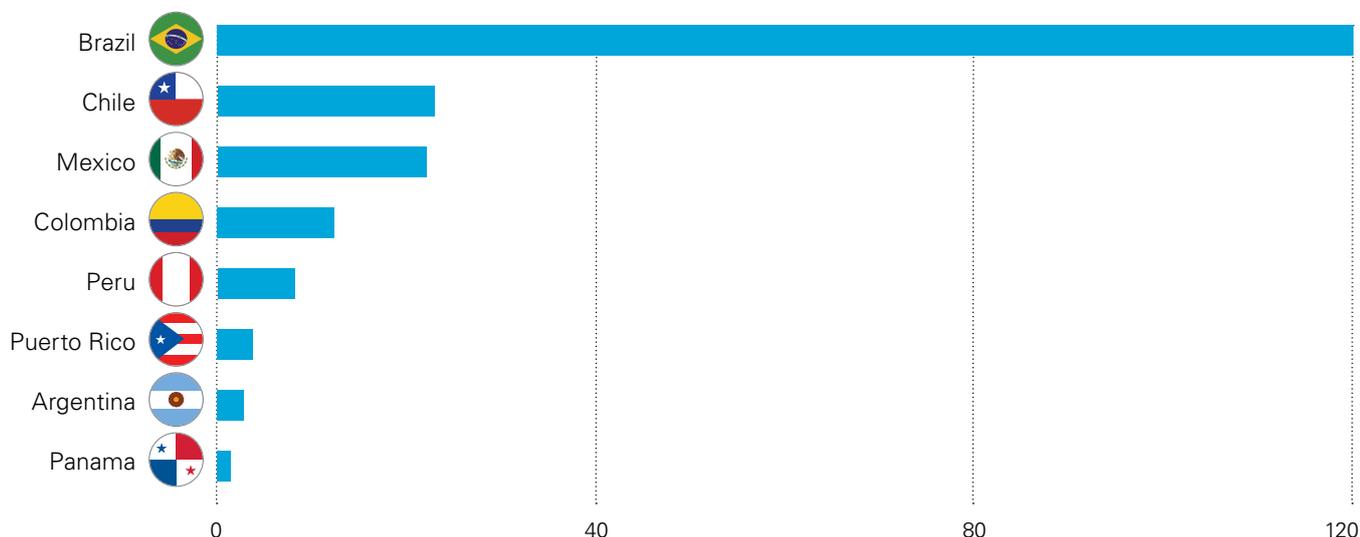
Figure 2: M&A activity: Top targets by value Q2 2019 – Q2 2021

Target location: Latin America and Caribbean

Bidder location: Global

Sectors: All sectors

Deal value (US\$ billion)



Source: White & Case M&A Explorer, in partnership with Mergermarket (Note: Exclude Bermuda + Cayman)

from France, China, Spain, Canada, Japan and Italy along with Chile and Colombia have followed suit (see figure 3). This deal activity is mainly driven by private capital, funds and strategic investors looking to diversify into the region, low interest rates and, in the case of Brazil, by an investor-friendly policy that has facilitated M&A activity across borders.

THE ENERGY TRANSITION AND CLIMATE CHANGE MITIGATION INITIATIVES ARE DRIVING ACTIVITY IN THE ENERGY AND NATURAL RESOURCES SECTORS; DIGITAL AND OTHER INFRASTRUCTURE, AND FINTECH, ALSO PROVE RESILIENT

Deal activity during H2 of 2020 and H1 of 2021 has mainly been concentrated in three major sectors: energy, mining and utilities (including infrastructure), financial services and technology. Energy and infrastructure sectors, especially related to power, have performed notably well. Diversifying fossil-fuel power generation into renewable energy and transmission assets is pivotal for regional governments to drive economic development and energy security while simultaneously

meeting their environmental, social and governance (ESG) commitments under the Paris Agreement and other related multilateral agreements to reduce greenhouse gas (GHG) emissions. The COVID-19 pandemic might have slowed down the implementation of such plans, but the long-term intent of regional governments to transition into more sustainable energy policies remains undeterred. Legislation currently under consideration in Chile, for example, will likely end coal-fired power generation in that country by 2025. Brazil has committed to a 37 percent reduction from 2005 GHG levels by 2025, and a 43 percent reduction by 2030.¹ The upcoming COP26 conference in Glasgow in November will sustain focus on these issues through the remainder of 2021, and into 2022 and beyond.

Governments are not alone in driving this transition. Investors too are experiencing increasing pressure from their constituencies and management to divest equity positions in conventional power assets and to replace them with clean energy assets that can help achieve their own ESG objectives. Also, prices of renewable energy technologies are at record lows

today, as is the cost of funding, making the transition less expensive than it would have been just a few short years ago.

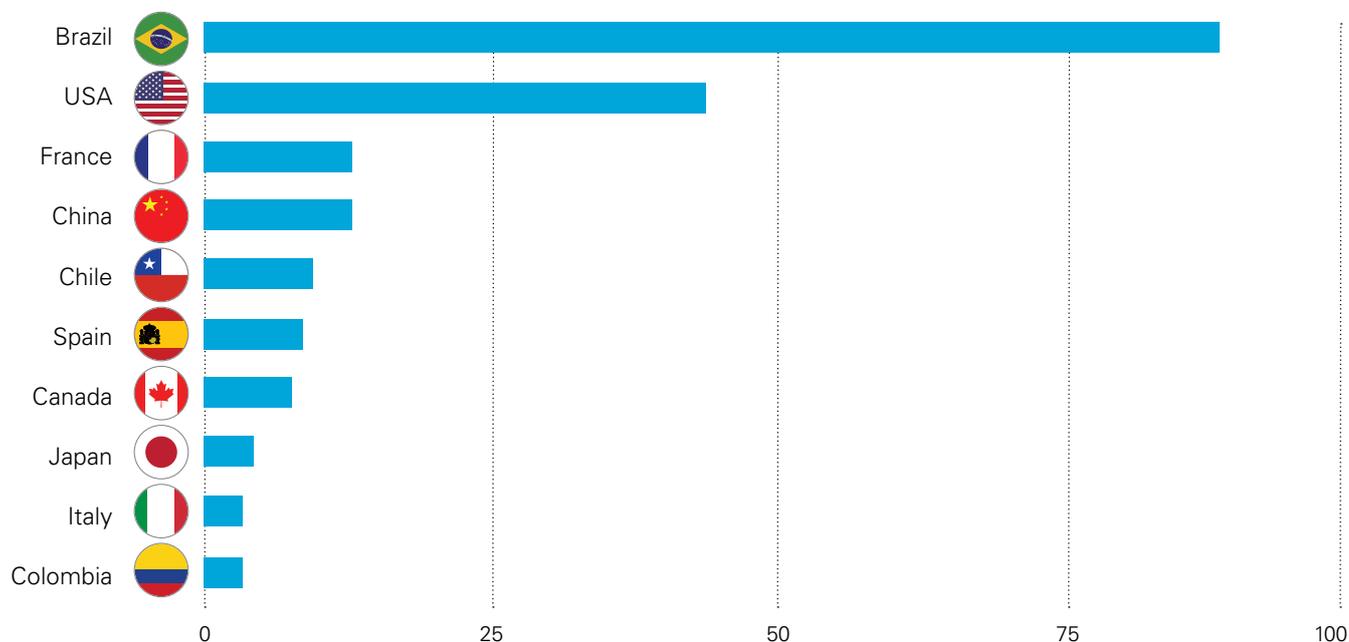
This transition will continue to generate a great amount of M&A work in the region, and we expect Brazil and Chile to lead the market. Colombia’s National Program of Greenhouse Gas Tradable Emission Quotas (Programa Nacional de Cupos Transables de Emisión de Gases de Efecto Invernadero or PNCTE), established in 2018, is having a similarly positive impact on renewables in that country. On the other hand, Mexico’s role in the energy transition efforts remains to be seen. While Mexico implemented a very ambitious energy reform a few years ago, policy changes by the current administration have significantly downscaled Mexico’s commitments under the Paris Agreement, compared to other leading Latin American countries.

Besides solar and hydro-electric generation, “green” and “blue” hydrogen has also generated a great deal of interest in Latin America as an alternative for transport fuel and industrial processes.² This is spurring joint ventures that might in turn translate into M&A activity. Chile led

Figure 3: M&A activity: Top bidders by value Q2 2019 – Q2 2021

Target location: Latin America and Caribbean **Bidder location:** Global **Sectors:** All sectors

Deal value (US\$ billion)



Source: White & Case M&A Explorer, in partnership with Mergermarket

the way by announcing last year its national green hydrogen strategy in line with its decarbonization policy, setting ambitious but apparently achievable goals for electrolysis capacity within this decade. Chile's energy and mining minister regularly appears in industry and academic conferences preaching his country's mission to be a global leader in green hydrogen production. Pilot projects have been announced in several countries, including multibillion-dollar projects in Brazil and Chile for green hydrogen export, and bills intended to attract investment into this sector have been drafted. Colombia, for instance, has enacted an energy transition law that grants certain fiscal incentives to green and blue hydrogen.

Significant regional opportunities in infrastructure also exist outside of the energy and natural resources sectors. Latin America continues to require significant investments in transport and social infrastructure to meet national development objectives and the demands of young and increasingly economically active populations. Concessions

for roads and other transportation assets across the region need to be expanded, improved and, in some cases, refinanced. In countries such as Colombia, a new wave of tenders is expected, which create opportunities for both strategic and financial sponsors. Investment managers with a global footprint are making their first ventures into Latin American infrastructure, entering into M&A transactions for assets in electric mass transport that meet their stakeholders' ESG goals.

President Biden's newly announced "Root Cause" program, consisting of a US\$4 billion investment to address poverty, violence and inequality in El Salvador, Guatemala and Honduras, will likely also provide a good boost to infrastructure transactions in Central America. According to public sources, Mexico, Japan, Korea and the United Nations have committed to provide relief to the region as part of this program. Participants in the plan will prioritize investments in digital infrastructure, housing and financial services. The Root Cause program aims

to reduce illegal migration to the US by addressing the root causes of the migration in the countries from which migrants originate.

The COVID-19 pandemic, including the effects of shifts to wholesale "work-from-home," accelerated digital transformation trends that had been under way for some time, in Latin America as in other global regions. This has driven demand for new, improved digital infrastructure, catalyzing innovation and driving M&A activity in this sector too. Brazil, Mexico, Chile, Colombia and Peru lead the charge, with several technology sector transactions announced in 2020 and the first half of 2021. Technology assets are also achieving more attractive valuations than in the US and Europe, enhancing the relative attractiveness globally. By the end of 2020, more than 20 technology unicorns (technology companies with market capitalizations exceeding US\$1 billion) had emerged across Latin America. Six months into 2021, that list had grown to at least 23, one-third of which were located in Brazil.

Night view of modern colorful fountains, Lima, Peru

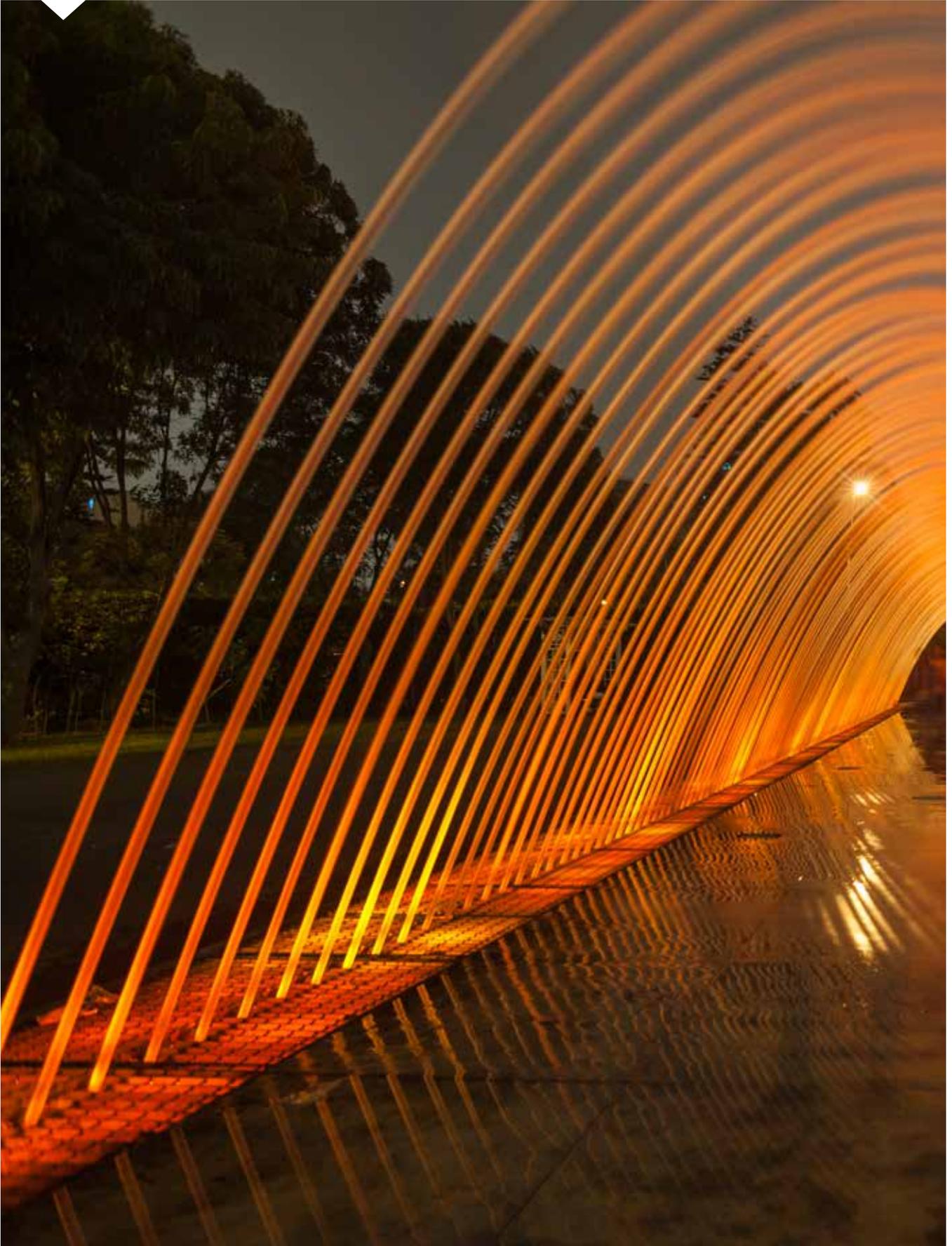
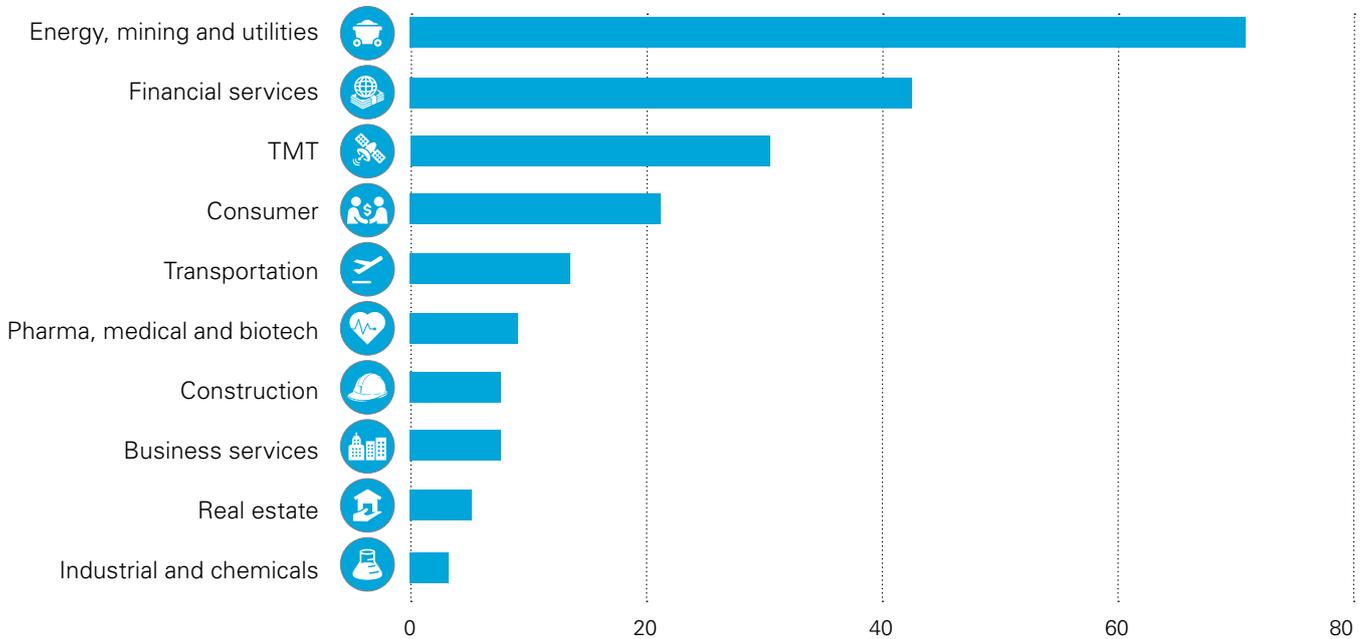


Figure 4: M&A activity: Top sectors by value Q2 2019 – Q2 2021

Target location: Latin America and Caribbean **Bidder location:** Global **Sectors:** All sectors
Display: Deal value (US\$ billion) | Volume



Source: White & Case M&A Explorer, in partnership with Mergermarket

The growth has been driven mainly by large private equity investments in regional fintech companies.

The fintech sector will be perhaps the biggest winner in post-pandemic times, as market participants have realized the opportunity resulting from the convergence of the stay-at-home economy, a younger demographic who are familiar and comfortable with consuming digital services, and a historically underserved and underbanked population. Banking services in the region have traditionally focused on conventional brick-and-mortar banking, to the exclusion of a large portion of the population located in rural and less developed regions. For instance, it is estimated that more than 50 percent of Mexico’s population is unbanked, which opens a wide array of opportunities for the fintech sector in the country. Brazil has an estimated 34 million unbanked adults.³ With economies that are largely cash-based, we anticipate the M&A activity in this sector to remain strong in 2021 and beyond. Although laws governing their use vary widely

across the region, from Bolivia that has comprehensively banned them to El Salvador’s attempts to make bitcoin legal tender in that country, interest in cryptocurrencies is also burgeoning across Latin America. Opportunities will likely continue to emerge for financial and institutional investors to build up equity positions in strong companies with enormous growth potential. We also expect traditional banks to engage in defensive M&A to improve their technology platforms and serve a very young demographic across the region but, most importantly, to retain their market share and client base.

As 2021 draws to a close, and the COVID-19 pandemic is brought under control, M&A players must keep a close eye on how to protect their regional investments and the stability of the economies in which they invest. Latin America has experienced variable geo-economic and socio-political volatility for the past half-century at least. Investors need to understand the risk-affecting nuances of the host country in order to optimize their ROI and, at an

extreme, to avoid expensive failures. With a more detailed understanding of the local legal framework and challenges, Latin America’s promising growth trajectory, fueled by its young demographic eager for better and improved services, a growing middle-class, and vast natural resources, offers opportunity for successful investments and significant profit.

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 2 C. Lenton (2021), *Latin America Looking to Take Slice of Global Hydrogen Pie*, Natural Gas Intelligence blog accessed on September 19, 2021, available at: <https://www.naturalgasintel.com/latin-america-looking-to-take-slice-of-global-hydrogen-pie/>.
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