Social Bonds
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Social bonds may be the youngest member of the sustainable bonds family, but they are growing up fast. The promising start suggests that they may, in time, even catch up with their older green siblings.

Having started life as an offshoot of the green bond category, social bonds are proving that while they are separate in nature they are equally viable for both issuers and investors. They dovetail neatly with the green bond market, in terms of their structures and overall commitment to Environmental Social Governance (ESG) purposes for the use of proceeds, while still developing as a distinct asset class in their own right.

In 2007 the green bond market kicked off with issuance from multilateral institutions European Investment Bank (EIB) and World Bank. The wider bond market started to react after the first $1bn green bond was sold by IFC in March 2013. The new impetus for sustainable fixed income instruments, aimed at the growing constituency of socially responsible investors, soon gained momentum. Between 2008 and 2012, issuers brought $2.5 billion of green bonds to market, but in 2013, issuances took an exponential leap, vaulting to $11 billion, new issuance trebled again to $35 billion in 2014 and stepped on to $42 billion in 2015. 2016 so far has seen approximately $31 billion green bonds issued with China alone issuing around $11 billion equivalent.

Social and Sustainability bonds, the more recently developed categories, have experienced remarkable traction of their own. In the first four years of their existence, these products reached almost $15.6 billion in issuance. Can they maintain their appeal at such a rate - as green bonds have done in the last few years?
The birth of Social Bonds

The Spanish Instituto de Credito delivered the first formal ‘Social Bond’ offering in January 2015, aligned to the Green Bond Principles and with a second opinion from Sustainalytics, this inaugural issuance sets a precedent for bonds of this type. The purpose of the transaction was to help finance SMEs in economically depressed regions of Spain, which generate lower GDP per capital than the national average. In an effort to spur employment, the bond offered loans at favourable rates and terms to SMEs and micro enterprises. Companies deemed to be unsustainable from a socially responsible angle were excluded. The results were extremely successful. The one billion euro bond, with a three-year term, captured interest from a wide range of investors, with 24% of bonds distributed to Asia and the Middle East, followed by Spain, Germany and other European buyers.

More recently towards the end of 2015, Kutxabank issued the first and largest social covered bond the market has seen (EUR 1bn 10yrs), with focus towards subsidising dwelling units with regulated dimensions and prices, for low income residents in the Basque region.

The evolution of social bonds

The following diagram demonstrates the connections between the different categories of sustainable financing, it is helpful to see how both green and social bonds overlap to create “sustainability” offerings, which can cover either types of transaction, or a combination of both.

Moving out more broadly from strictly environmental or social goals, sustainability bonds comprise a hybrid set of objectives, bridging both green and social issues. For instance, previous issuances have included energy efficient buildings for disadvantaged people, or clean public transport with tramway extensions and bicycles lanes. A glance through some of the transactions which have been completed demonstrate the wide array of projects that have been funded: Looking back at the period from 2008 through June 2015, certain landmark issuances have included the Inter-American Development Bank’s EYE bonds, aimed at education, youth and employment, and Air Liquide’s SRI bonds, aimed at home healthcare services. FMO has focused on Green Investments – including Renewable energy and Energy Efficiency projects and Inclusive Investments – including financing of micro, small- and medium-sized enterprises, while Munchener HypothenkenBank used covered bonds to support social housing.

Notably these transactions largely follow the same set of principles as green bonds do, when it comes to establishing their structures, producing documentation, monitoring progress and reporting results.

Integrity and Transparency

With the move from niche to mainstream for the sustainable financing market, investors are keen for clarity that they are spending their money wisely, both financially and socially. In the green bond space, the Green Bond Principles (GBP) play a key role in providing that clarity, by defining the structure, documentation, monitoring and reporting.

Taking a leaf out of the same book, a Social Bond Guidance has just been launched by ICMA, (International Capital Markets Association), with a complementary mission of promoting transparency, disclosure and integrity in the social and sustainability bond market. A trio of leading sustainability underwriters – HSBC, Credit Agricole CIB and Rabobank - joined forces in July last year, to leverage their combined expertise to develop a proposal for Social Bond Guidance to be considered by the GBP. Earlier this year, a dedicated working group was formed to review the proposal, which was then considered by the Green Bond Principles Executive Committee at ICMA. The Social Bond Guidance was then released publically on the 16th June 2016 as part of the 2016 GBP update at the ICMA GBP AGM.

The Guidance states ‘Social Projects are projects, activities and investments that directly aim to help address or mitigate a specific social issue and/or seek to achieve positive social outcomes especially, but not exclusively, for target population(s).’ (For Full guidance
Social Projects should provide clear benefits that can be described and, where feasible, quantified and/or assessed. Examples of expected positive social impacts should be stated and may include, but are not limited to, the number of beneficiaries from these projects.

Please see below illustrative examples of Social Project categories that seek to achieve positive socio-economic outcomes for men, women and children in target populations.

Social Project categories include, but are not limited to, providing and/or promoting:

- Affordable basic infrastructure (e.g. clean drinking water, sewers, sanitation, transport)
- Access to essential services (e.g. health, education and vocational training, healthcare, financing and financial services)
- Affordable housing
- Employment generation including through the potential effect of SME financing and microfinance
- Food security
- Socioeconomic advancement and empowerment

Examples of target populations include, but are not limited to, those that are:

- Living below the poverty line
- Excluded and/or marginalised populations and/or communities
- Vulnerable groups including as a result of natural disasters
- People with disabilities
- Migrants and/or displaced persons
- Undereducated
- Underserved
- Unemployed

The creators of the initiative hope that releasing this guidance will help to build on the first-to-market successful bond issuances, and to lay the foundations for future issuers to engage in funding social projects.

Both the GBP and the Social Bond Guidance share several dominant goals, primarily providing a backbone for their respective markets. The frameworks are designed to offer issuers guidance on the key components required for launching a credible instrument; furnish investors with the necessary information for assessing the social/environmental impact of their investment; and facilitate transactions by shaping certain standard disclosures.

It is important to point out that the GBP, as well as the Social Bond Guidance, remain voluntary guidelines, rather than fully fledged regulations. In other words, an issuer might deliver a green or social bond that does not fully adhere to those principles, although naturally it is strongly recommended that they do so. The crux is to achieve a fine balance between maintaining integrity and transparency and imposing overly structured requirements that might intimidate issuers from coming to market. A heavy handed emphasis on regulation at these early stages might actually prove counterproductive, by discouraging issuance. The immediate objective is to aid issuers in coming to market, and assist them in retaining scale and building a conducive environment.

The next chapters
As social bonds acquire a firmer footing and more widespread recognition, we would expect to see further issuances across Europe, building on the back of the early successes. Key players will likely include the supra nationals, sovereigns and agencies (SSAs), which blazed the trail in the formative years. In addition, more corporates are bound to join the ranks, with a wider spectrum of ratings, as well as specific regions, local authorities and banks.

At the next stage, we may also see prospects opening up in emerging economies. In those parts of the world, green bonds are already provoking interest, which suggest that social and sustainability bonds will follow suit. The foundations have been laid, as emerging markets prepare to turn their attention to the imperatives of climate change. It is worth noting that the agreement reached in December 2015 during COP21, not only included the Americas, Asia and Europe but also including a number of developing economies. These collectively represent around 95% of global GHG emissions (according to HSBC Climate Change Centre of Excellence Research, Dec 2015). This level of commitment would suggest that, as emerging market investors realize that green bonds offer direct access for climate change projects, by the same token, money ploughed into healthcare or social resources could find an equally appropriate home.
Investor Appetite
Several strands have motivated the tide of investor interest in sustainable investments. The most salient driver is the increasing public and political mobilisation around population and environmental issues. Hence the United Nations Principles for Responsible Investment has, to date, over 1,500 signatories, whose AUM amount to more than $63 trillion, compared to $4 trillion at PRI’s launch in 2006. Investors run the gamut, from asset managers and hedge funds, to real estate trusts, banks and pension funds, all deriving from both within and beyond the Social Responsible Investment (SRI) investor space.

At the same time, from the financial standpoint, returns on green, social and sustainability bonds often match the equivalent levels of conventional fixed income instruments. Given that investors can frequently receive a comparable rate of return, based on the overall credit rating of the issuer, it is unsurprising that they should welcome an additional opportunity which requires no sacrifice.

A further inducement for investors is the chance to diversify their portfolios, both by assets and geography. For example, while currently a clear tangent connects European investors with projects in their own regions, down the road, we may see more interest in social programs from a wider geographical base, especially as investors begin to appreciate the potential for exposure to variegated locations and types of instruments.

Government policy support should provide an additional tailwind. At this moment, senior level conversations are taking place from Europe to China over how various jurisdictions could support Sustainable Finance initiatives. Green Bond regulations developed in China to support domestic green bond issuance demonstrate the huge political and business support for this product and may in time also assist with supporting the Social Bond category. Similarly, the French label applied by Asset Managers in France to identify/promote Energy and Climate Transition, may also morph into the promotion of Social Aligned funds in the fullness of time.

Lately we have seen an initiative by Morningstar (a leading provider of independent investment research) introducing an ESG score on 20,000 funds they cover within the first half of 2016. Also MSCI (an independent provider of investment research) has introduced an ESG rating system which will be employed to some 20,000 funds by the end of 2016. We also expected a significant impact on investment behaviour based on the introduction of the Financial Stability Task Force on Climate-related Financial Disclosures (TCFD) and its intention to develop voluntary, consistent climate-related financial risk disclosures for use by financial institutions and non-financial institutions. With more transparency and data available, we expect to see more qualified investment decisions incorporating ESG principles as a standard for investment decisions.

Looking to the future
Just as we must be vigilant to protect against greenwashing, or misleading investors about environmental benefits, we must equally guard against irresponsible claims in the social arena. Again, it is a matter of finding the equilibrium between credible causes and viable issuers, while supporting these burgeoning sustainability markets as they coalesce.

As the industry continues to steadily grow, it is possible that regulation will evolve in due course given the attention this market is getting. In tandem with these discussions, there is often the mention of incentive structures, potentially in the form of tax or other regulatory areas to encourage more issuers to market and further foster institutional demand for sustainable investments. To build scale in this market the landscape will likely change, and with the political support and need to fill the finance gap, it may only be a matter of time. But, at this juncture, the main focus remains on encouraging issuers to engage, at least until the time is ripe for establishing a more formal incentive structure.

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