The surge in social debt issuance

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Foreword

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Social issues came to the fore in a massive way in 2020, and with them widespread global recognition for sustainable finance as a potentially powerful tool to help with solutions.

Social bonds and loans, and sustainability linked loans with social KPIs, have all gained momentum over the past year as a consequence and, in 2021, issuance and investor interest is continuing apace.

Beyond the pandemic, there's increasing uptake from governments, businesses and investors in financial instruments linked to tackling some of society's enduring – and often confounding – pain points, such as public health and education, modern slavery and diversity and inclusion.

Socially focused sustainable debt has faced similar obstacles to those previously confronted by green funding instruments. Questions about KPIs and how to measure the impact of projects have abounded. But it's quickly catching up, with clear guidelines now in the Loan Market Association's new Social Loan Principles and the International Capital Markets Association's Social Bond Principles, which clarify the definition of social project categories. Further work is also underway on impact reporting, and a social taxonomy is expected to be released by the EU before 2022.

Westpac has been active in this highly dynamic social space for a number of years now. In mid-2021 the bank became the sole sustainability structurer on Australasia's first social loan aligned with international sustainable finance principles.

As part of this trailblazing NZD125 million social loan, Te Pūkenga – the New Zealand Institute of Skills and Technology – will measure tangible social outcomes, as outlined in this third report in our series with Bloomberg that examines different aspects of sustainable finance globally.

Our thanks to Ashley Schulten, Managing Director, Head of Responsible Investing for Global Fixed Income at Blackrock and Heather Lang, Executive Director, Sustainable Finance Solutions at Sustainalytics for sharing their expert insights for our report on this fast-evolving field.

The surge in social debt issuance

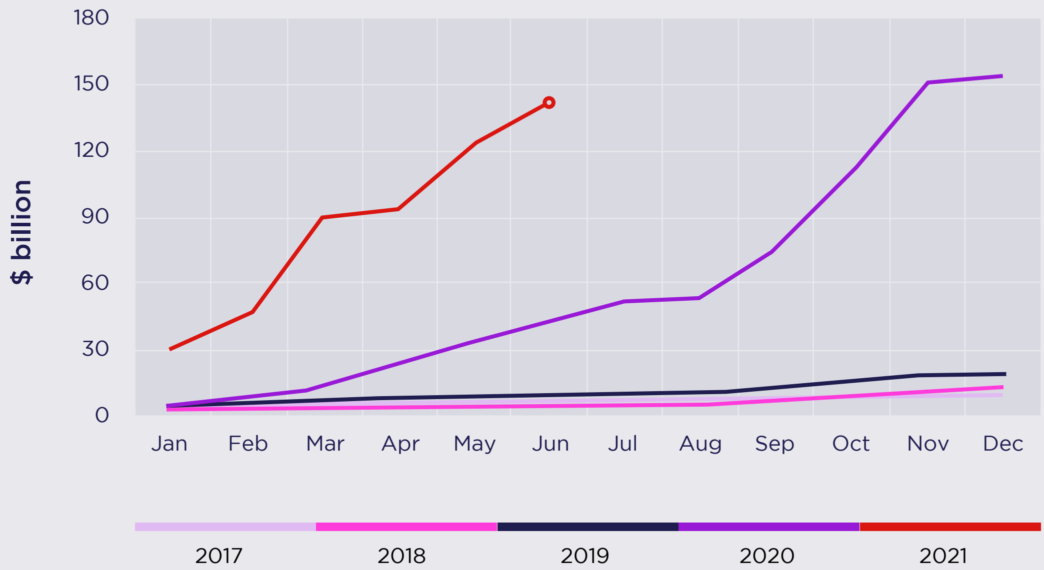
Sustainable debt showed its potential to address social issues in 2020. After a decade of lethargy, social bond issuance surged amid the fallout from Covid-19, while sustainability-linked bonds and loans extended their momentum from the previous year. As issuance reaches new heights in 2021, the question remains: Is this temporary, or has sustainable debt cemented itself as a tool for change?

Companies, governments, and development institutions issued USD147.7 billion worth of social bonds in 2020, harnessing the power of private capital to address solvency risks and social inequalities stemming from the pandemic.

This marked a 720 per cent on-year increase in issuance, albeit from a low base. With issuance of nearly USD150 billion in the first half of 2021, the focus on social issues seems unlikely to wane.[1]

[1] BNEF

SOCIAL BOND ISSUANCE



Source: BloombergNEF

“The momentum from last year is sticking,” says Ashley Schulten, Managing Director, Head of Responsible Investing for Global Fixed Income at Blackrock. “While it is not as strong as green bonds, we are starting to see clients introduce social bonds into their ESG holdings. And we are starting to have consultations from index providers about providing a social bond index. The demand is there.”

Executives agree. Risks related to climate change and social issues are likely to increase the most in importance over the next two years, according to a global survey of risk managers by Deloitte. Focus on the social element extends beyond Covid-19. Increasingly, businesses are paying attention to a broader set of social responsibilities amid the global drive towards greater justice and equality.

As more corporations recognise the importance of social resilience, issuance of social bonds and loans may continue to grow. Therein lies an opportunity to marry purpose and profit.

Social bonds and loans – an overview

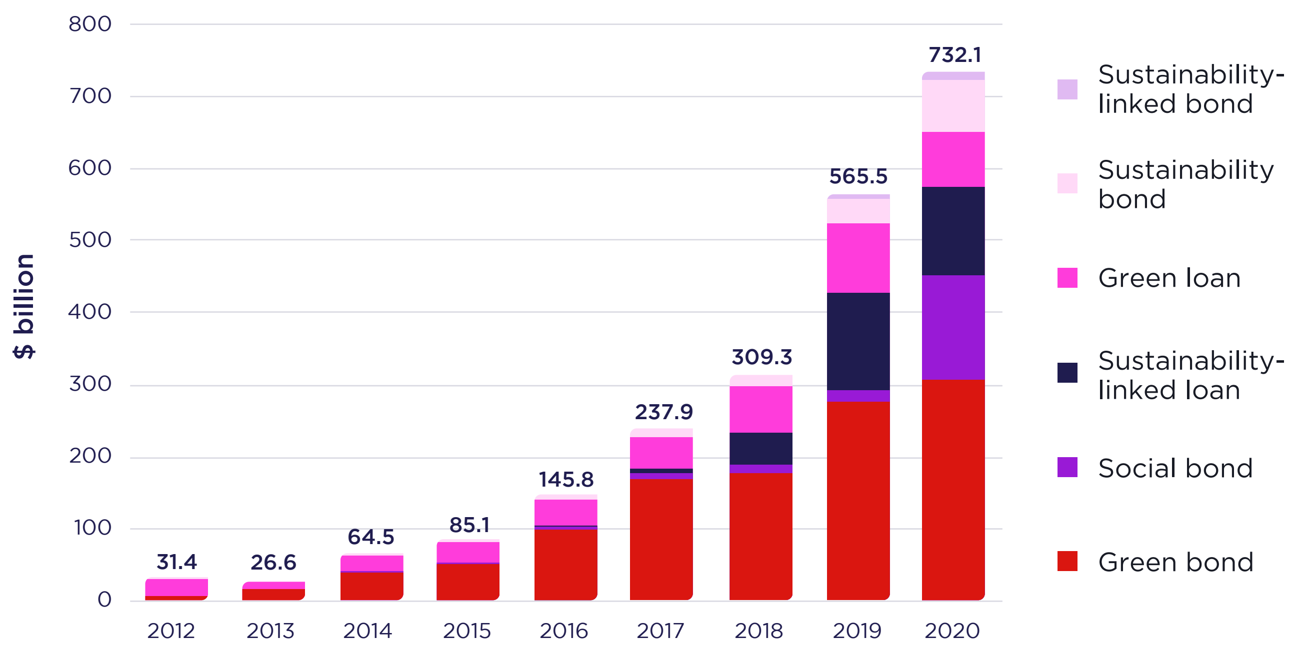
Social bonds are securities used to fund projects and activities that have a positive impact on individuals, communities, or society. Issuers can use the proceeds for a variety of projects such as building basic infrastructure for clean drinking water, providing access to essential services like health and education, bolstering food security and enabling socioeconomic empowerment.

"Social bonds enable us to really think about certain pockets of the population that we want to target and invest in best-in-class social projects around that," Schulten says. "Target populations include people living under the poverty line, marginalised communities, people with disabilities, those who lack access to education and more. Ultimately, social bonds are about resilience. They provide a way to build stronger communities."

An early example for a social pure play issuer came to market in 2006. Issued by the International Finance Facility for Immunisation (IFFIm), the objective was to accelerate the rate of immunisation in impoverished countries, reduce vaccine prices and secure supply by increasing long-term funding predictability.

IFFIm raised USD6 billion through social bonds between 2006 and 2018, using the proceeds to vaccinate some 80 million children. Despite IFFIm's success, social bonds have long been a niche category of sustainable debt.

SUSTAINABLE DEBT ANNUAL ISSUANCE



Source: BloombergNEF, Bloomberg LP

“Social bonds long predated the Covid-19 pandemic, but compared to green bonds, transactions were not as high,” says Heather Lang, Executive Director, Sustainable Finance Solutions at Sustainalytics. “Social use of proceeds have also been included in sustainability bonds, which have gained considerable momentum over the last several years. In the context of sustainability bonds, the social focus may be overlooked given the combined emphasis on both social and environmental use of proceeds, often with greater emphasis on the latter.”

Social loans are another form of sustainable debt that is starting to gain momentum. Much like social bonds, they aim to finance projects that address or mitigate specific social issues and achieve positive social outcomes. That includes everything from affordable basic infrastructure and access to essential services to food security and socioeconomic empowerment.

In one such example, Westpac NZ and Te Pūkenga—New Zealand’s largest tertiary education provider—signed Australasia’s first ever Social Loan in alignment with newly-released international sustainable finance principles. These include improving the quality of education, reducing inequality, and creating work opportunities and economic growth.

More recently the bank played a key role in structuring Australia’s first sustainability-linked loan for the development of a Reconciliation Action Plan, part of a wider AUD 1.9 billion refinancing deal for NSW Land Registry Services. Additional sustainability metrics in the AUD 300 million sustainability-linked loan focus on greenhouse gas emission reduction, gender diversity and continued leadership in the GRESB Infrastructure Assessment.

Photo: Te Pūkenga

A framework for clarity and transparency

Like many forms of sustainable debt, social bonds frameworks have been developing and are still gaining clarity and uniformity. In 2017, the International Capital Markets Association (ICMA) published its Social Bond Principles—a set of guidelines on issuing social bonds. Issuance increased fourfold to USD9.1 billion that year and reached USD18 billion by 2019.

ICMA updated the publication in 2020 to reflect the growth and development of the social bond market. The update broadens and clarifies the definition of eligible social project categories and adds additional target populations. Some elements were added to alleviate the impact of natural disasters and crises. That set the ground for a rise in issuance amid Covid-19.

"Impact reporting is one of the most powerful things that we have in the green bond market," Schulten says. "The question is, how can we do that with social bonds? How can we target things like the number of people put on public transport or the percentage of population educated? What can we flesh out to show the end user why they should carve out their money for these social bonds? One of the things that ICMA is working on to address that is a harmonised framework for impact reporting. If you have a project in healthcare, for example, the template will show you which KPIs you should report on."

Social loans face a similar challenge. In April, the Loan Market Association published its

ICMA SOCIAL BONDS USE OF PROCEEDS

Example Target Populations

- Living below the poverty line
- Underserved, owing to a lack of quality access to essential goods and services
- Excluded and/or marginalised populations and/or communities
- Unemployed
- People with disabilities
- Women and/or sexual gender minorities
- Migrants and/or displaced persons
- Aging populations and vulnerable youth
- Undereducated
- Other vulnerable groups, including as a result of natural disasters

Source: ICMA (June 2020)

Social Loan Principles to create a high-level framework of market standards and guidelines. It enables all market participants to understand clearly the characteristics of a social loan, based on use of proceeds, process for project evaluation and selection, management of proceeds, and reporting. Importantly, it recommends the use of qualitative performance indicators and, where feasible, quantitative performance measures, including the disclosure of the key underlying methodology and assumptions used in any quantitative determination.

At the government level, the EU Commission is also considering how best to direct private capital towards sustainable social activities. It created a social taxonomy subgroup of the EU Platform for Sustainable Finance with the aim of developing a structure for a social taxonomy. That structure will answer three important questions: What constitutes a substantial social contribution? How can we ensure that economic activities do not significantly harm social sustainability? And what activities are considered harmful?

Thus far, ideas for a structure are classified under three broad themes: respect for human rights; governance; and promote adequate living conditions for all. The Platform on Sustainable Finance's advice on this will feed into the Commission's report on the potential extension of the taxonomy framework to be adopted by the end of 2021. The work done on the social taxonomy is also likely to be incorporated into existing legislative texts such as the Non-Financial Reporting Directive and the Sustainable Finance Disclosure Regulation.

While all of these discussions are ongoing, they are a much-needed step towards greater transparency and reporting, both of which are critical to support the future growth of social bonds and loans.

"Approximately 25 per cent of the second-party opinions that Sustainalytics has conducted since we started working in this space in 2014 have been focused on social bond frameworks, peaking in recent years," Lang adds. "We are seeing increasing demand for transparency on the impact of investments and the methodologies for calculating those impacts. In doing so, issuers can really differentiate themselves among their peers."

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Social bonds boom amid Covid-19

Social bond issuance soared in 2020. Firms needed to invest in their human and social capital, and protect their solvency, while governments had to alleviate the social and economic burden of the crisis. In many cases, densely populated poor and minority areas—often target populations for social bonds—were hit hardest by the virus. That made social bonds ideal financing instruments amid Covid-19.

"Covid-19 marked a turning point for social bonds," Lang says. "It triggered an uptick in issuance and innovation in use of proceeds, addressing both the direct and indirect impacts of the pandemic by focusing on healthcare, as well as broader socioeconomic impact mitigation. Social bonds demonstrated their ability to redirect capital on short notice to pressing socioeconomic challenges. And that bodes well for future crises and shocks. We also saw social bonds promptly respond to other emerging social challenges in the past year, with a noteworthy emphasis on diversity, equity and inclusion."

While several businesses raised money for social objectives, sovereigns, supranationals and government agencies (SSA) led the way. They accounted for 84 per cent of total social bond issuance in 2020.

The EU alone issued USD46.8 billion worth of social bonds last year, nearly one-third of global issuance. After SSAs, financials were the second-biggest issuer. Citigroup was the biggest issuer, raising USD2.5 billion with a focus on affordable housing.

The EU's temporary Support to mitigate Unemployment Risks in an Emergency (SURE) bond program accounted for the lion's share of social bond issuance last year. SURE bonds helped member states mobilise capital to fight the negative economic and social consequences of the pandemic. They acted as a second line of defence by supporting short-time work schemes and similar measures. Issuance and investor appetite for SURE bonds remained strong in early 2021.

While investors embraced social bond offerings that helped to fight the effects of the pandemic, they raised questions about the definition of social impact in the context of a crisis.
Much like greenwashing can make green bonds seem more impactful than they are, social bonds face a similar threat. Thus it remains important for bond issuers to select truly impactful projects for social bond use of proceeds, those that are better than just business as usual.

Taking cues from Europe on social sustainability

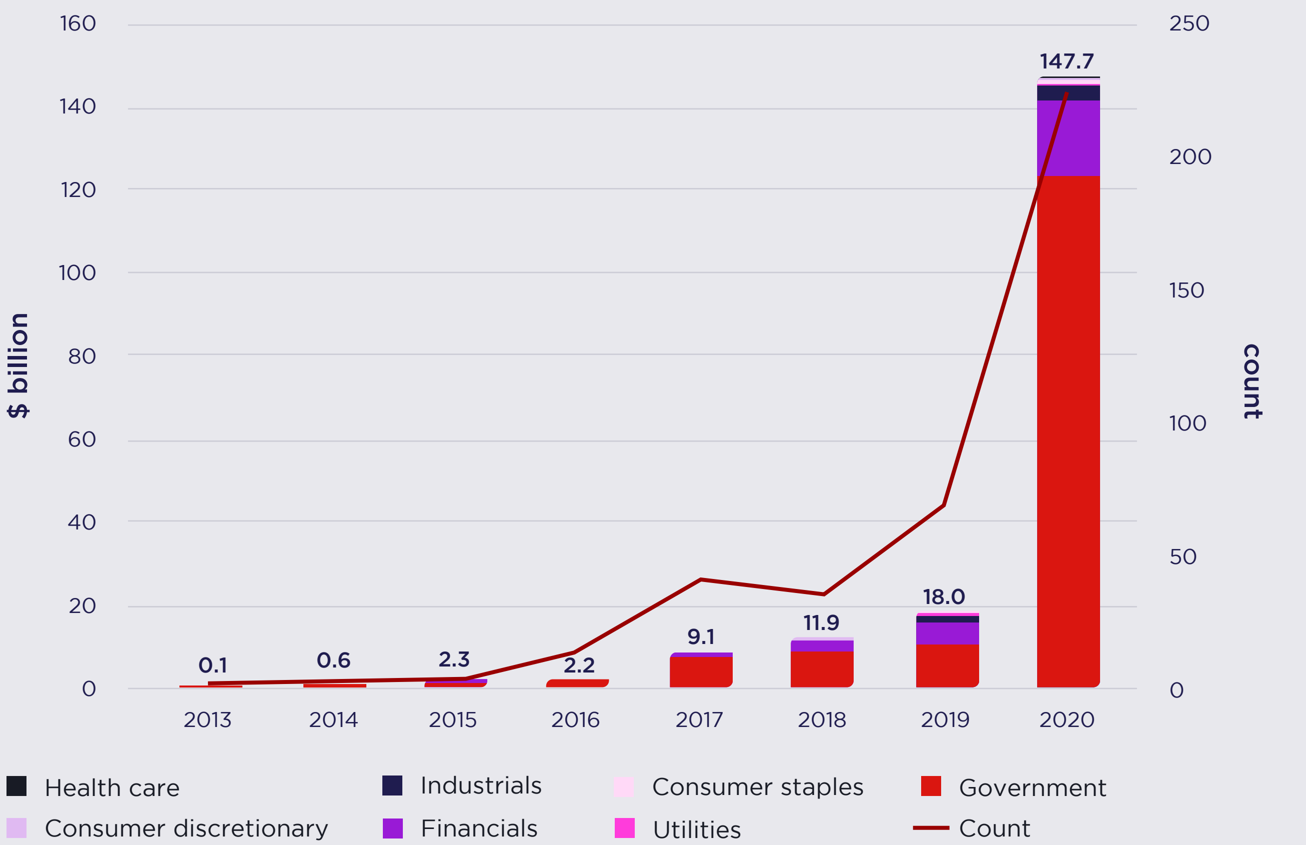
Socially focused sustainable debt will likely endure long after the pandemic. Investors keen to increase their sustainable investments will finance this kind of debt, while issuers will seize the opportunity to amplify their social strategy.

The diversity of issuers last year serves the point. While industrials, consumer staples and consumer discretionary accounted for a small fraction of social bonds issued last year, many issuers came to market for the first time. If diversity continues to increase in 2021, that would be a positive sign of things to come.

Regional diversity, would be another positive sign. That Europe led the charge in 2020 is not surprising. Historically, the region has been first to move when it comes to launching ESG-tilted assets and building governance frameworks. The EU continues to lead issuance in 2021. While it will take some time for other regions and countries to catch up, they have greater impetus to do so following the disruptions we experienced last year.

“There is a stronger embrace of stakeholder capitalism in Europe, and historically there has been more regulatory support,” Schulten says. “But other regions are changing. We are seeing a good pickup of green and social bond issuance and investment in Asia. That is true in the U.S. as well. So, Europe leads, but the rest of the world is catching up very quickly.”

SOCIAL BOND GROWTH 2013-2020



Source: BloombergNEF

Australian investments in clean energy, conservation and other initiatives that have a positive environmental or social outcome are set to increase five-fold to AUD100 billion by 2025, according to a survey from the Responsible Investment Association Australasia. Respondents indicated that their ideal allocation toward impact investments would increase to 4 per cent of assets under management from around 0.7 per cent in mid-2020.

To realise the full potential of social bonds, social loans and sustainability-themed debt in the coming years, regulators can help by developing a sturdy framework that enables businesses to bring new offerings to the market, while ensuring greater transparency and a measurable social impact.

"Social and sustainability bonds still have some catching up to do on the global stage," Lang says. "Such momentum stems in part from the role that leading financial institutions and corporate issuers can play in taking leadership, developing expertise and championing sustainable finance."