Legal update

Social bonds – A sustainable response to the current difficulties

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Sustainable finance
Environmental, social and governance (ESG)
Debt capital markets

Sustainable finance has gained momentum in recent years due to an increasing appetite among investors for responsible investment options that appropriately consider environmental, social and governance (ESG) criteria in their valuation processes. The term “sustainable finance” includes green bonds (for projects that positively impact the environment), social bonds (for projects that contribute to positive social outcomes) and sustainability bonds (for projects that have positive effects, both environmentally and socially).

Traditionally, green bonds have dominated the sustainable finance space, with 2019 statistics from Sustainalytics showing a massive disparity in global issuance: US$257 billion in green bond issuance, dwarfing a mere US$13 billion in social bond issuance and US$40 billion in sustainability bond issuance. However, the ensuing COVID-19 crisis has already started turning this tide. As the severe economic implications of the pandemic generally slow the issuance of bonds, social bonds (which are taking over as the new green bonds) are stepping into the spotlight as many investors view them as an innovative solution to addressing pandemic-related issues.

A host of social issues have arisen as a result of COVID-19. In addition to the strain on the global healthcare industry, individuals and businesses across all industries will undoubtedly feel the financial effects of preventative measures, including the temporary closure of non-essential businesses, social distancing and other physical distancing strategies. Social bonds have the potential to finance projects that address or mitigate these specific social issues.

What types of projects are eligible?

The International Capital Market Association has been monitoring developments across global capital markets in response to the pandemic and, in March 2020, published a Q&A for Social Bonds related to Covid-19 to facilitate the issuance of social bonds to alleviate pandemic-related issues, stating that “[a]ll types of issuers in the debt capital markets can issue a social bond related to COVID-19, as long as all four components of the Social Bond Principles are addressed, and that the use of proceeds of the bond go exclusively towards addressing or mitigating social issues wholly or partially emanating from the coronavirus outbreak.” The Q&A provides examples of COVID-19-related projects that are potentially eligible for social bonds, including medical research projects and investment in manufacturing and obtaining necessary medical supplies.

Eligible projects also include those specifically intended to alleviate unemployment caused by the pandemic, as well as small and medium-sized enterprise (SME) loans that support employment generation in affected small and medium-sized businesses. The issuance of a bond for such purposes would promote the preservation and creation of jobs in the midst of an unstable financial climate by ensuring businesses have uninterrupted access to financial services during the downturn.

An April 2020 BMO Capital Markets report considering social and sustainability bonds issued in response to COVID-19 incorporates the UN’s Sustainable Development Goals (SDGs) in its analysis, explaining that when quality education (SDG #4), gender equality (SDG #5), decent work and economic growth (SDG #8) or sustainable cities and communities (SDG #11) are improved, reduced inequalities (SDG #10) follow. The UN Department of Economic and Social Affairs, through its newly launched online portal, expressed how the COVID-19 crisis is affecting all SDGs, including those aimed at reducing poverty and hunger and increasing health, sanitation and economic growth.
Who is the target population?

The target population underlying social bonds varies depending on the industry and initiative, with three notable industries used by the International Finance Corporation (IFC) as case studies: pharmaceuticals, manufacturing and financial institutions. In an effort to accelerate COVID-19 testing, vaccines and medications, proceeds raised by the pharmaceutical industry are expected to benefit and target the general population, given the widespread nature of the issue. The same is true for the manufacturing industry in its effort to improve the production of personal protective equipment, with particular benefit for healthcare workers given their vulnerability to exposure. Finally, initiatives to provide relief to businesses negatively affected by the economic slowdown targets businesses and employees at risk of unemployment as a result of COVID-19 control measures.

Notably, the pharmaceutical and manufacturing initiatives are positively linked to good health and well-being (SDG #3) while the financial institutions’ initiative is positively linked to decent work and economic growth (SDG #8). These three case studies highlight how issuers from various industries may utilize social bonds in order to raise financing that will go towards addressing social issues emerging as a consequence of the COVID-19 pandemic.

Looking forward

Many social bond issuers have already started to raise funds to address these issues. The BMO Capital Markets report notes that as of early April 2020, pandemic-related bonds totalling approximately US$16 billion had been issued since the start of March, mainly by development banks. The IFC also recently issued a bond to support affected developing countries by reducing the pandemic’s economic consequences through job maintenance and ongoing access to financial services.

Clearly, for many investors the pandemic has underscored how critical sustainable planning and ESG considerations are, with investors increasingly mandated to dedicate some or all of their assets under management in this area. With global pandemics expected to become more frequent in the future, sustainable finance could become a useful tool for mitigating harmful impacts felt across all sectors by ensuring continued access to the capital necessary to meet healthcare needs, restore economic stability and preserve jobs.

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