Sovereign social bonds in a post-Covid-19 world

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The Covid-19 pandemic has brought about a multitude of changes to our lives. The disruption it has had on societies across the world is unparalleled in recent times, affecting everything from employment to our health, wellbeing and daily routines. But capital markets are responding to this crisis, and it is a comparatively unsung part that is taking centre stage.

When considering environmental, social and governance (ESG) investments, social attributes are often overlooked for the more salient environmental and governance characteristics. Perhaps this is because assessing the "E" and the "G" aspects of a company is easier: we can measure carbon emissions from aircraft or board diversity relatively easily.

The "S" is a bit more challenging in that regard. So while coronavirus has reinforced the importance of ESG overall, it is social that is currently the fastest-growing part of sustainable finance, with the outbreak proving a catalyst for increased interest in social bond issuance.

Boom time for bonds

Bond markets have traditionally been a great barometer of investor interest in ESG-related activities through the issuance of green, social and sustainability bonds. These are defined as "specific use-of-proceeds" bonds, which means the financing is exclusively channelled to pre-identified projects where the outcome will be green, social or sustainable (a mixture of green and social).

Figure 5: Global bonds in numbers

$930 billion
Amount issued globally in green, social and sustainability bonds

400%
Increase in social bond issuance year-on-year

$42 billion
Amount issued since March for Covid-19-specific projects

15
Number of countries who have listed sovereign green bonds

Source: Bloomberg and Columbia Threadneedle Investments, 2 June 2020.

This area has grown rapidly in recent years, with the total amount of issuance exceeding $900 billion.[44] So far in 2020 alone there has been $141 billion issued, versus $107 billion issued at the same time 12 months ago.[45] Within that, however, the Covid-19 outbreak has invigorated social bonds in particular as they allow borrowers to raise financing for projects aimed at alleviating the pandemic, such as health care and job preservation.

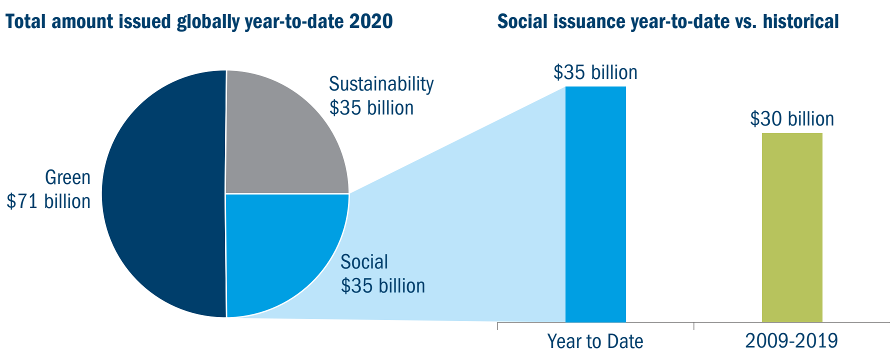
Since the International Capital Markets Association introduced the social bond principles back in 2017, social bonds have steadily gained traction – prior to the pandemic there had been more than $50 billion issued. However, they were outweighed by green bonds and represented only about 7% of "specific use-of-proceeds" issuance.[46] What the coronavirus crisis has done is push people to widen their scope to also include social and sustainability bonds.

So while we have seen a 13% decrease in green bond issuance versus the same time last year – $82 billion in 2019 versus $71 billion in 2020 year-to-date – we have seen a 400% increase in labelled social bonds versus the same time last year – $7 billion in 2019 versus $35 billion in 2020 year-to-date (Figure 6). In addition, there has been $42 billion in dedicated Covid-19-related issues using social or sustainability bonds.[47]

During this increased period of activity there have been some standout examples: from 2017-2019 International Finance Corporation (IFC) raised $1.46 billion across 28 social bonds, but in March this year sold $1 billion in a single issue.[48] In May, meanwhile, France's National Professional Union for Employment in Industry and Trade, Unédic, issued its inaugural social bond worth €4 billion, which was the largest social bond ever issued worldwide for any type of issuer. Then in June the agency issued a second social bond, attaining another €4 billion.

There has also been Covid-19-specific issuance from the financial community: Banco Bilbao Vizcaya Argentaria (BBVA), Bank of America, and Kookmin Bank in South Korea have all issued social

Figure 6: Global social bond issuance



Source: Columbia Threadneedle Investments and Bloomberg, as at 2 June 2020.

bonds whereby the use of proceeds have been directed towards social projects which aim to mitigate the impacts of the virus.

So, we've seen unprecedented numbers over the year-to-date. Will this trend persist? We think it is likely, even as we move through and out of the pandemic. On the question of whether social will ultimately eclipse green bonds, however, we are less sure.

Post-virus prospects

Psychologically, investors are typically monothematic – we can only concentrate on one big idea at a time. As social has temporarily stolen the limelight as investors focus on the Covid-19 crisis, we expect social bond issuance to blossom in the short run.

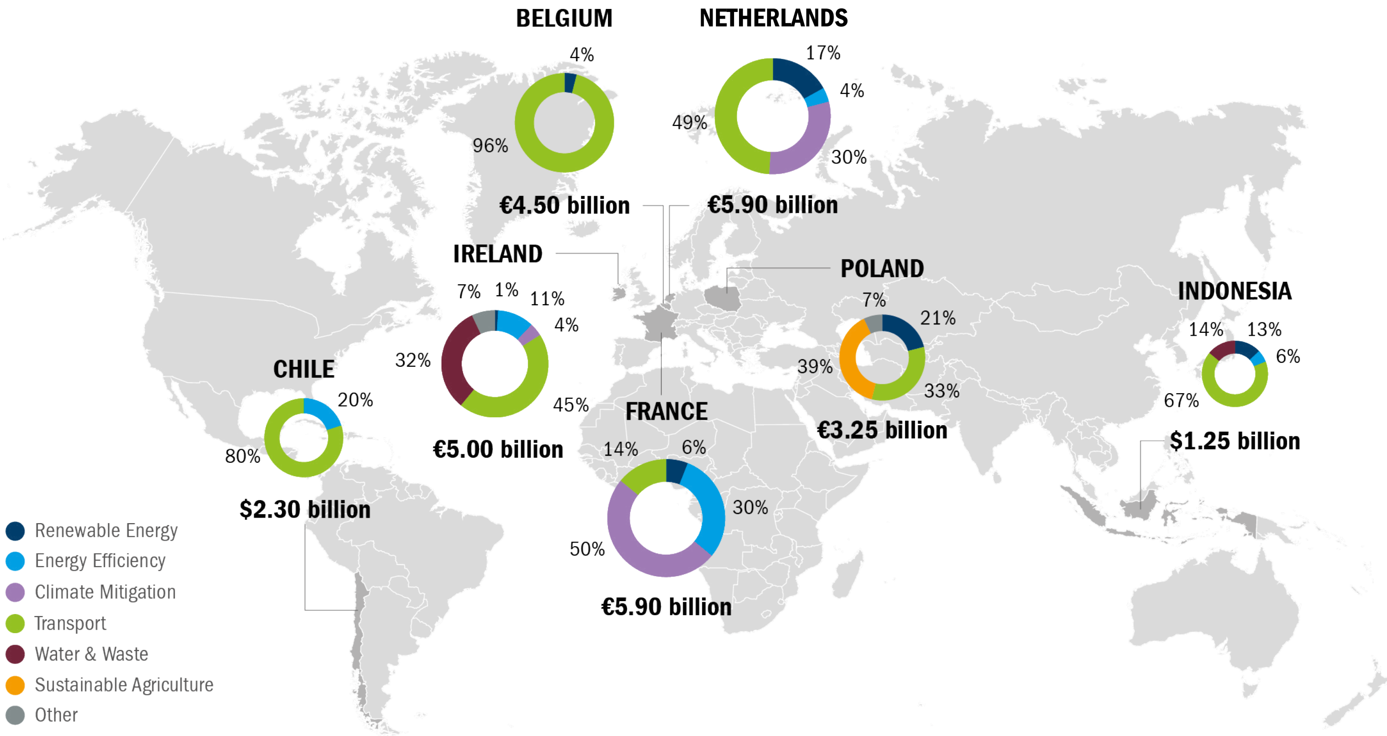
But the coronavirus has also exposed the fragility of the ecosystem and the urgency to reduce emissions. As crises traditionally increase the absorption of trends which were present beforehand, we believe climate change will be a great example of this, and recent policy signals from governments around the world suggest as much. With the EU already having increased its emissions reduction target for 2030 from a fall of 40% (versus 1990 levels) to 50%, it has put tackling climate change at the heart of its economic recovery. Its announcement of a €1.85 trillion European Recovery Plan to aid a post-Covid world includes at least €200 million for specific climate investment. Elsewhere around the globe a long-term structural shift towards climate change alleviation remains. So, although social will remain prominent in people's minds in a post-Covid-19 world, climate change is likely to resume its role as the key ESG theme.

The Covid-19 pandemic is also expected to further reinforce the importance of ESG considerations in corporate behaviour and investment decisions, and the sector has "passed a test" through the crisis: ESG-focused strategies scored positively on flows and investment performance through the crisis, with ESG fund flows year-to-date up 3% versus broadly flat flows for non-ESG funds.

This demand is certainly an opportunity for governments to follow supranationals and issue sovereign bonds in response to this crisis. This is not a new idea: a number of countries have done so in the past three years, including the Netherlands, France, Ireland and Belgium, all of which were green bonds focusing on renewable energy, energy efficiency and green transport (see Figure 7), and over the next six months it is expected that Sweden, Germany and Spain will follow suit. Mexico, meanwhile, is poised to release a United Nations Sustainable Development Goal (SDG) a bond aligned to the UN Sustainable Development Goals.

Despite UK investors consistently being one of the largest purchasers of such bonds – for example, with the recent Council of Europe Social Bond they represented 14% of purchasers, behind only France and Asia[49] – the UK government has yet to issue a gilt of this nature. We continue to campaign for this.

Figure 7: Global new sovereign social issues



Source: Dutch State treasury Agency, May 2020/Ministry of Economy and Finance (France), 2017/Irish Sovereign Green Bond Allocation Report, 2018/Federal Public Service Health, Food Chain Safety and Environment, Belgium, 2018/Ministry of Finance Poland, 2017/Republic of Indonesia Ministry of Finance, 2019/International Finance Corporation, 2017.

So Covid-19 has heralded unprecedented times, which should ultimately be a positive for "specific use-of-proceeds" issuance across the board, and in the future we expect greater interest from governments, corporates and investors around social, with 2020 likely being a record year for issuance. Although this will not supersede green bond issuance in the long term, from here-on "S" will likely be viewed as equal to "E" and "G" over the coming years.

Source:

44 Bloomberg and Columbia Threadneedle Investments, June 2020.
45 Columbia Threadneedle Investments, as at 2 June 2020.
46 Bloomberg, June 2020.
47 Columbia Threadneedle Investments, as at 2 June 2020.
48 https://www.ifc.org/wps/wcm/connect/2be3dc0e-ec8e-40ce-8f71-3d8cafe25a59/2_IFC_Factsheet_SocialBond_02122019.pdf?MOD=AJPERES&CVID=mXsodH5
49 CEB, CEB issues social inclusion bond in response to Covid-19 Pandemic, 8 April 2020.

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