Social Bonds—Recent Developments and Trends

A Primer and Recent Developments in Asia

Harnessing the power of private capital to address compelling societal needs is critical to meeting the challenges of developing Asia.[10] Social bonds, which raise funds to create social as well as financial value, are instruments with a vital role to play in spurring recovery from the coronavirus disease (COVID-19) crisis and future socioeconomic progress.

Under the framework developed by the International Capital Market Association (ICMA), there are three types of environmental, social, and governance (ESG) bond instruments: (i) green bonds, which raise capital for projects with environmental and climate benefits; (ii) social bonds, which raise funds for projects with social benefits; and (iii) sustainability bonds, which raise funds for projects with both green and social benefits. In June 2020, the ICMA expanded its list of eligible projects and target communities relevant to social bonds in response to the rapid growth of the social bond market amid the COVID-19 pandemic.

Driven by growing investor demand for instruments that deliver ESG value, equity and bond markets have innovated over the past 2 decades to develop a number of sustainable finance instruments. The global bond markets have embraced this movement; ESG-linked bond issuance jumped 33% year-on-year (y-o-y) to USD330 billion in 2019 and another 58% y-o-y to USD522 billion in 2020, while outstanding ESG bonds passed the USD1 trillion threshold in the middle of 2020. The ESG market initially was dominated by green bonds, but social bonds experienced exceptional growth in 2020, partly due to the to the strong demand for social bonds to finance activities that mitigate the fallout from the pandemic.

This development is ushering in a new era of explosive growth for ESG-labeled bonds in general and social bonds in particular.

Economic and social development needs in developing Asia highlight the urgency—as well as the opportunity—for creating a robust social bond market in the region. With the stunning impact of COVID-19 still unfolding, the Asian Development Bank assesses that the pandemic has already taken a heavy toll on the region's developing economies. In December 2020, the Asian Development Bank forecast that developing Asia's gross domestic product would contract by 0.4% in 2020, the region's weakest economic performance since 1961.[11] This is expected to be followed by a 6.8% expansion in 2021, with downside risks—rather than upside potential—prevailing.

The fallout from the pandemic has been disproportionately damaging to vulnerable and underserved people and communities throughout the region, as vital areas such as tourism, the informal economy, and small and medium-sized enterprises (SMEs) in particular have been affected. This has exacerbated the funding gap needed to attain the United Nations (UN) Sustainable Development Goals. Prior to the pandemic, the UN warned that developing economies in Asia and the Pacific faced an annual funding gap of USD1.5 trillion compared with what was needed to achieve the Sustainable Development Goals. Recent developments underscore the opportunity for social bonds to help close this funding gap by financing social investments and improving the quality of project outcomes through a commitment to measuring and reporting impact.

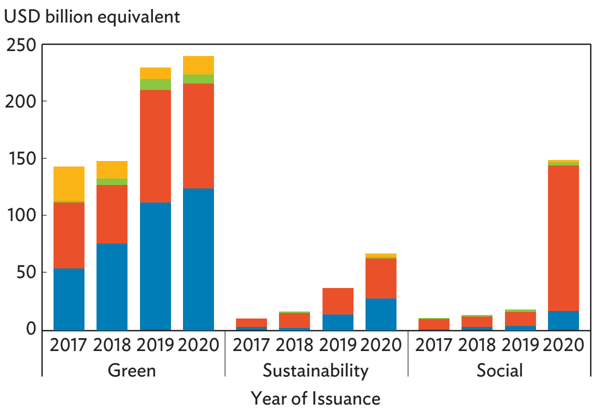
Global social bond issuance saw tremendous growth in 2020, as the COVID-19 pandemic and economic

[10] This section was written by Jason Mortimer (Head of Sustainable Investment—Fixed Income) at Nomura Asset Management and Jane Hughes (Professor) at Simmons University (United States). The content is based on Asian Development Bank. 2021. *Primer on Social Bonds and Recent Developments in Asia*. https://www.adb.org/publications/social-bonds-recent-developments-asia. Developing Asia comprises the 46 developing member economies of the Asian Development Bank. The information and views expressed in this report are made in the authors' personal capacity and is not in any way a product of or reflect the views of Nomura Asset Management or any entity in the Nomura Group of companies. This material does not in any way constitute an offer to sell or buy any financial product, nor is it a disclosure document based on the Japan Financial Instruments and Exchange Act.

[11] Developing Asia comprises the 46 developing member economies of the Asian Development Bank.

shutdowns greatly increased market supply and demand for financing response and recovery efforts. Following y-o-y growth of 28% in 2018 and 44% in 2019, the issuance of global social bonds surged to nearly USD150 billion equivalent in 2020 (**Figure 19**). In comparison, global issuance of green bonds, which have typically dominated the labeled ESG bond market, rose 4% y-o-y to USD239 billion equivalent in 2020.

Figure 19: Global ICMA-Compliant Green, Sustainability, and Social Bond Issuance, 2017–2020

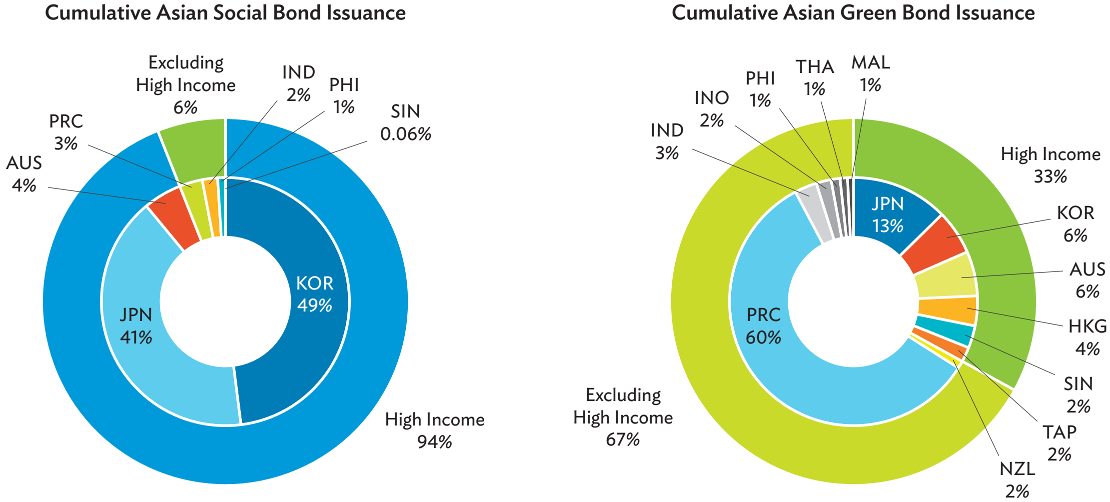


ICMA = International Capital Market Association, USD = United States dollar.
Source: Authors' calculations based on Bloomberg data.

Social bond issuance in Asia has consistently lagged behind European issuance, but recent growth in the region has been impressive. From 2017 to 2019, annual Asian social bond issuance grew from 12% to 38% of the global total (excluding supranational issuance) before falling back to 23% in 2020 due to exceptionally high issuance from Europe, particularly France. However, Asia is now consistently the second most active region in terms of social bond issuance, as annual issuance grew 22.3 times from 2017 to 2020, compared with growth of 9.8 times for Europe and 14.3 times for global issuance excluding Asia. Nonetheless, the Asian social bond market is still less than half the size of the European market, and the need—and opportunity—for even faster growth is apparent. In the Asia social bond market, issuance so far has been dominated by government-related agency issuers in high-income economies such as Japan and the Republic of Korea, where such issuance makes up 41% and 48% of the entire outstanding Asian social bond market, respectively (**Figure 20**).

While philanthropic and supranational institutions are significant issuers of social bonds, they also help to develop the market ecosystem and support prospective participants to enter the market. Governments, including both policymakers and regulators, also are key to ecosystem development. Together, these groups can provide market education, technical assistance, thought

Figure 20: Share of Asian ICMA-Compliant Social and Green Bond Issuance by Income Level and Economy, 2017–2020
(cumulative USD-equivalent notional issuance)



AUS = Australia; ICMA = International Capital Market Association; IND = India; INO = Indonesia; JPN = Japan; KOR = Republic of Korea; MAL = Malaysia; NZL = New Zealand; PHI = Philippines; PRC = People's Republic of China; SIN = Singapore; TAP = Taipei,China; THA = Thailand; USD = United States dollar.
Source: Authors' calculations based on Bloomberg data.

leadership, and an enabling regulatory framework; they can also take an active role in crowding in private capital by offering first-loss capital or capital guarantees.

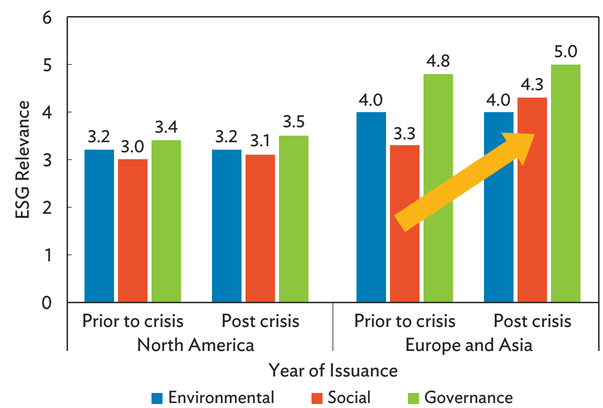
It seems likely that neither investors' nor issuers' attraction to social bonds will fade with COVID-19. Obstacles to market growth, however, include the lack of a standardized set of metrics to measure impact, which leads to concerns about "social washing" (i.e., overstating the social value of a bond); a need for higher issuance volume and diversity (i.e., more corporate issuers); a lack of training among financial advisers; and the lack of a social bond framework—which can take time, money, and manpower to develop—for many of Asia's sovereigns and corporates that would like to tap the market.

There is undoubtedly an urgent and compelling case for the development of a robust social bond market in Asia. Harnessing the power of private capital to meet critical social needs is an opportunity for both issuers and investors to address these needs in a financial context. While the COVID-19 pandemic will eventually recede, one lasting impact may well be its catalytic effect on the development of social bonds worldwide. 2020 was the year when mainstream investors "discovered" social investments; this presents an opportunity for investors to expand their commitment to this area and advance the possibilities of what social investing can deliver in terms of real-world outcomes over a broad range of issues.

A Nascent Opportunity for ESG Investing

The COVID-19 pandemic has amplified inequality.[12] The crisis may push 71 million more people into extreme poverty. Highlighting the importance of social issues, the pandemic has created sizable new investment opportunities as social theme becomes increasingly important for investors. In North America, the social pillar outperformed the environmental and governance pillars in the first quarter of 2020. Furthermore, Asian and European institutional investors are paying more attention to the social pillar in their investment strategy (**Figure 21**).

Figure 21: Importance of Environmental, Social, and Governance for Institutional Investors



ESG = environmental, social, and governance.
Note: ESG relevance is measured on a scale from 1 to 5, with 1 being the least relevant and 5 the most relevant.
Source: Greenwich Associates Coronavirus Flash Study, May 2020.

Social bond markets grow rapidly since COVID-19 outbreak. Social bonds account for approximately 15% of the USD1,366 billion in cumulative sustainable fixed-income issuance. Europe is the dominant social bond issuer, accounting for 45% of new social bond issuance in 2020. However, issuance in Asia and the Pacific and North America is on the rise with the Asian market experiencing the most rapid growth.

There are a number of reasons why institutional investors are showing greater interest in social bonds. First, investing in social bonds does not sacrifice returns. The risk-return profile of social bonds is comparable to vanilla bonds from the same issuer.

Importantly, social bonds provide a platform for engaged dialogue with corporate issuers. Such active ownership enables investors to encourage issuers to prioritize long-term sustainability in their business operations.

Furthermore, institutional investors can request issuers to report about the social outcomes of the investment projects. This gives investors clearer information about the measurable social impact of their investments while reducing the risk of social impact washing.

[12] This section is based on *Social Bonds: A Nascent Opportunity for ESG Investing* written by Elodie Laugel (Chief Responsible Investment Officer) and Isabelle Vic-Philippe (Head of Euro Aggregate) of Amundi.

To sum up, the pronounced impact of COVID-19 on the poor has exacerbated inequality. However, one positive consequence has been the accelerated growth of social bonds, which can generate positive social outcomes. Going forward, the growth of social bond markets is likely to be sustainable because they offer substantial benefits for investors. The prospects for further expansion are especially promising in Asia, where the markets remain relatively small despite rapid recent growth.

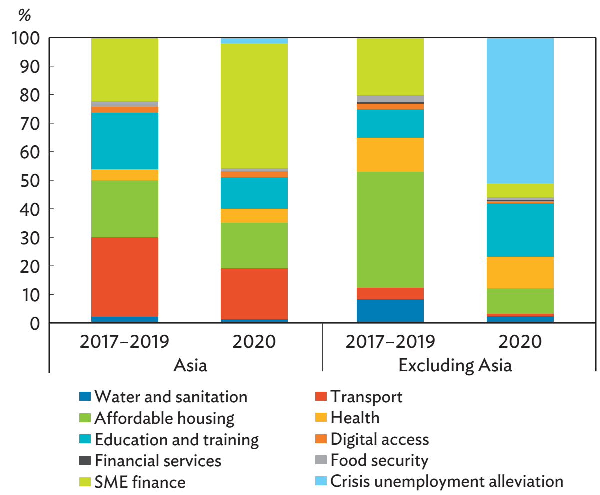
Promoting Social Bonds for Impact Investments in Asia

With the volume of global social bond issuance having achieved a new record in 2020, it becomes critically important to understand how to optimize use of these financial instruments, specifically in terms of which social issues to address and which project types to target to maximize deep and lasting impact.[13] It is crucial that Asia gets this right so that social bonds are used to "build back better" and not for minimally impactful projects or, worse, for social washing.

As the prefix "pan" indicates, the COVID-19 pandemic is much more than a health crisis; indeed, it affects virtually all aspects of human development. It has magnified the pernicious effects of poverty and inequality, and led to much greater suffering among vulnerable communities as compared to the better-off. Recovery work can thus be viewed as double-pronged: (i) meeting urgent short-term needs such as employment generation, support for small business, and healthcare provision; and (ii) launching longer-term public works programs to reduce poverty and develop resilience to future shocks.

Along with a more than sevenfold y-o-y increase in social bond issuance in 2020, there has also been a significant change in the pattern of target areas for social bond use of proceeds. Most notably, there was a shift from the pre-2020 focus on affordable housing to more pandemic-related project categories such as education and training (especially retraining for unemployed workers), and crisis alleviation efforts (a new category in the 2020 Social Bond Principles that is primarily related to employment generation). In Asia, social bond issuance has always focused on socioeconomic areas such as SME finance and transport access, representing 37% and 21%, respectively, of allocated social bond issuance from 2017 to 2020 (**Figure 22**).

Figure 22: Changing Composition of Social Bond Target Project Allocations, 2017–2019 vs. 2020 (share of USD-equivalent notional issuance, estimated)



SMEs = small and medium-sized enterprises, USD = United States dollar.
Notes: "Asia" includes all social bonds from issuers domiciled in Asia and the Pacific, excluding supranational issuers. "Excluding Asia" includes social bonds from all issuers not domiciled in Asia and the Pacific and all supranational issuers.
Sources: Authors' calculations based on review of Bloomberg data, issuer social bond frameworks, and reviewer second opinions.

Moving on from the immediate need to save lives in the midst of a pandemic, medium- to longer-term healthcare needs top the list of priority issue areas for social bond financing. The pandemic has exposed the vast weaknesses, inequities, and shortages associated with healthcare in many developing economies; surely, a build-back-better approach must be founded on a resilient and equitable healthcare system to prevent and mitigate future crises.

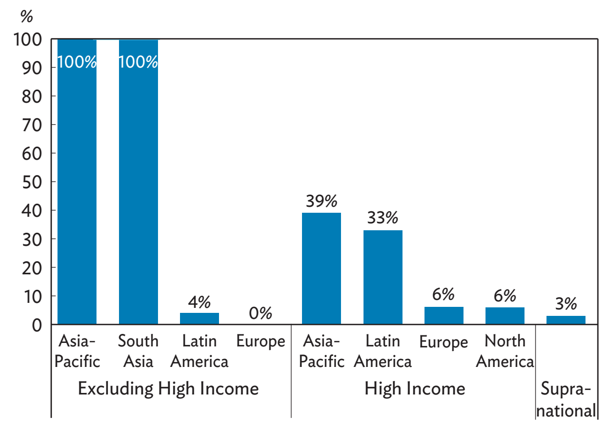
COVID-19 has also exposed critical vulnerabilities in global food and water systems by straining supplies, disrupting food chains, and increasing food insecurity for millions of people. Frequent handwashing is among the most effective measures in containing COVID-19 and other diseases, but chronic underinvestment in water infrastructure has left

[13] This section is based on Asian Development Bank. Forthcoming. *Promoting Social Bonds for Impact Investments in Asia*, which was written by Jason Mortimer (Head of Sustainable Investment—Fixed Income) at Nomura Asset Management and Jane Hughes (Professor) at Simmons University (United States). The information and views expressed in this report are made in the author's personal capacity only and is not in any way a product of, or reflect the views of, Nomura Asset Management or any entity in the Nomura Group of companies. This material does not in any way constitute an offer to sell or buy any financial product and is not a disclosure document based on the Japan Financial Instruments and Exchange Act.

hundreds of millions without access to running water and soap at home. This is a wake-up call alerting the world to the potential for improved water and nutritional systems in the developing world to fundamentally improve global health outcomes for everyone.

Providing support to SMEs is a short-term necessity to get both businesses and people back on their feet again after the demand shock of the pandemic and lockdown policies. SMEs account for more than 96% of all businesses in Asia and the Pacific, and more than two-thirds of the private sector workforce. Even before the pandemic, SMEs faced a number of critical obstacles, most importantly their lack of access to finance. We estimate that 100% of Asian social bond issuance (excluding issuers in high-income economies) in 2020 was allocated to SME financing, which is not surprising given the nature of the shock and economic structure of the region (**Figure 23**).

Figure 23: Social Bond Issuance Allocation to SME Finance by Region and Income Level, 2020 (share of USD-equivalent notional, estimated)



SMEs = small and medium-sized enterprises, USD = United States dollar.
Sources: Authors' calculations based on review of Bloomberg data, issuer social bond frameworks, and reviewer second opinions.

While it is imperative to raise funds to meet the short- to medium-term needs of people and businesses in the wake of the pandemic, it is just as imperative to address the need for greater levels of resilience in advance of the next crisis—and, even better, to prevent the next crisis. Much of developing Asia is considered to be lacking in the area of resilience. The UN Economic and Social Commission for Asia and the Pacific estimates that over 60% of the population of Asia and the Pacific lacks access to social protection, as do 70% of workers in the region's informal sector. Poverty increases vulnerability to shocks in a number of ways, as the pandemic has amply demonstrated.

Perhaps the greatest opportunity for impactful investment is education, especially girls' education. This is not only a basic human right, but it is also one of the most effective ways to drive sustainable development, improve health, reduce conflict, and save lives. Even before the pandemic, girls' access to education was limited in a number of Asian economies. The pandemic has made a difficult situation much worse, as girls who were forced out of school by the pandemic are much less likely than boys to return to their studies. If this trend is not reversed, it could have repercussions for many years to come. This, in turn, highlights the pressing need for innovative finance to advance gender equity, as the pandemic has had a dramatically gender-differentiated impact throughout Asia and the Pacific.

Poverty and inequality underpin many of the abovementioned social ills and present unique intersectional dimensions. While poverty has declined substantially in Asia and the Pacific over the past several decades, its rate of reduction has slowed since 2010, and the pandemic is certain to reverse a number of those gains. Social ills are deeply and fundamentally intersectional; many problems bleed into and are connected to others, so solving these problems demands an intersectional approach.

The knotty and unresolved question of social impact measurement is central to the theme of building back better. Social bonds are only as good as the impact they help to achieve, so it is imperative that they and all other ESG-linked instruments are assessed by as rigorous a method of social impact measurement as is practicable. But practicability in this area is a serious constraint and thus it is not surprising that social impact measurement is by no means a settled issue. There is much experimentation and innovation going on in the field, much of it useful and instructional, but there is as yet no widespread coalescence around a single model of social impact assessment.

To promote more standardized impact measurement, an ICMA working group has released a draft version of recommendations for social bond issuers. In particular, it proposes standardized reporting based on ICMA project categories and subcategories, project allocation share, target population, project lifetime, and measurements based on the output, outcomes, and/or impact of projects; but it does not propose a definitive list of such impact measurements.

Some discomfort around this is appropriate, as social impact measurement is to some extent an exercise in quantifying the unquantifiable. None of this, however, lessens the importance and value of impact measurement.

It will be challenging for policymakers, issuers, and investors to determine which issue areas should be addressed through social bond financing. Without standardized impact measurement methodologies, market participants' ability to compare projects is limited; and with so many high-priority needs, hard decisions will be necessary. The good news is that social bonds have proven themselves to be valuable instruments for directing private capital to these myriad priorities, while impact measurement is improving and deepening throughout the industry. From resilience to SME support, from gender equity to healthcare, social bonds will be an essential tool for financing the work needed for developing Asia to build back better.