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The Issuance of Social Bonds in Response to the COVID-19 Pandemic

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Introduction

The launch of the Sustainable Development Goals ("SDGs") by the United Nations in 2016 brought the world together on a mission to end poverty, fight inequality, and tackle climate change.

The UN Department of Economic and Social Affairs, stated that the COVID-19 pandemic is affecting all SDGs, including those aimed at reducing poverty and hunger and increasing health, sanitation and economic growth.[1]

In order to facilitate the financing of prevalent social issues and financing of the SDGs a bond market has emerged and deepened to finance or re-finance in part or in full, new or existing eligible social projects. The emergence of this bond market is supported by a growing number of investors who have begun to embed Environmental, Social, and Governance ("ESG") standards into their investment decisions.

Since the expansion of the ESG bond market in recent years, social bonds have been a small but growing portion of the market. These bonds are used to finance projects or assets that result in a positive social outcome, such as providing financing for employment generation in lower-income regions, social housing projects, and the delivery of healthcare.[2]

With the outbreak of Covid-19, the market demand for social bonds has increased, the International Capital Market Association (ICMA) analysis of the environmental finance database stated that the social bonds issuance for 2020 totalled $11.58 billion as of May 15, compared to just $6.24 billion in the same period of 2019.[3]

The Need for Social Bonds

Social bonds are vital to containing the economic fallout of Covid-19 and building resilience against future shocks. The proceeds from the issuance of social bonds could waive health insurance costs, subsidize pharmaceuticals, and support small businesses to prevent insolvencies.

In developing countries with limited fiscal capacity, the issuance of social bonds will be needed to keep essential industries afloat, unlike ordinary bonds, social bonds disclose exactly how their proceeds are used which is an attractive prospect for institutional and millennial investors who want to know how their money are used.

Responding to the current pandemic requires the involvement of a broad range of actors, including governments, development banks, central banks, companies and investors to foster the financing of undertakings that can help first to mitigate the effects of the pandemic, and to also assist businesses, especially SMEs, that are facing adverse economic impacts of the pandemic.

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[1] United Nations Department of Economic and Social Affairs, COVID-19 portal: We will help the world rise stronger after COVID-19 (2020) <https://www.un.org/development/desa/en/covid-19.html>
[2]BBVA 'Social Bonds; their time to shine' (2020) <https://www.bbva.com/en/social-bonds-their-time-to-shine/>
[3] Jennifer Laidlaw ' Social bond surge appears here to stay as Covid-19 crisis shifts funding needs' (2020) <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/social-bond-surge-appears-here-to-stay-as-covid-19-crisis-shifts-funding-needs-58602191 >

Social Bonds ensure both social return and financial return. They represent an opportunity for portfolio diversification, both in terms of type of assets and geographical area. Indeed, Social Bonds could encourage investors to broaden their area of influence.[4]

Some Examples

The Macao branch of Bank of China in February 2020 raised more than $600 million from its Covid-19 Impact Alleviation bond to support Macao's small and medium enterprises. The Chinese government had also announced a plethora of fiscal and monetary actions to provide relief to small companies.

The African Development Bank on 3 April 2020 listed a $3 billion "Fight Covid-19" social bond on the London Stock Exchange, the proceeds of which will be used to support struggling African healthcare systems in the wake of the Covid-19 pandemic

The World Bank's International Finance Corporation in March 2020 issued a $1 billion three-year social bond designed to boost financing in healthcare systems in developing countries. The European Investment Bank, which is the main lending arm of the European Union issued a €1 billion sustainability awareness bond on 3 April 2020 and this bond issuance was oversubscribed.

The Nordic Investment Bank also issued a €1 billion three-year response bond in Helsinki and a three-year 4 billion kroner bond in Stockholm to finance healthcare investments and increases in social security spending in Nordic and Baltic countries.

The issuance of social bonds by supranational bodies, investment banks and corporates, indicates that bond issuers will increase their focus on social issues and guarantee funding to alleviate unemployment and promote access to healthcare in the next six to nine months as global economy rebuilds.

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.

[4] Social bonds: the social bonds markets towards a new asset class 2018 (2018) <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Public-research-resources/II-LAB2019-02Social-Bonds-130219.pdf >

Issuance of Social Bonds in Response to the Pandemic

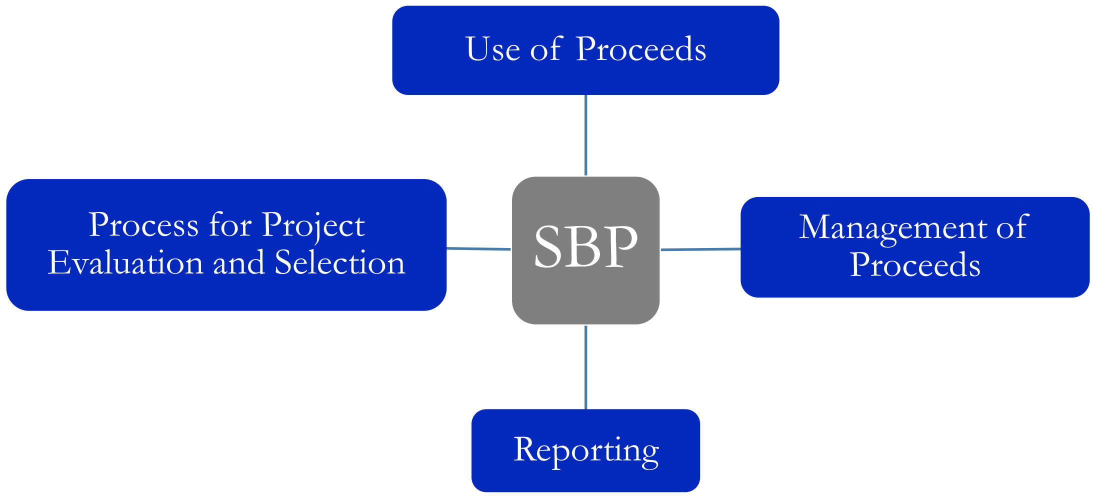
In order to facilitate the issuance of social or sustainability bonds that aim to address the Covid-19 pandemic, the ICMA published guidelines to facilitate the issuance of social bonds to alleviate pandemic related issues.

These guidelines indicate how proceeds from the issuance of social bonds may be used, and the target groups that the proceeds would be applied to including specific groups that have been directly impacted by the Covid-19 pandemic, although the proceeds may be used to also support a wider population that have been affected by the economic crisis.

The ICMA guidelines which were updated in June 2020, provide that all types of issuers in the global debt capital markers can issue social bonds which are related to the Covid-19 pandemic but the issuance must address the four components of the Social Bond Principles ("SBP").[5]

The SBP are voluntary guidelines that recommend transparency and disclosure and promote integrity in the development of the social bond market by clarifying the approach for issuance of a Social Bond and provide the requisite information needed to increase capital allocation.

The four components of the SBP are:



[5]Social Bond Principles; Voluntary process guidelines for issuing social bonds (2020) https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Social-Bond-PrinciplesJune-2020-090620.pdf

Use of Proceeds

This is the cornerstone of a Social Bond which requires that utilisation of the proceeds of the bond are exclusively for social projects. All designated social projects should directly aim to address or mitigate a specific social issue and achieve positive social outcomes which will be assessed and, where feasible, quantified by the issuer.

Process for Project Evaluation and Selection

The issuer of a social bond should clearly communicate the social objectives of the bond issuance, the process by which the issuer determines how the project(s) fit within the eligible Social Project categories; and any other process applied to identify and manage potentially material social and environmental risks associated with the project(s).

The SBP ensures that the investors are well apprised of the social project that they will be investing in, the types of social projects are usually included in the security documents. All social bonds for designated social projects always provide clear social benefits, which will be assessed and where feasible, quantified by the issuer of the bonds.

Management of Proceeds

The net proceeds of the social bond, or an amount equal to these net proceeds, is required to be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for the social projects.

For as long as the social bond is outstanding, the balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible social projects made during that period.

The SBP also encourages a high level of transparency and recommends that the issuer's management of the proceeds from the issuance of the social bonds be supplemented by an auditor, or other third party, to verify the internal tracking method and the allocation of funds from the proceeds.

Reporting

Issuers are required to make, and keep, readily available up to date information on the use of proceeds to be renewed annually until full allocation, and on a timely basis in case of material developments. The annual report should include a list of the projects to which the Social Bond proceeds have been allocated, as well as a brief description of the projects and the amounts allocated, and their expected impact.

In order to ensure that the reporting standards of the SBP is adhered to, the issuer of the bonds has to be prompt in communicating the expected impact of projects.

The Need for the Issuance of Social Bonds in Nigeria

In December 2017, Nigeria became the first African nation and the fourth nation in the world to issue a sovereign green bond worth ₦10.69 billion. This maiden issuance of the Nigerian Sovereign Green Bond was received with much enthusiasm by the Nigerian investment community as the bond was oversubscribed at ₦10.791 billion at the close of the Offer, higher than the ₦10.69 billion offered.

The issuance of this sovereign green bond indicated that the Nigerian Government intends to diversify its bond market and ensure that sustainable bonds which were ear-marked for specific environmental projects were properly invested. The proceeds of the first tranche of sovereign green bonds were invested in specific projects which include renewable energy micro utilities in 45 unserved communities in Nigeria, energizing education which is a rural electrification initiative to provide clean Off Grid Independent Power Plant to rural communities in Nigeria and the afforestation program which is aimed at increasing forest coverage through the plantation of seedlings to cover 131,000 hectares of land.

With the outbreak of the Covid-19 pandemic, the economies of several countries have been affected, and most governments are ramping up efforts to cushion the effect of the pandemic on their economies. Nigeria, like most African countries has limited fiscal capacity to mitigate the effect of the pandemic on the economy and provide palliatives to small businesses.

In most African countries like Nigeria with limited financial capacity, the issuance of social bonds is needed to combat the effect of Covid-19 pandemic on the economy, as the proceeds from these social bonds will be utilised to ensure that industries are kept afloat, companies are supported to prevent insolvencies, health insurance costs are waived and pharmaceuticals are subsidized.

Nigeria's revenue expectations and fiscal projections for the year 2020 have been drastically reviewed downward, predicated on the crash in oil prices that was experienced due to the Covid-19 pandemic.

Consequently, it is advisable that social bonds are issued on the Nigerian Stock Exchange to combat the effect of the pandemic which is far-reaching as it will ensure that private capital is utilised for public good and the needed palliatives will be provided.

Conclusion

Regardless of the gradual phasing out of the lockdowns and the re-opening of the economy, most companies are facing liquidity constraints and questions about their long-term viability. As policymakers worldwide set out comprehensive packages in response to this crisis, social bonds are a key tool to help finance those measures.

The change occasioned by the Covid-19 pandemic could ensure that the demand for sustainable bonds for years after the pandemic will increase as investors might need to incorporate more sustainable bonds into their portfolios, which would shift the focus of investment portfolios to the social element in light of Covid-19 pandemic

With the occasioned change from traditional debt market to sustainable finance, this is the right time for the Federal Government of Nigeria to issue social bonds as it will provide the needed finances to alleviate the effect of pandemic on the Nigerian economy with the phased easing of the lockdown in Nigeria and the re-opening of the economy.

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