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Global Roundtable – Sustainable Finance Responding to COVID-19

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A WORLD OF INSIGHT
INVESTORS RUSH TO COVID-19 SOCIAL BOND MARKET

New COVID-19 social bonds have been met with overwhelming support from investors, leading to rapid growth in the sustainable debt market and a welcome outperformance, experts told a NAB Roundtable.

The social and sustainable debt market has surged since March as governments, banks and companies rush to issue special COVID-19 bonds to raise capital to alleviate the impacts of the pandemic, a recent NAB Roundtable was told.

Investors have proved keen to support a range of COVID themed bonds, while sustainable and ESG funds have seen a global rise in inflows even as the broader fund universe was heavily sold off. Notably, spreads of green and social bonds have outperformed as the coronavirus pandemic has unfolded.

"Investor demand has been the biggest surprise through this market," David Jenkins, Global Head of Sustainable Finance at NAB told a recent NAB Corporate and Institutional Banking Roundtable. The global virtual roundtable was shared via webinar with clients in Australia, New Zealand and Asia.

"The scale and speed with which investors have mobilised capital to support this issuance of COVID-themed bonds has been amazing," he said.

Jenkins cited recent estimates by two large European institutional investors that the market has already reached over €60 billion in size with potential to reach €100 billion by the end of 2020[1]. Those investors, APG Asset Management and Axa Investment Managers, have invested €554 million and €230 million respectively in COVID-19 debt[2].

According to data from Bloomberg New Energy Finance[3], social bond issuance for the first four months of 2020 has exceeded US$20 billion, already surpassing the total global issuance in 2019 of US$17.3 billion. The sharp increase was driven by institutions issuing COVID-19 response social bonds.

1. https://realassets.axa-im.com/content/-/asset_publisher/x7LvZDsY05WX/content/insight-covid-19-how-a-new-breed-of-bonds-can-help-finance-the-fight/23818
2. https://www.environmental-finance.com/content/news/apg-and-axa-buy-big-in-60bn-covid-19-bond-market.html
3. https://www.bnef.com/insights/23083/view

PARTICIPANTS IN THE NAB GLOBAL ROUNDTABLE

Participants

BNZ
Louise Tong
General Manager, Sustainable Finance

IFC
Marcin Bill
IFC Treasury, Senior Financial Officer – Funding

QIC
Marayka Ward
Senior Credit Manager & ESG Champion

Sustainalytics
Nicholas Gandolfo
Director, Sustainable Finance Solutions

Moderator

NAB
David Jenkins
Global Head of Sustainable Finance

Tapping capital markets

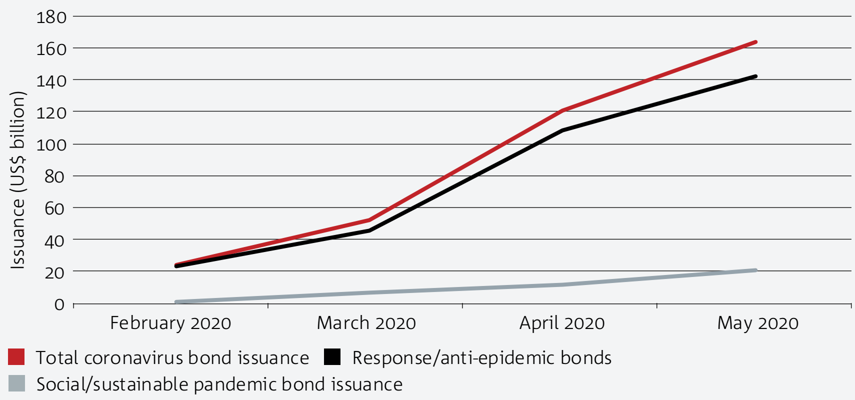
Issuing social bonds has helped market players to leverage capital markets to rapidly secure financing. Bank of China kickstarted issuance in February with the first COVID impact alleviation bond, followed by the Nordic Investment Bank among others. The first COVID-19 corporate bond in the US, Bank of America's US$1 billion four-year issue, will support lending to clients to fund treatment of COVID-19 patients at non-profit hospitals, skilled nursing facilities and manufacturers of healthcare equipment and supplies.

Under guidance published by the International Capital Markets Association, all types of issuers in the debt capital markets can issue social bonds related to COVID-19, providing that certain criteria including reporting are met and that the proceeds are allocated towards addressing social issues arising from the coronavirus outbreak[4].

> "The scale and speed with which investors have mobilised capital has been amazing."

David Jenkins, NAB.

Coronavirus-themed bond issuance



Source: BloombergNEF

4. https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Social-Bonds-Covid-QA310320.pdf

Opportunities for investors

Governments around the world have proposed a total of US$9 trillion in emergency lifelines in response to the pandemic through direct budget support, loans and equity injections, according to the IMF[5].

Investors say governments now have a deep pool of assets to support COVID-19 related debt issuance.

“We prefer deals with established asset pools,” said Marayka Ward, Senior Credit & ESG Manager at QIC. “With the large packages that have been announced we see the opportunity for issuers with a very ready pool of socially focussed assets to issue social bonds.”

She said QIC incorporates ESG considerations in the investment decision-making process because they can have a material impact on the long-term outcomes of investment portfolios. QIC’s approach reflects a trend with a growing proportion of fund managers that support responsible investment, making up about half of global institutional assets under management[6].

In Australia, the responsible investment market continues to grow, with the latest benchmark report from the Responsible Investment Association Australasia estimating 44% of assets under management meet this definition[7].

Ward said her team is closely monitoring the new COVID-19 bond issues and sees huge opportunities for investors who are focused on sustainable outcomes. “With all the socially focused assets that are going to be deployed, this is probably going to be one of those once-in-a-lifetime investment opportunities for sustainable investors.”

Through the first quarter of 2020, investors globally poured US$45.6 billion into funds focused on ESG, according to a recent Morningstar report[8], in contrast to global outflows of US$384.7 billion for the overall fund universe.

What types of proceeds are eligible for a COVID-19 focused Social Bond?

According to guidance provided by the ICMA Social Bond Principles (SBP), social bonds finance projects that “directly aim to address or mitigate a specific social issue and/ or seek to achieve positive social outcomes.”

The following is an excerpt from ICMA SBP guidance on COVID-19 bonds*:

Relevant projects could be undertaken by various industries and sectors where the aim of the project(s) is to mitigate COVID-19-related social issues and bring about positive social outcomes, especially for target populations, which may also include the general population affected by the crisis.

Illustrative examples for eligible social projects can include COVID-19 related expenditures to:

- increase capacity and efficiency in provisioning healthcare services and equipment
- medical research
- SME loans that support employment generation in affected small businesses
- projects specifically designed to prevent and/or alleviate unemployment stemming from the pandemic.

5. https://blogs.imf.org/2020/05/20/tracking-the-9-trillion-global-fiscal-support-to-fight-covid-19/
6. https://business.nab.com.au/investors-taking-action-to-support-a-sustainable-economy-38174/
7. https://responsibleinvestment.org/resources/benchmark-report/
8. https://www.morningstar.co.uk/uk/news/202274/investors-back-esg-in-the-crisis.aspx?utm_source=dlvr.it&utm_medium=twitter

* https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Social-Bonds-Covid-QA310320.pdf

ESG bonds outperforming

Sustainable debt market investors have also been rewarded with a modest outperformance by green and social bonds during the market volatility since March.

"So far over the pandemic period, spreads on sustainable bonds didn't go as wide as vanilla bonds, they have retraced marginally better, and volatility has been less pronounced," Ward said.

New forms of ESG debt issuance have flourished in recent months to meet investor demand, from ESG derivatives to the first ESG-linked issue in the US Private Placement market for Sydney Airport, green deposits and green supply chain finance.

Marcin Bill of the International Finance Corporation (IFC), one of the most active issuers in the social bond market, agreed that green and social bonds were performing better on price and yield. "On the back of demand and supply dynamics, it seems like ESG bonds are starting to develop a bit of a pricing advantage versus the vanilla bonds," said Bill, Senior Financial Officer, Treasury Market Operations – Funding at the IFC.

He said the IFC, which aims to foster further growth in the social bond market, hopes the pricing advantage will encourage a broader range of issuers to finance their projects with social bonds.

In March 2020, IFC issued a three-year US$1 billion social bond as part of the IFC's COVID-19 US$8 billion response package. "We have been overwhelmed by the positive response in the market," Bill told the NAB Roundtable from Washington, DC. "With a final order book of over US$3.4 billion, the deal was very well received and is a testament to investors being keenly interested in supporting the alleviation of social issues."

In Australia, the IFC priced an initial A$200 million 15-year social bond in April, later upsized to A$375 million[9]. The World Bank priced a NZ$450m tap of its outstanding Kauri bond for sustainable development projects as well as COVID-19 response, with BNZ acting as joint lead manager.

"ESG bonds are starting to develop a bit of a pricing advantage versus the vanilla bonds."

Marcin Bill, IFC.

Prospects for growth

Louise Tong, General Manager, Sustainable Finance at BNZ, told the NAB Roundtable that the sustainable debt market in New Zealand is "in its infancy", but with strong prospects for growth.

In particular, the development of sustainability-linked loans will help make sustainable debt relevant to a wider range of companies. Unlike green or social bonds, the proceeds of sustainability-linked loans can be used for general corporate purposes.

"It's particularly important for New Zealand, where a significant portion of the economy is focused on small and medium size enterprises and in food production. Much of the asset base is not well suited to green bonds, but they have real ESG ambitions and can be supported and incentivised with sustainability linked loans," Tong said.

9. As at 12 June 2020.

> “It’s been interesting to see a sudden change in narrative about what makes a business sustainable.”

Marayka Ward, QIC.

Demand for transparency

One of the key themes that emerged in the NAB Roundtable discussion was the clear expectation of investors for transparency in the use of proceeds of the COVID-19 related debt raised, considering the varied nature of the asset pools and underlying lending.

“There has been a strong call for greater assurance of where the proceeds will be allocated and how impacts will be reported, and that is to avoid potential for social washing,” said NAB’s Jenkins.

Some borrowers have launched issues without the usual second party opinion attached to the transaction and instead made commitments to follow up with an assurance provider’s report later.

However, labelling a social bond issue is a more robust approach and appeals to a wider range of investors, according to Nicholas Gandolfo, Director of Sustainable Finance Solutions at Sustainalytics, the largest second-party opinion provider globally.

“The benefit of labelling is transparency, which a lot of investors demand, as well as the ongoing reporting aspect,” he told the Roundtable from Singapore. “Our goal is to ensure when we are doing an opinion that the use of proceeds, the framework, and the governance is impactful and credible and aligns to the Social Bond Principles.”

Sustainalytics has identified COVID bond use of proceeds for two main areas: in healthcare (medical services, equipment, procurement, infrastructure and training); and socioeconomic activities such as financial support to small businesses affected by the pandemic or projects to alleviate unemployment.

A light bulb moment

As nation after nation has shut down large parts of the economy to slow the spread of the coronavirus, there has been an equally dramatic shift in the focus of many companies from shareholders towards their staff and customers, in a broadening of corporate purpose that has gained traction in recent years.

Before the pandemic, companies often limited their discussion with investors on ESG issues to health and safety reports or a reduction in their environmental footprint, said QIC’s Ward. She has seen a dramatic shift from the environmental and governance concerns to sustainability in discussions with companies.

“It’s been interesting to see a sudden change in narrative about what makes a business sustainable,” Ward said.

“Now all the company calls in recent months have been led with a discussion of employee and customer welfare. The value of these two groups to business sustainability has almost been a light bulb moment for some issuers.”

Get in touch

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