Solactive Social and Sustainable Bond Index

Fixed income investors seeking to generate positive impact while investing in liquid securities can now track the **Solactive Social and Sustainable Bond Index**. This index provides investors exposure to the "S" in ESG, by tracking bonds whose proceeds are intended for the build-up and maintenance of sustainable and resilient societies worldwide.

Impact & liquidity: mutually exclusive?

Solactive has recently unveiled the Solactive Social and Sustainable Bond Index, which aims to provide investors exposure to the social aspect of ESG investing.

The index relies on data from the Climate Bonds Initiative's ("CBI") Social & Sustainability Bond database, marking a continuation of Solactive's partnership with CBI that began almost 10 years ago with the launch of the world's first green bond index.

The Solactive Social and Sustainable Bond ("SSB") Index tracks bonds issued by central governments, government-related entities, and corporations, and is designed to be rules-based and market-value weighted. Importantly, the index is broad in its scope, making it adaptable to the specific requirements and preferences of individual clients.

One of the key benefits of social and sustainability bonds is their ability to allow investors to generate positive impact through a conventional, liquid, asset class – a feature which echoes that of green bonds. By once more leveraging CBI's expertise in the sustainable debt space, the Solactive Social and Sustainable Bond Index represents a natural extension to our successful green bond index series.

What are social & sustainability bonds?

For those unfamiliar with the concept of social and sustainability bonds, these securities are labelled bonds whose proceeds are directed towards delivering positive social outcomes or a combination of green and social projects. [1]

Social bonds may focus on tackling social issues such as pandemic relief and gender inclusion, while sustainability bonds may be used to finance the achievement of Sustainable Development Goals ("SDG") and Socially Responsible Investments ("SRI"), among others.

With the introduction of their Social and Sustainability Bond database, CBI has managed to expand its suite of Green, Social and Sustainability-labelled bonds databases. This new database aims to provide transparency on global social and sustainability bonds and complements CBI's existing sustainable debt market datasets.

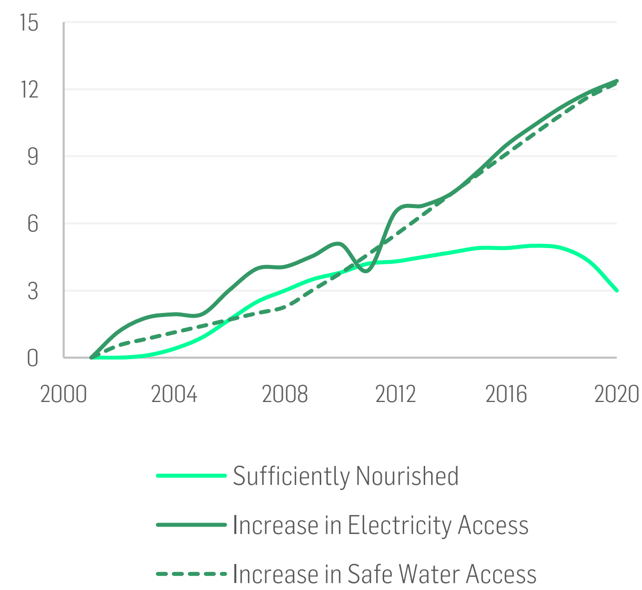
The global need for SSBs

The economic expansion in the latter half of the 20th century was nothing short of miraculous. This is reflected by the remarkable compounded annual growth rate in global real GDP per capita of 6.5% between 1960 and 2000 – which has led to an unprecedented period of global prosperity and development. [2]

Despite a deceleration in global growth in the early 21st century, global standards of living have continued to improve at a fast pace. For instance, although the annual per capita GDP growth rate moderated to 3.4% between 2000 and 2020 globally, the share of undernourished people declined by 3 percentage points over this time period. Further, the share of people with access to electricity and safe water worldwide grew by 12.4 and 12.3 percentage points, respectively. [2][3][4][5]

However, according to data from the World Health Organization and United Nations Children's Fund, as of 2020, over a quarter of the world's population still lacked access to safe and easily accessible drinking water. [5]

Improvement across different development indicators since 2001 (percentage points)

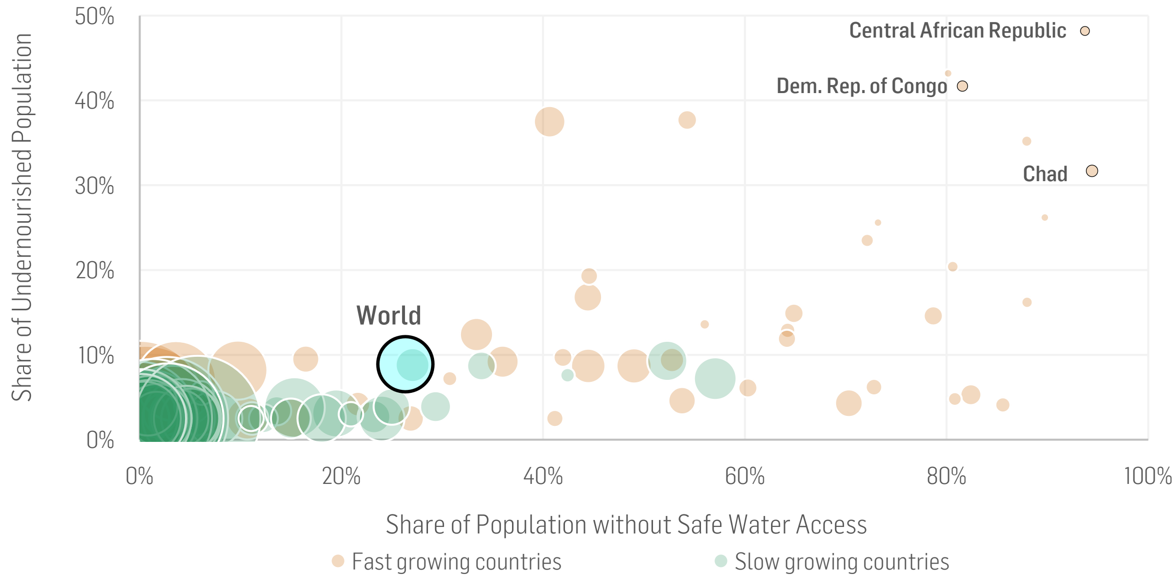


Source: WHO, UNICEF, the World Bank, FAO, and Solactive

Furthermore, the unequal distribution of the COVID-19 pandemic's economic impact, coupled with the global cost of living crisis, supply chain disruptions, the Ukraine conflict, and extreme weather patterns, have resulted in a reversal of progress in the fight against global hunger. These factors have led to an estimated 150 million additional people being undernourished in 2021 relative to those in 2019. [6]

These challenges are compounded by a global population that is projected to increase by over 2 billion people by 2050, and whose growth is primarily expected to occur in the poorest, most capital-starved, nations in the world. For instance, the Democratic Republic of Congo, Chad, and the Central African Republic are expected to have over twice their 2020 number of inhabitants by 2050. [7]

Share of population that is undernourished (y-axis), lacks safe water access (x-axis), and GDP per capita (bubble size) per country



Source: World Health Organization, UNICEF, the World Bank, FAO, and Solactive

The amount of capital required to solve these challenges is considerable. According to the World Food Program, up to USD 40 billion is necessary each year to eradicate global hunger and provide food to all those in need by 2030. However, this amount is just a fraction of the estimated USD 7.5 to 23.1 trillion required by 2030 for further development of global water and sanitation infrastructure to achieve the goals set forth by SDG 6 (Clean Water and Sanitation). [8][9]

Amidst this pressing issue, SSBs can help address the problems posed by global hunger and lack of safe water access by providing financing solutions aimed at bridging the significant funding gap implied by these challenges. Additionally, the proceeds from such bonds can also be directed towards various other equally crucial sustainability-related causes around the world.

Are SSBs and Green Bonds alike?

Given the existence of CBI's flagship Green Bond ("GB") database, some may wonder to what degree do GBs and SSBs overlap. Overall, the themes addressed by SSBs may coincide with those financed by GBs. However, while there may be some securities that could qualify for both databases, not all SSBs classify as GBs and vice-versa.

This is due to the fact that for a bond to qualify for CBI's GB database, it must allocate 100% of its net proceeds to eligible green assets, projects, and activities. Nevertheless, there are two specific cases in which SSBs and GBs may overlap. [1]

The first case is if a bond is labeled as sustainable or under another similar label according to its issuer's sustainable finance framework, but only finances (eligible) green projects, such as a sustainability bond that finances wind power.

Additionally, if a bond possesses a social or sustainability label, but the nominated use of its proceeds generates clear climate or environmental benefits that meet the Climate Bonds Initiative Green Bond Database Methodology requirements, then this bond would be classified both as a GB and a SSB. An example of this type of bond is one whose financing is geared towards a social housing project that also meets the GB database requirements for green building certification.

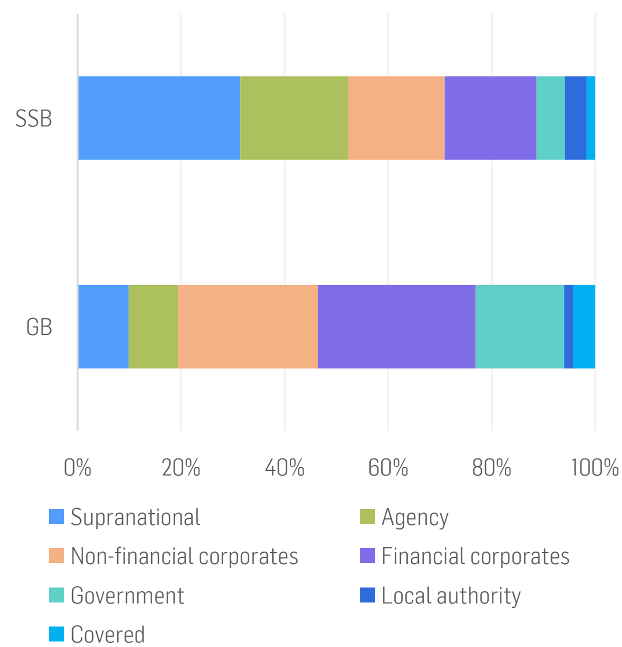
Index Analytics

The overall degree of overlap between the Solactive SSB and GB indices is minor. As of March 2023, there are only 9 overlapping bonds between the two, which is a relatively small number considering the almost 2700 bonds that comprise their combined security universe (it's worth noting that the GB index universe is nearly twice as large as the SSB one regarding number of bonds). These 9 securities make up 0.95 and 0.75 percent of the weight of the SSB and GB indices, respectively.

When it comes to aggregate index duration, the GB index has a Macaulay Duration of 6.6 years, while the SSB has a slightly shorter one at 6.1 years – implying that the latter is less exposed to interest rate risk.

In terms of sector allocation, almost 60% of the weight of the GB index is concentrated in, both financial and non-financial, corporate issuers and approximately 17% in government bonds, while the equivalent values for the SSB index are around 36 and 5 percent, respectively. In contrast, the SSB index is considerably more heavily exposed to bonds from supranational and agency issuers, which combined make up over half of the SSB index's weight (while these type of bonds compose less than 20% of the GB index' weight).

Sector allocation of SSB and GB indices



Source: Solactive and CBI

This sectorial divergence led to broader disparities between both indices. For example, the aggregate credit rating of the SSB index's rated issues was 1.4 notches above that of the GB index's rated constituents. This is largely due to the SSB index's heavy exposure to high grade supranational and agency bonds and the GB index's overweight in riskier corporates, mostly from the financial and utilities industries.

Despite the SSB index's lower degree of interest rate and (rating-implied) credit risk, the aggregate yield of its rated issues was 10 bps higher than that of the GB index as of March 2023. However, this apparent paradox can largely be attributed to the SSB index's heavier exposure to USD-denominated debt (+17.0 percentage points) over EUR-denominated bonds (-12.4 percentage points) relative to the GB index.

Once currency-specific reference yields were taken into account, the spread of the SSB index was approximately 17 bps lower than that of the GB index.

SSBs' proceeds case studies

As of time of writing, the Caisse d'Amortissement de la Dette Sociale ("CADES") holds the title of the most prevalent social bond issuer globally. The organization's securities make up approximately 10% of the SSB index's weight.

CADES has the specific mission to finance and redeem the French Social Security system's debt while maintaining continuous access to liquid funds at the lowest cost possible. The organization issues social bonds according to their Social Bond Framework, which was published in 2020. The proceeds from these bonds are intended to replace French resident's income during idle periods attributed to illness, maternity, retirement, and workplace injuries or occupational diseases, as well as for partially covering their parenthood related expenses. [10]

When it comes to social investments, NatWest, the British lender, recently issued a highly innovative social bond on International Women's Day 2023. The proceeds from this particular bond, which amounts to EUR 500mn, will be used to refinance and finance loans given to women-led enterprises. This is the first debt issuance by a European financial institution specifically designed to lend to women-led businesses, contributing towards the achievement of SDG 5 (Gender Equality). [11]

However, SSB issuance is not limited to developed markets. In 2022, the Government of the State of Mexico issued a local currency bond equivalent to approximately USD 145mn. The purpose of this bond is to finance 18 social, sustainable, and green projects, with about 60% of the resources going towards state mobility, urban development, and social projects. [12]

Among the social projects funded by this bond are two "Ciudad Mujer" ("Woman City") developments. These communities aim to support 2.2 million women by providing economic and legal advice to them, as well as a safe space for victims of violence to report crimes committed against them or their acquaintances. [13]

Additionally, in 2021, against the backdrop of COVID-19, the Philippines' UnionBank issued a USD 150mn bond acquired by the International Finance Corporation. The proceeds from this bond are intended to finance over 2000 loans to micro, small, and medium-sized enterprises, which were disproportionately impacted by the pandemic. [14]

Final remarks

The social and sustainability bond market has experienced remarkable growth since its inception, a trend which is expected to continue. An area that could further grow moving forward is, for instance, the hybrid green and social bond one – as social impact metrics to measure the physical externalities of climate change are developed.

The continuing expansion of the market would create more opportunities for bond investors to generate impact. This would particularly be the case if institutions, both public and private, increasingly issue social and sustainability bonds to more granularly finance social issues such as literacy, obesity, and criminal reoffending rates.

However, the lack of taxonomy for social and sustainability bonds, and the challenges in creating one, pose a risk of "social washing" (just as greenwashing is a concern in the green debt market). Therefore, it is crucial to rigorously analyze and screen social and sustainability debt to ensure that resources are allocated to truly impactful initiatives.

The Solactive Social and Sustainable Bond Index offers investors a chance to accurately track the social and sustainability debt market, as determined by CBI. Thus, the index enables investors to generate impact through a conventional asset class by channeling resources towards crucial social and sustainability projects worldwide.

References

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[2] GDP per capita (current US$) (data.worldbank.org)

[3] Access to electricity (% of population) (data.worldbank.org)

[4] Prevalence of undernourishment (% of population) (data.worldbank.org)

[5] Data (washdata.org)

[6] The State of Food Security and Nutrition in the World 2022 (fao.org)

[7] Population estimates and projections (data.worldbank.org)

[8] We have the resources to end hunger – no child should be allowed to starve (wfp.org)

[9] Water Scarcity: Addressing the key challenges (credit-suisse.com)

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[11] NatWest issues social bond linked to women-led enterprises (natwestgroup.com)

[12] Government of the State of Mexico issues social and sustainable bond (greenfinancelac.org)

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[14] Union Bank of the Philippines to Issue First Social Bond with Investment from IFC (pressroom.ifc.org)

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