

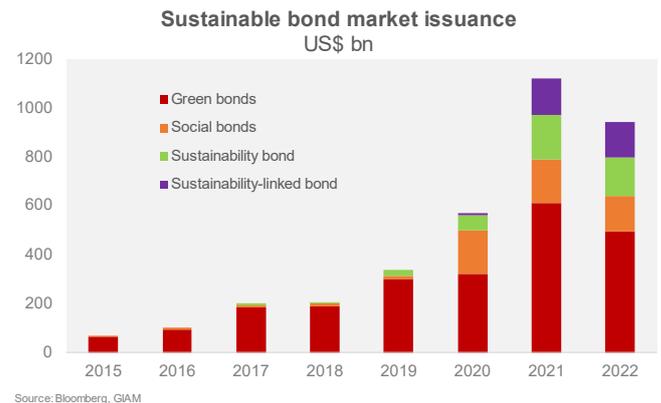
CORE MATTERS

Social Bonds – An attractive diversification opportunity with little yield penalty

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Our Core Matters series provides thematic research on macro, investment, and insurance topics

- Mounting social tensions fuelled by war and climate events on the one hand and the desire of investors to invest in sustainable assets on the other, have sparked the rapid growth of social bonds in recent years.
- In this report, we take a deeper look into this relatively new asset class, its different types, and potential ways to address 'social washing'. We briefly discuss the ICMA's social bond approach and the elusive path to an EU social taxonomy, which is not without controversy even within the EU, and compare them to the yardsticks of the better established EU green taxonomy.
- The social bond segment is dominated by European issuers and the bulk is denominated in euro. Most issuers belong to the government sector, which results in a rather high median AA rating. In a case study on EU securities, we show that social bonds have similar characteristics to conventional bonds, especially in terms of yield level and volatility. This opens up the possibility for investors to buy labelled bonds without a yield penalty – and still have an information advantage compared to conventional bonds due to the reporting requirements.
- Despite the strong growth, the social bond segment is significantly smaller than the green bond one. Going forward, we expect demand for social bonds to remain high. The main issuers will likely remain government-related entities. On the private side, financial issuers will continue to dominate.
- Our analysis shows that social bonds have no significant yield disadvantage compared to conventional bonds. However, given potential controversy risks, a preceding in-depth analysis seems indispensable. Moreover, as in any sustainable investment, conflicting signals may arise when an issuer's "E" and "S" scores differ. This trade-off cannot be resolved and we assume that investments in social bonds are made subject to the observance of minimum environmental safeguards.



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1. Introduction

The sustainable bond family (bonds that finance green and/or social projects) is growing fast. Although green bonds still make up the majority, bonds covering social issues have increased significantly recently, with two drivers standing out. On the supply side, the increase in frequency and severity of economic crises have intensified the need to raise money to alleviate the social cost of turmoil (e.g., the Covid-19 pandemic and the turbulence in the food and energy markets triggered by the Ukraine war have exacerbated social tensions). Then again, demand for this type of securities has increased as responsible investing has become mainstream, and investing in social bonds is a means of aligning decent returns with sustainability objectives. Hence, social bonds are equally viable for both issuers and investors.

The field of application of social bonds is wide. The proceeds are used to fund social activities to generate positive social outcomes such as reducing unemployment, improving health care, or building basic infrastructure. The security of food and water supply can also be an objective.

However, not only is there a variety of targets but also in types of bonds. So as a first step we introduce some fundamental dimensions in constructing social bonds. Furthermore, the fast growth of the market has increased the risk of social washing (as analog to green washing). Accordingly, we then present mechanisms for how investors can protect themselves against it. This is followed by a short outlook on what the EU social taxonomy could bring in the future and the influential UN targets setting.

In the next step, we analyse the social bond market regarding size and issuer structure. This is complemented by a case study flagging how social bonds differ from conventional ones in terms of returns and volatility. We conclude with the challenges of social bond investment and the outlook of the social bond market.

2. Characteristics of social bonds

Social bonds differ in several fundamental dimensions. The first concerns the question, how the proceeds of the bond will be used. The basic distinction here is between earmarked vs un-earmarked use of proceeds. The second dimension follows the issue, how the bond can be protected against social washing. Subsequently, we will mainly focus on these two dimensions. However, social bonds can also be qualified against the background of how much impact they are intended to generate. As this is less relevant for a portfolio investor, we only touch upon these topics¹.

2.1 Earmarked vs. un-earmarked use of proceeds

Earmarked social bonds require the proceeds to finance social projects that achieve positive social outcomes and/or address a social issue. Thus, the focus is on projects (instead of issuers). This characterises not only “**social bonds**” but also “**sustainable bonds**”. The latter often refers to combining positive social and environmental targets. However, sometimes the term “sustainable” is also used more generic, i.e. it covers not only green and social but also special purpose **bonds**.

Financing projects contrasts **financing an issuer**, i.e. an **un-earmarked** use of proceeds. In this case, the funds go to a single or multiple issuer, often supranational, international, or governmental institutions. The bond type is then typically referred to as **sustainability-linked investments** (SLB bonds) “such as key performance indicator (KPI)-linked or sustainable-development-goals (=SDG)-linked bonds” (for details see below). They normally finance the general working of an issuer that has explicit sustainability targets.

The earmarked use of proceeds has the clear advantage in that a detailed description of the project allows for close monitoring. However, this does not prevent “misconduct” of the issuer, and thus even a “use of proceeds bond” could still face troubles. Financing an issuer comes with higher hurdles for monitoring and requires more trust. Linking the

¹ [UN Report Financing for Sustainable Development Report 2022](#), SDR22, Chap. III.B.5

construction of the bond to KPIs or SDGs (SDG refers to the list of 17 UN-defined development goals in the Agenda 2030, see chapter 3.3). attempts to mitigate the problem.



Source: adapted from UN / DESA, GIAM

2.2 Approaches to mitigate social washing

It is often difficult for investors to verify that an issuer complies with stated social goals. Moreover, there may be conflicting goals. Thus, the second fundamental dimension covers the question how the issuer chooses to demonstrate his commitment. From a buyer's perspective, this is his/her protection against social washing. "Ideally" investors would be in a position to verify the "social" objectives by clear measurement criteria/data and associated publication/disclosure obligations. However, this ideal world may not be achievable, not only due to a lack of openness by the issuer but as well due to associated costs in collecting, processing, and disclosing the information. Four, not necessarily completely distinct approaches help reduce this information asymmetry (see [SDR22](#)):

Approaches to assess company alignment with sustainability goals				
	Principles	Activity-based taxonomies	KPIs	Rating/Score
Approach	Complies with sustainable business principles	Has a business in sustainable activities	Achieves a minimum rate of improvement	Exceeds a minimum sustainability rating/score
Benefits	<ul style="list-style-type: none"> - Safeguards against harmful practices - Data availability - Well-known by markets 	<ul style="list-style-type: none"> - Credibility/Rigor - Tailored to sector specificities - Required for green/social bond market 	<ul style="list-style-type: none"> - Simplicity - Applicable to all sectors - Adapted for companies in transition 	<ul style="list-style-type: none"> - Combined different factors - Already used by financial actors - Flexibility to adjust new data
Challenges	<ul style="list-style-type: none"> - No assessment of positive impact - No capacity from those issuing the principles to verify compliance 	<ul style="list-style-type: none"> - Companies have multiple activities - Limited to some sectors - Binary assessment 	<ul style="list-style-type: none"> - Not easily applicable to all SDG-related norms - Consensus on a rate of improvement 	<ul style="list-style-type: none"> - No consistency in assessment - Proprietary methodologies - Possible conflict of interest

Source: adapted from UN/DESA, GIAM

Principles: The issuer promises to comply with high-level principles, which can come from international organisations like the UN (e.g. [10 principles of the UN Global Compact](#) of

human rights, labour, the environment, and anti-corruption) but may also be based on best practices as in the case of the International Capital Market Association (ICMA) (see chapter 3.1). The ICMA provides the [Social Bond Principles](#) (SBP), the [Green Bond Principles](#) (GBP), the [Sustainability Bond Guidelines](#) (SBG), and the [Sustainability-Linked Bond Principles](#). The principles mainly provide a "benchmark" to assess the issuer's alignment. However, principles are less suited to document a positive achievement.

Activity-based taxonomies: A taxonomy is a positive list of (deemed) sustainable economic activities. The best-known example is the [EU green taxonomy](#). The European Commission (EC) [Platform on Sustainable Finance](#) released a [Final Report on the Social Taxonomy](#) in February 2022 (which also covers issues related to governance). Despite the word "final", the report marks "only" the beginning of an EC reviewing process. A definite timeline is not known. It could be [delayed substantially](#) and rather end up as a list of (very influential) guidelines.

Key Performance Indicator (KPI): The KPI (or SDG) is a well-defined indicator, showing that a social (or green) goal has been achieved. They play a defining role in sustainability-linked bonds. The financial performance of the bond is [structurally linked](#) to the issuer's achievements, such that the coupon of the bond decreases in case of documented progress (and vice versa). The ICMA has published a new list of 300 KPIs for sustainability-linked bonds (SLBs, [see ESG investor](#), and [here](#)).

ESG Rating/Score: An issuer can also be assessed by an ESG rating (for some commercial providers, see [Deloitte](#)). There are several challenges. The needed trust concerning the issuer must be replaced by the reliability of the rating provider, its methodology, and its independence/incorruptibility. However, ratings may differ due to different underlying methodologies.

2.3 Additional aspects of investor engagement

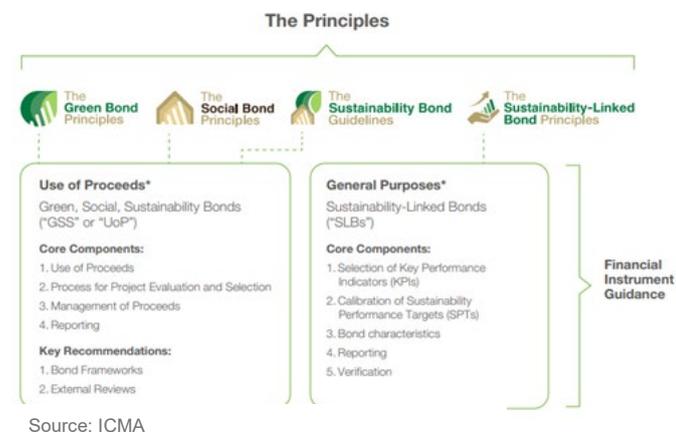
As already mentioned above, social bonds may also come in the tradition of bond buyers wishing to generate a positive impact instead of an of "just" being a portfolio investor. This distinction is also present in the EU green taxonomy and called [Article 8 vs Article 9 funds](#). Article 8 funds are integrating ESG considerations and promote "E" or "S" characteristics but do not have them as the overarching objective. By contrast, Article 9 funds have sustainable goals as their objective, focussing on sustainable economic activities and impact. Investors may also not only be bondholders but actively engaged in setting up and stirring the

social activity. The [Global Investors for Sustainable Development \(GISD\) Alliance](#) provides criteria for development investing (SDI). Overall, the degree of influence bondholders wish to have on the investment varies, from portfolio investors who will typically ensure that their ESG criteria will not be compromised to other forms of control including “specific mandates”, “impact investment” or “active ownership (also called stewardship)” (see [GISD definition](#)).

3. Predefined/future social bond standards

3.1 The ICMA approach to social bonds

In practical terms, a lot of social bonds refer to ICMA ([International Capital Market Association](#)), a self-regulatory body and trade association in capital markets. It promotes internationally accepted standards of best practices, rules, recommendations, and standard documentation. ICMA has been tracking green, social and sustainability bonds issued since 2016 and sustainability-linked bonds since February 2021. It also publishes a [sustainable bonds database](#).



Referring to the dimensions discussed above, the ICMA [Social Bond Principles \(SBP\)](#) (and analog the green and sustainable bonds) combine “earmarked proceeds” with “principles”. Its core components and key recommendations are shown in the graph above (left part). ICMA provides a list of project categories consistent with the definition of a social bond. They include: affordable basic infrastructure, access to essential services, affordable housing, employment generation, food security and sustainable food systems, socioeconomic advancement, and empowerment. The target population encompasses those living below the poverty line or otherwise excluded or marginalised populations or communities.

The other “core components” (see graph above) aim at securing robust **Processes** over the lifetime of the project, starting with **Project Evaluation and Selection, followed by the management of proceeds** and the **Reporting** (in a formal process). Two additional recommendations are meant to strengthen the trust in the issuer. The **Social Bond Framework** documents its alignment with SBP, while an **external auditor** (adding to trust) shall verify the alignment of the bond to the SBP before its issuance and check the use of funds afterward.

By contrast to the earmarked use of proceeds, ICMA defines “**sustainability-linked bonds**” as instruments funding companies that contribute to sustainability from either an environmental and/or social and/or governance perspective (and can be limited to one aspect). The “[Sustainability-linked Bond \(SLB\) Principles](#)” centre on the selection of Key Performance Indicators (KPIs) to be benchmarked and publicly communicated including their rationale and materiality together with the motivation and ambition. On top, this should be consistent with the overall strategic planning of the issuer. The ICMA gives further help through an “[Illustrative KPI Registry](#)” and a “[Q&A](#)”.

3.2 Aspects of the EU social taxonomy

Like in the green case, a social taxonomy is intended to give guidance on how to distinguish “social” from “non-social/other” investment. At the request of the EC, the Platform on Sustainable Finance published a [final draft of a social taxonomy](#). At some point in the future, an EU social taxonomy could become as influential as the green taxonomy. Yet, the final draft does not offer definite criteria but discusses relevant methodological issues. Some market participants already use elements of the concept (e.g. the AAAQ concept meaning Availability, Accessibility, Acceptability, Quality). We will focus here only on some basics.

It looks tempting to consider the EU social taxonomy as just a fresh application of the same ideas governing the green taxonomy. Indeed, the social taxonomy follows structural aspects of the green taxonomy related to (i) the development of social objectives; (ii) types of substantial contributions; (iii) “do no significant harm” (DNSH) criteria; and (iv) minimum safeguards. Nevertheless, a simple transfer would come with major potential pitfalls (An example of the working of this structure can be found in the Appendix.)

- **Defining the objectives:** In the case of the green taxonomy, the clear-cut, scientific objective is mitigating climate change. Acting on social norms is inherently much more controversial. They need to be based on

widely accepted, authoritative standards. The report refers to a wide range, among them the “Universal Declaration of Human Rights”, the “ILO Declaration on Rights at Work”, the SDGs, the UN Global Compact, and the OECD guidelines for MNEs. These standards set minimum requirements for three groups of stakeholders (i) an entity’s workforce; (ii) end-users or consumers; and (iii) affected communities. Combined, the report proposes three objectives a social investment should foster:

- (1) Decent work (including value-chain workers)
- (2) Adequate living standards and well-being for end-users
- (3) Inclusive and sustainable communities and societies.

As these topics may need different approaches for prioritising sectors, different substantial contributions as well as different DNSH criteria, the report adds a large list of sub-objectives which is a major difference to the green taxonomy.

Substantial-contribution type	Explanation
Avoiding and addressing negative impact	Targeting both: (i) high-risk sectors with documented human-rights and labour-rights abuses of relevance to the objective; or (ii) sectors that are less likely to contribute to the objectives of the European social pillar.
Enhancing the inherent positive impacts of: (i) social goods and services; and (ii) basic economic infrastructure	Targeting social goods and services sectors that provide: (i) goods and services for basic human needs; and (ii) basic economic infrastructure of direct relevance to the right to an adequate standard of living. By doing this, help progress towards the SDGs and the objectives of the European social pillar.
Enabling activities	Where economic activities have the potential to enable substantial risk reductions in other sectors*, these activities should also be classified.

- **Level of contribution:** The green taxonomy is built on the “avoidance” of further polluting activities, i.e. a “negative” criterium. A pure “avoidance” concept is not feasible for a social taxonomy, as e.g. not violating human rights cannot already be considered a positive contribution. The final draft comes up with three types of substantial contributions which cover “increasing” levels from “avoiding” to “enhancing” to “enabling” (see table).
- **DNSH, safeguards, and target conflicts:** The DNSH criteria will serve the same purpose as in the green taxonomy, ensuring that when an activity makes a substantial contribution it does not harm the other social objectives. Given the sub-objectives, criteria might become much more granular. However, some activities with social purposes could run against environmental

goals. The exact interaction between green and social taxonomies is still work in progress.

Sectors: Finally, the draft suggests prioritising some economic sectors for the attainment of each (sub)objective, suggesting that specific sectors may come with typical social problems. Like in the green taxonomy, this could rely on the NACE classification, “supplemented by additional categories, where the current level of granularity within NACE is not sufficient”. However, a selection of “high” risk sectors may differ according to the “avoiding”, “enhancing” and “enabling” level of contribution, each having its own merits. On September 22, 2022, the president of the European Economic and Social Committee published an [OPINION](#) on the social taxonomy, to foster the discussion. Generally, more details precisions on safeguards, targets as well as sectors are still needed, together with an impact study. In sum, there is quite a lot of work left for years, but especially long-term investors might stay aware of the process.

3.3 UN Sustainable Development Goals

Sustainable development has also been a long-standing goal of international development financing. Apart from public assistance, the UN has set up a range of initiatives to foster the role of private sector investment in sustainable development (see [here](#) for an overview). Among them are the [UN Global Compact](#) and UN Environment Programme Finance Initiative ([UNEP FI](#)) together with the [Principles for Responsible Investment](#) (see also [PRI investment briefings](#) for various topics) and their action platform (see [SDG Bonds - Leveraging Capital Markets for the SDGs](#)). Details cannot be discussed here, instead, we confine ourselves to clarify the notion of the UN Social Development Goals (SDGs), which have become a most influential reference standard.



The 17 [UN Sustainable Development Goals \(SDGs\)](#) were set up in 2015 by the United Nations General Assembly and

accepted by all nations. They are part of the [2030 agenda](#) and a “blueprint to achieve a better and more sustainable future for all”. The goals address the global challenges we face, including poverty, inequality, climate change, environmental degradation, peace, and justice. To the extent the goals cover social topics (alongside green ones), bonds issued under this label are social bonds.



The SDG can be broken down further as each SDG typically has 8–12 sub-targets, and each target has between one and four indicators used to measure progress. The UN Statistics Division provides a current [official indicator website list](#). ICMA provides a [mapping](#) by which issuers, investors, and bond market participants can evaluate the financing objectives of a given green, social, or sustainability bond programme against the SDGs. Aligning investment with SDGs has been a recent trend in markets (e.g. compare [Paribas](#), and [Credit Suisse](#)). Since 2021, the ECB accepts SDG bonds as collateral (see [Bundesbank](#) and [ECB FAQ](#)).

4. How does the social bond market look like?

In this chapter, we take a deeper look at the structure of the market and what role social bonds play in the global fixed income market. As already explained above, the market for social bonds has grown rapidly in recent years. **Social bonds** currently have an outstanding amount of more than EUR 510bn. However, related fixed income products have also gained importance. The outstanding volume of **sustainability bonds** now amounts to EUR 550bn and that of **sustainability-linked bonds** sums up to more than EUR 220bn. In the following, we focus on social bonds in a narrower sense and analyse the market environment.

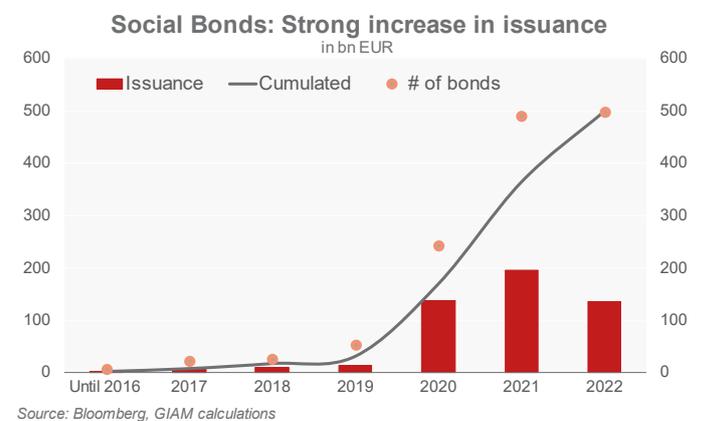
² Social bonds are fixed income instruments for which the use of the proceeds is entirely dedicated to projects or activities that promote improved social welfare and positive social impact directly for vulnerable,

4.1 Overview

All data used in the current chapter are based on the definition of social bonds used by Bloomberg.² This serves in particular to distinguish social bonds from sustainability bonds and sustainability-linked bonds. In case a bond receives a “social bond” tag by Bloomberg it is guaranteed that a bond is neither additionally classified as a sustainability nor a sustainability-linked bond.

Social bond issuance in 2022 almost halved compared to 2021

First, we make some important distinctions. US mortgages are tagged by Bloomberg as social bonds. They are nevertheless excluded because there is usually no market price and they are therefore not investable. Moreover, US municipal bonds are not considered either. While there are more than 4500 municipal bonds tagged as social instruments currently outstanding (from a total of over 940000), the overall amount sums up to only around USD 30bn. This means the average amount is only USD 8m and less than 20 bonds have a volume of more than USD 150m. Accordingly, tradability for an institutional investor is generally not given.

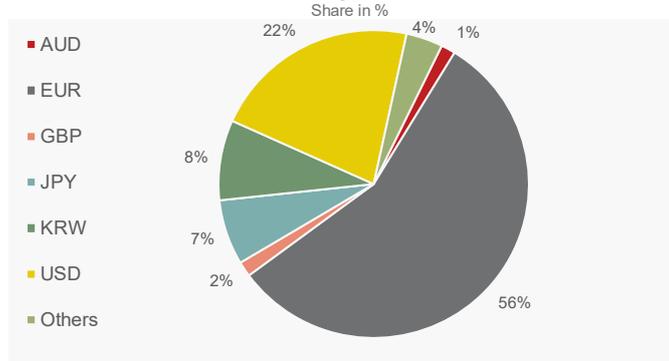


As the chart above shows the 2020/21 Covid-19 pandemic has proven to be a catalyst for social bonds with an overall issuance volume of almost EUR 340bn. However, issuance activity slowed markedly in 2022 (in terms of volume) because of the difficult bond market environment but even more due to the expiry of the EU SURE programme (see below). Another reason could also be that there is some

marginalized, underserved, or otherwise excluded or disadvantaged populations. For more details see [here](#).

uncertainty about future regulation and requirements and issuers prefer to wait until there is more transparency.

Social Bonds: Mainly denominated in EUR

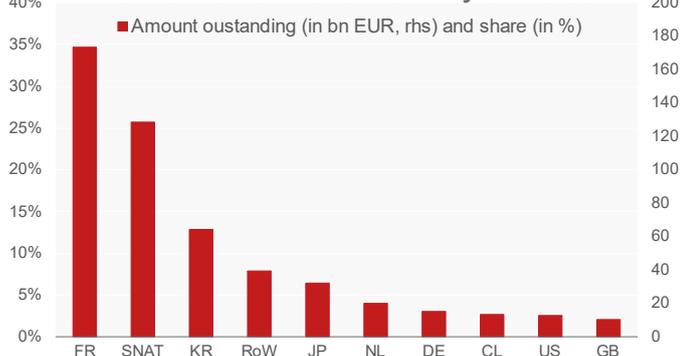


Source: Bloomberg, GIAM calculations

4.2 Selected features of the social bond market

The social bond market is **dominated by EUR-denominated issuances** (almost 60% of traded social volume) while only somewhat more than 20% is USD denominated. This means that euro-denominated bonds are much more strongly represented than, e.g., in the global corporate or government bond market. Strikingly, a rather large share (8%) is also in Korean won, reflecting the high relevance of ESG issuance (and social in particular) in Korea.

Social Bonds: Broken down by countries

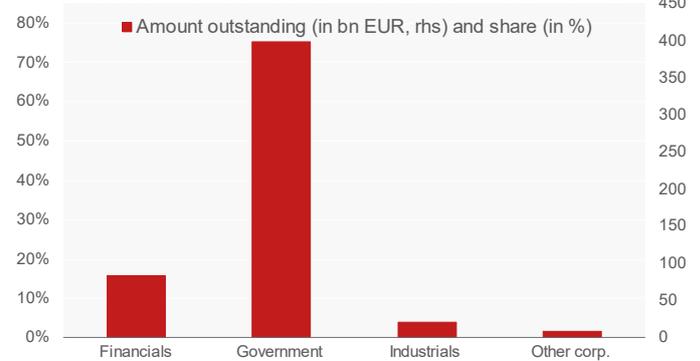


Source: Bloomberg, GIAM calculations

France is **by far the most active country**. More than one-third of all analysed bonds (in terms of nominal value) is issued by French entities. This is mainly due to CADES (Caisse d'Amortissement de la Dette Sociale, an administrative state agency). With around EUR 140bn, it is the largest issuer of social bonds worldwide. More than a quarter of the outstanding amount is released by supranationals. This is mainly because of the European Union, which has issued 13 large-volume bonds in the last

two years (see also below). Among the other countries, only Korea and Japan still have a significant share. The rest is spread over 34 other countries.

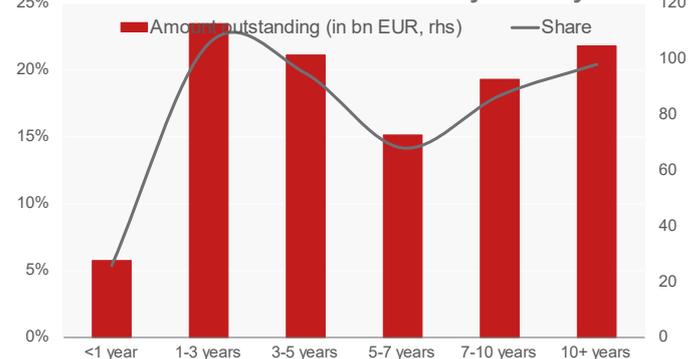
Social Bonds: Governments dominate market



Source: Bloomberg, GIAM calculations

The issuer base for social bonds differs significantly from that of green bonds. **More than three quarters are attributable to the government sector**. However, only less than 5% are sovereign bonds. Government-related agencies (e.g., CADES) account for more than 40% of all social bonds as social matters are in many cases the main purpose of these entities. While financial corporates have issued approximately 16% of all social bonds (financial institutions usually use them to refinance loans issued to governmental entities that are employed to implement social projects), non-financials are underrepresented.

Social Bonds: Broken down by maturity



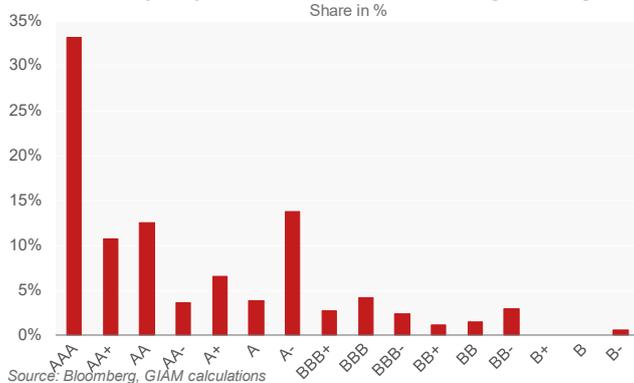
Source: Bloomberg, GIAM calculations

The clear difference to the issuer profile of green bonds implies that investments in social bonds provide tangible diversification opportunities for market participants seeking to invest in sustainable bonds. This applies even more as most social bond issuers that came to the market in 2020 or later did not also launch green bonds.

The maturity profile of social bonds is comparable to the ones of brown government bonds. The weighted average maturity

is around 7.4 years which is considerably shorter than the ones of green bonds.

Majority of Social Bonds with high rating



Around one-third of all social bonds have an AAA rating and more than a quarter of each have an AA rating or an A rating. Hence, 270 social bonds (out of around 320 that are subject to the current analysis) have a rating of at least A (or 85%). The rating level of social bonds reflects the high share of government and government-related bonds, and it is higher than, e.g., green bonds, which are characterised by a much higher proportion of corporate issuers.

4.3 Case study: European Union Social Bonds

For the case of the EU as a leading issuer, we analyse to what extent social bonds trade at a premium over conventional bonds and how this has developed over time. We also examine the question of whether social bonds are characterised by higher or lower volatility.

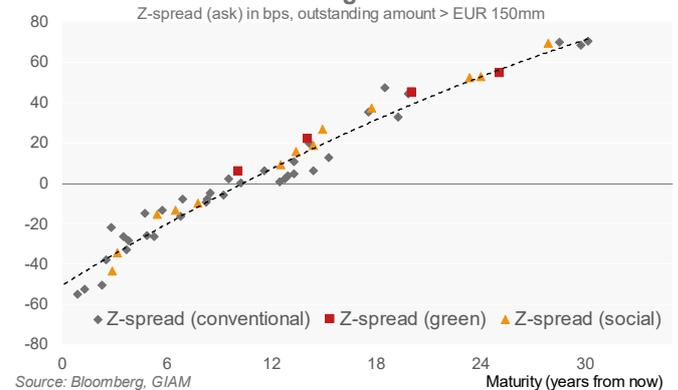
EU largest issuer of social bonds in the last 2 years

The EU is a supranational entity with a high rating (Aaa by Moody's, AA+ by S&P, and AAA by Fitch). To mitigate the socioeconomic impact of the Covid-19 pandemic the EU set up a loan programme SURE (Support to mitigate Unemployment Risks in an Emergency) to provide financial assistance to member states. SURE was financed via **13 EU social bonds (total outstanding amount of EUR 98bn)** issued between 2020 and 2022. The EU has thus supported investors in allocating funds to ESG debt instruments. Particularly, it has contributed to the further development of the social bond market. These social bonds complement the

³ However, the results for very short- and very long-dated bonds should be taken with a pinch of salt as bonds lying at the extreme ends of the curve are usually less reliable. In fact, the EU 0.3% 04/10/2050 offers the

existing 4 EU green bonds and a further 53 EU conventional bonds.

Outstanding EU Bonds



Restricting the analysis to bonds with an outstanding amount of more than EUR 150m we find that the EU spread curve shows a standard pattern. As no conventional bonds are matching exactly the maturity profile of social bonds, we estimate a conventional yield curve using a quadratic interpolation of the conventional yields. The set of coefficients is then used to derive yields of synthetic conventional bonds matching exactly the maturity of the social bonds. Afterward, the premium for social bonds – defined as the yield spread between a conventional bond and a social bond – is calculated.

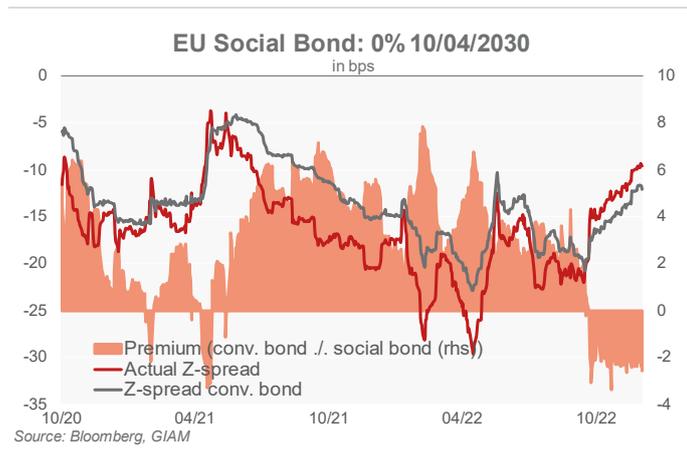
EU social bonds give up slightly less yield than EU green bonds

Hence, a positive premium for social bonds implies a lower z-spread for social than for conventional bonds, et vice versa. It turns out that the premium is quite low for all social bonds (single-digit range, see chart above). While it is slightly positive for short- and medium-dated EU social bonds, it appears to be even moderately negative for long-dated SURE bonds.³ This implies that **market participants investing in EU social bonds do hardly suffer a yield penalty**. Noteworthy, the premium for green bonds (often labelled “greenium”) is slightly higher in the case of EU bonds. The higher premium for green bonds (=lower yield) could be related to a stronger demand for green bonds which in turn could be because some funds can buy green bonds but not social bonds. Additionally, the clear reporting requirements and high transparency ensured by the EU green taxonomy,

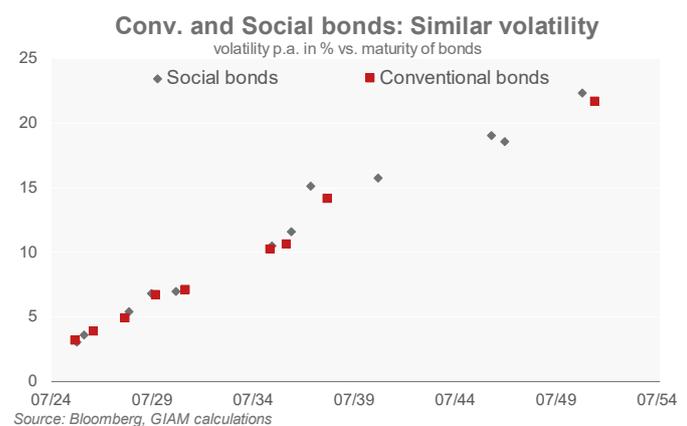
highest z-spread of all EU bonds, although it does not have the longest maturity.

for example, may also be a reason for the different pricing of green bonds.

The evolution of the premium of social bonds over time is similar for all social bonds. Consequently, it is sufficient to trace the development of one bond graphically (we take the first social bond: EU 0% 04/10/2030) that is representative of all EU social bonds.



As the chart below shows, there was a positive premium at issuance. This is a general observation. According to our calculations, all newly issued EU social bonds initially have a lower yield than conventional bonds. However, excess demand is not sufficient to ensure a constant/increasing premium on the secondary market. The premium remains volatile. In the case of the bond analyzed here it has fluctuated between -3 bps and +7 bps. This implies that no direct conclusions can be drawn regarding the relative performance of social bonds over the lifetime of the bond.



However, given the positive issuance premium, it should be noted that investors who hold EU social bonds from issuance to maturity achieve a moderately lower return compared to conventional bonds. Overall, the premium has tended to decrease over time, and it is now even slightly in negative

territory. This pattern is representative of all EU social bonds, and other analyses also conclude **that the premium of social (and green) bonds has generally declined recently**. The reasons for this development have not yet been fully clarified. This includes, among other things, possible credibility issues, a maturing of the ESG market, worsening liquidity conditions in sovereign bond markets, and a demand that cannot keep pace with the increasing supply.

Volatility is also an important factor in the assessment of a bond. As usual, volatility increases as the maturity of bonds increases. As the chart above shows, **the fluctuations of EU social bonds are comparable to those of conventional EU bonds**. Only long-dated EU social bonds show a slightly higher annual volatility. The risks of social bonds are therefore quite comparable to those of conventional bonds.

Summing up, EU social bonds have a very similar (risk) profile to conventional EU bonds. Moreover, the investment in a social bond is only associated with a small (if any at all) yield disadvantage.

5. Investment implications

As explained above, social bond is a fast-growing area of fixed income although it is far from being as developed as the green bond market. The demand for social bonds is just beginning to evolve implying less pricing distortions compared to the green bond market.

5.1 Supply will remain dynamic, particularly on govies

The demand for well-identified social needs financing is here to stay. We estimate that **in the coming years social bonds issuance volumes will be in the region of EUR 60bn annually** (excluding SLBs). The supply should remain largely skewed towards public issuers directly funding public services as they already announced multi-annual issuance plans including social bonds.

Private sector issuance excluding covered bonds should represent nearly 25% of the volumes, i.e. EUR 15bn, which will be mostly made of banks refinancing loans to the public sector. Hence pure social bonds are mostly directly or indirectly used to finance the public sector. SLBs are, on the contrary more often used to fund genuinely private sector social needs.

Although should the requirements become more stringent faster than expected, along the lines of the social taxonomy, this may also lead to a temporary pause in issuances as

issuers will have to transition from a non standardised reporting standard (ICMA principles currently prevailing) to a more standardised one, that may cause some delay.

In the corporate space, it is unlikely that social bond volumes will ever equal those of green bonds.

In the non-financial space, the offer is slow to pick up for several reasons:

1/ The size of identifiable capex is often far from representing an amount large enough for the bond to be included in Investment Grade corporate benchmarks. (i.e., EUR 500m). which is required

2/ The reputational risk is perceived as elevated from a company management perspective. Issuing a social bond attracts scrutiny by NGOs and the public, increasing the risk controversies.

3/ The complexity of reporting on the social side is also a source of concern for companies. Despite the ICMA efforts to reduce subjectivity, it is indeed more complicated to produce impact data for social expenditures than for green ones. Still issuing social bonds, like green bonds, is a nice marketing tool for companies, helping them to market their ESG commitments to the investment community.

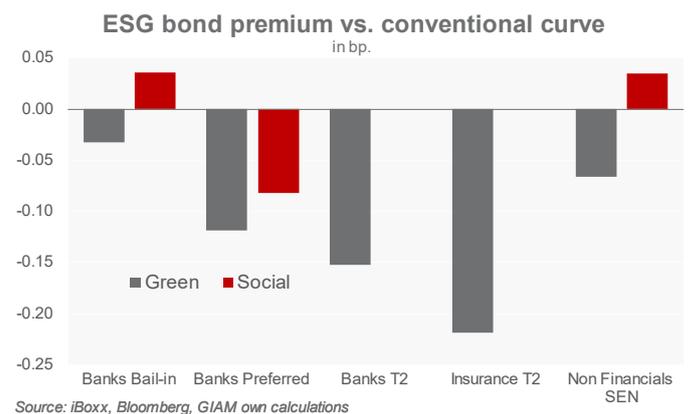
The above only applies to the use of proceeds bonds and not to SLBs that offer more flexibility. Also, sustainable bonds that combine both green and social objectives are not counted in these numbers. As they often are not very transparent on the social/green split, it is difficult to quantify the amount.

Hence in the coming years, we expect that in the use of proceeds area, the banks exposed to the public sector are going to be a sizeable growth driver as, given the [growing demand from investors](#) for well-flagged social issuance, they are currently working on mapping their social eligible activities. Although delayed, the likely future implementation of the social taxonomy, be it binding or not, will further grow the issuance pipeline.

Also in the Pharmaceutical sector, sustainable-linked bonds are very mature, based on KPI measuring the accessibility of drug distribution to certain populations/regions, and this will continue to develop. For instance, Novartis has been issuing in 2020 an SLB (see [link](#)) committing to expanding access to its innovative medicines and addressing key global health challenges. Teva Pharmaceuticals and Sanofi followed the path since then.

5.2 A cheap instrument for impact strategies

According to the [Environmental Finance](#) Bond Database, funds that have more than 50% of their portfolio in green bonds, saw their assets under management soar by 31% to USD 34bn from USD 26bn in 2021. The number of funds reaching the 50% threshold rose to 68 from 55, while new funds are being registered. On the social side, only very few dedicated bond funds have been created over the last two years.

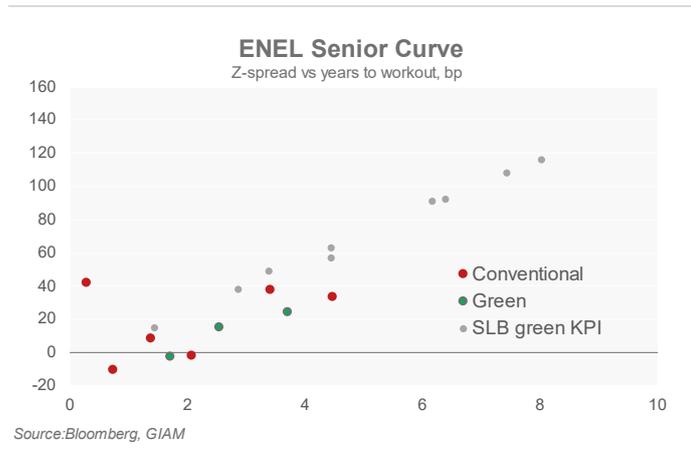


Strong interest in dedicated green bond funds, even if they hold only 10% of the total of green bonds outstanding, has contributed to the 'greenium' (pricing differential between green and conventional bonds) which is not yet observable for social bonds. Strikingly, according to our proprietary calculations (see chart above) issuing social bonds on the corporate market can even be more expensive than conventional bonds. We do estimate the differential on fitted curves that may not prove fully reliant yet the differential in results between green and social bonds is striking. Consequently, it currently offers the opportunity for fixed income **investors to do impact investments without accepting a lower remuneration** as they do it on the green bond market with the greenium. Although we can expect a premium for social bonds as the demand for social bonds is fast growing.

Social bonds tend to yield more than conventional bonds in the private space

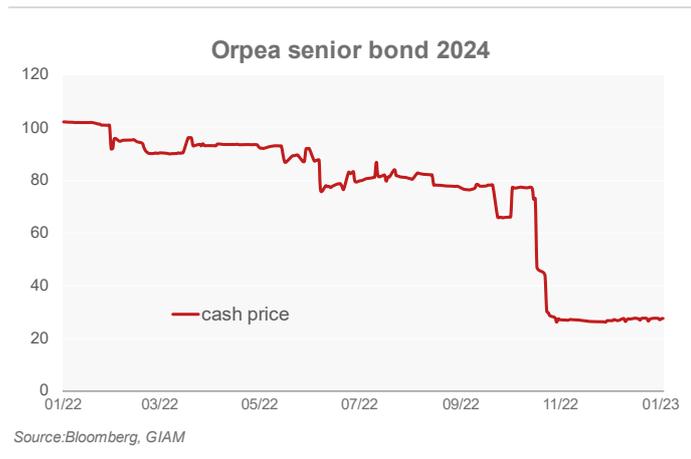
On the SLB market, we barely identify pricing differences in both the green and social securities. Yet in contrast to the use of proceeds bonds that are mostly focused on society-wide goals, SLBs tend to have objectives linked to the issuing company and can be used for impact strategies linked to diversity and inclusion for instance. The performance measurement is therefore much easier on SLBs than on

proceed bonds, but so far we do not observe a pricing impact on one type of bond or the other.



5.3 The overall social profile is key to limiting the controversy risk

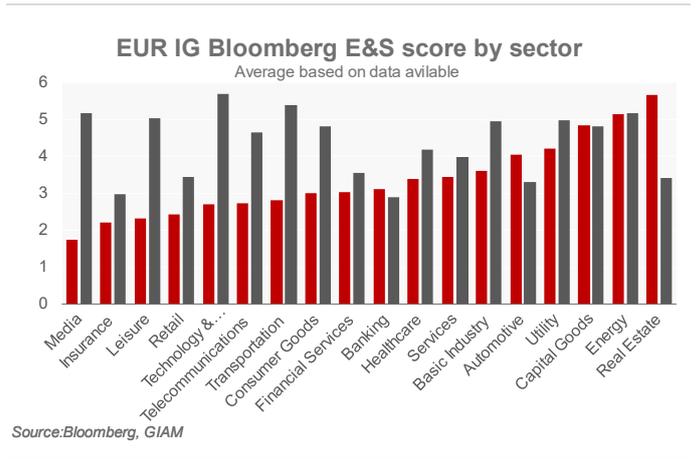
Investing in social bonds requires an in-depth analysis of the social profile of issuers as, the controversy risk a particular risk for labelled bonds including social ones. ESG funds are usually very fast in selling their holdings in case of bad practices allegations with potentially severe impacts on market pricing. One recent example is Orpea, a French care home group, plunged into crisis by mistreatment allegations (see [link](#)), resulting in a sharp fall in the price of its senior bonds (see chart), and will soon enter a debt renegotiation with its creditors.



In the banking sector controversy risks may arise if issuers fail to commit to systematically reallocating funds towards new social loans as loans are amortized. This should be a point of vigilance for investors in their bond selection process.

5.4 Managing the possibly conflicting signals from green and social taxonomy

Social objectives may conflict with climate goals. For instance a public transport company may finance school buses using diesel oil. A social taxonomy can't be science-based hence it has to be values-based. E goals can more easily be linked to quantitative goals while social more often to value based which makes them more prone to subordination. In terms of conflicts, just as the EU climate Taxonomy observes minimum social safeguards, the EU working group document on the social taxonomy suggests that also the social taxonomy should observe minimum environmental safeguards. It ultimately comes down to the values of the investors - how do investors weigh "E", "S" and "G"? How do investors balance CO2 emissions and infant mortality or access to education, for example? Interestingly, EDF has issued a social bond to help finance the construction of its Hinkley Point C nuclear plant in the UK as it provides electricity for people (see [EDF social bond framework](#)).



Currently, investors' investment strategies seek to align portfolios with the green taxonomy, and similar objectives will likely be set with respect to the social one. However, this may **create conflicting objectives for investors**. In the European investment grade space, the sectors that score well on the "E(nvironmental)" front are not necessarily well ranked on the "S(ocial)" scores (source Bloomberg) (see chart). Consequently, investors will have to define a clear set of ESG priorities like deforestation in E or gender equality in the S to help navigate potential conflicts that may arise with the S growing in importance.

6. Conclusions

In this report, we have introduced a comparatively new, fast-growing asset class. The regulatory environment is still in flux

and will continue to change over the next years. Given the social challenges, there will be a high supply of social bonds going forward. However, we have explained why demand will also remain elevated given the request for sustainable investments.

This applies even more as social bonds offer an attractive return with little (if any) yield disadvantage. Even considering statistical noise, which can in principle affect the validity of the analysis, the conclusion that social bonds achieve a return comparable to that of conventional bonds seems certain. Particularly, they provide a slightly higher yield than green bonds. What is more, the intersection between “S” and “E” issuers is not very large, making social bonds a good diversification option for sustainability-minded investors. However, the problem that an investment in social bonds may hurt environmental objectives remains and limits possible diversification effects. Despite this restriction, we consider social bonds to be an appealing investment for impact-oriented investors.

Having said that, given the nascent state of development of the social bond market it is too early to conclude the success. Given the complexity of social bonds compared to conventional bonds, they still have to prove their superiority in terms of efficiency and effectiveness in the provision of social services. This is all the more true if the social outcome cannot be easily measured.

Finally, the analysis is also made more difficult by the fact that, in contrast to the example of green bonds, there is hardly any generally recognized scientific base. Social norms are not globally uniform and are much more controversial. In addition, they change over time.

7. Appendix

Rationale for selecting sectors			
Selection of sectors	Sectors which contribute to reductions in the number of people without adequate, safe, and affordable housing. Building and managing apartments and houses; NACE Code 41.20. Construction of residential and non-residential buildings.		
Type of substantial contribution	Enhancing positive impact inherent in economic activity (examples)		
Substantial contribution	Improving the availability/accessibility of housing units Percentage of flats available for low income and disadvantaged people. Flats should have at least a x % cheaper rent than average in the region, and access should be by means of a housing permit only. Percentage of m ² assigned through a public waiting list.		
	Improving accessibility Build open spaces designed for social activities; foster access for vulnerable groups; ensure the presence of additional public services; ensure the existence of a social-management project.		
	Adequate living standards and wellbeing for end users	Decent work	Inclusive and sustainable societies
DNSH	<p>Guarantee acceptability Housing units/flats must follow the environmental taxonomy for protection of biodiversity and ecosystems</p> <p>Guarantee quality Housing units/apartments must respect DNSH criteria set for the sector under the environmental taxonomy.</p> <p>There must be security of tenure for vulnerable groups.</p> <p>On process-related criteria, human rights and labour rights must be respected when building the units/apartments.</p>	<p>ILO core labour standards must be met.</p> <p>There must be adequate OHS.</p> <p>The minimum wage must be paid to workers.</p>	<p>No involuntary resettlement, and no pollution of drinking water when building apartments</p>

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