Sustainable bond issuance to be flat in 2022 amid market headwinds

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Sustainable Finance – Global

Sustainable bond issuance to be flat in 2022 amid market headwinds

Summary

Sustainable bond volumes moderated in the first quarter of 2022 as global market headwinds intensified. Global issuance of green, social, sustainability and sustainability-linked (GSSS) bonds totaled $203 billion in the first quarter of 2022, down 11% from the fourth quarter of last year, and down 28% from the first quarter of 2021. While the duration of Russia's invasion of Ukraine is unknown at this time, the military conflict has impaired global economic growth prospects, stoked existing inflationary pressures and heightened the prospects for accelerated monetary policy tightening. While our baseline expectation is that sustainable bond issuance growth will resume when market volatility abates, broader market conditions will provide greater than anticipated headwinds for sustainable bond issuance this year. As a result, we now anticipate GSSS bond volumes will be roughly flat compared with last year's total, with around $1 trillion of issuance for the whole of 2022. At an instrument level, we now forecast $550 billion of green bonds, $125 billion of social bonds, $175 billion of sustainability bonds and $150 billion of sustainability-linked bonds.

Long-term sustainable bond growth potential remains strong despite temporary market headwinds. We continue to see many drivers supporting growth in the sustainable debt markets despite weaker issuance in the first quarter and our expectations for suppressed issuance the remainder of the year. The need for climate mitigation and adaptation financing, accelerated decarbonization efforts to achieve net zero goals, growing regulatory attention on sustainability and a continued focus on the interconnectedness of environmental and social objectives will all support the sustainable debt markets over the long term. Indeed, several developments during the first quarter highlight that these trends remain significant. These include heightened European attention on shifting to renewable energy to enhance energy security following Russia's invasion of Ukraine, and the publication of two new IPCC reports that highlight the magnitude of physical climate risks and the need for both climate mitigation and adaptation financing.

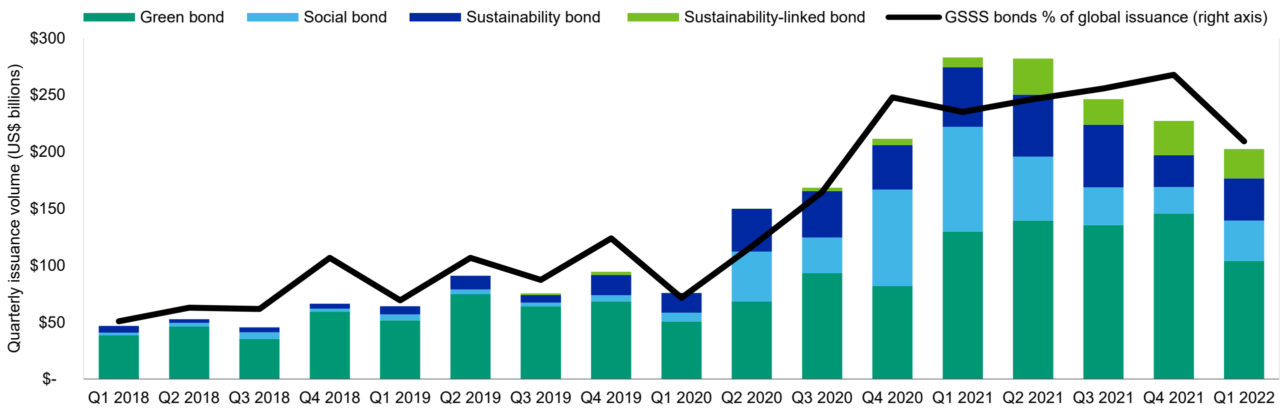
Sustainable debt markets are increasingly financing projects to promote gender equity. Global gender inequality comes at the expense of global GDP with estimated losses of $160 trillion in human capital wealth due to disparities in earnings between men and women. There is increasing demand from investors seeking to remedy these challenges to finance projects that provide services to help bridge the gender divide. Since 2016, proceeds from a cumulative $72 billion of GSSS bonds have been earmarked – in whole or in part – for the financing of projects tied to SDG5 for the achievement of gender equality and empowerment of all women and girls. Despite the steady increase in issuance tied to SDG5 in recent years, there is much work to be done and ample room for market growth. Of the sustainable debt issuances citing projects linked to SDGs since 2016, we estimate around 1% of proceeds have been allocated to SDG5, with a much larger share of issuance going to other sustainable development projects, such as for climate mitigation efforts.

Sustainable bond volumes moderated in the first quarter of 2022 as global market headwinds intensified

Global issuance of green, social, sustainability and sustainability-linked (GSSS) bonds totaled $203 billion in the first quarter of 2022, down 11% from the fourth quarter of last year, and down 28% from the first quarter of 2021 (see Figure 1). Across the four segments, there were $104 billion of green bonds, $35 billion of social bonds, $37 billion of sustainability bonds and $26 billion of sustainability-linked bonds. GSSS bond volumes fell for the fourth straight quarter in Q1 2022, with the lowest quarterly issuance since the third quarter of 2020. The $203 billion first quarter GSSS issuance is 22% below the average quarterly issuance of $260 billion achieved in 2021.

Figure 1 Sustainable bond issuance moderated in Q1 2022 against backdrop of greater market volatility

Quarterly issuance of GSSS bonds since 2018, US$ billions



Sources: Moody's ESG Solutions, Environmental Finance Data, Dealogic

The combined $203 billion of GSSS bond issuance came during a quarter when market volatility was greater than previously anticipated, driven in large part by the effects of Russia's invasion of Ukraine. While the duration of Russia's invasion of Ukraine is unknown at this time, the military conflict has impaired global economic growth prospects, stoked existing inflationary pressures and heightened the prospects for accelerated monetary policy tightening.[1]

According to data from Dealogic, overall global bond volumes were approximately 20% lower in the first quarter of 2022 than during Q1 2021, contributing to the lower issuance volumes of labeled GSSS bonds. Sustainable bonds accounted for just under 10% of global volumes in the first quarter, a drop from the 11.7% share for all of 2021. One possible explanation is relative softness in the European market – which typically accounts for the bulk of global sustainable bond volumes – where markets were very quiet following the onset of Russia's invasion of Ukraine. Another potential explanation is issuers forgoing some borrowing for long-term capital investment in an uncertain environment, instead favoring borrowing to shore up liquidity, or shifting their financing needs to the loan markets.

While we continue to see many long-term drivers supporting growth in the sustainable debt markets, as detailed in the next section of this report, broader market conditions will provide greater than anticipated headwinds for sustainable bond issuance this year. Against this backdrop, our original 2022 forecast of $1.35 trillion sustainable bond issuance appears out of reach. While our baseline expectation is that issuance growth will resume when market volatility abates, quarterly issuance would need to average over $375 billion a quarter the remainder of the year to achieve our original forecast, a rate significantly higher than the record $283 billion quarterly issuance during Q1 2021.

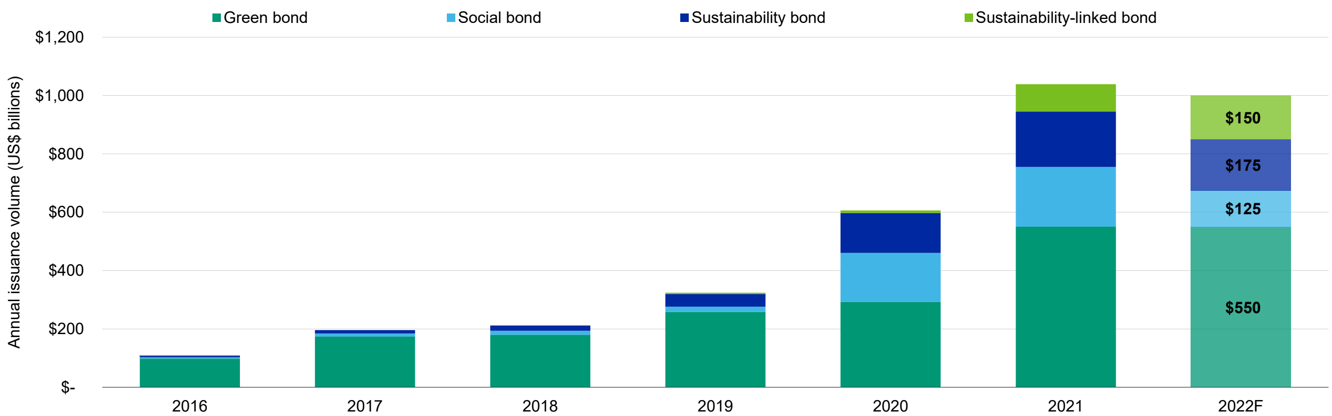
As a result, we now anticipate GSSS bond volumes will be roughly flat compared to last year's total, with around $1 trillion of issuance for the whole of 2022. At an instrument level, we now forecast $550 billion of green bonds, $125 billion of social bonds, $175 billion of sustainability bonds and $150 billion of sustainability-linked bonds (see Figure 2). This forecast incorporates a

[1] See Global Macro Outlook 2022-23 (March 2022 Update): Economic growth will suffer as fallout from Russia's invasion of Ukraine builds, Moody's Investors Service, March 2022.

significant level of uncertainty in the current volatile environment, but does anticipate a rebounding in volumes during the second half of the year as more issuers resume their long-term sustainable financing plans.

Figure 2 2022 sustainable bond issuance to be relatively flat compared with last year given broader market conditions

Annual issuance of GSSS bonds since 2016, US$ billions



2022F reflects Moody's updated forecast for full-year GSSS bond issuance.

Sources: Moody's ESG Solutions and Environmental Finance Data

Green bond issuance lagged in the first quarter but still accounted for half the GSSS bond market

Green bond volumes declined in the first quarter of the year to $104 billion, 29% lower than the record $146 billion issued in the fourth quarter of 2021, and the lowest quarterly volume since Q4 2020. Green bonds remain the primary contributor to the GSSS bond market, however, accounting for 51% of GSSS bond volumes in the first quarter. Against the backdrop of a more challenging than anticipated issuance environment, we now anticipate around $550 billion of green bonds globally for 2022, in line with total issuance during 2021. While this is a downward revision from our original expectations, it does incorporate an expected rebounding in volumes during the second half of 2022 as market conditions improve and financing of climate mitigation and adaptation projects remains top of mind for many issuers.

European issuers continued to hold a dominant share of green bond issuance in the first quarter, with $47 billion accounting for 45% of the global total (see Figure 3). The European market share has been in decline since the first quarter of 2021, however, with more acute challenges in the European bond market in Q1 2022 likely contributing to lower sustainable bond volumes. Compared with the first quarter of last year, European green bond volumes were 37% lower year-over-year, marking a challenge for global green bond issuance. Conversely, Asia-Pacific and North American green bond issuance held up better compared with the first quarter of 2021, remaining roughly flat with the same period last year. These regions accounted for 25% and 20% of global issuance, respectively, in Q1 2022. The leading countries for green bond issuance through the first three months of 2022 were the US with $15 billion (14% of global issuance), Germany with $14 billion (13%), China with $13 billion (12%) and France with $7 billion (6%).

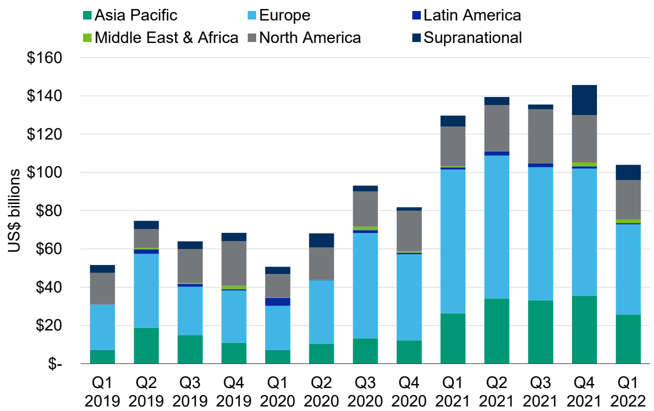
From a sectoral standpoint, nonfinancial corporates held a leading share of green bond issuance in the first quarter, with issuance of $52 billion representing 50% of the global total (see Figure 4), up from a 37% share of market in the last quarter of 2021 and 42% during Q1 2022. Following non-financial corporates, financial institutions accounted for $27 billion, or 26% of global green bond issuance. Issuance from sovereigns, supranationals, and agencies (SSAs) and municipalities lagged their corporate peers, accounting for a combined $26 billion, or 25% of green bond issuance, down significantly from the 45% share and $65 billion issuance during last quarter.

Notable green bond transactions in the first quarter included first-time sovereign issuer the Government of Canada, which debuted with a CAD5 billion ($4 billion) transaction in March to finance nine eligible environmental categories as defined in its green bond framework including clean transportation, renewable energy and energy efficiency.[2] Debut automotive manufacturer

[2] See Canada publishes Green Bond Framework in advance of inaugural issuance, Government of Canada, March 2022.

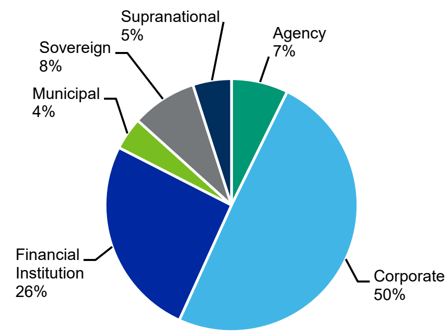
Honda Motor Co. also came to market in March with a three-tranche $2.75 billion offering as part of its strategy to invest in electric vehicles to contribute to its goal of net zero operations.

Figure 3 Green bond issuance fell sharply in the first quarter of 2022



Sources: Moody's ESG Solutions and Environmental Finance Data

Figure 4 Share of Q1 2022 global green bond issuance by issuer type



Sources: Moody's ESG Solutions and Environmental Finance Data

Social bond volumes increased in the first quarter, but 2022 issuance will be down as pandemic financings abate

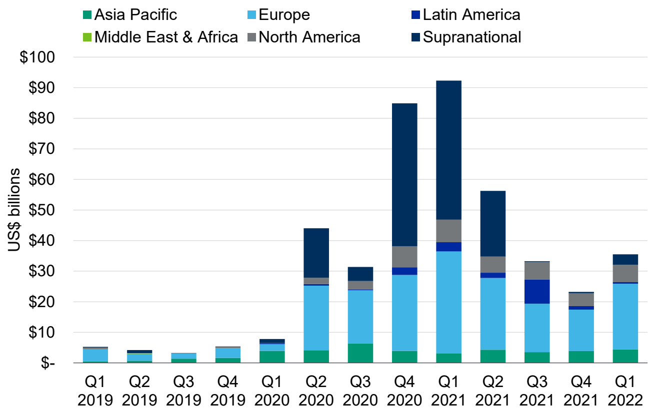
Social bond issuance increased in the first quarter of the year, with $35 billion of volumes accounting for an 18% share of the GSSS bond market. Issuance was up modestly against the past two quarters, reversing a trend of three straight declining quarters. Volumes were still 62% lower than the first quarter of last year, however, when social bond financings for pandemic relief were in full swing. While we anticipate that social bonds will remain an instrument of choice for many issuers focused on social objectives, broader market conditions, the winding down of pandemic-driven social bonds and the shift to broader sustainability-labeled instruments will suppress volumes for the remainder of the year. As a result, we now forecast social bond issuance of $125 billion for all of 2022, 39% lower than the $205 billion issued during 2021.

The rise in Q1 2022 social bond issuance was supported in large part by issuance from the French public finance agency Caisse d'Amortissement de la Dette Sociale (CADES), which issued an aggregate $12.4 billion during the quarter, part of its €40 billion debt operations scheduled to run until end of 2022.[3] This was a peak in issuance for the agency since Q1 2021. CADES has been one of the largest social bond issuers since the start of the pandemic. Other large pandemic-focused social bond issuers, including the European Union and UNEDIC, have pulled back social bond financing, thus limiting the upside for issuance the rest of the year.

Europe still holds the highest share of social bond issuance with $22 billion issued in the first quarter, followed by North American and Asia Pacific issuers with $6 billion and $4 billion, respectively (see Figure 5). Agencies held a majority share of volume issuance accounting for 50% of issuance, followed by financial institutions (23%) and non-financial corporates (12%) (see Figure 6). Agencies have held a dominant share of the market since the second quarter of 2021, only rivaled by sovereign social bond issuance from the European Union. We do see some potential for social bond issuance from banks, such as the $2.5 billion in social bond issuance from Citigroup during the first quarter.

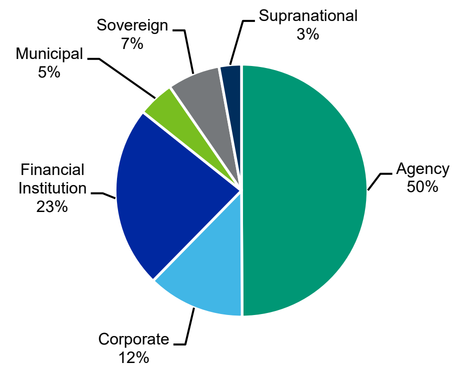
[3] See CADES continues its 2022 funding programme with a new bond in US dollars, CADES, January 2022.

Figure 5 Social bond issuance up modestly in Q1 2022 but remains well below pandemic-fueled peak



Sources: Moody's ESG Solutions and Environmental Finance Data

Figure 6 Share of Q1 2022 global social bond issuance by issuer type



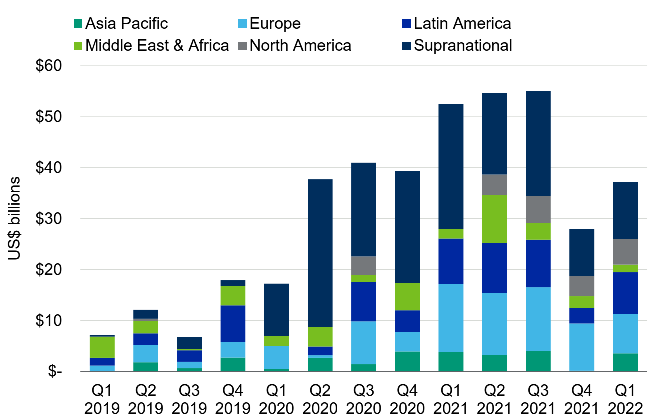
Sources: Moody's ESG Solutions and Environmental Finance Data

Sustainability bond issuance rebounded in the first quarter of the year but trailed record 2021 quarterly issuance peaks

Sustainability bond issuance totaled $37 billion in the first quarter, up a significant 33% from Q4 2021, but down 29% compared with the first quarter of last year (see Figure 7). A greater focus on highlighting both environmental and social initiatives will continue to support sustainability bond volumes from a diverse array of issuers, but a pullback in some sustainability bonds for pandemic relief and broader market conditions will temporarily halt the growth of these instruments. As such, we now believe sustainability bond issuance will total approximately $175 billion this year, around 8% lower than in 2021.

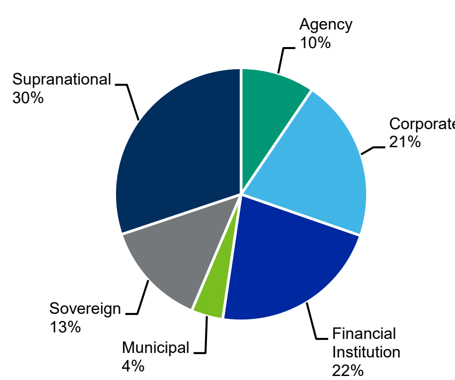
Supranational issuers continued to be the leading regional contributor to the sustainability bond market in the first quarter, with $11 billion of issuance accounting for 30% of the global total. Asia Pacific issuers brought $8 billion to market in the first quarter and accounted for 22% of the total, while European issuers followed closely behind with $7 billion accounting for 19%. Issuance continues to be more diverse from a sectoral perspective than in the green and social bond markets, with supranationals, financial institutions, non-financial corporates, sovereigns and agencies all representing at least 10% of global issuance in the first quarter (see Figure 8).

Figure 7 Sustainability bond issuance rebounds in first quarter of 2022



Sources: Moody's ESG Solutions and Environmental Finance Data

Figure 8 Share of Q1 2022 global sustainability bond issuance by issuer type



Sources: Moody's ESG Solutions and Environmental Finance Data

Sovereign issuance continues to be a bright spot in the sustainability bond market, with $5 billion of issuance accounting for around 13% of the total market. Sovereign sustainability bond issuance in the first quarter included a three-tranche $4 billion offering from the [Republic of Chile] in January, and the debut $1 billion offering from the [Republic of the Philippines] in March.

Proceeds from bonds issued under each countries' frameworks will contribute to 11 UN Sustainable Development Goals (SDGs). We believe the potential remains strong for other sovereigns to issue sustainability bonds as they seek to advance their commitments under the Paris climate agreement while also seeking to finance social objectives consistent with the SDGs.

Sustainability-linked bond volumes down modestly in the first quarter but growth poised to resume

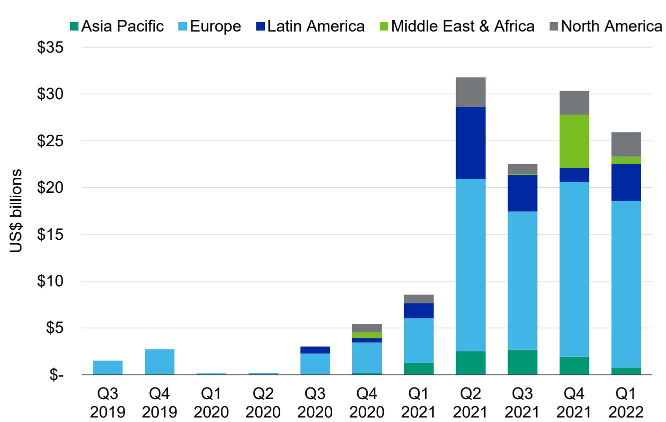
Sustainability-linked bond (SLB) volumes totaled $26 billion in the first quarter of 2022, a modest 15% decline from the fourth quarter of 2021 (see Figure 9). Despite the decline, however, issuance remained roughly in line with the volumes achieved during the past three quarters as the SLB market continues to establish itself as a key contributor to the labeled GSSS bond space. We anticipate growth in issuance will resume in the second half of the year, as there remains significant appetite from issuers to utilize general corporate purpose financing tied to ESG-related key performance indicators, especially among issuers in hard-to-abate sectors. Another potential avenue of growth is from high-yield issuers, among whom debt issuance was largely absent during some weeks in the first quarter, but have been more likely to utilize SLBs than other GSSS bonds. As a result, we anticipate SLB issuance can reach $150 billion for all of 2022, lower than our original forecast but still higher than the rate achieved in the first quarter.

European issuers remain the driving force behind sustainability-linked bond volumes, accounting for a leading 69% share of issuance in the first quarter. Latin American issuers have also become strong issuers in the market with 15% share ($4 billion) in the first quarter, followed by North American issuers with 10% ($3 billion). Nearly all SLBs have been issued by non-financial corporates to date, with $122 billion of the cumulative $132 billion issued since 2019 (see Figure 10).

In the first quarter of 2022, however, the Republic of Chile issued the first ever SLB from a sovereign government.[4] The $2 billion transaction included two KPIs related to the country's decarbonization goals under the Paris climate agreement. The first target aims to have cumulative carbon dioxide emissions not to exceed 95 metric tons of CO_2eq by 2030, while the second aims for 60% of electricity production to be derived from renewable energy by 2032. The bond received strong investor demand, reaching $8.1 billion in orders.

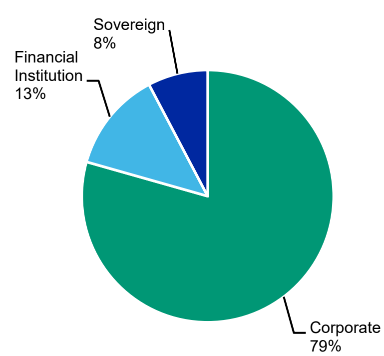
Other notable SLB issuances in the first quarter included Italian utility company Enel issuing a €2.75 billion three-tranche deal in January, bringing its total SLB issuance to over $20 billion since bringing the inaugural SLB to market in Q3 2019.

Figure 9 Sustainability-linked bond issuance fell modestly in the first quarter of 2022



Sources: Moody's ESG Solutions and Environmental Finance Data

Figure 10 Share of Q1 2022 global sustainability-linked bond issuance by issuer type



Sources: Moody's ESG Solutions and Environmental Finance Data

Long-term sustainable bond growth potential remains strong despite temporary market headwinds

Despite market headwinds leading to declining sustainable bond issuance in the first quarter and our expectations for suppressed issuance the remainder of the year, we continue to see many drivers supporting growth in the sustainable debt markets. The need for climate mitigation and adaptation financing, accelerated decarbonization efforts to achieve net zero goals, growing regulatory attention on sustainability and a continued focus on the interconnectedness of environmental and social objectives will all support

4 See Chile sweeps aside vol to tighten SLB landmark, Global Capital, March 2022.

the sustainable debt markets over the long term. Indeed, several developments during the first quarter highlight that these trends remain significant.

European push for energy security to spur long-term investment in strategic renewable energy plans

While Russia's invasion of Ukraine has contributed to a series of market conditions that have temporarily dented the growth prospects for the sustainable bond market, the conflict has also raised the prospects of greater long-term sustainable debt issuance to finance Europe's energy goals. The continent's reliance on Russian fossil fuels has spurred a growing number of European leaders to push for a more rapid shift away from fossil fuels as a means to foster the region's energy independence.

Indeed, the European Commission proposed its "REPowerEU" plan outline in March, which highlights ambitions to diversify its gas supplies with non-Russian suppliers and through larger volumes of biomethane and renewable hydrogen production and imports, while also aiming to more quickly reduce the continent's use of fossil fuels by boosting energy efficiency, increasing renewables and electrification, and addressing infrastructure bottlenecks.[5] A group of 102 European lawmakers also called for removal of gas as an eligible project in the EU taxonomy in response to Russia's invasion of Ukraine,[6] while the EU is now mulling over a potential embargo on Russian oil.[7]

While many EU lawmakers have the ambition to shift to renewable energy as quickly as possible, the realities of Europe's energy infrastructure and economic situation suggest that the continent will remain heavily reliant on hydrocarbons from other providers in the short term.[8] Growth in European renewable energy consumption has been slow in recent years, growing from 16% in 2012 to just 22% in 2020. Significant infrastructure investment is needed to more rapidly accelerate the continent's shift to renewable energy, suggesting opportunities for investments that could potentially be financed with sustainable bonds. Although this will be a longer-term shift, the need to think about accelerating the continent's energy security plans could be a boon for sustainable debt volumes in coming years.

Climate mitigation and adaptation financing more urgent than ever as IPCC reports highlight significant physical risks

The latest reports from the Intergovernmental Panel on Climate Change (IPCC) on climate adaptation[9] and mitigation[10] clearly indicate that only immediate, ambitious action will reduce the greatest risks of devastating climate change.[11] These reports are just the latest reminder that urgent climate action is needed, and climate mitigation financing will need to accelerate in order to avoid the worst impacts of climate change. While mitigation financing remains paramount in the sustainable bond market to date, the growing realization that many physical impacts are now locked in is also dramatically raising the need for climate adaptation financing to rise to the challenge.

The IPCC report focusing on adaptation and financing notes that between \$7.9 and \$12.7 trillion of assets could be exposed to the risk of severe coastal flooding by the end of the century, assuming a 1.4°C increase in average global temperature by 2046-65. If global temperatures increase 2.0°C over the same period, the value of assets exposed to severe flood risk could rise as high as \$14.2 trillion. The devastating heat wave crisis in India, with land temperatures in northwest India soaring to above 60°C,[12] is just the latest reminder of the dangerous effects that climate change is already having on many communities around the globe.

To date, however, GSSS bond proceeds allocated to adaptation and resilience projects have been limited. In the first quarter of 2022, only 3% of green and sustainability bond proceeds were allocated to climate change adaptation projects, with most proceeds going to climate mitigation categories such as renewable energy, green buildings, clean transportation and energy efficiency (see Figure 11). We anticipate more financing will be allocated to adaptation projects going forward as the physical impacts of climate change become more frequent and severe.

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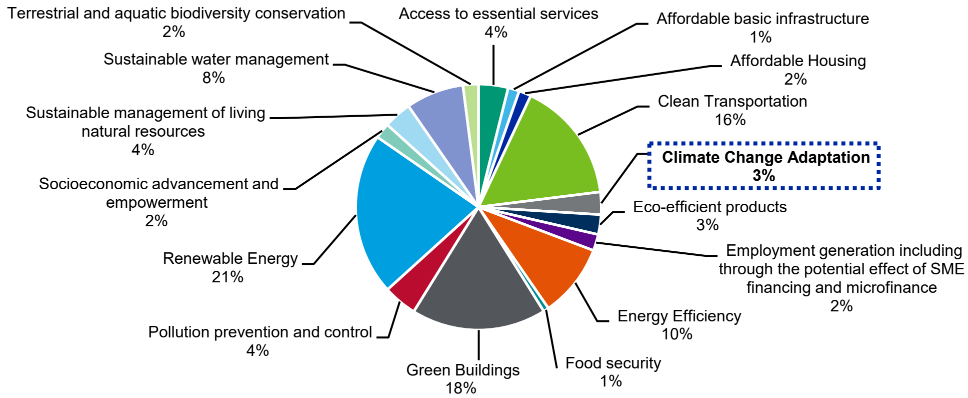
5 See REPowerEU: Joint European action for more affordable, secure and sustainable energy, European Commission, March 2022.
6 See EU parliamentarians demand withdrawal of gas from taxonomy, citing Russia, Environmental Finance, March 2022.
7 See Russia-Ukraine Conflict: EU mulls over oil embargo, Moody's Analytics, May 2022.
8 See Carbon Transition – Europe: Energy security needs will slow emissions reductions, but long-term targets still intact, Moody's Investors Service, April 2022.
9 See Climate Change 2022: Impacts, Adaptation and Vulnerability, UN IPCC, February 2022.
10 See Climate Change 2022: Mitigation of Climate Change, UN IPCC, April 2022.
11 See Latest IPCC Report Demonstrates Urgency & Opportunity of Reaching Net Zero, Moody's ESG Solutions, April 2022.
12 See No respite from heat, surface temperature crosses 60°C in parts of north India, Free Press Journal, May 2022.

Figure 11 Q1 2022 green and sustainability bond issuance by use of proceeds, % of total issuance



Sources: Moody's ESG Solutions and Environmental Finance Data

The importance of adaptation financing will also raise the prospects for innovative financing in other adjacent areas. As the financial sector begins to grapple with the valuation of natural capital, especially in light of the newly formed Taskforce on Nature-related Financial Disclosures (TNFD), opportunities arise for organizations to develop green financing projects aimed at adaptation capacity building.[13] The link between nature-based solutions and mitigating climate change's physical impacts is well understood but the financing networks to implement such strategies remain nascent and largely in the project phase.

Blended finance projects such as that between the Government of Belize and The Nature Conservancy, which aims to generate $180 million for marine conservation,[14] bring together debt financing structures and valuation of ecoservice benefits from intact oceanic ecosystems. We expect this trend will particularly be led by blended financing partnerships between sovereigns and other public finance entities with broader social mandates and at the forefront of combating the detrimental effects of climate change.

A recent example of an innovative structure in this space is the United Nations Development Programme's (UNDP) proposed debt-for-nature swap for the Government of Sri Lanka. Under the UNDP proposal, the debt-for-nature swap would allow a portion of the government's debt burden to be forgiven in exchange for the implementation of environmental policies or funding of conservation programs.[15]

Development of climate and sustainability disclosure regimes continues to advance

The development of climate-related financial disclosure standards and harmonized disclosure frameworks play an increasingly important role in creating a transparent sustainable investing environment in global markets. Standardized reporting of climate change-related risks and opportunities, and of their estimated financial impact on companies, was a key theme in the first quarter of 2022. Regulatory bodies like the US Securities and Exchange Commission (SEC)[16] and recently formed market standard setter International Sustainability Standards Board (ISSB) by the International Financial Reporting Standards (IFRS)[17] have each released formative disclosure requirements and frameworks that lean on market best practices and work toward harmonization and comparability. Another recent example is the European Financial Reporting Advisory Group (EFRAG), the European Commission's financial reporting advisory group, launching a public consultation on draft EU sustainability reporting standards for corporates.[18] Such initiatives continue to heighten market focus on climate and sustainability risks, with financing projects to address such risks likely to paramount for many issuers.

13 See The TNFD Nature-Related Risk & Opportunity Management Disclosure Framework Beta v0.1, Taskforce on Nature-related Financial Disclosures, March 2022.
14 See The Government of Belize partners with The Nature Conservancy to Conserve 30% of its Ocean Through Debt Conversion, The Nature Conservancy, November 2021.
15 See Government of Sri Lanka: Debt-for-nature swaps can provide debt relief, long-term environmental benefits, but could constitute event of default, Moody's Investors Service, April 2022.
16 See SEC's proposed climate-risk disclosures will benefit investors, but implementation will be challenging, Moody's Investor Service, March 2022.
17 See ISSB's proposed climate disclosures add momentum for improving climate risk data, Moody's Investor Service, April 2022.
18 See EFRAG flags SFDR PAI links in draft corporate reporting standards, IPE, May 2022.

Regulatory bodies' action on climate-related disclosure requirements are based on the need for fair and orderly markets so investors and lenders can responsibly manage risk and opportunity posed by climate-related impacts. The US SEC proposed a draft rule in late March 2022 on climate disclosure requirements for publicly listed companies on oversight and governance of climate-related risks, greenhouse emissions and intensity, and transition plans. The draft rule leverages market disclosure frameworks such as the Taskforce on Climate-related Financial Disclosure (TCFD) and Greenhouse Gas Protocol, with a goal of ensuring global alignment and reducing duplicative effort in disclosure. If the rule is successfully implemented, it would represent another step toward global climate-related financial disclosures and enhance investors' understanding of the financial risk that climate impacts pose to disclosing entities.

Market disclosure frameworks are rooted in improving and standardizing climate-related disclosures made by companies using market expertise and leveraging multiple players in global markets. ISSB released in late March 2022 a draft climate-related disclosure standard mirroring the three pillars of governance, strategy and risk management in the TCFD framework. The exposure draft proposed by ISSB aims to help financial institutions better evaluate the climate risks in lending and investment portfolios. The framework would provide a baseline of sustainability disclosure standards that can be adopted with regional regulatory requirements by agencies such as the SEC or Financial Stability Board (FSB). Given the increased demand for globally harmonized standards, if successfully adopted and implemented, the proposal would increase the value and volume of climate related disclosures, which are critical to the assessment of climate-related risks.

Social risks remain top of mind despite winding down of pandemic-fueled social bond boom

Despite the decline in social bonds responding to the pandemic, social financing remains top of mind for investors. This is evidenced by the Russa-Ukraine military conflict bringing humanitarian crises into greater focus and the potential for labeled bonds to respond to such events. In April, the International Capital Market Association published a Q&A document on how sustainable bonds can be used to raise capital for social projects to support "fragile and conflict states."[19] The document provides details on the types of issuers than can issue such bonds, as well as examples of eligible projects and other requirements. Illustrative projects cited in the report include direct emergency relief such as food, shelter and healthcare and specific projects designed to alleviate unemployment of affected populations.

With the growing interest in financing social projects comes the need to more clearly define what constitutes a robust social project. Market best practices and taxonomies, such as a potential EU social taxonomy[20] can help alleviate these challenges. During the first quarter of 2022, the Platform on Sustainable Finance (PSF) advising the European Commission released its final report with recommendations on the development of a social taxonomy. The PSF proposes a detailed framework centered around social objectives, building on the existing EU environmental taxonomy's structure. The proposed framework is supported by a Do No Significant Harm (DNSH) principle and minimum environmental safeguards. Importantly, the PSF recognizes the complexity of operationalizing a social taxonomy and developing quantifiable criteria to determine the substantial contribution of an activity to a social objective, and social DNSH criteria, and underlines that more work is needed in these areas. In light of these complexities, and given the expectation that a social taxonomy likely will not be translated into legislative action in the near-term, the PSF encourages practitioners to move forward in developing market-led social taxonomies.

While it remains too early to tell what impact a potential EU social taxonomy may have on the labeled bond market, the final report from the PSF marks an important step forward in more clearly defining social projects and their associated benefits.

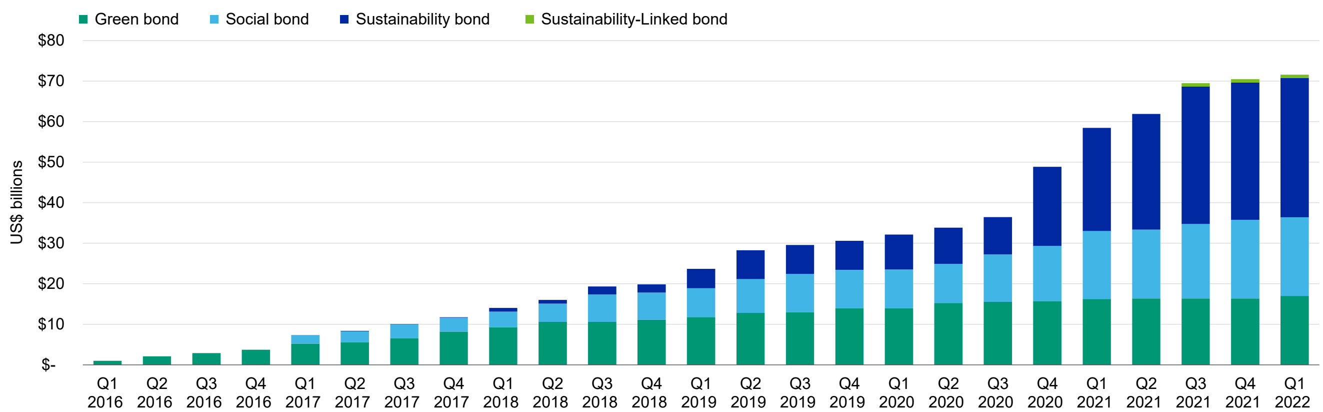
Sustainable debt markets are increasingly financing projects to promote gender equity

In a report we published in March coinciding with International Women's Day, we explored how sustainable debt instruments can finance projects to support gender equity, as the economic and social implications of gender inequality come into greater focus. Global gender inequality comes at the expense of global GDP with estimated losses of $160 trillion in human capital wealth due to disparities in earnings between men and women.[21] There is increasing demand from investors seeking to remedy these challenges to finance projects that provide services to help bridge the gender divide. There is also increasing regulatory pressure on investors and companies to disclose information on issues such as gender pay gaps and gender diversity on corporate boards.[22]

[19] See Q&A for Social and Sustainability Bonds used to raise capital for social projects to support fragile and conflict states, ICMA, April 2022.
[20] See Final Report on Social Taxonomy, European Commission Platform on Sustainable Finance, February 2022.
[21] See Unrealized Potential: The High Cost of Gender Inequality in Earnings, The World Bank, May 2018.
[22] See Corporate sustainability reporting, European Commission, 2022.

Against this backdrop, there is greater need for financing tied to alleviating issues stemming from gender inequality. Since 2016, proceeds from a cumulative $72 billion of GSSS bonds have been earmarked – in whole or in part – for the financing of projects tied to SDG5 for the achievement of gender equality and empowerment of all women and girls. Such volumes have been steadily growing in recent quarters, as shown in Figure 12.

Figure 12 Cumulative sustainable bond issuance linked to SDG 5 totals $72 billion since 2016



Sources: Moody's ESG Solutions and Environmental Finance Data

Primary GSSS debt instruments of choice are sustainability bonds – where issuers can combine environmental objectives with social objectives such as gender equity – and social bonds where gender can be the sole or primary focus of the bond. There is also growing use of sustainability-linked bonds to address gender equity goals, where issuers can incorporate gender-related targets into their financing structures with the cost of capital directly tied to the achievement of such targets. Continued growth in such issuance is critical given that the socioeconomic impacts of the COVID-19 pandemic have disproportionately impacted progress to date on closing the gap in gender equality.[23]

Despite the steady increase in issuance tied to SDG5 in recent years, there is much work to be done and ample room for market growth. Of the sustainable debt issuances citing projects linked to SDGs since 2016, we estimate that just over 1% of proceeds have been allocated to SDG5, with a significantly higher share of issuance going to projects such as for climate mitigation efforts.

Nevertheless, there are initiatives underway globally to promote the continued advancement of gender equity in capital markets. In November 2021, for example, the International Capital Market Association, International Finance Corporation (IFC) and UN Women published a guide to using sustainable debt for gender equality which highlights the types of gender projects that can be financed by private and public sector issuers and provides examples of gender-based targets for issuers of sustainability-linked bonds.[24] We anticipate such efforts will continue as the financing gap to meet gender equity goals remains significant.

[23] See Development finance for gender equality and women's empowerment: a 2021 snapshot, OECD, April 2021.

[24] See Bonds to bridge the gender gap: A practitioner's guide to using sustainable debt for gender equality, UN Women, November 2021.

Appendix

Sustainable debt instruments defined

Throughout this report, we refer to a variety of sustainable debt instruments. These include: use-of-proceeds green bonds, social bonds and sustainability bonds, whose proceeds are typically earmarked to finance specific eligible environmental and/or social projects; and sustainability-linked instruments, whose proceeds can typically be used for general corporate purposes but whose interest rates are tied to the achievement of various sustainability targets. These instruments include:

- **Green bonds:** Bonds where the proceeds will be exclusively applied to finance or refinance new and/or existing eligible green projects, such as renewable energy, energy efficiency, clean transportation, sustainable water management and green buildings. Typically issued in accordance with the Green Bond Principles.
- **Social bonds:** Bonds where the proceeds will be exclusively applied to finance or refinance new and/or existing eligible social projects, such as affordable basic infrastructure, access to essential services, affordable housing and food security. Typically issued in accordance with the Social Bond Principles.
- **Sustainability bonds:** Bonds where the proceeds will be exclusively applied to finance or refinance a combination of new and/or existing eligible green and social projects. Typically issued in accordance with the Sustainability Bond Guidelines.
- **Sustainability-linked bonds:** Bonds that incentivize the issuer's achievement of material, quantitative, predetermined, ambitious, regularly monitored and externally verified sustainability objectives through Key Performance Indicators and Sustainability Performance Targets. Typically issued in accordance with the Sustainability-Linked Bond Principles.
- **Sustainability-linked loans:** Loan instruments and/or contingent facilities that incentivize the borrower's achievement of predetermined sustainability performance objectives. Typically issued in accordance with the Sustainability-Linked Loan Principles.

Note on our sources

Our primary source for sustainable debt data throughout this report is Environmental Finance Data, with such data referenced in this report downloaded as of 28 April 2022.