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SOCIAL BONDS FOR SUSTAINABLE DEVELOPMENT: SEC'S EXPOSURE RULE

Introduction

On June 7, 2021, the Securities and Exchange Commission (SEC) released its Exposure Rule on Social Bonds. SEC noted that Social Bonds have increased in popularity across the world in the capital markets, especially as the COVID-19 crisis has led investors to place more emphasis on the social component of environmental, social and governance-driven investing.

In Nigeria, due to the financial crunch occasioned by the pandemic, funding of social projects has been affected as resources were diverted to unexpected areas of expenditure, which creates an avenue for the issuance of Social Bonds. Social bonds are a relatively new type of financial security that creates funding for public sector projects primarily aimed at achieving better social outcomes within the society. The SEC new rule on Social Bond focuses on eligible projects, conditions for approval, utilization and management of proceeds, reporting, refinancing, external review etc.

In this article, we examine the key elements of the Exposure Rule and the possible impacts on the Nigerian Economy.

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What Is A Social Bond?

The Rule defines a Social Bond as a type of debt instrument, where the proceeds would be exclusively applied to finance or refinance new and/or existing eligible projects with clear and identifiable social objective(s) and which are dedicated to an identified population. In other words, social bond aims at creating funds for public sector projects with the goal of achieving better social outcomes within the society.

What projects can be financed by social bonds?

The proposed Rule defines Social Project as a project developed directly to address or mitigate a specific social issue and seeking to achieve positive social outcomes whether or not exclusively, for a target population.

According to the Rule, for any money or instrument to qualify as a social bond, it must be invested towards any of the following social projects:

- Affordable basic infrastructure (e.g. clean drinking water, sewers, sanitation, transport, energy, etc.)
- Access to basic services (e.g. health, education and vocational training, healthcare, etc.)
- Affordable housing.
- Job creation including the potential effect of small and medium-sized enterprises financing and microfinance.
- Food security.
- Socio-economic advancement and empowerment.
- Any other social project as may be approved by the Commission from time to time.

Who is to issue a Social Bond under the Rule?

Though not explicitly mentioned in the proposed Rule, the public sector would typically issue Social Bonds, however, nothing precludes private sector organisations from issuing them.

How is a Social Bond issued under the Rule?

SEC General Rules and Regulations for debt issuance are to be followed for the issuance of a Social Bond. In addition, certain other conditions are required to be satisfied for approval including;

- A letter committing to invest proceeds for the bond in social projects; and
- Feasibility stating the benefits of the project.

Social Bond Principles

The Social Bond Principles (SBP) are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the Social Bond market by clarifying the approach for issuance of a Social Bond. The SBP are intended for broad use by the market: they provide

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issuers with guidance on the key components involved in launching a credible Social Bond; they aid investors by promoting availability of information necessary to evaluate the positive impact of their Social Bond investments; and they assist underwriters offering vital steps that will facilitate transactions and preserve integrity of the market.

The SBP recommend a clear process and disclosure for issuers, which investors, banks, underwriters, arrangers, placement agents and others may use to understand the characteristics of any given Social Bond. The SBP emphasize the required transparency, accuracy and integrity of the information that will be disclosed and reported by issuers to stakeholders through core components and key recommendations.

Who is the target of social projects financed by social bonds?

Social projects financed by social bonds are dedicated to serve the following people;

- People living below the poverty line.
- Excluded and/or marginalised populations and/or communities.
- Vulnerable groups.
- People with disabilities.
- Migrants and/or displaced persons.
- Undereducated population.
- Underserved population, due to lack of access to essential goods and services.
- Unemployed persons.

Conditions for approval of a Social Bond

The Rules highlights the basic conditions prospective issuers of Social Bonds must satisfy, which, in addition to the general registration requirements for debt issuance contained in other SEC Rules. These conditions include:

- A letter committing to invest all the proceeds of the bond in projects that qualify as social project(s) or assets.
- A feasibility report stating clearly, the measurable benefits of the proposed social project or assets.
- A prospectus, which shall disclose the social objectives, project selection criteria, decision-making procedures, social and environmental benefits, risks associated with the projects, use and management of the proceeds.
- An independent assessment or certification issued by a professional certification authority approved or recognized by the Commission.
- Any other documents as may be required by the Commission from time to time.

Utilization and Management of Social Bond Proceeds

Proceeds of Social Bonds are to be used solely for purposes set out in the approved offer documents and deployed within the given timeframe prescribed in

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the prospectus. It must be domiciled with a Custodian in an escrow account specifically opened for that purpose, and the issuer and the Trustees shall be signatories to this escrow account.

Unallocated proceeds shall be invested by the Trustees in money market instruments with investment grade rating that include projects which are consistent with the delivery of positive social outcomes especially but not exclusively for a target population(s).

Social Bond Report and Assessment Report

Throughout the duration of the bond, the issuer shall issue, at least annually, a Social Bond Report containing the list of projects and assets to which proceeds have been allocated. The Social Bond report will also include description of the projects and amounts disbursed, expected impact of the projects, performance indicators and impact measures including the methodology for arriving at same.

In addition to the Social Bond report to be published and filed by the issuer, an independent professional assessment or certification agency is also expected to be engaged to conduct annual follow-up assessments and issue its own reports, called an assessment report, which shall also be filed with SEC and published online.

Other Provisions

The proposed rules also contain provisions for disclosures towards refinancing and external reviews. The external review is meant to confirm the alignment of the proposed bonds with all components of the Social Bond Principles, and it may be total or partial.

Possible Impacts of Social Bonds on the Nigerian economy

In developing countries like ours, with limited fiscal capacity, the issuance of social bonds is paramount to keep essential industries afloat as the proceeds from these social bonds will be utilized to ensure that socio-economic development is not placed on hold. Unlike ordinary bonds, social bonds disclose exactly how their proceeds are used which is an attractive prospect for institutional and millennial investors who want to know how their money are used.

Conclusion

The Rules are a welcome development, and they created an avenue for Local Governments to access debt capital markets for the implementation of eligible social projects. The framework provided by the exposure rules also will serve the purpose of assuring investors that their social contributions are utilised properly while implementing philanthropic or developmental efforts, ensuring transparency and accountability while preventing diversion of funds.

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We are focused on delivering excellent bespoke service to our Clients and towards achieving this objective, we configure teams according to each Client's needs in a system that ensures that personnel with specialist knowledge are always assigned to their areas of specialization.

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