Group Economics | Financial Markets & Sustainability Research | 6 March 2022
Marketing Communication

SustainaWeekly

Social taxonomy taking shape

- **Economics Theme: The sixth IPCC report finds that the extent and magnitude of climate change impacts are larger than previously estimated. Risks and impact start to become broadly elevated at a global warming level in excess of 2°C, while in the case of unique ecosystems and extreme weather events, impacts become elevated even at 1.5°C.**
- **ESG Bonds: The BIS launched its third green bond fund. It will target projects in Asia and the Pacific. Its first fund was a USD-denominated fund, while the second focussed on EUR-denominated assets. Assets under management of the three funds are expected to eventually reach USD 3.5bn.**
- **Policy and Regulation: The Platform on Sustainable Finance released its final recommendation report on the development of a social taxonomy. The new version aligns to the extent possible to the structure of the existing EU Taxonomy. The European Commission will review the report and evaluate the next steps but there are no timelines.**
- **ESG in figures: In a regular section of our weekly, we present a chart book on some of the key indicators for ESG financing and the energy transition.**

In our latest edition of the Sustainaweekly, we start by discussing the sixth IPCC report, which warns the extent and magnitude of climate change impacts are larger than previously estimated. In addition, these adverse impacts and related losses and damages escalate with every increment of global warming. Furthermore, as there was limited issuance over the last few days, we then move to take a closer look at the news that the BIS has launched a third green bond fund. Last but certainly not least, we report on the contours of a social taxonomy taking shape. Although the timelines of next steps are unclear, they could not come soon enough. The current annual average funding gap towards social objectives – at USD 2.5 trillion – is partly due to the lack of a clear definition of what a social investment entails. Enjoy the read and, as always, let us know if you have any feedback!

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IPCC warns of more severe climate impacts

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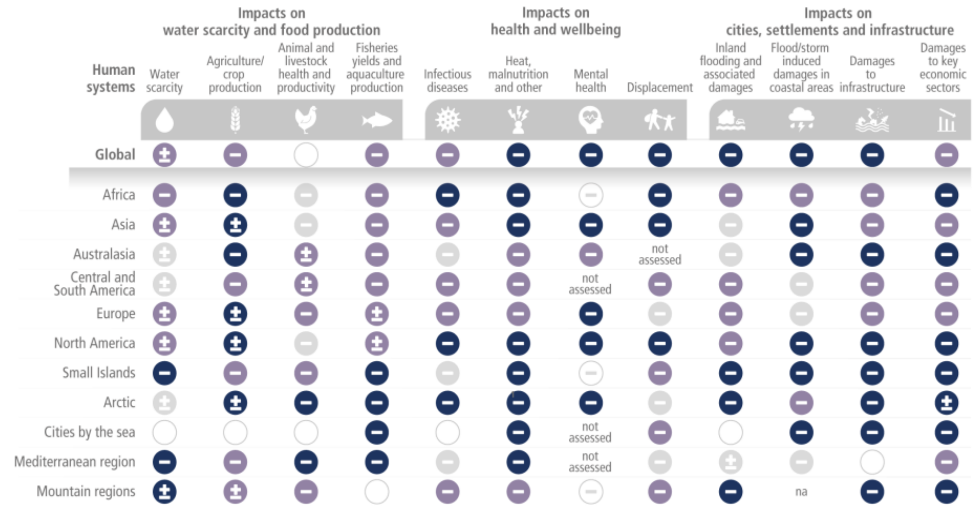
- **Sixth IPCC report finds that the extent and magnitude of climate change impacts are larger than previously estimated**
- **Risks and impact start to become broadly elevated at a global warming level in excess of 2°C, while in the case of unique ecosystems and extreme weather events, risks become elevated even at 1.5°C**
- **For Europe, the key risks identified are human health, crops, water scarcity and flooding**
- **Following COP26, we are heading for 1.8-2.7°C, depending on assumptions about policy implementation**

The International Panel on Climate Change (IPCC) published in end of February the contribution of Working Group II to the Sixth Assessment Report (AR6), focused on the global impact, adaptation and vulnerability to climate change. It examines in particular the interactions between climate, ecosystems and society, which are the basis for emerging risks from climate change. In this note we attempt to bring across some of the main points and implications.

A key conclusion from the report is that the extent and magnitude of climate change impacts are larger than estimated in previous assessments. The table below shows an overview of observed impacts of climate change on society. As can be seen, climate change has had a broad range of adverse impacts across regions, while these impacts are generally increasing (denoted by the minus sign in the chart). A similar pattern emerges of the observed impact on ecosystems. These impacts resulted from increases in the frequency and intensity of climate and weather extremes and the IPCC states with high confidence that this has led to some 'irreversible impacts' as human and natural systems have been pushed beyond their ability to adapt.

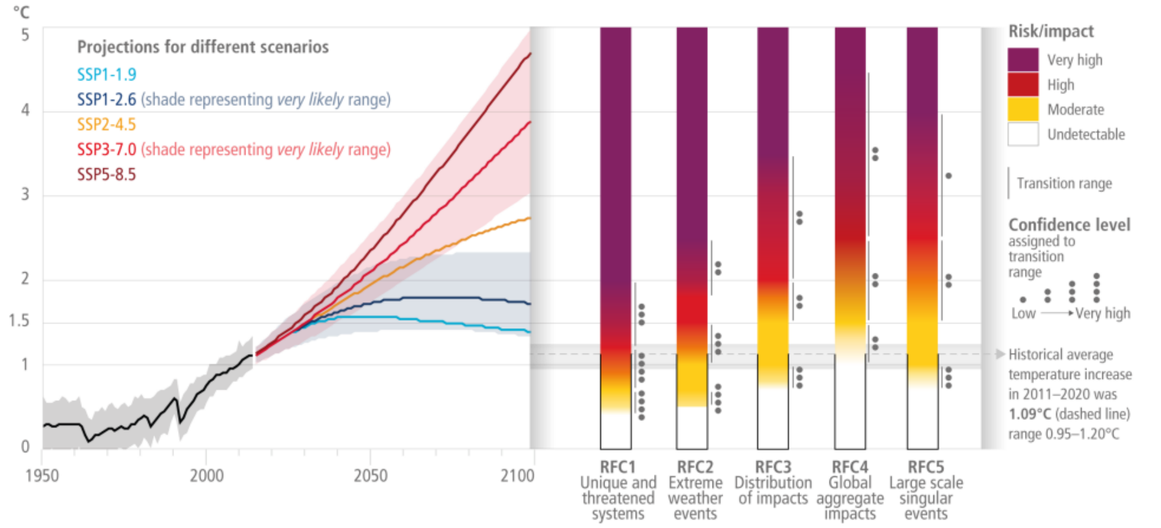
Observed impacts of climate change on people and society



Source: IPCC Sixth Assessment Report

The IPCC also looks forward. Projects for temperature change are provided for five different scenarios, while it also sketches out the impacts across a wide range of areas of different levels of global warming (see chart below). The IPCC group classifies risks to climate change into five main categories (The Reasons for Concern - threats to unique and threatened systems, damages from extreme weather events, effects that fall most heavily on particular groups, global aggregate impacts and large-scale singular events, such as ice sheet disintegration). As can be seen in the chart, the risks and impact start to become elevated across categories at a global warming level in excess of 2 degrees. In addition, in the case of unique and threatened systems and extreme weather events, risks become elevated even at 1.5 degrees. The analysis below assumes 'low to no adaptation' to climate change. The report calls for stepped up and ambitious adaptation efforts, and sets out a detailed list of options. However, it also notes that adaptation must go hand-in-hand with ambitious reductions in greenhouse gas emissions because with increased warming, the effectiveness of many adaptation options declines.

Risks from global warming by temperature and category



Source: IPCC Sixth Assessment Report

The IPCC asserts that projected adverse impacts and related losses and damages escalate with every increment of global warming. It sets out extensive data on this point across a wide range of areas. Some examples are set out below for the mid to long term period (2041-2100):

- **Biodiversity**: In terrestrial ecosystems, 3-14% of species assessed will likely face very high risk of extinction at global warming levels of 1.5°C, increasing up to 3-18% at 2°C, 3-29% at 3°C, 3-39% at 4°C, and 3-48% at 5°C.
- **River floods:** Projected increases in direct flood damages are higher by 1.4 to 2 times at 2°C and 2.5 to 3.9 times at 3°C compared to 1.5°C global warming without adaptation.
- **Coastal floods:** The population potentially exposed to a 100-year coastal flood is projected to increase by about 20% if global mean sea level rises by 0.15 m relative to 2020 levels.
- **Food security:** Increases in frequency, intensity and severity of droughts, floods and heatwaves, and continued sea level rise will increase risks to food security in vulnerable regions from moderate to high between 1.5°C and 2°C
- **Economic damages:** Global aggregate economic damages increase non-linearly with global warming levels

For Europe specifically, the IPCC identifies four key risks, with largely negative impacts projected for southern countries. As described above the impact and risks intensify at higher levels of global warming. The key risks identified are:

- **Human health impacted by heat:** Relative to a 1.5°C scenario, the number of deaths and people at risk of heat stress increases by two to three fold in a 3°C scenario. Fire-prone areas are projected to expand,
- **Agriculture impacted by heat and drought:** Significant production losses are projected in most of Europe, which not be offset by gains in the north.
- **Water scarcity:** In a 2°C scenario, a third of the population in the south will be exposed to water scarcity. This risk doubles in a 3°C scenario

- **Flooding:** In a 3°C scenario, the damage costs and people affected by river flooding would double. Coastal flood damage would increase ten-fold by the end of the century.

Overall, the IPCC report provides sobering reading in terms of what has already been observed and what might be to come, with impacts intensifying markedly at higher levels of global warming. Fortunately, based on progress on the policy front, the IPCC's most negative scenarios of temperature rises in the 4-5°C do not seem very plausible. Following COP26, the IEA estimated that if all announced pledges and targets were implemented in full and on time, the world would be headed for warming of 1.8°C. However, implementation is of course the key, and under a 'stated policies' assumption, the world would be headed for warming of 2.7°C. In addition, as the IPCC report makes clear, the risks and impact kick in even at lower levels of warming.

ESG bonds: BIS launches third green bond fund

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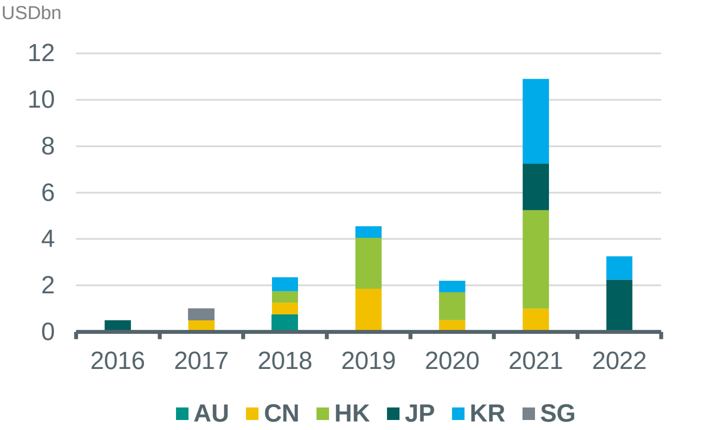
- **BIS has launched a third green bond fund**
- **It targets green projects in Asia and the Pacific**
- **In total, the BIS funds will manage around EUR 3.5bn**
- **The bonds need to meet the ICMA Green Bond Principles and/or the Climate Bond Standard as published by the Climate Bond Initiative**

The BIS has recently launched an Asian green bond fund (see here). It will be its third green bond fund since it opened the first two green bond funds in 2019 and 2021, respectively. The first fund was a USD-denominated fund, while the second focussed on euro-denominated assets. The Asian green bond fund will again be in USD, while it will focus on financing investments in green projects in Asia and the Pacific region, such as renewable energy and energy efficiency. In the end, it is expected to take the total assets under management of the three funds to USD 3.5bn, up from USD 2bn for the first two funds.

The Asian green bond fund has been set up in close cooperation with the BIS Asian Consultative Council as well as the Asian Development Bank. It is open for central banks in Asia and beyond, which can participate in the fund. It will then invest the funds raised in green bonds issued by sovereigns, financial institutions and corporates. The bonds need to have a minimum average rating of A- and they need to comply with the ICMA Green Bond Principles and/or the Climate Bond Standard as published by the Climate Bond Initiative. What is more, the fund will be reviewed annually in order to remain up to date with the latest developments in green finance. It will also publish an impact report on an annual basis.

There are currently USD 25bn of green bonds are outstanding in the Asian/Pacific region (only USD denominated and with a minimum size of USD 300mn and a minimum rating of A-).Issuance breached the EUR 10bn mark last year and has totalled around EUR 3.25bn so far this year.

Issuance of green bonds from the Asia/Pacific region



Note: considers only green bonds with minimum issuance size of USD 300mln and rating: A-. Source: Bloomberg, ABN AMRO Economisch Bureau

A step closer to a social EU taxonomy

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- **Last week, the Platform on Sustainable Finance released its final recommendation report on the development of a social taxonomy**
- **The report follows a draft published in July 2021, in which the new version aligns to the extent possible to the structure of the existing EU Taxonomy**
- **As a next step, the European Commission (EC) will review the report and evaluate the next steps regarding the potential development of a social taxonomy by the EC**
- **There is therefore no clear timelines of when (and if) a social taxonomy would come into force**

The Platform on Sustainable Finance (PSF) published last week a final report on a proposal for the development of a social taxonomy. The recently released report follows a draft published in July 2021, which was later on open for a 2-month feedback period. The PSF acts as an advisory body to the European Commission (EC). Hence, the social taxonomy report by the PSF will still need to be reviewed by the EC, which will only then define what the appropriate next steps will be.

Why do we need a social taxonomy?

The UN estimates that roughly USD 4.5 trillion needs to be mobilized every year to achieve the objectives of the UN's 2030 agenda for sustainable development (UN SDGs). At today's level of both public and private investment in SDG-related sectors, developing countries face an average annual funding gap of USD 2.5 trillion. Most of the funding available also seems to be going mostly to tackle environmental issues, not social ones. Looking at private investments for example, and using public bonds as a proxy, we can see that only roughly 35% of the outstanding green, social or sustainability bonds are estimated to support one of the "social" UN SDGs (i.e. 1, 2,3,4,5,8,10,16). The remaining 65% is directed to "environmental" SDGs, with almost all of it (99%), related to support UN SDGs 7, 9 or 11.

The current funding gap towards social objectives also partly reflects that there is currently no clear definition of what a social investment entails. It is also sometimes hard to quantify social impact, which makes the "socialwashing" a much more common problem for investors than the "greenwashing". This hinders the development of these social investments and potentially also their contribution to solve social problems.

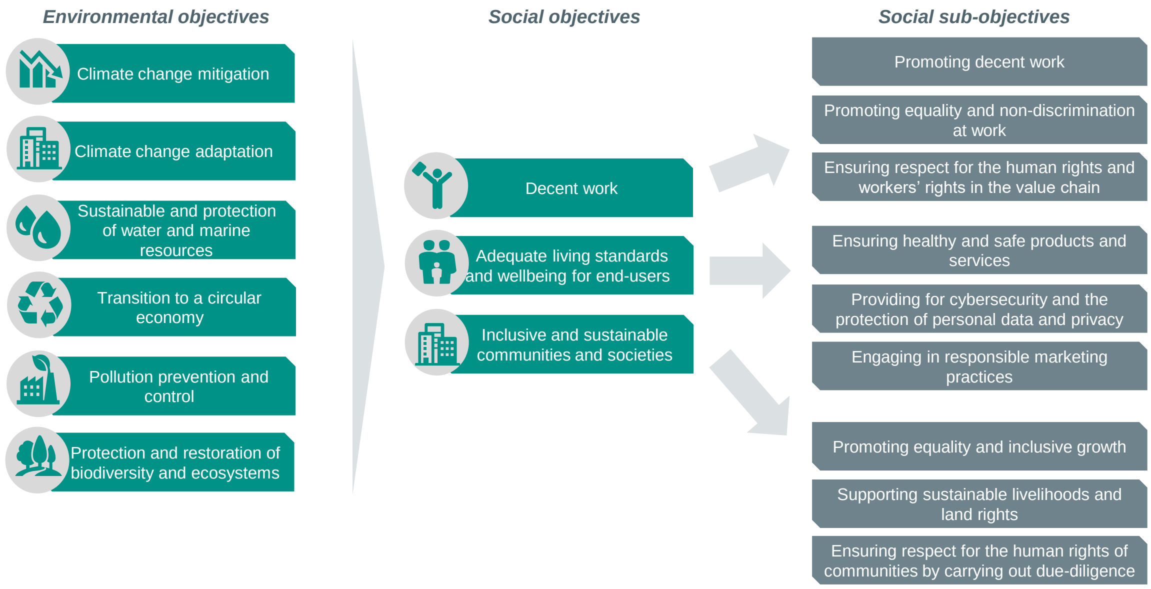
Hence, the PSF believes that a social taxonomy has the potential to address these issues and harmonise how social sustainability is measured. It would make it easier for investors to make informed and consistent decisions, and at the same time help to direct resources towards socially responsible activities and companies.

Summary of the proposal for a social taxonomy

The PSF clearly states in the final report that they had the goal to structure the social taxonomy so that it is aligned as possible with the existing environmental taxonomy (i.e. the EU Taxonomy). Hence, in a similar way as the EU Taxonomy is built on six environmental objectives, the PSF had proposed the social taxonomy to use three social objectives: (1) decent work, (2) adequate living standards and wellbeing for end-users and (3) inclusive and sustainable communities and societies. Furthermore, the social taxonomy would also employ the concept of "substantial contribution" (what is now the technical screening criteria under the EU Taxonomy), as well as the 'do no significant harm' (DNSH) and the minimum safeguards concepts.

A key difference between the EU Taxonomy and the proposed social taxonomy is that the latter would also contain sub-objectives, which spell out different aspects of the three social objectives. Furthermore, under the social taxonomy, it would be possible for a company to make a substantial contribution to several of the objectives and sub-objectives simultaneously. For example, a fair-trade products certification scheme could make a substantial contribution to both (1) decent work and (2) adequate living standards and wellbeing for end-users. This is currently not the case for the EU Taxonomy.

The proposed social objectives vs. the existing environmental objectives (as per the EU Taxonomy)



Source: ABN AMRO Group Economics

Additionally, the PSF also noted that the structure of the three stakeholder groups – workers, consumers and communities (as laid down under the three objectives), followed EFRAG's European Lab Project Task Force with regards to company's reporting under the proposed Corporate Sustainability Reporting Directive (CSRD). Hence, the proposed taxonomy was structured so that there is a clear overlap between the topics companies will have to report on under the CSRD and information needed for companies to comply with the suggested social taxonomy.

How is the "substantial contribution" defined in the social taxonomy?

Within each of these objectives, there are three different types of substantial contributions. The first type relates to avoiding and addressing negative impact. This refers therefore to an activity that would substantially contribute to avoid or address, for example, the lack of human rights or labour-rights. This could include e.g. a company from the agriculture sector which is promoting minimum living wages. The second refers to enhancing the inherent positive social impact of the activity itself. A good example would be medicine production by a pharmaceutical company: producing drugs is part of the company's business and cannot therefore be considered as a substantial social contribution. However, if it acts towards improving the accessibility and affordability of certain drugs for certain groups of people, this could be identified as an additional social benefit. The third and last type of substantial contribution relates to enabling activities – which is also included in the EU Taxonomy. It refers to an activity that, "by provision of their products or services, enables a substantial contribution to be made in other activities". This includes for example social audits, which make it possible to avoid and address negative impacts on decent work.

How is the "Do No Significant Harm" criteria structured?

Similarly to how it is under the current EU Taxonomy, also under the social taxonomy the concept of DNSH means that an activity that substantially contributes to an objective shall not harm the two other ones. For example, an activity that makes a substantial contribution to the objective on decent work (i.e. objective 1) should not harm end-users (i.e. objective 2) or communities and societies (i.e. objective 3). Nevertheless, there are also key changes when it comes to the social taxonomy DNSH criteria.

Firstly, under the social taxonomy, the DNSH criteria could also relate to sub-objectives from the same objective to which it substantially contributes to. This means an activity that substantially contributes to objective 1 would not necessarily need to prove "no harm" to only objective 2 and 3 - it could also prove "no harm" to certain sub-objectives of objective 1. As an example, an agricultural company that promotes minimum living wages (objective 1), could also need to show that it does no harm to equal employment opportunities for women, that it does not undermine collective bargaining processes or does not use child or forced labour in supply chains. These all refer to sub-objectives under objective 1 (decent work).

Another distinction refers to the fact that it might not be possible to draw a DNSH criteria for certain activities, as it is currently the case under the EU Taxonomy. For example, it might be challenging to build a meaningful criteria for objectives like 'avoiding and addressing' child labour or forced labour. This is because these issues are generally subject to zero-tolerance in law and are sometimes subject to import bans and exclusion criteria. It can be also the case that the full criteria for these activities need to be built on the minimum safeguard requirements (see below). Hence, the PSF advises to have DNSH criteria "wherever possible", but it could fairly be that the final (official) version of the social taxonomy would have activities which do not have a DNSH criteria at all.

Minimum safeguards

In the EU Taxonomy, this refers to minimum social safeguards. Hence, one could assume that under a social taxonomy, it would relate to minimum environmental safeguards. Not entirely true. While certain activities could potentially include only minimum environmental safeguards, it might not be the case for all activities: some could have both, environmental and social minimum safeguards. This is because, in contrast to the EU Taxonomy, important social topics are in some cases not linked to an activity but to the entity instead. For these situations, minimum safeguards based on the UNGPs and OECD guidelines in a social taxonomy would ensure that basic social criteria are met. As an example, a pharmaceutical company producing affordable drugs should – as a starting point – be able to also prove compliance with e.g. OECD guidelines (currently a minimum social safeguard in the EU Taxonomy).

It is important to note that the PSF has acknowledged that its task is first to work out a structure for a social taxonomy, and only then give advice on the minimum safeguards. Hence, no firm proposal was included on how the minimum safeguards should be structured in a social taxonomy.

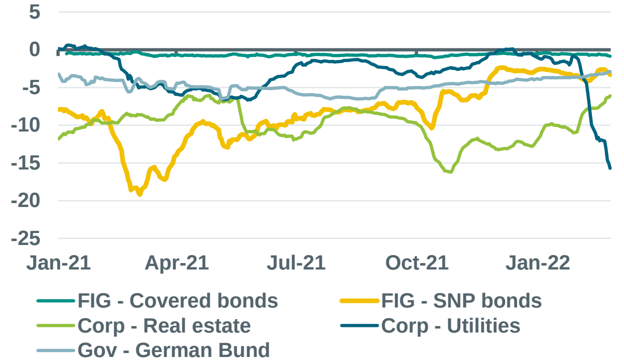
What were the key changes compared to the draft released in July 2021?

The most notable change to this newly released version of the social taxonomy, compared to the draft published by the PSF in July 2021, is the collapse of the previously proposed "horizontal" and "vertical" dimensions. In the draft report, the PSF had proposed a double dimension when evaluating social impact. The horizontal one would relate to promoting positive impacts and avoiding and addressing negative impacts on affected stakeholder groups (top-down or bottom-up approach), while the vertical would relate mostly to promoting the adequate living standards, this included e.g. improving accessibility for basic human needs such as water, food, housing, etc. Under the final report, these dimensions eventually became objectives (and sub-objectives), which ultimately brings therefore the social taxonomy closer to the structure of the existing EU Taxonomy.

ESG in figures

ABN AMRO Secondary Greenium Indicator

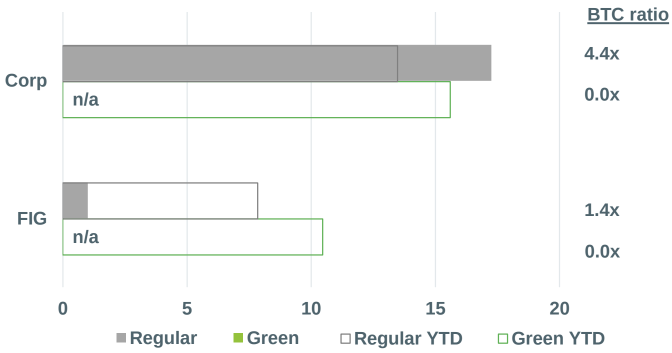
Delta (green I-spread – regular I-spread)



Note: Secondary Greenium indicator for Corp and FIG considers at least five pairs of bonds from the same issuer and same maturity year (except for Corp real estate, where only 3 pairs were identified). German Bund takes into account the 2030s and 2031s green and regular bonds. Delta refers to the 5-day moving average between green and regular I-spread. Source: Bloomberg, ABN AMRO Group Economics

ABN AMRO Weekly Primary Greenium Indicator

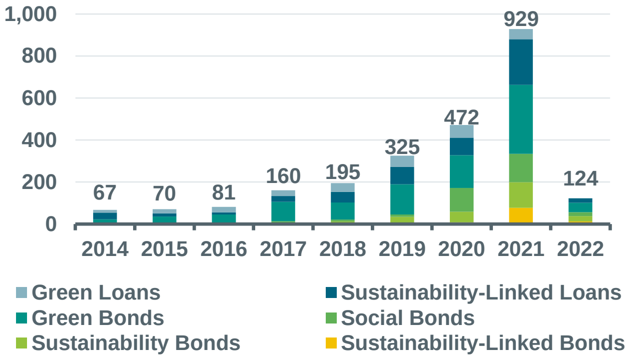
NIP in bps



Note: Data until 4-3-22. BTC = Bid-to-cover orderbook ratio. Source: Bloomberg, ABN AMRO Group Economics.

Sustainable debt market overview

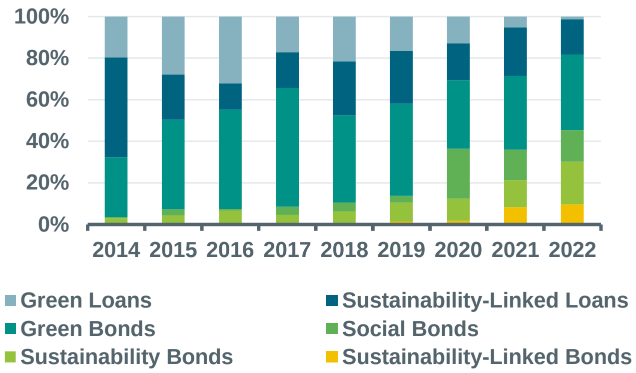
EUR bn



Source: Bloomberg, ABN AMRO Group Economics

Breakdown of sustainable debt by type

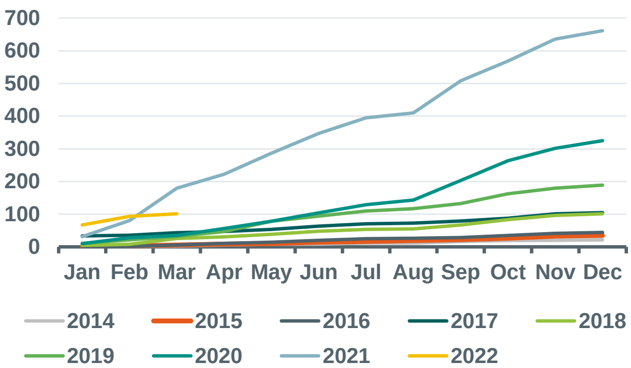
% of total



Source: Bloomberg, ABN AMRO Group Economics

YTD ESG bond issuance

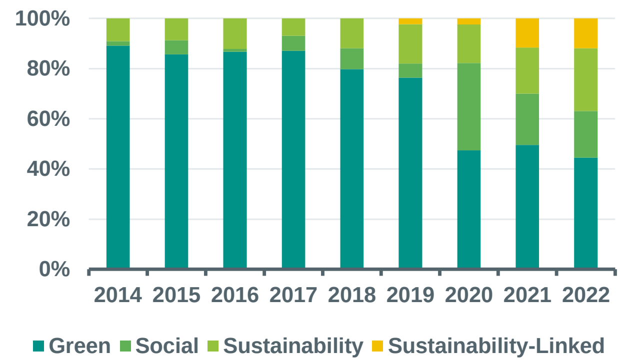
EUR bn



Source: Bloomberg, ABN AMRO Group Economics

Breakdown of ESG bond issuance by type

% of total

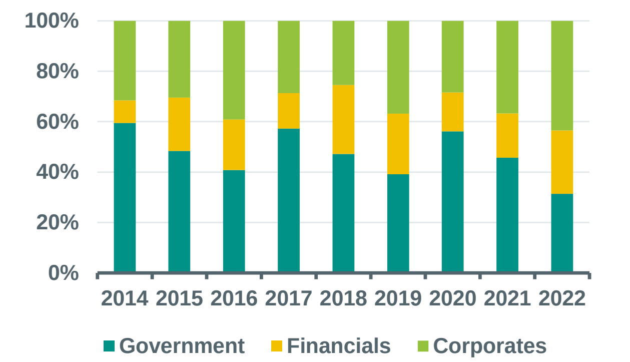


Source: Bloomberg, ABN AMRO Group Economics

Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

Breakdown of ESG bond issuance by sector

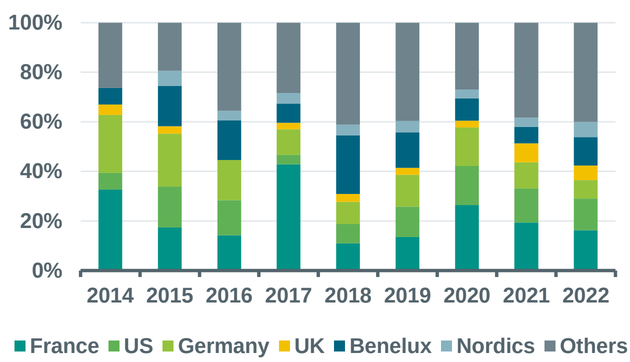
% of total



Source: Bloomberg, ABN AMRO Group Economics

Breakdown of ESG bond issuance by country

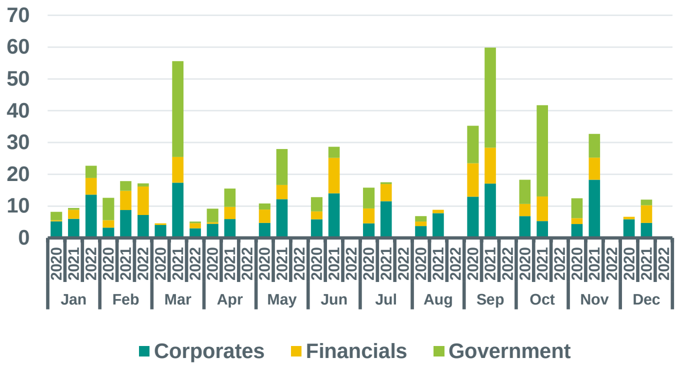
% of total



Source: Bloomberg, ABN AMRO Group Economics

Monthly Green Bonds issuance by sector

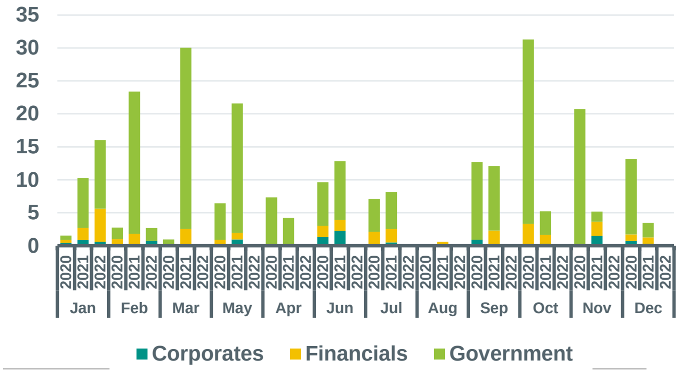
EUR bn



Source: Bloomberg, ABN AMRO Group Economics

Monthly Social Bonds issuance by sector

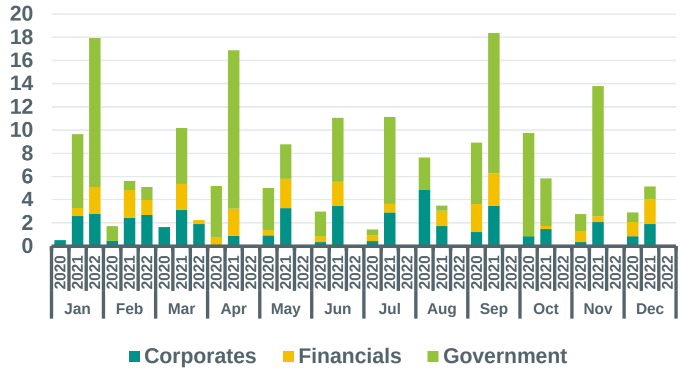
EUR bn



Source: Bloomberg, ABN AMRO Group Economics

Monthly Sustainability Bonds issuance by sector

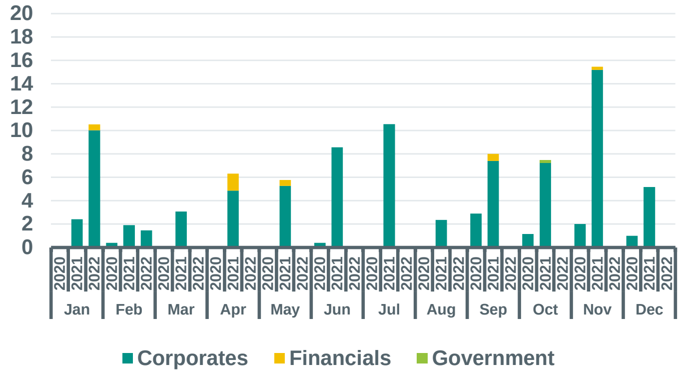
EUR bn



Source: Bloomberg, ABN AMRO Group Economics

Monthly Sust.-Linked Bonds issuance by sector

EUR bn



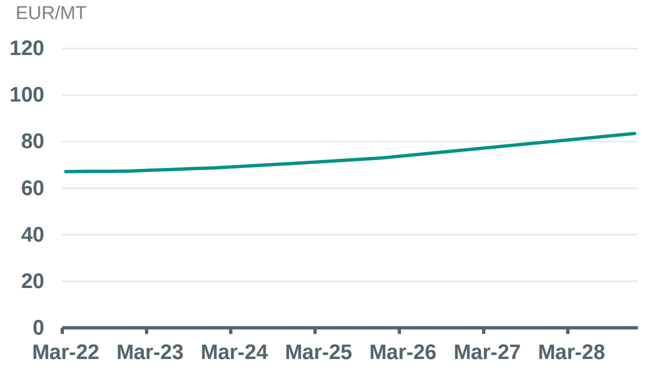
Source: Bloomberg, ABN AMRO Group Economics

Figures hereby presented take into account only issuances larger than EUR 250m and in the following currencies: EUR, USD and GBP.

Carbon contract current prices (EU Allowance)

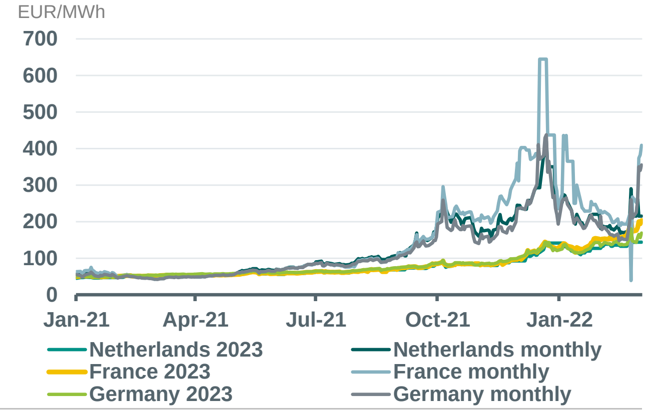
Source: Bloomberg, ABN AMRO Group Economics

Carbon contract future prices (EU Allowance)



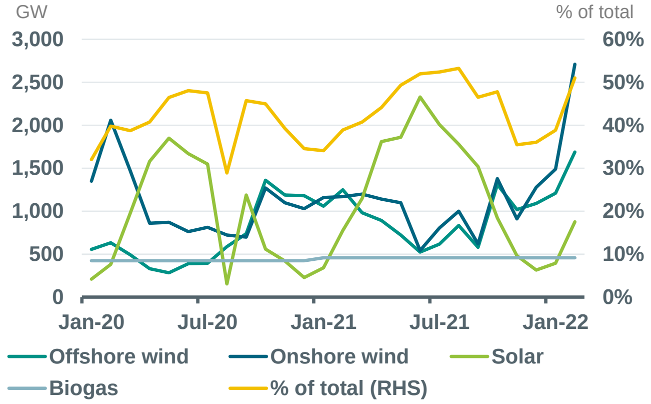
Source: Bloomberg, ABN AMRO Group Economics

Electricity power prices (monthly & cal+1 contracts)



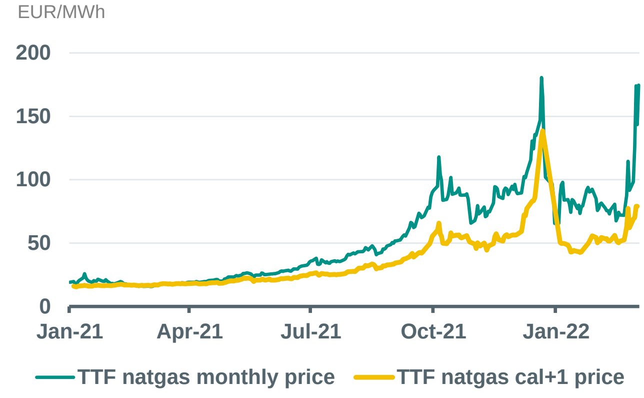
Source: Bloomberg, ABN AMRO Group Economics. Note: 2023 contracts refer to cal+1

Electricity generation from renewable sources (NL)



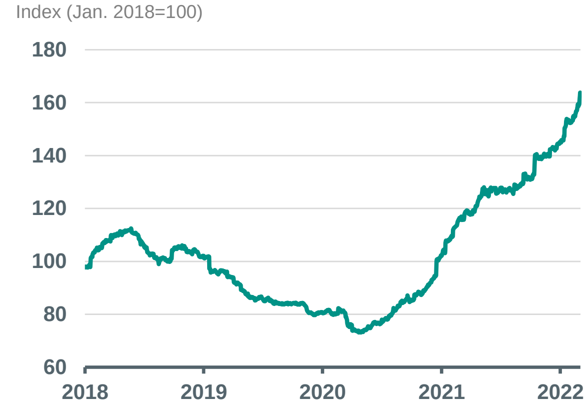
Source: Energieopwek (Klimaat-akkoord), ABN AMRO Group Economics

TTF Natgas prices



Source: Bloomberg, ABN AMRO Group Economics

Transition Commodities Price Index



Note: Average price trend of 'transition' commodities, such as: corn, sugar, aluminium, copper, nickel, zinc, cobalt, lead, lithium, manganese, gallium, indium, tellurium, steel, steel scrap, chromium, vanadium, molybdenum, silver and titanium. Source: Refinitiv, ABN AMRO Group Economics

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