

## Social Bond / Social Bond Programme

### External Review Form

#### Section 1. Basic Information

Issuer name:

Japan Finance Corporation

Social Bond ISIN or Issuer Social Bond Framework Name, if applicable: *[specify as appropriate]*

Synthetic SME CLOs

Independent External Review provider's name:

Japan Credit Rating Agency, Ltd.

Completion date of this form:

February 12, 2019

Publication date of review publication: *[where appropriate, specify if it is an update and add reference to earlier relevant review]*

February 12, 2019

#### Section 2. Review overview

##### SCOPE OF REVIEW

*The following may be used or adapted, where appropriate, to summarise the scope of the review.*

The review assessed the following elements and confirmed their alignment with the SBPs:

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> Use of Proceeds        | <input checked="" type="checkbox"/> Process for Project Evaluation and Selection |
| <input checked="" type="checkbox"/> Management of Proceeds | <input checked="" type="checkbox"/> Reporting                                    |

##### ROLE(S) OF INDEPENDENT REVIEW PROVIDER

- |   |  |
|---|--|
| <input type="checkbox"/> Second Party Opinion           | <input type="checkbox"/> Certification             |
| <input type="checkbox"/> Verification                   | <input checked="" type="checkbox"/> Scoring/Rating |
| <input type="checkbox"/> Other <i>(please specify):</i> |  |

*Note: In case of multiple reviews / different providers, please provide separate forms for each review.*

##### EXECUTIVE SUMMARY OF REVIEW and/or LINK TO FULL REVIEW *(if applicable)*

1. About Japan Finance Corporation

Japan Finance Corporation (JFC), the originator of this issue, is a policy-based financial institution established on October 1, 2008, under the Japan Finance Corporation Act (JFC Act), through the integration of National Life Finance Corporation, Agriculture, Forestry and Fisheries Finance Corporation, Japan Finance Corporation for Small and Medium Enterprise, and international finance function of the Japan Bank for International Cooperation. JFC is committed to supplementing the financing provided by ordinary financial institutions. In the field of SME business, one of JFC's core operations, the government supports the growth and development of SMEs through finance, supplementing private-sector financial institutions, in particular as policy-based financial institutions specializing in SMEs, in order to provide financial support to relatively higher-risk areas, such as the development of new businesses, business revitalization, business succession, and overseas expansion, which are regarded as important measures in Japan's policy-based finance. The government also serves as a safety net, as well as providing support for the growth and development of SMEs through finance. SME businesses are divided into three pillars: (1) providing stable, long-term, fixed-interest loans for the stable supply of funds required for the development of SMEs; (2) insurance underwriting of debt guarantees for borrowing to support the smooth procurement of funds by SMEs and micro-enterprises; and (3) securitization support services to facilitate the provision of unsecured funds to SMEs.

## 2. Subject

This time, JCR shall evaluate whether the synthetic type of regional financial institutions CLO (loan receivable-backed securities) (LLC Clover 2019), which is one of JFC's securitization and refers to unsecured loans to small and medium-sized companies. JCR shall evaluate whether the notes issued under the CLO, meet the core components of Social Bond Principles (2018)<sup>1</sup> and is consistent to SDGs goals<sup>2</sup>. In the JFC's Small and Medium Enterprise Business, the CDS agreement<sup>3</sup> is concluded with 25 regional financial institutions and the limited liability company (SPC) will acquire some of the notes that the SPC is planning to issue. However, the remaining notes are scheduled to be sold to investors. The Series One Class A Notes issued under the CLO, the Series One Class B Notes, and the Series One Class C Notes guaranteed by the JFC are subject to evaluation.

## 3. Social Impact Evaluation

JFC aims to achieve two social improvement effects through the implementation of the CLO. The first is the effects of regional revitalization, such as the maintenance and creation of employment, through the smooth provision of funds to SMEs through unsecured loans provided through regional financial institutions. The second is the support for stable management of regional financial institutions through the assumption of part of the risks associated with unsecured loans to SMEs by JFC and investors under CDS agreements with JFC. Looking at the borrowers of loans from participating financial institutions, which are the reference obligations of the CLO, approximately 40% of the total loans are to SMEs with small-scale demand for funds, with JPY 10 million or less. Currently, local governments are facing social issues such as the hollowing out of local economies due to the population decline and depopulation in rural areas, and business succession. JCR acknowledges that the development of local industries and the survival of regional financial institutions supporting them from the financial side are important measures for revitalizing Japan's local communities in order to resolve these issues. Based on the above, JCR concludes that the use of proceeds contributes to the "access to essential services (financial services)" and "employment generation including through the potential effect of SME financing and microfinance" among the eligible social project categories listed in the social bond principles. In addition, among the SDGs targets of 8 "Decent Work and Economic Growth," the objective is consistent to target No. 8.3., "Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services". In the "Specific Measures to Achieve SDGs" formulated by the Government of Japan, JCR confirmed that the use of proceeds is consistent with "the strong economy that creates hope, and the challenge of raising

<sup>1</sup> ICMA (International Capital Market Association) Social Bond Principle, 2018.

<sup>2</sup> Social bond principles are not binding as they are "principles" voluntarily published by the International Capital Markets Association and are not regulations. However, they are referenced when judging the social value of financing instruments on a global basis. Therefore, evaluation shall be conducted in accordance with these principles.

<sup>3</sup> CDS agreements = Credit Default Swap Agreements. A type of loss indemnification agreement.

productivity by motivated individual businesses will be supported by support agencies such as the government, business associations, regional SME associations, and regional financial institutions," which are listed as measures closely related to SDGs8, etc. JCR concludes that JFC's policy is consistent to these international and national policy/initiatives.

#### 4. Evaluation on management, operation and transparency

JCR confirmed that the proceeds in lieu of the issuance of the notes are appropriately allocated for the use of funds in accordance with the methodologies stipulated in the Company Bond Memorandum, CDS agreement, and other agreements related to this matter. In addition, JFC's business operations are evaluated annually by an evaluation and examination committee composed of outside experts in accordance with the JFC Act, and JCR evaluates that the management and operation systems are transparent.

#### 5. Overall evaluation result

As a result, based on the JCR social finance evaluation methodology, JCR assigned "s1" for the preliminary evaluation of "Social Impact Evaluation (Use of Proceeds)" and "m1" for the preliminary evaluation of "Management, Operation and Transparency." Consequently, JCR assigned "Social 1." for the overall evaluation. "Detailed evaluation results are discussed in detail in the next chapter. The notes also fully meet the standards for the requirements of the Social Bond Principles and are consistent with the SDGs Objectives and concrete measures for the SDGs Goals of the Government.

### **Section 3. Detailed review**

*Reviewers are encouraged to provide the information below to the extent possible and use the comment section to explain the scope of their review.*

#### **1. USE OF PROCEEDS**

##### **Overall comment on section (if applicable):**

JFC aims to achieve two social improvement effects through the implementation of the CLO. The first is the effects of regional revitalization, such as the maintenance and creation of employment, through the smooth provision of funds to SMEs through unsecured loans provided through regional financial institutions. The second is the support for stable management of regional financial institutions through the assumption of part of the risks associated with unsecured loans to SMEs by JFC and investors under CDS agreements with JFC. Looking at the borrowers of loans from participating financial institutions, which are the reference obligations of the CLO, approximately 40% of the total loans are to SMEs with small-scale demand for funds, with JPY 10 million or less. Currently, local governments are facing social issues such as the hollowing out of local economies due to the population decline and depopulation in rural areas, and business succession. JCR acknowledges that the development of local industries and the survival of regional financial institutions supporting them from the financial side are important measures for revitalizing Japan's local communities in order to resolve these issues. Based on the above, JCR concludes that the use of proceeds contributes to the "access to essential services (financial services)" and "employment generation including through the potential effect of SME financing and microfinance" among the eligible social project categories listed in the social bond principles. In addition, among the SDGs targets of 8 "Decent Work and Economic Growth," the objective is consistent to target No. 8.3., "Promote development-oriented policies that support productive activities, decent job creation, entrepreneurship, creativity and innovation, and encourage the formalization and growth of micro-, small- and medium-sized enterprises, including through access to financial services". In the "Specific Measures to Achieve SDGs" formulated by the Government of Japan, JCR confirmed that the use of proceeds is consistent with "the strong economy that creates hope, and the challenge of raising productivity by motivated individual businesses will be supported by support agencies such as the government, business associations, regional SME associations, and regional financial institutions," which are listed as measures closely related to SDGs8, etc. JCR concludes that JFC's policy is consistent to these international and national policy/initiatives.

#### **Use of proceeds categories as per SBP:**

- |  |  |
|--|--|
| <input type="checkbox"/> Affordable basic infrastructure   | <input checked="" type="checkbox"/> Access to essential services (Financial Services)              |
| <input type="checkbox"/> Affordable housing  | <input checked="" type="checkbox"/> Employment generation (through SME financing and microfinance) |
| <input type="checkbox"/> Food security   | <input type="checkbox"/> Socioeconomic advancement and empowerment                                 |
| <input type="checkbox"/> Unknown at issuance but currently expected to conform with SBP categories, or other eligible areas not yet stated in SBPs | <input type="checkbox"/> Other (please specify):   |

If applicable please specify the social taxonomy, if other than SBPs:

## 2. PROCESS FOR PROJECT EVALUATION AND SELECTION

**Overall comment on section (if applicable):**

JCR evaluates that all of the selection criteria presented in the evaluation phase 1 for the use of proceeds to be social projects with a high degree of social contribution, as discussed in evaluation phase 1. It is highly transparent that the selection criteria take into account the environmental and social risks considered in the evaluation phase 1, and that the selection criteria are clearly disclosed in the annual securities report. In addition, the Corporation has built a network of diverse sourcing routes and external experts in order to acquire, maintain, and manage high-quality properties.

JCR evaluates that the selection criteria are operated with validity, as the roles of each organization are clearly divided and the decision-making process passes through a department with specialized knowledge. These selection criteria and the selection and evaluation process will be published in this report to the lender at the time of individual funding.

### Evaluation and selection

- |   |   |
|---|---|
| <input checked="" type="checkbox"/> Credentials on the issuer's social objectives                                   | <input checked="" type="checkbox"/> Documented process to determine that projects fit within defined categories               |
| <input checked="" type="checkbox"/> Defined and transparent criteria for projects eligible for Social Bond proceeds | <input checked="" type="checkbox"/> Documented process to identify and manage potential ESG risks associated with the project |
| <input checked="" type="checkbox"/> Summary criteria for project evaluation and selection publicly available        | <input type="checkbox"/> Other (please specify):  |

### Information on Responsibilities and Accountability

- |  |   |
|--|---|
| <input checked="" type="checkbox"/> Evaluation / Selection criteria subject to external advice or verification | <input checked="" type="checkbox"/> In-house assessment |
| <input type="checkbox"/> Other (please specify):   |   |

## 3. MANAGEMENT OF PROCEEDS

**Overall comment on section (if applicable):**

The proceeds are used to bear the credit risk of loans to small and medium-sized enterprises, which are substantially underlying assets, through the CDS agreements. As the borrowers of the underlying assets, SMEs repay the principal of their loan receivables on a monthly basis, the outstanding balance of the pool of loan receivables during the securitization period decreases. As a result, the principal amount of the notes is also redeemed and reduced according to the terms and conditions of the corporate bond memorandum and other agreements.

In addition, the use of credit risk in the pool of loan receivables whose underlying assets are the funds in lieu of the issuance of the Company Notes is clearly stipulated in the CLO agreement, and therefore tracking management is not required.

Transactions that the proceeds are deposited in the bank and substantially bear the credit risk of loan receivables on small and medium-sized enterprises under certain conditions by covering losses under the CDS agreements are clearly stipulated in the agreements. Therefore, it is considered that controls are secured as long as businesses are conducted in accordance with the agreements.

Since the entire amount of the proceeds is allocated to the payment of the amount of compensation for losses under the CDS agreements, there is no unallocated funds. In addition, in the event of prepayment of the loan receivables to be backed, the notes will be redeemed in accordance with the water fall stipulated in the Corporate Bond Memorandum, etc., and therefore JCR judged that there is no need for re-appropriation.

#### Tracking of proceeds:

- Social Bond proceeds segregated or tracked by the issuer in an appropriate manner
- Disclosure of intended types of temporary investment instruments for unallocated proceeds
- Other (please specify):

#### Additional disclosure:

- |  |  |
|--|--|
| <input type="checkbox"/> Allocations to future investments only                  | <input type="checkbox"/> Allocations to both existing and future investments                                   |
| <input type="checkbox"/> Allocation to individual disbursements                  | <input type="checkbox"/> Allocation to a portfolio of disbursements  |
| <input type="checkbox"/> Disclosure of portfolio balance of unallocated proceeds | <input checked="" type="checkbox"/> Other (please specify):<br>Allocation to referred pool of loans of the CLO |

## 4. REPORTING

#### Overall comment on section (if applicable):

JCR highly evaluates that JFC disclose social reference data of the referred pool of loans to SMEs and monitor and report asset status monthly and quarterly. In addition, JFC has been evaluated by the external experts committee to calculate the social outcomes of its structured finance business.

#### Use of proceeds reporting:

- |  |   |
|--|---|
| <input type="checkbox"/> Project-by-project            | <input type="checkbox"/> On a project portfolio basis                           |
| <input type="checkbox"/> Linkage to individual bond(s) | <input type="checkbox"/> Other (please specify):<br>On a pool of referred loans |

#### Information reported:

- Allocated amounts
- Social Bond financed share of total investment
- Other (please specify):

**Frequency:**

- Annual
- Semi-annual
- Other (please specify):

**Impact reporting:**

- Project-by-project
- On a project portfolio basis
- Linkage to individual bond(s)
- Other (please specify):  
On a referred pool of loans basis

**Frequency:**

- Annual
- Semi-annual
- Other (please specify):monthly

**Information reported (expected or ex-post):**

- Number of beneficiaries
- Target populations
- Other ESG indicators (please specify):

*Scale of SME borrowers, Outcomes from this securitization such as creation of production amounts and Number of employment created*

**Means of Disclosure**

- Information published in financial report
- Information published in sustainability report
- Information published in ad hoc documents
- Other (please specify):  
Information published in SDGs Impact Report
- Reporting reviewed (if yes, please specify which parts of the reporting are subject to external review):Use of Proceeds, reporting and overall alignment with ICMA's social bond principle

Where appropriate, please specify name and date of publication in the useful links section.

**USEFUL LINKS** (e.g. to review provider methodology or credentials, to issuer's documentation, etc.)

Website of Japan Finance Corporation  
<https://www.jfc.go.jp/n/english/operations.html>

JCR's Social Finance Evaluation Methodology  
<https://www.jcr.co.jp/en/greenfinance/>

**SPECIFY OTHER EXTERNAL REVIEWS AVAILABLE, IF APPROPRIATE**

**Type(s) of Review provided:**

- Second Party Opinion
- Certification
- Verification
- Scoring/Rating
- Other (please specify):

**Review provider(s):**

**Japan Credit Rating Agency, Ltd.**

**Date of publication:**

**February 12, 2019**

## ABOUT ROLE(S) OF REVIEW PROVIDERS AS DEFINED BY THE SBP

1. **Second Party Opinion:** An institution with social expertise, that is independent from the issuer may issue a Second Party Opinion. The institution should be independent from the issuer's adviser for its Social Bond framework, or appropriate procedures, such as information barriers, will have been implemented within the institution to ensure the independence of the Second Party Opinion. It normally entails an assessment of the alignment with the Social Bond Principles. In particular, it can include an assessment of the issuer's overarching objectives, strategy, policy and/or processes relating to social sustainability, and an evaluation of the social features of the type of projects intended for the Use of Proceeds.
2. **Verification:** An issuer can obtain independent verification against a designated set of criteria, typically pertaining to business processes and/or social criteria. Verification may focus on alignment with internal or external standards or claims made by the issuer. Also, evaluation of the socially sustainable features of underlying assets may be termed verification and may reference external criteria. Assurance or attestation regarding an issuer's internal tracking method for use of proceeds, allocation of funds from Social Bond proceeds, statement of social impact or alignment of reporting with the SBP, may also be termed verification.
3. **Certification:** An issuer can have its Social Bond or associated Social Bond framework or Use of Proceeds certified against a recognised external social standard or label. A standard or label defines specific criteria, and alignment with such criteria is normally tested by qualified, accredited third parties, which may verify consistency with the certification criteria.
4. **Social Bond Scoring/Rating:** An issuer can have its Social Bond, associated Social Bond framework or a key feature such as Use of Proceeds evaluated or assessed by qualified third parties, such as specialised research providers or rating agencies, according to an established scoring/rating methodology. The output may include a focus on social performance data, process relative to the SBP, or another benchmark. Such scoring/rating is distinct from credit ratings, which may nonetheless reflect material social risks.