

JCR Social Bond Evaluation

January 22, 2018

Preface

Social Bonds are the bonds that raise funds for new and existing projects with positive social outcomes¹. To be more specific, social bonds are those issued by organizations including corporations and local governments, and are ensured to limit its Use of Proceeds to projects which largely contribute to resolve social issues, to track the management of proceeds and to be keep transparency in the reporting after the issuance

The issuance of social bonds is still limited compared to those of green bonds. Meanwhile, there are certain amount of investors who want to contribute specifically to social issues among ESG investments. Under such situations, International Capital Market Association (hereinafter, “ICMA”) published “the Guidance for Issuers of Social Bonds issued by the Green Bond Principles (GBP)²” in June 2016 for the first time. In June 2017, “The Social Bond Principles (hereinafter, “SBP”) has replaced the Guidance, which are mostly the similar framework as GBP.

Looking at the global trends in social development, the Millennium Development Goals (hereinafter, “MDGs”), which were mainly targeted to the social development in developing countries has been replaced by Sustainable Development Goals (hereinafter, “SDGs”), which is the globally common goals to tackle both in developing and developed world in 2015. SDGs have 17 development goals and 169 targets to save all the people in the world. In 2030 Agenda, “Each government are expected to reflect global targets with higher goals into its national projects, process, policies and strategies”. In Japan, SDGs’ promoting headquarter was established in the Cabinet office. It cooperates with related governmental agencies closely and implements relevant policies effectively and comprehensively. Social bonds are expected to be one of the effective financing tools to realize positive social outcome It is expected that the social bonds are the use of proceeds which will contribute to positive social impacts under each country’s efforts in sustainable development.

JCR provides a third party evaluation for social bonds as “JCR Social Bond Evaluation” based on ICMA’S SBP. JCR applies a transparent evaluation system based on scoring the evaluation items defined in JCR Social Bond Evaluation. JCR believes that this evaluation system will indicate the issuers³ what they need to do for preparing the issuance of social bonds precisely and it will also help investors to decide its investment policy regarding social bonds more appropriately. Through the provision of this social bond

¹ ICMA Social Bond Principles 2017

² ICMA Social Bonds – Guidance for issuers

³ In case of social bond evaluations to SPC or a project company of the debts, etc., “issuer” includes those who actually manage the companies such as a sponsor or an asset management company in its definition.

evaluation, JCR aims to contribute to spread the knowledge about social bonds to the market, to develop a sound social bond market and to improve global social issues.

Some of the social projects have environmental benefits as well⁴. The debts which have the natures of both green project and social projects are called as “Sustainability Bonds”. In evaluating sustainability bonds, JCR applies both Green Bond Evaluation Methodology and this Social Bond Evaluation Methodology together. An issuer shall decide whether the bonds are identified as Green Bond, Social Bond or Sustainability bonds, considering what the most important goal for the use of proceeds is.

I Subject of Evaluation

JCR Social Bond evaluation is applicable to various financing tools, such as bonds, loans, etc. whose use of proceeds are social projects, whose examples are raised in GBP or Guidelines. The followings are the sector or product classifications of those financing tools:

- (1) Corporation, Financial Institutions, Government, Local Government, Multilateral Financial Institutions, Public entities and FILP Agencies
- (2) Project finance
- (3) Investment Funds
- (4) Asset backed securities

II Basic Framework of JCR Social Bond Evaluation

JCR implements three steps to evaluate social bonds.

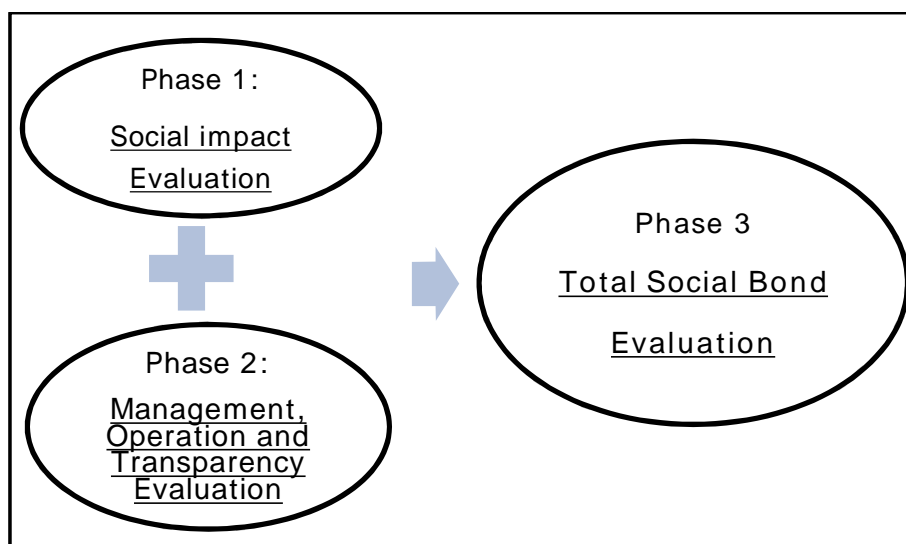
In “Evaluation Phase 1”, JCR evaluates “the Social Beneficial Impacts” of the bonds, etc. First, it assesses whether the projects which are financed by the bonds, etc. are social projects or not. If JCR can judge it as a social project, JCR assesses how much the proceeds are allocated to the social projects.

In “Evaluation Phase 2”, JCR evaluates “Management, Operation and Transparency”. JCR evaluates the issuers’ management and operation system and transparency. JCR believes if the management and operation system is well developed, it will improve the certainty of implementing the planned use of proceeds and the social projects. In addition, JCR evaluates the degree of disclosures related to the use of proceeds, management of proceeds, selection policy, criteria and processes. (JCR calls this as “certainty of realizing the social contribution evaluation at the phase 1”)

In “Evaluation Phase 3”, JCR determines the total evaluation results by comprehensively considering “Social Contribution” result and “Management, Operation and Transparency Evaluation” result.

⁴ ICMA Social Bond Principle and ICMA The Sustainability Bond Guidelines 2017

JCR Social Bond Evaluation Flow:



III Evaluation Framework by each evaluation phase

1. Evaluation Phase 1 : Social impact Evaluation

In this evaluation phase, JCR assesses how much the use of proceeds is allocated to social projects, if the projects are considered as social projects. Evaluation results shall be classified into five grades from “s1” to “s5” as follows.

Social impact evaluation (how much the use of proceeds is allocated to social projects)	Evaluation Grade
100% to 90% (Almost all the proceeds are allocated to social projects)	s1
>90 to 70% (Most of the proceeds are allocated to social projects)	s2
>70 to 50% (More than half of the proceeds are allocated to social projects)	s3
>50 to 30% (Less than half of the proceeds are allocated to social projects)	s4
>30 to 10% (Very low amount of the proceeds are allocated to social projects)	s5
>10%	Not qualified

2. Evaluation Phase 2 : Management, Operation and Transparency

In this phase, JCR evaluates the issuers’ management and operation system and the degree of transparency based on the four evaluation items, which is followed the SBP. The evaluation results are classified into five grades, from “m1” to “m5”.

Evaluation scores by grade	Evaluation grade
100 to ≥ 80 (AM system is well developed and the degree of transparency is very high. The project implementation and allocation of the proceeds are highly likely to be made as were planned.)	m1
>80 to ≥ 60 (AM system is developed and the degree of transparency is high. The project implementation and allocation of proceeds are expected to be made as were planned.)	m2
>60 to ≥ 40 (AM system and the degree of transparency have some problems and there are little concerns that the plan and the fund allocation will not be processed as were planned.)	m3
>39 to ≥ 20 (AM system and the degree of transparency have problem and there is a concern that the plan and the fund allocation will not be processed as were planned.)	m4
> 20 (AM system and the degree of transparency have serious problems and it is difficult to expect the plan and the fund allocation will not be processed as were planned.)	m5

3. Evaluation Phase 3: Overall evaluation

In phase 3, JCR determines an overall evaluation from Social 1 to Social 5, based on social impact evaluation (s1 to s5), adding up the administration, management and transparency evaluation (m1 to m5).

When determining the overall evaluation, use the JCR social bond evaluation matrix, described below:

Social 1 is the highest social bond evaluation in JCR social bond evaluation. This is assigned to those which get the highest evaluation in both “social impact evaluation” and “management, operation and transparency evaluation”.

When determining the overall evaluation, use the below JCR social bond evaluation matrix:

Social 1 is the highest social bond evaluation in JCR social bond evaluation. This is assigned to those which get the highest evaluation in both “social impact evaluation” and “management, operation and transparency evaluation”.

【JCR Social Bond Evaluation Matrix】

Management Operation & Transparency Social impact Evaluation	m1	m2	m3	m4	m5
s1	Social 1	Social 2	Social 3	Social 4	Social 5
s2	Social 2	Social 2	Social 3	Social 4	Social 5
s3	Social 3	Social 3	Social 4	Social 5	Not qualified
s4	Social 4	Social 4	Social 5	Not qualified	Not qualified
s5	Social 5	Social 5	Not qualified	Not qualified	Not qualified

4. Evaluation symbols

JCR's social bond evaluation symbols are expressed by the combination of "Social Impact Evaluation as s1 to s5", "Management, Operation & Transparency Evaluation as m1 to m5" and "Overall Evaluation as Social 1 to Social 5".

【JCR Social Bond Evaluation Results】

Overall Evaluation	Social 1 ~ Social 5
Social Impact Evaluation (Use of Proceeds)	s1 ~ s5
Management, operation and Transparency Evaluation	m1 ~ m5

IV Evaluation Methodology (Evaluation factors and scoring)

1. Phase 1: Social Impact Evaluation Factors

When evaluating social impacts, JCR assesses the following factors.

(1) Assessing whether the project has social impacts or not.

Assessing whether the project falls into the definition of social projects

- (1) The proceeds are allocated to Social Projects, such as those listed in SBP.
- (2) The project has clear positive social impacts.
- (3) The positive social impacts are clearly larger than the negative social impacts.

* The negative impacts in this methodology include the follows:
distortion of the project area's social structures improperly, any adverse impacts on the project area such as issues related to religious or tribal dispute in the region, or environmental negative impacts such as damages in ecosystems, pollutions including GHG emissions, etc.

* If the negative impacts are higher than the positive social impacts, such use of proceeds may be out of evaluation, even if other evaluation factors' scores are high.

(2) To confirm the Use of Proceeds (how much the proceeds are allocated to social bonds, if the project is regarded as a social project.

Use of Proceeds (How much the proceeds are allocated to social projects)

- (1) Determine the degree of positive social impacts by the percentage of the proceeds which will be used to the social project

2. Phase 2: Management, Operation and Transparency

(1) Four major factors of phase 2 and the score weight

Major evaluation factors	Weight
1. Appropriateness and Transparency concerning selection criteria and processes of the use of proceeds	25%
2. Appropriateness and Transparency of management of the Proceeds	25%
3. Reporting	25%
4. Efforts taken by the organization	25%

(2) Breakdown of each evaluation factor

Evaluation items by each factor
1. Appropriateness and Transparency concerning selection criteria and processes of the use of proceeds
(1) The degree of positive social impacts of the each project is assessed and affirmed by an issuer.
(2) In case that the social project has both positive and negative impacts, an issuer takes any measures to avoid or mitigate such negative impacts.
(3) (a) The <u>objectives</u> in social development or social contribution that the issuer tries to realize through the social bonds (Social improvement effects), (b) the <u>criteria</u> to select a social project which satisfies the objective and (c) the <u>process</u> to determine the project, are appropriate
(4) The objective, the criteria and the process are well explained to investors.
2. Appropriateness and Transparency of management of the Proceeds
(1) Funding plan is appropriate.
(2) The issuer has a system to track all the proceeds in proper way.
(3) There is an internal control system to check the above tracking systems by taking internal audit or external audit, etc.
(4) Documentary evidence to track the proceeds is retained.
(5) If there is unallocated proceeds, the issuer explains how to manipulate these proceeds to investors in advance. There is a plan to manipulate these unallocated proceeds with safe and liquid asset.
3. Reporting
(1) The use of proceeds are explained to investors by prosperous or other legal documents, etc.

Evaluation items by each factor

- (2) The issuer plans to disclose the most updated information about the use of proceeds after the issuance.
- (3) Information disclosure is planned to be made at least once a year. After allocating all the proceeds, the issuer plans to disclose any significant changes after allocating all the proceeds, if necessary.
- (4) Disclosures includes the following;
 - List of social project where the proceeds are allocated
 - Outline of each social project, including its progress
 - Amount allocated to each social project
 - Positive impacts brought by each social project
 - Unallocated amount, plan to allocate, and how to manipulate the unallocated proceeds.
- (5) When disclosing the positive impacts, the issuer uses appropriate key performance indicator considering the nature of each social project. It is preferable that such impacts are quantitative and that the issuer prepares to disclose the calculation formula and assumptions.

4. Efforts taken by the organization

- (1) Senior Management identifies the social issues as one of the important and prioritized issues for their management strategy.
 - (2) An internal department/division which has expertise in social issues or external institutions is involved in the process.
 - (3) The issuer has clear policy and procedures for social bond issuance and criteria to determine the social projects where the proceeds are allocated.
 - (4) The issuer verifies its social project and social policy by asking the opinions from external social experts.
-

V Description of how JCR considers each evaluation factor

1. Social impact evaluation (Phase 1)

When identifying the bond as a social bond, it is important that the proceeds are allocated to social projects which clearly have a positive social impact. JCR shall affirm the degree of such social impact of the use of proceeds, by the reference of social project list in SBP (please see the attachment.) These lists are examples and JCR may find other cases as a social project by its own judgment.

When identifying a social project, it is important to specify the targeted populations, in addition to the type of social projects. JCR shall consider the appropriateness of specifying the beneficial targeted populations in accordance with SBP. The identification of project type and beneficiaries shall be

determined according to each country's or each region's current situations. JCR may refer national implementation policies for achieving the goals of SDGs when implementing its evaluation.

The type and its positive social impacts may change day after day. JCR will implement its evaluation referring to the most updated social and economic situations of the project area at the time of evaluation.

2. Management, operation and transparency evaluation (Phase 2)

(1) Appropriateness and transparency concerning selection criteria and processes of the use of proceeds

JCR assesses whether the following factors are internally well considered and planned to make them properly or not. In addition, it also affirms whether the following factors are sufficiently explained to the investors in advance.

- i. The objectives that will be realized by the social bond (for example, improvement of accessibility of the vulnerable groups to the financing tools such as microfinance, etc.; formal employment of younger generations, improvement in access to education by providing scholarship to those who have limited chance to access to education services, provision of affordable housing to vulnerable group, etc.)
- ii. The Criteria for selecting social projects (how assess and select a social project which has a positive social impact in terms of the objective the issuer plans to realize)
- iii. Outlines of the process to determine the project ((a) Is it appropriate as the use of proceeds considering the issuer's planned objectives and criteria?, (b) Who judges the selected social projects matches the social objectives based on which criteria?)

JCR also considers that it is preferable to have an internal specific department/division or a person who is responsible for the social issues, or get opinions from external institutions when determining these factors.

JCR also thinks that it is preferable to have an internal specific department/division or get opinions from external institutions when determining these factors.

(2) Appropriateness and transparency concerning management of the process

It is expected that there are various ways to manage the proceeds depending on each issuer. JCR will assess whether the proceeds funded by social bond issuance are ensured to allocate to social projects or not. In addition, JCR also checks whether there is a tracking system to grasp how much the proceeds are allocated to the social project easily and internal control are effectively developed or not.

If there is unallocated proceeds, JCR also assesses whether such unallocated portion will be allocated to the social project promptly and also assesses how to manage and manipulate the unallocated proceeds.

(3) Reporting

According to SBP, the issuer should report the most updated information about the use of proceeds periodically, at least once a year, until all the proceeds will be allocated, if necessary. In such report, the outline of the social project where the proceeds are allocated, allocated amount, expected social positive impacts (it is preferable to use both quantitative and/or qualitative performance indicators.) should be included.

JCR evaluates whether the issuer plans periodical reporting after issuing social bonds precisely and effectively at the time of issuing social bonds, based on SBP.

(4) Efforts taken by the organization

It is important that the senior management of the issuer identifies the social issues or social contribution as one of the prioritized issues in its management strategy. Under this strategy, it is also important that they establish policy, procedures of issuing social bonds and selecting criteria of social projects with the involvement of internal department/division, which specifically deals with environmental issues or in cooperation with external institutions.

The department is not necessarily specialize only on environmental issues, however, it is preferable that the issuer ensures some staff who are responsible for social bond and social issues or social contributions.

VI Assumptions and limit of this evaluation

JCR's social bond evaluation is to affirm the social positive impact at the time of planning the issuance or the time of issuing social bonds are calculated quantitatively or qualitatively by the issuer or the third parties. This evaluation will not guarantee such impacts will continue in the future.

Positive and negative impacts of social projects are calculated internally or by external institution by the request of issuers. JCR evaluates the impacts based on this calculated results and it will not calculate the impacts by itself.

VII Periodical Review

JCR may implement periodical review, if it finds the necessity to follow up the unallocated proceeds and planned reporting after the issuance.

End.

Social project categories by ICMA Social Bond Principles

ICMA SBP Project type
1. Affordable basic infrastructure (e.g. clean drinking water, sewers, sanitation, transport)
2. Access to essential services (e.g. health, education, vocational training, healthcare, financing and financial services)
3. Affordable housing
4. Employment generation including through the potential effect of SME financing and microfinance
5. Food security
6. Socioeconomic advancement and empowerment

Target populations for social project
1. Living below the poverty line
2. Excluded and/or marginalised populations and/or communities
3. Vulnerable groups, including as a result of natural disasters
4. People with disabilities
5. Migrants and/or displaced persons
6. Undereducated
7. Underserved
8. Unemployed

(Source)

ICMA Website URL :

<https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-social-and-sustainability-bonds/social-bond-principles-sbp/>

Inquiries about green/social bonds : GB/ESG Evaluation Dept.

Atsuko Kajiware (Ms.): kajiware@jcra.com,

Tomohiko Iwasaki (Mr.): iwasaki@jcra.com

Kosuke Kajiware (Mr.): kosuke.kajiware@jcra.com,

Naoki Okada (Mr.): okada@jcra.com