

## JCR Social Finance Evaluation

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### Preface

Social Bonds are the bonds that raise funds for new and existing projects with positive social outcomes<sup>1</sup>. 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

There are certain amount of investors who want to contribute specifically to social issues among ESG investments, and the issuance of social bonds is expected to increase more. International Capital Market Association “ICMA”) published “Social Bonds – Guidance for issuers” in June 2016 for the first time. In June 2017, “The Social Bond Principles (“SBP”) has replaced the guidance, which are mostly the similar framework as Green Bond Principles (the “GBP”). In addition to the revision of SBP in June 2018, mapping table of SDGs targets and social project category, and guideline for impact reporting of social bond were established. In June 2020, SBP was revised again, to explicit expression of target population and exemplifying in detail as social project.

Looking at the global trends in social development, the Millennium Development Goals (“MDGs”), which were mainly targeted to the social development in developing countries has been replaced by Sustainable Development Goals (“SDGs”), which is the globally common goals to tackle both in developing and developed world in 2015.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.

The move to support efforts to solve social issues that contribute to the SDGs is not limited to financing through bonds. In October 2015, the United Nations Environment Program Finance Initiative (UNEP FI) issued a Positive Impact Declaration and in January 2017 established a framework (Positive Impact Finance Principles) to help banks bridge the gap between sustainable development and SDG achievement.

In Japan, in response to the "ESG Finance Roundtable Recommendations - Toward an ESG Finance Superpower" released by the Ministry of the Environment in July 2018, ESG Finance High Level Panel

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<sup>1</sup> ICMA Social Bond Principles

was held in March 2019 to discuss the importance and promotion of green, social, and governance-oriented financing, not only in direct finance but also in indirect finance, to promote Japan's efforts to achieve the Paris Agreement and SDGs.

JCR has included loans in the scope of JCR Social Bond Evaluation from the beginning, but on January 11, 2019, the name of the evaluation methodology was changed to "JCR Social Finance Evaluation" to reflect this international trend.

Following the publication of the Social Loan Principles (SLP) by the Loan Market Association, Asia-Pacific Loan Market Association and Loan Syndications & Trading Association in April 2021, JCR Social Bond Evaluation shall be conducted in accordance with the SBP for social bonds and the SLP for social loans (hereinafter "JCR Social Bond Evaluation" and "JCR Social Loan Evaluation" are collectively referred to as "JCR Social Finance Evaluation"). In addition to the SBP and the SLP, the consistency with Japan's measures for the SDGs shall also be considered when examining the social nature.

JCR applies a transparent evaluation system based on scoring the evaluation items defined in JCR Social Finance Evaluation. JCR considers that this evaluation system will indicate the issuers or the borrowers ("Issuers")<sup>2</sup> what they need to do for preparing social finance and it will also help investors to decide its investment policy regarding social bonds more appropriately. Through the provision of this Social Finance Evaluation, JCR aims to contribute to spread the knowledge about social finance to the market, to develop a sound social finance market and to improve global social issues.

## I Subject of Evaluation

JCR Social Finance Evaluation is applicable to various financing tools, such as bonds, loans, etc. whose use of proceeds are social projects, whose examples are raised in SBP and SLP. The followings are sectors or product classifications of those financing tools:

- (1) Corporations, Financial Institutions, Governments, Local Governments, Multilateral Financial Institutions, Public Entities and Government Agencies
- (2) Project Finance
- (3) Investment Funds
- (4) Asset Backed Products

## II Basic Framework of JCR Social Finance Evaluation

JCR implements three steps to evaluate social finance.

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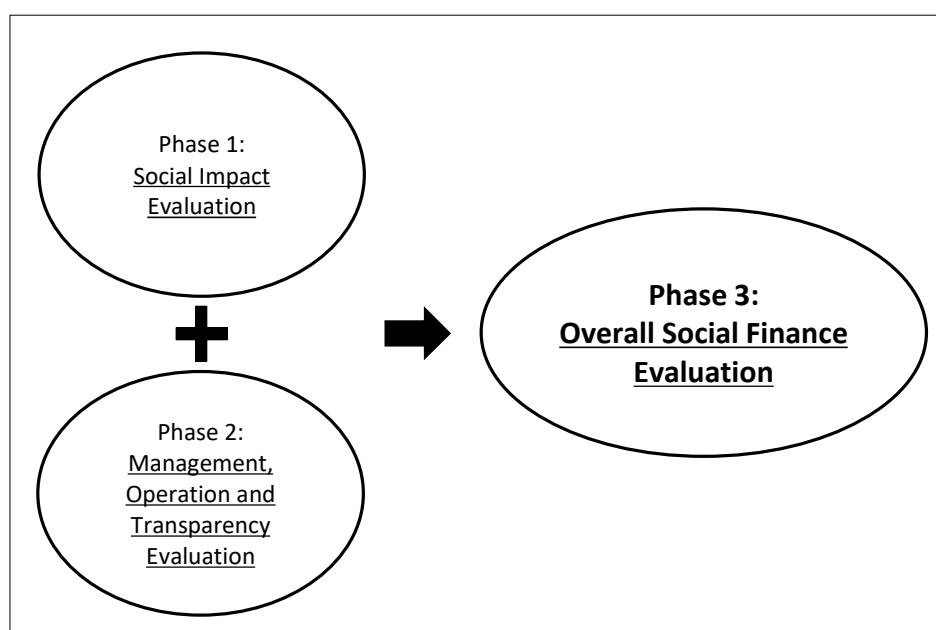
<sup>2</sup> In case of social finance evaluations to SPC or a project company of the debts, etc., "Issuer" includes those who actually manage the companies such as a sponsor or an asset management company in its definition.

In “Evaluation Phase 1”, JCR conducts “Sociality Evaluation” of social finance. First, JCR assesses whether the projects which are financed by social finance 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 conducts “Management, Operation and Transparency Evaluation”. JCR evaluates the Issuers’ management and operation system and transparency. JCR considers 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 sociality evaluation at the phase 1”)

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

JCR Social Finance Evaluation Flow:



### III Evaluation Framework by Each Evaluation Phase

#### 1. Evaluation Phase 1 : Sociality 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.

Sociality 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 Evaluation

In this evaluation phase, JCR evaluates Issuers' management and operation system and the degree of transparency based on the four evaluation items, which is followed the SBP and SLP. 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 Sociality Evaluation (s1 to s5), adding up Management, Operation and Transparency Evaluation (m1 to m5).

When determining the overall evaluation, use the JCR Social Finance Evaluation Matrix, described below:

Social 1 is the highest social finance evaluation in JCR Social Finance Evaluation. This is assigned to those which get the highest evaluation in both "Sociality Evaluation" and "Management, Operation and Transparency Evaluation".

[JCR Social Finance Evaluation Matrix]

		Management, Operation and Transparency Evaluation				
		m1	m2	m3	m4	m5
Sociality Evaluation	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 Finance Evaluation symbols are expressed by centering on “Overall Evaluation as Social 1 to Social 5” , and “Sociality Evaluation as s1 to s5” and “Management, Operation and Transparency Evaluation as m1 to m5” together.

[JCR Social Finance Evaluation Results]

<b>Overall Evaluation</b>	<b>Social 1 ~ Social 5</b>
<b>Sociality Evaluation (Use of Proceeds)</b>	<b>s1 ~ s5</b>
<b>Management, operation and Transparency Evaluation</b>	<b>m1 ~ m5</b>

### IV Evaluation Methodology (Evaluation Factors and Scoring)

#### 1. Phase 1: Sociality Evaluation Factors

When evaluating social impacts, JCR assesses the following factors.

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

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

- (1) The proceeds are allocated to Social Projects, such as those listed in SBP and SLP.
- (2) The project has clear social benefits.
- (3) The social benefits 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 social benefits, such use of proceeds may be out of evaluation, even if other evaluation factors’ scores are high.

- (ii) To confirm the use of proceeds (how much the proceeds are allocated to social bonds, if the project is regarded as a social project.)

## 2. Phase 2: Management, Operating and Transparency Evaluation Factors

- (i) Four major factors of phase 2 and the score weight are as follows.

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%

- (ii) Breakdown of each evaluation factor

Evaluation Items by Each Factor
<b>1. Appropriateness and Transparency Concerning Selection Criteria and Processes of the Use of Proceeds</b>
(1) The degree of social benefits of the each project is assessed and affirmed by Issuers.
(2) In case that it is possible for the social project to have both positive and negative impacts, the Issuers take any measures to avoid or mitigate such negative impacts.
(3) (a) The social benefits that Issuers try to realize through the social bonds, (b) the <u>criteria</u> to select a social project which satisfies the social objective and (c) the <u>process</u> to determine the project, are appropriate
(4) The social objective, the criteria and the process are well explained to investors.
<b>2. Appropriateness and Transparency of Management of the Proceeds</b>
(1) Funding plan is appropriate.
(2) Issuers have 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, there is a plan to manipulate these unallocated proceeds with safe and liquid asset. Issuers explains how to manipulate these proceeds to investors in advance.
<b>3. Reporting</b>
(1) The use of proceeds are explained to investors by prosperous or other legal documents, etc.
(2) Issuers plan to disclose the most updated information about the use of proceeds after the issuance.

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### Evaluation Items by Each Factor

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- (3) Information disclosure is planned to be made at least once a year. After allocating all the proceeds, Issuers plan to disclose any significant changes after allocating all the proceeds, if necessary.
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- (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 social contribution results, Issuers use appropriate key performance indicator considering the nature of each social project. It is preferable that such impacts are quantitative and that Issuers prepare to disclose the calculation formula and assumptions.

#### 4. Efforts Taken by the Organization

- (1) Management identifies the social issues as one of the important and prioritized issues for their management strategy.
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- (2) An internal department/division which has expertise in social issues or external institutions is involved in the process.
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- (3) Issuers have clear policy and procedures for social bond issuance and criteria to determine the social projects where the proceeds are allocated.
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- (4) Issuers verify its social project and social policy by asking the opinions from external social experts.
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## V Description of How JCR Considers Each Evaluation Factor

### 1. Sociality 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 and SLP (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 and SLP. The identification of project type and beneficiaries shall be determined according to each country's or each region's current situations. The 2018 SBP revision clarified that the definition of the target population varies with each local context and may assume the general public. In such cases, Issuers are nonetheless encouraged to identify any particular segments of the general populace that are expected to especially benefit from the project. 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 properly or not. In addition, JCR also affirms whether the following factors are sufficiently explained to the investors in advance.

- i. The objectives that will be realized by the social finance (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.<sup>3</sup>)
- ii. The criteria for selecting social projects (how assess and select a social project which has social benefits in terms of the objective the Issuer plan to realize)
- iii. Outlines of the process to determine the project ((a) Is it appropriate as the use of proceeds considering Issuers' planned objectives and criteria?, (b) Who judges the selected social projects matches the social objectives based on which criteria?)

JCR also consider 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 finance 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 will be allocated to the social project promptly and also assesses how to manage and manipulate the unallocated proceeds.

### (3) Reporting

According to SBP and SLP, Issuers 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

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<sup>3</sup> Important to set goals consistent with SBP



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 Issuers plan periodical reporting after issuing social bonds precisely and effectively at the time of issuing social bonds, based on SBP and SLP.

#### (4) Efforts Taken by the Organization

It is important that the senior management of Issuers identify 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 establishes policy, procedures of social finance 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 specializes only on social issues, however, it is preferable that Issuers ensure some staff who are responsible for social finance and social issues or social contributions.

## VI Assumptions and Limit of This Evaluation

JCR's Social Finance Evaluation is to affirm the social positive impact at the time of planning the conduct or the time of conducting social finance are calculated quantitatively or qualitatively by Issuers or the third parties. This evaluation will not guarantee such impacts will continue in the future.

Social benefits or negative impact to society/environment 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 Evaluating Social Finance Framework

At the request of the Issuers, JCR may conduct a Social Finance Framework Evaluation of their social bond issuance or social loan borrowing policy to confirm compliance with the SBP and SLP. In such a case, this evaluation method shall apply, but the evaluation mark shall be indicated by (F) at the end of the evaluation mark.

Evaluation of the Social Finance Framework involves evaluation of the Social Finance Framework of the Issuers, and does not include sociality evaluation, and management, operation and transparency evaluation of the individual uses of proceeds implemented based on the social finance framework.

Therefore, it is necessary to separately evaluate individual bonds or individual loans for social finance.

## VIII Periodical Review

JCR may implement periodical review, if Issuers find the necessity to follow up the unallocated proceeds and planned reporting after the issuance/borrowings.

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### **Japan Credit Rating Agency, Ltd.**

Jiji Press Building, 5-15-8 Ginza, Chuo-ku, Tokyo 104-0061, Japan  
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026

## Social project categories of Social Bond Principles and Social Loan Principles

SBP, SLP Project type
1. Affordable basic infrastructure (e.g. clean drinking water, sewers, sanitation, transport, energy)
2. Access to essential services (e.g. health, education and vocational training, healthcare, financing and financial services)
3. Affordable housing
4. Employment generation, and programs designed to prevent and/or alleviate unemployment stemming from socioeconomic crises, including through the potential effect of SME financing and microfinance
5. Food security and sustainable food systems (e.g. physical, social, and economic access to safe, nutritious, and sufficient food that meets dietary needs and requirements; resilient agricultural practices; reduction of food loss and waste; and improved productivity of small-scale producers)
6. Socioeconomic advancement and empowerment (e.g. equitable access to and control over assets, services, resources, and opportunities; equitable participation and integration into the market and society, including reduction of income inequality)

Example of Target populations for social project
1. Living below the poverty line
2. Excluded and/or marginalised populations and/or communities
3. People with disabilities
4. Migrants and/or displaced persons
5. Undereducated
6. Underserved, owing to a lack of quality access to essential goods and services
7. Unemployed
8. Women and/or sexual and gender minorities
9. Aging populations and vulnerable youth
10. Other vulnerable groups, including as a result of natural disasters

(Source)

ICMA Website URL :

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

LMA Website URL :

Social\_Loan\_Principles (lma.eu.com)