standard ethics

Solicited Sustainability Ratings

GUIDE TO
EXPLAINING CORPORATE UNSOLICITED RATINGS
ESSENTIALS

INDEX

ABOUT THIS GUIDE

This guide is designed to provide an understanding of the issue of Corporate Unsolicited Ratings.

This guide:

1. Helps explain when and why Corporate Unsolicited Ratings are issued.
2. Provides an overview of the analysis methodology.

BACKGROUND

In the last two decades, new elements – such as communication technologies and Internet – have created open and transparent financial markets, participated by growing segments of non-professional investors (through funds and pension funds or trading platforms). The result of this is greater attention to extra-financial issues, both tangible and intangible, with repercussions at the level of trust and new assessments on the quality and long-term durability of listed financial products, whether related to companies (stocks / bonds / green bonds) or institutional issuers (such as government bonds).

Today, regulated markets, although they can be fallible and volatile, have evolved and are proving to be the most important and independent system in order to assess the long-term Sustainability of many human activities.

The conclusion of Standard Ethics is that we are facing the end of the classic financial era, focused exclusively on economic variables, and a new class of rating is necessary: the **Solicited Sustainability Rating**.

Standard Ethics issues, in some cases, **Unsolicited Sustainability Ratings**.

WHY UNSOLICITED RATING

Standard Ethics, in order to maintain and update or develop its Indices, issues **Corporate Unsolicited Ratings (Corporate UNSOL SER)**.

The issue of unsolicited ratings follows the same methodology adopted for the issuance of solicited ratings, but, in this case, Standard Ethics examines only public documents and is not able to provide in-depth analysis reports.

SE Indices act as benchmarks for both components and the market to refer to as a measurement of their alignment with the international indications on Sustainability, as recommended by the **European Union**, the **OECD** and the **United Nations**.

The methodology used for selecting the constituents is public and easy to understand. In fact, the indices are open and freely usable as benchmarks in the area of **ESG** (Environmental, Social and Governance) assessment.

UNSOLICITED RATING METHODOLOGY

Gathering the necessary information to issue unsolicited ratings to listed companies is carried out by analyzing the official documentation published by the companies themselves or through publicly available documents, documents issued by the judicial authorities, investigations as well as governmental, EU, OECD and UN reports and other accessible materials.

In principle, Standard Ethics advises that in their Articles of Association, companies formally refer to the Universal Declaration of Human Rights approved by the United Nations on 10 December 1948. Standard Ethics also advises that, in general terms, companies have adapted their structures according to the UN, OECD and EU regulations on sustainability (with particular reference to corporate governance). The basic conditions that listed companies have to meet are as follows:

- to hold a competitive position and not a monopolistic one and not being linked to cartels;
- to make sure that their shares are listed and can be bought without restrictions and that they enjoy substantive rights (voting trusts, for instance, are not acceptable);
- to have widespread ownership of the capital or no conflict of interest;
- all Board members must be independent of capital ownership and must abide by a Code of Conduct that ensures transparency;
- to have procedures to check observance of the latest internationally recognized social and environmental standards (according to UN, OECD and EU guidelines).

Further positive elements are: transparent staff selection (including managers); an independent internal monitoring body (liaising with the Shareholders' Meeting and working at Board level) to check that the Board works in line with the latest UN, OECD and EU standards and principles on conflicts of interest and Corporate Governance; an independent internal monitoring body (e.g. the Audit Committee) which is accountable to shareholders and monitors that the Board works in line with the latest UN, OECD and EU standards and principles on extraordinary accounting and finance; an internal body which reports and facilitates the company's adherence to the latest international social and environmental standards and principles; an external relations and communications department which works in line with the latest standards and principles on sustainability and transparency and applies with due independence the "comply or explain" principle whereby failure to comply with international guidelines on sustainability has to be duly motivated.

Apart from exceptional cases, Standard Ethics does not ask listed companies to provide information because it assumes that they regularly supply all the necessary information and data to their shareholders and the market to enable them to judge their business.

Only by measuring said conformity with comparable, transparent and third-party methodologies will it be possible to ascertain the degree of sustainability of an economic entity and its effect on tomorrow's generations.

Thanks to this approach, the Standard Ethics Rating model is the first to be based on a standard Proprietary Algorithm.

Standard Ethics Algorithm ©

$$\frac{(Fc_{EU}+Sa+Id_{EU\text{-}OECD}+Mw \cdot f(Sa) \cdot f(Id_{EU\text{-}OECD})+Cg_{UN\text{-}OECD\text{-}EU} \cdot f(Fc) \cdot f(Id_{EU\text{-}OECD}))}{10} + k$$

To ensure accuracy and comparability, Standard Ethics does not use weights and KPIs based analyses or indicators, but a more sophisticated method based on its own six-group variable algorithm, five "standards" and a premium variable called "k". Standard Ethics does not use Artificial Intelligence in its analysis or decisional process.

- The first variable of the formula (**Fc**) is related to competition, which positively evaluates the company that competes and faces the market in an appropriate way. While it views negatively risky elements such as antitrust, investigations, fines or sanctions, tax evasion or simply a position of privilege that could, in the long run, prove problematic.
- The metric of the second and third variables (**Sa** and **Mw**) is also linked to typical considerations for many long-term institutional investors and analyses the importance of sensitive aspects for minority shareholders or for new shareholders, for example, with regards to shareholder agreements (not justified by operational needs), double voting rights, the presence of a controlling shareholder, conflicts of interest, and low contendibility.
- The fourth variable (**Id**) looks at managerial scope, risk management and control as well as the reporting models and the composition of the Board of Directors, including areas such as independence and gender equality.

- The fifth (**Cg**) focuses on ESG factors: to see if the company is aligned with strategies such as the Paris COP21 for the reduction of climate effects or the OECD guidelines for multinational enterprises as examples.

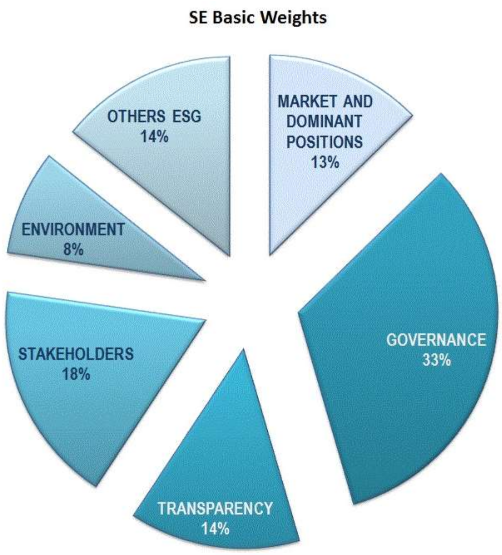
k = Sustainability at Risk (**SaR**)

The relationship between these variables is significant: it would be inconsistent for a company to propose itself as sustainable with the aim of publicising environmental factors, if at the same time it made it difficult for investors because of little transparency, or if it infringed the rules of the market with unfair fiscal or competitive practices.

The Sustainability package, as we are reminded by the OECD and the EU, is complete if it includes all the factors that make the company an asset for future generations.

This Proprietary Algorithm evaluates these elements and weighs them in a harmonious way making the rating of Standard Ethics a best practice of comparable, public and several-times-a-year analysis on sustainability.

Standard Ethics analyses various aspects of environmental, social and governance (ESG) issues that it calls “markers”, which are grouped into further macro areas. The following chart shows their relative percentages, which are subsequently weighted by the Standard Ethics Proprietary Algorithm.



HOW STANDARD ETHICS RATINGS ARE DISCLOSED

In general, Standard Ethics does not publish **Solicited Standard Ethics Ratings** because they belong to the Applicant who can decide whether to disclose them or not. This is not the case for **Ratings** issued to listed companies that are constituents of Standard Ethics Indices, whether they are solicited or unsolicited.

Standard Ethics follows standard procedures to disclose the ratings. The release of new ratings, downgrades and upgrades are communicated through **press releases**, which take into account **Press Release Guidelines published by ESMA**.

MANAGING POTENTIAL CONFLICTS OF INTEREST

As in the case of credit rating agencies, critics here point out that both models have the potential for conflicts of interest since the entities paying for the rating, investors and companies, may attempt to influence the ratings opinion.

In order to mitigate that, Standard Ethics has taken a number of steps to protect against potential conflicts of interest: self-regulates based on the model of the credit rating agency, adheres to the **Applicant-pay Model** and does not act as a consultant to investors or investment funds.
These measures include, for example, a clear separation of function between those who negotiate the business terms for the ratings assignment and the analysts who conduct the analysis and provide the ratings opinions.
Another safeguard is the **Rating Committee** process that limits the influence any single person can have on Standard Ethics' ratings opinions. The role of the Committee is to review and assess the analyst's recommendation for a new rating or a rating's change as well as to provide additional perspectives and checks and balances regarding adherence to the agency's ratings criteria. Standard Ethics client business managers, who respond to applicants' rating requests and deal with commercial matters such as pricing, contract negotiations, and maintaining client relationships, do not participate or vote in rating committees.

A further safeguard is the appointment of the **Compliance Officer** that has access to all documentation of the Company for which she/he deems necessary to carry out his controlling and supervisory role and can independently report likely conflicts of interest.

Finally, the **Board of Directors** (complying with the international guidelines on diversity of nationality, professional skills and gender equality) establishes clearly defined policies and procedures. To ensure the maximum level of independency, the Board is not involved in the issuing rating process, but appoints the Compliance Officer and the Rating Committee.

Sustainability in Governance & Policy

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Important Legal Disclaimer.

All rights reserved. The Standard Ethics Rating (SER) is assigned by Standard Ethics Ltd in accordance with its established methodology on Sustainabilitybased on the principles provided by the European Union, the OECD and the United Nations. More information is provided on www.standardethics.eu.

Solicited Ratings are assigned on a Client's request through a direct and regulated bilateral relationship.
Unsolicited Ratings are issued through official press releases only and for statistical or scientific purposes. Currently, to update Indices, as well as OECD countries ranking (including Brazil, China, Russia, India, South Africa, Egypt, Romania, Argentina, Bulgaria and Vatican City).

By issuing a Solicited or Unsolicited Rating, or publishing Indices, Standard Ethics Ltd does not supply financial, legal, tax or investment consultancy. The opinions and analyses by Standard Ethics Ltd are not, even indirectly, invitations or solicitations to purchase or sell securities or to make investment decisions. Under no circumstances will Standard Ethics Ltd be liable for damages to, loss, or reduction in the value of shares of companies following or as a result of its analyses, its Indices or Ratings.

Standard Ethics Ltd will not be held responsible for any conflict arising from the use of information or data issued by customers relating to its Standard Ethics Rating. In particular, Standard Ethics Ltd is not answerable in any way whatsoever for any decisions and/or assessments made by companies on the basis of the above-mentioned data related to the Rating service. The Standard Ethics Rating is for information purposes only and companies under Rating will be wholly responsible for any decision made on the basis of the information arising from the Rating itself.
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The Standard Ethics Rating, if there are no other indications, is valid for twelve months from the date of issue. Standard Ethics reserves the right to modify, suspend or revoke a previously assigned Rating at any time.

The **Standard Ethics Rating** can be renewed by requesting annual visits by Standard Ethics' analysts without having to start the entire assignment procedure again. Unless updated, the **Rating's** validity ends on its natural expiry date, at which point the Client loses the right to use and publicise the Rating.
The final decision on changes to, or suspension or revocation of, the **Rating** will be communicated to the Client in writing and in a confidential manner. There will also be a request to bear the changes, suspension or revocation in mind in related company communications if the Standard Ethics Rating has been made public. If the Client does not adequately publicise the changes to the public **Rating**, Standard Ethics reserves the right to make the changes, suspension or revocation known.