Solicited Sustainability Ratings

GUIDE TO EXPLAINING

SECURITY STANDARD ETHICS RATINGS

ESSENTIALS

Solicited Sustainability Ratings

INDEX

ABOUT THIS GUIDE

This guide is designed to provide an understanding of the issue of **Security Standard Ethics Ratings (Security SER).**

This guide:

1. Helps explain when and why Security SER 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 for assessing 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 **Security Standard Ethics Rating.**
This new category of rating stems from the economic crisis caused by the Covid-19 pandemic and the consequent need for listed companies and nations to obtain financing for substantial amounts and additional resources to fund country and company recovery through **conventional debt instruments**. Being able to provide companies and investors with a sustainability assessment of these instruments, covers an information gap and is in line with the wishes of the **European Union**, the **OECD** and many governments to steer recovery efforts towards long-term Sustainability.

WHY A SECURITY STANDARD ETHICS RATING?

A new category of non-financial Sustainability rating, specifically dedicated to the evaluation of conventional General-Purpose debt emissions (Bonds and other kinds of General-Purpose debt instruments) and their long-term investment in Sustainability, is strongly needed to verify how funding is used in the area of Sustainability in such a fragile historical period such as the post-pandemic one.

To date debt financial products of this kind - unlike well-regulated Green Bonds and similar ESG-linked instruments - are not covered by specific and comparable ESG ratings and form a significant gap in the market.

In the aftermath of the pandemic and with the current transition towards a new economy, Standard Ethics believes that **all debt must be sustainable**. This means that **all** emissions - starting with corporate emissions - must reach an adequate level of Sustainability, and therefore, fund strategic & industrial plans that are coherent with global environmental and social policies. This level is identified by the agency as an "**EE-**".

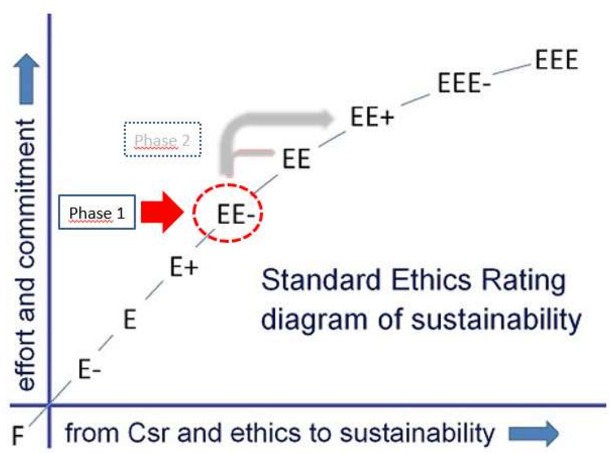
In Standard Ethics' opinion, an "**EE-**" rating (or above) **qualifies** the security issue as **suitable** for an **ESG/SRI portfolio.**

SECURITY STANDARD ETHICS RATING METHODOLOGY

The **Security SER** takes into account the issuer, the nature and the industrial plans of the issuer, as well as its development and sustainability strategies. The analysis process is divided into two phases: the first one concerns the issuer and the second one refers to the issue evaluation. The issuer evaluation is carried out by analysts based on circa 40 standard markers used to measure the alignment of ESG policies and the Governance of Sustainability with UN, OECD, and EU indications concerning:

- fair competition, market, dominant positions, market distortions
- shareholders' agreements, ownership and shareholders
- market weight, participation and voting at general meetings
- directorships, board of directors, independence and conflict of interest
- governance of sustainability, governance, ESG policies, ESG disclosure
- human rights

The result of the analysis is then synthesized and entered into the Standard Ethics Proprietary Algorithm. The **Baseline Rating** – internally calculated by Standard Ethics - is the starting point from which the General-Purpose Security issue is assessed.

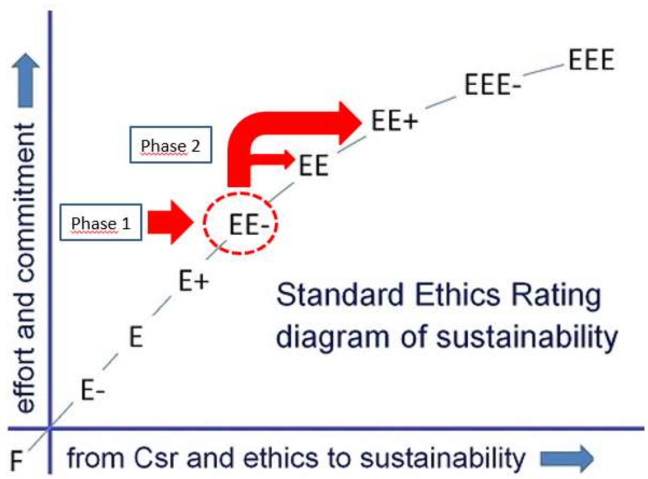


The second phase (Phase 2) is carried out by analysts through the application of other standard markers in order to evaluate whether the strategic & industrial plans and sustainability plans (financed by the debt instrument) are aligned with Sustainability Policies determined by UN, OECD, and EU. The evaluation points are the following:

- main features of the financial instrument
- futures ESG and financial impacts – in compliance with the **EU DNSH** principle ("Do No Significant Harm") – with particular regard to the following strategic macro-areas:
    - carbon neutrality (based on the strategic & industrial plans & ESG reporting)
    - circular economy (based on the strategic & industrial plans & ESG reporting)
    - gender equality (based on the strategic & industrial plans & ESG reporting)

Policy for increasing Baseline Ratings is the following:

- If a very substantial[1] part of proceeds is allocated to value-added sustainable activities (given the company industry), then the Baseline Rating could be raised by **two notches**
- If a substantial[2] part of proceeds is allocated to value-added sustainable activities (given the company industry), then the Baseline Rating could be raised by **one notch**
- If there is no traceable report or specification on the allocation of the proceeds, or if the company's strategic & industrial plans do not improve the future positioning of the issuer with respect to the principles of Sustainability according to analysts, the final **Security Standard Ethics Rating** will correspond to the **Baseline Rating.**



[1] This variable is calculated on the basis of the business of the company, its geographical position, sector of activity and the extent and duration of the issue.
[2] This variable is calculated on the basis of the business of the company, its geographical position, sector of activity and the extent and duration of the issue.

standard ethics
Solicited Sustainability Ratings

Security Standard Ethics Rating Algorithm

$$\underbrace{\left(\frac{(Fc_{EU}+Sa+Id_{EU\text{-}OECD}+Mw \cdot f(Sa) \cdot f(Id_{EU\text{-}OECD})+Cg_{UN\text{-}OECD\text{-}EU} \cdot f(Fc) \cdot f(Id_{EU\text{-}OECD}))}{10} + k \right)}_{\text{Phase 1}} \underbrace{+\, g\,(Cg_{UN\text{-}OECD\text{-}EU})}_{\text{Phase 2}}$$

To ensure accuracy and comparability, Standard Ethics does not use weights and KPIs based analyses or indicators, but uses a more sophisticated method based on its own proprietary six-group variable algorithm. 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)

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 it 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: it 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

www.standardethics.eu
headquarters@standardethics.eu

Important Legal Disclaimer.

 The Standard Ethics Rating (SER) is assigned by Standard Ethics Ltd in accordance with its established methodology on Sustainability based 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.
In no event shall Standard Ethics be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of its opinions, analyses and ratings.

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.