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METHODOLOGY FOR ASSIGNING ENVIRONMENTAL, SOCIAL AND GOVERNANCE RATINGS TO CORPORATES

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1. General definitions

An environmental, social and governance (ESG) rating represents the opinion of the Agency on how well corporations manage their exposures to environmental, social and governance risks through policies, programs, disclosures and actions. It also represents the Agency's opinion on how the entity takes advantage of opportunities related to environmental and social factors.

This methodology describes the system of factors and sub-factors used in the process of assigning ESG ratings to corporates. The overall ESG rating is also separated into environmental (E), social (S) and governance (G) ratings. This allows the users of this methodology not only to understand the overall ESG position of the company, but also the individual exposures and mitigation of E, S and G risks.

These ratings are comparable with peers in the same industry and can be used by investors in the investment decision-making process as well as in the course of responsible investment portfolio selection. Furthermore, these ratings are used by the rated entities and the general public to identify the entity's ESG risks and opportunities and how well the companies mitigate these risks and take advantage of the opportunities. Our analysis can be performed for any company around the globe and across different industries.

Each rating is assessed by considering the exposure of the company to particular environmental, social and governance risks and opportunities in a particular country, industry or activity. After exposures to different risks and opportunities have been identified, this methodology assesses the policies, reporting and performance of the company in different E, S and G topics which contributed to mitigate the risks and get advantage of the opportunities.

In this methodology, the following definitions are used:

- **Risk exposures:** conditions which expose the entity to potential negative material effects on the company. Each factor may have a risk exposure related to one or a combination of the following risk exposure categories:
    - **Industry risk exposure:** a risk exposure is material to an industry when it is likely that companies in a given industry will incur substantial costs in connection with it (e.g. the factor *Water use* will measure the water consumption and this will depend on the industry. The agricultural industry is highly exposed to this factor).
    - **Country risk exposure:** a risk exposure is material to a country when conditions to operate in that country can be detrimental for the entity (e.g. the factor *Water use* will measure the water stress and this will depend on the aridness of the country).
    - **Activity-based risk exposure:** there are certain factors for which the risk exposure is material for a company depending especially on the nature of the company's activities regardless of the industry and country where they operate. In this case, we base the exposure assessment on the activity of the company (e.g. in the retail industry the exposure to the factor *Generation of contaminants* could vary depending on the scope and type of transport of the specific company. Thus, the exposure cannot be considered to be the same for the whole industry).
    - **Broad-based risk exposure:** a risk exposure which is material for every company regardless of the country and industry where it operates as well as the activity it performs (e.g. every company in the world and across industries is exposed to a factor such as *Talent attraction & retention*. Regardless of the company being a

manufacturer or a service provider, the impact of not having HR policies or compensation packages, for instance, will be the same).

- **Opportunities:** Favorable circumstances which, if exploited, can have a positive material effect on the company's finances. An opportunity is material to an industry when it is likely that companies in a given industry could benefit or profit from it (e.g. opportunities in *Renewable energy* for companies developing LED lighting).
- **Policies:** Companies' internal arrangements, initiatives or strategies aimed at mitigating a risk or getting advantage of an opportunity, which can have a material impact on the company.
- **Reporting:** Companies' internal or external appraisals and reports aimed at disclosing advances and/or results of the implementation of policies.
- **Performance:** Assessment of the achievements reached by the company to mitigate a risk or get advantage of an opportunity. Basically, we analyze how well the results are compared with the strategy and objectives set in advance.

Risk exposure assessment note:

The type of exposure described in this methodology as the default type of exposure per factor was selected as the best fit for the type of factor being analysed. For instance, if *Country + Industry* was selected for the factor *Water use* it means that for most of the companies the expected impact of the risk factor on the company is related to a risk exposure per country and a risk exposure per industry.

Every factor, however, is subject to a qualitative assessment to finally determine the final risk exposure. This means, a company could belong to a type of industry with a certain level of exposure to certain factor (e.g. the automotive industry has a high risk exposure related to the carbon emissions factor). However, given the nature of the operations of a specific company, this company may have a different degree of risk exposure than the rest of the industry. Thus, it can be decided that this specific entity does not have any risk exposure to the mentioned factor as it has been assessed that the risk derived from the factor is not material to the company in question.

2. Sources of information

2.1 While assigning a rating score, the following sources of information are used:

- Questionnaire filled in by the company according to the Agency's form;
- Audited financial statements and annual reports of the company;
- Information from the mass media and other public sources;
- Website of the company;
- Other relevant data sources.

2.2 The Agency is neither responsible for controlling the accuracy of the documents provided by the company, nor for the authenticity of the information included in these documents. However, the Agency can carry out additional checks to verify the accuracy of the information provided.

2.3 The Agency has the right to use additional sources of information.

3. Rating classes

The environmental, social, governance and total ESG ratings assigned by Rating-Agentur Expert RA GmbH are defined on the basis of allocating the company to one of nine rating classes according to the following scale:

Table 1. Rating classes

Rating ESG	Rating E	Rating S	Rating G	Rating level	Score	Rating Band
AAA[esg]	AAA[e]	AAA[s]	AAA[g]	Highest level	89 - 100%	**A-rating band** The entity's position is above average. Minor or no further actions are required, but the entity can benefit from any additional improvement or innovation.
AA[esg]	AA[e]	AA[s]	AA[g]	Very high level	78 - 89%	
A[esg]	A[e]	A[s]	A[g]	High level	67 - 78%	
BBB[esg]	BBB[e]	BBB[s]	BBB[g]	Moderately high level	56 - 67%	**B-rating band** The entity's position is average. The entity faces a bearable amount of risks, which can be mitigated with a reasonable number of further actions.
BB[esg]	BB[e]	BB[s]	BB[g]	Sufficient level	44 - 56%	
B[esg]	B[e]	B[s]	B[g]	Moderately low level	33 - 44%	
CCC[esg]	CCC[e]	CCC[s]	CCC[g]	Low level	22 - 33%	**C-rating band** The entity's position is below average. Strong actions are required. The entity faces a significant amount of risks and there is big room for improvement.
CC[esg]	CC[e]	CC[s]	CC[g]	Very low level	11 - 22%	
C[esg]	C[e]	C[s]	C[g]	Lowest level	0 - 11%	

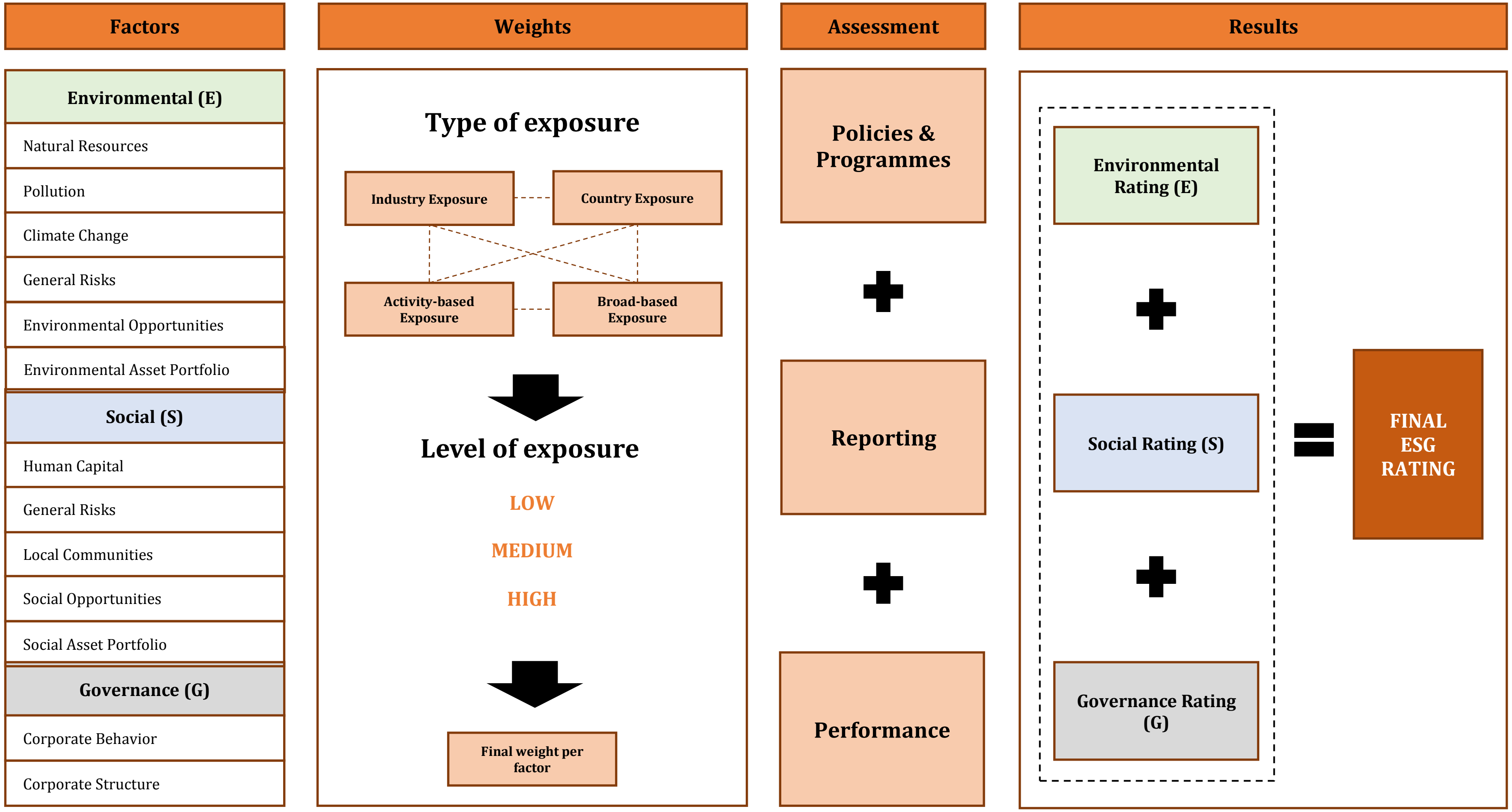
4. Order of the rating assignment

The ESG rating is calculated as the weighted average of the rating scores obtained for the individual environmental, social and governance ratings. The weights assigned to each individual rating to calculate the overall ESG rating are assessed as the share of the section exposure to the overall exposure of the company (for example: the exposure of the environmental topic on the total ESG exposure). Likewise. the weights assigned to each factor used to calculate the E, S and G ratings are assessed as the share of the factor's exposure to the total section's exposure (for example: the exposure of natural resources to total environmental exposure). In table 2 and graph 1 below we show all the factors and sub-factors per topic as well as a schematic structure of the rating assessment process.

Table 2. Topics, factors and sub-factors

Topic	Factor	Sub-factor
Environmental	Natural Resources	Water stress
		Biodiversity
		Energy use
		Controversial sourcing
	Pollution	Waste management & recycling
		Generation of contaminants
		Extended product responsibility
	Climate Change	Carbon emissions
		Climate change vulnerabilities
	General Risks	Stakeholder engagement
		Supplier chain
	Environmental Opportunities	Renewable energy
		Energy productivity
		Climate adaptation
	Environmental asset portfolio	Environmental responsible investment
		Environmental loan portfolio
Social	Human Capital	Labour practices
		Occupational health & safety (OHS)
		Talent attraction & retention
		Diversity & inclusion
	Local Communities	Social benefits
		Corporate social responsibility (CSR)
		Human rights
	General Risks	Suppliers chain
	Social Opportunities	Access to finance
		Access to communication & logistics
	Social asset portfolio	Social responsible investment
		Social loan portfolio & financial inclusion
		Financial product responsibility
Governance	Corporate Structure	Board structure & transparency
		Ownership
		Risk management
	Corporate Behaviour	Business ethics
		Anti-competition practices
		Tax payment & transparency

Graph 1. Main integral factors of the rating analysis



4.1 Environmental

The purpose of this section is to assess the exposure of the corporation to environmental risks and how this exposure is mitigated. Moreover, we also assess any potential opportunities the company might be exposed to and how the entity takes advantage of the potential environmental opportunity. The section is divided into five factors:

- Natural Resources
- Pollution
- Climate Change
- General Risks
- Environmental Opportunities
- Environmental Asset Portfolio

At the same time, each factor is evaluated according to a number of sub-factors.

4.1.1 Natural Resources

A. Water use

Risk exposure assessment:

Type of exposure: Country + Industry

To define the country risk exposure we look at the baseline water stress in the **country**. Baseline water stress measures the total annual water withdrawals expressed as a percentage of the total annual available blue water. To assess the risk exposure related to the **industry**, we look at the water consumption by sector as measured by the ratio of cubic meters used to sales. If this information is not available, the assessment is done qualitatively by comparing the use of water of the industry with others. The higher the water consumption of an industry, the stronger the exposure of the industry to the risk of water stress.

Risk mitigation assessment:

First of all, we assess if there are any policies and programmes focused on using water resources more efficiently, reducing the amount of water used (less water overall), monitoring the amount and efficient use of water and undertaking a precautionary approach to water stress challenges. Once we have detected which programmes and policies are in place, we assess the level of reporting linked with these policies. We measure mainly the frequency of reporting the efficient use of water and whether or not the company is certified by a third party and to which level they are certified. Usually, certified companies are obliged to provide periodical reporting on certain indicators in order to maintain the certification. Finally, we assess the performance of the company in regard to water use. We analyse whether the company's water use trend shows a decline and if there are reasons to consider that the trend is going to remain in place.

B. Biodiversity

Risk exposure assessment:

Type of exposure: Country + Industry

In order to identify the country risk exposure, we evaluate the amount of protected sites in the **country**. The larger the amount of protected sites, the higher the exposure of the company to the risk of damaging biodiversity in that country. In this methodology, a protected site is defined as an area of land and/or sea specially dedicated to the protection and maintenance of biological diversity. The **industry** risk exposure is defined by measuring the need of the industry to operate in or close to protected areas. For example, some oil and mining companies operate close to the areas which have previously not been economically exploited and mostly protected. As a result of the economic activity from such industries, these areas can be partially damaged or polluted. In contrast, banks typically operate in urban areas and their operations do not represent a risk to the local biodiversity.

Risk mitigation assessment:

We begin by assessing the policies and programmes the company has in place to mitigate this risk. These policies and programmes should show the company's commitment to undertake a precautionary approach towards biodiversity as well as the commitment of the rated entity to monitor the company's biodiversity impact on the regions of operations. Following this, we continue by evaluating the reporting level. We check if the company reports regularly on its impact on biodiversity and whether or not internal or external appraisals are conducted to assess the impact of the company on biodiversity. Finally, the performance is assessed by making sure the company has not suffered any reputational damage linked to destruction of biodiversity.

C. Energy use

Risk exposure assessment:

Type of exposure: Country + Industry

The exposure of the country is assessed by the level of energy consumption in the **country** as measured by the energy deficit or surplus. The higher the energy demand on top of the available supply, the stronger the exposure to the country risk. The **industry** risk exposure is assessed by the analyst based on the energy intensity[1] OR the energy consumption of the sector in the country. The higher the energy intensity of an industry, the stronger the exposure of the industry to the risk of energy consumption.

Risk mitigation assessment:

The policies and programmes implemented by the company must be dedicated to use energy more efficiently (less energy per unit of output / reuse water), to reduce the amount of energy used (less energy overall), to monitor the amount and effectiveness of energy used and to undertake a precautionary approach to energy shortage challenges. When assessing the reporting for this sub-factor, we focus on regular reporting regarding the energy use and efficiency as well as on internal or external verifications conducted to assess the efficient use of energy. The performance is finally assessed by evaluating if the company's use of energy is below the industry's average, making sure that the energy use trend shows a decline over the years AND there are reasons to consider that such trend will remain in place in the future. We also analyse if the trend shows that the company is using energy in a more efficient way over the years.

D. Controversial sourcing

Risk exposure assessment:

Type of exposure: Activity-based

The exposure to this risk is assessed only for companies whose **activity** shows materiality to this potential risk. Therefore, the final exposure for this factor depends specifically on the activity of the company regardless of the industry it belongs to and the country where it operates. The exposure assessment is done by analysing the company's specific type of raw materials used and by checking how controversial these materials are, the more controversial materials the company uses the higher the risk exposure.

[1] Energy intensity is measured as Kilogram oil equivalent per USD at a constant exchange rate, price and purchasing power parities of a particular year. Energy intensity is a measure of the energy efficiency of a nation's economy.

Risk mitigation assessment:

For the mitigation assessment we first analyse whether or not the company has policies and programmes in place used to regularly assess the raw materials' country of origin. Policies should also map or identify smelters/refiners in the supply chain, define corrective actions to address non-compliance of controversial sourcing policy, have a plan for educating downstream suppliers about risks and demonstrate initiatives to reduce the use of raw materials that can be conflict materials. For reporting, we look for transparent reporting on due diligence at the smelter/refinery level, we also check for regular external and internal audits of supplier and of refiners/smelters to check the use of controversial materials. Finally, the performance is assessed by analysing the trend over the past 5 years in regard to the use of these materials.

4.1.2 Pollution

A. Waste management & recycling

Risk exposure assessment:

Type of exposure: Country + Industry

The risk exposure for the **country** is assessed qualitatively based on the waste management practices in the country. This may include the assessment of the amount of waste generated per capita, the share of waste recycled as well as the existing regulation. The **industry** risk exposure is assessed qualitatively based on the level of pollution of the waste generated by the industry. The stronger the pollution generated by the waste of the industry the higher the risk exposure.

Risk mitigation assessment:

In order to assess the adequacy of policies and programmes in place we search for policies and programmes containing a plan to continuously improve waste management, commitment to reduce total waste produced by the company, a programme to recycle or monitor waste management processes and commitment to monitor the amount of waste produced and recycled. For reporting, we assess whether or not the company performs periodic reporting on waste management and recycling practices. In order to assess performance as positive, the company must show a declining waste trend over the past 4 years as well as an increasing trend in recycling over the same period of time. Also, we check that the company has not suffered any reputational damage linked to poor waste management practices.

B. Generation of contaminants

Risk exposure assessment:

Type of exposure: Activity-based

The exposure to this risk is assessed only for companies whose **activity** shows materiality to this potential risk. Therefore, the final exposure for this factor depends specifically on the activity of the company regardless of the industry it belongs to and the country where it operates. The risks are assessed by the estimated amount of pollutants issued during its operational activity and the combination of transports used by the specific company to transport its goods.

Risk mitigation assessment:

To assess this factor's policies and programmes, we look for these to monitor and quantify the means of pollution from transport and operational activities as well as to cover plans and procedures to reduce this pollution. When assessing the reporting level, we make sure the company reports periodically on the amount of pollutants issued during the production and transportation stages. Finally, we measure the level of performance assessing whether or not the company's pollution shows a decline over the years and if the company's pollution is below its industry peers.

C. Extended producer responsibility

Risk exposure assessment:

Type of exposure: Activity-based

The extended producer responsibility[2] (EPR) strategy aims to make producers responsible for the environmental impacts of their products throughout the product chain, from design to the post-consumer phase.[3]

The exposure to this risk is assessed only for companies whose **activity** shows materiality to this potential risk. Therefore, the final exposure for this factor depends specifically on the activity of the company regardless of the industry it belongs to and the country where it operates. The risk is assessed through a number of questions to the entity, which are aimed at understanding the existence and features of the EPR policy of the company.

The EPR factor is considered a stress factor for the company in the sense that a company which does not have a well-defined and transparent EPR is assessed negatively according to this methodology. On the contrary, a company which has an EPR policy in place is NOT positively affected according to this methodology, the effect remains neutral.

Assessing a company's EPR is difficult for a number of reasons:

- A considerable lack of data;
- Analytical difficulties in distinguishing the impact of EPR policies from other factors;
- The wide variety of EPR strategies which limits comparison among them.

For these reasons, this methodology allows to assess this risk based on available information about the practices and controversies on an industry level.

Risk mitigation assessment:

We initially look for policies and programmes aimed at tracking extended producer responsibility with the aim of better treat or dispose products after being consumed. In the reporting we mainly take into account if the company keeps a record of the life cycle of products. In regard to performance, we evaluate whether or not there is evidence suggesting that the company takes responsibility for the product along its life cycle and we assess if the company has suffered any reputational damage linked to insufficient extended producer responsibility.

4.1.3 Climate Change

A. Carbon emissions

Risk exposure assessment:

Type of exposure: Country + Industry

The **country** risk exposure is assessed by the amount of carbon emissions (CO_2) per capita in the country. The higher the amount of CO_2 emissions per capita, the stronger the exposure to the country risk. The assessment of the **industry** risk exposure is performed by looking at the amount of carbon emissions (CO_2) intensity[4] in the industry of a particular country. The higher the emissions intensity the stronger the risk exposure to the industry.

Risk mitigation assessment:

[2] "Extended Producer Responsibility (EPR) is a strategy designed to promote the integration of environmental costs associated with goods throughout their life cycles into the market price of the products" (OECD, 2001).
[3] Extended Producer Responsibility, Guidance for efficient waste management – OECD, 2016.
[4] Emission intensity the degree of discharge from a certain pollutant relative to the intensity of an activity; for instance, the amount of carbon emitted per unit of energy consumed (e.g. per mega joule of energy produced).

In order to assess the policies and programmes we look whether these include the company's commitment to reduce CO_2 emissions, managerial responsibility for CO_2 emissions and if the company has established certain CO_2 reduction targets and deadlines. For the level of reporting, we evaluate if the company performs external and internal regular CO_2 emissions audits or verifications. In order to assess the performance as positive, the company's emissions trend (as % of revenues) must show a decline over the past 4 years, the CO_2 emission level (as % of revenues) should be lower than the industry's average and the company should not have suffered any reputational damage linked to CO_2 emissions.

B. Climate change vulnerabilities

Risk exposure assessment:

Type of exposure: Country + Activity-based

The exposure to this risk is assessed for the **country** as climate change vulnerabilities relevant for the country can be material to any company in any industry. The risks are assessed through the Global Climate Risk index, which analyses to what extent countries have been affected by the impacts of weather-related loss events (storms, floods, heat waves etc.). We also assess the exposure to this risk based on the **activity** of the company as some activities may suffer a higher impact depending on the type of weather-related loss events (e.g. a halt on operations due to a storm is more likely to happen for companies whose activities are performed outdoors).

Risk mitigation assessment:

The policies and programmes from the company must show a clear commitment to monitor the impact of climate change and plans for mitigation of climate change impact are in place. Reporting should be regular showing the effects of climate change on the company. In regard to performance, we make sure the plans are actually being implemented and that climate change impact on the company's activity or production is managed and mitigated.

4.1.4 General Risks

A. Stakeholder engagement

Risk exposure assessment:

Type of exposure: Activity-based

The exposure to this risk is assessed only for companies whose **activity** shows materiality to this potential risk. Therefore, the final exposure for this factor depends specifically on the activity of the company regardless of the industry it belongs to and the country where it operates. The risk assessment is aimed at understanding the existence and features of the engagement of different stakeholders[5] with the decisions of the company. This methodology considers that the stronger the engagement of stakeholders in the decisions of the company, the better the transparency and reputation of this company among market participants. This ultimately has a financial impact to the company by increasing trusts and awareness among the consumers and investors.

Risk mitigation assessment:

Policies and programmes in place must show the commitment to consult with the stakeholders on environmental issues as well as to promote greater environmental responsibility among the stakeholders. For the reporting to have a positive assessment we check whether or not there is a special department responsible for engaging with the stakeholders regarding the environmental issues and that the results of these meetings are clearly reported internally. A good performance would show that there is evidence of environmental plans implementation where the stakeholders

5 A stakeholder is a member of the groups without whose support the organization would cease to exist. - *Freeman, R. Edward; Reed, David L. (1983).* "Stockholders and Stakeholders: A new perspective on Corporate Governance".

were involved. Also, we make sure the company has not suffered any reputational damage linked to insufficient stakeholder engagement.

B. Suppliers chain

Risk exposure assessment:

Type of exposure: Broad-based

The level of exposure to this risk is assessed equally for every company regardless of its geographical location and the industry where it operates. This methodology considers that every company by default is exposed to a **Medium** risk of obtaining raw materials from suppliers which do not follow an environmental management program (the so called supplier chain environmental risk). The existence and the level of formality of a policy aimed at detecting the environmental practices of suppliers affect the rating positively.

Risk mitigation assessment:

We assess the policies and programmes of the company in a positive way if these include company-wide managerial responsibility for environmental management of suppliers, if monitoring of suppliers' environmental performance is conducted and if there are feedback and coordination with suppliers as well as a plan in place for periodical reviews of the system in order to achieve improvements. Reporting should include regular checks on environmental issues in the supply chain with its respective performance metrics and regular reporting on environmental issues in the supply chain. Finally, a positive level of performance will show that the company has not suffered reputational burdens linked to poor management of supply chain systems.

4.1.5 Environmental Opportunities

This section is intended to capture the environmental opportunities that the company has in a particular country and industry. The methodology considers, if available in a country or industry, that the company can take advantage of these opportunities and ultimately have a material benefit from them.

A. Renewable energy (RE)

Opportunity exposure assessment:

Type of exposure: Country

A company's opportunity to benefit from renewable energy is bounded by the geographical, climatic, institutional and economic stance of the country of operation. The Renewable Energy Country Attractiveness Index developed by Ernst & Young (RECAI)[6] collects exactly such opportunities from a pool of 40 emerging and developed countries.

If the company's country of operations is not included in the RECAI, the methodology allows to solve this issue by looking at the closest country peer included in the ranking and in this way assign a level of opportunity. This is based on the conception that countries which share the same geographical, institutional or economic position tend to offer similar opportunities in the RE ground.

Opportunity exploitation assessment:

We assess the degree and extent of exploiting the benefits of this opportunity, based on the needs and industry of operation of the company and the industry where it operates.

B. Energy productivity (EP)

Opportunity exposure assessment:

[6] http://www.ey.com/gl/en/industries/power---utilities/ey-renewable-energy-country-attractiveness-index-methodology

Type of exposure: Country

A company's opportunity to benefit from energy productivity[7] is assessed by the capacity of a country to generate a certain volume of output of products and services per unit of energy used. The higher the energy productivity in a country, the higher the amount of output a company can generate with a unit of energy. This is evaluated by the Energy Productivity Index[8] developed by Ecofys.

Opportunity exploitation assessment:

We assess the degree and extent of exploiting the benefits of this opportunity, based on the needs and industry of operation of the company and the industry where it operates.

C. Climate adaptation

Opportunity exposure assessment:

Type of exposure: Country

This opportunity is assessed based on the result obtained in section 4.1.3-B (climate change vulnerabilities). The stronger the vulnerability in a country, the more the company can benefit from climate adaptation in that country. The assessment is done qualitatively based on the available climate adaptation guidelines and initiatives in the country.

Opportunity exploitation assessment:

The analyst assesses the degree and extent of exploiting the benefits of this opportunity, based on the needs and industry of operation of the company and the industry where it operates.

4.1.6 Environmental Asset Portfolio

A. Environmental responsible investment

Risk exposure assessment:

Type of exposure: Country + Industry

The risk exposure is based on the level of environmental investment requirements where the financial institution operates. The higher the level of regulations and/or requirements, the higher the exposure to this risk as the financial institutions have increased pressure to invest in environmentally friendly assets and to develop policies and procedures in order to comply with the requirements.

The industry risk exposure is applied only to the financial sector and it is assessed as high. Industry exposure to other sectors is nil.

Risk mitigation assessment:

The policies of the company are assessed favourably if these include certain conditions to avoid investing in environmentally controversial industries or, in case they do, which policies are in place to reduce the environmental impact of the object of investment. In addition, it is also considered positive if the company includes in its policies goals for environmental investing as well as if the institution is a signatory of frameworks committed to promote assessing and managing environmental risk in project finance. Ideal reporting should include the green impact and green allocation of the investment portfolio. Finally, favourable performance will show a portfolio with a high level of environmental investments in the categories defined as well as low or no investments in environmentally controversial industries.

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[7] "Energy productivity is defined as the volume of services or products that can be generated per unit of energy. It is not the same as energy efficiency, which measures the inverse, i.e., how much energy is needed to produce a given level of output" (Ecofys, 2015).
[8] https://www.ecofys.com/en/publication/the-2015-energy-productivity-and-economic-prosperity-index/

B. Environmental loan portfolio

Risk exposure assessment:

Type of exposure: Country + Industry

The risk exposure is based on the level of environmental requirements in the jurisdiction where loans are issued. The higher the level of environmental regulations and/ or requirements in regard to the issuance of loans, the higher the exposure to this risk as the financial institutions have increased pressure to issue environmentally friendly loans and to develop policies and procedures in other to comply with the requirements.

The industry risk exposure is applied only to the financial sector and it is assessed as high. Industry exposure to other sectors is nil.

Risk mitigation assessment:

The policies and programs of the company are evaluated positively if there are measures in place to issue loans avoiding any type of involvement in any environmentally controversial entities, to issue loans avoiding any type of involvement in any environmentally controversial entities and order to issue green loans in the defined categories. We also take into account whether or not the institution is a signatory of frameworks committed to promote assessing and managing environmental risk in project finance. In terms of reporting, we expect the entity to show a Commitment to report regularly on the green impact of the loan portfolio and on the green allocation of the loan portfolio. Finally a successful performance will be reflected by the loan portfolio demonstrating high level of environmental loans in the categories defined as well as no involvement in environmentally controversial entities.

4.2 Social

The purpose of this section is to assess the exposure of the corporation to social risks and how this exposure is mitigated. Moreover, we also assess any potential opportunities the company might be exposed to and how the entity takes advantage of the potential social opportunity. The section is divided into five factors:

- Human Capital
- Local Communities
- General Risks
- Social Opportunities
- Social Asset Portfolio

At the same time, each factor is evaluated through a number of sub-factors.

4.2.1 Human Capital

A. Labour practices

Risk exposure assessment:

Type of exposure: Country + Industry

This risk is assessed on the basis of the **country**'s labour conditions, as shown by the Incidence of the following metrics by **industry** and region (classified by income group):

- Excessive working hours[9]
- Underemployment[10]
- Informal employment

The final risk exposure is determined qualitatively by the analyst through considering the highest exposure among all the previously mentioned metrics.

Risk mitigation assessment:

Policies and programmes are evaluated as positive if there is a clear engagement from the company to improve labour practices and conditions, to monitor and control working hours, to monitor and prevent underemployment, to monitor and prevent informal employment and to incorporate in the policy ways to compensate for poor labour practices. The reporting should include regular reporting on the improvements regarding labour practices and conditions. Also, there should be evidence that internal or external appraisals to the company's labour practices and conditions are conducted. Finally, in order for the performance to be assessed positively, there must be evidence that the company reports good labour conditions and the trend should show that the company has improved the labour conditions over the past 4 years.

B. Occupational health & safety (OHS)

Risk exposure assessment:

Type of exposure: Country + Industry

[9] Workers are subject to excessive working hours when they work more than 48 hours per week.
[10] Underemployment is the under-use of a worker due to a job that does not use the worker's skills, or is part time, or leaves the worker idle.

The risk exposure is measured by the occupational injury rates of the **industry** and region (group of **countries**)[11] where the company operates.

Risk mitigation assessment:

Policies and programmes must show commitment to outline internal OHS standards as well as to mitigate the risk of OHS incidents. Reporting is positively assessed as long as there is regular internal monitoring to check that the OHS standards are in compliance and if the company reports regularly on the OHS incidents. Finally, when analysing performance, we expect absence of OHS reported incidents as well as a trend showing that the number of injuries declined over time.

C. Talent attraction & retention

Risk exposure assessment:

Type of exposure: Broad-based

The level of exposure to this risk is assessed as equal for every company regardless of its geographical location and the industry where it operates. This methodology considers that every company by default is exposed to a **Medium** risk of attracting and retaining human resources. However, the risk can differ depending on the amount of internal training required. The existence of internal policies aimed at attracting and retaining employees affects the rating positively.

Risk mitigation assessment:

When analysing policies and programmes, we evaluate whether these include the company's commitment to develop internal HR policies aimed at attracting and retaining employees, if there are innovative compensation and benefits package, career development initiatives and opportunities as well as if rewards and recognition policies are in place. For reporting, we expect the company to report periodically on employment satisfaction. Finally, we assess the performance by evaluating the employee rotation at the company and analysing how long it takes for the entity to find human resources.

D. Diversity & inclusion

Risk exposure assessment:

Type of exposure: Broad-based

The level of exposure to this risk is assessed as equal for every company regardless of its geographical location and the industry where it operates. This methodology considers that by default every company is exposed to a **Medium** risk of having poor diversity and inclusion policies. The existence of internal policies aimed at improving diversity and inclusion affects the rating positively.

Risk mitigation assessment:

Policies and programmes to mitigate this risk factor should include commitments to take into account polices aimed at fostering diversity and inclusion, a structured policy showing targeted recruitment to ensure internal diversity and inclusion quotas in the company, programmes for employee training and guidance regarding diversity as well as enough initiatives in place to support a diverse workforce. Reporting shall include the regular monitoring of diversity and inclusion is regularly with its respective monitoring results. If there is evidence that the company implemented initiatives to encourage diversity and inclusion and diversity metrics have improved over the past 4 years, then we assess performance as positive.

[11] Countries were grouped into 7 regions depending on their income: High Income countries (HIGH), Low- and middle-income countries of the African Region (AFRO), Low- and middle-income countries of the Americas (AMRO), Low- and middle-income countries of the Eastern Mediterranean Region (EMRO), Low- and middle-income countries of the European Region (EURO), Low- and middle-income countries of the South-East Asia Region (SEARO), Low- and middle-income countries of the Western Pacific Region (WPRO).

4.2.2 Local Communities & Human rights

A. Social benefits

Risk exposure assessment:

Type of exposure: Country

The exposure to this risk is assessed by country regardless of the company's industry of operation. This methodology assess the risk based on the number of social security conventions that each country ratified out of the 9 Social Security Conventions of the International Labour Organization[12].

Risk mitigation assessment:

Policies and programmes which we consider positive should have a clear commitment to provide above-the-law social benefits. Moreover, the company should have policies in place in order to provide: medical care OR sickness benefits, unemployment benefits, benefits to pensioners OR their family members and family OR maternity benefits. In order to assess an adequate level of reporting, the company must perform regular internal checks to track social security policies of the company; also, if there are unions OR internal associations responsible for controlling the performance of social policies and these provide periodical analysis on the issue, it is also assessed as a mitigating factor. Performance is favourable as long as there is evidence that the company implements social security policies and that the company provides above-the-law social security benefits.

B. Corporate social responsibility (CSR)

Risk exposure assessment:

Type of exposure: Country + Industry

The country risk exposure is assessed by the rate of CSR reporting in the country. This methodology considers that the lower the CSR reporting rate, the stronger the exposure to the country risk. The level of the industry risk exposure is assessed by the rate of CSR reporting in the industry. The lower the CSR reporting rate, the stronger the exposure to the industry risk. The non-involvement of a company in the CSR initiatives is likely to derive in a reputational burden, which can ultimately have a material impact on its finances.

Risk mitigation assessment:

A favourable assessment of the company's policies and programmes for this factor includes the company's commitment to get involved in CSR initiatives. In addition, the CSR policy of the company should include investments aimed at benefiting local communities. The reporting is assessed by making sure the company performs regular checks or audits to track CSR initiatives or policies of the company. Finally, positive performance means that the company shows that there is evidence that the CSR initiatives of the company had a positive impact on local communities and the company has not suffered any reputational damage linked to insufficient CSR practices.

C. Human rights

Risk exposure assessment:

Type of exposure: Country

The exposure to this risk is assessed by country regardless of the company's industry of operation. The exposure to this risk is assessed for each country through the Human Rights Risk Index calculated by Verisk Maplecroft. This metric considers that the failure of states to enforce legal protections for workers, and in many cases, the complicity of law enforcement authorities in

[12] The ILO social security conventions are intended to enforce benefit coverage in the following social spheres: medical care, sickness, unemployment, old age, employment, injury, family, maternity, invalidity, and survivors. http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:2899614733118296::NO:12100:P12100_ILO_CODE:C128:NO

repression of civil and political rights are the key factors driving countries into the higher risk categories.

Risk mitigation assessment:

We assess policies and programmes taking in into account the company's commitment to develop internal policies to avoid human rights violations in the workplace. Moreover, policies in place shall contain: initiatives to prevent discrimination, initiatives to prevent unequal pay for equal work, initiatives to encourage sufficient rest and leisure, initiatives to encourage the creation of unions and join them and initiatives to encourage freedom[13]. If regular reports are performed to track human rights enforcement in the workplace, the level of reporting is assessed positively. Finally, favourable performance is confirmed if the company has not suffered any reputational damages linked to breaches of human rights in the workplace and absence of human rights breaches were reported.

4.2.3 General Risks

A. Suppliers chain

Risk exposure assessment:

Type of exposure: Broad-based

The exposure to this risk is assessed for every company regardless of its geographical location and the industry where it operates. This methodology considers that by default every company is exposed to a **Medium** risk of obtaining raw materials from suppliers which do not follow a proper management of programs aimed at mitigating their negative social impact. The existence and level of formality of a policy aimed at detecting the social impact of suppliers affect the rating positively.

Risk mitigation assessment:

The policies and programmes in place should include a company-wide managerial responsibility for social impact of suppliers, monitoring of suppliers' performance on the social sphere, feedback and coordination with suppliers as well as review of the system for improvements. A positive level of reporting includes regular checks on social performance of the supply chain as well as overall reporting on social issues in the supply chain. If the company has not suffered any reputational burdens linked to the impact of the supplier chain activities on society, performance is positively assessed.

4.2.4 Social Opportunities

This section is intended to capture the social opportunities that the company has in a particular country and industry. The methodology considers, if available in a country or industry, that the company can take advantage of these opportunities and ultimately have a material benefit from them.

A. Access to finance

Opportunity exposure assessment:

Type of exposure: Country

The assessment of this opportunity is conducted for each country. This methodology considers that the easier the access to finance in a country, the easier for a company to conduct its operations and benefit from that. The access to finance is directly linked to the Domestic credit to private sector as compared to the GDP of the country.

Opportunity exploitation assessment:

[13] Freedom of religion, political orientation and general beliefs. Also, any form of modern slavery should be considered as a lack of freedom.

We assess the degree and extent of exploiting the benefits of this opportunity based on the needs and the industry of the company's operations.

B. Access to communication & logistics

Opportunity exposure assessment:

Type of exposure: Country + Activity-based

The assessment of this opportunity is conducted for each country and the activity the company performs. Therefore, the final exposure for this opportunity depends specifically on the activity (type of communication and logistics the company uses) of the company regardless of the industry it belongs to plus the different level of access to communication and logistics channels per country. This methodology considers that the easier the access to communication and logistics channels in a country, the easier for a company to conduct its operations and benefit from that. The access to communications and logistics is assessed through the availability of air, road and water transportation alternatives and facilities.

Opportunity exploitation assessment:

We assess the degree and extent of exploiting the benefits of this opportunity, based on the needs and the industry of the company's operations.

4.2.5 Social Asset Portfolio

A. Social responsible investment

Risk exposure assessment:

Type of exposure: Country + Industry

The risk exposure is based on the level of social investment requirements where the financial institution operates. The higher the level of regulations and/or requirements, the higher the exposure to this risk as the financial institutions have increased pressure to invest in to socially beneficial assets or assets which have underlying social responsibility and to develop policies and procedures in order to comply with the requirements.

The industry risk exposure is applied only to the financial sector and it is assessed as high. Industry exposure to other sectors is nil.

Risk mitigation assessment:

The risk mitigation is considered as appropriate when there are policies in place to exclude all types of involvement in socially controversial industries and these include also social targets for investing. In addition, we also analyse if the institution is a signatory of the Equator principles or other frameworks committed to promote assessing and managing social risk in project finance. In terms of reporting, we would assess it as adequate if the entity reports regularly on the social impact and on the social allocation of the investment portfolio. Finally, performance is measured by evaluating the level of social investments in the categories defined as well as the avoidance of involvement in socially controversial industries.

B. Social loan portfolio & financial inclusion

Risk exposure assessment:

Type of exposure: Country + Industry

The risk exposure is based on the level of social requirements where the financial institution issues loans as well as where it offers other financial non-loan products as well as the level of access to finance. The higher the level of regulations and/or requirements, the higher the exposure to this risk as the financial institutions have increased pressure to invest in to socially beneficial assets or assets which have underlying social responsibility and to develop policies and procedures in order to comply with the requirements. Moreover, in countries where access to finance is low, financial institutions are faced with the challenge to create and propel financial inclusion.

Risk mitigation assessment:

Policies and programs need to show commitment to issue loans avoiding any type of involvement in socially controversial industries and to issue social loans in the defined categories. Moreover, policies should also focus on extending non-loan social products to propel financial inclusion. As mentioned before, being a signatory of frameworks committed to promote assessing and managing social risk in project finance is also viewed as favourable. The level of reporting should include the social impact of the loan portfolio and other products as well as its social allocation. Finally, performance is appraised as positive if the institution's loan portfolio shows high level of social loans in the categories defined, shows no involvement in socially controversial industries and reflects high level of social non-loans products to propel financial inclusion.

C. Financial product responsibility

Risk exposure assessment:

Type of exposure: Country + Industry

The geographic risk exposure is based on the level of the population's trust on the financial services offered in a country. The lower the level of trust in financial and/or banking services, the higher the financial institution must invest in client relationship management, transparency and communication in order to sell product and protect the consumer.

The industry risk exposure is applied only to the banking sector and it is assessed as high. Industry exposure to other sectors is nil.

Risk mitigation assessment:

In order for the risk mitigation to be complete, the entity must have policies in place for the successful implementation of client relationship management practices in the sales stage as well as the post-sales stage. Moreover, the institution shall have procedures to be transparent in their financial product offering and to minimize the social impact of their financial product offering. Successful reporting is determined if the institution reports regularly on its strides to improve transparency and client relationship management. Finally, a good level of performance can be proved by a stable and growing customer base, no signs of reputational damage, successful brand awareness, low or nil legal costs arising from conflicts with customers and low or nil customer incidents.

4.3 Governance

The purpose of this section is to assess the exposure of the corporation to governance risks through the company's board and its efficiency, ownership structure, business ethics, anti-competition practices, quality of the risk management processes, as well as quality of reporting and to assess how well these risks are being mitigated. The section is divided into two factors:

- Corporate Structure
- Corporate Behaviour

At the same time, each factor is evaluated through a number of sub-factors.

4.3.1 Corporate Structure

A. Board structure & transparency

Risk exposure assessment:

Type of exposure: Country

This risk is assessed qualitatively based on the typical business practices regarding the composition, independence, stability, remuneration and transparency of the board of directors in every **country**. Countries where companies tend to have independent and stable boards and disclose this, are considered to have a low risk exposure in this sense.

Risk mitigation assessment:

Policies and programmes are assessed positively if they regulate: the board's independence, the size, activities and structure of the board as well as the remuneration of the board. In order to consider the level of reporting as favourable, we check whether or not the remuneration (or nature of remuneration) of the board is publicly disclosed and the board meeting results are also publicly disclosed. Finally, to assess the performance, we evaluate if the size of the board is adequate for the size of the company, if the board number and structure are stable and we make sure the company has not had any reputational burdens coming from board actions.

B. Ownership

Risk exposure assessment:

Type of exposure: Country

This risk is assessed qualitatively based on the typical business practices regarding the transparency, stability, conflicts of interests and restrictions of company owners in every **country**. Countries where companies tend to have publicly disclosed and stable ownership structures, are considered to have a low risk exposure in this sense.

Risk mitigation assessment:

We assess the sufficiency of policies and programmes if there is a clear commitment to disclose the owners of the company and if the company has a policy which defines owners' managerial restrictions and potential conflict of interests. Furthermore, a policy in place defining the ownership structure and stability is also assessed as positive. Reporting is also positively evaluated if the owners are publicly disclosed and there is absence of offshore companies in the corporate structure of the company. Moreover, public disclosure of any changes in the ownership structure is also assessed positively. If there has been no material damage to the company derived from the owners' reputation and the number of owners and the ownership structure are stable, the performance is assessed favourably.

C. Risk management

<u>Risk exposure assessment</u>:

Type of exposure: Country

This risk is assessed qualitatively based on the typical risk management practices in the **country**. Countries where companies tend to have well developed risk management practices, are considered to have a low risk exposure in this sense.

<u>Risk mitigation assessment</u>:

Policies programmes in place must include plans and procedures to mitigate the risks identified by the company. Also, there should be a CRO/special department in charge of risk management. The policies should also show a clear commitment to perform risk management quality controls. When we assess the level of reporting, we look at the quality of risk management controls carried out periodically as well as the reporting on the results of the RM audits are directed to the board. Performance is positive when there have been no reputational damages coming from insufficient management of risks and there is absence of major risk management breaches.

4.3.2 Corporate Behaviour

A. Business ethics

<u>Risk exposure assessment:</u>

Type of exposure: Country

This risk is assessed based on the typical business ethics practices as well as the perception of corruption in the **country**. Countries where companies tend to have good business ethics practices, are considered to have a low risk exposure in this sense.

<u>Risk mitigation assessment</u>:

Policies and programmes which include the company's code of conduct outlining and regulating the ethical behaviour of employees and cover cases of corruption, bribery or any other kind of fraud are positively assessed. Moreover, there should be policies which make sure that the code of conduct is intended to be followed by every employee of the company. There should also be policies or programmes aimed at performing checks of business ethics compliance. If the company publicly reports breaches of the code of conduct, it has a whistle-blower protection scheme which is used and tracked carefully and it has in place other arrangements to detect breaches of the code of conduct, levels of reporting are assessed positively. Performance is assessed favourably if there were no reputational damages coming from breach of the code of conduct and no major breach of the code of conduct was identified.

B. Anti-competition practices

<u>Risk exposure assessment:</u>

Type of exposure: Country

This risk is assessed based on the effectiveness of the anti-monopoly policies in the country. Countries which tend to have strong anti-monopoly policies practices, are considered to have a low risk exposure in this sense.

<u>Risk mitigation assessment</u>:

Policies and programmes which include compliance with anti-monopoly practices are assessed as positive. If the company anti-monopoly policy and the results of its monitoring are publicly available and the company performs regular checks on the compliance of anti-monopoly practices, the reporting level is considered as encouraging. Finally, positive performance means that no reputational burdens coming from anti-monopoly practices have been identified.

C. Tax payment & transparency

Risk exposure assessment:

Type of exposure: Country

This risk is assessed based on the tax payment and transparency of companies in the **country**. Countries in which companies tend to avoid taxes or not report tax payments are considered to have a high risk exposure in this sense. Companies which avoid or do not report taxes are highly exposed to reputational and economic sanctions.

Risk mitigation assessment:

Policies and programmes which include plans and procedures to comply with tax payment and transparency are assessed favourably. Adequate reporting levels should include internal OR external accounting audits conducted periodically and the company should report financial statements also periodically. If there have not been any reputational damages coming from tax avoidance or non-reporting of tax payments, performance is assessed as positive.