ESG Risk Evaluation Criteria for Entities

Credit Rating Agency

HR Sustainable Impact
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ESG analysis helps to identify risks in different types of entities that are not found in traditional financial analysis. Without an appropriate response plan to handle such risks, they could negatively affect finances, operations, or the reputation of an entity or its interested parties. HR Ratings' assessment identifies the most relevant risks for each entity and considers its ability to respond to or mitigate them by comparing the entities with their industry peers and applicable standards and regulations.

The assessment consists of assigning labels that describe, on the one hand, the magnitude of the potential damage and the frequency with which these risks could occur and, on the other, how efficient the entity's mechanisms are or have been in addressing these risks and mitigating potential future impacts.

The scope of these criteria refers to private and public entities. Financial institutions and corporations are considered for private entities. We consider both banking and non-bank institutions among financial institutions. The analysis of these entities involves evaluating the extent to which their portfolios and/or investments promote the development of activities that reduce or mitigate their environmental and/or social impact. With regard to companies, the analysis should identify which factors are relevant considering the diversity of economic activities and lines of business in which they may be involved. In this regard, the materiality assessment is very important since it identifies the risks associated with ESG factors in business operation, which may vary even among entities operating in similar industries or markets.

The analysis of public entities has a different focus, since it identifies which regulations or laws are implemented to regulate the use of resources and provide the most sustainable management for the environment. This involves not only the use that the entities themselves make of these resources, but also the incentives they grant to private entities. From a social stand point, public entities typically have information that allows them to measure the population's quality of life and wealth. This makes it possible to determine a certain comparability between different public entities.

The criteria are based on the assignment of labels for risk identification and mitigation. In terms of risk exposure, one of three labels may be assigned to each material or relevant risk: Low, Average or High. The labels associated with the risk mitigation mechanisms are the following: Superior, Average and Limited. The combination of these labels generates a value for each material or relevant risk, which is weighted and generates a final result. This result helps us understand the extent to which ESG risks, if not addressed, could impact the operation, finances or business continuity or the public entity in the future. The materialization of any of these risks could permanently increase current expenditure or lead to extraordinary expenditure and therefore, an opportunity cost.

HR Rating's ESG assessment is not a credit opinion on the entity. Furthermore, the ESG level assigned will reflect the risks and opportunities obtained from the information, which may be from public sources or private information provided by the evaluated institution. The ESG level is dynamic; therefore, HR Ratings will continuously follow up and monitor it for the entire time the assessment is in effect

The ESG assessment provided by HR Ratings will be assigned an Outlook in addition to the level resulting from the analysis process. The Outlook attribute refers to the trends observed in the assessment process; whether macroeconomic, industry-related, regulatory, market preferences, technological, demographic or specific to the rated entity. As the outcome of the effect is known, its outlook will therefore be labelled: "Positive", "Negative" or "Stable".

The ESG assessment provided by HR Ratings may be conducted using the following products:

- An assessment report implementing the entire analysis described in this document.
- An indicative assessment, where a simplified analysis of the criteria submitted in this document is applied, resulting in a final indicative ESG level.
- An indicative assessment where one of the three available analysis strands (Environmental, Social, Governance/Corporate Governance) is evaluated, resulting in a final indicative level solely for the selected strand.

This document is the exclusive property of HR Ratings and substitutes the document “ESG Evaluation Criteria” published in *December 2021.* This document will come into effect after October 31, 2024.

Introduction

The purpose of HR Ratings' ESG assessment Criteria is to evaluate an entity under specific parameters focused on the analysis of environmental, social and governance or corporate governance factors. The assessment’s objective is to measure the relative strength or weakness of all ASG factors and parameters for each entity against applicable local and international standards, as well as against its peers. The ESG analysis does not represent an opinion on credit quality, as it does not measure the entity's ability and/or willingness to pay its debt obligations. Nonetheless, the risks identified with the criteria detailed in this document may affect the entity's financial position and credit quality. Any possible credit quality effects will be captured in the credit risk methodologies and, accordingly, in their credit rating.

In general, the process described in these assessment criteria first identifies the material factors each entity is exposed to based on its industry and lines of business before measuring how its management, operation, employees, processes, corporate governance practices and formalized strategies can be exposed to these risks and mitigate their potential impact.

It is important to identify the material factors to which the entity is exposed is necessary to later measure the potential magnitude of the costs and the frequency with which the risks could occur. Material ESG factors vary from industry to industry as certain factors may be relevant in one sector, but not in another. For example, environmental lending policies are material in the financial institutions sector, but not in the corporate sector. The magnitude of materiality may also vary between industries. For example, solid waste and toxic material generation has high materiality for the mining industry, but moderate materiality for the service industry. As a result, environmental analysis factors have a greater impact in some industries than in others. The same goes for social and corporate governance factors.

Regarding mitigation policies, our aim is to identify whether the entity has the mechanisms to formalize and implement the necessary measures to counteract them and whether they adequately respond to the risks identified. The concepts of exposure and risk mitigation are jointly analyzed in these assessment criteria through a system of labels that, in the case of exposure, will allow HR Ratings to determine whether it can be categorized as Low, Average or High. The label system aids in determining whether the strategy is Superior, Average or Limited regarding the ability to mitigate risks. This document details the criteria for assigning each of these labels as well as how they interact for determining the final ESG assessment.

It should also be noted that ESG factors are dynamic in nature, since each industry constantly adopts new standards and regulations, and entities compete and benefit from incorporating best practices. HR Ratings' assessment considers the trends observed in the different markets and its assessment considers the extent to which the entity is aware of and adapts to these trends.

HR Ratings also considers different ESG factors for private and public entities. The analysis for private entities considers four different factors for the environmental component, eight for the social component and nine for corporate governance. The analysis of public entities considers seven different factors for the environmental component, five for the social component and four for the governance component. This document details each factor and explains what HR Ratings considers for each component. The structure of the assessment is summarized in Figure 1 below:

Figure 1: General Structure of the Assessment

Identify relevant or material subfactors

Environmental Factor

Sub-Factors for Private Entities	Sub-Factors for Public Entities
Policy Framework	Regulatory Framework & Policy Implementation
Pollution Control	Vulnerability Assessment
Resource Efficiency	Contingency Planning
Environmental Investment and Commitment	Environmental Stress
Risk Management and Preparedness	Environmental Conservation
	Energy Efficiency & Conservation
	Market Initiatives for Environmental Solutions

Social Factor

Sub-Factors for Private Entities	Sub-Factors for Public Entities
Social Goal Framework	Social Framework and Indicators
Community Engagement	Education, and Social Services
Ethical Practices	Socioeconomic Status and Inequality
Stakeholder Consideration	Health and Security
Human Capital Development	Population Dynamics
Employee Well-Being	
Safety and Incident Management	
Fair Compensation Practices	

Governance Factor

Sub-Factors for Private Entities	Sub-Factors for Public Entities
Governance Framework	Regulatory Framework & Rule of Law
Board Oversight	Governance Effectiveness & Institutional Independence
Information Transparency	Public Engagement and Control Measures
Shareholder Protection	Risk Management and Policy Frameworks
Integrity and Ethics Framework	
Malpractice Detection and Enforcement	
Resolutions and Decision-Making	
Due Diligence and Oversight	
Risk Management	

Assign labels to risks

Risk Exposure Labels	Risk Mitigation Level
Low	Upper
Average	Average
High	Limited

Label Assignment

Based on the assigned labels, a value between 2 (lowest) and 6 (highest) is determined for each subfactor.

Factor Result

A weighted average is performed with the values for each sub-factor to determine the result of the evaluation on the respective scale.

Source: HR Ratings

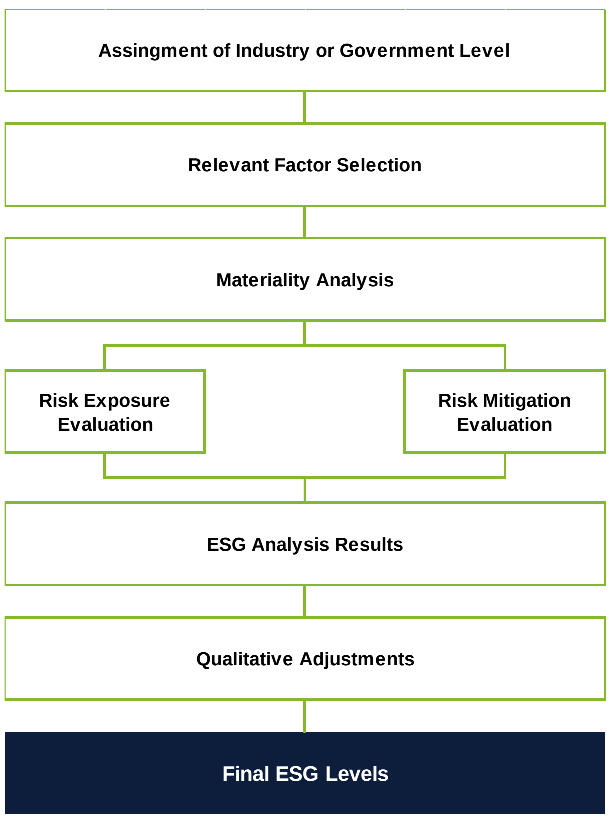
Structure of the ESG Assessment

HR Ratings evaluates each entity and its position in the market on a case-by-case basis, in order to accurately identify the risks and needs faced by the entity. Therefore, before beginning the ESG assessment it is first necessary to determine the following:

- The nature of the entity evaluated i.e., type of public or private entity.
- The materiality of each factor depends on the nature of the entity, which is in turn determined by the type of industry in a previous analysis, which can vary even for similar entities;
- How risk is measured based on the entity's operation, processes and administration considering frequency, severity and sensitivity;
- Mitigation mechanisms, which measure the entity's adaptive capacity to manage costs and its environmental and societal impact.

The nature and industry of the entity are used to determine the analysis factors and their materiality. Materiality in turn assigns the percentage of the assessment represented by each factor. Meanwhile, risk exposure and mitigation are used to assign labels, allowing the final numerical assessment to be calculated. Finally, qualitative adjustments may be applied to the assessment results, which will be explained in the submitted report. Figure 2 shows the general structure of the assessment process.

Figure 2: General Assessment Process



Source: HR Ratings

Factors for Private Entities

Environmental Analysis

Environmental risks are divided into five factors. Each analyzes a different dimension of the environmental risk that an entity may face. The factors analyzed include: Policy Framework, Pollution Management, Resource Efficiency, Investments and Environmental Commitment, Risk Management and Preparedness.

Policy Framework

This factor assesses the strength and maturity of a company's environmental policies and frameworks. It evaluates not only the documented policies in place, but also the mechanisms for their implementation and enforcement. Strict adherence to formalized policies will positively influence HR Ratings' assessments, particularly those focused on long-term environmental impact over short-term gains.

Pollution Management

HR Ratings evaluates a company's comprehensive approach to managing air, water and solid waste emissions. This assessment considers the various strategies employed, including mitigation, treatment, generation, minimization and oversight, while prioritizing the maturity and effectiveness of each action. Companies demonstrating proactive and well-developed pollution management policies will be viewed positively by HR Ratings. Efficient pollution management can reduce compliance costs, improve operational efficiency and mitigate future liability, fostering long-term financial stability.

Resource Efficiency

HR Ratings evaluates a company's commitment to environmental management by assessing the tangible impact of its programs and contributions in meeting sustainability goals. The analysis can be divided into two aspects: the use of resources and the company's externalities. HR Ratings considers both internal and supply chain processes for this factor. The analysis focuses on two broad categories: material and energy efficiency.

- Material efficiency: This measures the minimization of an entity's ecological footprint in its operations, including use of resources and applicable externalities. Minimizing waste and maximizing resource recovery are key aspects.
- Energy efficiency: Evaluates the optimization of energy use, ensuring a diverse and sustainable energy portfolio. HR Ratings analyzes historical trends to assess progress in both categories.

Investments and Environmental Commitment

HR Ratings evaluates an entity's commitment to environmental preservation through its Investments and the impact of its programs and contributions. Strong, strategic environmental investment can create new business opportunities, attract environmentally conscious investors and mitigate future environmental risks, leading to positive financial profits.

- Investments in financial institutions: These are measured by company size and should reflect a strategic sustainability approach.
- Program impact and contribution: This refers to the concrete benefits of the entity's sustainability initiatives on its environmental objectives.

Risk Management and Preparedness

HR Ratings analyzes a company's vulnerability to natural hazards and its preparedness to mitigate associated risks. This involves assessing how facilities and the supply chain are exposed and vulnerable to environmental conditions such as floods, droughts or storms. Contingency response plans and risk management strategies minimize operational disruptions, reduce insurance costs and protect the company's reputation, helping the company become more resilient.

Social Analysis

Social factors assess the extent to which the company or financial institution adopts policies that focus on social development. The ability to create a significant impact on various communities will depend on its positioning and market share. This section also evaluates the company's human capital management policies, with emphasis on its recruitment, retention, training, inclusiveness and development.

Social Objectives Framework

HR Ratings evaluates the soundness of a company's strategy and commitment to its defined social objectives. This includes not only having a well-developed framework in place, but also a successful track record of performing initiatives to achieve the stated objectives. Strict adherence to the social framework will positively influence the analysis, especially if it favors long-term over short-term impact.

Community Involvement

HR Ratings recognizes the strategic value of effective community involvement for companies. This commitment should include initiatives encouraging positive relationships and teamwork with local communities. Good community involvement can lead to benefits from improved brand reputation, better talent acquisition and innovation in ideas.

Consideration of Interested Parties

HR Ratings evaluates a company's approach to managing relationships with key internal and external stakeholders. Proactive consideration and engagement strategies that address the needs and concerns of all interested parties lead to higher accountability, transparency and access to resources. In addition, expert personnel are viewed favorably for this assessment. This can ultimately contribute to operational efficiency, risk mitigation, long-term business success and improved relationships.

Ethical Practices

HR Ratings recognizes companies that maintain high ethical standards in all their business operations. This includes transparent and fair dealings with customers, suppliers and employees, as well as adherence to responsible marketing practices and sound protocols for personnel data protection. Robust ethical practices build trust and improve reputations, leading to competitive advantages, better risk management and increased attraction and retention of talent and customers.

Human Capital Development

Investing in employee development and talent management is considered a competitive advantage. Companies committed to providing professional development opportunities, training programs and effective talent retention strategies cultivate a highly skilled and motivated workforce. This translates into greater operational efficiency, innovation and resilience when facing challenges.

Employee Well-being

HR Ratings considers an entity's approach to employee well-being as a valuable asset. This includes offering competitive benefits packages that meet employee needs and promote work-life balance, as well as implementing inclusive policies encouraging a healthy and motivating work environment. Investing in employee well-being increases employee engagement, reduces turnover costs and increases brand reputation, which ultimately contributes to long-term organizational success.

Fair Compensation Practices

HR Ratings evaluates an entity's commitment to compensation, fairness and transparency. This includes analyzing wage differentials related to skills, experience, responsibilities and employee value contribution. Companies that make efforts to close wage gaps and ensure fair compensation across all demographic groups benefit from higher morale, greater productivity and better talent retention. Conversely, unfair compensation practices can lead to higher turnover costs and potential legal liabilities in adverse labor markets.

Safety and Incident Management

HR Ratings evaluates an entity's approach to workplace safety and incident management. This includes having well-defined safety protocols in place that are consistently implemented and demonstrate commitment to continuous improvement. Effective safety management can reduce accident-related costs, improve employee productivity and foster a more stable and engaged workforce. A strong incident management track record, demonstrated through transparent reporting and proactive risk mitigation strategies, strengthens a company's reputation and competitive advantage. The entity must have established protocols that ensure a safe and comfortable work environment when implemented and followed.

Corporate Governance Analysis

The corporate governance assessment focuses on policies that promote transparency and best market practices, and also evaluates the formal tools available to the company or financial institutions to identify, mitigate and resolve risks arising from external sources such as applicable regulations or macroeconomic events, as well as internal sources such as potential conflicts of interest or instances of corruption. In the case of financial institutions, special attention will be paid to the processes for determining the risk tolerance that guides the allocation of the institution's resources in the acquisition of portfolio and investment assets.

Corporate Governance Framework

HR Ratings prioritizes companies with a well-established and effective governance framework. This framework should outline clear decision-making processes, promote ethical and transparent practices and mitigate risk. In turn, this will signal a commitment to long-term sustainable market growth through efficient operations and responsible management. A sound governance framework serves as the foundation for an entity's culture and objectives, contributing significantly to long-term financial stability and resilience.

Board Effectiveness and Oversight

HR Ratings evaluates the effectiveness of a company's Board of Directors in overseeing management's activities. An engaged and competent board actively monitors and evaluates the entity, contributing to greater operational efficiency, risk mitigation through sound management structures and alignment of strategic direction with organizational objectives. A reputable and experienced board also fosters positive investor relations by providing transparent oversight of financial institutions and executive decisions, which could prevent internal conflicts and reputational damage. This factor considers the controls over the board as well as member rotation and diversity policies. Any other applicable measures to ensure effectiveness according to current best practices such as external audits are also taken into account.

Transparency of Information

HR Ratings values a company's commitment to transparency and open communication, particularly with investors. This transparency builds trust, enables informed decision making and facilitates investor risk assessment, in addition to going beyond regulatory requirements. Openly sharing relevant information fosters a healthy relationship between investors and entities, which contributes to a more efficient financial environment.

Shareholder Protection

HR Ratings examines a company's approach to protecting shareholder interests. This includes assessing voting rights, dividend policies, regulatory oversight, board accountability, legal recourse mechanisms and fair handling among different shareholder classes. Strong shareholder protection mechanisms foster stronger investor relations, promote transparency and facilitate informed decision-making. This ultimately leads to better access to capital and possible long-term financial stability.

Integrity and Ethics Framework

HR Ratings values a company's commitment to ethical conduct through a well-defined integrity framework. This framework establishes expectations of honesty, fairness and ethical behavior at all organizational levels. It also builds trust and reputation with interested parties, promotes regulatory compliance and minimizes the risk of internal misconduct. A strong integrity framework can attract and retain talent, foster a positive work environment and potentially prevent legal and reputational risks.

Detection and Sanctioning of Bad Practices

HR Ratings recognizes the importance of effective internal controls that complement good governance practices. This includes comprehensive and regular audits of all managerial and operational levels and robust mechanisms to detect and address potential bad practices. A proactive approach to detecting and sanctioning bad practices mitigates financial and reputational risks, increases transparency and protects valued employees. Ultimately, this contributes to long-term sustainable growth and builds lasting relationships with interested parties.

Conflict Resolution and Decision Making

HR Ratings evaluates a company's track record in handling and resolving disputes. The analysis considers the presence of defined complaint procedures, transparency in decision making, evidence of learning and evolution of processes from past experience. Well-defined conflict resolution processes and comprehensive whistleblowing practices promote teamwork, legal compliance and risk mitigation, ultimately contributing positively to organizational reputation and stability.

Due Diligence and Oversight

HR Ratings values a company's commitment to effective due diligence and internal control processes. This includes comprehensive audits, risk assessments and sound compliance practices. An exhaustive due diligence practices protects the assets, reputation and involvement of interested parties, while effective oversight systems ensure operational efficiency, identify potential problems early and minimize costly errors. Sound due diligence and oversight practices also contribute to regulatory compliance and a smoother supply chain process.

Proactive Risk Management

HR Ratings prioritizes companies with a formalized and proactive approach to risk management. This includes identifying potential operational and supply chain risks, developing mitigation strategies and implementing effective oversight and improvement processes. A sound risk management framework helps prevent incidents, improve decision making, build investor confidence and provide competitive advantages. It also contributes to higher profitability, long-term financial stability and overall organizational resilience.

HR Rating also evaluates an entity's exposure and compliance with applicable regulations, as well as historical performance in these areas. The risk and costs related to current and future regulations could also affect appraisal decision. An independent third party oversight and evaluation of the entity's practices could be considered a strength in the entity's profile, as it encourages the entity to keep up with best market practices.

Public Entity Factors

This section details the factors analyzed for all public entities. This analysis mainly refers to the implications or impacts that poorly implemented policies or lack of regulatory compliance could have on current expenditure over time. Environmental factors refer mainly to the management and handling of available natural resources, social factors at different population vulnerability measurements, and governance factors for governmental institution quality.

Environmental Analysis

The environmental analysis category focuses on identifying risks associated with climate change and the frequency and severity of natural phenomena. HR Ratings believes that the costs of mitigating the impact of global warming will be lower as policies and regulations are adopted in the short term. If sufficient measures are not implemented, entities may be forced to increase their current expenditure in the medium and long term in order to respond to this phenomenon on a daily basis.

Another aspect analyzed in this section is the management of the entity's natural resources. A large part of these resources may be non-renewable and crucial for the well-being of the population and social development, and their excessive exploitation could also lead to increasing current expenditure in the future as well as institutional instability. In addition, HR Ratings evaluates the entity's capacity to handle and dispose of solid and liquid wastes associated with productive activity or human settlements. Resulting current costs shall typically increase to the extent that appropriate treatment is not provided. The ESG factors analyzed in the environmental category include the following:

Regulatory Framework and Policy Implementation

HR Ratings evaluates the government's environmental policy framework for comprehensiveness, clarity and enforceability. A robust framework addresses a variety of environmental issues, provides clear guidelines for interested parties and is effectively implemented through consistent oversight and compliance mechanisms. Robust policies demonstrate a commitment to long-term environmental sustainability, contribute to resilience in the face of future environmental challenges and adhere to international standards, ultimately promoting long-term economic stability and public welfare.

Vulnerability Assessment

HR Ratings assesses the government's vulnerability to climate change-related risks, considering potential impacts on infrastructure, natural resources, public health and economic sectors. This assessment includes the quantification of potential financial institutions losses caused by extreme weather events, resource depletion and other climate change-related shocks. Proactive identification and climate vulnerability management demonstrate fiscal responsibility and commitment to long-term economic resilience in the face of climate change through adaptation strategies and risk mitigation plans.

Environmental Pressure

HR Ratings evaluates the government's effectiveness in managing resource consumption, waste generation and emissions. This includes analyzing water stress levels, air quality and solid waste management practices. We evaluate not only current environmental burdens, but also future trends and projections. Sound policies and regulations, coupled with effective enforcement, demonstrate a commitment to managing environmental impact and mitigating potential economic risks associated with resource depletion, pollution and climate change.

Environmental Protection

HR Ratings analyzes the government's efforts to protect natural ecosystems and preserve biodiversity. This includes habitat restoration, species conservation and sustainable resource management initiatives. Effective environmental protection contributes to long-term economic stability by ensuring ongoing ecosystem service and natural resource availability. In addition, preserving biodiversity increases a country's resilience to climate change and environmental shocks.

Contingency Planning

HR Ratings evaluates the government's preparedness for environmental emergencies such as natural disasters or environmental accidents. This includes the existence of comprehensive contingency plans, proper resource allocation and effective emergency response systems. Strong disaster preparedness and response capabilities minimize economic losses, protect infrastructure and public safety, and increase long-term investor confidence.

Energy Efficiency and Conservation

HR Ratings evaluates the government's commitment to promoting sustainable energy efficiency and diversity. This includes analyzing energy intensity per unit of GDP or per capita, dependence on different energy sources, and efforts to diversify into renewable energy and energy efficiency technologies. Clean energy infrastructure investments and sustainable technology adoption are viewed favorably, as they demonstrate commitment to long-term energy security, environmental sustainability and economic diversification. Finally, if the entity is implementing a sustainable decarbonization plan for its most polluting sectors, HR Ratings will consider the progress and importance of such a plan.

Market Initiatives for Environmental Solutions

HR Ratings evaluates the government's effectiveness in fostering market-based solutions to environmental challenges. This includes assessing policy instrument implementation such as carbon pricing, green finance initiatives and market incentives for environmentally responsible companies. A supportive policy framework for environmental innovation promotes sustainable economic growth, attracts green investments and accelerates the transition to a sustainable economy.

Social Analysis

HR Ratings' analysis of social factors focuses largely on the quality of life of the population; accordingly, a higher quality of life facilitates economic activity and its tax base capacity, as well as revenue collection through other sources. This section aims to identify whether factors such as poverty and income inequality, access to education and food have any effect on demographic trends or other factors that could eventually have an impact on the spending needs of an entity and consequently on the development and welfare of the population.

The population's vulnerability in terms of income and lack of basic services must also be assessed. The entity's ability to provide security and mitigate crime and violence are important, as well as the social perception of the rule of law.

Social Framework and Indicators

HR Ratings assesses whether the government's social policy framework is appropriate and competent. This includes analyzing the presence of clear guidelines, measurable social indicators and a commitment to evidence-based policymaking. Robust social indicators make it easier to track progress, identify areas for improvement and compare profits, while the effective translation of policies into actions demonstrates accountability and commitment to social development.

Education and Social Services

HR Ratings evaluates the government's commitment to quality education and accessible social services. This includes analyzing investments in public education, health care and social safety nets. Access to quality education promotes the development of human Share Capital and social mobility, while comprehensive social services contribute to the well-being of citizens. These Investments are considered strategic long-term social and economic stability drivers.

Socioeconomic Status and Inequality Analysis

HR Ratings evaluates the government's efforts to reduce poverty, income disparity and other forms of social inequity. This includes examining metrics such as poverty rates, employment trends, the Gini coefficient (economic inequality) and factors such as the gender wage gap and family-friendly policies (social inequality). Effective policies aimed at closing gaps and promoting equality of opportunity contribute to long-term economic stability, social cohesion and greater political resilience.

Health and Safety

HR Ratings evaluates the government's effectiveness in promoting public health and maintaining a safe environment. The analysis includes health care access and affordability, life expectancy, infant mortality rates, disease prevalence and crime index. Strong public health systems and effective law enforcement contribute to a healthy and productive population, less economic disruption and greater trust in institutions. Public perceptions of security and political stability are also considered, as these affect social cohesion and long-term economic prospects.

Demographic Dynamics

HR Ratings analyzes population structure, migration patterns and demographic composition changes. This involves assessing potential impacts on workforce, social services and overall economic development. Age distribution, ethnic diversity and migration trends are considered when promoting social cohesion and economic stability to ensure that policies effectively address social group needs. Understanding and managing population dynamics allows the government to plan for the future and foster a stable and inclusive society.

Governance Analysis

This section evaluates factors that are common in HR Ratings' analysis for any public entity, such as the technical quality of its officials and institutions and the policies they implement, as well as aspects related to communication with the population and the extent to which regulations are adapted to social and environmental needs. Both the incentives offered to the private sector relevant, as well as the mechanisms available to ensure the correct application of the laws are considered relevant in the evaluation of the assessment. In HR Ratings' experience, these factors have the greatest influence on an entity's capacity to face social and environmental risks, as they constitute the necessary prevention and response systems for the proper management of these risks.

Regulatory Framework and Rule of Law

HR Ratings evaluates the company's commitment to good governance and compliance with the Rule of Law. This includes analyzing regulatory framework soundness and effectiveness, ensuring that policies are clear, comprehensive and aligned with established objectives. Robust implementation mechanisms with evidence-based evaluation processes demonstrate transparency, accountability and commitment to effective policymaking. Upholding the rule of law fosters predictability, promotes investor confidence and minimizes legal and regulatory risks.

Governance Effectiveness and Institutional Independence

HR Ratings evaluates the performance and efficiency of government institutions, including the executive, legislative and judicial branches of government. This analysis considers factors such as transparency, accountability, quality of services and control of corruption. In addition, we evaluate institutional independence from undue influence, ensuring that each branch is able to perform its function effectively. Effective governance and strong institutional independence contribute to policy coherence, improved service delivery and reduced economic volatility.

Public Commitment and Control Measures

HR Ratings evaluates the government's commitment to transparency, public participation and accountability. This includes analyzing: opportunities for citizen participation in decision making, public official control mechanisms (such as public feedback channels and oversight committees), and the effectiveness of tax audits in deterring and detecting tax evasion. Strong public engagement and robust accountability mechanisms foster trust, legitimacy and sound governance, which ultimately contribute to long-term economic stability and resilience.

Risk Management and Policy Frameworks

HR Ratings evaluates the government's approach to risk management and mitigation. This includes the proper application of: internal control systems, due diligence processes and risk assessment frameworks (e.g. risk matrices) to identify and prioritize potential risks in the economic, political, social and environmental domains. Proactive risk management, including sound monetary and tax policies and resilience to external shocks, generates and demonstrates fiscal responsibility and a commitment to long-term financial stability, resulting in greater investment attraction.

Materiality Analysis

The materiality analysis determines the weight that each factor will have within the ESG assessment. This weight may vary from case to case depending on the importance of the factor within the sector to be analyzed and the indicators available for its analysis. Each indicator will be classified into two possible categories 1) moderate materiality and 2) high materiality.

- Moderate materiality, all of which will receive the same weight.
- High materiality, which will receive twice the weight of those with moderate materiality.

Figure 3 shows a simplified example where the applicable materiality is determined for the evaluation of a public entity.

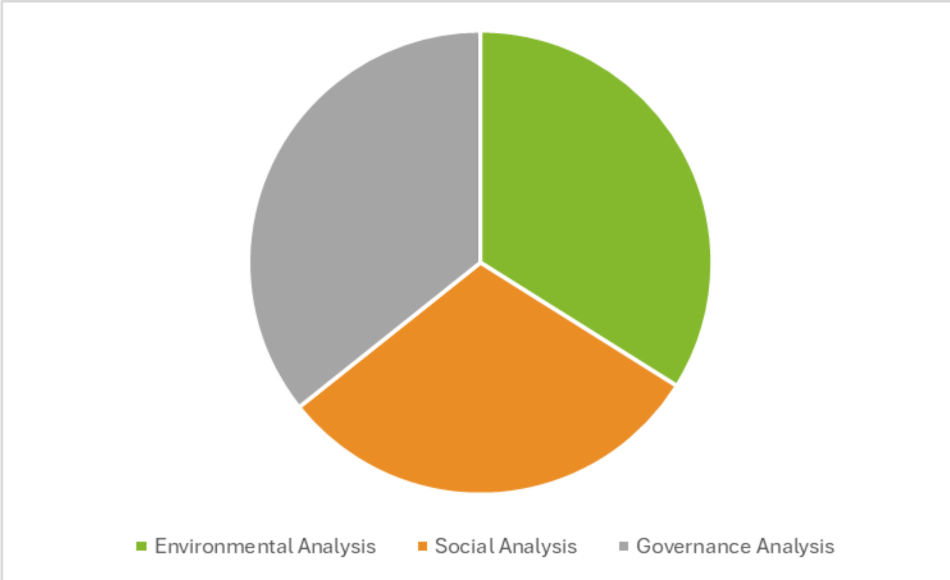
Figure 3. Example of Materiality for a Public Entity

Factors	Indicators	Materiality
Regulatory Framework & Policy Implementation	Indicator 1	2
	Indicator 2	1
Vulnerability Assessment	Indicator 1	2
	Indicator 2	1
Environmental Stress	Indicator 1	2
	Indicator 2	1
Environmental Conservation	Indicator 1	1
	Indicator 2	1
Contingency Planning	Indicator 1	2
	Indicator 2	1
Energy Efficiency & Conservation	Indicator 1	1
	Indicator 2	1
Market Initiatives for Environmental Solutions	Indicator 1	2
	Indicator 2	1
Social Framework and Indicators	Indicator 1	2
	Indicator 2	2
Education, and Social Services	Indicator 1	2
	Indicator 2	2
Socioeconomic Status and Inequality	Indicator 1	1
	Indicator 2	2
Health and Security	Indicator 1	2
	Indicator 2	1
Population Dynamics	Indicator 1	2
	Indicator 2	1
Regulatory Framework & Rule of Law	Indicator 1	1
	Indicator 2	2
	Indicator 3	1
Governance Effectiveness & Institutional Independence	Indicator 1	2
	Indicator 2	1
	Indicator 3	2
Public Engagement and Control Measures	Indicator 1	2
	Indicator 2	1
	Indicator 3	2
Risk Management and Policy Frameworks	Indicator 1	2
	Indicator 2	2
	Indicator 3	2

Source: HR Ratings

Figure 4 shows the weighting that each aspect of ESG analysis would receive according to the weighting assigned to the evaluation factors.

Figure 4. Materiality Distribution for the Evaluation



Factor Labels

The assessment of each ESG analysis factor considers two dimensions 1) Exposure to the risks for the factor 2) The capacity to mitigate those risks. Any relevant public or private information source may be used to assess both dimensions.

Industry expectations, market standards and applicable local and international regulations should be taken into account when assigning a label.

Risk exposure assessment

HR Ratings' analysis consists of determining the level of exposure to a risk by assigning one of three possible labels: Low, Average, High. These labels describe the relative positioning of the entity in its industry or region, and will be assigned for each identified risk during the assessment. Risk exposure typically focuses on the potential harm faced by an entity as measured by magnitude and frequency.

Typically, the ***Low*** risk exposure label indicates that the entity, compared to its peers, is less exposed to the factor under analysis. This means that, if the risk materializes, the potential cost will be below what is considered common in the industry or region.

The ***Average*** exposure label suggests that the entity, compared to its peers, is exposed in the ranges commonly expected for the weighted factor. This means that, if the risk analyzed materializes, the potential cost is close to what is expected for the rest of the industry or region.

Finally, the ***<u>High</u>*** exposure label refers to cases in which the entity is exposed to the weighted factor to a greater extent compared to its peers. This means that, if the risk analyzed materializes, the potential cost is above what would typically be faced by any other entity in the industry or region.

The analysis to be carried out for each of the factors identified, and which will allow the relevant labels to be assigned, will not only consider how sensitive an entity is to risks, in terms of costs or operational capacity, but also risk frequency and any existing seasonal pattern.

Assessment of risk mitigation capacity

The risk mitigation analysis refers to the entity's capacity to adapt to the risks caused by ESG factors. This is determined through an analysis that assigns one of the following labels: Superior, Average, Limited. They also describe the relative positioning of the entity within its industry, compared to similar entities or those in the operation's region. The mitigation is mainly focused on the mechanisms that the entity can and has implemented to mitigate its exposure to each type of risk.

Typically, the ***<u>Superior</u>*** mitigation label indicates that the entity has the necessary and, to some extent, sufficient mechanisms and processes in place to greatly mitigate its risk exposure. This means that appropriate policies have been formalized and that mechanisms are in place to incorporate best practices on an ongoing basis.

The ***<u>Average</u>*** mitigation label suggests that the entity has the most common mechanisms and processes in place to mitigate its risk exposure. This label is assigned when policies may not be formalized, despite having been previously applied, or when the entity does not have the mechanisms in place to adopt new market standards.

Finally, the ***<u>Limited</u>*** mitigation label refers to cases in which the entity does not have adequate mechanisms and processes in place to mitigate the assessed risk. This may be because the strategies are not appropriate or because they do not have the necessary resources and abilities to deal with the occurrence and potential frequency of the risk.

The purpose of the risk mitigation analysis is to identify the extent to which best practices have been adopted, as well as if mechanisms that incorporate new standards have been formalized and strategies have been put in place to deal with such risks. In the case of public entities, their compliance with current laws and/or accounting recommendations is assessed, among others. They are also assessed on their governmental management and whether this reflects clear and regular communication with the population.

Label Assignment

A value between 2 (lowest) and 6 (highest) is assigned to each of the factors considered material based on their exposure and mitigation labels. Each possible combination of labels carries a specific score, which is detailed in Figure 6 below:

Figure 5: Label Scores

Possible Label Combinations: Exposure	Possible Label Combinations: Mitigation	Score
Low	Upper	6
	Average	5
	Limited	4
Average	Upper	5
	Average	4
	Limited	3
High	Upper	4
	Average	3
	Limited	2

Source: HR Ratings

The combination with the lowest score, 2, implies high exposure and limited mitigation, while the combination with the highest score, 6, is for low exposure and superior mitigation. In Figure 5 we can see how the combination of each exposure and mitigation labeled creates a final numerical value for each factor which is used to determine the final assessment.

Determination of Final ESG Level

Figure 6 shows the transformation curve between the final numerical result of the assessment and the HR Ratings ESG Scale.

Figure 6: Range and Assessment

Ranges	ESG Scale
[5.70 , 6.00]	HR ESG 1 +
[5.40 , 5.70)	HR ESG 1
[5.13 , 5.40)	HR ESG 1 -
[4.87 , 5.13)	HR ESG 2 +
[4.60 , 4.87)	HR ESG 2
[4.32 , 4.60)	HR ESG 2 -
[4.03 , 4.32)	HR ESG 3 +
[3.75 , 4.03)	HR ESG 3
[3.33 , 3.75)	HR ESG 3 -
[2.92 , 3.33)	HR ESG 4 +
[2.50 , 2.92)	HR ESG 4
[2.25 , 2.50)	HR ESG 4 -
[2.00 , 2.25)	HR ESG 5

Source: HR Ratings

For private entity involved in different industries, the final level assigned will take into account a joint assessment of the risks faced by the entity within each industry in which it participates.

Assessment Example

Figure 7 groups the items presented throughout this document to exemplify how an ESG level would be determined for a public entity. In this example, 36 indicators are used to perform the assessment, each of which is given a materiality level between 1 (Moderate) and 2 (High). They also receive an exposure and mitigation label leading to a result between 2 (minimum value) and 6 (maximum value). The materiality allocation results in an assessment where environmental, social and governance analysis represent 34%, 30%, and 36% respectively of the ESG assessment, leading to an ESG Level of HR ESG 3+.

Figure 7. Evaluation of a Public Entity

Environmental Analysis

Factors	Indicators	Materiality	*Exposure Label*	*Mitigation Label*	Value
Regulatory Framework & Policy Implementation	Indicator 1	2	Low	Average	5
	Indicator 2	1	Average	Limited	3
Vulnerability Assessment	Indicator 1	2	High	Limited	2
	Indicator 2	1	High	Limited	2
Environmental Stress	Indicator 1	2	Low	Limited	4
	Indicator 2	1	Average	Superior	5
Environmental Conservation	Indicator 1	1	Average	Limited	3
	Indicator 2	1	High	Limited	2
Contingency Planning	Indicator 1	2	Average	Average	4
	Indicator 2	1	High	Superior	4
Energy Efficiency & Conservation	Indicator 1	1	High	Superior	4
	Indicator 2	1	Average	Superior	5
Market Initiatives for Environmental Solutions	Indicator 1	2	Low	Superior	6
	Indicator 2	1	High	Superior	4

Social Analysis

Factors	Indicators	Materiality	*Exposure Label*	*Mitigation Label*	Value
Social Framework and Indicators	Indicator 1	2	Average	Average	4
	Indicator 2	2	Average	Average	4
Education,and Social Services	Indicator 1	2	Low	Average	5
	Indicator 2	2	Average	Limited	3
Socioeconomic Status and Inequality	Indicator 1	1	Average	Superior	5
	Indicator 2	2	Low	Limited	4
Health & Security	Indicator 1	2	Average	Superior	5
	Indicator 2	1	Low	Superior	6
Population Dynamics	Indicator 1	2	Low	Average	5
	Indicator 2	1	Average	Average	4

Governance Analysis

Factors	Indicators	Materiality	*Exposure Label*	*Mitigation Label*	Value
Regulatory Framework & Rule of Law	Indicator 1	1	Average	Superior	5
	Indicator 2	2	Average	Average	4
	Indicator 3	1	Low	Average	5
Governance Effectiveness & Institutional Independence	Indicator 1	2	Average	Superior	5
	Indicator 2	1	High	Limited	2
	Indicator 3	2	Low	Average	5
Public Engagement and Control Measures	Indicator 1	2	Low	Average	5
	Indicator 2	1	Average	Superior	5
	Indicator 3	2	High	Superior	4
Risk Management and Policy Frameworks	Indicator 1	2	High	Limited	2
	Indicator 2	2	Average	Limited	3
	Indicator 3	2	High	Limited	2

Evaluation Result	
Environmental Analysis	34%
Social Analysis	30%
Governance Analysis	36%
Final Value	4.04
ESG Level	**HR ESG 3+**

Source: HR Ratings

Annex: ESG Rating Scale

ESG Evaluation Results	Implication of the Level Assigned to the Evaluation Result
HR ESG 1	The evaluated entity is not exposed to ESG risks or the exposure is reduced. It also refers to entities that, regardless of the exposure level, have adequate mitigation mechanisms and resources to efficiently adapt their policies in the short term.
HR ESG 2	The evaluated entity maintains a reduced ESG risk or has efficient mitigation mechanisms in place. HR Ratings believes that the potential damage from ESG risks in the medium to long term will be significantly mitigated by existing mechanisms.
HR ESG 3	The entity maintains an ESG risk that could unfold financially or structurally in the medium or long term; however, HR Ratings believes that the mechanisms to identify new risks, mitigate the risks already identified, and the resources to adapt these mechanisms are partially efficient.
HR ESG 4	The entity is highly exposed to a range of ESG risks and lacks adequate mechanisms to identify and/or mitigate these risks. Therefore, the entity could be financially or structurally affected in the medium or long term.
HR ESG 5	The entity is greatly exxposed to a range of ESG risks and lacks the mechanisms to identify and mitigate these risks. Therefore, the entity will be financially or structurally affected in the medium or long term.

Source: HR Ratings

HR Ratings assigns, starting from HR ESG 1 and up to HR ESG 4, "+" o "-" to represent the relative strength or weakness (whenever necessary) within the level.

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