

modefinance

Transparency Report 2017

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Introduction

modefinance is a rating agency specialized in Big Data Analysis and Artificial Intelligence for Credit Rating Management.

The company is registered by ESMA (the European Securities and Markets Authority), the European financial markets supervisory authority and, as such, allowed to operate as a credit rating agency in Europe.

modefinance was founded by **Mattia Ciprian** and **Valentino Pediroda**, who, together, had the foresight to apply big data techniques to the world of finance. The company commenced as a spin-off of the University of Trieste in 2009 with the objective of operating in the emerging Fintech (a portmanteau of finance and technology) market referring to the sphere of new financial services proposed by innovative companies.

modefinance, the first **fintech** rating agency in Europe, can provide credit assessments on more than 100 million companies in over 200 countries throughout the world and compiles more than 100 million financial statements per year. All modefinance's credit scores are available on the free mobile app and web s-peek (www.s-peek.com).

The company was designated the best Italian fintech company in 2014 at the Fintech Grand Prix organized by CheBanca!, the Politecnico di Milano and StartupItalia!

In October 2016 modefinance becomes the first Italian rating agency to issue rating on financial corporates thanks to the innovative, proprietary technology "MORE for Banks", that manages to simplify and summarise in a single element, the credit score, the analysis of organisations that are as complex as banks.

At the end of the 2017 fiscal year modefinance continued the double-digit percentage growth in sales recorded in recent years (see Paragraph 8 of Transparency Report). Its employees, with an average age of less than 35, are highly specialized in finance and information technology.

1. Information on legal structure and ownership of modefinance

modefinance is established as a limited company ("Società a Responsabilità Limitata") under Italian law, with Tax Code and VAT Number IT01168840328, LEI 815600B85A94A0122614,

Since 2015, modefinance has the officially recognized status of "Innovative SME" ("PMI Innovativa"). modefinance shareholder structure as of December 31st, 2017 is the following:

Name	Direct interest
Corvallis Business Information Srl	43.0%
Dr Mattia Ciprian (founding partner)	28.5%
Dr Valentino Pediroda (founding partner)	28.5%
Total	100.0%

As of December 31st, 2017, modefinance owns a 24.9% stake in Credit Service Srl.

2. Internal Control Mechanisms

With the main purpose of ensuring quality and integrity of the rating process, as well as independency and avoidance of conflicts of interest in the rating activities, modefinance has adopted a clear and unambiguous organizational structure and dedicated policies and procedures which cover the agency's activities at all levels.

2.1 Board of Directors

The Board of Directors is the administrative body of modefinance. As of December 31st, 2017, the members are:

Name	Position
Dr Mattia Ciprian	President
Dr Valentino Pediroda	Vice-President
Mr Daniele Melato	Non-Executive Member
Prof Guido Modugno	Independent Non-Executive Member
Prof Giorgio Valentinuz	Independent Non-Executive Member

2.2 Audit Committee

In addition to the responsibilities as of Point 2, Section A, Annex I to Reg. 1060/2009, the independent members of modefinance Board of Directors constitute an **Audit Committee** with the main task of monitoring and evaluating the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with the Regulation on Credit Rating Agencies and reporting to the Board on appropriate measures to address any deficiencies.

The internal audit function is an independent, objective assurance and consulting activity designed to add value and improve operations. It assists modefinance in accomplishing its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and the governance process.

The main objective of internal audit function is to determine whether the systems of financial and risk management, internal control and governance processes, as designed by modefinance policies and procedures, are adequate and functioning in the following manner:

- risks are appropriately identified and managed;
- operations are carried out according to the provisions included in modefinance policies and procedures;
- regulatory requirements are recognized and met.

2.3 Internal Review Function

The responsibility of **Review** of core models and methodologies is attributed to modefinance Quantitative Methods function.

Such responsibility consists in periodically reviewing modefinance methodologies, models and key rating assumptions, and any significant changes or modifications thereto, in compliance with specific policies and procedures.

The responsible for Review Function is nominated by modefinance Board of Directors.

modefinance rating methodologies are subject to validation based on historical experience, including back-testing. In regulated credit rating activities modefinance uses **MORE** and **RATING** Methodologies (for non-financial corporations) and **MORE for BANKS** and **RATING for BANKS** Methodologies (for financial corporations). There are separate validation processes for the four rating methodologies, which take place at least with yearly frequency.

The Review Function may advance a proposal for review of core methodologies in specific cases defined by policies and procedures, including negative results from validation, the detection of systemic factual errors or whenever required by regulation or compliance.

2.4 Compliance Function

modefinance instituted an independent **compliance** function, whose primary role is to monitor and report on compliance of the agency and its own employees with the obligations established under EU Regulation, and the policies and procedures adopted by the agency.

modefinance **Compliance Officer** is nominated by the Board of Directors and reports directly at least with monthly frequency.

The Compliance Function, which is independent from all other operational functions, has the responsibility of:

- (a) monitoring and assessing the adequacy and effectiveness of all modefinance policies and procedures and the actions taken to address any deficiencies in modefinance's compliance with its obligations;

(b) advising and assisting all managers and employees or any other person involved in rating activities to comply with modefinance's obligation under EU Regulation on Credit Rating Agencies.

The Compliance Function follows the requirements set out in European CRA Regulation (Points 5 and 6 of Section A of Annex I).

2.5 Code of Conduct

modefinance adopted an internal **Code of Conduct** based on IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies. All employees are required to adhere to the Code.

The updated version of modefinance Code of Conduct is based on IOSCO's revision of the Fundamentals published in March 2015.

modefinance Code of Conduct is available at <https://cra.modefinance.com/en/transparency/code-of-conduct>.

2.6 Credit Rating Issuance and Review Processes

The process of credit rating issuance for financial and non-financial entities differs only for the specific methodologies used, and can be summarized in the following steps:

a) Search of the publicly available information on the rated entity

Since modefinance issues unsolicited ratings only (under regulated activities), the credit rating assessment is based on publicly available information only. Rated entities (or related third parties) do not participate in the rating process and modefinance has no access to accounts, management and other relevant internal documents for the rated entities (or related third parties).

b) Credit Score obtained via MORE (or MORE for BANKS) Methodology (the process is entirely automated)

The Multi Objective Rating Evaluation (MORE / MORE for BANKS) model has been developed by modefinance in order to assess the level of distress of industrial companies by using data included in financial statements. It provides mainly a creditworthiness opinion (Assessment) by means of a risk class (MORE class) according to a predefined scale.

The basic idea of the model is to analyze a set of financial and economic ratios in a predictive corporate bankruptcy model with the purpose of creating a fundamental credit scoring model for each industrial sector.

Results of the model are obtained by applying newly developed numerical methodologies, drawing together financial theory, data mining and engineering design methodologies. The heart of MORE is a

multi dimensional and multi objective algorithm that produces a classification of each company, by taking into account any attributes (such as sector and country) characterizing a firm.

The model gives the opportunity to assign a risk class to a company even without considering a complete data analysis and allows to process quality information. It induces a better understanding of a company's strength and weakness thanks to sophisticated data mining tools and taking into account the analysts' knowledge.

The model includes a tool such as the MORE Confidence Level, which is used by modefinance analysts (along with RATING Relevant Information checklist) in order to evaluate the quality and availability of data on the entity to be rated.

c) Credit Rating through RATING (or RATING for BANKS) Methodology (implies the substantial intervention of modefinance rating analysts)

modefinance RATING (RATING for BANKS) Methodology represents the basis for the credit assessment analysis carried out by modefinance rating analysts.

The analysis are carried out in the following substeps:

Company (Bank) and the group: considers entity's size, longevity, legal status, governance and group analysis. The main inputs of this phase are the official and public information by the textual texts of the annual accounts (explanatory notes). In those textual parts the analyst must focus the attention on potential source of risk (or risk attenuation) that are not evident merely from a numerical analysis i.e. guarantees, business management reports, audit reports, etc. The assessment includes the analysis of the mutual dependence inside the company's group (if it is applicable).

Industry and country: covers the aspects of industry's (specialization's) creditworthiness and relevant news, influence of macroeconomic conditions, political risk and country-specific relevant news. Concerning country risk, the following aspects are considerate: Scale of the Economy, GDP Growth and Volatility, National Income, Inflation Level and Volatility, General government gross debt, Current account balance and Political risk.

Final adjustment: represents the effect of a final overall assessment of the entity performed by analysts. In this section the analyst is required to perform a fine tuning of the final assessment taking into account all the information regarding the corporate.

Rating Methodology includes a checklist ("RATING Relevant Information") which is used by modefinance rating analysts (along with MORE Confidence Level) in order to evaluate the quality and availability of data on the entity to be rated.

d) Approval of Credit Rating by modefinance Rating Team

The credit rating proposed by the Head Analyst is reported to modefinance Rating Team, who act as a rating committee deciding on the approval or modification of the rating and who is responsible for the rating issuance.

e) Notification to the rated entity and possible appeal process

As prescribed by Regulation, modefinance informs the rated entity during working hours before publication of the credit rating. The information includes the principal grounds on which the credit rating was based in order to give the entity an opportunity to draw attention of the credit rating agency to any factual errors.

modefinance policies and procedures allow the rated entities two full working days before rating publication.

If the rated entity appeals against rating decision, the publication of the rating is suspended and the Rating Team may consider to accept or deny the appeal.

f) Distribution of Credit Rating to users (via subscription)

All modefinance ratings and rating actions are disclosed on a non-selective basis and in a timely manner to all active and applicable subscribers, via modefinance rating website (cra.modefinance.com).

modefinance applies an ongoing monitoring of all credit ratings issued, until formal withdraw.

The review procedure for a credit rating issued begins whenever the Rating Team becomes aware of updated information on the rated entity and such information is judged as potentially relevant, or due to provisions related to a change in methodology, or due to changes in macroeconomic or financial market conditions that might affect the credit rating.

In any case, modefinance reviews credit ratings as soon as interim or annual accounts are published.

Internal controls on rating process (issuance and monitoring), notification and appeal processes, publication policies and procedures are performed by single employees, compliance functions and are subject to periodic internal audit procedures.

3. Allocation of Staff to Credit Ratings

The following table reports personnel allocation as of December 31st, 2017:

Body/Function	Headcount
Senior Management	5
Compliance	1
Rating Analysts	7
Quantitative Methods function (includes review and IT responsibilities)	8
Marketing and Sales	2

4. Description of Record-Keeping Policies

All **records** are kept inside modefinance databases and redundant back-up systems in digital format for at least 5 years.

As prescribed by Regulation, data to be stored and kept for at least 5 years include the following:

- a) for each **credit rating decision**, the identity of the rating analysts participating in the determination of the credit rating, the identity of the persons who have approved the credit rating, information as to whether the credit rating was solicited or unsolicited, and the date on which the credit rating action was taken;
- b) the account records relating to **fees** received from any user of ratings;
- c) the account records for each **subscriber** to the credit ratings or related services;
- d) the records documenting the established **procedures** and **methodologies** used by the credit rating agency to determine credit ratings;
- e) the internal records and files, including non-public information and work papers, used to form the basis of any **credit rating** decision taken;
- f) credit analysis **reports**, credit assessment reports and private credit rating reports and internal records, including non-public information and work papers, used to form the basis of the opinions expressed in such reports;
- g) records of the procedures and measures implemented by the credit rating agency to **comply** with the Regulation; and
- h) copies of internal and external **communications**, including electronic communications, received and sent by the credit rating agency and its employees, that relate to credit rating activities.

According to relevant policies and procedures, **Information processing systems** include appropriate measures to separate and control access to all relevant data in order for it to be retrieved by authorized personnel only.

Access control involving user management and password protection is used specifically to separate the systems used to report fees to those used by rating analysts to input information on rated entities, as well as to restrict access to confidential information received from rated entities following credit rating notification and appeal processes.

5. Internal Review of the Independent Compliance Function

The opinion of modefinance **Independent Non-Executive Directors** on Compliance and Review function, reported at the end of 2017, is the following:

*“We confirm that both **compliance** and **review** functions have at their disposal the required skills, competences and resources necessary to perform the activities for which they are responsible.*

The whole modefinance organizational structure, as well as all human resources employed by modefinance, developed a “shared culture” which allows a better performance in the activities and duties assigned to compliance and review functions.

*The development of a **compliance-oriented culture** within the organization is supported by the full legitimization and involvement that executive members of the Board attribute to Compliance Officer towards the rest of the organization, as well as by the moderate size of modefinance, well-oriented to teamwork.*

*The activities of review function are facilitated within modefinance by the shared attitude towards **numerical methods** sustained by scientific criteria, as well as by human resources with academic and research backgrounds who show an orientation to continuous improvement with regards to the duties they are required to perform.”*

6. Description of Credit Rating Analysts' Rotation Mechanisms

modefinance adopted a **rotation procedure** that Rating Team considers when nominating the analysts for each rating issuance/review processes.

The general procedure, which can be overruled only by written decision of the Rating Team, consists in the following:

- **Head Analyst** shall be identified in the analyst not being nominated as such for the longest period among all analysts;
- **Assistant analyst** shall be identified in the analyst not being nominated as Head or Assistant Analyst for the longest period among other analysts.

The rotation procedures shall always take into consideration the following restrictions as of Article 7(4) of Regulation 1060/2009:

- (i) the rating analysts shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding **four years**;
- (ii) the persons approving credit ratings shall not be involved in credit rating activities related to the same rated entity or a related third party for a period exceeding **seven years**.

The persons referred to in points (i) and (ii) shall not be involved in credit rating activities related to the rated entity or a related third party referred to in those points within **two years** of end of the periods set out in those points.

7. Financial Information on the Activities of modefinance

In the fiscal year ended December 31st, 2017, the revenues generated by modefinance activities were € **1,173,000.00**.

As of December 31st, 2017, modefinance Srl provides the following types of services (for more information visit www.modefinance.com):

- a) modefinance **Corporate Credit Ratings**: issuance and review of unsolicited credit ratings on financial and non-financial companies to be distributed via subscription (on a subscriber-pays model), in compliance with Regulation (EC) No. 1060/2009 of the European Parliament and of the Council. The rating process involves a scoring process according to MORE Methodology and the substantial intervention of modefinance rating team of analysts. modefinance began issuing this type of assessments after registration with effect from July 10th, 2015.
- b) **Private Credit Ratings**: issuance of on-demand private ratings (solicited or unsolicited). Private ratings differ from scores to the extent that the former imply the intervention of an analyst, who performs a deeper credit assessment, writes a comment, and proposes an opinion on the company's creditworthiness in the form of a symbol, according to a predefined rating scale. The private rating is approved and issued by modefinance.
- c) **Credit Scoring**: issuance of entirely automated, unsolicited credit assessments on a worldwide database of companies in the form of scores (according to a predefined scoring scale), probability of default estimates, credit limits. This type of credit assessments is available to clients in "ASKMORE basic" reports and via "s-peek", a mobile application developed and published by modefinance. Since 2009 modefinance has produced over a hundred million of credit scores and credit score updates. Those evaluations are daily used by over a hundred multinational corporates and banks worldwide.
- d) **Credit Reporting** with ancillary information: production of credit reports which also include commercial information and financial analysis such as: payment status, litigations, financial statements, ratio analysis, sector analysis and comparison, company's shareholders, subsidiaries, board of directors and more.
- e) **other financial analysis and research**, such as sector analysis, sector comparison, country comparison, market search.
- f) **Credit Risk Software**, particularly for corporate clients that need to implement (or improve the performance of) their own internal credit risk management function. Development and implementation of software typically involves specific training and consultancy activities, whose topics however cover only the software itself. In any case, modefinance does not

provide consultancy services to any rated entity or any related third party regarding the corporate or legal structure, assets, liabilities or activities of that rated entity or any related third party.

In **2017**, modefinance issued three unsolicited public Corporate Credit Ratings under EU Reg. 1060/2009; all revenues were generated by other services:

Type of service	Revenues	Revenue composition
Credit rating regulated activities	€ 0.00	0.0%
Other services	€ 1,173,000.00	100.0%
Total	€ 1,173,000.00	100.0%

The **geographical** share of total turnover in 2017 is the following:

Geographical area of clients	Revenues	Revenue composition
European Union	€ 748,000.00	63.77%
Worldwide	€ 425,000.00	36.23%
Total	€ 1,173,000.00	100.0%

Please note: the amount of revenues reported above is taken from unaudited accounts prepared by the executive members. modefinance 2017 financial statements are subject to approval by the Board of Directors and the Shareholders' Assembly.

8. Governance Statement

The following is the governance statement within the meaning of Article 46a(1) of Council Directive 78/660/EEC of 25 July 1978.

Article 46a, paragraph 1, section (a) and (b)

modefinance Srl adheres to IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies revised in March 2015.

In general terms, modefinance decided to include in its own Code of Conduct all provisions indicated by IOSCO Fundamentals, even if some of them are specifically designed for credit rating agencies that issue solicited ratings or structured finance ratings (as of December 31st, 2017, modefinance ratings are unsolicited only, and do not cover structured finance). There are no substantial deviations from 2015 version of IOSCO Code.

modefinance Code of Conduct is available at

<https://cra.modefinance.com/en/transparency/code-of-conduct>

Article 46a, paragraph 1, section (c)

modefinance internal control mechanisms are described in Paragraph 2 of the present Report.

Article 46a, paragraph 1, section (d)

Not applicable.

Article 46a, paragraph 1, section (e)

modefinance is a privately owned limited company ("Società a Responsabilità Limitata") under Italian Law. Shareholders rights are governed by modefinance Corporate Bylaws.

Article 46a, paragraph 1, section (f)

Composition and responsibilities of Board of Directors and other relevant functions are described in Paragraph 2 of the present Report.

moderfinance

The Credit Rating Agency for your risk management

moderfinance independently develops procedures, criteria and models that constitute the foundations of its credit rating activity. Corporate ratings issued by moderfinance are the result of two methodologies: the first, purely quantitative, is MORE Methodology, widely tested on millions of companies worldwide during a continuous scoring activity; the second methodology, RATING Methodology, implies the intervention of moderfinance team of rating analysts, who are responsible for the activity of issuance, monitoring and publication of credit ratings.

moderfinance is a
Credit Rating Agency
registered by ESMA

moderfinance, as a registered Credit Rating Agency in accordance with EU Reg. 1060/2009 and following, issues solicited and unsolicited credit ratings to financial and non-financial companies under both issuer-pays and subscriber-pays model.