

modefinance

Transparency Report 2021

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Introduction

Founded in 2009 by Valentino Pediroda and Mattia Ciprian, **modefinance** is a native Fintech company that provides Artificial Intelligence solutions for credit risk assessment and management.

Originally a spin-off of the University of Trieste, it soon became the first European Fintech Credit Rating Agency.

modefinance aims to prevent companies and financial institutions from insolvency and default risks by providing Fintech solutions for investment management and assessment that automatize all the economic and financial analysis' procedures.

Thanks to the integration of different competences and disciplines, it developed MORE, an innovative credit risk assessment methodology based on the most advanced data analysis and Machine Learning technologies.

The MORE algorithm is embedded in every product developed by modefinance: from s-peek, the first mobile and web app that provides users the free credit score of all the companies in Europe, to Rating as a Service platform, a comprehensive Augmented Analytics platform for exposures management that provides predictive analysis tools for assessing the counterparty insolvency risk.

The company is registered as a CRA and ECAI 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.

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 Code 815600B85A94A0122614,

modefinance shareholder structure has changed during 2021 and as of December 31st, 2021, it was composed as follows:

Name	Direct interest
TeamSystem SpA	59.0%
Dr Mattia Ciprian (founding partner)	20.5%
Dr Valentino Pediroda (founding partner)	20.5%
Total	100.0%

As of December 31st, 2021, modefinance owns a **9.66%** stake in Credit Service Srl and a **65%** stake in modefinance international 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, 2021, the members are:

Name	Position
Mr. Vincenzo Ferrari	President, Non-Executive Member
Mr. Mattia Ciprian	Executive Member
Mr. Valentino Pediroda	Executive Member
Mr. Tommaso Cohen	Non-Executive Member
Mr. Gian Luigi Rizzo	Non-Executive Member
Mr. Enrico Causero	Non-Executive Member
Mr. Michelangelo Bottesini	Non-Executive Member
Mr. Luca Velussi	Non-Executive Member
Mr. Fausto Salvador	Independent, Non-Executive Director
Mr. Michele Bertoni	Independent, Non-Executive Director
Mr. Massimo Caldara	Independent, Non-Executive Director
Ms. Paola Lanzoni	Independent, Non-Executive Director

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 modefinance 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 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

modefinance instituted a dedicated Review function to cover the responsibility of **Review** of core models and methodologies.

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 & Risk 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 quarterly frequency.

The Compliance & Risk 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).

During 2021, modefinance decided to institute a broader risk management function which, given the size of the CRA, was merged into the compliance function (with the latter becoming a compliance & risk function).

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.modefiance.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) **Collection of information on the rated entity**

As a first step in the rating process, the analysts are required to collect relevant information on the rated entity. In the case of unsolicited credit ratings, only publicly available information is gathered, and 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). In the case of solicited credit ratings, private information is also collected, directly from the rated entity (or related third parties), under specific procedures allowed by modefinance internal policy.

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 qualitative 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 statements of the annual accounts (explanatory notes). In those textual parts the analyst must focus the attention on potential source of risk (or risk mitigation) 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 considered: 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 or public

All modefinance ratings and rating actions are disclosed on a non-selective basis and in a timely manner to public, or 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 withdrawal.

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 the notice of availability of new interim or annual accounts is published and/or received.

Internal controls on rating process (issuance and monitoring), notification and appeal processes, publication policies and procedures are performed by the Rating Process Manager, employees of the compliance & risk function 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, 2021:

Body/Function	Headcount
Executive Members	2
Compliance & Risk	2
Review	1
Rating Analysts	8
Rating Process Management	1
Quantitative and Development	13
Other (Administration, IT, Sales and Marketing)	22

modefinance coverage on credit ratings refers to corporate class only (financial and non-financial).

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 Compliance & Risk Function

An excerpt from the opinion of modefinance **Independent Non-Executive Directors** on Compliance & Risk and Review function, reported at the end of 2021, is the following:

*“One of our duties is to supervise the **compliance** and **review** functions, which have respectively the responsibility to monitoring modefinance's compliance with the regulatory standards and the development and the testing activities on the methodologies used.*

Taking into consideration also last changes and additions, we believe that the policy & procedures are adequate to ensure the quality and relevance of the information used for issuing ratings and the absence of conflicts of interest between analysts and the rated entities.

Based on our control activities, it also emerges that the procedures are correctly applied e that they respond to the need to ensure the revision of the methodologies in line with Esma indications and Guidelines.

We recommended that the policy & procedures, at least for the parties concerning to the activities carried out by each employee, shall be properly disclosed and illustrated to the concerned ones. For this purpose, we suggested the further development of training activities, as to allow the sharing of a “control culture” into the corporate organizational environment which is a fundamental component for the proper functioning of line controls.”

6. Credit Rating Analysts' Rotation Mechanisms

modefinance **rotation procedure** is now fully aligned to the limitations required by the Regulation, despite having still an exemption to do so.

The following limitations are applied to the general procedure:

(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, 2021, the revenues generated by modefinance activities were **€ 5.3 million**.

As of December 31st, 2021, modefinance Srl provides the following types of services (for more information visit www.modefinance.com):

- a) modefinance **Corporate Credit Ratings**: issuance and review of solicited and unsolicited credit ratings on financial and non-financial companies to be distributed via subscription (on a subscriber-pays model), or to the public (on an issuer-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.

As of **December 31st 2021**, modefinance had revenues from solicited credit ratings outstanding issued under EU Reg. 1060/2009 as well as from other services, as follows:

Type of service	Revenues	Revenue composition
Credit rating regulated activities	€ 147.2 K	2.8%
Other services	€ 5,115.8 K	97.2%
Total	€ 5,263.0 K	100.0%

The **geographical** share of total turnover in 2020 is the following:

Geographical area of clients	Revenues	Revenue composition
European Union	€ 4,210.0 K	80.0%
Worldwide	€ 1,053.0 K	20.0%
Total	€ 5,263.0 K	100.0%

Please note: all figures are reported in thousands of euros. At the date of publication of the present report, only unaudited values are available.

8. Governance Statement

The following is the governance statement within the meaning of Article 20(1) of Directive 2013/34/EU of 26 June 2013.

Article 20, 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 structured finance ratings (as of December 31st, 2019, modefinance ratings 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 20, paragraph 1, section (c)

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

Article 20, paragraph 1, section (d)

Modefinance shareholding structure is reported in paragraph 1 "Information on legal structure and ownership of modefinance.

Administrative Board members are appointed and replaced by Shareholders' meeting in accordance with Corporate Bylaws and all applicable law and regulations. Corporate Bylaws can be modified by the Shareholders' meeting.

Article 20, 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 20, paragraph 1, section (f)

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

modefinance

The Credit Rating Agency for your risk management

modefinance independently develops procedures, criteria and models that constitute the foundations of its credit rating activity. Corporate ratings issued by modefinance 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 modefinance team of rating analysts, who are responsible for the activity of issuance, monitoring and publication of credit ratings.

modefinance is a Credit Rating Agency registered by ESMA

modefinance, 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.