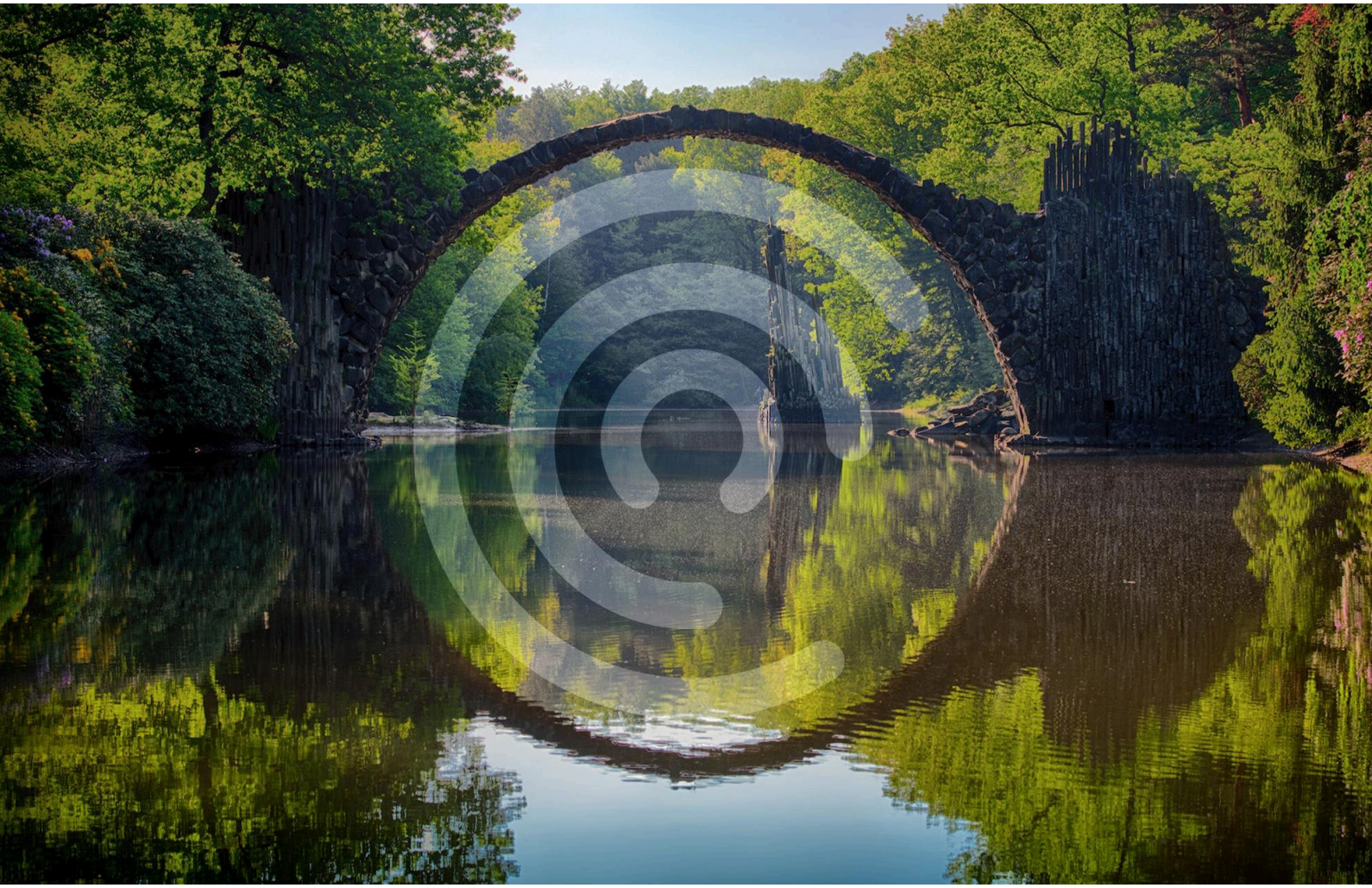

Clarity AI - MiFID II Sustainability Requirements

Methodology Document

Version 1.0, June 2026

Version History

Methodology Title	MiFID II Sustainability Requirements
Version Number	1.0
Approval Date	30 June 2026
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Overview

The Markets in Financial Instruments Directive, also known as MiFID II, is a European Directive that came into effect in 2018. It aims to strengthen investor protection and improve the functioning of financial markets, making them more efficient, resilient, and transparent. It applies to all firms that provide investment services to users, in particular retail investors in the EU. More specifically, wealth managers, private banks, insurance distributors, and robo-advisors.

In 2021, MiFID II was amended to incorporate sustainability requirements, as part of the EU's broader Sustainable Finance agenda. This amendment requires financial advisors to:

- Ask users about their sustainability preferences as part of the suitability assessment
- Integrate those preferences into product recommendations
- Consider three dimensions of sustainability preference:
    - Taxonomy-aligned investments (EU Taxonomy for sustainable activities)
    - Sustainable Investments as defined under Article 2(17) of SFDR
    - Principal Adverse Impacts (PAIs) — products that consider negative sustainability impacts

In that context, Clarity AI provides a comprehensive dataset that allows financial institutions to classify the products they offer to investors in line with the three dimensions of the suitability requirements of MiFID II.

Investors may indicate a sustainability preference at a high level and not give granular preferences for criteria and/or minimum proportions. In those cases, financial institutions may rely on Clarity AI's high-level classifier to categorize financial products based on simple and intuitive criteria, in line with ESMA guidelines[1].

[1] See Annex III, point 26.

Glossary of Terms

Term	Definition
Article 6 / 8 / 9 Fund	SFDR fund classifications. Article 6: integrates sustainability risks. Article 8: promotes environmental/social characteristics. Article 9: has sustainable investment as its objective.
Best-in-Class Screening	An ESG investment strategy that selects or weights the top-performing issuers within a peer group based on ESG criteria.
Clarity AI Classifier	Proprietary three-level classification system (Levels 0, 1, 2) developed by Clarity AI to provide a high-level sustainability assessment aligned with Green MiFID requirements.
DNSH	Do No Significant Harm — a principle requiring that an investment does not materially harm any environmental or social objective.
EET	European ESG Template — Standardized template that allows product manufacturers (i.e., asset managers) operating in the European Union to publish fund-level ESG data in a structured and consistent manner.
EU Taxonomy	The classification system established by Regulation (EU) 2020/852 that defines environmentally sustainable economic activities based on their contribution to one of six environmental objectives without significantly harming the others and meeting minimum social safeguards.
Green MiFID	Common shorthand for the sustainability amendments to MiFID II.
MiFID II	Markets in Financial Instruments Directive II — EU legislation in force since 2018, amended in 2022 to incorporate sustainability preference requirements for investment advice.
Negative Screening	An ESG investment strategy that excludes issuers involved in certain harmful activities or exhibiting poor performance on defined metrics.
PAI	Principal Adverse Impact — a metric quantifying the negative effects of investment decisions on sustainability factors, as defined in SFDR RTS Annex I.
SFDR	Sustainable Finance Disclosure Regulation — EU framework requiring financial market participants and advisers to disclose sustainability-related information.
Sustainable Investment	An investment as defined in Article 2(17) of the SFDR that: (i) contributes to an environmental or social objective; (ii) does not significantly harm any other objective; and (iii) follows good governance practices.
UN SDGs	United Nations Sustainable Development Goals — 17 global goals adopted in 2015 as part of the 2030 Agenda for Sustainable Development.
UNGC and OECD Guidelines	UN Global Compact principles and OECD Guidelines for Multinational Enterprises

1. Analytical Framework

1.1. Methodology Overview

The MiFID II Sustainability Requirements module consists of two pieces: a set of sustainability indicators that help financial advisors integrate specific sustainability preferences into product recommendations, and a Classifier that can be used by financial advisors to integrate the sustainability preferences of investors more comprehensively.

1.1.1 Sustainability Indicators

For each security, whether an individual company or an investment fund, Clarity AI produces a standardized set of sustainability indicators across three dimensions:

- **EU Taxonomy alignment:** the share of economic activities classified as environmentally sustainable under the EU Taxonomy regulation
- **Sustainable Investment Article 2(17) exposure**: the product's conformance, in percentage, with Clarity AI's sustainable investment criteria under the SFDR Article 2(17) definition
- **Principal Adverse Impact consideration**: binary flag indicating whether the company accounts for key environmental and social harm indicators

1.1.1 Clarity AI's Classifier

The Classifier assigns to corporate organizations (both equity and fixed income instruments) and investment funds a rating that reflects its overall sustainability characteristics, where:

- **0:** Not Sustainable
- **1:** Avoids Harm
- **2:** Contributes to Sustainability Objectives

Fixed-income securities identified as Use-of-proceeds sustainable bond instruments — including Green, Transition, Social, and Sustainability Bonds — are assessed under a dedicated framework detailed in Appendix B. Sovereigns are not covered by this assessment except for the sustainable bonds issued by them.

Fund-level rating is based on self-reported data through the European ESG Template (EET), when available. If that information is not available, Clarity AI calculates it by aggregating the values of each fund's underlying holdings, weighted by their portfolio allocation. EET data is not used for organizations because the template is published at the fund level.

Our ratings are primarily rules-based, rather than analyst-driven assessments. In very limited instances when humans are involved, their role is to compare the outcome of automated models against detailed and standardized rubrics to ensure model accuracy. We do not produce individual

ESG qualitative assessments or opinions. Our ratings are updated and made available to users at regular intervals through the Clarity AI platform, following the data release process and calendar (typically every two weeks, aligned with underlying data updates). A change in an entity's rating between scheduled updates will only occur if new entity-specific information becomes available or if there is a material change to the methodology.

1.2. Methodology Details

The Classifier is based on the three required dimensions under MiFID II: EU Taxonomy, sustainable investment as defined in the SFDR regulation, and PAIs consideration.

What follows is a brief introduction to the three dimensions. For a more detailed description, please refer to their respective methodology documents on the Clarity AI website.

1.2.1 Scoring Dimensions

1.2.1.1. EU Taxonomy Alignment

The EU Taxonomy is a standardized, science-based classification system that defines which economic activities are considered environmentally sustainable. For a company's activity to be aligned with the EU Taxonomy, the activity must satisfy three criteria:

- Make a substantial contribution to an environmental objective
- Do No Significant Harm (DNSH) to the other objectives within the EU Taxonomy framework

Additionally, the entity must meet the minimum Social Safeguards within the EU Taxonomy framework.

For this assessment, Clarity AI relies on its EU Taxonomy solution and methodology, based on the metrics described in Appendix A. The EU Taxonomy alignment of an organization is based on either reported data in the context of non-financial disclosure requirements in the EU or estimated data based on segment-level disclosures of listed companies. To estimate EU Taxonomy alignment:

1. Clarity AI maps the segments to the activities described in the EU Taxonomy Regulation
2. It evaluates whether those activities meet the technical criteria for contribution based on publicly available information
3. It tests whether there are environmental violations associated with those activities.
4. Finally, it evaluates whether the organization has any social violations associated with the UN Guiding Principles on Business and Human Rights or the OECD Guidelines.

A fund's EU Taxonomy alignment is calculated as the weighted average of the constituents' taxonomy alignment, based on their portfolio weights.

1.2.1.2. Sustainable Investment Article 2(17)

As per SFDR Article 2(17), a sustainable investment is one that invests in an economic activity that contributes to an environmental or social objective. To be classified as such, the investee company needs to meet **all three** of the following requirements:

- Contribute to an environmental or social objective,
- Do not significantly harm any other environmental or social objective ("**DNSH**"), and
- Be made in an investee company that follows **good governance** practices.

Clarity AI measures whether an organization meets the three requirements in the following way:

1. To determine whether the company **contributes** to an environmental or social objective, it must meet at least one of the following:
    a. Positive contribution through relative performance on the applicable Principal Adverse Indicators: the entity must be in the top quartile of at least one of the following indicators across all companies covered by Clarity AI for that indicator:
        i. Carbon Footprint
        ii. Share of non-renewable energy consumption
        iii. Share of non-renewable energy production
        iv. Energy consumption intensity per high-impact climate sector
        v. Emissions to Water
        vi. Hazardous Waste
    b. Alignment with the EU Taxonomy: the company must have a positive alignment with the EU Taxonomy.
    c. SDGs Revenue Alignment: 20% of the revenue of the company is aligned with the UN SDGs.

2. To determine if the entity does not significantly harm any other environmental or social objective **(DNSH)**, Clarity AI checks that the entity meets all of the following requirements:
    a. The company must meet the minimum safeguard screen:
        i. No violations of human rights standards and labor rights, in line with global norms regarding societal and employee welfare
    b. The entity has no exposure to the following topics, as defined under SFDR:
        i. Exposure to Fossil Fuels
        ii. Exposure to Controversial Weapons
        iii. Activities negatively affecting biodiversity-sensitive areas
        iv. Violations of UNGC and OECD guidelines
        v. Lack of mechanisms for conformance with UNGC and OECD guidelines

3. To determine if the company follows **good governance** practices, Clarity AI checks that the company has no violations that involve:
    a. management structures (shareholder rights & insider dealing),
    b. employee relations (working conditions & diversity)
    c. remuneration of staff (employee wages & management compensation)
    d. tax compliance

A fund's proportion of sustainable investments is calculated as the portfolio-weighted average of holdings classified as Sustainable Investments.

The list of metrics can be found in Appendix A.

1.2.1.3. Classifying companies for PAI consideration

The MIFID regulation requires financial advisors to ask investors whether they consider negative sustainability impacts as defined under the SFDR PAI metrics.

An investor can consider PAIs in their investment approach in various ways, for example, by engagement or via negative screening strategies[2]. Clarity AI estimates whether an organization or financial product considers PAIs based on its performance against the mandatory PAI indicators, which are listed in the first table of Appendix A.

For an organization to be eligible for an investment approach that considers PAIs (i.e., PAI consideration is True), it must not:

- Be exposed to harmful operations or products and services as identified by the following PAI indicators:
    - Exposure to Fossil Fuels
    - Exposure to Controversial Weapons
    - Negative Biodiversity Activities
    - Violations of UNGC / OECD Guidelines
    - Lack of Conformance with OECD MNE & UN Guidelines
- Have any of the quantitative PAI indicators listed Appendix A in the bottom 5th percentile of all companies covered by Clarity AI for that indicator.

For a fund to be identified as one that considers PAIs, it must have at least 80% exposure to companies that are eligible for an investment considering PAIs. That is, its value is based on the portfolio weight of such companies.

1.2.2. Clarity AI Classifier

Clarity AI's solution classifies **organizations** into three categories of sustainability performance:

- **0 - Not Sustainable:** Does not meet thresholds for avoiding harm or contributing to Sustainability Objectives
    - This is the case when the organisation does not meet the criteria for qualifying as an investment that considers PAIs, that is, the company is either flagged to be exposed to harmful operations or products and services, or is in the 5th percentile in terms of performance of at least one quantitative PAI.
- **1 - Avoids Harm**, including investments that meet the criteria for considering environmental and social PAI.

[2] Clarifications on the ESAs' RTS under SFDR, point 45.

- This is the case when the organisation qualifies for investments that consider PAIs , but at the same time, the organisation does not meet the requirements of contribution to sustainability objectives.

- **2 - Contributes to Sustainability Objectives**, including investments that meet the criteria for considering PAIs in addition to being aligned to the EU Taxonomy and/or meet the criteria to be sustainable investments.
    - This is the case when the organisation avoids harm and either:
        - have an EU taxonomy alignment greater than or equal to 10%
        - is classified as a sustainable investment based on our Article 2(17) assessment methodology

The assessment is made sequentially, in the sense that, once an organisation is found not to meet the requirements of avoiding harm, it cannot be said to contribute to sustainability objectives.
The following table summarizes the Classifier criteria for an **organisation**:

Step 1 **Avoid harm**	**Step 2** **Contribute to Sustainability Objectives**		**Classifier**
Eligible for PAI consideration (True)	**>= 10% EU Taxonomy Aligned**	**Meets requirements for Sustainable Investment**	
False	*Any value*	*Any value*	**0**
True	False	False	**1**
True	True	*Any value*	**2**
True	*Any value*	True	**2**

For **funds**, the classifier uses the same three levels based on the same underlying dimensions but evaluates the metrics at the portfolio level (i.e., weighted average of the issuer level metrics based on holding weights). The thresholds used to assess fund-level metrics are the following,

- EU Taxonomy alignment, using a weighted average threshold of 10%
- Sustainable Investment classification, using a weighted average threshold of 45%
- PAI Consideration, where a fund is considered to consider PAIs if at least 80% of its constituent investments (by weight) individually qualify as investments that consider either environmental or social PAIs

The following table summarizes the Classifier criteria for a fund:

Step 1 **Avoid harm**	**Step 2** **Contribute to Sustainability Objectives**	**Classifier**

>= 80% weight eligible for PAI consideration	>= 10% EU Taxonomy Aligned	>= 45% meets requirements for Sustainable Investment	
False	*Any value*	*Any value*	**0**
True	False	False	**1**
True	True	*Any value*	**2**
True	*Any value*	True	**2**

1.3. Weighting & Aggregation Logic

The Classifier value does not aggregate E, S, and G categories into a single numerical score. Instead, it applies a categorical value (0, 1, or 2) based on the performance of environmental and social metrics across the three dimensions described in the methodology details section.

1.4. Minimum Data Requirements

For non-fund securities (equity and fixed income instruments) to have a Classifier assessment, their issuers must at least: 1) have been evaluated under Clarity AI's assessment of violations of UNGC and OECD Guidelines (PAI 10) and 2) have a value for three additional PAIs from those described in the first table of Appendix A.

For funds, they must either:

1. have EET-reported data covering Sustainable Investment Article 2(17) proportion, EU Taxonomy alignment, and PAI consideration
2. Have at least one investee company with an assessment of Violations of the UNGC and OECD Guidelines (PAI 10).

2. Rating Product Specifics

2.1. Materiality Objectives & Dimensions

The Classifier is based on three dimensions, which all measure social and environmental impact rather than risk. As such, the Classifier itself measures impact, with the **Step 1** check measuring negative impact and the **Step 2** check measuring positive impact.

2.2. Factor Scope & Specific Issues

The methodology provides a comprehensive ESG assessment, covering environmental, social, and governance factors across a broad range of thematic areas within the dimensions covered by MIFID

II. The framework incorporates environmental, social, and governance factors in the following roles:

- **Environmental** factors are assessed through the EU Taxonomy, the environmental PAI considerations, and the environmental SFDR Article 2(17) sustainable investment classification.
- **Social** factors are assessed through the social PAI consideration and the social SFDR Article 2(17) sustainable investment classification.
- **Governance** factors are assessed through the Good Governance screen of Article 2(17) sustainable investment assessment, which covers management structures, employee relations, remuneration, and tax compliance.

2.3. Alignment with EU Reporting Standards

The methodology's thematic coverage maps to the following CSRD topics:

CSRD Topic	Coverage in this Methodology
Climate Change	• EU Taxonomy climate change mitigation/adaptation objectives • GHG-related PAIs (Carbon Emissions, Carbon Footprint, GHG Intensity, Energy Consumption)
Pollution	• Hazardous waste PAI
Water & Marine Resources	• Emissions to water PAI • EU Taxonomy water/marine objectives
Circular Economy	• EU Taxonomy circular economy objective • Hazardous waste PAI
Biodiversity	• Activities negatively affecting biodiversity-sensitive areas PAI • EU Taxonomy biodiversity objective
Equal Opportunity	• Unadjusted gender pay gap PAI • Board Gender Diversity PAI; Diversity Opportunity controversy screen
Working Conditions	• Violations of UNGC principles PAI • Wages & Working Conditions controversy screen
Human Rights	• Violations of UNGC principles and OECD-GME PAI
Corporate Oversight	• Shareholder Rights controversy screen • Good Governance screen
Business Conduct	• Insider Dealings

	• Accounting; Tax Fraud/Avoidance & Money Laundering controversy screens

2.4. Assessment Model

The module performs a Classifier assessment that evaluates securities on absolute terms, but to arrive at it, it uses components that measure performance on both a relative and absolute basis.

Relative assessments benchmark performance against other companies:

- **PAI Consideration for quantitative PAIs:** an organization must not have any quantitative PAI indicator in the bottom 5th percentile of all companies covered by Clarity AI for that indicator. Appendix A indicates which PAIs are quantitative and thus follow a relative assessment based on percentile.

Absolute assessments apply fixed thresholds regardless of relative performance:

- **EU Taxonomy alignment:** alignment >=10% for organizations, >=10% for funds.
- **Sustainable Investment Article 2(17):** for organizations, whether the entity qualifies as a sustainable investment or not. For funds, whether the fund has >=45% of investment weight allocated to sustainable investments.
- **PAI Consideration for binary PAIs:** an organization must not have any binary PAI indicator with a False value. Appendix A indicates which PAIs are binary and thus follow an absolute assessment.

2.5. EU Taxonomy & International Agreement / Standards Alignment

The methodology incorporates references to the following international agreements:

- **EU Taxonomy:** Within this framework, EU Taxonomy alignment is used in three distinct ways:
  - **a.** explicitly, as EU Taxonomy alignment, eligibility, and DNSH (Do No Significant Harm) compliance at the instrument level
  - **b.** as one of three positive-screening criteria underpinning the Sustainable Investment Article 2(17) contribution screen, whereby any degree of EU Taxonomy revenue alignment is sufficient to satisfy this criterion
  - **c.** as a threshold condition for Level 2 classification within the Clarity AI Classifier, requiring funds and issuers to demonstrate a minimum of EU Taxonomy alignment to qualify

- **UN Sustainable Development Goals (SDGs):** UN SDG revenue alignment (>20%) is one of the three positive-screening criteria used to assess whether a company contributes to an environmental or social objective for the purpose of the Sustainable Investment Article 2(17)

definition.

- **UN Global Compact (UNGC) and OECD Guidelines for Multinational Enterprises:** Used in the DNSH check via PAI 10 (Violations of UN Global Compact principles and OECD Guidelines for Multinational Enterprises) and 11(Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises) to identify violations of international social and governance standards.

2.6. Industry Classification Standards

Company-to-sector mapping is facilitated through Clarity AI's proprietary internal classification system, which comprises 169 sub-industries. This system is technically anchored in the Global Industry Classification Standard (GICS[3]) level 4, but features refined categorizations designed to more granularly capture specific sustainability and impact characteristics in key carbon-intensive industries.

2.7. Scientific Evidence

We prioritise aligning our methodology and selecting metrics in accordance with science-based standards. Where such scientific standards are lacking, we rely on recognised industry standards wherever possible. Any gaps or ambiguities in standards are addressed on the basis of scientific findings from reputable publications.

The following industry standards inform this methodology:

- SFDR RTS (Annex I of the regulatory text, Table 1): The 16 mandatory PAI indicators are sourced directly from the SFDR Regulatory Technical Standards published by the European Supervisory Authorities.
- EU Taxonomy Regulation and Technical Expert Group (TEG) Reports: The EU Taxonomy technical screening criteria and the five-step assessment approach are grounded in the TEG's scientific assessment of environmentally sustainable activities.
- ESAs' Clarifications on SFDR RTS: Point 6 of the ESAs' clarifications acknowledges the use of PAI indicators to measure overall sustainable impact, which forms the basis for Clarity AI's contribution-to-objective assessment. Point 7(a) mandates the use of PAI indicators for DNSH demonstration.

[3] The Global Industry Classification Standard (GICS) is an industry taxonomy developed by MSCI and Standard & Poor's (S&P).

3. Data Sourcing & Revisions

3.1. Data Sources Overview

In line with its data quality standards, Clarity AI sources company data directly from a variety of corporate disclosures, including but not limited to sustainability and integrated reports. This includes, where applicable, regulatory disclosures prepared under frameworks such as the Corporate Sustainability Reporting Directive (CSRD), as well as other reporting standards. These reports may or may not have been subject to an external assurance assessment.

For primary data collection, Clarity AI has developed a proprietary platform that allows custom data collection combining human collectors and automatic collection (natural language processing): Igloo. Human collectors are typically a mix of external resources (outsourced service) and internal resources that are in charge of quality controls and collection of more complex data that requires in-depth expertise or has a high error rate when outsourced. The platform has embedded quality controls supported by machine learning models and a menu of different workflows (e.g., double manual entry; comparison of automated extraction with manual entry) to ensure only high-quality data inputs are processed further.

Clarity AI also uses third-party data (i.e., information collected by others and licensed as a data package to Clarity AI) for certain metrics, primarily company reference data (e.g., industry code) and fundamental data (e.g., revenues, headcount). The selection of third-party data follows a specific outsourcing procedure. Clarity AI performs a lifecycle assessment of third-party providers ("Data Vendors") to ensure competent, duly authorized, and capable provider selection and supervision, as well as effective monitoring and control of outsourced collection activities and associated risks.

For this methodology, Clarity AI draws on a combination of primary and third-party data sources across all three criteria. PAI indicators are sourced primarily from company sustainability reports and regulatory disclosures, supplemented by Clarity AI's proprietary machine learning estimation models where reported data is unavailable. EU Taxonomy alignment data is drawn from company disclosures under Regulation (EU) 2020/852, where available, and supplemented by Clarity AI's internal EU Taxonomy assessment methodology. SDG revenue alignment is derived from Clarity AI's internal mapping of company segment-level revenue information to SDG-contributing activities, using publicly available data from company reports and third-party providers. Violation assessments rely on Clarity AI's in-house NLP monitoring of global news sources to identify and flag relevant controversies. EET data at the fund level is sourced directly from product manufacturers (i.e., asset managers) disclosures.

3.2. Data Quality & Reliability

Clarity AI operates a data validation and quality control framework applied at each stage of the data ingestion, processing, and release process. The framework covers pre-release validation of raw data, validation of ratings, a defined remediation process, and a policy for the revision of historical data. The validation process is reviewed and updated at least annually.

Prior to each data release, the dedicated Raw Data Team performs a validation of the candidate raw data dataset proposed for release. The validation covers all metrics in scope for the release. The following checks are applied:

- Coverage checks: unexpected losses in metric, provider, or entity coverage relative to the prior release are investigated. Losses affecting priority metrics are treated as release blockers;
- Value range checks: data points are verified against pre-defined acceptable ranges for each metric. Points outside those ranges are flagged for review;
- Absolute value change checks: individual data point values are compared between the candidate release and the version in production. Unexpected deviations are flagged for review;
- Historical series consistency: Z-scores are calculated per metric for each entity across all available years. Year-on-year changes are also monitored, with large deviations between consecutive years triggering a flag on both affected data points;
- Related metrics consistency: internal consistency across logically related metrics is verified, for example, by checking that the sum of component values does not exceed the corresponding total;
- Policy metric checks: transitions in policy values are monitored, with particular attention to losses of previously reported policies. Data points inconsistent with the prevailing industry profile are subject to sample-based review.

Data points that fail validation checks are added to a provisional blacklist, blocking them from the release. All blocked data points are documented and tracked in dedicated tickets. Issues that cannot be resolved within the validation window result in a rollback to the previously released version of the affected dataset, on a case-by-case basis. Following raw data validation, relevant experts perform additional product-level checks on ratings, which include, but are not limited to, coverage checks, data freshness, methodology alignment, and an in-depth review of sampled data.

Data is updated through full releases, which follow the complete validation process described above, and targeted releases, which cover specific datasets or corrections and follow an accelerated validation timeline. Urgent corrections addressing factual errors in the data are incorporated on an ad hoc basis through the quality inventory, subject to prioritization and verification.

3.3. Data Revision Policy

Clarity AI maintains a policy for the revision of historical data, reflecting the fact that companies regularly restate previously reported figures. Restatements are classified by reason — corrections, methodology updates, boundary updates, fiscal year adjustments, or unspecified — and are identified systematically during the collection process. For GHG emissions metrics, automated tooling is used to detect restated values at source. For other metrics, the standard approach is to collect the first published value, with restatements incorporated upon identification. All restatements are documented and traceable, and restated values undergo the same quality controls

as current-year data before being reflected in the platform. Where a restatement is material, it may trigger a broader review of affected ratings.

3.4. Missing Data & Estimations

In this methodology, estimations are used for EU Taxonomy alignment, Sustainable Investment Article 2(17), and SFDR Principal Adverse Impact (PAI) values where reported data is not available.

3.4.1. EU Taxonomy

Estimations in the EU Taxonomy are based on public segment-level revenue segmentation of companies, which Clarity AI maps to EU Taxonomy activities based on how well those segments reflect the regulation's activity descriptions. After that, estimations are used to evaluate how well the activities meet the technical requirements in the regulation, based only on publicly available information such as cement manufacturing intensity or the percentage of vehicles sold that are electric. Beyond that, DNSH and Minimum Safeguard tests are risk-based assessments based on publications from reputable sources on environmental and social violations of UNGC and OECD guidelines.

3.4.2. PAI Consideration

PAI Consideration is based on the PAIs of each organization. For those PAIs, estimated data may be used when a company does not report the data needed to calculate the quantitative PAI. The main inputs for the estimation are the sector a company operates in, the size of the company (measured by its revenue or enterprise value), and the behaviour of other companies in that sector.

The PAI metrics for which estimations are available are the environmental quantitative PAIs, as described in the first table of Appendix A.

3.4.3. Sustainable Investment Article 2(17)

Sustainable Investment Article 2(17) assessment may use estimations from EU Taxonomy and SFDR PAIs, which are described above. Additionally, it uses estimations for the percentage of revenue aligned with the UN SDGs. Revenue alignment requires a breakdown of company revenue across its different business activities.

Since companies rarely disclose revenue at the level of granularity the methodology requires, revenue alignment figures are, in most cases, estimated rather than directly reported. In these cases, our third-party provider maps a company's reported business segments to granular product and service categories and assigns a revenue share to each. Where company disclosures permit, these estimates are refined using regulatory and reported sources, including the EU Taxonomy disclosures referenced earlier in this methodology, which provide a directly reported basis for certain environmentally aligned activities. Research from subject-matter experts supplements these sources where neither third-party segmentation nor company disclosure is sufficient.

3.5. Handling of major new information

The valid time horizon of the rating is defined as the time between Clarity AI data releases, which is typically two weeks. Please note that our ratings are rules-based, rather than analyst-driven assessments. They are updated and made available to users at regular intervals through the Clarity AI platform, following the data release process and calendar (typically every two weeks, aligned with underlying data updates).

A material change to an individual rating can be triggered by:

- the ingestion of updated corporate disclosures or third party data
- significant modifications to the rules-based analytical framework
- the remediation of identified data errors
- changes to the estimation model or the estimation model inputs
- new controversies that result in an applicable violation, or the expiration or remediation of existing ones

4. Artificial Intelligence (AI) Usage

4.1. Methodology Implementation

Clarity AI integrates AI-assisted software development tools to facilitate the translation of approved ESG rating methodologies into production-ready code. In this capacity, AI functions as an engineering support tool to optimize efficiency and code quality by assisting with logic drafting, unit test generation, refactoring, and the systematic identification of potential edge cases or implementation defects.

AI is not deployed as an autonomous decision-maker; it does not independently define or modify rating methodologies. All methodology design, regulatory interpretation, and final deployment decisions remain the sole responsibility of our engineers and methodology owners, governed by established review protocols.

The integration of AI into methodology implementation introduces specific risks, including potential misinterpretation of requirements, subtle calculation errors, or the creation of technical debt through unmaintainable logic. Furthermore, there is a risk of over-reliance leading to insufficient independent validation or reduced traceability if implementation decisions are not rigorously documented and peer-reviewed.

These implementation risks are systematically mitigated through our standard software development lifecycle (SDLC) and rigorous engineering controls.

Human Accountability and Review: All AI-assisted implementations are fully owned and validated by Clarity AI engineers. AI tools are prohibited from approving code or deploying changes. Every methodology-related code change undergoes mandatory peer review to ensure correctness against approved requirements, architectural consistency, and data integrity.

Testing and Validation: AI-assisted code must adhere to a comprehensive testing pyramid, including unit tests for specific calculations, integration tests for data pipelines, and regression tests to ensure historical stability. Deterministic logic is validated against predefined test cases and controlled datasets to confirm that the implementation aligns with the intended methodology behavior.

Good Engineering Practices: We apply standardized MLOps and engineering safeguards, such as version control, continuous integration, and static analysis. By enforcing small, reviewable pull requests and clear ownership of code changes, we maintain high standards of transparency and allow for the rapid rollback of production changes if anomalies are detected.

Traceability and Governance: Every technical implementation is transparently linked back to its underlying methodology documentation and acceptance criteria. AI-generated suggestions are only promoted if they are traceable to approved inputs, ensuring that AI remains a constrained tool within our broader methodology governance framework.

4.2. Data Collection

Clarity AI uses AI, specifically Large Language Models (LLMs), to support the extraction of ESG data points from unstructured corporate disclosures (e.g., annual and sustainability reports). This extraction process is always grounded in the underlying source document.

The use of AI in this context involves inherent limitations and risks. These include the risk of "hallucination" (producing a plausible but unsupported value), "misinterpretation" (confusing units or materially different figures), and performance degradation over time ("drift") as reporting formats or the underlying LLMs evolve. Additionally, accuracy may be uneven across different sectors, languages, or company sizes (disparate performance). Extractors are also limited by the quality and content of the source documents provided.

These risks are systematically mitigated by designing our internal data extraction platform around the principle that AI outputs must be measured, reviewed, traceable, and reversible.

Quality and Consistency: Every new extractor version is rigorously tested against human-verified "ground-truth" annotations before deployment. All extractors running in production are under ongoing human monitoring, with review intensity adapted based on the extractor's historical performance. This continuous monitoring helps us catch drift and disparate performance proactively.

Transparency and Governance: Every value is transparently linked back to its source; most values are returned with the supporting quote and page location, ensuring full traceability. Strict human oversight on the extractor version is enforced through a two-stage workflow where only designated experts can approve and deploy an extractor version. This creates an auditable record of which AI configuration produced any given data point at any time, and allows for the quick disabling or downgrading of an extractor if input distributions change.

4.3. Controversies screening

Our ESG rating methodology integrates a specialized AI/ML pipeline to monitor global news and convert unstructured text into structured sustainability signals. The system processes high volumes of news through distinct models that handle entity extraction, company attribution, controversy detection, category mapping, severity scoring, and episode clustering to prevent double-counting. Additionally, large language models (LLMs) filter borderline content, summarize events, and evaluate data quality.

While highly efficient, using AI for controversy tracking involves inherent limitations. These include potential false positives or negatives, ambiguity in mapping multi-company news, classification or clustering errors, source coverage gaps, and LLM-specific risks like hallucination. If unmitigated, these limitations could present operational risks, such as score volatility, bias against highly covered organizations, or decisions made based on incomplete information.

To safeguard data integrity, we combine technical and human-in-the-loop validation. Structurally, all AI models are benchmarked against human-labeled datasets, alternative approaches are systematically logged, and company names are masked during training to eliminate brand bias. Performance is continuously tracked using automated quality dashboards.

Crucially, human oversight guides the system.

In addition, a dedicated team of subject-matter experts performs daily reviews of incidents using documented methodologies. For global norm violation cases, we enforce a strict four-eyes review and a formal 3-tier review process. Human expert labels permanently override model predictions, correcting immediate data points while simultaneously retraining and refining future AI model iterations.

4.4. Data estimations

The deployment of advanced Machine Learning (ML) models is necessary to close data gaps, introducing specific methodological risks which we manage through a standardized operational and Data Governance framework designed to systematically validate model outputs.

Advanced ML models, while highly accurate, capture complex relationships but can sometimes obscure the reasoning behind an output (the "black box" problem). To ensure auditability and trust, we enforce strict documentation protocols and invest in systematic explainability tools.

Furthermore, every automated validation check is mapped back to clear, real-world domain knowledge, ensuring the rejection or flagging of any estimate can be diagnosed.

We actively prevent the generation of unreliable data for industries with low public disclosure by enforcing strict minimum reporting thresholds. If an industry falls below the required data volume, the ML estimate is automatically suppressed to prevent unwarranted statistical extrapolation.

To prevent algorithms from predicting impossible scenarios, we integrate "Essential" validation checks that enforce physical constraints, automatically blocking outputs that violate physical realities, such as estimations of negative waste generation.

To ensure stable historical trends for financial applications, we apply temporal validations that detect and cap extreme year-on-year variations against expected industry distributions. This prevents artificial volatility and enforces trend consistency.

Finally, to actively mitigate the risk of algorithmic bias that could inadvertently facilitate greenwashing, our models are not solely optimized for prediction error minimization. Instead, we prioritize the accurate differentiation between industry leaders and laggards (relative rank preservation). We only deploy a complex ML model if it achieves a substantial performance gain (defaulting to a >20% improvement) over simpler, existing methods, ensuring the investment in complexity is justified.

5. Assumptions & Limitations

5.1. Key Assumptions

The methodology rests on several key assumptions:

- **Self-disclosure validity:** Reported data from company disclosures is assumed to provide a sufficiently reliable basis for assessment. At the fund level, self-disclosures by fund managers collected through European ESG Templates (EETs) are treated as a valid and reliable representation of fund-level sustainability characteristics.
- **Activity-based revenue alignment as a contribution proxy:** Activity-based revenue alignment — as measured through the EU Taxonomy and SDG frameworks — is considered a valid proxy for an organization's contribution to sustainable objectives.
- **Relative PAI performance as a meaningful signal:** Relative PAI performance assessed against the broader Clarity AI universe is considered a valid basis for identifying organizations that cause significant harm under the DNSH assessment. Furthermore, an 80% fund-level exposure threshold is considered sufficient to characterise a fund as systematically considering Principal Adverse Impacts or meeting the Do No Significant Harm (DNSH) requirement.
- **Controversial incidents as a relevant proxy:** Controversial incidents, as identified and verified through Clarity AI's controversies model, are assumed to serve as a reliable proxy for an organization's underlying company practices.

5.2. Limitations in Data Sources

The methodology is subject to several data limitations that users should consider when interpreting assessment outputs:

- EET reporting remains voluntary. As a consequence, the default option for a substantial portion of fund-level assessments relies on bottom-up estimation rather than reported fund-level data, introducing a degree of approximation that is inherent to the current state of market disclosure.
- Where EET data is available, it is self-assessed by fund managers and is not necessarily subject to independent verification. Variations in the interpretation of the SFDR framework across market participants may give rise to inconsistencies in reported data.
- Company-level sustainability data is typically disclosed on an annual basis, resulting in a reporting lag of months between a company's actual activities and the associated metrics reflecting those activities. Intra-year developments are therefore not captured until the subsequent reporting cycle, which may limit the timeliness of the assessment for rapidly evolving situations.
- For bonds, equities, and funds outside the scope of EU SFDR, no equivalent mandatory sustainability disclosure framework exists. Coverage for these instruments relies on voluntary corporate disclosures and proprietary estimation methodologies, which might rely on incomplete information.
- The methodology is subject to an inherent disclosure bias, whereby companies may disproportionately report positive sustainability metrics while omitting or downplaying adverse impacts. This asymmetry may result in an overstatement of sustainability performance for more transparent issuers relative to less transparent ones, and should be considered when comparing assessments across entities with differing disclosure practices.

5.3. Limitations in Methodologies and Models

In addition to data limitations, the following methodological limitations apply:

- **Categorical Classification:** The categorical structure of the Classifier assessment does not capture gradations of sustainability performance. Organizations that narrowly pass or fail a threshold are treated identically to strong performers or clear non-qualifiers.
- **Proxy Calibration Reliance:** The PAI Consideration and EU Taxonomy thresholds are calibrated using our own assessment of funds sold in the EU, which may not be representative of the market as a whole.
- **Regulatory Ambiguity:** An important component of the Classifier is the sustainable investment assessment under Article 2(17) of SFDR, which does not prescribe specific thresholds or metrics, leaving the definition subject to interpretation. Clarity AI's

methodology represents one defensible interpretation, but other interpretations are permissible under the regulation.

- **Backward-Looking Bias:** Input metrics rely on historical data. Organizations undergoing significant operational transformations may be misclassified if their current performance has improved materially relative to the data reflected in the assessment.
- **Percentile Ranking Stability:** The percentile thresholds used for contribution assessment are periodically recalculated as data are updated. New data update may shift threshold values, potentially altering the classification of organizations at or near the top-quartile boundary without any change in their underlying performance.
- **Peer universe:** The PAI Consideration metrics of quantitative PAIs use the percentile performance of companies against Clarity AI's full coverage universe. As a result, companies that may perform well within their sector, but underperform against the full universe may be penalized with respect to peer-based comparison approaches.
- **Controversy Model Sensitivity:** The LLM-based incident detection model is trained on a defined corpus of news sources and may exhibit lower sensitivity to controversies reported in languages or media markets not well-represented in the data.

6. Methodology Governance

Clarity AI maintains a robust methodology governance framework designed to ensure that all rating methodologies remain independent, rigorous, systematic, and impartial. To uphold these core principles, Clarity AI subjects its methodologies to a structured development, review, and approval process overseen by dedicated internal governance bodies, in line with our ESG Ratings Governance Policy.

Process and Frequency for Revising Methodologies

Methodologies are reviewed on a regular basis and at least annually to verify that they remain fit for purpose, aligned with emerging regulatory requirements, and reflective of market trends. The revision process follows a systematic approach divided into three core phases: Preparation, Development & Testing, and Review & Approval.

The Review & Approval Phase includes a formal peer review and mandatory final approval by the Methodology Committee before any update can be deployed.

Clarity AI is committed to transparent communication with users and rated entities and makes information about its methodologies publicly available. The Chief Research Officer (CRO) oversees that methodology-related documentation intended for disclosure meets external transparency requirements.

Clarity AI does not run market consultations with respect to its methodologies. Once the methodologies are disclosed, users, rated entities, and other stakeholders may submit their feedback in respect thereof via the existing communication channels.

Conditions for Determining a Revision

Clarity AI has established specific conditions that trigger an official review and potential material modification of its rating methodologies. A review is initiated when there are updates to external sustainability standards or regulatory frameworks that directly impact the assessment criteria. It can also be driven by the availability of new or improved data sources, or conversely, by modifications, additions, or the discontinuation of data from third-party providers. Furthermore, enhancements to internal quantitative engines or underlying assessment models necessitate a review. Lastly, the governance framework mandates that formal complaints or external stakeholder feedback are reviewed by the Methodology Committee to determine if specific methodological adjustments are required.

Assessing Rating Impact

To prevent arbitrary adjustments, changes to existing methodologies are implemented via new or adapted algorithms and are automatically applied across the entire rated sample, including corporate, financial instruments, or sovereign scores. When a methodology modification is deemed material, Clarity AI mandates that a comprehensive impact assessment be conducted prior to the scheduled data release. This ensures that any subsequent rating shifts are fully traceable to verifiable data processing or predefined methodological adjustments rather than qualitative overrides. Information about material changes to the methodologies is made available to users and rated entities, accompanied by a clear explanation of the change's motivation and its expected impact analysis.

6.1. Engagement Process

The methodology is applied to the assessed universe on an unsolicited basis, relying exclusively on publicly available information. Rated items do not participate in the assessment process. Once the rating is issued, rated items can access Clarity AI's platform for free to review it, including the underlying data used to calculate the rating, and to submit complaints in case there are any errors.

Appendices

Appendix A: Full List of Key Performance Indicators (KPIs)

This appendix provides a comprehensive list of all KPIs used in the MiFID II Methodology, organized by their dimension framework.

PAI Consideration

KPI	PAI Ref.	Objective	Assessment Type
Total GHG emissions	1	Environmental	Quantitative
Carbon footprint	2	Environmental	Quantitative
GHG intensity of investee companies	3	Environmental	Quantitative
Exposure to companies active in the fossil fuel sector	4	Environmental	Binary
Share of non-renewable energy consumption	5.1	Environmental	Quantitative
Share of non-renewable energy production	5.2	Environmental	Quantitative
Energy consumption intensity per high-impact climate sector	6	Environmental	Quantitative
Activities negatively affecting biodiversity-sensitive areas	7	Environmental	Binary
Emissions to water	8	Environmental	Quantitative
Hazardous waste	9	Environmental	Quantitative
Violations of UN Global Compact principles and OECD Guidelines for Multinational Enterprises	10	Social	Binary
Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	11	Social	Binary
Unadjusted gender pay gap	12	Social	Quantitative
Board gender diversity	13	Social	Quantitative
Exposure to controversial weapons	14	Social	Binary

EU Taxonomy

KPI	Objective
Alignment with the EU Taxonomy	Environmental
Eligibility for the EU Taxonomy	Environmental
EU Taxonomy DNSH	Environmental

Sustainable Investment Article 2(17)

KPI	Objective
Sustainable investment classification	Environmental/Social
Sustainable investment contribution assessment	Environmental/Social
Sustainable investment DNSH assessment	Environmental/Social
Sustainable investment good governance assessment	Environmental/Social

Appendix B: Sustainable Bonds

For securities identified as sustainable bonds, Clarity AI applies a dedicated assessment process rather than the standard calculation used for corporate issuers. This is because sustainable bonds are evaluated based on the characteristics of the projects they finance, rather than those of the issuer alone.

Sustainable bonds in this context are bonds issued with a sustainability-related objective. These bonds can be classified as:

- **Green bonds**: The proceeds are used to finance or refinance new or existing Green Projects[4].
- **Transition bonds**: The proceeds are used to finance the transition to a low-carbon economy.
- **Social bonds**: The proceeds are used to finance social projects.
- **Sustainability bonds**: The proceeds are used to finance both social and green projects.
- **Sustainability-Linked Bonds (SLBs):** Not tied to specific projects; linked to the issuer's commitment to improve sustainability KPIs.

When a security is identified as a sustainable bond, the following treatment is applied:

PAI Considerations Assessment Adjustment

Sustainable bonds are automatically categorized as considering PAIs (passing step 1). However, the Sustainable Investment and EU Taxonomy requirements for step 2 are assessed independently and are not assumed by virtue of the bond's categorization.

Sustainable Investment Assessment Adjustment

Contribution: For Green Bonds, Transition Bonds, Social Bonds, and Sustainability Bonds, the use-of-proceeds requirement signals that the investment is directed toward activities contributing to a social or environmental objective. These bond types are therefore classified as *contributing* under the Clarity AI Sustainable Investment framework by virtue of their use-of-proceeds designation.

SLBs do not finance specific sustainable projects. Accordingly, SLBs are assessed based on the sustainability characteristics of the issuer itself, applying the standard three-step entity-level assessment.

DNSH: For use-of-proceeds bonds (Green, Transition, Social, Sustainability), the DNSH check is applied at the project level. Since these bonds require the issuer to identify and manage risks to environmental and social objectives as part of the bond framework, the bond-level DNSH assessment is considered equivalent to the project-level DNSH. For SLBs, the DNSH check is applied at the issuer level using the standard entity-level DNSH screen.

[4] ICMA (2021) - The Green Bond Principles

Good Governance: The Good Governance check applies to the bond *issuer* (investee company), regardless of bond type. Sustainable Bond issuers must meet the same Good Governance requirements as any other assessed entity.

Exception for Government Issuers: For Sustainable Bonds issued by governments and other public entities, the Good Governance check is not applicable, consistent with ESMA's clarification that good governance practices under Article 2(17) SFDR do not apply in the case of investments in government bonds. Government-issued sustainable bonds are therefore classified as sustainable investments provided they meet the DNSH requirements.

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