GISR™ Global Initiative for Sustainability Ratings

Sustainability Ratings Standard
Component 1: Principles

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Introduction

Launched in June 2011 as a joint project of Ceres and Tellus Institute, the Global Initiative for Sustainability Ratings (GISR) is a new participant in the family of initiatives aimed at making capital and other markets agents for the achievement of a just and sustainable future. As a global, multi-stakeholder initiative, GISR's vision is to transform the definition of corporate value in the 21st century such that markets reward the preservation and enhancement of all forms of capital – human, intellectual, natural, social, and financial.[1] Toward this end, GISR's mission is to build and steward a widely-accepted, world-class standard for corporate sustainability ratings, rankings, and indices.[2] Through a ratings accreditation process, GISR will elevate the rigor, transparency, and utility of ratings to companies, investors, stock exchanges, and other financial market players, thereby realizing the full potential of ratings to recognize and reward true excellence in sustainability performance.

This document presents the background, role, and architecture of the GISR standard and the associated accreditation process. Its core content presents the first tier of the emerging three-part standard, namely, *Component 1: Principles Version 1.0*. For readers seeking a condensed version of this document, two companion pieces are available at www.ratesustainability.org:

- GISR Component 1: Principles Summary
- GISR Component1: Principles: Summary and Interpretative Guidance

Release of the Principles Version 1.0 marks the first major step in a process that will culminate in 2015, with the release of Version 1.0 of the complete standard. An accreditation process will unfold in tandem with each component. Exposure drafts, beta versions, and pilot tests will ensure both global engagement and multi-stakeholder input throughout the standard-building process.

Background

The year 2012 marked the 20th anniversary of the seminal United Nations Conference on Environment and Development (UNCED). Many of the Earth's vital signs – environmental, social, and economic – are perilously fragile. Ecosystem destruction continues with minimal abatement. Climate volatility is intensifying. Human and labor rights are under assault in many parts of the world. Although value shifts and technological advances promise to temper these ominous trends, the political will to undertake systemic changes is in short supply. The future prosperity of investors, companies, and society-at-large hinges on aggressive efforts to address these threats to the long-term well-being of people and the planet.

The opportunity and urgency for business to elevate and accelerate its contribution to the global sustainability agenda has never been greater. Companies that move toward embedding sustainability into core business strategy and practices are more likely to emerge as innovation leaders poised to prosper in the inevitably turbulent decades that

1. GISR's focus is on the first four of these capitals. However, it recognizes the possibility of a future in which financial capital is blended with other capitals to create an "integrated rating" of both companies' sustainability and debt issues, analogous to the contemporary efforts to construct a framework for "integrated reporting." (www.theirrc.org).

2. Such ratings, rankings, and indices are commonly referred to as ESG – environmental, social, and governance. GISR opts for the term "sustainability" to connote a standard that embraces a long-term horizon, recognition of the role of thresholds, limits, and norms in performance assessment, and an integrated perspective that includes, but is not limited to, traditional ESG factors.

lie ahead. In addition to the financial capital that is essential to business prosperity, a commitment to the preservation and enhancement of all forms of capital – human, intellectual, natural, and social – is prerequisite for long-term business success. To realize this outcome, a fundamental rethinking of the definition and measurement of corporate value is required, along with the creation of instruments, standards, and incentives that induce shifts beyond incremental change to encourage a "race to the top" among companies worldwide. Sustainability ratings are one such instrument for driving transformational change.

At present, approximately 100 sustainability raters exist, many of which administer questionnaires to thousands of companies worldwide, comprising a mix of investor- and consumer-facing instruments that range from issue-specific (e.g., climate change) to multi-issue (integrated environmental, social, and corporate governance) ratings, rankings, and indices. In addition to these external raters, a second type of rating occurs in the form of investors' proprietary internal ratings methodologies and databases that support asset management decisions. A third type of rating is developed by credit rating agencies. Here, the language of "social risk," "political risk," and "environmental risk" bears some resemblance to the content commonly associated with sustainability ratings. As the connection between long-term financial and sustainability performance becomes increasingly recognized, credit rating agencies may intensify inclusion of sustainability content data in their analyses of private and public debt issues.

From an investor perspective, sustainability ratings offer a potentially valuable instrument for assessing a company's capacity to anticipate and manage risks that may undermine its long-term competitiveness, reputation, innovation, license to operate, and, ultimately, its value. The gradual emergence of empirical evidence that sustainability performance enhances financial performance via lower cost of capital and reduced risk and share price volatility portends a future in which both company and credit raters will seek ratings products that rigorously distinguish sustainability leaders and laggards.

Investors typically utilize multiple sources for ESG information and ratings to meet their specific needs, which vary widely across classes of investors. Missing from this investor-rating relationship is a trusted, external, and impartial intermediary that provides guidance on what constitutes excellence in ratings. Such an intermediary would help inform investor decisions regarding the use of various ratings products, as well as expand the global market for high-quality products to the benefit of current and future rater organizations.

From the raters' perspective, users are best served with transparent and customizable ratings that meet specific purposes, investment or otherwise. Raters often face economic incentives and pressures from their investor clients to expand company coverage. But such expansion may come at the expense of deeper analysis of issues and indicators.

Different types of investors bring different needs to the ratings community. Long-term institutional investors, private equity funds, and social investors may have different time horizons, appetite for risk, and tolerance for volatility. Responding to these differences presents the opportunity to innovate and expand markets with new products.

The multiple forms of sustainability ratings have led to a multitude of data requests to companies via questionnaires and analyst inquiries. A single large company may receive two dozen or more surveys annually, all of which seek information – often duplicative – tailored to meet the data needs of individual ratings. Companies question whether the requested data is truly relevant to their business and express skepticism that ratings actually drive performance improvement.

Survey fatigue also is a concern among companies, leading to a search for ways to streamline data collection. With steady improvement in the quality of sustainability reporting, the future may see a reduction in the volume and scope of rating-related surveys. Meanwhile, companies often respond selectively to organizations deemed most trusted by their stakeholders and most beneficial for guiding performance improvement. For a company, a selective response is rational but risky, since a non-response to portions of the survey may adversely affect a company's rating outcome.

Upon release of sustainability ratings, rankings, and indices, a company may be scored a sustainability leader by some ratings and a laggard by others. Further, ratings of the same company by the same rater are often volatile year-to-year. Users are uncertain as to the causes of such volatility, owing to incomplete access to a rating's methodology. Companies also express concern with how ratings deal with incomplete information occasioned by data gaps and/or resource constraints.

While financial markets remain a principal audience for sustainability ratings, consumer markets also are increasingly attentive to the sustainability performance of the brands behind the products and services they choose. Consumer-facing ratings applied to pharmaceutical, food, apparel, and IT companies focus on issues such as access to affordable medicines, social and environmental conditions in the food supply chain, and privacy and freedom of expression in social networks. While GISR's primary focus is financial markets, its standard promises to help drive excellence in consumer-facing ratings in the coming years.

Understanding and reconciling company, investor, and rater perspectives – all valid and compelling in their own right – is prerequisite to realizing a future in which ratings achieve their full potential to drive markets toward sustainable outcomes. Where interests diverge, compromise and harmonization will be necessary, such that all parties view solutions as reasonably, if not perfectly, aligned with their respective needs and objectives, with the understanding that the market for rigorous ratings benefits all actors.

Landscape

GISR is one player in the evolving suite of initiatives that is collectively shaping the evolving sustainability information value chain (Figure 1). It complements the reporting focus of the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), and International Integrated Reporting Council (IIRC). Three linked functional clusters comprise the value chain:

1. Information **sources** – *e.g., companies, assurers, aggregators;*
2. Information **intermediaries** – *e.g., researchers and raters; and*
3. Information **users** – *e.g., investors, indexers, regulators*.

The inner loop depicts the information flows from sources to intermediaries to users. Raw data from companies, after assurance and bundling into products by aggregators, is transformed into decision-support information through the application of decision-support tools developed by researchers and raters. Next, the output of such analytics informs the decisions of investors, indexers, regulators, and other users. These, in turn, may drive change in the companies' behavior and practices. As in any system, impulses triggered by a change in any one link reverberate across all elements in the system. For example, better information from sources enables more rigorous ratings, which, in turn, may induce companies to refocus their sustainability practices from one aspect of environmental performance to another, or from environmental issues to social issues. Company and credit ratings, of course, are not the only driver of behavior. But, if rigorously developed and impartially administered, they represent one tool with the potential to move markets to encourage and reward strong sustainability performance.

Linked to the inner loop of sources, intermediaries, and users are a number of externally developed standards that appear in the outer loop of Figure 1 – GRI, SASB, and IIRC for reporting; ARISTA for quality of the research organization; and the International Auditing and Assurance Standards Board (IAASB) for auditing. In various ways, each of these standards seeks to advance the credibility and impact of sustainability information through the creation of norms for defining excellence for various activities in the system.

GISR is one such player, complementary to but distinct from the others, with a focus on creating a benchmark of excellence for corporate sustainability ratings that harmonizes with various kindred standards. The GISR Principles, for example, are informed by GRI's reporting principles, the multiple capitals framework advocated by IIRC and SASB, as well as NGO initiatives such as Ceres' Roadmap for Sustainability. At the same time, GISR is distinct from the supply-side orientation of GRI, IIRC, and SASB, owing to its focus on the "demand" side – namely, by expanding the investor uptake of high-quality ratings. Achieving this objective will require collaboration with three critical actors in the information value chain – companies, investors, and raters, with an emphasis on financial market raters that are in the early stages of exploring how to tap the value of sustainability information.

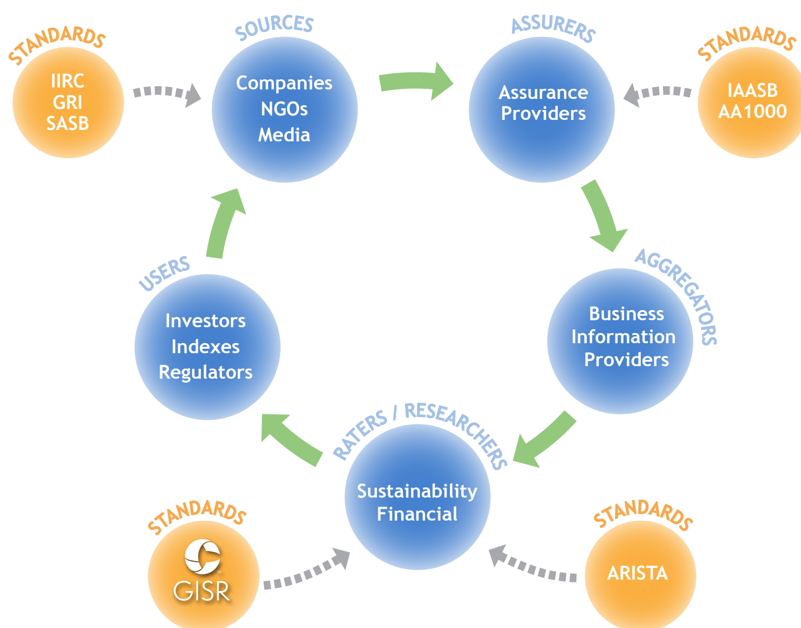

Figure 1: Sustainability Information Value Chain

At the same time, GISR's cooperation with other players in the system – assurers, aggregators, and other standard-setters – synchronizes its activities and strengthens prospects for achieving its vision and mission. An integrated approach offers the most promising pathway to optimizing the system and realizing the full potential of ratings to accelerate the integration of sustainability into financial markets worldwide.

GISR seeks both to influence and serve the rapidly evolving field of sustainability ratings. Historically, investor-facing ratings have focused on publicly listed equities in developed nations. Ratings now are poised to make major inroads in emerging economies where private/group/ sovereign ownership and/or control is the rule. In the future, these companies may well see ratings as an instrument for reputation enhancement, risk management, identification of new market opportunities, and lower capital cost. Meanwhile, the fields of "mission investing" and "impact investing" have spawned a new form of ratings geared towards measuring corporate social value creation, exemplified by the Global Impact Investment Ratings System (GIIRS). In short, the era of large public equities as the sole focus of sustainability ratings is fading. This shift creates the need and opportunity for an independent, non-commercial standard of what constitutes ratings excellence regardless of scope, audience, or geography. GISR is designed for that purpose.

GISR is a standard-setter and accreditor. Implementation of the GISR standard will be the task of entities that voluntarily seek accreditation and are equipped to competently and faithfully apply the standard to companies for which user communities seek a GISR-based sustainability performance assessment. Towards this end, GISR will offer training programs to ensure implementation of its accredited ratings in a way that conforms to the spirit and intent of the standard.

Architecture

GISR recognizes the diversity of purposes and audiences that ratings serve. The design and stewardship of the standard will proceed with attention to this diversity, while striving to create a globally-recognized benchmark for assessing sustainability performance excellence.

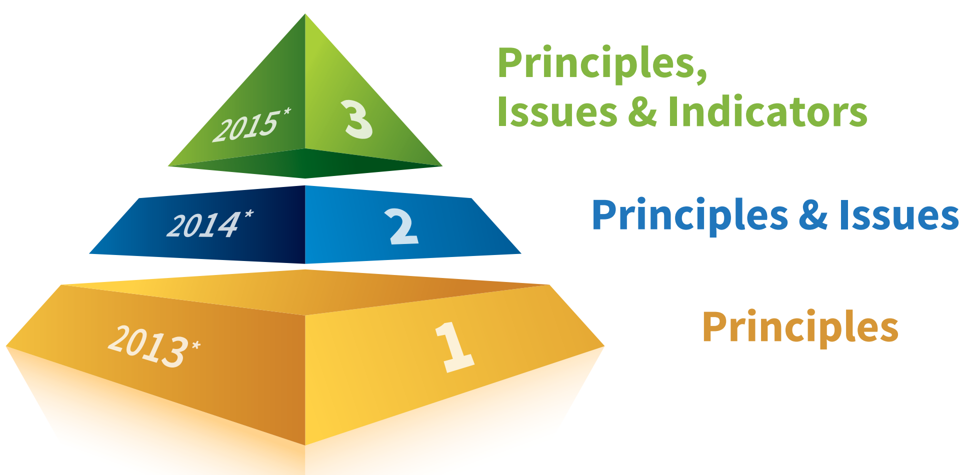

Figure 2: Standard and Accreditation Architecture

*The target schedule for release of Version 1.0 of each Component – Principles, Issues, and Indicators. The accreditation program for Levels 1, 2, and 3 will follow the release of each Component.

The GISR standard will comprise three components: Principles, Issues, and Indicators (Figure 2):

- **Principles:** The core attributes of a ratings framework required to achieve credibility among key stakeholders.
- **Issues:** Themes, topics, or aspects of sustainability that are material in assessing a company's sustainability performance.
- **Indicators:** Metrics that measure a company's sustainability performance for each Issue.

The process for staging the three components of the standard begins with a mapping of the state-of-play salient to each. In the case of Principles, such mapping covered a representative sample of kindred initiatives in which principles are either the centerpiece or one aspect of the program.[3] A similar approach applies to Issues and Indicators, by mapping a representative sample of hundreds of issues and thousands of indicators to detect those that are most commonly used, uncommonly used but significantly in play, or absent entirely, but are nevertheless deemed material. GISR will conduct these exercises with an eye towards maximum harmonization with leading, complementary standard-setters – most notably, GRI, SASB, and IIRC – and informed by best practices among leading raters.

The release of each component of the standard will occur in three steps: Exposure Draft, Beta Version, and Version 1.0. The first two steps will be followed by a global public consultation period. The target date for Version 1.0 of each component is:

Principles	**2013**
Issues	**2014**
Indicators	**2015**

GISR views its stepwise release strategy as essential to promoting market understanding and uptake and to harmonizing its standard with kindred initiatives now underway. Adjustments to the schedule will be made as needed to ensure robust vetting of each interim product.

Accreditation

Accreditation of ratings against the future standard is integral to GISR's mission since it is the vehicle for activating the standard as the benchmark for ratings excellence. As a voluntary standard, GISR will invite ratings to apply for accreditation to specific, transparent criteria to evaluate alignment of the rating with the three components of the standard.

An accreditation process will accompany each component and ratings will be accredited at one of the three levels (Figure 2):

Level 1 – Principles

Level 2 – Principles + Issues

Level 3 – Principles + Issues + Indicators

Accreditation levels will be cumulative; i.e., Level 2 will include adherence to Level 1 requirements, and Level 3 will include adherence to Levels 1 and 2.

GISR views its Principles, Issues, and Indicators, and associated accreditation levels, as complementary and interdependent aspects of its mission. The stepwise implementation of the standard's three-part architecture – and the cumulative structure of the accreditation process – seeks to foster steady progress towards ratings excellence. Protocols and tools will accompany the Principles, Issues, and Indicators to assist raters and ratings' users in faithfully applying the three components of the standard. To encourage uptake, GISR will design various mechanisms to accommodate differences in the business models and client bases in the rater community, as well as the readiness and capacity of raters to seek accreditation at the three levels of the standard.

GISR will seek to balance a state-of-the-art standard that sets a high bar for ratings excellence with current practices characterizing the field. Achieving this balance will require gradualism and gradation in accreditation for all types of eligible single- and multi-issue ratings, rankings, and indices developed by for-profit and not-for-profit entities. GISR commits to continuous innovation as it builds a widely-accepted standard of excellence.

3. A copy of this map, "Sustainability Principles Comparison," is available at: http://ratesustainability.org/resources.

Review Process

GISR commits to a rigorous internal and external multi-stakeholder review of all aspects of its work, including Version 1.0 of Component 1: Principles. A typical process comprises the following:

Step 1. Internal development and oversight

GISR's interim governance structure comprises the Secretariat, Steering Committee (SC), Technical Review Committee (TRC), and Expert Advisor Council (EAC). The Secretariat researches and drafts initial technical documents for presentation to the TRC. The TRC reviews and modifies content that the Secretariat integrates in preparation for SC review. Individual EAs periodically review portions of working documents connected to their areas of expertise. Working drafts are shared with sustainability raters engaged with GISR at various stages of discussions. The SC, in consultation with the Secretariat, determines the readiness of interim products for public consultation.

Step 2. Public consultation

Draft products, including both Exposure Drafts and Beta Versions, are released for public comment and are accompanied by structured instruments to facilitate efficient reception and processing of public comments. GISR strives to attract diverse and global feedback from all stakeholders. The Secretariat compiles and synthesizes comments for consideration by the TRC. The TRC recommends changes to interim work products, which the Secretariat implements. Revised products are transmitted to the SC for final review prior to release.

Step 3. Release of products and programs

As various products are released, GISR receives feedback from investors, companies, raters, and other stakeholders through formal, open feedback mechanisms. Where appropriate, GISR will issue interim guidance documents, supplemental protocols, and related documents to ensure that users of the standard are able to optimize their ratings activities.

Role of Principles

Principles, the subject of this document, are the foundation of the three-part standard. Collectively, they constitute a high-level normative statement to guide the process and content aspects of sustainability ratings. Procedures and protocols regarding operationalization will be part of the accreditation process that will follow the release of Principles Version 1.0.

In the course of designing sustainability ratings, developers encounter a multitude of branch points necessitating critical choices that determine the character, content, and uptake of their products. Some of these decisions are conceptual, e.g., defining the boundaries of social capital, while others are data-driven, such as the desire to include chronic exposures in the workplace coupled with absence of available data to do so. A comprehensive set of Principles provides a compass for navigating these many choices, informs the selection of Issues and Indicators, and signals to financial markets and other users that their practices are of the highest quality in terms of process and content.

Principles are widely accepted as foundational to various information initiatives aimed at advancing the global sustainability agenda. In designing its Principles, GISR benefits from the rich legacy of organizations that have developed principles as part of their activities, including GRI, SASB, IIRC, Principles for Responsible Investment (PRI), and ARISTA, standard of the Association of Responsible Investment Services.[4]

The key lesson drawn from these initiatives is that

4. A map of organizations and principles, "Sustainability Principles Comparison," is available at: http://ratesustainability.org/resources.

effective principles should be limited in number, crisp in language, and broadly understandable and usable by key stakeholders. Principles should define the core attributes of a ratings framework that are essential to achieving a high level of credibility and utility across user groups.

It is, of course, impossible to anticipate every question, ambiguity, and choice point that ratings developers encounter in the process of designing their methodologies. Nonetheless, a thoughtful set of principles plays a pivotal role in guiding information providers, researchers, raters, and users toward decisions that align with the spirit and intent of the GISR standard.

Definitions

1. **Rating:** A methodology, rules, and procedures, including, but not limited to, principles, issues, and indicators, used to assess one or more aspects of the sustainability performance of a company or debt issue.
2. **Rater:** Any entity, commercial or non-profit, that applies a rating. Ratings may be the exclusive, principal, or minor activity of such an entity.
3. **Corporate Sustainability:** Stewardship and enrichment of multiple forms of capital – human, intellectual, natural, and social – in ways that enhance human and ecological well-being for the present and future generations.

Applicability

1. The Principles apply to any rating, ranking, or indexing applied to companies in relation to, or based on, their sustainability performance.
2. The Principles apply to any rating, both existing and future, regardless of its ownership structure.
3. The Principles intend to guide the development of ratings, as well as inform the decision-making of rated entities and ratings users.
4. The Principles apply to multi-issue (integrated), single-issue, and sector-specific ratings.

The Principles

The GISR Principles comprise two categories: Process and Content (Figure 3). Interpretive guidance that follows each principle explains its rationale and application. GISR's accreditation policies and procedures will provide more details on the criteria by which a rating will be evaluated against each principle.

		PROCESS
1	**Transparency**	A rating should be transparent to those whose decisions are affected by the application of such rating.
2	**Impartiality**	The design and application of a rating, whose primary users are external to the rated company, should be protected from undue influence by the rated company.
3	**Continuous Improvement**	Through periodic update, a rating should track and integrate the best-available science, measurement techniques, issues, and indicators.
4	**Inclusiveness**	Development of a rating should identify and systematically engage those stakeholders whose decisions are influenced by the application of the rating.
5	**Assurability**	A rating should be designed to allow for independent, third-party assurance that its application comports with the GISR Standard.
		CONTENT
6	**Materiality**	A rating should assess performance based on sustainability issues relevant to the decision-making of stakeholders for which a rating is designed.
7	**Comprehensiveness**	Rating one or more aspects of sustainability performance should systematically assess for impacts on human, intellectual, natural, and social capital.
8	**Sustainability Context**	A rating should assess performance in the context of science-based thresholds and limits, or, if unavailable, widely-accepted norms pertaining to long-term human and ecological well-being.
9	**Long-Term Horizon**	A rating should enable the evaluation of the long-term performance of a company while simultaneously providing insights into short- and medium-term outcomes in alignment with the long-term.
10	**Value Chain**	A rating should reflect all portions of a company's value chain over which the company exercises significant influence.
11	**Balance**	A rating should utilize a mix of measurement techniques to capture historical and prospective performance.
12	**Comparability**	A rating should allow users to compare the performance of the same company over time and of different companies within the same time period.

Figure 3: The 12 Principles

PROCESS

Principles Pertaining to the Design, Application, and Maintenance of a Rating to Ensure Excellence, Credibility, and Integrity

1 TRANSPARENCY: *A rating should be transparent to those whose decisions are affected by the application of such rating.*

The Transparency Principle calls for a compact among parties that honors the need for companies, investors, and other stakeholders to understand the rating, while respecting the need for justifiable intellectual property protection. A confidentiality agreement may provide sufficient protection in cases where a user seeks disclosure of core elements of intellectual property, e.g., the weightings and indicator combinations embedded in the methodology. When a rater believes confidential disclosure will adversely affect its interests, it should explain the basis for its judgment, pursuant to a "Disclose-or-Explain" process. In general, all ratings should be subject to a publicly available Transparency Policy that details what is disclosed, to whom, and why.

The appropriate level of transparency involves tradeoffs between credibility and trust, protection and competiveness. Too much transparency can undermine a critical element of the rater's business model, as well as suppress the incentive to innovate. Too little transparency leaves companies, investors, and other stakeholders with inadequate understanding concerning the scores companies receive. Without adequate transparency, it is not possible to understand why performance assessment by the same rater fluctuates widely from year to year, or within the same year for the same company subject to multiple ratings.

2 IMPARTIALITY: *The design and application of a rating, whose primary users are external to the rated company, should be protected from undue influence by the rated company.*

The Impartiality Principle addresses the need for raters to remain independent from rated organizations in order to avoid the perception or reality of conflicts of interest that may affect the structure and application of the rating. Undue influence occurs when the integrity of the design and/or implementation of a rating is compromised, leading to deviations from sound analytics and biased outcomes misaligned with a given methodology. Preempting such a situation begins with transparency. Raters that market their products to third parties (investors, consumers, and/or NGOs) should establish and publicly disclose a code of conduct that fully describes the nature of such relationships and the associated policies and procedures, even if names of specific companies are withheld for competitive reasons.

Even with such disclosure, however, stakeholders who seek an unequivocal detachment between rater and company may question the relationship between the two parties. Two remedies will mitigate this situation. First, raters routinely should disclose any and all relationships, commercial or otherwise, with rated companies, as well as policies and procedures to ensure ratings remain untainted by conflicts of interest. Second, rating organizations should safeguard against conflicts by establishing a firewall between the rating unit and those units with a commercial relationship with a rated company. Historically, firewalls in financial markets have demonstrated imperfect results. Those who view breaches as inevitable have the option of seeking regulatory remedies that mandate the separation of activities that may otherwise be prone to conflicts of interest.

3 CONTINUOUS IMPROVEMENT: *Through periodic update, a rating should track and integrate the best-available science, measurement techniques, issues, and indicators.*

Decisions concerning continuous improvement should take into account at least two matters: clustering and disclosure. Clustering refers to the desirability of implementing multiple, significant changes at the same time, judiciously scheduled at regular, predictable intervals. Minor adjustments, defined as small departures from an existing practice, may occur more often. Clustering mitigates the problem of a "moving target" faced by investors, companies, and other stakeholders, a situation that undermines rating's utility, credibility, and uptake.

Disclosure refers to timely reporting of improvements in methodology and content to companies, investors, and other users. Alerting stakeholders in advance of improvements (the preferred option) or prompt notification when improvements have been implemented (the second-best option), as well as the anticipated frequency of future changes, enhances understanding of shifts in ratings' outcomes over time. Also, how changes generally affect ratings outcomes, e.g., percent of companies significantly upgraded or downgraded, allows users to calibrate the significance of a change. Alerting stakeholders well in advance of, for example, a methodological adjustment or addition/deletion of an issue serves as a valuable tool for stakeholder engagement. This, in turn, builds trust and credibility between raters and their audiences.

4 INCLUSIVENESS: *Development of a rating should identify and systematically engage those stakeholders whose decisions are influenced by the application of the rating.*

Engagement encompasses both the governance and technical aspects of the rating. Governance engagement implies an active and continuing role for stakeholders in supporting the development of a rating, in order to understand and consider the needs and priorities of its user community. Engagement in the technical aspects of the rating helps ensure continuous improvement by tapping the knowledge and insights of stakeholders that might otherwise be overlooked. Relevant stakeholders may include parties whose interests are directly affected by the rating, e.g., investors and companies, as well as those whose interests are affected by the sustainability performance of rated companies, e.g., employees, consumers, and communities.

Stakeholder engagement takes many forms, including focus groups, surveys, workshops, and advisory committees. Documentation of all approaches serves the dual purpose of informing continuous improvement and demonstrating to external parties that the rating considers their views.

Stakeholder engagement entails trade-offs. Deciding the optimal depth and breadth of engagement within limited financial and human resources necessitates a balance between the scope of engagement, its frequency, and the instruments used for information-gathering. Documentation and communication of these trade-offs helps strengthen credibility among users.

5 ASSURABILITY: *A rating should be designed to allow for independent, third-party assurance that its application comports with the GISR Standard.*

Assurance assumes a variety of forms and scopes, the details of which vary across countries and the professional assurance bodies that operate therein. Assurance by independent entities, and the attestation statements they prepare, should align with the objective of the exercise and the needs of user communities. For some users, assurance of a rating at Accreditation Level 1 – Principles may be adequate. For ratings accredited at Levels 2 or 3, assurance will require more extensive investigation to determine whether, in practice, a rating adheres to the Issues and Indicators contained in Components 2 and 3 of the standard. Assurance at Level 3, comprising adherence to Principles, Issues, and Indicators, will indicate that a rating has achieved the "gold standard" in its alignment with GISR.

Users may seek evidence of suitable governance and oversight of the rating process, including data quality, documentation procedures, and the expertise and objectivity of parties applying the rating. Examples of assurance of some of these key process attributes are included in ARISTA 3.0, ISAE 3000, and AA1000.

CONTENT

Principles Pertaining to the Scope, Quality, and Measurement Aspects of a Rating

6 MATERIALITY: *A rating should assess performance based on sustainability issues relevant to the decision-making of stakeholders for which a rating is designed.*

The basic materiality test for a rating is whether exclusion of an issue would significantly alter the decisions of a rating user. Materiality is not constant; it varies over time and across users, even within specific stakeholder groups. Variations over time reflect changing scientific knowledge, societal norms, and the understanding of determinants of long-term business prosperity. Variation across user groups occurs even within individual constituencies. Among investors, for example, pension funds, private equity, and impact investors may hold different views on the substance and/or weighting of specific environmental and social issues. Further, materiality is affected by the governance of environmental and social policies and laws that act to attenuate or amplify opportunities and risks affecting company sustainability performance.

Materiality assessment begins with mapping the universe of sustainability issues germane to a company's core activities. This should encompass issues across the multiple capitals – human, intellectual, natural, and social – that underpin the GISR standard. Evidence of materiality may be found in multiple sources, including academic literature, company reports, the media, and shareholder actions. Following this assessment is a prioritization of the universe of issues most likely to impinge upon stakeholder decision-making.

Evidence of both short-term and long-term performance is useful to this process. From the standpoint of investors, for example, deficient sustainability management that leads to crises – major product recalls, environmental disasters, supply chain accidents and abuses – have both near-term effects on share price and long-term effects on reputation, in addition to the harms incurred by workers, communities, and consumers. On the other hand, evidence that strong sustainability management systems both avoid and mute the adverse repercussions of such crises speaks to the interdependence of sustainability materiality and financial materiality. These assessments have both common themes and specific applications, as evidenced, for example, by the different diligence and time horizons of different asset classes.

Understanding these connections is in the interest of both ratings and the users they serve though, here again, the actions that may follow will vary even within a user community. For example, public equities, private equity, retail investors, and pension funds typically seek different information and apply different time horizons in managing assets.

Ultimately, the test of materiality is uptake by, and feedback from, the user community. When feedback from the market signals the need to add a new rating category or update an existing one, such changes should be executed judiciously in order to avoid undue volatility in rating outcomes and to ensure timely notification to users of impending modifications.

7 COMPREHENSIVENESS: *Rating one or more aspects of sustainability performance should systematically assess for impacts on human, intellectual, natural, and social capital.*

In the course of conducting its business, a company inevitably preserves, expands, or depletes various forms of capital. Within the constraints of user needs and resource requirements, a rigorous rating, whether integrated or issue-specific, should attend to these multiple capitals, even if its focus is more narrowly defined. From a systems perspective, changes in one form of capital in an organization are likely to trigger changes in others. Thus, even ratings specific to climate (natural-capital focused), living wages (human-capital focused), or community impacts (social-capital focused) should be attentive to linkages across the other capitals. To illustrate, competitive wages strengthen community well-being which, in turn, builds a more stable, productive, and loyal workforce. Stewardship of a stressed aquifer in an arid region helps preserve a critical form of natural capital, which, in turn, reduces company-to-community friction (enhancing social capital) and builds the foundation for long-term job opportunities.

In practice, leading ratings already do this to some degree, even if an explicit reference to "multiple capitals" does not appear. Issues and Indicators pertaining to carbon emissions, water use, and biodiversity, for example, fall under the umbrella of natural capital. Human rights, occupational health and safety, and living wages enrich human capital. Capacity to innovate, patent generation, and resources devoted to advanced educational programs for staff training contribute to intellectual capital creation. When ratings speak of impacts, externalities, intangibles, and off-balance-sheet liabilities, such language expresses the concept of multiple capitals, though without explicit reference to the unifying thread that the capitals framework presents.

Implementation of the Comprehensiveness Principle by ratings should be gradual, in order to accommodate variations in rater and user readiness to embrace the multiple capitals framework. Widespread adoption and general acceptance will require pilot programs, experimentation, research, and consultation with all stakeholders. GISR, through both its standard development and accreditation program, is committed to supporting this transition, which it believes will yield long-term benefits to companies, users, raters, and society at-large.

8 SUSTAINABILITY CONTEXT:

A rating should assess performance in the context of science-based thresholds and limits or, if unavailable, widely-accepted norms pertaining to long-term human and ecological well-being.

Performance assessment relative to externally-defined targets based on physical limits, thresholds, or social norms reflects that companies are not isolated entities but, instead, operate in a local, national, regional, and global milieu, part of larger ecological and social systems, delineated by biophysical limits and socially-defined thresholds. Without contextualization, the capacity to fully assess an individual company's contribution to the collective impact across all companies is compromised. In such cases, despite incremental progress by individual companies, the aggregate impact of business activity may still overshoot ecological thresholds or undershoot social norms.

For some ecological resources, externally-defined thresholds are emerging at the local, regional, national, and global levels. Such is the case for climate change, biodiversity, and water resources. For social systems, consensus is slower to evolve, though moving forward. Global frameworks, such as the ILO Core Labor Standards and the UN Guiding Principles for the Implementation of the "Protect, Respect, and Remedy" Human Rights Framework, offer raters guidelines for assessing aspects of a company's social performance. Living-wage levels, for example, exemplify a social issue where norms may be expressed in the form of purchasing power parity established by an independent, non-partisan body. While externally-defined thresholds offer the advantage of independence from both companies and raters, internal thresholds and norms serve as valuable, interim exercises in building familiarity with the concept of Sustainability Context.

Incorporating Sustainability Context in ratings should evolve slowly and in concert with the emergence of scientifically-developed thresholds and limits and social norms at various geographic scales. With the benefit of continuous experimentation, Sustainability Context should take its place alongside time series, goal-based, and peer group benchmarks as integral to current and future sustainability ratings.

9 LONG-TERM HORIZON: *A rating should enable the evaluation of the long-term performance of a company while simultaneously providing insights into short- and medium-term outcomes in alignment with the long-term.*

Sustainability ratings routinely should favor outcomes associated with stewardship and enrichment of the multiple capitals that materialize in the 3–5 year time horizon and beyond. This perspective does not preclude short-term considerations. Near-term actions that align with desirable long-term outcomes are indispensable to rigorous sustainability ratings. Examples include yearly R&D expenditures focused on sustainable products and services, percentage of products and services that meet sustainability standards, investments in training that elevate employee IT-competency, and development of advanced data systems that track and report the societal cost of environmental externalities – all of these entail short-term operating or capital expenses with returns in the form of multiple capital expansion, spanning many years. All signal a company's commitment to the long-term via the yearly budgeting process. Such a perspective is essential to sound ratings methodologies.

10 VALUE CHAIN: *A rating should reflect all portions of a company's value chain over which the company exercises significant influence.*

A systematic assessment of control and influence of the rated company, informed by the scale of impacts and their materiality to stakeholders, is integral to a credible rating. Such assessments represent new territory for many raters, as they require data that only now is emerging via sustainability reports, business information services, and rater questionnaires administered to companies. While significant data and cost barriers exist now, over time ratings should incorporate the full array of outsourcing and procurement characteristics of company operations worldwide, where such operations are considered to present significant influence over suppliers.

Delineation of the entity for rating purposes may be addressed through methodologies developed by leading standard-setters. Examples include the Corporate Value Chain Accounting and Reporting Standard developed by the World Resources Institute and the Guidance for Report Boundary Setting of GRI. Transparency, with regard to the methodology and data sources in delineating the boundary of the rated company, is essential for both interpretation and credibility of the resulting assessment of sustainability performance.

11 BALANCE: *A rating should utilize a mix of measurement techniques to capture historical and prospective performance.*

Pertinent to the Balance Principle are a number of dimensions that define performance measurement:

- **Lagging vs. leading:** Lagging indicators describe past performance at either a point in time or in a time series; e.g., water intensity or dollars spent on lobbying for the prior one, two, or five years. In contrast, leading indicators anticipate future performance, most usefully in the mid- and long-term.
- **Process vs. outcome:** Process indicators comprise statements of sustainability-relevant strategy, policy, and procedures of the company. Outcome indicators provide measures of the actual effects, or impacts, on strategy, policy, and procedures.
- **Quantitative vs. qualitative:** Quantitative indicators are expressed in numerical form. Qualitative indicators convey the character or nature of an aspect of performance without numerical expression.
- **Absolute vs. relative:** Absolute indicators communicate performance without reference to either internal or external benchmarks. Relative indicators communicate performance relative to the company's own past or future performance, a peer group, a physical threshold/limit, or social target established by external parties, per the above Sustainability Context Principle.

A rigorous rating contains a mix of the above. Users seek insights into the mindset, culture, and quality of management of a company, as well as the hard, quantitative evidence of the company's capacity to achieve its performance objectives. In some instances, quantitative indicators may serve as proxies for qualitative aspects of the organization; e.g., employee turnover past, present, and future may indicate the long-term prospects for attracting and retaining human capital in the form of top talent. A commitment to carbon neutrality or zero waste within five years, or a commitment to measure and report the cost of environmental externalities within three years, represents a mix of policy, forward-looking, and quantitative attributes.

12 COMPARABILITY: *A rating should allow users to compare the performance of the same company over time and of different companies within the same time period.*

Achieving comparability is a multifaceted challenge. When tracking performance of a single company, a rating must be reasonably stable to avoid excessive year-to-year volatility driven by changes in the rating methodology, as opposed to actual company performance. If significant organizational change occurs, for example, through acquisition, merger, or divestiture, comparability over time likely will be undermined in the absence of data normalization. In such cases, a rating should both acknowledge and strive to balance the tradeoff between comparability and adaptability, in alignment with the Principle of Continuous Improvement.

Comparability of ratings of peer companies within a single time period requires a high level of uniformity and quality of data across rated companies. Where uneven and/or incomplete data is in play, sound comparisons are not possible. Where data deficiencies severely compromise comparability, a rating should seek reasonable proxy issues and/or indicators to maximize analytically defensible comparisons.

Comparability is enhanced when the rating provides clarity and consistency as to whether increases or decreases in numerical values reflect higher or lower levels of performance. Ratings that rely on ratios to measure performance need adequate explication. Only through full and understandable disclosure of ratio data can users properly interpret shifts in company performance that are expressed in ratio forms.

Comparability across ratings, as opposed to across companies or within peer groups, is a separate but equally critical challenge. Users understandably seek multiple ratings to guide decision-making. Diversity is strength, providing a variety of perspectives based on different issues, indicators, weightings, and other features of each rating. At the same time, when performance assessment of the same company in a single time period varies dramatically across ratings, users are left wondering about the causes of such disparities. Adherence to both the Comparability Principle and the above Transparency Principle will mitigate such confusion.

Next Steps

Component 1: Principles Version 1.0 provides the foundation for subsequent components of the GISR standard. The Principles seek to establish a compass for building rigorous and credible ratings in the years ahead. By so doing, they will serve to strengthen confidence and uptake among all players in financial markets and beyond. Through its accreditation process, pilot programs, and monitoring of market awareness and behavior, GISR will identify needs and opportunities for research and education to ensure the Principles achieve their purpose.

Building on the experiences of 2013, GISR commits to continued broad-based, global public consultation in the next phase of standard development – Component 2: Issues in 2014 and Component 3: Indicators in 2015. Engagement with investors, companies, raters, and other stakeholders in GISR's governance structure and public consultation processes are critical to its mission. GISR welcomes continued engagement by all individuals who have contributed thus far and invites newcomers to join its widening circle of collaborators worldwide.

For questions concerning this document, please contact Emily Kilroy, emily.kilroy@ratesustainability.org.

Appendix I: Rationale for GISR's 12 Principles

As the foundation of the Standard, the Principles were carefully considered for their connection to and alignment with GISR's vision and mission to drive corporate sustainability excellence. The 12 Principles that comprise Component 1 of the GISR Standard establish the process and content benchmarks for sustainability ratings. These Principles evolved over a period of 18 months in coordination with the TRC, SC, and EAC, as well as extensive public consultation through the Exposure Draft and Beta Version. These Principles and accompanying interpretive guidance were refined over time to align with GISR's mission and to contribute to excellence in ratings. The following text provides the rationale and context for why each Principle was selected for inclusion in the standard, as a supplement to the interpretive guidance found within the text of this document.

1. TRANSPARENCY: *A rating should be transparent to those whose decisions are affected by the application of such rating.*

The Transparency Principle addresses the need for stakeholders to understand a rating's data sources, assumptions, scoring methodology, and extrapolations, in cases where data gaps exist. Transparency is essential for making informed decisions as to which ratings are best suited to specific needs and how such ratings generate the resulting performance outcomes.

Companies benefit from understanding the methods, algorithms, issues, indicators, and analytical models that determine how raters measure and rate their performance. Such transparency also helps companies identify targets for improvement. In most cases, companies understand that boundaries will exist between information essential to understanding a rating and information that raters regard as intellectual property.

Investors benefit when ratings are fully transparent because full disclosure of information affords a higher degree of confidence when applying the rating to an investment decision. It also enables investors to effectively communicate to their clients why investment decisions are made.

Whether a rating is constructed solely on company data or in conjunction with data from the media, NGOs, and other sources should be disclosed. Investors purchase ratings from outside vendors to augment the analytical models they develop internally precisely because they prefer to outsource the data collection and development of analytical tools. In cases where they do, confidential disclosure of a rating may be negotiated with the client on a confidential (Non-Disclosure Agreement) basis.

2. IMPARTIALITY: *The design and application of a rating, whose primary users are external to the rated company, should be protected from undue influence by the rated company.*

Maintaining impartiality is a balancing act. Raters benefit from – indeed, require – regular interaction with rated companies in the process of data collection and quality assurance. Similarly, engagement with investors and other stakeholders enriches the quality of the rating. At the same time, interaction between the rater and rated that compromises the integrity of the outcome undermines the credibility of both parties. Instances where a rater establishes a consulting, advisory, or other commercial relationship with a rated company without proper transparency undermines trust on the part of users seeking a truly independent, unbiased assessment of performance. Ratings applied to financial organizations that offer services to both rated entities and rater clients are particularly vulnerable to perceived conflicts of interest.

3. CONTINUOUS IMPROVEMENT: *Through periodic update, a rating should track and integrate the best-available science, measurement techniques, issues, and indicators.*

The Continuous Improvement Principle speaks to the need for periodic enhancement of a rating in light of methodological and scientific innovations, as well as the emergence of new issues, indicators, and widely-accepted norms in the field of sustainability. Responding to these changes involves trade-offs. Too much change in content and/or methodology exacerbates the problem of excessive volatility and incomparability, whereas too little change runs the risk of stagnation amidst evolving definitions of corporate value and value creation.

4. INCLUSIVENESS: *Development of a rating should identify and systematically engage those stakeholders whose decisions are influenced by the application of the rating.*

The Principle of Inclusiveness in various forms is common to most contemporary standards, including GRI, SASB, IIRC, and ARISTA. It signifies that relevant stakeholders and experts are to be identified and engaged on a continuing basis in the development, application, and evolution of a rating. Stakeholder engagement is prerequisite to ensuring that the process of building a rating is credible, informed, and useful to its intended audiences. It is an asset that strengthens relevance and utility. Engagement builds trust in the user community that the rating's coverage, methodology, content, and other attributes are aligned with the interests of relevant stakeholders.

5. ASSURABILITY: *A rating should be designed to allow for independent, third-party assurance that its application comports with the GISR Standard.*

The Principle of Assurability concerns the "assurance-readiness" of a rating. Assurability requires the use of objective and verifiable criteria for assessing alignment of a practice to a specific standard. Investors and others who elect to rely on GISR-accredited ratings may seek assurance that such ratings comport with GISR's Principles, Issues, and Indicators. Further, assurance may play a role for GISR itself, to assess, after initial accreditation, that a rating is still being faithfully applied at the level of accreditation granted.

The goal of assurability is to make it possible to assure users that the rating adheres to the requirements embodied in each component of the GISR Standard to which the rating is accredited and that the rating outcomes are based on data and analysis that have been subject to rigorous quality-assurance procedures. Because GISR is global in scope, international auditing and assurance standards should be applied wherever possible, either internally or with assistance from a third party, regardless of the geographic location of the assurance body.

6. MATERIALITY: *A rating should assess performance in the context of science-based thresholds and limits, or, if unavailable, widely-recognized norms pertaining to long-term human and ecological well-being.*

The use of terminology such as "Material Business Impacts" versus "Material Sustainability Impacts," or "Financial Materiality" versus "Sustainability Materiality" connotes a distinction that may be valid in the short-term, but is misleading from a long-term perspective. The horizon inherent to all matters pertaining to sustainability is intrinsically long-term. While the future is by nature indeterminate, large-scale social and ecological shifts are subject to increasingly powerful analytics and provide insights, however imperfect, to opportunities and risks relevant to long-term business prosperity. Companies whose vision and strategies are rooted in long-term horizons recognize that business/financial materiality and sustainability materiality likely will converge over time. Business prosperity in the long-term is inseparable from healthy and productive workers, communities, societies, and ecologies. While ratings will always be customized to user needs, it behooves raters not simply to respond to, but to help foster market interest in ratings that reflect this convergent trajectory.

A starting point for identifying the material, universal issues are the "aspects" contained in the GRI G4 framework. For sector-specific materiality, indicators under development by SASB and GRI's Sector Supplements (and future sector-specific products) also provide useful guidance. GISR is using these and other sources as a point of departure in designing its own materiality map and in identifying the issues and indicators that will eventually appear in its rating standard. As this process unfolds, GISR will be attentive to emerging material issues that may be absent or underrepresented in current rating practices.

7. COMPREHENSIVENESS: *Rating one or more aspects of sustainability performance should systematically assess for impacts on human, intellectual, natural, and social capital.*

The concept of multiple "capitals" – financial, human, intellectual, manufactured, natural, and social – refers to the stock of resources, tangible or intangible, attributable to the company's activities that advance both business and societal well-being. Leading reporting initiatives such as IIRC and SASB include references to multiple, or "vital," capitals. GISR embraces the multiple capitals framework as well. For the purpose of sustainability ratings, four capitals – human, intellectual, natural, and social – are the most germane.

The advantage of the capitals framework is three-fold: (1) the concept of capitals, measurement complexities notwithstanding, provides a common denominator for expressing the various forms of value that companies create in the course of advancing organizational, human, and ecological well-being; (2) "capital," in the sense of a stock of valued assets, is foundational in the language of financial markets; and (3) unbundling impacts into categories of capital provides a more precise taxonomy to guide the future development of ratings. Further, as much as 75 percent of a company's market value is attributable to intangibles, though they rarely appear in financial reports. In practice, the multiple capitals concept represents a next step in the evolution of the ESG framework that dominates contemporary ratings. The capitals framework lends itself more effectively, both conceptually and analytically, to rigorous sustainability performance assessment than the contemporary ESG framework.

Ratings are user-driven, and users may resist methodologies that reach beyond the narrow confines of measuring performance along a single dimension of sustainability. The Comprehensiveness Principle encourages raters to pursue a holistic approach when interacting with users. Failing to do so will result in ratings that may affect sustainability performance in ways that misrepresent the full range of business impacts, both positive and negative. Further, in the absence of a comprehensive approach, a rating user will be unable to detect whether enhancement of one form of capital is occurring at the expense of other forms of capital. A rigorous rating will, in effect, provide a multiple capitals "balance sheet."

8. SUSTAINABILITY CONTEXT: *A rating should assess performance in the context of science-based thresholds and limits or, if unavailable, widely-accepted norms pertaining to long-term human and ecological well-being.*

Performance assessment may be expressed from several perspectives including: (1) performance across time periods, i.e., time series; (2) performance relative to an internally defined goal; (3) performance relative to a peer group, e.g., recognizing "best in class" or "top 15 percent"; and (4) performance relative to externally-defined targets based on physical limits, thresholds or social norms, i.e., "sustainability context."

The first three of these approaches dominate contemporary ratings. Together, they offer valuable, but incomplete, perspectives on sustainability performance. The fourth, sustainability context, appears to some extent in, for example, sector- or facility-based environmental regulations built on maximum tolerable thresholds to protect human health. The sustainability context goes beyond such practices to encourage greater company-level accountability for adhering to science-based thresholds, limits, and norms that capture the collective impacts of business activity.

The GRI G2 reporting framework, launched in 2002, pioneered a Sustainability Context Principle. Ratings should follow suit to provide greater value to users by helping to identify long-term sustainability opportunities and risks. In an increasingly resource-constrained environment, and amidst rising expectations that companies should create social value, companies that apply the Sustainability Context Principle are likely to emerge as leaders in forward-looking strategy, management acuity, and long-term value creation.

9. LONG-TERM HORIZON: *A rating should enable the evaluation of the long-term performance of a company while simultaneously providing insights into short- and medium-term outcomes in alignment with the long-term.*

The Long-Term Horizon Principle stresses the intrinsic long-term (e.g., > 5+ years) nature of sustainability, while recognizing the role of medium- (e.g., 3-5 years) and short-term (e.g., < 3 years) benchmarks that occur along the way. The Principle confronts the dominance of short-term measures for business success – e.g., daily/weekly share price, quarterly earnings, or revenue growth – while drawing attention to the interdependency of sustainability performance and long-term financial success.

Investor propensity to employ long-term horizons varies widely, even among institutional asset owners, whose responsibilities are intergenerational. Pressures to outperform near-term market benchmarks flow from beneficiaries to trustees to asset managers to companies. The Principle of Long-Term Horizon seeks to infuse sustainability considerations in assessing portfolio risk and opportunity, and to encourage longer-term horizons among asset owners, asset managers, and companies. It supports the notion that a long-term perspective in strategy, management, R&D, and products and services will be rewarded, even if short-term financial metrics fall short of analysts' expectations.

10. VALUE CHAIN: *A rating should reflect all portions of a company's value chain over which the company exercises significant influence.*

The Value Chain Principle addresses the boundaries of accountability that define the rated company's principal impacts. Because of the complexity and reach of contemporary value chains, the questions of "control" and "significant influence" loom large. Shifting impacts backwards and forwards along the value chain does not absolve the parent entity of responsibility for positive and negative impacts on the supply and demand of goods and services. Rating companies in industries with complex and far-flung value chains, e.g., apparel, electronics and food, necessitate coverage of upstream and downstream impacts that are integral from a holistic perspective of long-term sustainability performance. Value chains are dynamic, with frequent boundary shifts inevitable in a fast-changing, global economy. A credible rating will disclose and normalize for such changes to enable reliable time series comparisons and to minimize misleading volatility in performance outcomes.

11. BALANCE: *A rating should utilize a mix of measurement techniques to capture historical and prospective performance.*

The Principle of Balance concerns the use of different types of data sources, issues, and indicators that characterize a company's performance. Companies benefit from such diversity that translates ratings into instruments that drive continuous improvement. Investors benefit from both lagging and leading indicators, though the latter most directly influence long-term valuation. Other stakeholders – e.g., consumers, suppliers, and employees – look to both past and anticipated performance in making judgments as to the quality and prospects of a company.

In general, contemporary ratings overweight backward-looking historical measures of performance and underrepresent forward-looking, leading measures. Correcting this imbalance is complicated by the inherent difficulty in quantifying the future. That is, what indicators will most accurately predict the performance of a company 3-5 years in the future and beyond? Rigorous sustainability ratings should contribute to this critical challenge.

A rating that comprises a balance of indicators is more likely to achieve strong market uptake than one that leans heavily in one direction or another. Further, ratings that rely exclusively on backward-looking, policy- and procedure-based indicators, with minimal attention to forward-looking, measurable outcomes, are unlikely to satisfy users who seek insights into a company's long-term prospects of becoming both a sustainability leader and a prosperous organization.

12. COMPARABILITY: *A rating should allow users to compare the performance of the same company over time and of different companies within the same time period.*

The Principle of Comparability seeks to bring sufficient consistency to a rating such that users can, with confidence, compare performance for the same company over time and across peer companies within the same time period. Comparability is critical to decision-making, investment or otherwise. Choices on the part of asset owners and asset managers, for example, require analysis of a time series, single-company perspective, as well as cross-company comparisons within sectors. The utility of a rating is compromised when either of these conditions is not met.