

SECOND PARTY OPINION (SPO)

Sustainability Quality of the Issuer and Green Bond Framework

Republic of Serbia
2 September 2021

VERIFICATION PARAMETERS

Type(s) of instruments contemplated	<ul style="list-style-type: none">• Green Bond Framework
Relevant standards	<ul style="list-style-type: none">• ICMA's Green Bond Principles
Scope of verification	<ul style="list-style-type: none">• Republic of Serbia Green Bond Framework (as of August 2021)• Eligible expenditure categories' selection criteria (as of August 2021)
Lifecycle	<ul style="list-style-type: none">• Pre-issuance verification
Validity	<ul style="list-style-type: none">• Until material changes are made to the Green Bond Framework and selection criteria

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Scope of work

The Republic of Serbia (“Serbia” or “The Republic”) commissioned ISS ESG to assist with its Green Bond Framework by assessing three core elements to determine the sustainability quality of the instruments:

1. Green Bonds’ link to Serbia’s sustainability strategy – drawing on Serbia’s overall sustainability profile and issuance-specific Use of Proceeds categories.
2. Serbia’s Green Bond Framework (August 2021 version) – benchmarked against the International Capital Market Association’s (ICMA) Green Bond Principles (GBPs).
3. The Selection Criteria – whether the projects contribute positively to the UN SDGs and perform against ISS ESG’s issue-specific key performance indicators (KPIs) (See Annex 1).

ISSUER OVERVIEW¹

The Republic of Serbia is committed to fight today’s multiple global challenges related to climate change, extinction of flora and fauna, endangered ecosystems, continuous growth of waste and pollution, and shortages of natural resources that result from climate change and pollution.

Located in the Balkans Peninsula, Serbia is among the European countries heavily affected by the impact of climate change and this trend is projected to continue, with estimates of temperature increases of 1.7 – 4.0°C, and even exceeding 5.0°C by the end of the century², depending on the global effort to reduce greenhouse gas (“GHG”) emission. Analysis of climate change in the region shows that human health, safety and quality of life are highly vulnerable to the effects of natural hazards and sectorial weather-related losses. Over the past two decades, droughts, floods, exceptionally harsh winters and other weather-related extreme events have caused major physical damage and financial losses in the country, with significant impacts on the economy, especially in the agricultural sector.

In light of such potentially devastating effects, Serbia has joined the global efforts to confront the threat of climate change through participation in global and regional initiatives in order to shift to a green economy.

¹ As provided by the issuer

² <https://www.rcc.int/news/383/rcc-publishes-study-on-climate-change-in-the-western-balkans-alarming-increase-of-temperature-over-the-whole-territory>

ISS ESG ASSESSMENT SUMMARY

SPO SECTION	SUMMARY	EVALUATION ³
<p>Part 1:</p> <p>Green Bonds link to issuer's sustainability strategy</p>	<p>According to the ISS ESG Country Rating published on 10.08.2021, the Republic of Serbia shows a medium sustainability performance on key ESG issues faced by sovereign issuers.</p> <p>The Use of Proceeds financed through these bonds are consistent with the issuer's sustainability strategy and material ESG topics for sovereigns. The rationale for issuing green bonds is clearly described by the issuer.</p>	<p>Consistent with issuer's sustainability strategy</p>
<p>Part 2:</p> <p>Alignment with GBPs</p>	<p>The issuer has defined a formal concept for its Green Bonds regarding use of proceeds, processes for project evaluation and selection, management of proceeds and reporting. This concept is in line with the ICMA Green Bond Principles.</p>	<p>Aligned</p>
<p>Part 3:</p> <p>Sustainability quality of the Selection Criteria</p>	<p>The overall sustainability quality of the Selection Criteria in terms of sustainability benefits, risk avoidance and minimisation is good based upon the ISS ESG assessment. The Green Bonds will (re-)finance eligible project categories which include renewable energy, green buildings, energy efficiency, pollution prevention and control, wastewater management and clean transportation.</p> <p>Those use of proceeds categories have a significant contribution to SDGs 6 "Clean water and sanitation", 7 "Affordable and clean energy", 11 "Sustainable cities and communities", 12 "Responsible consumption and production", 13 "Climate action" and SDG 15 "Life on Land" and a limited contribution to SDG 3 "Good health and well-being"⁴. The most material environmental and social risks associated with those use of proceeds categories have been well managed.</p>	<p>Positive</p>

³ ISS ESG's evaluation is based on Serbia's Green Bond Framework (August 2021 version), on the analysed Selection Criteria as received on the 30.08.2021, and on the ISS ESG Country Rating applicable at the SPO delivery date (updated on the 31.08.2021).

⁴ All green categories under Serbia's Green Bond Framework have a positive contribution to relevant SDGs. Some example of eligible expenditures are assessed as having no net impact on SDGs.

ISS ESG SPO ASSESSMENT

PART I: GREEN BONDS FRAMEWORK'S LINK TO SERBIA'S SUSTAINABILITY STRATEGY

A. ASSESSMENT OF SERBIA'S ESG PERFORMANCE

Methodological note: Please note that this section of the SPO is derived from the ISS ESG Country Rating of Serbia. In the context of the SPO, the analyst in charge of this report engaged with the issuer and reflected in this section further information collected throughout the engagement process.

The ISS ESG Country Rating provides material and forward-looking environmental, social and governance (ESG) data and performance assessments. For the purpose of assessing Serbia's ESG performance, ISS ESG used Serbia's Country Rating as a basis for this assessment. The overall analysis is graded on a twelve-point scale from A+ (the country shows excellent performance) to D- (the country shows poor performance or fails to demonstrate any commitment to appropriately address the topic).

COUNTRY	RATING
REPUBLIC OF SERBIA	C

ESG performance

As of 31.08.2021, Serbia is assessed as a moderate performer in terms of sustainability by the ISS ESG Country Rating methodology.

Key challenges faced by sovereign issuers in terms of sustainability management are displayed in the charts below, as well as the issuer's performance against those key challenges in comparison to the other countries' performance.

Governance opinion

Serbia is a parliamentary republic with a multi-party system. Yet, despite its democratic constitution and political system, the Freedom House Index considers Serbia as 'partly free' since 2019⁵. During the last general elections in June 2020, the eight-party government coalition For Our Children won a supermajority of seats with around 60% of the votes. The Government is led by Prime Minister Ana Brnabić of the center-right Serbian Progressive Party. Elections are considered free and fair, yet, some

⁵ Freedom House is a non-profit non-governmental organization that conducts research and advocacy on democracy, political freedom, and human rights. As part of its proprietary methodology, ISS ESG utilizes datasets published by Freedom house (among others) to conduct the governance assessment for the countries.

of irregularities have been observed in a past⁶ While fighting corruption and judicial reform remain key priorities for Serbia, population's confidence in the rule of law and corruption are perceived as major issues, with the latter negatively affecting the judiciary's independence.

Basic human rights and fundamental freedoms are protected by the Constitution and laws and - with a few exceptions - are respected by the government. There are reports that authorities arbitrarily interfere with citizens privacy and of police employing abusive and degrading treatment of suspects and detainees. Moreover, the freedom of speech and press is impaired since untransparent ownership structures of the media market lead to biased information coverage and occasionally journalists continue to be the victims of harassment. Although the law prohibits the discrimination of minorities, persons with disabilities and based on gender or sexual orientation, reports of such discrimination occurring are common. Serbia is one of the five countries which have reduced the gender pay gap the most in recent years⁷, but still gender pay gap remains high. However, women's political participation has improved significantly over the past years.

Serbia is an official candidate for membership in the European Union since 2012⁸. The country is not involved in any violent international conflicts, the military expenditure of 1.9% of the GDP in 2020 is on a higher level but still below the global average of 2.2%.

Social opinion

Serbia provides its citizens with a solid social security, healthcare and educational system⁹. Income and wealth are unequally distributed across the society. The past years have seen positive trends in form of a reduction of long-term unemployment and youth unemployment, while the overall employment rate has increased. Poverty rate is still above the average of the European Union. Basic labor rights are protected by law. However, the prohibition of forced labor is not always warranted, and child labor still occurs. Trafficking of people is not always effectively prosecuted.

Sustainability summary

Compared to other European countries Serbia is still a relatively new sovereign state.—Today, Serbia is a candidate country for the European Union membership, reflecting the significant progress made so far in structural and institutional reforms. Yet, levels of corruption are still perceived to be high, which has undermined the confidence of the population in the country's institutions and hampers societal change. Social conditions are sometimes harsh, and wealth is unequally distributed, compared to the EU average. Despite pledges to raise the share of renewables in the energy mix, Serbia's energy consumption and greenhouse gas emissions remain high and leave a considerable environmental impact. Its reliance on fossil fuel is not yet in line with the 1.5°C climate goal stipulated by the Paris Agreement.

⁶ The Organization for Security and Co-operation in Europe's (OSCE) Office for Democratic Institutions and Human Rights (ODIHR) noted that unbalanced media coverage significantly disadvantaged the opposition during the past presidential elections

⁷ Global Gender Gap Report 2021, World Economic Forum: "The five most-improved countries in the overall index this year are Lithuania, Serbia, Timor-Leste, Togo and United Arab Emirates, having narrowed their gender gaps by at least 4.4 percentage points or more."

⁸ According to the issuer, since the opening of Serbia's accession negotiations in 2014, 18 out of 35 chapters have been opened, two of which provisionally closed.

⁹ Nevertheless, funding and quality of public services are rather low compared to e.g. member states of the European Union

Breaches of international norms and ESG controversies

The Republic of Serbia has been facing mild to severe controversies around child labor, corruption, freedom of speech and press and other human right related issues. However, in recent years, the country has implemented several measures to address these issues at a national level which are presented in the subsequent section.

B. CONSISTENCY OF GREEN BONDS WITH SERBIA'S SUSTAINABILITY STRATEGY

Key sustainability objectives and priorities defined by the issuer

On the international level, Serbia is a signatory to, and has ratified, international environmental agreements, including the 2030 Agenda for Sustainable Development, the UN Framework Convention on Climate Change, the Paris Agreement, the Kyoto Protocol and the Doha Amendments to Kyoto Protocol.

Subsequent to the adoption of the 2030 Agenda for Sustainable Development, the Republic of Serbia began to establish national mechanisms to implement it. By the end of 2015, the Government had established the Inter-Ministerial Working Group for the Implementation of the United Nations 2030 Agenda for Sustainable Development, composed of high-ranking representatives of 27 line ministries and other institutions. In addition to this crucial mechanism, established under the executive branch at national level, in 2017, the Focus Group of the Serbian National Assembly was established to develop oversight mechanisms and oversee the SDG implementation. This mechanism oversees and supports the implementation of the Agenda.

In July 2019, the Government of the Republic of Serbia submitted its first Voluntary National Review at the United Nations High-level Political Forum meeting, describing all its achievements in implementing the SDGs, with a special focus on local communities and youth. The first Voluntary National Review by the Republic of Serbia was a cornerstone of the process of review which required the cooperation of the Serbian Government and society in order to make concerted progress towards the national vision of growing into sustainable economy by creating equal sustainable opportunities accessible to all across Serbia.

In December 2020, the Progress Report on the Implementation of Sustainable Development Goals by 2030 in the Republic of Serbia was published. The progress on 17 SDGs has been monitored through 83 indicators. Mapping results show that, under its existing strategic framework, Serbia is already committed to the achievement of the Sustainable Development Goals.

The approach to the environment and climate change is strategically defined in a number of policies pertaining to the water management, sustainable use of resources, renewable energy resources and energy efficiency, and risk management. Some of strategic documents include:

- Water Management Strategy of the Republic of Serbia for the period 2016 – 2034
- Strategy for Agriculture and Rural Development for the period 2014 – 2024
- National Programme for Environmental Protection
- Spatial Plan for the Republic of Serbia 2010 – 2020

- National Strategy for Sustainable Use of Natural Goods and Resources
- National Sustainable Development Strategy
- National Environmental Approximation Strategy for the Republic of Serbia
- Energy Sector Development Strategy until 2025
- National Renewable Energy Action Plan 2013 – 2020
- Energy Strategy of the Energy Community
- National Energy Efficiency Action Plans (2010 – 2012, 2013 – 2015 and 2016 – 2018)

The Government's Economic Reform Programme 2021-2023, as a key strategic document for coordination of economic policies with the EU, was approved in January 2021, and sets out a number of structural reforms particularly in the areas of energy efficiency, circular economy, transportation, agriculture, industry, services, all linked to the UN SDGs.

In March 2021, the National Assembly of Serbia adopted the Law on Climate Change, which shows that environmental protection and climate change issues are high on the Governments' priority list. The goal of this law is to establish a system to reduce GHG emissions in a cost-effective way, thus contributing to the achievement of necessary of GHG emissions to avoid adverse effects of climate change. The law establishes mechanisms for timely, transparent, accurate, consistent, comparable and complete reporting and verification of information on fulfilment of Serbia's international obligations, such as the UN Framework Convention, the Paris Agreement and the Kyoto Protocol. It also harmonizes domestic legislation with European Union regulations and directives.

Further to the adoption of the Law on Climate Change, the following strategies and initiatives shall be implemented:

- 1) Low Carbon Development Strategy; prepared for a period of at least ten years; policy documents must contain a quantitative assessment of the effects on changing GHG emission levels;
- 2) Action Plan for the Implementation of the Strategy; prepared for a period of at least five years; prescribes general goals, measures and activities in the sectors; and
- 3) Programme of Adaptation to Changing Climatic Conditions; to identify the impacts of climate change on sectors and systems and determine adaptation measures in accordance with the law governing the Serbian planning system.

The law further establishes the National Council for Climate Change (as an advisory body to the Government) and the National GHG Inventory System. In order to achieve the intended aims of this legislation, public bodies, in addition to the adoption of specific by-laws and ordinances, should also adopt appropriate sectoral policies and measures.

In April 2021, the National Assembly of Serbia adopted the Law on the Use of Renewable Energy Sources, which is seen as a catalyst for major investment in the construction of energy utilities using renewable energy sources, with emphasis on solar power plants and wind farms, which will accelerate the decarbonisation of Serbia's energy sector. Within the same package of laws, the Assembly adopted the Law on Energy Efficiency and Rational Use of Energy ("LEERUE"). The purpose of this legislation is to improve energy efficiency, aiming, among other things, to reduce the negative impact of the energy sector on the environment and to support climate change mitigation. LEERUE is the legal basis for the establishment of Directorate that will provide financial support for improving energy

efficiency. Within this legislative package, an amendment to the Law on Energy was also passed, which creates a legal basis for the adoption of the National Energy and Climate Plan. The Plan sets out the goals relating to renewable energy sources, energy efficiency and the reduction of GHG emissions along with measures which will support achieving these objectives. The Republic of Serbia is currently developing its energy strategy for 2040 and beyond.

Rationale for issuance

Serbia’s dedication to a green transition is underpinned by its focus on the integration with the European Union (“EU”) and the related requirement to align national legislation with EU law. Given that integration with the EU forms part of Serbia's strategy, all reforms are geared towards that goal, and there is full consensus to implement the aims of the European Green Deal throughout Serbia’s EU integration process. By signing the Sofia Declaration on the Green Agenda for the Western Balkans, Serbia acknowledged the need to set the basis for a major transformation to turn sustainability and resilience challenges into opportunities and to transpose elements of the European Green Deal in all interrelated priority sectors.

In this context, the Green Bond Framework of the Republic of Serbia has been established to present details on the commitments and obligations that the government intends to fulfil as an issuer of Green Bonds. From a financial and legal point of view, these bonds must fulfil the obligation for all sovereign bond issuances in accordance to the Law on Budget System, Law on Budget of the Republic of Serbia and other related laws and by-laws. The proceeds raised from the issuance of sovereign bonds including Green Bonds will contribute to the financing of the sovereign budget as a whole. Bonds issued under this Framework rank pari passu with other bonds of the Republic of Serbia and can be issued in all formats and sizes such as a conventional instrument.

Contribution of Use of Proceeds categories to sustainability objectives and priorities

ISS ESG mapped the Use of Proceeds categories financed under this Green Bond Framework with the sustainability objectives defined by the issuer, and with the key ESG industry challenges as defined in the ISS ESG Country Rating methodology. Key ESG industry challenges are key issues that are highly relevant for sovereign or sub-sovereign issuers when it comes to sustainability. From this mapping, ISS ESG derived a level of contribution to the strategy of each Use of Proceeds categories.

USE OF PROCEEDS CATEGORY	SUSTAINABILITY OBJECTIVES FOR THE ISSUER	KEY ESG CHALLENGES FOR LOCAL AUTHORITIES AND SOVEREIGN ISSUERS	CONTRIBUTION
Renewable Energy	✓	✓	Contribution to a material objective
Energy Efficiency	✓	✓	Contribution to a material objective

Transportation	✓	✓	Contribution to a material objective
Pollution Prevention and Control and Circular Economy	✓	✓	Contribution to a material objective
Biodiversity and Agriculture	✓	✓	Contribution to a material objective
Sustainable Water and Wastewater Management	✓	✓	Contribution to a material objective

Opinion: *ISS ESG finds that the Use of Proceeds financed through this framework are consistent with Serbia’s sustainability strategy and material ESG topics for sovereign issuers. The rationale for issuing Green Bonds is clearly described by the issuer.*

PART II: ALIGNMENT WITH ICMA GREEN BOND PRINCIPLES

1. Use of Proceeds

The equivalent amount to the net proceeds of issued Green Bonds will be used to finance and/or re-finance new and existing expenditures ('**Eligible Green Expenditures**'). Eligible Green Expenditures may include capital expenditures, operational expenditures, tax expenditures and transfers. The Eligible Green Expenditures are considered in the budget of the Government of Serbia and are aimed at promoting Serbia's transition to a low-carbon, climate resilient and ecological economy as well as contributing to United Nations Sustainable Development Goals. In order to be eligible, the expenditures must fall in at least one of the categories described below ('**Green Categories**').

PROJECT CATEGORY	ELIGIBILITY CRITERIA	EXAMPLES OF GREEN EXPENDITURE
Renewable Energy	<ul style="list-style-type: none"> Expenditures to support the development of renewable energy generation capacity All assets have to respect a 100g CO₂e/kWh threshold Expenditures related to renewable energy storage capacities, grids managing higher renewable energy production and securing energy stability 	<ul style="list-style-type: none"> Expenditures and subsidies related to promote the production and distribution of energy from renewable sources including solar / wind / geothermal / biomass / small-scale hydro (<50MW) Expenditures and subsidies related to measures to ensure energy security Expenditures and subsidies related to state-owned energy company Investments and subsidies for financing projects from renewable sources (e.g. strategic partnership and strengthening the geothermal potential)
Energy Efficiency	<ul style="list-style-type: none"> Expenditures related to the improvement of energy efficiency of buildings, energy related products, industrial production and processes Expenditures related to increased usage of sustainable heating and cooling and efficient cogeneration, waste heat usage and thermal heat insulation 	<ul style="list-style-type: none"> Investments and subsidies related to increase of energy efficiency of existing residential and public sector buildings Investments to district energy (heating/cooling) powered by renewable energy sources incl. biomass Subsidies for wider use of efficient energy related products including energy efficient tyres Expenditures to develop more energy efficient agricultural and industrial production including systems, equipment and processes Expenditures to support energy efficiency improvement in the public and private sector

		<ul style="list-style-type: none"> Investments in efficient heat production systems, heat recovery and efficient cogeneration Other support for improvement of energy efficiency financed/promoted by the Directorate for financing and promotion of energy efficiency
Transport	<ul style="list-style-type: none"> Expenditures related to passenger and freight railway infrastructure and public transportation and infrastructure Expenditures related to the acquisition of hybrid or zero-emission vehicles and related charging infrastructures Expenditures related to waterway infrastructure 	<ul style="list-style-type: none"> Investments for the construction, improvement and maintenance of rail infrastructure and electric rolling stock for passenger and freight transportation Investment related to construction, maintenance and upgrade of new electric metro, tram and bus lines and electric rolling stocks/vehicles Investments related to (eco-friendly) road public transportation and higher usage of renewable energy sources in the transport sector Investments related to the extension, improvement and maintenance of waterway infrastructure Subsidies to incentivise the switch to more sustainable mode of transport including public transportation Subsidies to incentivize the acquisition of hybrid¹⁰ and/or zero-emission vehicles and related charging infrastructure Subsidies to establishing competent e-mobility services, research and development programmes, introducing bonus systems, awareness campaigns, simplifying regulations, among other measures Investment to purchase hybrid and/or zero-emission vehicles and related charging infrastructure own by the public authorities Investments in bicycle and pedestrian traffic infrastructure
Sustainable Water and Wastewater Management	<ul style="list-style-type: none"> Expenditures related to sustainable management of water 	<ul style="list-style-type: none"> Construction of drinking water treatment plant and infrastructure for clean water supply

¹⁰ For motorbikes, passenger cars, and light commercial vehicles, emissions must be lower than 50g CO₂e/km until 31 December 2025. From 01 January 2026, the CO₂ emissions threshold falls to 0g CO₂e/km.

	<p>resources and to secure water supply</p> <ul style="list-style-type: none"> ▪ Expenditures related to treatment of wastewater ▪ Expenditures related to flood protection and risk mitigation 	<ul style="list-style-type: none"> ▪ Construction of dams and reservoir for water collection ▪ Measures aimed at protection and preservation of water from pollution as natural resource and quality monitoring ▪ Installation and improvement of wastewater collection and treatment infrastructure ▪ Water supply and wastewater treatment program in medium-sized municipalities in Serbia ▪ Expenditures for the development of flood protection and to strengthen resilience of water infrastructure in case of severe weather and climate change events
<p>Pollution Prevention and Control and Circular Economy</p>	<ul style="list-style-type: none"> ▪ Expenditures related to waste management and resource recovery ▪ Expenditures to promote sustainable consumption and production 	<ul style="list-style-type: none"> ▪ Expenditures for waste collection, treatment and recycling infrastructure, equipment and projects ▪ Expenditures to prevent or address illegal waste disposal ▪ Rehabilitation and closure of unsanitary landfills ▪ Hazardous waste management and rehabilitation of eco-system ▪ Expenditures to incentivize increased usage of recyclable recycled, and/or re-used products and materials
<p>Protection of the Environment and Biodiversity and Sustainable Agriculture</p>	<ul style="list-style-type: none"> ▪ Expenditure related to sustainable land use as well as protection and restoration of biodiversity and ecosystems 	<ul style="list-style-type: none"> ▪ Expenditures to promote low-carbon farming and climate-friendly and organic practices ▪ Expenditures to development and implementation of new, more resistant, varieties and species ▪ Expenditure to monitor and improve quality of arable land ▪ Expenditures related to sustainable forest management ▪ Expenditures to protect and restore natural landscapes and preserve landscape diversity, including terrestrial, river and swamp ecosystems ▪ Measures to protect species and migratory species ▪ Management and maintenance of national parks

		<ul style="list-style-type: none"> ▪ Infrastructure and systems to improve resilient and offer protection against consequences resulting from climate change, e.g. floods, drought, hail, forest fires among others
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Exclusion Criteria

As Green Expenditure under this Framework, Serbia explicitly excludes financing the following activities:

- Exploration and production of fossil fuels
- Energy power generation using fossil fuels as feed stock
- Manufacturing and production of armaments, defense, tobacco and alcoholic products, and activities related to gambling
- Deforestation and degradation of forest

Naturally, any expenditures that violate the Constitution of Serbia, the EU Charter of Fundamental Rights, as well as national laws or regulations are excluded from the national budget.

Opinion: ISS ESG considers the Use of Proceeds description provided by Serbia’s Green Bond Framework as aligned with the ICMA Green Bond Principles. The Green Expenditures are aligned with the example of project categories defined by the GBPs. Furthermore, the issuer explicitly excludes harmful project categories in line with best market practices.

2. Process for Expenditure Evaluation and Selection

The Government of Serbia has established an evaluation and selection process to determine the eligibility of expenditures as part of the Green Bond Framework. An intergovernmental Green Bond Working Group (“GBWG”) has been established to oversee the process, the selection of Green Expenditures, allocation of funds received and the delivery of the allocation and impact reporting to investors and the public. Under the responsibility of the Ministry of Finance, the GBWG will pool all the expertise needed for a thorough and robust evaluation and selection of Green Expenditures. The GBWG will consist of members from:

- Prime Minister’s Office
- Ministry of Finance
- Ministry of Environmental Protection
- Ministry of Construction, Transport and Infrastructure
- Ministry of Mining and Energy
- Ministry of European Integrations
- Ministry of Agriculture, Forestry and Water Management

The process for evaluation and selection of Green Expenditures is performed on an annual basis, or more often if necessary, for example in the event of significant change of the underlying expenditures. The process includes ensuring that an amount corresponding to the proceeds from the issuance of Green Bonds is only linked to the qualified Green Expenditures based on the criteria determined in this Framework, forming the Green Expenditure Portfolio.

The Green Expenditure Portfolio may include expenditures made within the three budget years preceding the year of issuance, as well as those made in the same year as the issuance and/or future budget expenditures.

Each relevant ministry is requested to provide a list of budget expenditures with the necessary level of information to demonstrate alignment with the eligibility criteria for Green Expenditures defined in Serbia's Green Bond Framework. The GBWG reviews the potential expenditures, evaluates the compliance with eligibility criteria and approves the inclusion into the Green Expenditure Portfolio. The Ministry of Finance is responsible to initiate and coordinate the process and will be supported by the Public Debt Administration.

Opinion: ISS ESG considers that the Process for Expenditure Evaluation and Selection aligns with the requirements outlined in the ICMA Principles regarding the process for expenditure evaluation and selection. Serbia has set a clear and detailed process to assign responsibility and accountability among various departments of the Government to select expenditures in line with transparent selection criteria.

3. Management of the Proceeds

The proceeds from the issued Green Bonds will be part of the overall funding of the Republic of Serbia. As part of its overall responsibility, the Public Debt Administration is responsible for the issuance of Green Bonds and the proceeds will be managed in the same way as all government securities and will be administered in accordance to the general treasury policy.

The allocation of an amount equal to the proceeds of issued Green Bonds to the Green Expenditure Portfolio will thereafter be tracked using a virtual register following a portfolio approach.

In principle, for Green Expenditures that are partly financed by a subsidized loan by a multilateral agency, national or supranational entity, such as the European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Kreditanstalt für Wiederaufbau (KfW) VEB.RF, or World Bank Group, an amount net of funding with specific purposes will be included in the Green Expenditure Portfolio.

The virtual register will be managed by the Public Debt Administration, supervised by the GBWG. Serbia is committed to maintain a Green Expenditure Portfolio exceeding the amount of proceeds raised from Green Bond issuances. Moreover, proceeds from issued Green Bonds shall be allocated to Green Expenditure Portfolio as soon as possible, in any case within two budget years following the issuance. In case of a potential shortfall of the Expenditure Portfolio, for example due to postponement, cancellation, divestment or ineligibility, the selected expenditure will be replaced within twelve months. New Green Expenditure (including replacements) can only be included after approval of the GBWG.

Opinion: ISS ESG finds that Management of Proceeds proposed by Serbia's Green Bond Framework is well aligned with the ICMA Green Bonds Principles. An amount at least equal to the amount of Green

Bonds Proceeds will be allocated to green expenditures. The expected allocation period is defined and follows best market practices.

4. Reporting

The Republic of Serbia commits to publish a “Green Bond Report”, providing investor and the public with transparent disclosure on the allocation of proceeds to Green Expenditures, as well as on the results and positive environmental impact of those expenditures. The Green Bond Report will be published on an annual basis, as long as there is any outstanding Green Bonds, until full allocation of proceeds. The first report will be published during the year following the Green Bond issuance.

The Ministry of Finance will be responsible for the publication of the Green Bond Report. The information and data will be provided by the relevant ministries and the Public Debt Administration will be responsible for the coordination of data collection and the preparation of the Green Bond Report. The Green Bond Report will be published online at: <http://www.javnidug.gov.rs/>

Allocation Reporting

The Ministry of Finance, through the Public Debt Administration, will provide information on the distribution of the proceeds from issued Green Bonds between the expenditure in the Green Expenditure Portfolio, which may include:

- An overview of the allocation of the issued Green Bonds to the Green categories
- A description of Green Expenditures, at least on an aggregated basis
- Share of allocation of proceeds to refinancing existing Green Expenditures vs financing new and future Green Expenditures
- A breakdown of the type of Green Expenditures
- The amount of unallocated proceeds

Confidentiality agreements that could limit the amount of details may be applied, in response to which the information would be presented in generic terms and/or on an aggregate basis.

Impact Reporting

The impact report will address the positive environmental impact of Green Expenditures. The report will include result and environmental impact indicators outlining the positive environmental impact of Green Expenditures where the information is provided in existing publicly available reports, and may include:

- Specific result and environmental impact indicators, where feasible and available, related to the Green Expenditures to which proceeds from issued Green Bond have been allocated
- The underlying assumptions and methodology used

At least one indicator for each Green category will be reported. The result and environmental impact statement may be measured on a portfolio basis rather than directly corresponding impacts from funded projects during a specific year.

ELIGIBLE CATEGORY	POTENTIAL INDICATORS
Renewable Energy	<ul style="list-style-type: none"> ▪ Number of projects funded ▪ Annual GHG emissions avoided ▪ Renewable energy capacity installed ▪ Annual energy produced
Energy Efficiency	<ul style="list-style-type: none"> ▪ Number of projects funded and public calls implemented ▪ Number of buildings from the public and private sectors with improved energy efficiency levels to the threshold defined in national legislation ▪ Annual GHG emissions avoided ▪ Annual energy savings
Transport	<ul style="list-style-type: none"> ▪ GHG emissions avoided ▪ Annual energy savings ▪ Length of infrastructure constructed and/or maintained ▪ Number of people who use new ecological public transport ▪ Number of charging stations for electric vehicles constructed and/or maintained ▪ Number of vehicles subsidized
Sustainable Water and Wastewater Management	<ul style="list-style-type: none"> ▪ Number of projects funded ▪ Number of interventions on reservoirs and water supply systems ▪ Number of complex water systems whose safety is increased ▪ Construction and restoration of reservoir storage capacity ▪ Amount of clean water provided and number of people with access to improved sanitation facilities ▪ Reduction in water loss in transfer and/or distribution ▪ Amount of wastewater treated, avoided, reused and/or minimised at source ▪ Length of wastewater network installed / maintained ▪ Number of people and/or enterprises (e.g. companies or farms) benefitting from measures to mitigate the consequences of floods and droughts
Pollution Prevention and Control and Circular Economy	<ul style="list-style-type: none"> ▪ Number of projects funded ▪ Amount of waste collected, separated, treated and/or recycled ▪ Number of polluted sites under remediation ▪ Amount of recyclable goods produced

Protection of the Environment and Biodiversity and Sustainable Agriculture	<ul style="list-style-type: none">▪ Number of projects funded▪ Number of Natura 2000 sites▪ Area of (improved) sustainable forest management▪ GHG emissions removed and captured▪ Area protected / restored / maintained▪ Area of sustainable agriculture▪ Increase in certified agriculture measured in number of certification schemes▪ Number of people and/or enterprises (e.g. companies or farms) benefitting from measures to mitigate the consequences of floods, droughts, or hail
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Opinion: ISS ESG finds that the reporting proposed by Serbia's Green Bond Framework is aligned with the ICMA Green Bonds Principles. Allocation reporting is clearly described and in line with the requirements set in the principles. Serbia also defines the scope and magnitude of its impact reporting, in line with the market best practices.

External review

Republic of Serbia intends to engage an independent external verifier to provide assurance on the allocation reports in order to ensure sustainable conformity of the issued Green Bonds with this Framework. An assurance will be sought annually until full allocation of proceeds, and the results will be published alongside the respective reporting.

PART III: SUSTAINABILITY QUALITY OF THE ISSUANCE

A. CONTRIBUTION OF THE GREEN BONDS TO THE UN SDGs

Based on the assessment of the sustainability quality of the selection criteria applicable to eligible project categories under Serbia's Green Bond Framework and using a proprietary methodology taking into account the issuer's specific geographical and sectorial context, ISS ESG assessed the contribution of the Serbia's Green Bond Framework to the Sustainable Development Goals defined by the United Nations (UN SDGs). This assessment is based on the combination of two fundamental perspectives, namely a Use of Proceeds category's intended purpose and potential negative side effects that can be attributed with the Use of Proceeds category.

This assessment is displayed on 5-point scale (see Annex 1 for methodology):

Significant Obstruction	Limited Obstruction	No Net Impact	Limited Contribution	Significant Contribution
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Each of the Green Bonds' Use of Proceeds categories has been assessed for its contribution to, or obstruction of, the SDGs according to ISS ESG's methodology described above. Use of Proceeds contribution level is mapped according to an overall appraisal of each category.

USE OF PROCEEDS	CONTRIBUTION OR OBSTRUCTION	SUSTAINABLE DEVELOPMENT GOALS
Renewable Energy	Significant Contribution	<div style="display: flex; justify-content: space-around;"> <div style="background-color: #ffc107; padding: 5px; text-align: center;"> 7 AFFORDABLE AND CLEAN ENERGY </div> <div style="background-color: #28a745; padding: 5px; text-align: center;"> 13 CLIMATE ACTION </div> </div>
Energy Efficiency ¹¹	Limited Contribution	<div style="display: flex; justify-content: space-around;"> <div style="background-color: #ffc107; padding: 5px; text-align: center;"> 7 AFFORDABLE AND CLEAN ENERGY </div> <div style="background-color: #28a745; padding: 5px; text-align: center;"> 13 CLIMATE ACTION </div> </div>
Transportation ¹²	Significant Contribution	<div style="display: flex; justify-content: space-around;"> <div style="background-color: #ffc107; padding: 5px; text-align: center;"> 7 AFFORDABLE AND CLEAN ENERGY </div> <div style="background-color: #ffc107; padding: 5px; text-align: center;"> 11 SUSTAINABLE CITIES AND COMMUNITIES </div> </div> <div style="background-color: #28a745; padding: 5px; text-align: center; margin-top: 10px;"> 13 CLIMATE ACTION </div>

¹¹ The limited contribution refers to the overall appraisal of the various elements financed, including thermal insulation for existing buildings, district heating and cooling systems based on renewable energy including biomass, systems and equipment for energy efficiency in agricultura and industrial production, air conditioning systems, etc. Parts of the transport Use of Proceeds category is mapped to limited or no net contribution referring to the fact that the expenditures to be (re-)financed continues to partially rely on technologies where negative impacts cannot be excluded or positive impacts are difficult to quantify.

¹² The significant contribution refers to the overall appraisal of the various elements financed, including infrastructure supporting the provision of electric public transport and individual electric transports. Parts of the transport Use of Proceeds category is mapped to limited contribution referring to the fact that the transportation sector as a whole continues to partially rely on technologies where negative impacts cannot be excluded.

Pollution Prevention and Control and Circular Economy	Significant Contribution	
Protection of the Environment and Biodiversity	Significant Contribution	
Sustainable Agriculture¹³	Significant Contribution	
Sustainable Water and Wastewater Management	Significant Contribution	 
	Limited Contribution	

¹³ The significant contribution refers to the overall appraisal of the various elements financed, including organic agricultural production incentive programme (including crop farming and livestock) and irrigation, hail protection and agricultural machinery subsidies enabling the achievement of the organic production incentive programs. All expenditures under this category requires the subsidy receiver concluding a contract with a control organisation for the control and certification for organic production for the fiscal year in which they seek a subsidy , or being in a conversion period from traditional to organic agriculture, with a view to entering the certification process, or respectively for organic farming. Parts of the sustainable agriculture Use of Proceeds category is mapped to limited or no net contribution referring to the fact that the subsidy receiver which did not yet obtained organic label or complete conversion cycle partially rely on solutions where negative impacts cannot be excluded.

B. MANAGEMENT OF ENVIRONMENTAL AND GREEN RISKS ASSOCIATED WITH THE SELECTION CRITERIA

The table below presents the findings of an ISS ESG assessment of the Selection Criteria against ISS ESG KPIs.

ASSESSMENT AGAINST ISS ESG KPI

Biodiversity management

- ✓ Law on nature protection of the Republic of Serbia regulates production, collecting, and trade of protected species. It also establishes measures to ensure species' protection. For relevant expenditures categories, environmental impact assessment is carried out for all eligible expenditures.

Dialogue with local communities

- ✓ For infrastructure-related expenditures, dialogue with local communities feature as an integral part of the planning process in line with national legislation (e.g. sound and accessible information of communities through mass media and relevant authorities, grievance mechanisms, mandatory inclusion of comments and objections from public, legal and physical persons in drafting plan). However, no information is available on compensation schemes for affected local communities.

Labor and Health and Safety

- ✓ All eligible expenditures under the framework are subject to high standards regarding labour and health and safety defined by national legislation. Project-related government expenditures are then subject to supervision, compliance monitoring and audits supervised by administrative bodies within the Ministry of Labour and Social Policy. Any expenditures that violate the Constitution of Serbia that reflect ILO Core Conventions, the EU Charter of Fundamental Rights or national regulations are excluded from national budget and thus from eligibility under Serbia's Green Bond Framework.

Safety of buildings and infrastructure users

- ✓ Regarding infrastructure facilities, all expenditures are covered under the Law on planning and construction¹⁴ which mandates that any new construction must demonstrate fire protection compliance with national legislation. Local authorities conduct implementation check and audit on site to ensure law implementation. The Law on Housing and Maintenance of Buildings¹⁵ covers the requirement for installation for fire detection and notification systems, extinguishers, safety lighting etc. Building maintenance require ongoing preventative measures on evacuation procedures.

Waste management and pollution prevention

- ✓ For a majority of eligible expenditures, the issuer has implemented due diligence processes to ensure that enterprises managing projects have received certifications such as ISO 14001 and ISO 9001 or have implemented measures, policies and control mechanisms reflecting high

¹⁴ https://www.paragraf.rs/propisi/zakon_o_planiranju_i_izgradnji.html

¹⁵ https://www.paragraf.rs/propisi/zakon_o_stanovanju_i_odrzavanju_zgrada.html

standards on waste management and pollution prevention. For the remaining expenditures public enterprises have set business strategy to implement such measures and/or obtain such certificates, but no evidence is available on whether those are implemented.

Environmental impact of agriculture

✓ For all eligible expenditures, basic standards are in place regarding soil, biodiversity and water management in agriculture and forestry-related expenditures are in place. For projects which have received organic label, alignment with high standards can be ensured. However, some subsidy receiver which have committed to but have not yet obtained organic label or in the process of completing conversion cycle from traditional to organic agriculture, partially rely on solutions where negative impacts cannot be excluded.

Water management

○ All public enterprises in major cities have set business strategy based on ISO 14001, ISO 9001 and OHSAS 180001. However, no evidence is available on the share of enterprises, public or private, benefitting from expenditures under the Green Bond Framework that have received such certifications.

Environmental impact of hydropower plans

✓ All expenditures are related to hydropower plants of moderate scale (e.g. max 50 MW). Additionally, under the Public Procurement Law¹⁶ business entities are obliged to respect obligations in the field of environmental protection, social and labor law, as well as obligations from collective agreements, i.e. provisions of international law related to environmental protection, social and labor law, in the execution of public procurement contracts.

¹⁶ Public Procurement Law: <https://www.paragraf.rs/propisi/zakon-o-javnim-nabavkama.html>

DISCLAIMER

1. Validity of the SPO: Until material changes are made to the framework or the selection criteria.
2. ISS ESG uses a scientifically based rating concept to analyse and evaluate the environmental and Green performance of companies and countries. In doing so, we adhere to the highest quality standards which are customary in responsibility research worldwide. In addition, we create a Second Party Opinion (SPO) on bonds based on data from the issuer.
3. We would, however, point out that we do not warrant that the information presented in this SPO is complete, accurate or up to date. Any liability on the part of ISS ESG in connection with the use of these SPO, the information provided in them and the use thereof shall be excluded. In particular, we point out that the verification of the compliance with the selection criteria is based solely on random samples and documents submitted by the issuer.
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ANNEX 1: Methodology

ISS ESG Green KPIs

The ISS ESG Green Bond KPIs serve as a structure for evaluating the sustainability quality – i.e. the Green and environmental added value – of the use of proceeds of Serbia’s Green Bonds.

It comprises firstly the definition of the use of proceeds category offering added Green and/or environmental value, and secondly the specific sustainability criteria by means of which this added value and therefore the sustainability performance of the assets can be clearly identified and described.

The sustainability criteria are complemented by specific indicators, which enable quantitative measurement of the sustainability performance of the assets and which can also be used for reporting. If a majority of assets fulfill the requirement of an indicator, this indicator is then assessed positively. Those indicators may be tailor-made to capture the context-specific environmental and Green risks.

To review the KPIs used in this SPO, please contact Federico Pezzolato (details below) who will send them directly to you.

Environmental and Green risks assessment methodology

ISS ESG evaluates whether the assets included in the asset pool match the eligible project category and criteria listed in the Green Bond KPIs.

All percentages refer to the amount of assets within one category (e.g. wind power). Additionally, the assessment “no or limited information is available” either indicates that no information was made available to ISS ESG or that the information provided did not fulfil the requirements of the ISS ESG Green Bond KPIs.

The evaluation was carried out using information and documents provided to ISS ESG on a confidential basis by Serbia (e.g. Due Diligence Reports). Further, national legislation and standards, depending on the asset location, were drawn on to complement the information provided by the issuer.

Assessment of the contribution and association to the SDG

The 17 Sustainable Development Goals (SDGs) were endorsed in September 2015 by the United Nations and provide a benchmark for key opportunities and challenges toward a more sustainable future. Using a proprietary method, ISS ESG identifies the extent to which Serbia’s Green Bonds contributes to related SDGs.

ANNEX 2: ISS ESG Country Rating Methodology

Serbia

Methodology - Overview

The ESG Country Rating methodology was originally developed by Institutional Shareholder Services Germany (formerly oekom research) and has been consistently updated for many years.

ESG Country Rating – The ESG Country Rating universe comprises 58 countries, as well as Hong Kong and the European Union, representing 96 per cent of global outstanding sovereign debt (as of June 2018). The assessment of a country's sustainability performance is based on approximately 100 environmental, social and governance criteria with equal weight assigned to the social and environmental dimension. All criteria are individually weighted and evaluated and the results are aggregated to yield an overall score (rating). The selection of criteria is derived from ISS ESG's understanding of sustainability and reflects various global challenges that are embodied in the Sustainable Development Goals. Criteria are selected according to their relevance (materiality) and the quality of data regarding availability, up-to-dateness and consistency for all the countries rated.

Country controversies – In addition to the rating, ISS ESG conducts a comprehensive analysis of relevant controversies. Thereby, our clients have the possibility to consider, either separately or in addition to the rating, circumstances in areas they view as especially critical. The country controversy assessment is either directly derived from information provided by credible and acknowledged external sources, such as indices or blacklists, or it is based on the country's performance in the respective rating section. In the latter cases, underperformance in a specific set of indicators constitutes a controversy. Some controversy issues are delineated on different levels of severity.

Country leaders - List (in alphabetical order) of the top three countries from the ESG Country Rating universe at the time of generation of this report.

Criteria design – The rating comprises both qualitative and quantitative criteria. For instance, the safeguarding of fundamental freedoms by a country's government is mostly assessed in qualitative terms, while a country's consumption of resources is quantified. Qualitative criteria are evaluated against absolute targets and/or best practices, the assessment of quantitative indicators is based on thresholds. Those either reflect normative considerations and/or relative performance in a given area. In order to ensure their validity, some quantitative indicators are normalised against eligible denominators. To assess the quality of government policy in a specific area, we use indicators measuring input, such as spending on education as a proportion of GDP, as well as criteria measuring output, such as female participation in education.

Decile Rank - The Decile Rank indicates in which decile (tenth part of total) the individual Country Rating ranks from 1 (best – country's rating is in the first decile within the country universe) to 10 (lowest – country's rating is in the tenth decile within the country universe). The Decile Rank is determined based on the underlying numerical score of the rating. If the total number of countries cannot be evenly divided by ten, the surplus countries are distributed from the top (1. decile) to the bottom. If there are Country Ratings with identical absolute scores that would span a division in decile ranks, all ratings with an equal decile score are classified in the higher decile, resulting in a smaller number of Country Ratings in the decile below.

Distribution of Ratings - Overview of the distribution of the ratings of all countries that are included in the ESG Country Rating universe (country portrayed in this report: dark blue).

Rating Scale – countries are rated on a twelve-point scale from A+ to D-:

A+: the country shows excellent performance

D-: the country shows poor performance

Overview of the range of scores achieved in the ESG Country Rating universe (light blue) and indication of the grade of the country evaluated in this report (dark blue).

Sources of information - The sources we draw on include international institutions such as the World Bank, the International Energy Agency (IEA) and the World Health Organisation (WHO), as well as respected non-governmental organisations such as Amnesty International, Transparency International and the Stockholm International Peace Research Institute (SIPRI). A selection of sources used for this report is illustrated in the annex.

Status & Prime Threshold – Countries are categorised as Prime if they achieve/exceed the minimum sustainability performance requirements (Prime threshold) defined by ISS ESG for the Country Rating.

Update cycle - The vast majority of rating criteria is updated annually, only single indicators receive event-driven updates. The exact timing is determined by the publication dates of major sources of information.

ANNEX 3: Quality management processes

SCOPE

Serbia commissioned ISS ESG to compile a Green Bonds SPO. The Second Party Opinion process includes verifying whether the Green Bond Framework aligns with the ICMA Green Bonds Principles and to assess the sustainability credentials of its Green Bonds, as well as the issuer's sustainability strategy.

CRITERIA

Relevant Standards for this Second Party Opinion

- ICMA Green Bonds Principles
- ISS ESG KPI sets designed to assess most material environmental and social risks related to the eligible expenditures categories as listed in Serbia Green Bond's Framework

ISSUER'S RESPONSIBILITY

Serbia's responsibility was to provide information and documentation on:

- Framework
- Examples of Eligible expenditures / Eligibility criteria

ISS ESG'S VERIFICATION PROCESS

ISS ESG is one of the world's leading independent environmental, Green and governance (ESG) research, analysis and rating houses. The company has been actively involved in the sustainable capital markets for over 25 years. Since 2014, ISS ESG has built up a reputation as a highly-reputed thought leader in the green and Green bond market and has become one of the first CBI approved verifiers.

ISS ESG has conducted this independent Second Party Opinion of the Green Bonds to be issued by Serbia based on ISS ESG methodology and in line with the ICMA Green Bonds Principles.

The engagement with Serbia took place in July and August 2021.

ISS ESG'S BUSINESS PRACTICES

ISS has conducted this verification in strict compliance with the ISS Code of Ethics, which lays out detailed requirements in integrity, transparency, professional competence and due care, professional behaviour and objectivity for the ISS business and team members. It is designed to ensure that the verification is conducted independently and without any conflicts of interest with other parts of the ISS Group.

About ISS ESG SPO

ISS ESG is one of the world's leading rating agencies in the field of sustainable investment. The agency analyses companies and countries regarding their environmental and Green performance.

As part of our Sustainable (Green & Green) Bond Services, we provide support for companies and institutions issuing sustainable bonds, advise them on the selection of categories of projects to be financed and help them to define ambitious criteria.

We assess alignment with external principles (e.g. the ICMA Green / Green Bond Principles), analyse the sustainability quality of the assets and review the sustainability performance of the issuer themselves. Following these three steps, we draw up an independent SPO so that investors are as well informed as possible about the quality of the bond / loan from a sustainability perspective.

Learn more: <https://www.isscorporatesolutions.com/solutions/esg-solutions/green-bond-services/>

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