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CGRS
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CORPORATE GOVERNANCE RATING SYSTEM (CGRS)

The Nigerian Corporate Governance Rating System

- Methodology and Setup in a Global Context

Introduction

The Nigerian Corporate Governance Rating System (CGRS) is a joint initiative between the Nigeria Stock Exchange (NSE) and the Convention on Business Integrity in Nigeria (CBI). The system rates all listed companies in Nigeria on their corporate governance and integrity practices. Qualifying companies that clear certain market capitalization and liquidity criteria become part of a Premium Board on the NSE. The NSE also plans to rate all listed companies and place them in a tradable basket – the Corporate Governance Index.

Corporate governance (CG) is defined as involving "a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring," in the Preamble to the global best practice benchmark for corporate governance, the 2004 OECD Principles, Focusing more on the economic interest of investors, two prominent academics put forward a more succinct definition. Corporate governance deals "with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment." [1]

Corporate governance matters both on the company level to enable access to external finance and on the country level, to foster transparency in business culture and overall trust in the financial system. A good corporate governance framework is essential for the efficient allocation of capital. Through enhanced disclosure and transparency, a sound framework provides market confidence, attracts long-term capital and supports market discipline. It thereby also reduces the costs of issuing capital for companies. Consequently, many countries have made improving corporate governance a priority, with two principal pathways. Aside from the legal and regulatory pathway for policy makers and regulators, the second principal pathway to externally influence the governance practices of corporations is to create incentives for companies to meet the market governance demands by investors.

One of the most straightforward options to incentivize companies and communicate with investors is corporate governance ratings and the indices that result from such ratings. If done right, they can be an effective tool to enhance the legal and regulatory framework. They also offer companies an opportunity to differentiate themselves from the negative perception their host jurisdiction may have. Following this logic,

1 Shleifer, A., R.W. Vishny, 1997, A survey of corporate governance. The Journal of Finance 52, 737-783

since 2001, eight stock exchanges have launched corporate governance indices (CGIs), sometimes as part of broader environmental, social and governance (ESG) indices.

Corporate Governance Indices and Rating Systems Worldwide

As of January 2014, the following stock exchange CGIs exist around the world. Many more are in the planning stages such as Russia's Novy Ryknok and Chile's Sustainability index. Some of the best practice characteristics of existing CGIs will be referenced in the analysis of the CGRS below.

Table 1: Corporate Governance Indices around the World

	Index	Stock Exchange	Launch Date	Constituents Sept 2014
	Brazil BM&FBOVESPA CGI	BM&FBOVESPA	2001	174
	China SSE CGI	Shanghai Stock Exchange (SSE)	2008	307
	Italy FTSE STAR	Borsa Italiana	2001	70
	Mexico BMV IPC Sustentable	Mexican Stock Exchange (BMV)	2011	29
	Peru BVL Good CGI	Lima Stock Exchange (BVL)	2008	9
	South Africa JSE SRI Index	Johannesburg Stock Exchange (JSE)	2004	72
	South Korea KRX SRI Governance Index	Korea Stock Exchange (KRX)	2003	30
	Turkey ISE CGI	Istanbul Stock Exchange	2007	45

From the background of the launch of the CGRS, this report advances the principal features of the CGRS and where applicable, relates them to index structures and best practices found around the world.

[2] Grimminger, Di Benedetta, "Raising the Bar on Corporate Governance – A study of eight Stock Exchange Indices", IFC/World Bank 2013

Why Launch A Corporate Governance Stock Exchange Index?

In a 2013 comparative analysis for the World Bank and IFC[2], PGS Advisors identified three principal motives by stock exchanges to launch corporate governance indices

- To raise the national corporate governance "ceiling" by supplementing the existing national corporate governance framework of law, regulation and code.
- To give companies the opportunity to differentiate themselves by showing good CG practices.
- To gain access to funds committed to good CG practices and sustainability.

Raise the Corporate Governance "Ceiling"

This is perhaps the overriding objective in most cases. It refers to the motive to address actual and perceived weaknesses in the national corporate governance and integrity framework by introducing more stringent and credible criteria via a governance rating/evaluation mechanism. Incentivizing corporations to apply higher standards of corporate governance can be an effective policy tool for improving a country's overall corporate governance environment.

The best international example of such an approach is Brazil's Novo Mercado. In Brazil, corporate governance and investor protection had been shareholder concerns for many years. However, reformers found it difficult to attack the problem through changes to the legal and regulatory framework. In December 2000, the Brazilian Stock Exchange BOVESPA launched a new listing segment, the Novo Mercado, and its sister segments, Level 1 and Level 2. These listing segments have corporate-governance requirements that go far beyond Brazil's legal and regulatory framework.

Provide a platform for companies to differentiate themselves

Helping companies to distinguish themselves with a label of governance excellence is a key reason for creating a CG Index. It allows for the build-up of positive reputation that benefits companies, the stock exchange and the market-place as a whole. Companies in the index or market segment can expect to increase their access to capital, particularly that of foreign investors. These investors value information on company governance, especially for emerging-market companies.

Gain access to funds seeking high CG standards

Lastly, CG factors play an ever more important role in investment decisions, often as part of a broader ESG (environment, social, governance) analysis. Assets under Management (AUM) actively integrating ESG factors have grown exponentially over the last decade. According to the "Global Sustainable Investment Review 2012", US$13.6 trillion of professionally managed assets incorporate ESG concerns into their investment selection and management. This represents 21.8% of the total assets under management in the regions covered by the report. Therefore, creating a CG or ESG market index in the local stock market to draw investor capital has serious potential.

[2] Grimminger, Di Benedetta, "Raising the Bar on Corporate Governance – A study of eight Stock Exchange Indices", IFC/World Bank 2013

These objectives are by no means mutually exclusive; in fact, all three can be achieved with the right index setup. These objectives are also sequential to a certain degree, as companies will only gain better access to external funds once trust in the differentiation achieved by the index has been built.

The CGRS Objectives

Given the actual and perceived weaknesses in Nigerian corporate governance and business integrity, the CGRS primary and overriding objective is to provide a comprehensive, trustworthy diagnosis of Nigerian companies' corporate governance and business integrity practices. n becoming a diagnostic tool of the strengths and weaknesses of Nigerian corporate governance, the CGRS can become a critical mechanism in advancing Nigerian corporate governance and business culture, build trust and improve the perception of Nigerian capital markets.

Figure 1: CGRS Objectives

Diagnosis of Status quo of Corporate Governance in Nigeria	Become a trusted tool of measuring, analyzing and reporting corporate governance and business integrity practices of Nigerian listed companies.
Improve Corporate Governance and business culture in Nigeria	With the diagnosis of prevailing practices and awareness raising on corporate governance, and the training of company leaders, CGRS will contribute to improve Nigerian corporate governance.
Provide Incentives for companies committed to good Corporate Governance	By establishing a platform for companies with good corporate governance practices in Nigeria, CGRS will give companies an opportunity to distinguish themselves and thereby increase the incentives to improve practices.
Facilitate access of Nigerian companies to external capital	Providing a trustworthy rating and source of information on companies' corporate governance and business integrity practices will enable companies to access external capital more easily.

Who gets evaluated?

When launching a CG Index, two principal choices about its setup have to be made. How an index is constructed has important consequences for the level of company commitment and – crucially – the credibility and perception of the index. The two principal choices concern the degree of commitment of index constituents and the company participation model.

Degree of commitment of companies – Listing Tiers vs. Threshold Indices

There are two basic options with respect to the degree of commitment of companies. One option is to base the index population on those companies reaching a certain rating threshold in an evaluation. The second option is a **listing segment**. While joining a listing segment is voluntary, adherence to all listing rules becomes a contractual requirement once the segment is joined. To date, such CG segments only exist in Brazil with the Novo Mercado, and Italy with the STAR index for small and medium sized companies.

Company participation model – Voluntary vs Automatic evaluation

For indices based on rating thresholds, there are two basic models employed by stock exchange indices. **Automatic evaluation** of all listed or eligible companies whether they want to be assessed or not and **voluntary participation** of companies, indicating that companies apply to be evaluated. The Mexican IPC Sustentable and the JSE SRI index in South Africa automatically evaluate the eligible universe for example, while the Turkish ISE index relies on companies voluntarily contracting an accredited rating agency to be evaluated.

Table 2: Company participation models

Rating Threshold Indices		Rule Compliance
Voluntary Evaluation	Automatic Evaluation	Listing Segment
China	Mexico	Brazil
Peru	South Africa	Italy
Turkey	South Korea	

Relevance of Setup choices

In **listing segments,** violation of the listing governance criteria triggers defined consequences (review, fines, and non-monetary sanctions that include eventual delisting), and compliance is monitored continuously. As such they offer a higher degree of commitment and credibility than those indices where companies must reach a predetermined threshold of compliance to join, but are never required to score 100% compliance with the index criteria. Note, however, that the higher degree of credibility is directly tied to the integrity of the stock exchange in enforcing those elevated listing rules.

Indices based on **automatic evaluation** appear more credible than those based on voluntary application, since companies are not free to choose whether they want their CG practices analyzed. A consequence of voluntary application is often that only companies that can be assured of qualifying will apply. Meanwhile, companies with poor CG practices can simply claim not to be interested and will not suffer the embarrassment of a bad CG evaluation. An automatic assessment of all companies in the main index, such as occurs in Mexico and South Africa, carries a stronger message, since evaluation is not voluntary and is therefore a potentially more effective tool for improving governance.

The Rating Universe of the CGRS

Participation in the CGRS will be mandatory for all companies listed on the NSE, currently around 200 companies. This sends a strong message as no company can choose not to participate, since participation in the system is compulsory under NSE listing rules, applying to already as well as newly listed companies. For the objective of raising corporate governance and integrity standards in the country, short of introducing new comprehensive laws and regulations, this is the preferred course of action, especially if the credibility of the CGRS evaluation may be higher than an assumed compliance with special corporate governance listing standards. This setup also ensures that the maximum number of companies, i.e. all listed companies, participate in the process.

Companies qualify for the CGRS by scoring 70% and over from the criteria. All qualifying companies will be quoted in the Corporate Governance Index. In addition, if a qualified company also meets market capitalization and liquidity requirements[3] it will become part of the Premium Board at the NSE. An index based on the Premium Board and weighted by market cap of the constituent companies will be quoted on the NSE.

[3] A company must: (1) Have a consistent market capitalization that is equal to or in excess of US$1Billion prior to admission to the Premium Board. (2) Have a minimum free float of 20% or value of shares floated that is equal to or above US$1 Billion and the number of shares representing its issued share capital is equal to or above 10 billion units.

The CGRS consists of three components, which is a unique setup in the world of stock exchange corporate governance indices as will be further explained below.

Table 3: CGRS Rating Components

Rating Component	Type of Assessment	Component Indicator
Component 1 Corporate Compliance	Self-Assessment	36 Consolidated Indicators covering 5 categories: • Business Ethics & Anti-Corruption • Internal & External Audit and Control • Shareholder & Stakeholder Rights • Board Structure & Responsibilities • Transparency & Disclosure
Component 2 Fiduciary Awareness	Certification Training module	The Director certification consists of 40 questions in 6 modules mirroring the 5 categories of the corporate compliance self assessment, adding a module on the Background & Rationale of Fiduciary Duty
Component 3 Corporate Integrity	a. Stakeholder Questionnaire b. EMSG Assessment	The stakeholder questionnaire consists of 15 questions for staff and 17 questions for suppliers categorized in 10 sections The Expert Multi Stakeholder Group evaluation (EMSG) covers the 5 self-assessment categories.

What gets evaluated?

Existing stock exchange CG indices are mainly based on evaluation against a set of criteria, akin to the first component of the CGRS. The CG evaluation criteria used by the existing indices are in the majority derived from voluntary national CG codes, thus lending an incentive to companies for their implementation. The ISE CG Index for example is the result of an initiative by the Turkish Capital Market Board to promote the voluntary comply-or-explain Turkish Corporate Governance Principles.

In most instances, however, index criteria go beyond existing national CG criteria, since one of the principal motivations of indices is to move beyond prevailing practices. In going beyond the national code, they typically incorporate international best practice benchmarks such as the OECD's Principles of Corporate Governance. In addition, indices may contain elements that are of particular importance in the context of the jurisdiction. The South African SRI index for example has indicator categories addressing Black Economic Empowerment and HIV/AIDS issues.

The CGRS Indicators

Component 1: Corporate Compliance

Similarly to the development of indicators in other CGI indices, the CGRS derives the indicators for the self-evaluation tool from a number of distinct sources. The sources include rules that are already binding for listed companies such as the NSE Listing rules and material needed to establish their bonafides from the Nigerian Corporate Affairs Commission. Other sources are the voluntary 2012 SEC Nigerian Corporate Governance Code, and, as a global best practice benchmark, the United Nations Global Compact reporting guidance on the 10th principle against corruption. These criteria offer an opportunity for companies to distinguish themselves since they go beyond already mandatory Listing Rules. Given the Nigerian business culture context, they appropriately focus on anti-corruption factors. These criteria are also developmental in nature, meaning that while starting at a relatively low base, they will be revised upwards with the release of new standards by SEC and other key players and be reviewed at least once every three years.

Component 2: Fiduciary Awareness

The questions for the fiduciary awareness test for directors are based on the course material covering the 5 modules indicated in Table 3 above. The content of both training and test is largely derived from the same sources as the self-evaluation tool for corporate compliance. The 40 test questions during the fiduciary awareness certification are randomly drawn for a large pool of questions, so that each director will receive a different set of questions. Once certified, a director does not have to repeat the assessment. If a company changes directors between evaluation cycles, the new directors will have to take the certification if not already certified.

Component 3: Corporate Integrity

The stakeholder survey element of component 3 is based on a survey for staff and suppliers, of an evaluated company. The questions are intended to highlight elements of corporate governance that are perceptible to those stakeholders. They were developed by NSE and CBI and reviewed in partnership with the Humboldt-Viadrina School of Governance, who acted as international observers in the design and pilot phase of the CGRS.

Both the analyst/investor and regulator facilitated interviews as well as the Expert Multi Stakeholder Group evaluation (EMSG) follow a more qualitative format than Component 1 and 2, including relevant areas that have to be covered in the deliberations.

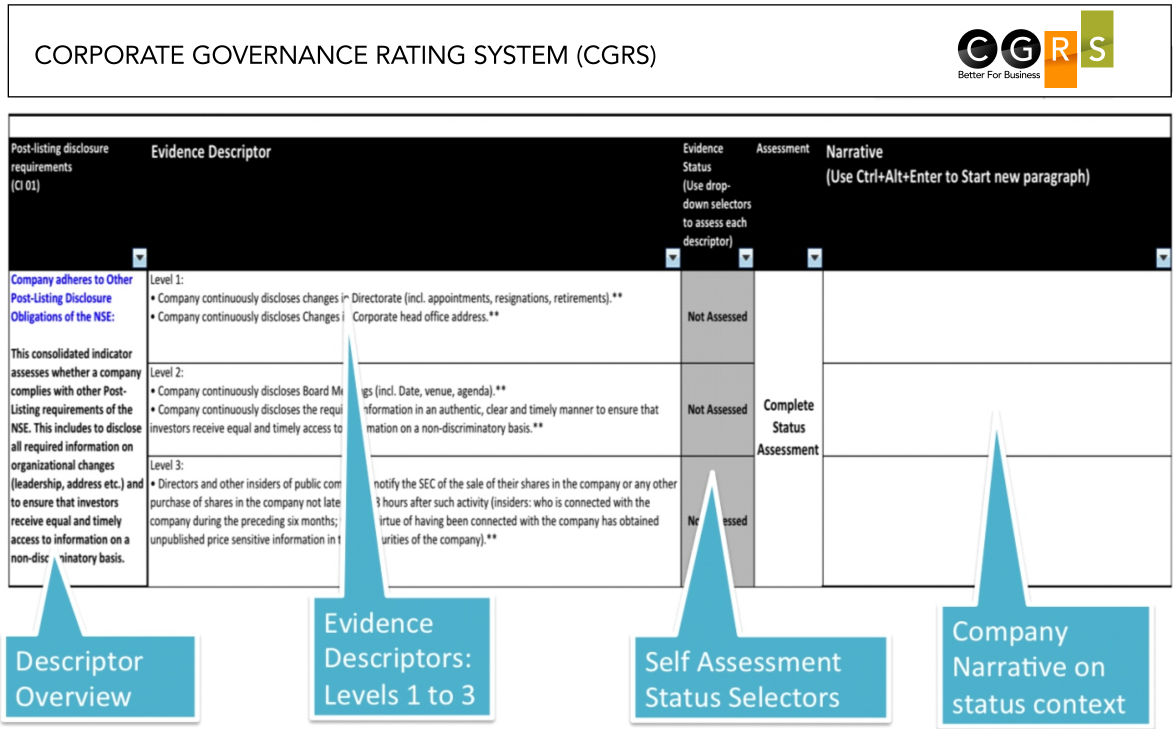
How the Evaluation Works

1. The three-component evaluation setup

Component 1: Corporate Compliance Self assessment

Both the analyst/investor and regulator facilitated interviews as well as the Expert Multi Stakeholder Group evaluation (EMSG) follow a more qualitative format than Component 1 and 2, including relevant areas that have to be covered in the deliberations.

FIGURE 2: Company participation models



How the self-evaluation works

Each of the 36 consolidated indicators grouped into 5 distinct sectors:

- Business Ethics & Anti-Corruption
- Internal & External Audit and Control
- Shareholder & Stakeholder Rights
- Board Structure & Responsibilities
- Transparency & Disclosure

Each consolidated descriptor has three levels of requirements in ascending level of difficulty of implementation. On each of these levels, a company assigns itself a level of compliance. The Evidence Descriptor specifies for each level the kind of documents and polices, procedures and practices a company should possess in order to claim compliance. Evidence needs to be recorded in the self-assessment in the Narrative section.

Compliance options available are:

- **NOT MET:** Where none of the items specified in the Evidence Descriptor can be supported with an appropriate narrative of context.
- **PARTIALLY MET**: Used where some (but not all) of the items listed in the Evidence Descriptor can be supported accordingly; and
- **LARGELY MET:** Used where almost all, bare a few of the items listed in the Evidence Descriptor can be supported accordingly; and
- **AT STANDARD:** Only used where an appropriate narrative can support ALL of the items listed in the Evidence Descriptor.

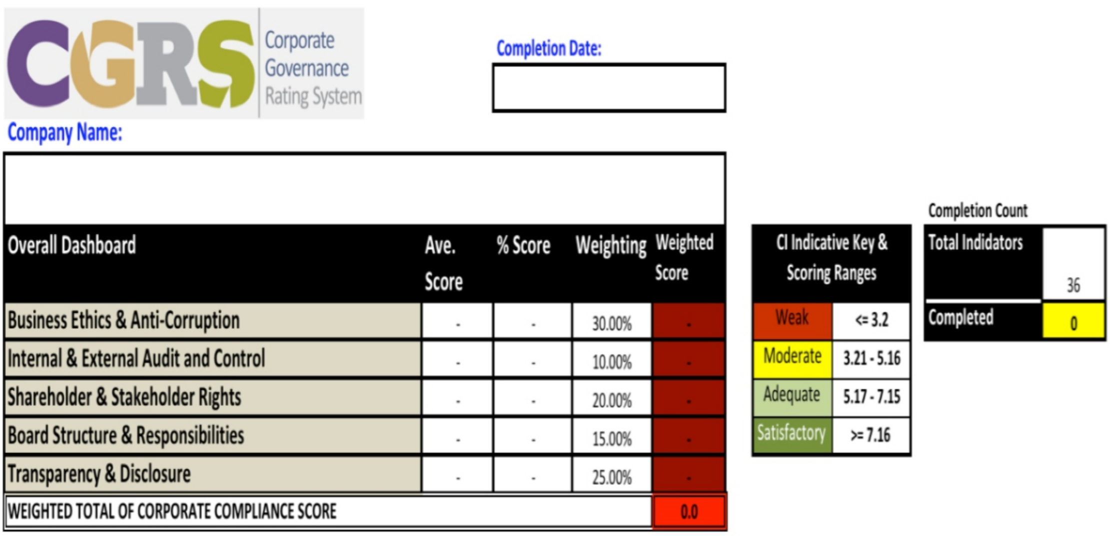
How the self-evaluation works

Upon assignment of one of the four degrees of compliance with each of the three levels, each Consolidated Indicator receives one of four assessments depending on the degree selected for each level.

Satisfactory	A substantial majority of elements of the indicators are in place. There may be minor gaps that require review and /or improvement, but they amount to a small governance risk to the company
Adequate	Many elements are in place but some may be limited in scope and/or quality. There are gaps in compliance that may pose a medium governance risk to the company and its partners
Moderate	There are compliance gaps in many elements of the indicators that require attention. There is a possibility of wider and significant governance risks to the company, its partners and perhaps industry.
Weak	Weak: There are major compliance gaps across a majority of indicator elements. Governance failure risk probability is high or has materialized as issues in some respects.

These levels get converted into numerical scores for each level and a weighted overall score of a maximum of 100 points. Companies wishing to qualify for assessment of Component 3 and ultimately for the Premium Board of the NSE need to score at least 70 out of 100 points, which basically translates into an overall rating of "Satisfactory". Companies that would qualify after completing all three rating components will be automatically subject to a verification of their self-assessment. All other self-assessment will be verified at least once every three years.

FIGURE 3: Self Awareness Overview Dashboard



CGRS Corporate Governance Rating System

Completion Date:

Company Name:

Overall Dashboard	Ave. Score	% Score	Weighting	Weighted Score
Business Ethics & Anti-Corruption	-	-	30.00%	-
Internal & External Audit and Control	-	-	10.00%	-
Shareholder & Stakeholder Rights	-	-	20.00%	-
Board Structure & Responsibilities	-	-	15.00%	-
Transparency & Disclosure	-	-	25.00%	-
WEIGHTED TOTAL OF CORPORATE COMPLIANCE SCORE				0.0

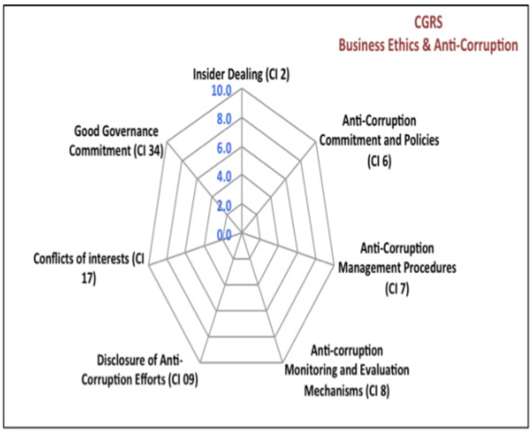
CI Indicative Key & Scoring Ranges	
Weak	<= 3.2
Moderate	3.21 - 5.16
Adequate	5.17 - 7.15
Satisfactory	>= 7.16

Completion Count

Total Indidators	36
Completed	0

FIGURE 4: Self Assessment - Sector Overview (DashBoard)

A	Business Ethics & Anti-Corruption	Max. Score Available (Points)	Total Score (Points)
1	Insider Dealing (CI 2)	10	
2	Anti-Corruption Commitment and Policies (CI 6)	10	
3	Anti-Corruption Management Procedures (CI 7)	10	
4	Anti-corruption Monitoring and Evaluation Mechanisms (CI 8)	10	
5	Disclosure of Anti-Corruption Efforts (CI 09)	10	
6	Conflicts of interests (CI 17)	10	
7	Good Governance Commitment (CI 34)	10	
	OVERALL	10	-



Component 2: Fiduciary Awareness

The Fiduciary Awareness of Directors component of the CGRS reviews the percentage of directors of a company that possess the fundamental knowledge required to fulfill their roles effectively and lawfully. The test module is a personalized certification for all directors using random questions based on the fiduciary awareness training offered in preparation.

The fiduciary awareness test is scored automatically by the knowledge management system. The test time is a maximum of 90 minutes. The pass mark is 70%, answering 28 out of 40 questions correctly. Once certified, a company's director does not have to repeat the test. Directors who are not already certified newly joining a company's board need to get certified in the next evaluation cycle.

Component 3 Fiduciary Awareness

Component 3 of the CGRS adds a qualitative measure of implementation and corporate integrity to the ratinprocess that other CGIs mostly lack. The CGRS attempts to measure implementation with two tools, the stakeholder survey and the Expert Multi Stakeholder Group. Companies will only be evaluated under Component 3 only if they clear the minimum rating thresholds of 70% in Component 1 and 50% in Component 2.

Stakeholder Survey

The Stakeholder structured interviews cover the five areas described earlier. In order to gain the broadest possible representative coverage of opinions on a company the interviews will target the following distribution and methodology.

Table 4: Stakeholder Survey structure

Interviews	Stakeholder Group	Methods
15-20	Staff/Employees	Automated Questionnaire
10-20	Suppliers/Business Partners	
5-7	Analyst/Investors	Consultant Interviews
3-5	Regulators	

Scoring

The score from the automated questionnaire for the Stakeholder Survey is calculated by the system in real-time from the responses received. The scoring ranges for each question are designed to allow respondents select an appropriate response based on their subjective view of specific company practices. These range from 'Very Strongly' to 'Not at all' but also allow respondents to indicate if they do not know how to respond.

FIGURE 5: Sample question from online stakeholder questionnaire

2. How strongly do you associate the company with a reputation for business ethics and anti-corruption? Please select the most suitable single response only.

- ○ Very Srongly
- ○ Somewhat Strongly
- ○ Rather Not
- ○ Not at all
- ○ Don't know

The qualitative score for the consultant-led interviews is calculated by recording the respondent's opinion on a company in the 5 assessment areas as well as the overall perception of the company. Upon conclusion of each section, the respondent is then asked to assign a score from 0 (strongly negative) to 100 (strongly positive) to each area. The overall score for the company is calculated from the individual section scores.

Expert Multi Stakeholder Group (EMSG)

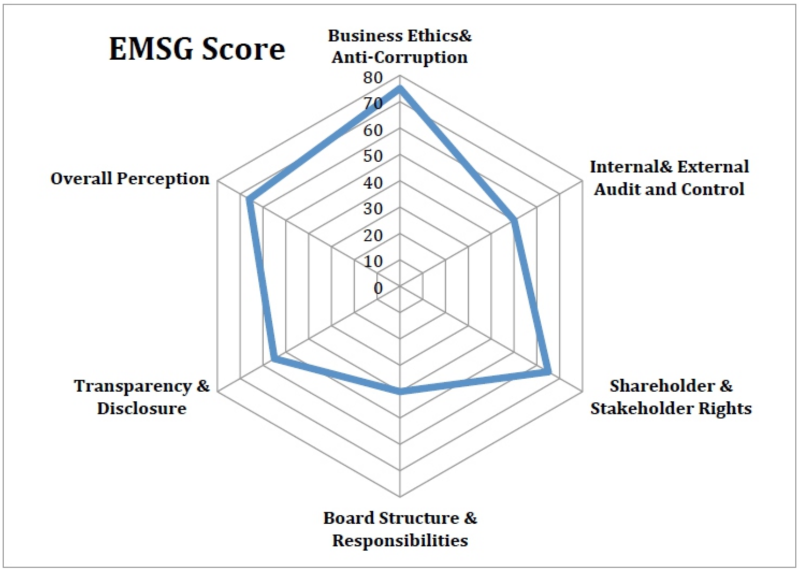
he EMSG's role comprises of experts from business, civil society and government. Its members are nominated by the Selections Committee, which is explained further below. The role of the EMSG is to provide informed opinions to the Ratings Committee on the corporate governance practices of listed companies.

EMSGs will be formed by sector to guarantee expertise of the group members for the respective sector. The number of EMSGs per sector depends on its size. Each EMSG consists of five members.

- A chair whose identity will be public.
- A corporate governance expert
- Three industry experts including a media representative.

The panel review focuses on the discussion areas depicted in the graph below. The EMSG also provides advice on existing and emerging issues of listed companies that may adversely affect its rating and position. Such expert advice can be instrumental in the early detection of issues at individual companies that may affect the integrity and reputation of the CGRS as a whole.

FIGURE 6: EMSG Factor Overview



Scoring

The EMSG expert panels deliberate on companies without knowledge of their prior evaluation results from Component 1, 2 and the stakeholder survey element of Component 3. The discussions focus on the five CGRS core assessment areas previously listed in Table 3. The expert panel discusses each assessment area and rates the company's performance on a scale from strongly negative to strongly positive, based on their knowledge of the market place behavior of the company. Crucially, the experts need to agree unanimously on a score for a company in each assessment area. The final score for the company is then calculated from the individual scores in each assessment area.

2. Rating Thresholds

Indices relying on companies meeting a threshold employ diverse models for reaching the cut-off as can be seen in the table below. Most indices do not go far over an "average" of 50%. This may be attributed to the motivation to have a sufficient number of companies qualify, which may not be the case with a higher threshold. The JSE SRI Index is representative in this approach. The threshold of the Mexican index is interesting. Mexican companies have to score over the global average of EIRIS' ratings of over 3,500 companies, which means the threshold can fluctuate from year to year.

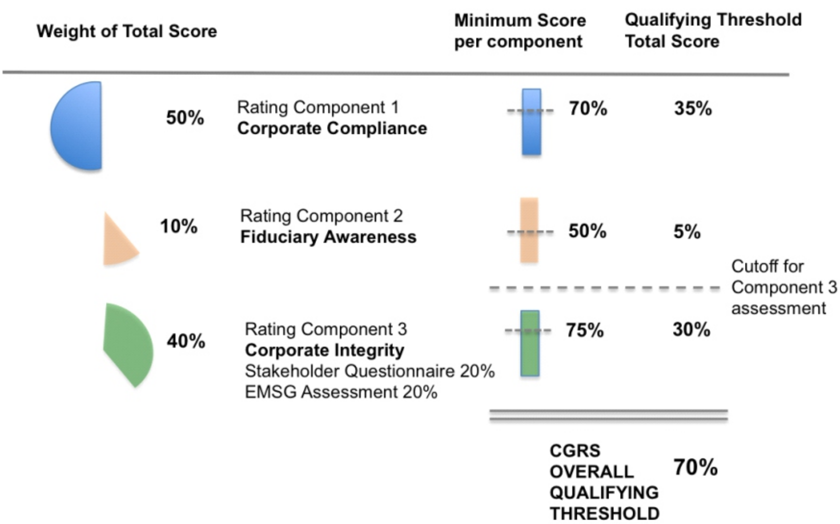
Table 7: Rating Thresholds of CGIs

Index	Automatic Evaluation	Qualifying Threshold
Brazil BM&FBOVESPA Special CGI	Novo Mercado, Level 1 and Level 2 listing rules	Compliance with listing rules
China SSE CGI	20 self-evaluation questions	Not disclosed
Italy FTSE STAR	STAR listing rules	Compliance with listing rules
Mexico BMV IPC Sustentable	100 ESG criteria	Higher than global EIRIS ESG average
Peru BVL Good CGI	26 governance criteria	60% of max score of 312
South Africa JSE SRI Index	90 ESG Indicators	50% of all indicators, 1/3 of core indicators
South Korea KRX KOGI	95 governance criteria	Rating above B+
Turkey ISE CGI	4 chapters of Turkish CG Code	Rating of at least 7 out of 10

Source: Grimminger, Di Benedetta,"Raising the Bar on Corporate Governance", IFC/World Bank 2013

Qualifying Rating Threshold of the CGRS

Figure 4: CGRS Rating Thresholds



The three-tier setup of the CGRS – with companies having to meet a minimum score between 50% and 75% in each component – is a unique model in the world of CG Indices. From our perspective it is very appealing since it addresses corporate compliance, board of directors' duties (arguably the most important body in CG) and CG practices with a focus on corporate integrity.

The **weighting** for each component is also motivating from a company perspective, since 60% of the rating score (Corporate Compliance self-assessment and the Fiduciary Awareness certification) are under the control of the companies.

Owing to the importance and challenge of corporate integrity in Nigeria, it is also critical that 40% of score is more qualitative and impartial in nature, and can only be influenced by the company via good practices.

T The **rating thresholds** are high from an international perspective. However, they make sense:

- If the CGRS wants to be a selective index, truly showing only the best of the best in Nigerian CG and Integrity;
- Since the criteria in the corporate compliance component are to a large degree based on mandatory NSE listing rules and the SEC CG Code. A 70% compliance with these criteria does not seem overly high, but will be hard enough to meet for Nigerian companies in the beginning, since the SEC Code has only recently been reformed. With the development of the CGRS rating criteria over the years it will be progressively harder to meet.

3. Sources of Information

Stock exchange indices are in principle built on publicly available information, which includes annual reports, company bylaws, security filings, and corporate governance reports based on comply-or-explain disclosure with the respective corporate governance codes. However, some are augmented by interviews, or company questionnaires and in a few cases, supplemented by proprietary research and company feedback.

Brazil's BOVESPA's ISE Sustainability index, which is otherwise not referenced in this report, is based on an evaluation questionnaire, which companies can opt to publish. In 2013, 22 of 40 constituents opted to do so. Some indices have also initially allowed non-public information but gradually phased it out. The South African SRI index for example discontinued the use of non-public information only in 2013, nine years into its existence, thus making the index more selective.

Both the information used in the evaluation and the company rating can be verified. In practice, the indices that are not based on listing tiers do not run additional verification on the information feeding into the evaluation. The exceptions are the indices primarily based on company self-evaluations such as the Peruvian CGI

CGRS Information Sources

Due to the three-component setup of the CGRS, the information utilized stems from a number of distinct sources.

Component 1 will be based on the company's self-assessment that will be verifiable with the company's publicly available information. As we will see in the Disclosure Section, the planned mandatory publication of the self-assessment essentially turns the self-assessment into public information, building trust into the process and mitigating risks.

In addition, as mentioned above, a company's self-assessment will be verified at least every three years whether the company qualifies or not and companies that would qualify after completing all three rating components will automatically have their self-assessment verified to assure the accuracy of information of potential index constituents.

Component 2 and 3 will be based on non-public, private information, in particular Component 3. This adds a qualitative dimension focusing on actual company practices to the rating, which is hard to achieve when ratings are purely based on public information. Information on company practices is then essentially limited to whether or not a company had been fined for any kind of violations.

4. Evaluators

The two principal concerns with respect to the entities conducting the evaluation are the qualifications of the evaluators and the possibility of a conflict of interest between company and evaluator. To avoid such conflicts, evaluation against governance or ESG criteria is outsourced in five of the six indices that are not listing tiers, with the exception of China's SSE GGI, which puts together a Selection and an Expert Consultation team to review the company application.

Internal or external evaluators

If done out-of-house, a number of different options exist: Evaluation through commercial rating agencies, universities and not-for-profit institutions. In reality, a number of mixed models exist, often pairing a university with a rating provider. South Africa's SRI index, for example, is the result of a collaboration of rating agency EIRIS and the Business School of the University of Stellenbosch.

Cost of evaluation

Most of the stock exchanges (four out of six) pay the evaluators to avoid potential conflicts of interest. However, in Peru, companies have to hire one of the accredited rating agencies to verify their self-assessment. In Turkey, companies pay one of the rating agencies registered with the Capital Market Board. As an incentive, the cost of the rating is partially offset, as new companies joining the CGI pay only half of the annual listing fee for the first two years, 75% for the next two years, and 90% thereafter.

Selection of Consultants

In the indices where evaluators cannot be chosen, they have remained the same since the inception of the indices, thus guaranteeing the continuity of the index evaluation. In Peru and Turkey, where the evaluators can be chosen by the companies, rating agencies have to register and be accredited by the respective capital market regulator.

The evaluation process of the CGRS

For the CGRS, evaluators will be inserted at three different levels in the rating process:

- **Verification of self-assessments for companies potentially qualifying for the CGRS.**

  The Selections Committee recruits and screens consultants to conduct the verifications. For the review of the self-assessments, the Rules Committee will assign and contract consultants from the pool of candidates recruited by the Selections Committee.

- **Stakeholder Interview Consultant**

  An Assessment Consultant, selected based on evidence of capacity, track record and assurance of no conflict of interest, screened by the Selection Committee, nominated by the Ratings Committee and approved by the CGRS Steering Board, will conduct the Stakeholder Structured interviews. This addresses the two main concerns with respect to selecting evaluators, their qualifications and potential conflicts of interests.

- **Members and Chairs of the EMSGs.**

  The EMSGs role in the rating process is to provide views, advice, recommendations and informed opinions to the Ratings Committee on the CG practices of companies that pre-qualified for the third stage of the evaluation process. They will be organized by sectors.

The nomination process for EMSG members will be open, include background checks on the shortlisted candidates, panel interviews and ultimately recommendation of suitable candidates to the Ratings Committee. The EMSG sector chairs will fill a special role, since they will have a longer tenure to assure rating integrity and continuity and will also be the public faces of the panels. As such, additional criteria for selection have been postulated for the Chairman position, essentially assuring that s/he will have the respect of the whole business community.

All participants in the CGRS process will be required to subscribe to a Code of Conduct and will be subject to due diligence reviews.

The presentation of results: Transparency and Disclosure of CGRS

Effective communication and transparency about the criteria and methods used in assessing companies for inclusion in a CG index are essential building blocks for an index's credibility. The disclosure of evaluation results is equally desirable and important for securing an index's credibility.

Transparency of index disclosure is determined by two components:

1. Disclosure of rating methodology including rating criteria;
2. Disclosure of rating results.

1. Disclosure of methodology

Criteria and methodology are disclosed in most existing indices (China's SSE does not publish a qualifying threshold or details of a methodology), but the degree of detail and ease of accessibility differs substantially. All stock exchanges have dedicated pages for their CG or ESG indices on their websites. However, these pages do not always include access to the index rating agencies, universities and not-for-profit institutions. In reality, a number of mixed models exist, often pairing a university with a rating provider. South Africa's SRI index, for example, is the result of a collaboration of rating agency EIRIS and the Business School of the University of Stellenbosch.

2. Disclosure of rating results

The disclosure of detailed results, ideally including the rating report, is important for an index's credibility. It is also critical for investors to know whether the criteria not met by a company are those important for their investment decisions. It is important to note that this does not apply to governance listing tiers, where the adequate presentation of the special listing rules and company disclosure is sufficient to ensure that a company complies with all governance-related listing requirements.

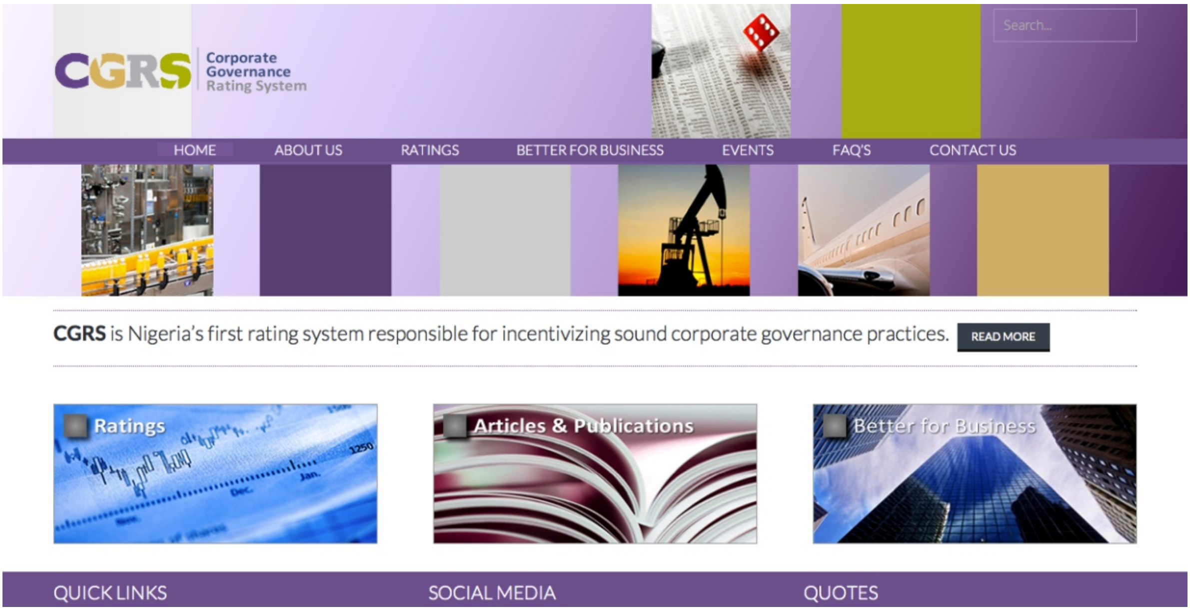
Despite the importance of transparency in this field, none of the six threshold indices from around the world disclose a significant degree of their rating results. The major obstacle to increased disclosure is the reluctance of companies to have detailed reports and scores published, since it would effectively rank them against other companies.

The two indices disclosing a limited part of the rating are South Korea and Turkey. However, the South Korean Index only discloses the rating (in letter grades ranging from B+ to A for qualifying companies), not the underlying report. Turkey's ISE index used to be the only index disclosing the full rating report on the website of the Turkish Corporate Governance Association. However, this practice has now been discontinued for non-members of the association. Companies are still free to individually publish their rating reports.

In sum, apart from Brazil and Italy as listing segments, and the JSE SRI Index for its index setup and methodology, no existing stock exchange CG index even reaches the condition of full transparency of disclosure for the index methodology let alone the rating results.

CGRS Disclosure

The CGRS is aiming at full publication of its rating methodology, governance structures, and – crucially – the rating results and reports for qualifying companies, as well as all data related to the ratings. For this purpose a dedicated website has been launched at **www.cgrsng.com**.



After the first round of full company ratings is published, each company will have a dashboard, from which access can be gained to the three different rating components, reports as well as documents supporting the ratings. Such a degree and ease of disclosure will put the CGRS ahead of all its peers in the field. It will also go a long way in securing the necessary trust in the rating methodology and process.

Index Governance

CG indices need a credible monitoring and supervision setup and governance structure to effectively mitigate reputational risk. Reputational risk can stem from both an inadequate supervision setup and one constituent's corporate scandal, which can easily damage the reputation of all companies in the index.

A CG Index has to be monitored for two distinct reasons: First, the index composition must follow the technical composition guidelines of the stock exchange. Second, compliance with governance criteria must be monitored. Also important is a credible procedure for the immediate exclusion of companies that gravely violate index criteria.

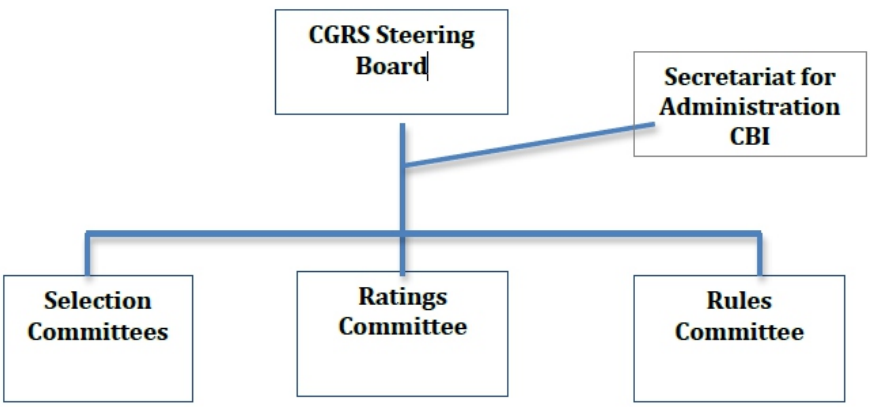
CG Compliance monitoring

Other than the listing segment in Brazil, where compliance is monitored continuously, formal evaluations take place annually. Regular exclusion occurs during the annual reviews if companies fail to qualify. All indices – with the exception of Peru - have procedures in place for the extra-ordinary exclusion of companies found guilty of a grave violation of governance criteria. Such exclusions can take place at any time. In practice, the only such exclusion witnessed to date occurred in the Chinese Index. The most common exclusions are for mergers and acquisitions, bankruptcies and failing to meet market-based criteria such as free float, liquidity and market cap.

Index Governance

None of the existing indices have particularly elaborate governance structures. In essence most structures merely secure that the stock exchanges are not directly involved in the ratings process. With respect to governing bodies, only South Africa discloses information on the existence of such bodies. The South African JSE SRI Index has an Advisory Committee, which is appointed by the JSE, but operates independently of the stock exchange. The Committee is responsible for reviewing the selection methodology for constituent companies, oversees the annual review process and advises the JSE on process issues, dealing controversies and borderline issues. However, the final decision on which companies are included in the Index rests with the JSE.

The CGRS Supervision & Governance Structure



The CGRS Steering Board (SB)

The SB is the governing body of the CGRS, defining its scope, guiding its development and its ultimate authority.

The SB will be composed of seven members, mainly representing the CBI, NSE, but also regulatory agencies,

The Selection Committee (SC)

The SC's responsibility is to create a long list of qualified consultants and companies, for possible membership of the EMSG and to serve as consultants for the stakeholder assessments and verification of company self-assessments. The SC will be composed of five members, including a representative from CBI/NSE, business associations and someone with investigative/due diligence skills. SC member term length is two years.

The Ratings Committee (RC)

The RC will be responsible for coordinating the different aspects of the ratings process. It also assigns the consultants to conduct the stakeholder interviews and the members of the EMSGs from the long list produced by the SC. The consultant assignment process includes conflict of interest checks. Given the importance of the Component 3 Corporate Integrity in the CGRS, it seems appropriate from our view to have a dedicated committee selecting the individuals taking crucial positions in the implementation of Component 3.

The RC will be composed of five members, including a representative from the CBI, but importantly not from the NSE, thus distancing the NSE from the actual ratings process. RC member term length is two years.

The Rules Committee (RuC)

The RuC's role is to supervise the quality and integrity of the ratings process as a whole including auditing the process and ensuring that quality control mechanisms are in place and implemented. As such it is specifically entitled to act on violations and rumours of violations of the CGRS governance criteria in ranked companies by recommending appropriate actions. It thus serves the very important role of protecting the CGRS from potential reputational damage stemming from a corporate scandal (or, ideally, detecting the early stages of the development of such a scandal). The RuC also selects the consultants to verify company self-assessments.

The RuC will be composed of five members, one each from CBI and NSE, a legal expert from civil society, a representative from the rated companies and an independent public relations expert. RuC member term length is two years.

Each of the committees has an important role in the overall CGRS process without apparent overlap. The SC is important due to the number of evaluators involved in the three component rating methodology and the RuC to mitigate the potential risk from corporate scandals and rumours. There is a strong focus on protecting the reputational integrity of the rating system, which is always important, but particularly so in the case of Nigeria.

Independent International Observers

To further increase the transparency and accountability of the CGRS, two international experts in the field of corporate integrity and corporate governance will serve as independent observers of the process and implementation of the rating system taking over from the Humboldt-Viadrina School of Governance that were the Independent International Observers during the design and pilot phase. For the first term the observers nominated are:

Jermyn Brooks: Jermyn is a board member of Transparency International. In 1962 he joined Price Waterhouse, leaving in 2000 as Global Managing Partner after leadership roles in many countries. He was a founding Board Member of the World Economic Forum's Partnering Against Corruption Initiative, and has frequently chaired the 10th Principle Working Group of the UN Global Compact. He also served as a member of the Wolfsberg Group, which developed the Wolfsberg Anti-Money Laundering Principles. Brooks chaired the Steering Committee of the Business Principles for Countering Bribery from 2002-2010, and the Audit and Finance Committee of the Centre for Humanitarian Dialogue, whose board he was appointed to in 2012.

Andreas Grimminger. Andreas is the Founder and Managing Director of PGS Advisors International, a boutique advisory firm on policy, governance and sustainability. He has worked with the IFC, World Bank and OECD on corporate governance and policy issues in Latin America, Asia and around the globe and with private clients on improving governance and sustainability structures. He has published extensively on corporate governance rating systems. Previously, he was Head of Research at the Financial Standards Foundation where public information on compliance with 12 Key Financial Standards such as the OECD's Principles of Corporate Governance was utilized to produce ratings and comprehensive profiles for 93 countries. Andreas is a regular participant and presenter in the OECD's Corporate Governance Roundtables in Asia and Latin America.

Funding Structure of the CGRS

Existing indices employ one of two models: either the company pays or the stock exchange pays. In China, Mexico and South Africa the stock exchange pays for the evaluation. The Korean Index is employing a hybrid. The Korean Corporate Governance Services, conducting the evaluations, is a not-for profit institution deriving a significant portion of its funding from the Korean Stock Exchange. The listing segments in Brazil and Italy charge an additional fee for companies. Another source of income is the licensing of ETFs replicating the CG index. To date, such ETFs exist to date only in Brazil and China.

The CGRS was developed with a grant from the Siemens Integrity Initiative. Moving forward, the ratings will be funded via two sources. First by an Integrity Fund, endowed by individual and company contributions. Secondly, by optional convenience fees charged to companies for enhanced access to the Fiduciary Awareness Course Training (such as an offline or flash drive version) and fees charged for administering the Fiduciary Awareness Certification Tests at sites other than the designated test centers at the NSE.

The Development of the CGRS

The Development of the CGRS

The idea for the CGRS originated from the 5 Star Rating system on governance and integrity that the Convention on Business Integrity (CBI) had been offering to its members since 1999. In 2012, CBI and the Nigerian Stock Exchange agreed to jointly develop a rating system for all listed companies in Nigeria. . The Humboldt- Viadrina School of Governance (HVSG), Berlin acted as an independent observer during the development and pilot stage, reporting independently on the process applied to establish the CGRS. The Siemens Integrity Initiative provided financial support for the development and pilot of the CGRS.

The Convention on Business Integrity

The Convention on Business Integrity (CBi) established in 1997, is a registered company limited by guarantee with the mission of empowering people, their transactions, systems and institutions against corruption by promoting ethical business practices, transparency and fair competition in the private and public sectors. The Convention on Business Integrity brings a company into fellowship with other companies, organizations and individuals interested in Collective Action in the fight against corruption.

THE Nigerian STOCK EXCHANGE

The Nigerian Stock Exchange (NSE) was founded in 1960 and today services the largest financial center in sub-Saharan Africa. The NSE, a registered company limited by guarantee, is licensed under the Investments and Securities Act (ISA) and is regulated by the Securities and Exchange Commission (SEC) of Nigeria. Along with securities listing and trading services, the Exchange offers market data dissemination services, market indices and much more.

Appendix

Matrix - How the CGRS compares to other CG indices around the world

	CGRS	Brazil CGI	China SSE CGI	Italy FTSE STAR	Mexico IPC Sust	Peru BVL CGI	SA JSE SRI	Korea SRI Index	Turkey ISE GGI
Company commitment	Automatic evaluation	Listing tier	Voluntary Evaluation	Listing tier	Automatic evaluation	Voluntary application	Automatic Evaluation	Automatic Evaluation	Voluntary application
Assessment type	Three component assessment	n/a	Self-assessment	n/a	Outside evaluation	Verified self-assessment	Outside evaluation	Outside evaluation	Outside evaluation
Indicator origin	Listing rules, SEC CG Code, UN Global Compact	International best practices	Chinese CG Code	Italian CG Code	CG Code, OECD Principles	Peruvian CG Code	CG code King III and international best practices	Korean CG Code and OECD principles	Turkish CG Code
Rating threshold	70%	Compliance with listing rules	Not disclosed	Compliance with listing rules	EIRIS global ESG rating average	60%	50% of all indicators, 1/3 of core indicators	At least grade of B+	7 out of 10
Sources used	Public and private information	n/a	Not disclosed	n/a	Public information	Self-evaluation	Public information	Public information	Public information suppl. With interviews
Evaluators	Nominated evaluators; EMS Group	n/a	SSE Selection Unit and nominated Expert Consultation Group	n/a	EIRIS and Universidad de Anahuac	Accredited audit firms	EIRIS and University of Stellenbosch	Korea Corporate Governance Services (KCGS)	Accredited rating agencies
Index transparency	Rating methodology; detailed rating results with access to supporting information	Listing rules are disclosed	No detailed methodology available, no rating results disclosed	Listing rules are disclosed	Only rating methodologies in Spanish	Only rating methodology in Spanish	Only rating methodology	Methodology on KCGS website, letter grades for index constituents	Rating methodologies on agencies website. Ratings no longer disclosed