SOVEREIGN
AFRICA RATINGS

ESG Rating Methodology

June 2024

1. Introduction

This methodology outlines Sovereign Africa Ratings' (SAR) fundamentals and analytical approach to assigning ESG ratings in various industry sectors. These ratings give lenders, investors, and other market players information about the rated entity's management of environmental, social and governance (ESG) factors. These ratings are also a helpful tool for rated entities, assisting them in finding areas for performance improvement, reducing emissions, and benchmarking against relevant peers and industry standards.

Our assessment of entity performance seeks to help investors understand the financially relevant ESG risks and opportunities for the entity. Entities with the highest ratings are those assessed as best managing their exposures to those material ESG risks and opportunities.

SAR's ESG assessment involves a quantitative and qualitative analysis to measure an entity's resilience to ESG risks that have the potential for financial impacts. To reflect variations in the effects of products and the production processes on the environment across industries, sector-specific indicators are evaluated in terms of the product's and the production process's environmental impact, incorporating upstream and downstream contributors. The assessment also involves the analysis of the management of waste, emissions, social impact and governance efficiencies.

The rating approach consists of the following three pillars: environmental (E), social (S), and governance (G), and each pillar consists of several connected attributes that are further broken down into various important indicators. The rating process involves scoring the rated entity's exposure risk, the relevant risk mitigation strategies and providing a residual risk score per factor assessed under each pillar. Varying weights are attributed to each factor under assessment in a manner suitable for the rated entity's industry. Industry benchmarks are also used in determining an entity's overall performance within its respective sector.

2. Methodology Overview

Financial Institutions			
Pillar	**Weight**	**Attribute**	**Weight**
Environmental	20%	Packaging Materials and Paper	3%
		Green Financing	7%
		Green Buildings and Carbon Footprint	6%
		Use of Renewables	4%
Social	40%	Human Resource Development	7%
		Community Engagement	6%
		Customer Financial Protection	10%
		Personal Information Management	12%
		Health and Safety	5%
Governance	40%	Board Composition	8%
		Ethics	8%
		Accounting Practices	14%
		Tax Compliance and Transparency	10%
	100%		**100%**

Industrials (Transportation, Manufacturing, Mining)			
Pillar	**Weight**	**Attribute**	**Weight**
Environmental	40% - 45%	Packaging Materials and Paper	4% - 5%
		Green Financing	7%
		Green Buildings and Carbon Footprint	10%
		Toxic Waste Management	13% - 15%
		Use of Renewables	6% - 8%
Social	30%	Human Resource Development	5%
		Community Engagement	6%
		Customer Financial Protection	8%
		Product Information Management	5%
		Health and Safety	6%
Governance	25% - 30%	Board Composition	5% - 6%
		Ethics	5% - 6%
		Accounting Practices	8% - 10%
		Tax Compliance and Transparency	7% - 8%
	100%		**100%**

Telecommunication Pillar	Weight	Attribute	Weight
Environmental	20%	Packaging Materials and Paper	3%
		Green Financing	7%
		Green Buildings and Carbon Footprint	6%
		Use of Renewables	4%
Social	40%	Human Resource Development	7%
		Community Engagement	6%
		Customer Financial Protection	10%
		Personal Information Management	12%
		Health and Safety	5%
Governance	40%	Board Composition	8%
		Ethics	8%
		Accounting Practices	14%
		Tax Compliance and Transparency	10%
	100%		**100%**

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2.1. Pillar 1: Environmental

Attribute 1: Packaging Material and Paper

In determining the packaging material and paper score, SAR will review the use of packaging materials in terms of relative intensity (industry-related benchmarks), recyclability, and management controls. The assessment includes an evaluation of the extent to which recyclable, biodegradable compostable, and reusable packaging solutions are used. The extent of paper-based communication channels is also assessed to determine the degree to which these channels are used in comparison to digital channels. This assessment also includes a review of storage and disposal management relating to paper and other packaging materials.

Attribute 2: Green Financing

SAR will review an entity's intensity of investment in green instruments, lending and/or underwriting exposure to operations and entities that suffer losses related to environmental concerns, litigation, and controversies. This assessment incorporates a review of the rated entity's strategic direction relating to green financing and concomitant monitoring.

SAR will also assess the executive strategy, policies and procedures related to green and sustainable financing as well as underwriting exposure to ascertain the level of target monitoring and policy compliance.

Attribute 3: Green Buildings and Carbon Footprint

SAR assesses an entity's exposure to high-cost and volatile energy sources and analyses emissions in comparison to the relevant industry average. For industrial and telecommunication entities, the analysis will also include an assessment of reported carbon emissions of products and suppliers.

The green building assessment evaluates factors such as energy efficiency, water conservation, waste management policies and procedures, and materials selection. Consideration is given to the reduction of the use of electrical lighting by introducing natural lighting and views into the workspace. SAR will also assess the protection and improvement of water bodies on-site, rainwater management and reuse opportunities, and potable water-use reduction. SAR will assess policies and procedures aimed at supporting water management and identifying opportunities for additional water savings by tracking water consumption.

The energy efficiency evaluation incorporates considerations for the use of exposed shelters including any roof used to shade or parking bays being covered by energy generation systems, such as solar thermal collectors, or photovoltaics. This evaluation will also consider any other renewable energy sources used by the entity, including the use of energy-saving devices.

SAR will also assess any available site improvement plans that include the following:

- documentation of existing site conditions
- site improvement objectives
- performance standards to evaluate ongoing progress
- monitoring protocols.

Attribute 4: Toxic Waste Management

This attribute is relevant for industrial entities; however, financial institutions and telecommunication entities are assessed based on relevant waste management practices concerning toxic waste disposal policies and procedures for items such as printer ink and electronic waste. The assessment of these policies and procedures generally would be included under attribute three for financial institutions and telecommunication entities.

In determining toxic waste management, SAR will review the entity's emissions of carbon monoxide (CO), volatile organic compounds (VOCs), nitrogen oxides (NOx), and sulphur oxides and assess the nature and effectiveness of emission mitigation strategies and exposure to controversies. The assessment is also inclusive of solid and hazardous waste management.

Consideration is given to storage locations for recyclable materials, including mixed paper, corrugated cardboard, glass, plastics, and metals. The establishment of safe storage areas for batteries and mercury-containing lamps will also be given consideration and assessed based on appropriateness and safety.

SAR will assess whether the entity has in place an environmentally preferable solid waste management policy, and if so, the policy will be evaluated to establish that it addresses the reuse, recycling, disposal, or composting of products purchased during regular operations of the building, including:

- Ongoing waste
- The five most purchased product categories based on total annual purchases
- Office equipment, appliances, and audiovisual equipment
- Electric-powered equipment
- Hazardous waste
- Safe disposal of batteries and lamps (indoor and outdoor, hard-wired and portable fixtures)

The policy must cover at least those product purchases within the building and site management's control.

Attribute 5: Use of Renewables

SAR will assess the extent to which renewables are used in terms of an entity's level of revenues generated from the use of public subsidies related to conversion to renewables. If no revenues are generated from public subsidies related to conversion to renewables, SAR will assess the entity's extent to which renewables are used in comparison to non-renewables and industry peers. SAR will also assess the changes in the level of operational costs due to the use of renewables.

The scoring categories below correspond to the strongest (10) and weakest (1) classifications; scores between 2 and 9 generally possess some, but not all, of the characteristics of the higher score. The final score provided for each attribute incorporates the entity's risk mitigation strategies in terms of the related effectiveness.

Attribute	Strong (10)	Weak (1)
Packaging Material and Paper	• High use of recycled packaging materials with strong distribution controls.	• High distribution of packaging materials without recycling options.
Green Financing	• Low lending and/or underwriting exposure to entities that suffer losses related to environmental concerns, litigation and controversies. • Strong capitalisation of investment opportunities related to green finance.	• High lending and/or high underwriting exposure to entities that suffer losses related to environmental concerns, litigation and controversies. Lack of green finance investment.
Green Buildings and Carbon Footprint	• **(Financial Institutions)** Low lending and/or underwriting exposure to entities that suffer losses related to environmental concerns, litigation and controversies. Capitalisation of investment opportunities related to green finance. • **(Industrials and Telecommunication)** Low exposure to high-cost and volatile energy sources and relatively low emissions in comparison to the industry average. The entity assesses and reports the carbon emissions of its products and suppliers.	• **(Financial Institutions)** High lending and/or high underwriting exposure to entities that suffer losses related to environmental concerns, litigation and controversies. Lack of green finance investment • **(Industrials and Telecommunication)** High exposure to high-cost and volatile energy sources and relatively high emissions in comparison to the industry average. The entity does not assess the carbon emissions of its products and suppliers.
Toxic Waste Management	• **(Industrials)** Relatively low to moderate emissions of carbon monoxide (CO), volatile organic compounds (VOCs), nitrogen oxides (NOx), and sulphur oxides with very strong mitigation strategies and very low exposure to controversies.	• **(Industrials)** Relatively high emissions of carbon monoxide (CO), volatile organic compounds (VOCs), nitrogen oxides (NOx), and sulphur oxides with weak mitigation strategies and high exposure to controversies.
Use of Renewables	• Relatively high revenues from the use of public subsidies related to conversion to renewables, or relatively high use of renewables in comparison to industry peers. Low operational costs from the use of renewables.	• No revenues from the use of public subsidies related to conversion to renewables, or little to no use of renewables in comparison to industry peers. High operational costs from the lack of renewables usage.

2.2. Pillar 2: Social

Attribute 1: Human Resource Development

SAR will review an entity's level of attraction and retention of skilled labour, its ability to train key personnel and its workforce turnover rate. The analysis will also assess workforce productivity by analysing the total output/revenue versus the total number of labour hours/labour cost for middle to low-level employees. The skills base and training standards are also reviewed to assess the entity's human resource development efforts.

Attribute 2: Community Engagement

SAR will review an entity's community relations by assessing the adequacy of policies related to treating customers fairly by considering client and community litigation rates, the entity's variation to market access due to community support or boycott/controversies and the availability and suitability of corporate social responsibility programmes.

Attribute 3: Customer Financial Protection

SAR assesses product transparency (user protection, limitations and risk information) and the entity's mitigation of reputational and regulatory risks arising from unethical practices and misinformation by reviewing the frequency of unanticipated claims against the entity. This assessment will also include a review of the suitability of products for its consumers and the level of litigation costs and regulatory penalties.

Attribute 4 (Financial Institutions and Telecommunication): Personal Information Management

SAR will assess an entity's vulnerability to data breaches by considering the effectiveness of internal control systems and policies related to the protection of personal information. SAR will therefore review the frequency of data breaches, controversial events such as litigation, and the extent of loss of revenue, due to information mismanagement.

Attribute 4 (Industrials): Product Information Management

SAR assesses an entity's vulnerability to data breaches by reviewing the effectiveness of internal systems, policies and procedures related to the management of product information. SAR will assess the frequency of controversy, and the extent of loss of revenue due to high-cost litigation caused by product misinformation.

Attribute 5: Health and Safety

SAR assesses the frequency of disruptions due to health and safety events characterised by operational inefficiency, increased litigation costs, and regulatory action leading to penalties and fines. SAR will also assess the effectiveness of risk mitigation systems in place to manage health and safety including but not limited to business continuity, and recovery and disaster management policies and procedures.

The scoring categories below correspond to the strongest (10) and weakest (1) classifications; scores between 2 and 9 generally possess some, but not all, of the characteristics of the higher score. The final score provided for each attribute incorporates the entity's risk mitigation strategies in terms of the related effectiveness.

Attribute	Strong (10)	Weak (1)
Human Resource Development	• Good retention of skilled employees, strong ability to train key personnel and moderate to low workforce turnover rate. Exhibited by high workforce productivity.	• Inability to attract and retain skilled labour, inability to train key personnel and high workforce turnover rate. Exhibited by low workforce productivity.
Community Engagement	• Strong community relations due to comprehensive policies and treating customers fairly effectiveness characterised by low client and community litigation rates, stable market access due to community support and strong corporate social responsibility programmes.	• Weak community relations due to inadequate policies and a lack of treating customers fairly effectiveness characterised by high client and community litigation rates, loss of market access due to community opposition and weak corporate social responsibility programmes.
Customer Financial Protection	• **(Financial Institutions)** Good product transparency, strong mitigation of reputational and regulatory risks arising from unethical practices and misinformation characterised by a low frequency of unanticipated policy claims denied (for insurance entities), or low frequency of financial institution deposit or investment withdrawal runs (deposit-taking institutions), suitable products, low litigation costs and very low regulatory penalties. • **(Industrials and Telecommunication)** Good product transparency, strong mitigation of reputational and regulatory risks arising from unethical practices and misinformation characterised by a low frequency of unanticipated claims, suitable products, low litigation costs and very low regulatory penalties.	• **(Financial Institutions)** Lack of product transparency, weak mitigation of reputational and regulatory risks arising from unethical practices and misinformation characterised by a high frequency of unanticipated policy claims denied (for insurance entities), or high frequency of financial institution deposit or investment withdrawal runs (deposit-taking institutions), unsuitable products, high litigation costs and regulatory penalties. • **(Industrials and Telecommunication)** Lack of product transparency, weak mitigation of reputational and regulatory risks arising from unethical practices and misinformation characterised by a high frequency of unanticipated claims, unsuitable products, high litigation costs and regulatory penalties.
Personal Information Management	• Low vulnerability to data breaches due to the strong effectiveness of internal systems and policies related to the protection of personal information characterised by low frequency of data breaches and infrequent or low-cost litigation due to information misuse and data breaches leading to low and stable compliance costs.	• High vulnerability to data breaches due to weak effectiveness of internal systems and policies related to the protection of personal information characterised by high frequency of data breaches, controversy, loss of revenue and frequent or high-cost litigation due to information misuse and data

		breaches leading to increased compliance costs.
Product Information Management	• Low vulnerability to data breaches due to the strong effectiveness of internal systems and policies related to the management and protection of product information characterised by low frequency of data breaches and infrequent or low-cost litigation due to information misuse and data breaches leading to low and stable compliance costs.	• High vulnerability to data breaches due to weak effectiveness of internal systems and policies related to the management and protection of product information characterised by high frequency of data breaches, controversy, loss of revenue and frequent or high-cost litigation due to information misuse and data breaches leading to increased or volatile compliance costs.
Health and Safety	• Low frequency of disruptions due to health and safety events characterised by high operational efficiency, low litigation costs and no regulatory action leading to penalties and fines.	• High frequency of disruptions due to health and safety events characterised by operational inefficiency, increased litigation costs and regulatory action leading to penalties and fines.

2.3. Pillar 3: Governance

Attribute 1: Board Composition

SAR will evaluate the extent to which an entity's board composition is compliant with King IV, including the proportion of independent members, board member voting rights, the board's tenure in the industry, the composition of the audit committee of the board concerning the extent of executive members' inclusion and the board's expertise in relation to the entity's industry or industries.

Attribute 2: Ethics

SAR assesses an entity's oversight and management of ethical matters such as corruption, key-personnel misconduct, fraud, and money laundering characterised by assessing the presence and effectiveness of internal systems and policies relating to whistleblowing, training, and reputational risk audits. The assessment also considers the frequency of concomitant litigation and revenue loss.

Attribute 3: Accounting Practices

SAR assesses an entity's timeliness in the filing of audit reports, audit findings (auditor's opinion of internal control systems) and outcomes (qualified or unqualified audits), investigations by regulatory authorities relating to accounting practices, and auditor tenure.

Attribute 4: Tax Compliance and Transparency

SAR assesses the frequency and extent of tax controversies, if any. The extent of tax controversies considers the difference between the effective tax rate and the statutory tax rate, whether the difference is below 5%, between 5% and 10% or above 10%.

The scoring categories below correspond to the strongest (10) and weakest (1) classifications; scores between 2 and 9 generally possess some, but not all, of the characteristics of the higher score. The final score provided for each attribute incorporates the entity's risk mitigation strategies in terms of the related effectiveness.

Attribute	Strong (10)	Weak (1)
Board Composition	• Board composition is compliant with King IV, the majority of the board comprises independent /non-executive members, one or fewer members of the board holds more than 30% of voting rights, more than 40% of the board has more than 15 years of tenure in the industry, the audit committee of the board comprises of independent and non-executive members of the board and has sufficient accounting or financial management expertise.	• Board composition is grossly incompliant with King IV, the majority of the board is not independent, more than one member of the board holds more than 30% of voting rights, more than 60% of the board has less than 10 years of tenure in the industry, the audit committee of the board comprises of executive members of the board and has no accounting or financial management expertise.
Ethics	• Effective oversight and management of ethical matters such as corruption, personnel misconduct, fraud, and money laundering, characterised by strong internal systems and policies relating to whistleblowing, training and audits resulting in managed reputational risk, limited litigation and stable revenue.	• Lack of oversight and management of ethical matters such as corruption, personnel misconduct, fraud, and money laundering characterised by a lack of internal systems and policies relating to whistleblowing, training and audits resulting in heightened reputational risk, litigation and significant revenue loss.
Accounting Practices	• Timely filing of audit reports, favourable audit findings (strong internal control systems) and outcomes (unqualified audits/clean audits), no investigations by regulatory authorities relating to accounting practices, and auditor rotation (at most every five years).	• Late filing of audit reports, adverse audit findings (weak internal control systems) and outcomes (qualified audits), frequent investigations by regulatory authorities relating to accounting practices, and long auditor tenure (over 10 years) leading to regulatory action such as penalties and fines.
Tax Compliance and Transparency	• No tax controversies.	• Presence of frequent or major tax controversies where the difference between the effective tax rate and statutory tax rate exceeds 10%.

3. ESG Ratings

ESG Ratings

SAR's ESG ratings are assigned on a scale of zero to 1,000, where 1,000 represents the highest rating. SAR also utilises pluses (+) and minuses (-) to further distinguish between different ESG ratings. All ESG ratings will be denoted as ESG ratings (AA+$_{ESG}$) to avoid confusion with credit ratings. Outlooks are also assigned to indicate the likely direction of the ESG ratings in the short to medium term, including a positive outlook indicating a high likelihood for an upgrade, a negative outlook indicating a high likelihood for a downgrade, and a stable outlook indicating a high likelihood for maintaining the assigned ESG ratings. The purpose of the rating scale is to give investors and other market participants a way to quantify and pinpoint best practices concerning ESG performance. Each report issued will denote the type of entity being rated, whether a financial institution (banking, non-banking, insurance, etc), Industrial (Transportation, Manufacturing, Mining), or telecommunication.

Sovereign Africa Ratings (SAR): Converting Scores into Ratings				
	Points Allocation			**ESG Rating**
Low ESG Risk Exposure and Strong Risk Management	Tier 1 – 800+	1	≥800	AAA
	Tier 2 – 700-799	2	767-799	AA+
		3	734-766	AA
		4	700-733	AA-
	Tier 3 – 600 - 699	5	667-699	A+
		6	634-666	A
Moderate ESG Risk Exposure and Adequate Risk Management		7	600-633	A-
	Tier 4 – 500 - 599	8	567-599	BBB+
		9	534-566	BBB
		10	500-533	BBB-
	Tier -5 – 400 - 499	11	484-499	BB+
		12	467-483	BB
		13	451-466	BB-
Considerable ESG Risk Exposure and Inadequate Risk Management		14	434-450	B+
		15	418-433	B
		16	400-417	B-
	Tier 6 – 300-399	17	367-399	CCC+
		18	334-366	CCC
		19	300-333	CCC-
	Tier 7 – 0-299	20	267-299	CC+
		21	234-266	CC
		22	0-233	CC-

Contact: info@saratings.com

+27 10 203 9921

Thornhill Office Park, Block 13, Ground Floor, 94 Bekker Road,
Midrand, Johannesburg, South Africa

www.saratings.com

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