



***CSR's***

***Corporate Governance Code –***

***Kuwait, April 2010***

***Principles & Recommended Best Practices for Public Companies***

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## PREAMBLE

### Introduction

The financial crisis that hit the capital markets worldwide raised many questions on management practices, especially in the MENA region. The impact of the crisis on the MENA region alone shows that countries in the MENA region are no more isolated from, and are becoming increasingly integrated with, the global economy. One of the major reasons for the financial crisis was attributed to poor corporate governance practices applied by public companies. Also, the region has witnessed a rise in the number of corporate scandals which have further dampened foreign investors' confidence in the region. These have raised the demand for higher standards of company transparency and disclosure in the MENA region from domestic & foreign investors and regulators. These events have served as a stark reminder of the importance of implementing sound corporate governance practices, for the MENA region to remain globally competitive, attract more foreign capital, ensure economic sustainability, and reduce corruption.

The concept of corporate governance hinges on total transparency, integrity and accountability of the management. In a larger sense, corporate governance is defined as a system for directing and controlling the activities of companies. Corporate governance defines the relationship between the shareholders, the Board of Directors, management and other stakeholders. Good corporate governance ensures investors that their investment is being used prudently by management to grow the company's financial & business activity and, therefore, to create shareholder value. It involves the protection of, and cooperation with stakeholders who have a legitimate interest in the company's performance, such as employees, consumers, creditors, the government, the public, and so forth.

### Corporate Governance in Kuwait

Even though corporate governance can have a significant influence on the value of the company, its cost of capital, and its performance, and despite the growing importance of corporate governance in the MENA region, the adoption and implementation of this concept is underdeveloped in Kuwait.

The corporate governance practices in Kuwait have not kept pace with the growth of Kuwaiti companies and the equity market. Out of the six GCC countries in the year 2009, Kuwait ranked as the most corrupt country on the "Corruption Perception Index"<sup>1</sup>. Kuwait has also been ranked as one of the lowest GCC countries on the "Competitiveness Index"<sup>2</sup> and "Ease of Doing Business Index"<sup>3</sup>. In addition to these statistics, companies in

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<sup>1</sup> The Corruption Index (published by Transparency International) ranks countries according to the degree to which corruption is perceived to exist among public officials and politicians, refer to Appendix D for GCC Rankings

<sup>2</sup> The Competitiveness Index (published by the World Economic Forum) measures the set of institutions, policies, and factors that set the sustainable current and medium-term levels of economic prosperity, refer to Appendix D for GCC Rankings

<sup>3</sup> The Ease of Doing Business (published by the World Bank) ranks economies based on how conducive the regulatory environment is to the operation of business, refer to Appendix D for GCC Rankings

Kuwait are characterized by large block and pyramid shareholdings, unusually complex corporate structures, poor disclosure & transparency practices, concentration of power in the hands of key directors, and interlocking directorship. These issues, combined with an overall weak regulatory environment and unstable political scenario in the country remain a hindrance for foreign investments and weaken investor confidence, which in turn can have a negative impact on the economic growth of the country.

### **Benefits of corporate governance**

It has become increasingly important for companies in Kuwait to comply with an effective corporate governance framework. This will promote investor confidence in Kuwait, help attract more foreign investments, and enable Kuwaiti companies to become internationally competitive. Effective corporate governance enables a company to:

- Improve the performance and competitiveness, thereby increasing the company's value over the long term;
- Optimize access to financing and the cost of capital;
- Improve the transparency level of the company to investors and regulators, thereby enhancing the market profile of the company;
- Increase local and international investor's confidence in the company;
- Enhance visibility and credibility across all stakeholders, thereby solidifying relations with the stakeholders.

On a national level, an economy with sound systems of corporate governance will not only improve the investment opportunities and the prospects for economic growth but it will also improve the overall reputation of Kuwait as a place to do business. That is, corporate governance plays a more fundamental role in fostering good self-governing corporate practices and transparent relations between the government and the private sector. Also, adoption of such practices will help develop and improve the efficiency of the capital market and can act as a catalyst for economic growth.

## **About this Document**

### **Purpose**

The aim of CSR's Corporate Governance Code is to actively promote the highest corporate governance practices in Kuwait. The corporate governance principles and recommendations can serve as a tool for Kuwaiti companies to benchmark themselves and improve their level of corporate governance compliance. This will improve the transparency and provide more clarity to the Kuwaiti corporate governance system. The ultimate objective is to boost investor confidence in the board, management and control systems of the company, improve transparency levels, and thereby improve the efficiency of the capital market and help achieve high

sustained growth for the corporate sector and the economy. These objectives are in line with Capital Standards' vision.

CSR's Corporate Governance Code also aims to supplement the current legislation. The Kuwaiti Commercial Companies law currently does not include corporate governance related requirements. Also, while the other GCC countries have made considerable progress in developing their respective country codes for corporate governance<sup>4</sup>, Kuwait has fallen behind in this reform. Therefore, this code is an initiative by CSR to improve the corporate governance environment in Kuwait.

### **Structure & Contents**

CSR's Corporate Governance Code is structured into principles and recommendations. The corporate governance principles consist of seven main sections and take into account the Board of Directors, management, shareholders, and stakeholders. The recommendations, while adapting to the corporate governance situation in Kuwait, identify the gaps in the current corporate governance framework adopted by companies and aim to ensure their compliance with the international best practices in the interest of the shareholders and other stakeholders.

### **Application of the Code**

According to the "Agency Theory" (Jensen, 1976), "Corporate Governance is most effective for companies with diversified ownership". Therefore, it is recommended that CSR's Corporate Governance Code be applied by public companies listed on the Kuwait Stock Exchange (KSE). In addition, it is strongly advisable for non-listed companies, which are economically significant in terms of ownership structure and value, to apply the corporate governance recommendations to the extent possible.

CSR acknowledges that the environment in which a company operates, its objectives & activities, and ownership structure are different from other companies and are constantly changing, and therefore, the corporate governance framework should also be flexible and adapt to these changes. The corporate governance principles and recommendations in this code are therefore not a mandatory application and should be implemented based on the company's unique structure and business model. To this extent, companies should apply the "comply or explain" principle. This means that companies should either comply with all recommendations or explain publicly why they are not complying with some of the recommendations, and describe the alternative solutions. A clear and comprehensive explanation will secure the trust in the decision made by the company and make it easier for the shareholders and other stakeholders to evaluate the deviation. Also, where applicable, companies should have written processes/procedures for recommended codes and policies, which should be included in relevant company documents such as the Articles of Association, Code of Conduct, and Annual Reports.

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<sup>4</sup> Corporate Governance Codes for Saudi Arabia, Bahrain, UAE and Oman are mentioned in the Bibliography. In 2009, Qatar initiated the process of developing a Corporate Governance Code along with Hawkamah Institute for Corporate Governance

CSR also provides professional services to develop a tailored corporate governance code for individual companies in line with CSR's Corporate Governance Code, especially designed to fit the company's needs, business activities, ownership structure and operating environment. We work in tandem with the company and its key stakeholders to put in place a system of controls and procedures, and evaluate, improve, and set up a good corporate governance framework best suited for the company.<sup>5</sup>

## References

CSR's Corporate Governance Code includes principles and recommendations which are primarily based on international best practices and the corporate governance principles issued by the Organization for Economic Co-Operation and Development (OECD)<sup>6</sup>. The recommendations have also been drawn from the Codes of corporate governance of other MENA countries.

At the same time, these principles and recommendations are tailored to the corporate governance needs and issues mainly faced by companies in Kuwait. The corporate governance environment in Kuwait lacks transparency and disclosure norms, especially the disclosure of non-financial information. Interlocking directorship, unitary leadership structures (one individual holding both the position of the Chairman and the CEO), complex corporate structures, and large block shareholdings are all prevalent in Kuwaiti companies. Taking these issues into consideration, CSR's Corporate Governance Code has been developed to strengthen the corporate governance practices in Kuwait, which in turn will improve the investment climate and the prospects for economic growth.

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<sup>5</sup> For more information on Corporate Governance Service, please visit CSR's company website <http://www.capstandards.com/>

<sup>6</sup> OECD is a Paris-based international economic organization of 30 countries. Most OECD members are high-income economies and are regarded as developed countries

## CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS

### I. Rights of Shareholders

Shareholders are the owners of a company and therefore, play a crucial role within the structure of companies. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the company on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the company. Shareholders, as legal owners of the companies, should expect to be able to enjoy these rights in all jurisdictions. The Board of Directors must recognize shareholders rights and avoid any actions that violate those rights.

#### Recommended Best Practices

##### **Facilitation of Basic Shareholder Rights**

- Companies should address, at a minimum, all the basic rights of shareholders, and the procedures and precautions for exercising these rights in their corporate governance policy.
- Companies should design and implement a communications strategy to improve the communication between the company and its shareholders, and between the individual shareholders in the company via the use of information technology or other mediums. Such a strategy should ensure that all information required by the shareholders to exercise their rights should be made available in a comprehensive, accurate and timely manner.
- Shareholders, both local and foreign, should have easy access to their rights, which include the right to information, voting on matters affecting their rights, and profit sharing (right to receive dividends). For example, procedures to attend and vote in a meeting should not be complicated or costly for shareholders, transparent voting in absentia procedures should be permitted, and voting options should be expanded to include electronic communications, etc. Such practices will facilitate shareholder participation.

##### **Rights related to General Shareholder Meetings and Voting**

- General shareholder meetings should be organized once a year, at least within the six months following the end of the company's financial year.
- To ensure maximum attendance and participation of shareholders, an announcement of invitation to the general shareholder meeting should be made through electronic means, and should be published in two daily newspapers. The date, time, venue, and all agenda items of the general shareholder meeting with complete supporting information should be provided to shareholders at least 20 days prior to the date the meeting.

- Shareholders should be informed of the criteria and procedures governing the company's shareholder meetings, including voting procedures. It is highly recommended that companies offer several voting methods to facilitate the exercise of voting rights by shareholders, including voting by proxy, voting by mail and electronic voting.
- Cumulative voting method should be permitted in the election of directors.
- Shareholders should be entitled to discuss matters listed in the agenda of the general shareholder meeting and raise relevant questions to the board members, committee members and the external auditors.
- The minutes of the meeting should be made available to all the shareholders in writing or by electronic means within 10 days after the meeting.
- Shareholders should be sufficiently informed and allowed to make decisions directly on fundamental corporate changes or any other issues which have a material influence on the company's very existence and the rights of shareholders, e.g. mergers & acquisition, corporate dissolution, etc.

#### **Dividend Rights**

- Clearly define and adopt a stable dividend policy, which should be announced to the shareholders at the general shareholder meeting and also included in the company's annual report, prospectus and circulars.
- Announcements of dividends should be made publicly and not selectively to avoid insider trading or unfair gains by insiders.
- In case the board proposes not to distribute any dividends, the reasons for this decision and use of any retained profits should be announced to the shareholders and published in the annual report or other financial reports of the company.

## **II. Ownership Structure**

The ownership structure of majority of the Kuwaiti companies, as well as companies in the MENA region, is concentrated to a single shareholder, or a small group of shareholders. In Kuwait, the government and its agencies, dominant families and institutional investors typically own large block shareholdings in listed Kuwaiti companies. These shareholders can play an active role in influencing governance and by taking responsibility for the company, using seats on the Board of Directors to improve the company's performance and in turn positively affect the company's value. However, such block shareholdings also raise concerns of use of the controlling position to access and misuse to insider information, and to engage in related party transactions, which may be detrimental to the minority shareholders and other stakeholders, and may dilute the value of the company.



According to the agency theory, companies which are closely held (or have less outsider ownership) are likely to voluntarily disclose less information as compared to widely held companies (diversified ownership). Since controlling shareholders can influence the level and quality of disclosure, the ownership structure of the company is at the core of corporate governance in Kuwait. Therefore, corporate governance policy regarding ownership should aim to disclose information on who may be the controlling individual/entity, restrict potential conflicts of interest and potential for insider dealing, and improve the effectiveness and transparency of the ownership structure.

### Recommended Best Practices

- Disclosure of the names of major shareholders, who own more than 5%, directly or indirectly (through subsidiaries, portfolios, or funds) in a table with the amount and proportion of shares held, share class, and percent of total voting rights. Such ownership table should also be incorporated into the annual report and disclosed on the company website.
- Disclosure should be made promptly of any change in the status or holdings of a major shareholder (2% or more).
- Disclosure of the ultimate owner (if any), who may have direct or indirect influence, particularly by means of pyramid ownership, cross shareholdings, special control rights, etc.
- Disclosure of the direct and indirect relationships between the company and major shareholders.
- In closely held companies, at least one third of the Board of Directors should be independent, which means they should be non-executive directors and also meet the criteria for independent directors set forth in Appendix A.

### III. Equitable Treatment of Shareholders

A good corporate governance framework ensures equitable treatment of shareholders, and protection of rights of all shareholders including minority and foreign shareholders. This principle also calls for transparency & disclosure with respect to purchase and sale of shares by directors, management and major shareholders, related party transactions, distribution of voting rights, and the way voting rights are exercised. The adoption of this principle helps strengthen shareholder confidence in the company.

### Recommended Best Practices

- Disclose capital structures and strategies/mechanisms which grant some shareholders higher proportions of control than their effective participation in the capital.
- The procedures of the annual general meeting should guarantee the equitable treatment of shareholders. This can be done, for example, by using identical means of conveying information to all shareholders and by applying the principle of "one share, one vote".

- Adopt practices to ensure the participation of minority shareholders in shareholder meetings, nomination of candidates for director's position, etc. Shareholders who cannot vote in person should be allowed to vote by proxy, by mail or electronically.
- The corporate governance policy should clearly state how minority shareholders are to be treated when there is a change in corporate control. For example, in case of an acquisition, such a transaction should be carried out in an efficient and transparent way, in a manner that will protect the right of the shareholders. The rules and regulations governing the acquisition of companies, as well as unusual transactions, such as mergers and sell-offs of a large section of a company, should be clearly revealed so that shareholders may understand the consequences and protect their rights. Transactions should be shown in clearly understandable figures and under fair conditions so as to protect the rights of all categories of shareholders.
- Establish internal controls to prohibit insider trading and self-dealing, and to protect the rights of minority shareholders. The details of such transactions should be disclosed through fair means and communicated to all shareholders.
- The Board of Directors and management should disclose whether they directly or indirectly, have any material interest in a transaction or matter directly affecting the company. If such information is declared, the individual should not participate in the decision making of such a transaction or matter to avoid any conflict of interest. If a requisite majority of the board has a material interest in a transaction, the transaction should be submitted for shareholder approval.

#### IV. Role of Stakeholders

A stakeholder of a company is defined as any person, entity, or party, who has an interest in the operations of the company and is directly affected by the company's decision and business. Stakeholders of the company include shareholders, employees, creditors, customers, suppliers, trade unions, various non-governmental organizations, governmental organizations, and potential investors.

A company's success in the long term is determined by the collective efforts of shareholders, management, and other stakeholders. Consideration of the stakeholders' interest in the process of corporate governance increases the company's financial stability & competitiveness, facilitates the accomplishment of its long-term objectives, and improves its business reputation.

##### Recommended Best Practices

- The Board of Directors should identify each group of stakeholders (internal and external) and recognize their legal rights.
- Stakeholders should be sufficiently informed about the company's policies and procedures, which aim to protect stakeholders' rights.

- In case the rights of the stakeholders are not legally organized, the Board of Directors should have clear procedures to protect the interest of stakeholders under good faith and within the capabilities of the company.
- Establish clear reporting structures for stakeholders to communicate concerns regarding their rights to the board.
- Stakeholders should be provided with access to timely and accurate information about the company necessary for effective cooperation.
- The company should encourage employees to become actively involved in the process of corporate governance and motivate them to work efficiently for the benefit of the company.
- The Board of Directors should establish and adopt a code of conduct, approve it by the general assembly, and disclose it to the public. The board should also ensure that all of the company's operations are carried out in accordance with the company's code of conduct.
- The company should be considerate of its social responsibility to ensure its contribution to sustainable economic development. The company should adopt principles of corporate social responsibility with regards to the environment (if applicable) and other social issues.

## V. Disclosure & Transparency

In light of the current weak regulatory framework that specifies comprehensive disclosure requirements for all public companies in Kuwait. As the current legal transparency & disclosure provisions and standards don't comply with the international best practices. Companies need to voluntarily adopt strong disclosure and transparency standards in both their financial and non-financial information. This will significantly boost investor confidence in the company and elevate the overall corporate governance environment in the country.

Transparency involves the timely disclosure of all material matters concerning a company including the operating performance, the financial performance, ownership and governance of the company. This also includes the disclosure of any major events and decisions that may affect the company's stock price. This allows stakeholders to effectively monitor the performance of the management and the company. It dictates a certain degree of openness regarding a company's non-financial information such as its competitive position and business operations. Effective communication and disclosure helps improve public understanding of the structure and activities of companies, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the stakeholders. It also enhances investor confidence and the inflow of capital.

### Recommended Best Practices

#### Principles and Means of Disclosures

- Establish an information policy & procedure and disclose it to the investors and stakeholders. Such policy should cover the category/type of information that should be disclosed to the public or in general shareholder meetings, and the form, frequency and method of disclosure.
- Any material events/transactions, that may affect the value of the company's stock in the market instruments or may impact the rights of the shareholders and stakeholders, should be disclosed on a timely basis.
- The company's website should be actively used as a means of public disclosure. The company should use its website to publicize annual and quarterly reports, auditor reports, special information and corporate governance code (if any). The company's website should be easily accessible, up to date, and should be posted in both Arabic and English languages.
- All the information disclosed by the company must be timely, relevant, clear, accurate and complete. The information should also be easily accessible and available at a minimum cost, for the purpose of assisting shareholders and stakeholders to make informed decisions.
- The company should use a variety of information distribution means, including print publications, its own website, distribution through stock exchange announcements and information agencies which disseminate information on Kuwait stock market. It also recommended using modern means of communication such as the internet. The company should also communicate directly with shareholders and stakeholders both at their request and on its own initiative.

#### **Related to Financial Disclosure**

- Periodic financial statements and footnotes should meet the internationally recognized financial reporting standards and practices, and report any deviations from and, changes in, the accounting methods applied.
- Qualified personnel with professional accounting qualifications and with at least five years of experience should be employed to prepare the company's financial statements and accounts.
- It is strongly recommended that an audit committee be established to examine the draft financial statements before they are released publicly, evaluate all auditing and accounting related risks, meet with external auditors, and recommend the selection of external auditors. The management report should include a section on the activity of the audit committee during the preceding financial year.
- The company's accounts should be examined by at least two external auditors. The external auditors should be independent, competent and qualified, in accordance with high international standards. They should meet periodically with the audit committee separately from company management.
- Historical financial statements (for the last 5 years, if available, or at least for the last 3 years) should be made available on the company's website.

- The below listed accounting and financial disclosures, but not limited to, should be made available to shareholders and to the public:
  - Annual audited financial statements with auditors' reports, including balance sheet, statement of profit or loss, statement of cash flows and statement of changes in ownership equity;
  - A management's discussion and analysis (MD&A) of the financial statements and business performance and liquidity status of the company;
  - Critical accounting policies, namely those accounting policies to which the financial results are particularly sensitive;
  - Dividend policy;
  - Report on the end use of funds raised from the public when issuing shares or bonds/Sukuk
  - Details of investments, including market valuation, in equities, government bonds, and other securities;
  - Off balance sheet transactions including contingent claims;
  - Foreseeable risk factors;
  - Risk management system;
  - Oversight & internal control system;
  - Forward looking information should be presented together with underlying statistical data and evidence. This information should not consist of any exaggerated provisions or misleading information that would lead to false interpretations about the company's financial status and operational results;

#### **Related to Non - Financial Disclosure**

- Disclosure of all material business relationships, and material provisions of contracts, with agencies/consultants/banks (for example, credit rating agencies, investment banks and research analysts), who provide information (in the form of opinions/views/recommendations/analysis) on the company.
- In addition to the mandatory disclosures, the disclosed information should include, but not be limited to, the following:
  - Vision, mission, business targets and strategy;
  - Information about the sector in which the company operates and the company's status within this sector;

- Shareholders composition/category (for example, Government, Institutional Investors, Individuals, etc.), and the geographical distribution of shareholders;
- Related party transactions.

#### **Related to Corporate Governance**

- The Board of Directors should disclose the corporate governance practices in the company, and report any deviations from the recommended best practices, describe the solution it has adopted instead and explain the reason in each case. This information should be disclosed in a separate "Corporate Governance" section in the annual report.
- The company should also have a section on the company website dedicated to corporate governance matters. This section must include the most recent corporate governance report, the current Articles of Association or any other incorporation document of the company. The corporate governance section of the website should also include up to date information regarding the Board of Directors, the CEO and the auditors.
- The major items concerning corporate governance disclosure are listed in Appendix B.

## **VI. Responsibility of the Board**

The Board of Directors is the central entity in the corporate governance system. The Board of Directors should have leadership, vision, and independence in making decisions for the best interest of the company and its shareholders. The board is accountable to the shareholders and stakeholders of the company. An independent, competent and committed Board of Directors can ensure protection of the shareholders and other stakeholder's rights, compliance with the prevailing company laws, and provide strategic guidance to the executive management.

### **Recommended Best Practices**

#### **Board Structure**

- The Board of Directors, with approval from the general assembly, should set the appropriate number of members that suits the company's operations, phase of development and other relevant circumstances. General rules in this respect should be incorporated in the Articles of Association of the company.
- Board members should be knowledgeable and possess relevant qualification, experience and skills.
- The majority of the members of the board of a widely held company should be non-executive members.
- The number of independent members on the board should not be less than two, or one-third of the members, whichever is greater.

- The company should also define what constitutes independence and which director is deemed independent in the annual report or the corporate governance section of its website.
- The Articles of Association of the company should specify the manner in which membership of the Board of Directors is terminated. At all times, the general assembly should have the power to dismiss all or any of the members of the board.
- On termination of membership of a director, the company should promptly notify the relevant authority and disclose the reasons behind the termination.
- A director should not serve as a member in the Board of Directors of more than three companies at the same time. In case of joint stock companies, a director should eliminate situations of interlocking directorates. This ensures that a director has sufficient time to undertake his or her duties. The company should publicly disclose the information about board membership positions of individual directors to shareholders.

#### **Separation of the Chairman's Role**

- To ensure an appropriate balance of power, increased accountability and greater capacity of the board for independent decision-making, it is recommended that companies separate the position of the Chairman from any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager.
- If deemed necessary for the Chairman to hold an executive position in the company, reasons for this should be stated in the annual report. In which case the deputy/vice chairman should be non-executive.
- The Chairman should be an independent director. Where the Chairman is not an independent director, the board should appoint a lead independent director and assign to him/her specific authorities that would be otherwise held by the Chairman.

#### **Committees**

- It is recommended that at least three different committees be created, namely an Audit Committee, a Compensation Committee and a Nomination Committee (refer to Appendices C & D). The Board of Directors should determine the advisability of adding other committees (such as risk management, investments, corporate governance etc.) with the conditions and necessities of the company.
- The Chairman for each committee should be elected from among independent members of the board. The Chairman of the Board of Directors should not be a Chairman of any committee unless, he/she is an independent director then he can serve as a member in any committee to ensure the independence. Also, the domination of the committee members should be of non-executive members.

- Each Committee must have a charter that details the following:
  - Purpose and objectives;
  - Responsibilities & duties;
  - Frequency of attendance at meetings;
  - Qualification for membership;
  - Appointment and removal procedures;
  - Structure and operations;
  - Reporting to the Board.

### **Roles & Responsibilities of the Board**

The role and responsibilities of the Board of Directors should be defined and clearly stated in the company's Articles of Association or By-Laws in consistence with its functions, and include the following:

- Review and approve key business matters such as the vision and mission of the company, strategy, financial targets, risks, major business plans and annual budgets. The board should also monitor the implementation of those business matters by management to ensure efficiency.
- Set and approve a written unique corporate governance policy for the company, review the implementation and level of compliance to the policy on an annual basis.
- Draft a written code of business conduct that states professional & business ethical standards, and which regulates the relationship of the company with its stakeholders for the purpose of protecting their respective rights. This code of conduct should be applied and its compliance should be closely monitored.
- Develop and implement an internal control system, including financial, compliance and policy control. The internal control system should be reviewed annually. The board should also assign a person or a department to independently audit and report on the system.
- Create a position for and appoint a Compliance Officer under the company's legal department.
- Establish a risk management policy to cover all activities of the company, assign the management team to implement the policy and request a report from management regularly. The board should review the risk management system and assess the effectiveness of risk management periodically and whenever there is a change in risk level.

### **Board Meetings**

- Meetings of the Board of Directors should be held at least once every two or three months, upon a written request of the Chairman, or upon a written request submitted by the majority of the directors.



- The Board of Directors should send its meeting notice in advance and provide sufficient materials including relevant background materials for the items on the agenda so that each member can manage time to attend and prepare themselves for the board meetings.
- Board members should attend regular and special meetings of the board in person. To encourage participation, remote access or attendance through teleconference may be allowed. Voting by proxy should not be permitted.
- The number of meetings of the Board of Directors and its committees held during the past financial year should be mentioned in the annual report, which must also provide the shareholders with any relevant information relating to the directors' attendance at such meetings.
- The board should document its meetings and prepare records of the deliberations and the voting, and arrange for these records to be kept in chapters for ease of reference.

### **Evaluation & Training**

- The Board of Directors and the board committees should annually (or as deemed necessary) self evaluate its size, composition, organization, tasks, and performance, as well as the contribution made by each of its members, the Chairman, using a systematic and structured process, with the aim of developing and improving the board's working methods and efficiency. The results of this evaluation are to be made available to the nomination committee and to the shareholders at the annual shareholder meeting.
- It is recommended to use an external specialized consultant to conduct such evaluation. The external consultant should make recommendations based on its evaluation and relevant parts of the evaluations should be disclosed to the shareholders.
- Director training courses should be developed for new and continuing directors to increase their skills and knowledge of directors' duties & responsibilities, best board practices, and strategic planning. New directors should be required to attend a corporate governance orientation or training offered by a reputed institution or trainer.

## **VII. Management Effectiveness**

The executive management team conducts the day-to-day management of the company and, therefore, is responsible for achieving the goals and implementing the strategy and policies of the company. The executive management reports to the Board of Directors and is expected to perform its duties in a fair, transparent, accountable and reliable manner. They play an essential role in making sure the company meets the corporate governance standards.

### **Recommended Best Practices**

- The Articles of Association or By-Laws of a company should clearly define and explain the role and responsibilities of the Chief Executive Officer (CEO) and key executive managers.
- The Board of Directors in consultation with the CEO should draft a written policy on the formation, composition and operation of the executive management team. Each member of the management team should have the required professional qualifications in order to perform the assigned duties. He/she must be an expert in his/her area and have adequate managerial experience and skills. They should have clear understanding of the roles & responsibilities and reporting lines.
- The Board of Directors should draft and annually review the management succession planning and strategies with the CEO. The CEO should provide recommendations and evaluations of potential successors to succeed the CEO and other senior management positions.
- Management remuneration should be linked to the company's performance and should be compatible with their qualifications and their contributions in the success of the company. Information about the total amount and form of compensation of members of the management team and the number of shares they own should be disclosed in the annual report or the corporate governance section of the website.
- Members of the management team should not exploit any confidential and publicly unavailable information about the company for personal benefits, and cannot provide information or extend news or make comments that are false, untrue, misleading or unfounded about the company.

## Appendices

### Appendix A: Definitions

#### **Closely Held Company**

In a closely held company, majority of shares are held by few controlling shareholders, and the rest of the minority shares are publicly traded. These majority shareholders do not have plans to sell their shares and tend to hold on to the company's shares to maintain control.

#### **Controlling Shareholder**

A controlling shareholder is a shareholder who has sufficient shares to elect majority of directors and exert control over the company. Through the use of cross shareholdings, special voting rights etc, a shareholder who owns less than 50% of the total shares may also be able to exert control over the company.

#### **Cross Shareholding**

The holding of shares between two or more companies.

**Cumulative Voting**

This voting procedure permits shareholders to cast all votes for one nominee for director, instead of voting separately for each nominee. Cumulative voting gives minority shareholders more power to appoint their representatives in the board, by allowing them to cast all of their votes for a single candidate.

**Independent Director**

A director will be considered independent when he or she has no direct or indirect relationship of any kind with the company, its parent or subsidiaries, its management or any other individual related to the company which would affect his or her independent judgment in carrying out the responsibilities of a director.

Specifically, an independent director (as well as the family members of the director) –

- Should not have a controlling interest in the company or in any other company within that company's group;
- Should not be a member of the board or the executive management team of the company or in any other company within that company's group, within the last 2 years;
- Should not be an employee of the company within the last 2 years;
- Should not be engaged directly or indirectly as an auditor or supplier of goods & services for the company.

Independent directors are important because they bring unbiased opinions regarding the company's decisions and diverse experience to the company's decision-making process.

**Internal Control**

This means those operations and procedures that are undertaken by the company to verify the compliance by the company with the Law and the regulations, decisions and By-Laws organizing its activity. In accounting and auditing, internal control is defined as a process affected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks). At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations. At the specific transaction level, internal control refers to the actions taken to achieve a specific objective (e.g., how to ensure the organization's payments to third parties are for valid services rendered.) Internal control procedures reduce process variation, leading to more predictable outcomes.

**Minority Shareholder**

Minority shareholders represent the class of shareholders whose ownership does not control the company.

### Non-Executive Director

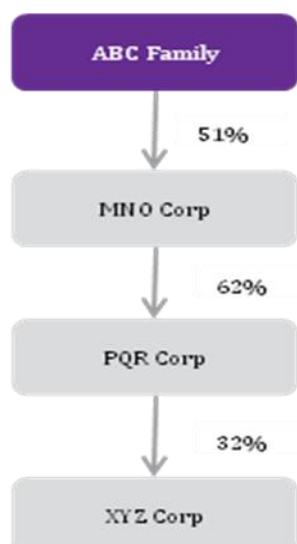
A member of the Board of Directors who does not form part of the executive management team and therefore, does not participate in the day to day management of the company.

### Pyramid Ownership Structure

Pyramid ownership structure resembles a hierarchical chain by which the ultimate owner controls the company.

For example: ABC family owns 51% of MNO Corp, making ABC the majority shareholder and the ultimate owner of the company. MNO Corp owns 62% in PQR Corp. As in the previous case, MNO is the major shareholder and the ultimate owner of PQR.

The fact that ABC family controls MNO Corp, who is the major shareholder of PQR Corp, gives the ABC family the right to control PQR too. Similarly the ABC family will have an indirect stake in XYZ Corp also. In the below pyramid group, ABC group has a direct ownership of 51% in MNO Corp only, however, the family has indirect ownership of 31.62% ( $51\% \times 62\%$ ) in PQR Corp, via its stake in MNO Corp and 10.12% ( $51\% \times 62\% \times 32\%$ ) in XYZ Corp, via its stake in both MNO and PQR.



### Related Party Transaction

A business transaction which is carried out between the company or any subsidiary of the company and any of its officers, Board of Directors, major shareholders, their close relatives and/or associates/affiliates

### Widely Held Company

Widely held company is a company where no one shareholder (or a group of shareholder with shared interest) owns more than 20% of equity ownership. This means that such companies have a diversified shareholding structure.

## Appendix B: Major Items for Corporate Governance Disclosure

- The company's mission, vision, objectives and its philosophy on corporate governance code, which includes the general governance structure, compliance with and adherence to the corporate governance principles and recommendations.
- Board of Directors
  - Composition and category of directors, for example, executive, non-executive and independent director;
  - Brief description on the credentials and work experience of the directors;
  - Nomination procedure of directors and any termination arrangements;
  - Directors ownership of shares in the company and its affiliates;
  - Statement on how the work of the board was conducted during the most recent financial year, including the number of board meetings held, and the attendance of each director at the board meetings and the last annual general meeting;
  - Number of other boards or board committees he/she is a member or chairperson of;
  - The remuneration policy and the remuneration of individual directors, divided into sitting fees and others (split between performance and non-performance based).
- Composition, working procedure and nomination process of the Audit, Remuneration, Nomination or any other specialized board committee.
- Executive Management Team
  - List and profile of each of the members;
  - Shareholding by the managers;
  - Total remuneration paid to the executive management including salaries, perquisites, bonuses, stock options, gratuities, pensions and any other components;
  - Details of fixed remuneration component and performance linked incentives along with the performance criteria.
- Communication policy for disclosure of information to shareholders and investors, whether financial or not.
- Description of internal control as well as internal and external audits and risk management procedures.
- Professional profile of the statutory auditor.
- Any infringement of the stock exchange rules applicable to the company.



## Appendix C: Audit Committee

### Structure and Membership

- The audit committee should be composed of at least 3 members, all of them being non-executive and majority of them being independent.
- The Chairman of the board should be an independent director and should not be a member of any other committee.
- At least one member of the board should have professional qualification, and relevant financial & accounting experience.

### Responsibilities

- The audit committee should meet at least 4 times a year, with majority of the independent directors remaining present.
- The duties and responsibilities of the audit committee should include the following:
  - Review and monitor the effectiveness of the company's internal controls and risk management systems;
  - Oversee the company's compliance with legal and regulatory requirements;
  - Review the integrity of the interim and annual financial statements of the company, the clarity of disclosure and the context in which statements are made; and give opinions and recommendations;
  - Discuss, review and assess the expediency of the accounting policies as well as the accounting estimates. In particular, changes in accounting policies, principles and accounting estimates in comparison to the previous year, adoption of new accounting policies and any deviation from the International Accounting Standards (IAS);
  - Review the scope of consolidation and examine all consolidated financial statements;
  - Approve the appointment and removal of the internal auditor, ensure the internal auditor possesses appropriate qualification & experience, is independent, has access to necessary information and resources so that internal audits can be effectively performed according to high standards;
  - Review the internal audit report and plans to ensure the efficacy of the internal auditing;
  - Make recommendations on the selection, appointment, replacement, and compensation of the external auditors and assess the independence, objectivity, and competence of external auditors;

- Supervise the activities of the external auditors and ensure that the external auditor performs no other functions that is likely to impair their independence;
- Review the external auditors comments on the financial statements, meet regularly with the external auditor, including at least once a year without management being present to discuss any issues arising from the external audit;
- Formalize a process through which employees can confidentially raise concerns regarding potential misconduct in the financial reporting or other matters, and ensure appropriate procedures are in place for independent and fair investigation of such matters.

**Evaluation**

- The audit committee should design and review with the Board of Directors an annual performance evaluation of the committee either through self evaluation techniques or using an outside evaluator. The objective of such evaluation should be to assess the committee's performance with the above requirements and make recommendations to the board for further improvement in performance.



## Appendix D: Nomination and Remuneration Committee

### **Nomination Committee**

The nomination committee's duties & responsibilities should include:

- Recommend candidates for vacant board or management positions to the Board of Directors. In performing this task, the committee should consider any criteria approved by the board and such other factors as it deemed appropriate. These may include competence, knowledge, specific skills, experience with other comparable businesses, and other factors.
- Periodically assess the structure, size and composition of the board and recommend changes if needed
- Consider all candidates for board membership recommended by relevant persons, including shareholders and current directors of the board.
- Develop and periodically review and revise as appropriate, a management succession plan and related procedures, including replacement in the event of an emergency or other unforeseeable vacancies.

### **Remuneration Committee**

The remuneration committee's duties & responsibilities should include:

- Recommend to the Board of Directors a clear remuneration policy that is equitable, provides incentives for directors & management, and is based on performance. The remuneration policy should cover all types of pay and remuneration, including salary performance-related schemes (including share-based remuneration), pension schemes as well as severance pay, etc.
- Evaluate the CEO's performance in light of the company's goals and objectives, taking into account the feedback from the nomination committee's annual review of the CEO and company's performance and shareholder return relative to comparable companies.
- Review and make recommendations to the board with respect to the appropriateness of the board's compensation.
- Establish and review incentive compensation and equity based plans.
- Responsible for engaging outside consultants for the purpose of incentive compensation and equity based plans.

## Appendix E: GCC Ranking on the Corruption, Competitiveness and Ease of Doing Business Indices

GCC Rankings						
	Corruption Index		Competitiveness Index		Ease of Doing Business	
	2008	2009	2009	2010	2009	2010
Bahrain	4	4	5	4	2	2
Kuwait	5	6	4	5	5	5
Oman	3	3	6	6	6	6
Saudi Arabia	6	5	2	3	1	1
Qatar	1	1	1	1	3	4
UAE	2	2	3	2	4	3

Source: Transparency International, World Economic Forum and World Bank

The Corruption Index, 2009 (published by Transparency International) ranks countries according to the degree to which corruption is perceived to exist among public officials and politicians, whereas the Competitiveness Index, 2009 – 2010 (published by the World Economic Forum) measures the set of institutions, policies, and factors that set the sustainable current and medium-term levels of economic prosperity. **Kuwait's ranking on both these indices has deteriorated making Kuwait the most corrupt GCC country and one of the least competitive economies.**

The Ease of Doing Business, 2010 (published by the World Bank) ranks economies based on how conducive the regulatory environment is to the operation of business. Higher rankings indicate better, usually simpler, regulations for businesses and stronger protections of property rights. **Again, Kuwait ranks 5th making it the one of the least conducive environments for operating a business as compared to other GCC Countries.**

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- Code of Corporate Governance for MSM Listed Companies
- CORPORATE GOVERNANCE REGULATIONS IN THE KINGDOM OF SAUDI ARABIA
- Corporate Governance Code for Joint-Stock Companies, UAE
- Ukrainian Corporate Governance Principles
- Corporate Governance Principles, Turkey
- MOROCCAN CODE OF GOOD CORPORATE GOVERNANCE PRACTICES

### Other

- Organization for Economic Co-Operation and Development (OECD), Principles of Corporate Governance, 2004
- A CORPORATE GOVERNANCE SURVEY OF LISTED COMPANIES AND BANKS ACROSS THE MIDDLE EAST & NORTH AFRICA, Hawkamah – March 2008