

Shariah Compliant Corporate Governance

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Dubai

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Agenda

Outline:

1. Definition, Concept and Principles
2. The Corporate Governance Framework
3. Importance of Corporate Governance: Business Case
4. Overview of key issues and standards on corporate governance for Islamic financial institutions
5. Hawkamah's work in addressing corporate governance in the Middle East and North Africa

Takeaways

By the end of this workshop, you should be able to:

- ✓ Understand what corporate governance is;
- ✓ Determine its importance to your company and country; and
- ✓ Understand Shariah compliant corporate governance framework

Corporate Governance Defined

“Corporate governance is the system by which companies are directed and controlled.”

Source: Sir Adrian Cadbury, UK Combined Code

“Corporate governance involves 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.”

Source: OECD Corporate Governance Principles, 2004

“Good Governance”

- Well performing institutions, enabling legal infrastructure, regulatory regimes and enforcement, “good governance” are major contributors to economic growth & prosperity and democracy
- Public Governance matters for effective CG:
 - **Control of corruption**
 - **Regulatory quality**
 - **Rule of law**
 - **Government effectiveness**
- “Good governance” is required by both the public sector and the private sector in the MENA
- There is a Governance ‘gap’ in the region

Corporate Governance Codes

- CG Codes and Principles have been developed for major sectors of modern economies
 - Listed Companies (OECD, WB)
 - Banks and financial institutions (BIS)
 - Insurance Companies (IAIS)
 - Investment managers (IOSCO, Hermes, ICGN)
 - Family enterprises (Cadbury)
 - State Enterprises (OECD)
- Need to adapt to national legal and institutional conditions

Principles of Corporate Governance

As put forth in the 2004 OECD Principles of Corporate Governance

Accountability	Fairness	Transparency	Responsibility
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These Principles should:

<ul style="list-style-type: none">▪ Ensure for mgmt.'s accountability to the Board▪ Ensure for the Board's accountability to SHs	<ul style="list-style-type: none">▪ Protect SH Rights▪ Treat all SHs, incl. minorities, equitably▪ Provide for effective redress for violations	<ul style="list-style-type: none">▪ Ensure for timely and accurate disclosure▪ On all material matters, incl. the:<ul style="list-style-type: none">✓ Financial situation✓ Performance✓ Ownership✓ Governance	<ul style="list-style-type: none">▪ Recognize the legal rights of stakeholders▪ Encourage co-op. between the Co. & stakeholders in creating<ul style="list-style-type: none">✓ Wealth✓ Jobs; and✓ Sustainability
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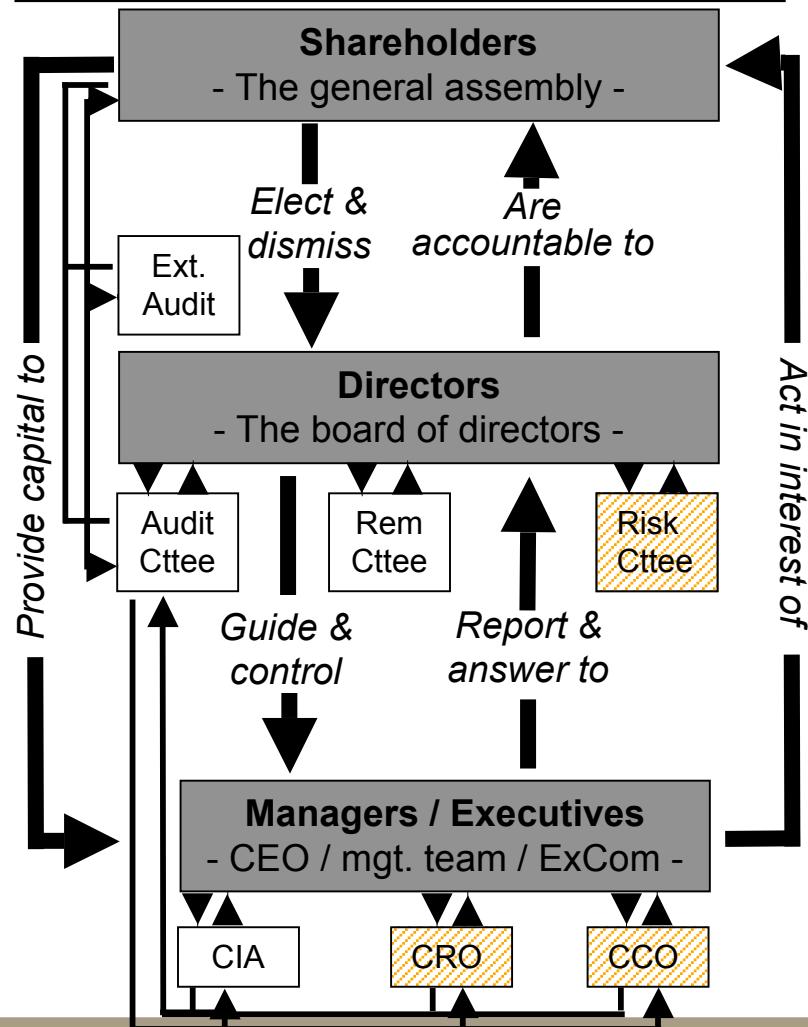
And while corporate governance issues will vary from company to company, these principles hold true for all companies.

The Two Basic Models of Corporate Governance

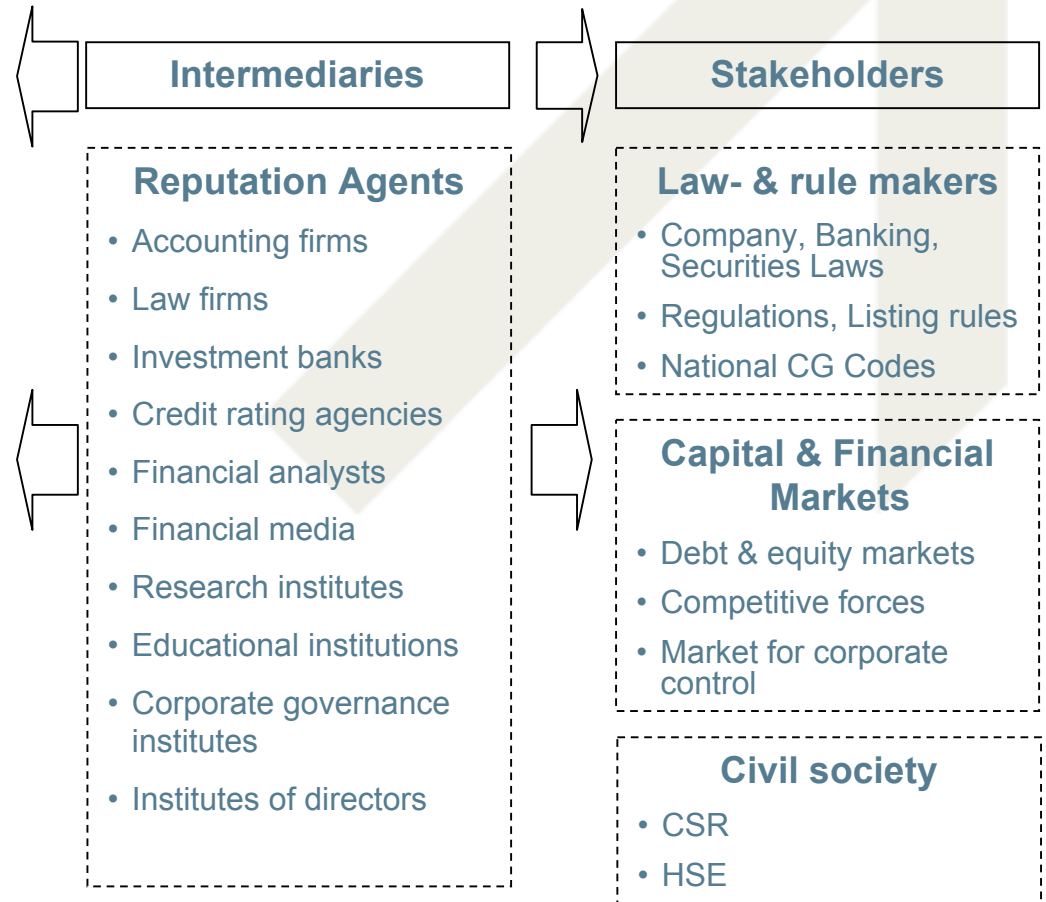
Anglo-Saxon	Continental European
Cultural Differences	
<ul style="list-style-type: none"> ✓ Market culture ✓ Aggressive/tension-oriented ✓ Short-term strategic focus ✓ (Relatively more) Reliance on equity 	<ul style="list-style-type: none"> ✓ Consensus culture ✓ Consensus/network-oriented ✓ Long-term strategic focus ✓ (relatively more) Reliance on debt
Difference in Terms of Governance Structures	
<ul style="list-style-type: none"> ✓ Dispersed ownership ✓ (Relatively less) Influence of controlling SHs ✓ Outsider system ✓ One-tiered board system ✓ CEO-Chairman singularity ✓ Shareholder focus ✓ Enforcement of rules 	<ul style="list-style-type: none"> ✓ Concentrated ownership ✓ (relatively more) Influence of controlling SHs ✓ Insider system, dominated by banks ✓ Two-tiered board system ✓ CEO-chairman duality ✓ Stakeholder focus ✓ Compliance with principles (also in UK)

The Internal vs. the External Perspective

Internal—Corporate—Perspective



External—Stakeholder—Perspective



External and Internal Framework Affecting a Company's Corporate Governance

External Laws, regulations

Mandatory:

- Civil Law
- Company Law
- Specialized—Securities, Banking—Law
- Listing rules

Voluntary:

- National corporate governance code
- **Articles of Association**
- **Corporate governance code**
- **Code of ethics or conduct**
- **Board charter**
- **By-laws/charters/ToRs on:** (i) board Committees; (ii) general assembly; (iii) corporate secretary; (iv) internal auditor, etc.
- **Policies and procedures on:** (i) dividends; (ii) information disclosure; (iii) enterprise risk management; (iv) internal controls; (v) internal audit procedures; etc.

Internal company documents

Why is the World Talking About Corporate Governance?

- Corporate failures
- Executive greed
- Economic stagnation
- The pension bomb
- Globalization
- Privatization
- Internal awareness of business case, i.e. creating long-term growth & shareholder value



Impact of Good Governance- Foreign Investment

- Recent survey of 4,411 firms in 29 countries looked at relationship between foreign investment and corporate governance
- Survey showed that foreign investors invest less in less governed companies
- Investors look at country level disclosures and governance practices and firm level improvements in governance or information flows in making investment decisions.
- (Source: Leuz, Lins, Warnock, “Do Foreigners Investment Less in Poorly Governed Firms?” 2005)

Impact Of Good Corporate Governance- Equity

- **Investors Will Pay for Good Governance:**
- More than 84% of the Institutional Investors are willing to pay a premium for the shares of a well governed company over one considered poorly governed but with a comparable financial record .
- (Source: Executive Summary of the King Report 2002, published by the Institute of Directors in Southern Africa)

Impact Of Good Corporate Governance- Equity

- An ABN-AMRO study showed that Brazil-based firms with the best corporate governance ratings garnered 2004 **P/E ratios that were 20% higher** than firms with the worst governance ratings.

(Source: Erbiste, Bruno. "Corporate Governance in Brazil: Is There a Link Between Corporate Governance and Financial Performance in the Brazilian Market?" ABN AMRO Asset Management, July 2005)

Impact Of Good Corporate Governance- Debt

- Better corporate governance standards make banks and rating agencies lead to improved Credit Ratings. This means:
- Lower borrowing costs for well-governed firms.

(Source: “Saints & Sinners: Who’s Got Religion?” CLSA CG Watch, April 2001)

Benefits of Implementing Corporate Governance... from the Investor's Perspective

- Corporate governance can provide for higher returns on investment
- **For example:** Calpers' biggest return came from its investment in corporate governance funds aimed at turning around failing companies.

Guess how? **by pressuring Boards**

Guess by how much? ... **by 69%**

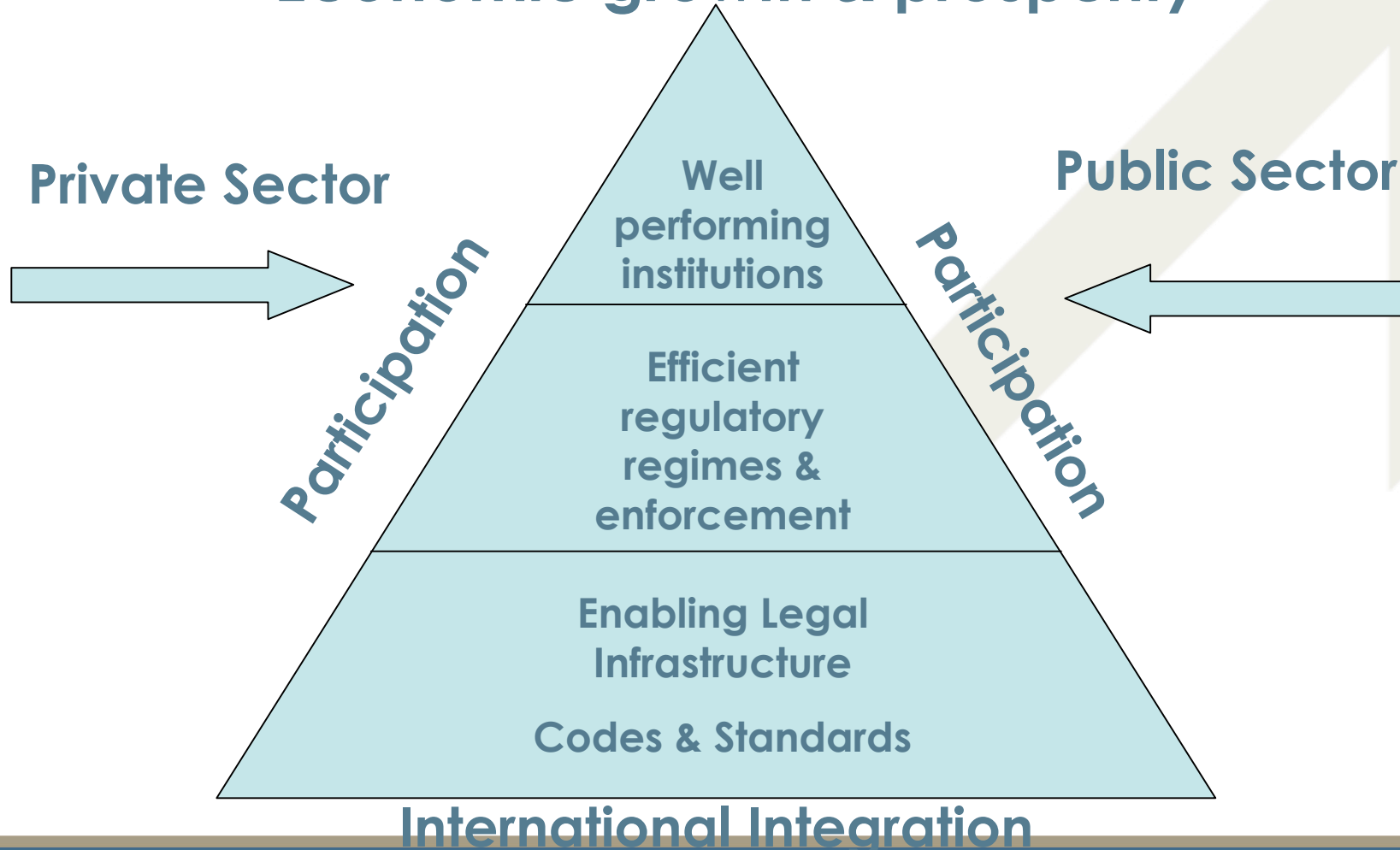
Source: CalPERS, 2005



Without Good Corporate Governance ...

- Too much power is centred on one individual without proper oversight
... **e.g. Enron**
- You enter markets that you do not understand and fail to properly set strategy and manage your risks
... **e.g. HSBC**
- Board fails to ensure controls are robust or question the unusual or the unrealistic
... **e.g. Barings/Amaranth**
- Poor disclosure and transparency becomes commonplace
... **e.g. WorldCom**
- Shareholder rights are mistreated
... **e.g. Parmalat et al**

Effective CG: Integral Element Of Sustainable Economic Growth & Development
Economic growth & prosperity



The Challenge of Implementing Corporate Governance

“There is nothing more difficult to carry-out, nor more doubtful of success, more dangerous to manage than to introduce a new system of things.

An innovator has as enemies all those who were doing well under the old order, and only hesitant defenders in those who would benefit from the new system.”

Source: Niccolo Machiavelli

List of Country CG Codes

Over 37 Countries have adopted 104 Corporate Governance Codes, Principles, Guidelines or Statements

OECD Countries			Emerging / Transition Countries			
Anglo-Saxon Countries	Continental Europe	Asia	Asia	Middle East & Africa	CIS & CEU	Latin America
Australia Canada UK USA	Austria , Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Spain, Sweden, Switzerland, Malta, The Netherlands, Portugal	Japan Korea	Hong Kong, India, Indonesia, Malaysia, Pakistan	Kenya, South Africa, Egypt, Turkey, Bahrain, Qatar, Lebanon UAE	Czech Republic, Poland, Romania, Russia	Brazil, Mexico, Peru
International Codes					Local Voluntary Codes	
OECD Principles ICGN Statement on Global Corporate Governance Principles					Guide to CG Principles in Egypt CG for Non Listed Companies (Lebanon)	

Source: http://www.ecgi.org/codes/all_codes.htm

<http://www.iccwbo.org>

Corporate Governance Structure in Islamic Banks

- Islamic bank is subject to an additional layer of governance since the suitability of its investment and financing must be in strict conformity with Islamic law.
- For this purpose, Islamic banks employ an individual Shariah Advisor and/or Board
- The Governance Structure in Islamic Banks is depicted in the Chart below which sketches the conceptual framework of corporate governance for Islamic bank.
- Central to such a framework is :
 - The *Shariah Supervisory Board (SSB)* and
 - The *internal controls* which support it.

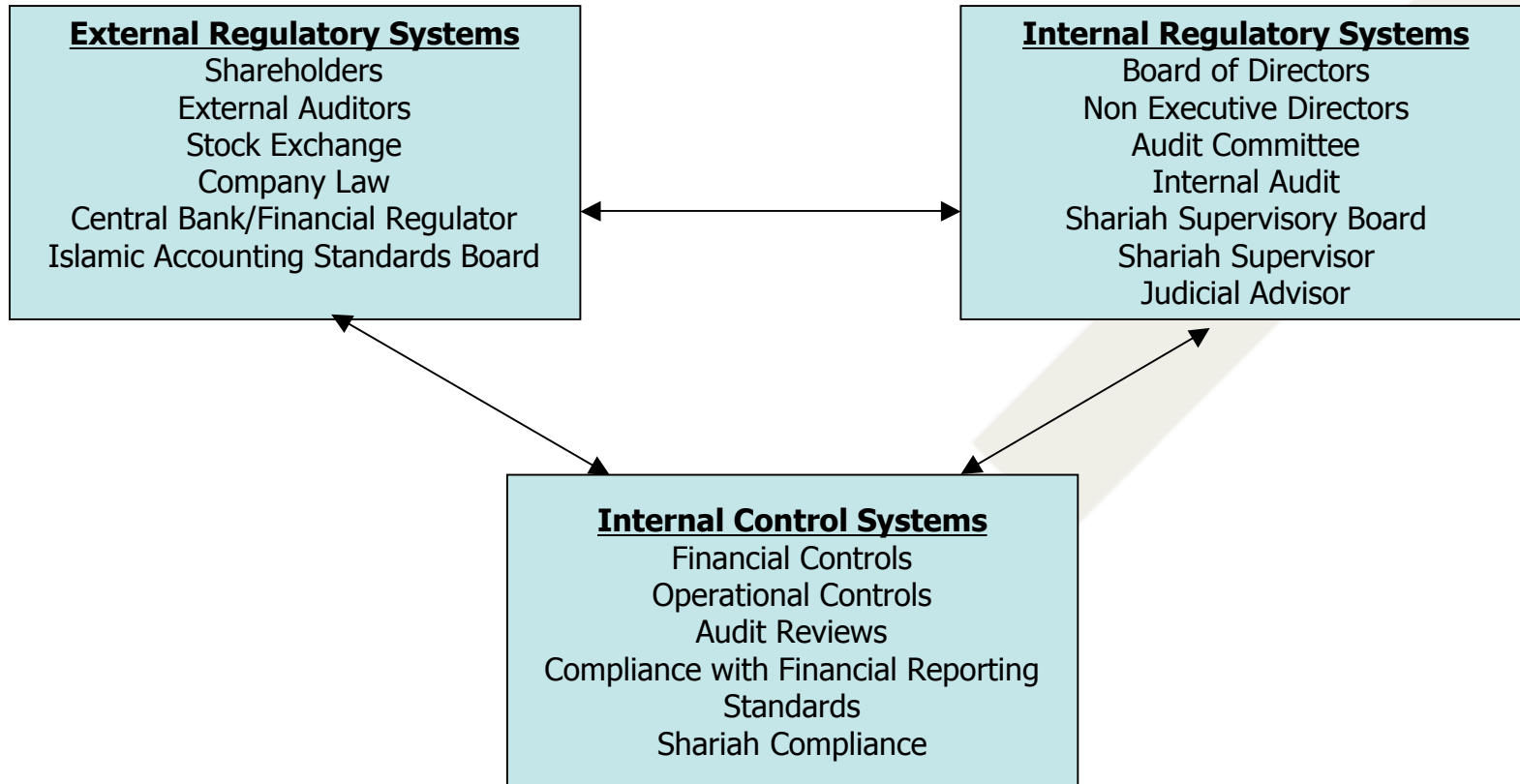
IIFS' Internal CG Structures and Processes

- Each IIFS has a ***Shariah Supervisory Board "SSB"***;
- Their tasks vary according to provisions stipulated in the charters of the institution or by national regulators;
- SSBs' prerogatives:
 - 1- certification of permissible financial instruments through *fatwas*;
 - 2- verification of transactions' compliance with issues *fatwas*;
 - 3- disposal of non *Shariah* compliant earnings;
 - 4- Advice on distribution of income or expenses among bank's shareholders and investment account holders.

IIFS' Internal CG structures and processes

- In addition to SSBs, **most IIFS particularly those complying with AAOIFI standards, have established *Shariah Review Units***;
- These units are independent of other departments or are part of the audit and control department;
- The array of their tasks include:
 - 1- ascertain that financial transactions implemented by management comply with SSB rulings;
 - 2- Exclusive competence on ex-post facto monitoring;

Corporate Governance Structure In An Islamic Bank



CG Importance to IIFS

1. **Stakeholders'** value is central purpose for IIFS;
2. Confidence feature in respect to IIFS is conformity with stakeholders religious beliefs;
3. Corporate Governance arrangements internal & external to the corporate entity include structures and procedures that provide sufficient comfort the business is conducted in accordance with stated objectives, in particular compliance with Shariah;
4. For both ICFS & IIFS sound CG practices create an enabling environment, which rewards banking efficiency, mitigates financial risk and increases systemic stability.

Mission statements IFIs

- Bank Islam Malaysia Berhad

“The corporate mission of the bank is to seek to operate as a commercial bank functioning on the basis of Islamic principles, providing banking facilities and services to Muslims and the whole population of this country, with viability and capability to sustain itself and grow in the process”-.

- Jordan Islamic Bank

“Commitment to providing banking services based on compliance with the rules and principles of the glorious Islamic Shariah in all our activities to serve our community as a whole. Commitment to equally serve the interests of all related parties including shareholders, depositors, and employees”.

Islamic Financial Services Board Guidelines

- The IFSB has developed seven guiding principles collectively referred to as **the Guiding Principles**, of prudential requirements in the area of corporate governance for institutions offering only Islamic financial services (**IIFS**).
- The Guiding Principles are divided into four parts:
 - (i) general governance approach of IIFS;
 - (ii) rights of investment account holders (**IAH**);
 - (iii) compliance with Islamic *Sharīah* rules and principles; and
 - (iv) transparency of financial reporting in respect of investment accounts.
- The Guiding Principles are designed to facilitate IIFS in identifying areas where appropriate governance structures and processes are required, and to recommend best practices in addressing these issues.

Models Of Shariah Governance From Selected Countries

- Malaysian Model
- UAE Model

Malaysian Model

- ❑ The establishment of **Shariah Advisory Council** at Bank Negara Malaysia by virtue of **section 16B** of the **Central Bank of Malaysia Act 1958 (CBA)**

- ❑ The SAC is **the final authority** in matters relating to—
 - ❑ Islamic banking business,
 - ❑ takaful business,
 - ❑ Islamic financial business,
 - ❑ Islamic development financial business, or
 - ❑ any other business which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia

Malaysian Model

- ❑ The SAC of BNM will be referred to by the court or arbitrator in disputes involving Shariah issues in Islamic banking & finance and takaful
- ❑ In the case of the arbitrator, the SAC's resolution "shall be binding" on the arbitrator (obligatory)
- ❑ In the case of the court, the SAC's resolution "shall be taken into consideration" on the court (advisory)

Malaysian Model

- BNM also issued “**Guidelines of the Governance of Shariah Committees for Islamic Financial Institutions (BNM/GPS1)**” which provides that –
- A Shariah body which is to be known as a “**Shariah Committee**” is to be established by each and every Islamic banks, Islamic windows & takaful operators
- Relationship – all these **Shariah Committees** play a **complementary role** to the SAC of BNM

Malaysian Model

- ❑ **Restrictions** imposed –
- ❑ Members of SAC of BNM are **not allowed to serve** in the Shariah Committee of any financial institutions (by virtue of s. **16B (6) of the CBA 1958**)
- ❑ **One Shariah advisor** can only serve as a member of Shariah Committee in **one financial institution in the same industry** (Islamic banking and takaful are considered as different industries)

U.A.E Model

- ❑ Establishment of “Higher Shariah Authority” to supervise Islamic banks, financial institutions and investment companies (Art. 5, Federal Law No. 6 of 1985)
- ❑ This Authority shall be accorded the final authority in Shariah matters in Islamic banking and finance
- ❑ Formation of Shariah Supervision Authority at the financial institution level (Art. 6 of the same Law)
- ❑ Nothing is mentioned about any restriction

Challenges for IIFS Governance

Internal & External CG Arrangements

SSBs

- Independence
- Confidentiality
- Competence
- Consistency
- disclosure

Centralized
SSBs

- Independence
- competence

External
providers

- Private mechanisms are Limited
- Financial Media not concerned
- External Auditors less concerned with assessments of Shariah compliance.
- Market solutions are non existent

These challenges and issues exist for all IIFS

Challenges To The Provision Of Financial Information on IIFS

- IFRS adopted by a number of countries to enable IIFS to produce credible financial statements are wholly unsuitable for IIFS. They generate financial statements that may incorrectly reflect the IIFS' performance
- While AAOIFI's standards, developed specifically to IIFS, would enable the accounting system to deal adequately with IIFS specificities, they may however make cross-sector comparisons difficult

Recommendations On Enhancing IIFS CG Arrangements

- Internal Issues to be addressed:
 - ✓ Protection of minority shareholders;
 - ✓ Increased disclosure;
 - ✓ Commingling of resources;
 - ✓ Balancing UIA holders risks & rights;
 - ✓ Utilization of reserve funds;
- External Issues to be addressed:
 - ✓ Recognizing the specificity of IIFS within the broader institutional infrastructure would contribute to greater transparency;
 - ✓ Developing regulatory frameworks acceptable to IIFS;
 - ✓ Private self-regulatory initiatives providing channels to market discipline;

Hawkamah's Approach To CG In IIFs

- To address Internal Issues:

- 1- Undertake an assessment of IIFs focusing on Protection of minority shareholders; Increased disclosure; Com- mingling of resources; Balancing UIA holders risks & rights and Utilization of reserve funds;
- 2- develop an improvement of CG plan where all the above issues are addressed respectively.

- To address External Issues:

- ✓ Set up an IIFS Hawkamah Advisory group in the MENA region which works on highlighting the specificity of IIFS within the broader institutional infrastructure;
- ✓ Developing regulatory frameworks acceptable to IIFS & IIFS corporate governance guidelines based on the Islamic Finance Board guidelines.
- ✓ Develop private self-regulatory initiatives providing channels to market discipline;

What Can Hawkamah Do For Shariah Compliant Institutions?

Partnership to improve CG in Shariah compliant institutions and markets

On the firm Level:

- Undertake an assessment of CG
- Conduct an Asset Managers CG Training program.
- A Board Development Training program.
- Board Secretary Training Program.

On the institutional level:

- Set up a Task Force devoted to the development and finetuning of shariah compliant corporate governance.
- Development of corporate governance guidelines & criteria for loans and investments
- Develop a corporate governance rating system for Shariah Compliant Banks and Financial Institutions
- Workshops, Seminars and Conferences.
- International IIFS Taskforces.

Hawkamah, the Institute for Corporate Governance

MISSION: Assists the countries and companies of the region to develop and implement sound and globally well integrated corporate governance frameworks.

VISION: Drives institution building, corporate sector reform, good governance, and sustainable economic development and growth in the region.

What we do...

- Provide technical assistance on regulatory and firm levels to develop the optimal corporate governance environment
- Conduct CG assessments and prepare CG improvement plans
- Provide advisory services
- Conduct consultations with various stakeholders
- Develop and implement training programs: Board Development Programme, Board Secretary Programme
- Serve as a knowledge centre and clearinghouse for corporate governance best practices from the region and beyond.
- Monitor & Report on the state of corporate governance

Our approach...



Strategic Partners

International Partners

- Organisation for Economic Co-operation and Development (OECD)
- World Bank-International Finance Corporation
- WB Global Corporate Governance Forum
- Center for International Private Enterprise
- Institute of International Finance (IIF)
- Financial Services Volunteer Corps (FSVC)
- INSOL (Insolvency Professionals)
- Information Systems Audit and Control Association (ISACA)
- Amsterdam Institute of Finance
- Institute for Internal Audit

Other Institutions

- Arab Monetary Fund
- Dubai School of Government, Young Arab Leaders
- Countries participating in the MENA-OECD Investment Program
- Corporate Governance centers, universities

Regional Partners

- Dubai International Financial Centre
- UAE Ministry of Economy
- Yemen Ministry of Finance
- Emirates Securities and Commodities Authority
- Oman Capital Market Authority
- Union of Arab Banks
- Abu Dhabi Chamber of Commerce and Industry
- Dubai Chamber of Commerce and Industry
- Jordanian Corporate Governance Association
- Central Bank of Jordan
- Jordan's Insurance Commission
- Egyptian Institute of Directors/Central Bank of Egypt
- Egyptian Banking Institute
- Economic Research Forum
- Oman Economists Association
- Corporate Governance Association of Turkey
- Lebanese Corporate Governance Task Force
- American University of Sharjah

Hawkamah Accomplishments To Date

Since its official launch in Q2-2006, Hawkamah has:

- Addressed over 5,000 market players in conferences, seminars, and workshops all over the Middle East, North Africa (to include Pakistan) advancing corporate governance reform and the role Hawkamah plays in achieving regional buy-in.
- Attracted over 200 members
- Signed 27 MOU's with international and regional partners
- Received institutional support from regulatory authorities and Central Banks of all GCC and ME countries. This diverse constituency includes regulators, banks, chambers of commerce and others.

Accomplishments To Date

Conducted an assessment of the corporate governance environment in the Gulf Cooperation Countries from an investor's perspective.

The publication, *IIF/Hawkamah GCC Comparative Corporate Governance Survey* and the six country specific reports, is a result of Hawkamah's meetings with over 100 stakeholders all over the GCC.



Accomplishments To Date

- Hawkamah has set up the following CG Task Forces at the Regional Level with its International Partners:
 - Banks
 - State Owned Enterprises
 - Insurance
 - Insolvency and Creditor Rights
- Launched the Hawkamah-UAB Bank Corporate Governance Award (with support from MasterCard International) to highlight good CG practices in Banks.
 - Attracted 40 applications from 12 countries of the region
 - Announcement in Doha, Qatar on November 6th

Accomplishments To Date

- Hawkamah has set up National CG Task Forces for Lebanon, Egypt, Morocco, Jordan, Bahrain and is in the process of setting one up for the UAE
- Hawkamah in partnership with Zawya- Dow Jones recently conducted a 2 day 'Corporate Governance Revealed Economic Journalism Program' for journalists in Dubai and Amman. This program focuses on educating journalists on concepts like corporate governance, transparency, and accountability to further enhance the quality of economic/financial reporting in the Arab world.

Accomplishments To Date

- Conducted jointly with the IFC a CEO survey of over 400 firms from all over the Middle East and North Africa on the regional private sector's CG practices and perspectives
- Partnered with a capital market regulator in the Gulf to develop a corporate governance law and established a model for capital market corporate governance codes.
- Participated in the development of the 1st CG code for State Owned Enterprises in Egypt, the first such code of its kind in the Arab world.
- Working with family businesses firm and listed companies to develop codes of corporate governance based on international best practices.

Beyond the institution building -

- Corporate governance reform starts in the Boardroom;
- Region needs more independent directors;
- Regional companies are looking at international board practices;
- And more important, the regulatory climate is moving towards greater transparency and accountability.

Hawkamah Institute of Directors

- Mission is to develop and train effective, knowledgeable and competent directors for MENA region
- Build capacity and strengthen institutions
- Membership organization
- Open to private and public sector companies, family businesses, entrepreneurs of start-up companies and people responsible for the strategic direction of a business organization
- Services offered include:
 - ✓ Training and certification programs
 - ✓ Executive coaching
 - ✓ Workshops, seminars and conferences
 - ✓ Financial planning and advisory services



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Hawkamah, the Institute for Corporate Governance

Hawkamah, the Institute for Corporate Governance, constitutes a groundbreaking development for institution building, corporate sector reform, good governance, financial market development, investment and growth in the region.

Hawkamah was created for the region, by the region, and of the region to advance corporate governance reform.

What is Corporate Governance?

Events

- ▶ **22-23 October**
Director Development Workshop
An Introduction to Board and Corporate Governance
Dubai, UAE
- ▶ **24-25 October**
Director Development Workshop
Practical Tools for Strategic Guidance and Managerial Oversight
Dubai, UAE
- ▶ **06 November**
OECD-MENA Working Group 5 Bank Corporate Governance Task Force Meeting
Doha, Qatar
- ▶ **07 November**

Media Centre

26 September 2007

Get Updates on Hawkamah's Activities: Hawkamah's Newsletter

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06 September 2007

Corporate Governance Revealed: Hawkamah & Zawya Dow Jones Announces Corporate Governance Training Day for UAE Business Journalists

[read more...](#)

08 August 2007

PricewaterhouseCoopers signs sponsorship agreement with Hawkamah to promote Corporate Governance in the MENA region

[read more...](#)

03 July 2007

Hawkamah and UAB

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