Developed Solutions

10 Steps To Transform Corporate Governance at MENA FI's

The Financial Crisis uncovered a series of weaknesses across the globe, at many levels, in the area of governance. Gaps were identified at the Global, National, and Corporate Governance levels. In the MENA region, while the onset of the crisis was somewhat delayed, a number of weaknesses have ultimately been identified, at the Corporate and Financial Institution levels. This was most evident at the level of Investment Banks, Public Investment companies, or Family owned holding companies. While Basel III, and OECD/Hawkamah guidelines set a number of requirements in this area, this paper is tailored to address the most pressing Corporate Governance gaps at MENA FI's, in a concise and customized fashion. Developed Solutions Consulting (DevSol, Bahrain) has built on the work of regional thought leaders, such as the Hawkamah Institute (UAE), and the practical experience of its Principal at two major MENA FI's, towards arriving at 10 steps that, in the considered view of DevSol, would help transform Corporate Governance (CG) at MENA Financial Institutions (FI's). These steps would not only address major CG gaps, but also create shareholder value at MENA FI's. IFC/Hawkamah studies and surveys of listed banks cite various authoritative studies demonstrating that the market value enhancement, or premium on the share prices, of banks that are well governed versus those that have poor governance ranged between 18-20% at major markets, such as the UK's or the US', and up to 30% in markets such as MENA, or 60% in South Korea. Hawkamah's site shows that almost 75% of MENA Listed companies, and/or 42% of listed Banks scored less than 5/10, on the scale of a governance indicator called BASIC, with the balance of banks scoring between 5 and 7/10 (the average for these banks was 6/10). These indicators clearly demonstrate that there are substantial shareholder value opportunities to be achieved out of improving CG structures and practices at MENA banks.

The rationale for limiting the reform proposal to 10 steps is to promote a manageable program that can be pragmatically implemented, at MENA FI's, in the near future. They are as follows:

STEP 1- APPOINT CG CHAMPIONS AT MENA FI's

Board Chairmen, Board Secretaries, and/or CEO's must personally champion CG programs in their respective institutions, based upon a conviction derived from the business case (net benefits) with respect to implementing such a program at emerging market institutions. This business case is built upon (a) easier access to equity and debt capital, at the regional and international levels, (b) international research demonstrating that, on average, publicly listed firms with superior CG attract anywhere between 20-30% premium in market value to those with weak CG practices, and (c) protection of shareholders, other stakeholders, and even the survival of the firm in case of further crises.

STEP 2- IMPLEMENT CG CODE

CG policies, structures and code should be formalized at each FI. All FI's implementing such codes in a given jurisdiction should encourage peers, along with the regulator, to adopt minimum standards for a national CG code template, in order for FI's to operate **on a level playing field**, as well as to reduce the systemic risks that all FI's are exposed to.

STEP 3- CG TRAINING FOR BOARD AND SENIOR MANAGEMENT

CG Champions, together with the regulator, should mandate a minimum level of CG training for Board Members and Senior Executives. This training may need to be in the form of an ongoing (annual) program that should include, at a minimum, High Level Regulatory Compliance, Risk Appetite formulation, review of FI Risk Profile, Stress Testing, and Liquidity Management.

STEP 4- NOMINATE INDEPENDENT BOARD DIRECTORS

Nominate at least 2 **Risk Qualified** Independent Board Directors to the Risk and Audit Committees, along with the Main Board. Independent members should not only be non executive, but also **at "arms length"** from major shareholder institutions, vendors, depositors, creditors and other major stakeholders.

STEP 5- CONSTITUTE BOARD NOMINATION, COMPENSATION AND RISK COMMITTEES

These three sub committees of the Board must also include **a minimum of 2 Risk Qualified Independent Directors**, such that compensation and performance reviews are conducted on a medium term risk adjusted basis.

STEP 6- INSTITUTE DIRECT AUDIT AND RISK GROUP BOARD REPORTING LINES

The Chief Auditor and the Chief Risk Officer of the FI, should be independent of Line Management at FI's, and must have **unfettered access** to relevant Board Committees, such as the Audit and Risk Committees, respectively. This should apply to the CRO even if he/she has a separate (dual) reporting line to the CEO. The nomination, compensation (including bonuses), and release of these officers should be decided upon by the Board Nominations Committee (which should include the concurrence of the two Independent Risk Qualified Directors as members).

STEP 7- INSTITUTE CONFLICT OF INTEREST AND RELATED PARTY DISCLOSURE POLICIES

Establish, and strictly comply with, a related party disclosure, concentration, and conflict of interest policy. Such a policy should require public disclosure of such dealings, voting abstention by conflicted Board Directors, and concentration limits set on such dealings.

STEP 8- ENHANCE REMUNERATION AND QUALITY OF BOARD DIRECTORS

Compensation and qualification of FI Board Directors should be enhanced to equate to best practice requirements and major market norms. This should include adjusting Board compensation to be on the basis of **medium term risk-adjusted performance**, require annual board member certification, and independent expert evaluation of FI Boards/Board Members. Certification should include Regulatory Compliance, Risk Appetite formulation, Risk Profile review, Stress Testing, and Liquidity Management.

STEP 9- COORDINATION OF BUSINESS STRATEGY WITH RISK STRATEGY

Establish a process for coordinating Business Strategy with Risk Strategy in line with Risk Appetite approved at Board level. This should include quarterly review of FI risk profile against plan, Stress Tests, and Contingency Plans at the Board Risk Committee level.

STEP 10- FI FIRMS TO ENGENDER CG PROMOTION AT CORPORATE CUSTOMERS

FI firms must encourage their major corporate customers to employ CG programs to help safeguard the FI’s investment in them, as well as systemic stability. This is especially important at large family owned corporations and listed corporations. FI firms, and their regulator, should encourage Capital Market regulators to legislate and enforce sound CG codes for implementation at all listed companies.