United Arab Emirates
Afridi & Angell

Spotlight on corporate governance

One of the impacts of the global financial crisis on the United Arab Emirates (UAE) has been an increased spotlight on corporate governance standards in the UAE.

On November 30 2009, the Ministry of Economy published Ministerial Resolution No. 518 of 2009 (MR 518) which provides for enhanced corporate governance rules and discipline standards for UAE Public Joint Stock Companies (PJSC). PJSCs are listed on at least one of the UAE's two stock exchanges: the Abu Dhabi Securities Exchange (ADX) and the Dubai Financial Market (DFM). MR 518 reflects the government's continuing efforts to bring the regulation of UAE capital markets in line with corporate governance standards of leading international financial centres.

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A central theme of the new rules is the emphasis on the management oversight function of the board of directors. The provisions relating to the composition of the board reflect the value of independence and expertise of a company's directors to the overall effectiveness of the board.

Pursuant to MR 518, at least one-third of the directors of the PJSC must be independent members and the majority of the board must be comprised of non-executive members who have been appointed for their technical skills and experience.

A board member will be considered independent if neither the director nor the director's spouse have within the past two years (i) been or are directly related to any member of the executive management of the PJSC; or (ii) had any financial dealings with the PJSC which exceed the lesser of 5% of the paid up capital of the PJSC or AED 5,000,000.

Non-executive board members are directors who are not involved in the full time management of the PJSC. However, non-executive directors must be able to devote sufficient time to discharge their duties with respect to the PJSC, which include providing guidance on strategic issues, corporate policy and performance standards.

To reinforce the management oversight function of the board, MR 518 prohibits the chairman of the board from simultaneously holding the office of the managing director.

Independence and expertise are also central to the function of board committees. Board committees must consist of at least three non-executive board members, of which two must be independent members. Only non-executive members may be appointed to committees where potential conflict of interest issues may arise, such as the committees responsible for reviewing interested party transactions, nomination of non-executive board members or setting management remuneration. At a minimum, the board is required to form an audit committee and a nomination and remuneration committee.

The chairman of any committee must be an independent member of the board. The board of directors is also required to lay out a transparent set of guidelines for the functioning and reporting obligations of board committees.

Internal control

Perhaps the most substantial obligation arising from MR 518 is the requirement for PJSCs to adopt a top-down risk assessment system similar to the protocols of the US Sarbanes-Oxley regime. The board, in consultation with management, must develop and apply an internal control system to assess internal control of areas such as risk management, compliance with corporate governance principles and applicable laws, internal authorization protocols and the PJSC's financial reporting system.

To monitor internal controls, every PJSC is required to create an internal control department which is independent from management and reports directly to the board. The rules also call for the appointment of a Compliance Officer, who may also serve as head of the internal control department. The function of the Compliance Officer is to ensure compliance with applicable laws and company regulations. In addition to corporate governance rules, company regulations must also include a corporate social responsibility (CSR) policy, environmental policy and a code of conduct.

The board is required to conduct an annual review of the company's internal control system to be signed by the board chairman. The results of the review must be disclosed to the UAE Securities and Commodities Authority and the PJSC's shareholders in a corporate governance report. In addition to describing the methodology used to review the internal control system, the board of directors must acknowledge that they are responsible for the application, review and efficiency of the company's internal control system.

External auditors

MR 518 also demarcates the role of the external auditors of a PJSC. In addition to new procedural rules regarding their appointment, external auditors are prohibited from rendering technical, consultative, or administrative services which may have an impact on the independence of the audit.

Although MR 518 represents a substantial development of the UAE's corporate governance regime, PJSCs have been given only five months to adopt the new protocols. Failure to comply with the provisions of MR 518 by April 30 2010 can result in penalties ranging from warnings and fines to suspension and de-listing.

The legislative framework of MR 518 provides for increased transparency and accountability, paralleling the latest developments in corporate governance regulation. The enhanced regulation is expected to spur increased investor confidence in UAE's capital markets. The response from the investment community may ultimately depend more on the adoption and enforcement of the regime than on the rules themselves.

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