

# Client Alert

Middle East and Islamic Finance Practice Group

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## Stricter Corporate Governance in Saudi Arabia

The Saudi Arabian Capital Market Authority (CMA) has earlier this year required increased compliance with the corporate governance regulations (Corporate Governance Regulations) dated 12 November 2006 G. (Corresponding to 21/10/1427 Hijri). The Corporate Governance Regulations generally apply to joint-stock companies listed on the Saudi Arabian capital market (Tadawul).

The rules of the Corporate Governance Regulations were initially not mandatory, and adopted the principle of comply-or-explain. However, effective January 2009, listed companies were required by the CMA to comply with certain rules of the Corporate Governance Regulations for the purpose of enhancing transparency and protecting shareholders' rights.

These selected mandatory rules require the directors' annual report to include information about (i) compliance with the Corporate Governance Regulations; (ii) the composition of the board of directors and the balance between executive and non-executive (including independent) directors, and the other joint-stock companies directors holding a seat in its board of directors; (iii) a brief description in respect of the composition of committees formed by the board of directors, such as audit, nomination and remuneration committees; (iv) the details of compensation and remuneration paid to the chairman, board members and the highest-paid five executives (the chief executive officer and chief financial officer if they are not amongst the highest-paid five executives); and (v) any punishment, penalty or restrictions imposed on the company by any regulatory, executive or judicial authority, and the annual review of the effectiveness of its internal audit.

Further, the mandatory rules require a majority of the board members to be non-executive and the independent members must not be less than two members or one third of the board members, whichever is greater. In addition, an audit committee must be established comprising at least three non-executive directors (one of whom must come from a financial background). The audit committee will be responsible, among other things, for establishing robust internal controls, dealings with external auditors and devising appropriate accounting policies.

In line with its efforts towards boosting transparency in the Saudi capital market, the CMA adopted other amendments to the mandatory rules of the

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Corporate Governance Regulations in 2009 and 2010. The purpose of these amendments were to clarify the definition and selection criteria of an “independent member,” and disclosures required in relation to conflict of interest and remuneration of board members.

Beginning January 2011, listed companies are also required to comply with Article 15 of the Corporate Governance Regulations by forming a nomination and remuneration committee by the Board of Directors. This committee, among other things, will generally advise, review and audit the rules and policies related to appointment, qualifications, structure, authorities, independency, and remunerations of the board members. The composition rules of the nomination and remuneration committee will be proposed by the Board of Directors and approved by shareholders in a general assembly.

Companies licensed by the CMA to conduct capital-market activities are also required to comply with corporate governance rules pursuant to circulars issued by the CMA. Effective January 2012, CMA-licensed entities are required to include independent members on their board of directors, and to disclose in annual reports information about board composition, activities, internal audit and financial matters. Further, CMA-licensed entities must establish corporate governance policies to cover different areas including board membership appointment criteria; authorities of the board members; ethics rules for employees and composition of audit and remuneration committees.

Violators have been penalized by the CMA, and for example, a fine of SR 50,000 has been imposed on a Saudi listed company for failure to include in the Board’s report on information related to a penalty imposed by the CMA, and a similar fine was imposed for not complying with paragraph (a) of Article 9 which requires the board to include in its report information about compliance with the Corporate Governance Regulations.

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