KEYNOTE ADDRESS ARAB REGULATORS CONFERENCE

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"ENHANCING CORPORATE GOVERNANCE IN THE ARAB REGION

- BUILDING BRIDGES WITH BOARDS OF DIRECTORS"

Your Excellencies, Ladies and Gentlemen

It is indeed my pleasure to address you today at the Second Arab Regulator's Conference here in Abu Dhabi on the subject of "ENHANCING CORPORATE GOVERNANCE IN THE ARAB REGION - BUILDING BRIDGES WITH BOARDS OF DIRECTORS".

I am particularly pleased to be here as I was one of the founding fathers and the first Chairman of the GCC Board Directors Institute when I was Senior Vice President of Finance for Saudi Aramco. GCC BDI was founded in 2007 as a not for profit company to promote professional directorship and to raise the level of board effectiveness in the GCC. Today GCC BDI has trained over 700 senior board directors in the GCC and continues to grow, making a significant contribution to effective corporate governance in the region.

I would like congratulate all the organizers of this conference for bringing together regulators and board directors to improve the dialogue and share views on this important subject. *Regulation, corporate governance and boards of directors are all key issues which are of fundamental importance not only to this audience, but also to the economies and countries of the Arab world.*

In the past Corporate Governance used to be a loosely defined subject. Elements were scattered in Company Law, accounting standards and the licensing of guidelines of various financial sector regulators. Since the late 1990s, the concept of Corporate Governance has begun to crystallize. Scandals and major corporate failures of companies such as Enron, Tyco and Worldcom, and many others, has focused more attention on this subject. The concept and importance of corporate governance has become more and more relevant. Civil law suits and criminal prosecutions of CEOs, CFOs, audit partners and board directors has made the senior executives of corporations more aware of their responsibilities and accountabilities. The substantial losses to the affected economies, both in terms of financial assets and creditability, has prompted those with responsibility - policy makers, government and regulators - to act swiftly and decisively. The public has demanded greater accountability and responsibility in corporate behavior. The Corporate Governance failure of large US companies provided the impetus for one of the most far reaching pieces of US legislation in US commercial and financial law history – the Sarbanes Oxley Act which came into force in July 2002. These responses, and others, make it clear that *the governance of corporations has become a central item on the public policy agenda.*

The latest G20/OECD Principles of Corporate Governance provide an international reference point. They are intended to help policy makers evaluate and improve the legal, regulatory, and institutional framework for corporate governance. These principles state that "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."

It is essential to highlight the importance of good corporate governance for overall economic stability and national credibility. The collapse of relatively few companies, due to lax corporate ethics, poor accounting practices and poor board oversight, led to major financial disruption and resulted in thousands of job losses. We all need to learn from these mistakes. These scandals highlighted the failure of self-regulation. They demonstrated that lax regulatory standards, institutions and enforcement can have huge implications for the economy and for the public. Of course Governments response to scandals should be well considered and effective. Regulatory reforms that over-react or fail to address the underlying causes can be costly and counter-productive. We need to ensure corporate integrity and market confidence without stifling the dynamism and entrepreneurship that underlies the development of a strong economy.

For the developing countries in the Arab region, the importance of good corporate governance is a key consideration. It is an important part of our individual National Visions. It is a sine qua non if we are to attract more foreign direct investment. The implementation and the maintenance of sound corporate governance practices and structures at every level of our societies is imperative for the continued well-being and development of our economies. *We therefore need effective regulatory systems and enforcement to ensure confidence in our capital markets.*

This means there is a vital role for the Regulator as an important standard setter in Corporate Governance. The Central Banks, the Commodities and Securities Authorities and the other regulators, have a clear responsibility to issue comprehensive guidelines on Corporate Governance, in line with the best international standards, and to ensure that licensees are fully compliant.

But regulation gives rise to 2 key questions - How to Regulate and How to Enforce? Regulators face a choice between principles and rules. Both choices have their upside and their downside. Rules have their virtues and are widely used, but may allow compliance with the letter of the law and not the spirit. And how aggressive should regulators be in their enforcement? Should the regulators pursue individual perpetrators or the corporations that misbehave or both? After all, it was Voltaire who said "It is well to kill from time to time an Admiral to encourage the others"! " Arthur Anderson was effectively put out of business after the Enron scandal after being convicted of obstruction of justice. Whether fair or not, criminal sanctions can certainly be effective in deterring corporate misconduct. The threat of going to jail or being put out of business tends to catch the attention of boards of directors! The threat of a civil penalty may not be enough to deter misconduct if the company simply sees the fine as the cost of doing business. *Effective enforcement sends the right signals to the market and deters bad actors*. But over enforcement can dampen legitimate business and positive risk-taking. So how do we find the right balance? I am sure this conference will discuss many of these issues and I look forward to that discussion.

The regulator is best positioned to represent and to balance the various stakeholder interests. Guidelines should be subject to wide consultation and adapted to the needs of the local markets and economies. *<u>All stakeholders should help to shape the requirements into a process that will strengthen the overall Corporate Governance.</u>* This will produce more positive results. The all-important "buy in" needed to achieve successful implementation of corporate governance frameworks.

There are some who say that introducing more regulation has clearly failed. *<u>What we need is better regulation which ensures businesses recognize the importance of corporate governance.</u>* And that Corporate Governance should be an integral part of the strategy and management, not just a box ticking exercise. The regulators have openly admitted that they did not understand the complex financial instruments that ultimately led to the collapse of the financial system in the 2008 Financial Crisis. Constructing new regulations to try to control circumstances that have yet to emerge is probably a futile task. If the regulatory burden becomes too great, it can increase cost and confusion. It will also encourage people to invent more and more complex systems to avoid detection. Organizations and board directors and other stakeholders will always disagree on the level of regulation. Is it overly-prescriptive or not precise enough? Some will be concerned about the penalties for non-compliance. Others will feel that the regulations are becoming too onerous and too costly. There is much excellent regulation and we really need to focus on the positive aspects. Let's avoid at all costs mere box ticking exercises. I hope this conference will also address these issues.

<u>The heart of sound Corporate Governance lies in the Boardroom with directors' responsibility and accountability.</u> Directors and senior management need to fully understand the underlying principles of good corporate governance. They need to understand best practices and how to adapt and implement them in their organization. *<u>An important aspect of good corporate governance is that directors should be required to certify that their organization is in compliance with the relevant Corporate Governance standards.</u>* They must describe the measures taken to ensure compliance with these principles throughout the year. This statement enables users of financial statements to assess whether an organization's governance structure is satisfactory.

<u>Another important aspect of good Corporate Governance is the quality of Annual Reports and the issue of disclosure requirements and accounting standards.</u> The corporate scandals of the

past decade have illustrated that these issues are as essential as the good ethics of directors. Financial information should be produced in a way that is useful to all stakeholders. Transparency, timeliness and materiality are the key ingredients here.

Boards also need to ensure the development of a business culture which is conducive and receptive to sound business principles. A sound corporate culture is essential. The tone starts at the top and Boards must be concerned with the reputation of their institution. The awareness of the importance of corporate governance must permeate all the way through the organization. The board must ensure that good policies and procedures are in place to prevent and detect any violations of regulations. Employees need to be properly trained and monitored. Recent legislative developments, particularly in the UK with the UK Bribery Act, require public companies to have a Code of Ethics, Certification of Financial Information by the CEO and CFO, and whistleblowing procedures.

The role of the Chairman of the Board is crucial. And Chairmen need to understand their role is to lead the Board; to facilitate board decisions and board dynamics. Their role is not to manage the company.

Prevention is better than a cure, they say. Including the knowledge of the principles and the practice of corporate governance in mainstream director training is essential. More and more attention is being paid to the qualifications of senior management to carry out their responsibilities but there has never been any formal qualification required to run an organization. And none to be a director. This gives rise to the importance of Directors' training in corporate governance. The role of the director has evolved. Companies operate in more and more complex globalized business environments. So it is only right that *directorship has finally begun to be seen as a profession, or at least a discipline, requiring specific professional training and development.* We would certainly like to see mandatory board training and induction.

Board evaluation should also be mandatory. The purpose of the exercise is to ensure that boards are staffed and led appropriately, that board members are effective in fulfilling their obligations, that reliable processes are in place to satisfy important oversight requirements; and that key board activities are being addressed.

The board of directors has to understand that the "buck" stops with them. They have to live up to their duties and responsibilities. *It is this corporate leadership that will ensure full confidence in our capital markets.*

GCC Board Directors Institute conducts a bi-annual survey on board effectiveness in the GCC and makes the following key recommendations to the Regulators in terms of Corporate Governance and Board effectiveness:

1. **Make induction training for new board members and annual training for incumbent board members mandatory**
2. **Make annual Board evaluations mandatory, with an external evaluation at east every 3 years**
3. **Strengthen the role of the board secretary and make it mandatory to have qualified board secretaries**
4. **Mandate that all compensations and benefits to management and the board be approved by the compensation committee and general assembly respectively**
5. **Strengthen the requirements for annual corporate governance reporting including the requirement for directors to certify that their organization is in compliance with the relevant Corporate Governance standards. Where there are deficiencies, these should be clearly identified and rectified within a given time frame**

I strongly believe that these 5 recommendations will go a long way to improving corporate governance in our region.

Ladies and gentlemen, to conclude

The importance of effective boards of directors and good corporate governance practices cannot be over-emphasized. Enhancing corporate governance in the Arab Region is a key factor in the development of our economies and the achievements of our Visions for the future. If we want to move from frontier markets to emerging markets to developed markets, we have to adopt the highest international standards of corporate governance. Many companies still lag behind in their adoption of good corporate governance practices by comparison with global standards.

So we need regulation that meets international standards and we need consistent and systematic enforcement. We need effective regulators able to balance the carrot and the stick - encouraging and nurturing the best adoption and compliance, while checking abuse and strongly sanctioning wrongdoing.

We need organizations which understand the underlying principles and benefits of effective corporate governance. Companies who are committed to these principles and act with integrity. And above all, we need board directors who understand their roles and responsibilities, who promote leadership with strong ethical values, setting the right tone at the top.

So ladies and gentlemen, I am sure we will all benefit from the dialogue between regulators and board directors on these important and complex issues. I wish you all every success with your deliberations and discussions at this conference.