



BUSINESS CLIMATE DEVELOPMENT STRATEGY

Phase 1 Policy Assessment

EGYPT

DIMENSION II-2

Corporate Governance

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EXECUTIVE SUMMARY

The concept of corporate governance has been gaining prominence on the agenda of policy makers in the Middle East and North Africa (MENA) region over the last decade. The Egyptian regulators are clearly among the regional leaders in recognising the value of good corporate governance and of promoting the concept within corporate circles. This is unsurprising given the overall level of development of the Egyptian capital markets vis-à-vis the rest of the region and the strong political support given to advancing the corporate governance agenda in the country. In their effort to improve governance practices in their country, the Egyptian authorities have been cooperating with the OECD since 2003. This project further reinforces the longstanding partnership between Egypt and the OECD. Egypt has also been cooperating with the World Bank and the IFC since 2004.

Achievements in Corporate Governance

Awareness of corporate governance has increased significantly

Reforms and related initiatives implemented in recent years by the Egyptian government have been effective in raising awareness of the benefits of good corporate governance. A number of corporate governance-related initiatives have been implemented. These include establishing the Egyptian Institute of Directors under the umbrella of the Ministry of Investment, the introduction of two governance codes (namely the Egyptian Code of Corporate Governance for Listed Companies in 2005 and Code of Corporate Governance for instate Owned Enterprises in 2006), both based on the OECD guidelines, the amendments to the Companies and the Capital Markets Laws and the tightening of the Listing Rules. The corporate governance framework in Egypt is expected to be significantly improved by the ongoing revision of the Companies Law and the Egyptian Code of Corporate Governance.

The regulatory framework is much improved

With regard to the institutional landscape, the creation of single non-bank financial regulator (the Egyptian Financial Supervisory Authority [EFSA]) and the establishment of a local institution to advance the corporate governance agenda (the Egyptian Institute of Directors [EIoD]) are important developments. The EFSA is responsible for investigating instances of shareholder abuse and is seeking to increase its oversight and enforcement capacities. The EIoD in particular has been very active in promoting the corporate governance agenda in Egypt, by raising awareness of the benefits of corporate governance and by providing training to directors.

Corporate governance regulation has been upgraded

A new legal framework, the Companies Law and its Executive Regulations, is a major step. These address issues such as

- Shareholder participation and voting in general and extraordinary shareholder meetings.
- Appointing and removing the board.
- Sharing in the profits of the company, and other important governance issues.

- Increasing the power of the board of directors. Based on concerns expressed by shareholders owning at least 5% of a company's shares, the board may halt the resolutions of the general assembly deemed to be in favour of a certain category of shareholders.
- Protecting the rights of single shareholder to lodge a complaint with the EFSA which it then has to investigate.

Governance of state-owned enterprises is also gradually being improved

In terms of the government's efforts to improve the governance of **state-owned enterprises (SOEs)**, the Code of Corporate Governance for State-Owned Enterprises, a first of its kind in the region, is of great importance. In addition, the Public Business Sector Law outlines a number of provisions regarding the governance of both holding and affiliate companies in Egypt, including appointing members of boards, disclosure requirements, and performance monitoring.

Progress in improving governance arrangements in SOEs is particularly evident in those SOEs which operate under the umbrella of the nine holding companies established under the Ministry of Investment. However, the governance arrangements of other SOEs have not been subject to the same standards and may therefore not have improved as rapidly. That said, competition between state- and privately-owned companies has been on the rise and lending by banks to other SOEs curbed.

Challenges and Recommendations for Corporate Governance

Tackling the high concentration of listed companies would increase policy options

The ownership landscape in Egypt remains extremely concentrated, even in comparison with other markets in the region. Free float is estimated at less than 10%, which is below the free-float estimates of other emerging market countries. The concentrated ownership landscape renders meaningful minority investor participation difficult.

Further improvement would be welcome within the listed companies sector. That said, the extremely concentrated ownership landscape limits the available policy options. Increasing the free float of companies remains a priority, as does minority investor protection. The development of block holders able and interested in taking an active role in corporate governance and with the power to challenge, if necessary, the decisions of controlling owners is essential.

Other measures would strengthen the *ex ante* protections available to minority shareholders, such as strengthening the framework around related party transactions, establishing an investor association, and introducing "majority of minority" approvals for some transactions. The strength of *ex post* protections is difficult to evaluate given the recent introduction of economic courts, but is vital.

Boards need to be made independent of their controlling shareholders, and annual reports should contain more information on boards' operations

A related area concerns the operation of boards in Egypt and, in particular, their lack of independence from controlling shareholders. In general, board reports remain relatively uninformative, and details of boards' operations are difficult to access, as is indeed the case in other countries. An in-depth review of the legal framework and its application leads to the conclusion that boards are dominated by insiders and are not as qualified and objective as may be hoped. The only committee that listed companies are required to have and whose composition is stipulated in the listing rules is the audit committee.

Achieving board independence – from the majority owners in private companies, and from the state in SOEs – remains a challenge. The ability of the board to maintain independence from management is also uncertain, especially given that the separation of the Chairman of the Board and CEO posts are not mandatory. In addition, the lack of a sufficient number of qualified independent directors is also a serious challenge.

Institutional investor participation in governance and their disclosure of voting practices, even when they are acting in a fiduciary capacity, is insufficient and needs to be subject to additional requirements.

Duties and rules for board members should be clarified and specified

The duties and responsibilities of the members of the board are not specified in the Egyptian corporate governance framework. Rules should tighten the framework on related party transactions and establishing minority investor associations.

Disclosure rules need to be further strengthened

The disclosure of listed companies remains unsatisfactory, particularly with regard to non-financial disclosure. Though the disclosure framework has been reinforced in recent years, its requirements remain incomplete and its implementation has been lagging, in particular with respect to non-financial disclosure (*i.e.* foreseeable risks, executive remuneration, etc.). The disclosure of shareholder agreements and information and share classes also needs to improve.

The accounting and auditing professions need improved oversight

A significant related weakness that has been identified concerns the framework for oversight of the accounting and auditing profession in Egypt. This is only addressed by the regulators on an *ad hoc* basis. The regulation of the accounting profession is currently fragmented and requires further educational and standard-setting efforts. In 2009, the Capital Markets Authority, now EFSA, created an Auditors' Supervisory Board, which is a step in the right direction, but it is too early as yet to see the results of this.

Ownership and regulatory functions for state-owned holding companies should be separated further

A number of observations highlighted in this report are applicable to state-owned enterprises (SOEs), since they comprise a substantial portion of market capitalisation of the Egyptian Stock Exchange. In addition, some governance challenges are unique to SOEs. In particular, the report discusses the appointment processes for boards of “holding” and “affiliate” companies and suggests that authorities should further separate the ownership and regulatory functions.

The establishment of an ownership or co-ordination entity which is currently under way, will go some way to address this issue, but care should be made to ensure this new entity also improves the ability of the state to fulfil its ownership obligations effectively.

INTRODUCTION

Alongside other policy dimensions explored in the present report, corporate governance is an integral element of the Business Climate Development Strategy (BCDS), and indeed of any private sector development approach. An appropriate corporate governance framework implemented by a range of private and state-owned companies is of consequence to the sustainability of domestic enterprises and to the attraction of foreign investment. The degree to which corporations observe basic principles of sound corporate governance is an important determinant of domestic and foreign investment decisions, influencing the confidence of investors, the cost of capital, the overall functioning of financial markets and, ultimately, the development of more sustainable sources of financing for enterprises. On a micro-economic level, good corporate governance practices have been linked to better financial performance of firms, and on the macro-economic level, to the increased competitiveness of national economies and the decline of systemic risk for the financial sector. Corporate governance is not only an integral component of any private sector development strategy, it is also one which is closely interrelated to other themes covered by the present report, not least privatisation policy, access to finance, and business law/commercial conflict resolution.

The objective of this chapter is to discuss the corporate governance framework and practices in Egypt with a view to appreciating the progress made to date and the remaining challenges and priorities. This is a unique exercise, a first of its kind, aiming to look at corporate governance practices and framework as part of the broader private sector development climate. It is a formidable task given the introduction of numerous private and public sector initiatives which, over the past decade, have impacted on both the corporate governance framework in Egypt and on related elements of the business climate. Whereas the concept of *hawkamah*, or corporate governance in Arabic, was essentially unknown in Egypt and in the broader MENA region in the 1990s, the awareness of the concept and its benefits has grown tremendously in various circles in Egypt. A number of legal and regulatory reforms and private sector initiatives have been instrumental in this regard.

While a number of relevant legislative amendments have been passed over the years, the introduction of the *Egyptian Code of Corporate Governance* in October 2005 was a step of particular importance.¹ The introduction of the *Code of Corporate Governance for the Public Enterprise Sector*² in July 2006, the first of its kind in the region, followed. Both codes have been modelled on the OECD instruments in the area of corporate governance, namely the *OECD Principles of Corporate Governance* and the *OECD Guidelines on Corporate Governance of State Owned Enterprises*, and have been developed with the input of OECD experts. Indeed, the OECD has been a longstanding partner to the authorities in their ambitions to upgrade the corporate governance framework in Egypt.

This dialogue started in 2003, when Egypt hosted a first regional forum on corporate governance in the MENA region, sponsored by the Global Corporate Governance Forum. Egypt has been an active participant in the MENA-OECD Working Group on Improving Corporate Governance since its inception in 2005. This Working Group has succeeded in engaging in its work government representatives from across the region. Furthermore, it has contributed to the establishment of the Hawkamah Institute for Corporate Governance as a regional body dedicated to improving awareness of good corporate governance practices.

The introduction of these two voluntary corporate governance codes was accompanied by a host of institutional reforms, key among which has been the creation of the Egyptian Institute of Directors (EIOD) in 2003 under the umbrella of the Ministry of Investment (MoI), responsible for drawing up the codes.

Another notable recent reform is the creation of a single non-banking financial regulator, the Egyptian Financial Supervisory Authority (EFSA), in mid-2009, after the compiling of this report. This authority consolidates the Capital Markets Authority (CMA), the Egyptian Insurance Supervisory Authority, and the Mortgage Finance Authority, which previously functioned as separate regulatory bodies. In parallel to these efforts, a number of legal/regulatory initiatives – such as the revision of the Companies Law and of the *Egyptian Code for Corporate Governance* – are currently underway. The following analysis cannot fully take these ongoing developments into account at the present stage. On the other hand, its recommendations can be incorporated into the ongoing planned review of the legal and regulatory framework which the government is currently undertaking (discussed in further detail in the section 2.2 below).

The analysis undertaken in this chapter seeks primarily to address listed companies (approximately 350), as they are seen as the driving force for improving corporate governance in Egypt, being subject to the listing and maintenance requirements of the Egyptian Stock Exchange (EGX) and of the relevant capital market laws and regulations. That being said, some of the observations made in this report apply to different categories of companies, even, in some instances, non-listed entities. (They do not, though, apply to small and micro-enterprises).

In Egypt, special attention to the listed companies sector is warranted by the fact that it includes some of the largest enterprises, which reflects the efforts of the authorities to encourage large family conglomerates to list on the stock exchange as holding companies. These listings have resulted in the significant growth of market capitalisation in Egypt, despite the de-listings forced by the regulator over the past several years. Market capitalisation as a percentage of GDP rose from only 29% in 2000 to 107% in 2007 (WDI, 2009). As of end of 2008, it stood at approximately USD 85 billion, slightly below the capitalisation of the Warsaw or Indonesian stock exchanges.

Given the recent efforts of the authorities to de-list non-compliant and inactive companies, the number of listed companies on the EGX has decreased dramatically from 740 in 2005 to some 350 in 2008.³ The newly established unified regulator is intent to continue de-listings of companies which fail to comply with stock exchange rules or which are not sufficiently traded. On the other hand, the efforts of the EGX and the CMA to attract listings have not been particularly successful in recent years – privatisations certainly increased the breadth of the capital markets, but few private companies chose to list their equity.⁴ The market is not particularly liquid with a turnover ratio of approximately 33% in 2009, down from almost 70% in the previous year (EGX, 2009). In 2009, the average of monthly traded companies was 213 out of the total listed companies (*ibid*). Market concentration is moderate with the market capitalisation of the top 10 listed companies accounting for just under one-half of the total market capitalisation and the turnover value of just over 40% (WFSE, 2009).

While the market concentration is moderate, ownership concentration is extremely high, even in comparison with other markets in the region. Estimates of free float are put at 5-8%⁵, which is below the free float in neighbouring countries.⁶ The exact ownership composition of the market is unknown, for reasons related to reporting of ownership discussed in more detail below. In its response to the questionnaire, the CMA has estimated that families own 30%, individuals 15%, institutional investors 25%, foreign investors 25%, and public sector bodies 5%.

However, these figures do not appear to paint an entirely accurate picture of the ownership structure of Egyptian listed companies, nor address its more important underlying characteristics. In particular, the

estimate that the state owns only 5% of the listed sector appears to be extremely conservative. In addition, it is understood that listed companies are controlled by individuals or families, whose majority block holdings severely limit other investors' participation in governance.

In a number of large companies, free float is even less than 5%, contrary to the listing rules. The listing of such companies may have been motivated by the tax advantages that used to be granted to listed firms or for reasons of prestige associated with listing. Given this high ownership concentration, other control mechanisms such as multiple class shares and pyramidal structures are not particularly common. Nonetheless, multiple class shares, usually capped at two votes per share, are legally permitted and do exist. Holding company structures, where the apex company is often listed, are common.⁷ Given this ownership structure, the report seeks to examine how minority investors can be effectively protected in this framework, but also how retail or institutional block holders who could oppose majority owners could eventually develop.

Alongside listed companies, the governance arrangements of state-owned enterprises (SOEs) are also examined, in particular where they differ from the governance practices adopted by the private sector. Presently, the size and composition of the entire SOE sector in Egypt is not known, due to the fact that some "strategic" companies operate under the umbrella of sectoral ministries, whereas others (approximately 153⁸) come under the aegis of the Ministry of Investment. For data availability reasons, the present report only looks at the corporate governance arrangements of the latter. As discussed in the section 2.5 of this report, those 153 companies are organised into nine holding companies operating under the umbrella of the Ministry of Investment.

The number of SOEs overseen by the Ministry of Investment has declined by approximately half since the inception of the privatisation programme in 1995. A large number of them have shares listed on the EGX. In fact, it is estimated that a quarter of the shareholdings in the top 50 Egyptian listed companies are still held by the state. The total assets of the SOEs under the purview of the Ministry of Investment amounted to EGP 60 billion in 2008.⁹ For fiscal year 2007-8, the net profits realised by the SOEs examined in this report amounted to EGP 5.2 billion¹⁰, up from EGP 3.9 billion the previous year.

It bears noting that the corporate governance arrangements of the non-listed companies are not examined in the present chapter. This is in part due to a difficulty accessing information about governance arrangements in unlisted companies. It is also due to the fact that good governance of listed firms and banks (mostly listed) are considered a priority in Egypt, as indeed in other emerging markets. It is expected that good corporate governance practices will trickle through to the non-listed sector over time, in particular to those which might be interested in improving their governance arrangements for reasons linked to prospective listing or succession planning.

The efforts of improving the corporate governance of family-owned firms and small and medium-sized firms (SMEs) are currently in their initial stages with the planned introduction of a corporate governance code targeting these firms. That being said, an examination of the governance arrangements of large non-listed firms is a high priority, particularly given the reluctance of families to list companies and the recent trend to de-list non-compliant companies from the EGX. Indeed, the authorities should consider whether, from a public policy perspective, some governance requirements should be imposed on non-listed firms above a certain size, as is currently done in Germany.

THE BCDS CORPORATE GOVERNANCE ASSESSMENT FRAMEWORK

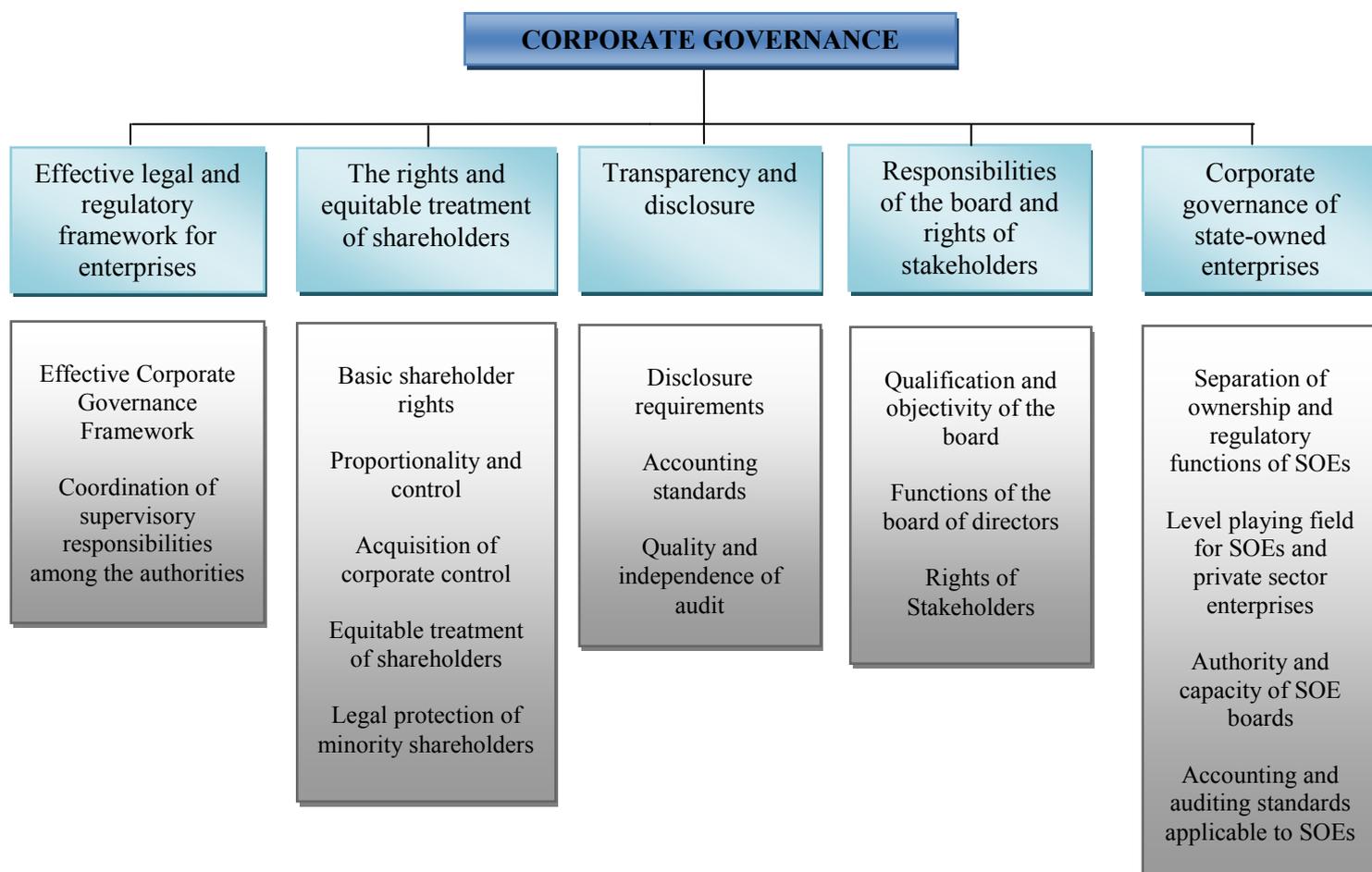
The two key corporate governance instruments of the OECD, which are the globally recognised standards in their respective areas, have been used as a basis for the framework constructed in this chapter. In particular, the *OECD Principles* constitute one of the Financial Stability Board standards and have been used by governmental and non-governmental actors all over the world as a model for promoting local governance standards. The World Bank uses the *OECD Methodology for Assessing the Implementation of the Principles* as a basis for assessments conducted under the programme of the Reports of Observance of Standards and Codes (ROSC). The underlying philosophy of the OECD Principles is that there is no single good model of corporate governance, but that there exist some common elements that underlie good corporate governance. The *Principles* therefore embrace the different corporate governance models that exist, seeking to identify policy objectives and suggest various means of attaining them.

The *Principles* define the concept of corporate governance rather broadly as “a set of relationships between a company's management, its board, its shareholders and other stakeholders”. They go on to suggest that good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. In keeping with the structure of the *Principles*, the following four sections have been included in the framework used for this chapter: 1) an effective legal and regulatory framework for enterprises, 2) the rights and equitable treatment of shareholders and stakeholders, 3) transparency and disclosure, and 4) the responsibilities of the board. In each of these sections, a number of indicators have been developed from the *Principles*.

A separate section on SOE governance was deemed worthwhile for the purposes of this exercise since SOEs continue to contribute significantly to the Egyptian economy. The *OECD Guidelines on Corporate Governance of State Owned Enterprises*, which explicitly take the perspective of state as owner, were used for the last section of this chapter. In particular, a number of key good practices highlighted by the *Guidelines*, such as the separation of ownership and regulatory functions, are included in this section. Though the selected indicators do not address all of the areas addressed by the *Guidelines*, they have been highlighted as being of priority in Egypt and, indeed, in the broader MENA region. The questions apply to both listed and fully owned SOEs and, primarily, to state-owned enterprises using a distinct legal form (*i.e.* separate from the public administration) and having a commercial activity in competitive or non-competitive sectors of the economy.

Figure 1 below illustrates the overall structure of this chapter on Dimension II-2, “Corporate Governance”, showing its sub-dimensions and indicators.

Figure 1. Overall Framework of Dimension II-2, “Corporate Governance”



The approach adopted in developing this chapter is similar to those that were used for the other chapters in this BCDS report. The framework was disseminated to public and private sector participants in order to gather the relevant information and to provide the participants in this exercise with an opportunity for conducting self-assessment in the areas covered by the framework. In some instances, for example, with respect to issues of quality and independence of audit, there appeared to be consensus among representatives of both public and private sectors. On other issues, there were differences in opinion among the respondents, and they have been taken into account in the following analysis. Where differences of opinion were noted in the written submissions of the private and public sectors, the interviews conducted during the mission of the OECD to Egypt on 15-18 June 2009 and the subsequent follow-up helped to shed light on them. During the mission, discussions were held with relevant key institutions in Egypt, notably the Ministry of Investment, the Capital Markets Authority, the Egyptian Stock Exchange, the Egyptian Accountants and Auditors Association, the Egyptian Banking Institute, representatives of international and local organisations, academia, law firms, business associations, and various other private sector participants.

In compiling the analysis, secondary research was also carried out. It involved consulting the Reports on the Observance of Standards and Codes (ROSCs) in the area of corporate governance (2001, 2004) and auditing and accounting (2002). These reports have made an important contribution to understanding and advancing corporate governance practices in Egypt, particularly given the relative lack of country-specific secondary research on corporate governance issues. It is understood that another corporate governance ROSC is currently ongoing. However, its results were not available at the time of writing and could not be taken into account. In addition, a review of studies prepared by other international organisations and academic institutions (International Finance Corporation, the Center for International Private Enterprise, etc.) was conducted. Overall, it appears that the available secondary research on corporate governance in Egypt is rather limited.

Finally, in terms of the scope and inherent limitations of the approach and the targeted nature of this exercise, the recommendations contained herein should not be treated as a definitive assessment of the corporate governance framework, but rather as an indication of its strengths and weaknesses. The outcome of this assessment does not aim to provide detailed prescriptions for national initiatives. Rather, the objective is to identify priority areas and suggest various means for addressing the remaining policy challenges. The recommendations are therefore indicative of the policy direction that the authorities might wish to consider. They should be treated as a basis for discussions both within policy-making circles and with the OECD and other organisations that have effectively collaborated with the Egyptian authorities in strengthening its existing corporate governance framework and practices.

Sub-Dimension 2.1.: Effective Legal and Regulatory Framework for Enterprises

An effective corporate governance framework requires a legal, regulatory and institutional foundation that all market participants can rely upon when they enter into contractual relations. Such a foundation typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific economic circumstances, history, and traditions. The desirable mix between legislation, regulation, self-regulation, and voluntary standards therefore varies from country to country and needs to be adjusted as new experiences accrue and business circumstances evolve. For regulators, the key challenge is to design a regulatory legal framework underpinning the corporate governance system that is sufficiently flexible to meet the needs of corporations operating in widely different circumstances.

This is indeed a significant challenge in a country such as Egypt, where the commercial sector is comprised of a variety of enterprises, including large family-led firms, widely held and actively listed firms, state-owned enterprises (wholly or with minority share), mid-size firms considering listing, not to mention small to micro joint stock companies, partnerships and proprietorships (Bremer and Elias, 2007). The structure and objectives of these different types of companies require distinct regulatory approaches. Specifically, standard-setting, implementation and enforcement functions have to take into account the different types of companies operating in Egypt. The fulfilment of these objectives necessitates effective coordination between different regulatory and enforcement authorities.

In light of the above, the two elements examined in this dimension bear on: 1) whether there is an effective corporate governance framework setting out legal and regulatory requirements, and 2) how the supervisory responsibilities of the authorities who introduced such requirements are co-ordinated. The first question is targeted towards understanding how the corporate governance framework (listing requirements, legal provisions, regulations or code of corporate governance) promotes overall economic performance and transparent and efficient markets. The second question takes an institutional angle and seeks to determine whether the responsibilities of the different authorities are clearly co-ordinated and whether they have the powers, integrity and resources to fulfil their duties in a professional and objective manner.

2.1.1. Effective Corporate Governance Framework

Generally speaking, the corporate governance framework in Egypt is underpinned by two pieces of legislation:

- the Capital Markets Law of 1992, and its Executive Regulations, which applies to all entities listed on the stock exchange and any others offering securities to the public;
- the Companies Law 159 of 1981, and its Executive Regulations, which applies to joint stock companies, partnerships limited by shares and limited liability companies.

These laws have been amended on a number of occasions. One reason for the amendments was to reflect the emerging recognition of good corporate governance practices and, as such, address a number of key issues. These included the exercise of shareholder rights, the make-up of boards and how they functioned, the relationship between management and board, and procedures related to the acquisition of corporate control, insider trading, etc. Other relevant laws and decrees, such as the Central Depository and Registry Law 93 of 2000 and the Accounting Practice Law of 1951, complement these two pieces of legislation on specific matters.

As the issue of corporate governance reform has gained the attention of policy makers, the *Egyptian Code of Corporate Governance* (henceforward the *Code*) was introduced in October 2005 by the Egyptian Institute of Directors (EIOD). It was a non-binding code which expanded on the governance provisions of

the above-mentioned laws. In many respects, this code is an important awareness-raising instrument which has succeeded in pushing the issue of corporate governance higher up the agenda of management, boards, and shareholders. While the scope of the code – both in terms of the companies it applies to and its provisions – is limited, its authors deemed it suitable for the market realities at the time it was issued. More importantly, although the code is non-binding, some of its provisions have been used as an inspiration for listing requirements on the Egyptian Stock Exchange.¹¹

The government has recently announced its intention of revising the *Code*, primarily to reflect the changing market realities in Egypt. Better definitions and more precise concepts in the *Code* would indeed be a welcome development. **However, any revision would need to be rooted in an assessment of the implementation of the *Code* in its current form and any challenges that have arisen in this regard.¹² No such attempt has been made to date.** Such an evaluation would help policy makers to calibrate their ambitions and listed companies to understanding the scope to which the code's provisions apply. Such an evaluation would have the secondary benefit of enabling policy makers to better target their awareness-raising efforts on areas where the challenges of implementation are evident. To this end, a review of the implementation of the code's provisions by the EIOD or another competent body might prove useful.

On the institutional side, the Capital Markets Authority (CMA) and, in a more narrow sense, the EGX acted as the relevant enforcement bodies until mid-2009 when a unified non-banking financial services regulator (the Egyptian Financial Supervisory Authority) was created. Prior to 2009, the enforcement powers of the CMA were gradually increased and were particularly enhanced by the 2008 amendment which gives the regulator the ability to impose a range of criminal and civil penalties. These prerogatives were transferred to the EFSA. In parallel, the amendment has increased the scope of punishable offenses, giving the EFSA a greater scope of issues to investigate. The EFSA's enforcement powers extend to a range of companies, including not just listed entities, but securities companies and investment funds. In particular, the Market Participants Complaints Department is charged with investigating all complaints filed with the EFSA. A notable exception to the regulatory and supervisory powers of the EFSA is the oversight of banks, which is the job of the Central Bank of Egypt. The responsibility for promoting good corporate governance standards lies with the Egyptian Banking Institute, which operates under the oversight of the Central Bank of Egypt.

Although the CMA was generally seen by market participants as effective in addressing investor grievances, it is unclear what investor protection disputes it has been involved in during the past several years and, more importantly, what market abuses may have occurred that it was not able to investigate. The organisation's annual report states that it has resolved 314 cases in the course of 2008 but the details of their resolution are unclear (CMA, 2008). **Nonetheless, it is understood that the recently created Egyptian Financial Supervisory Authority will have greater powers to investigate and enforce. In particular, it now has the power to launch criminal proceedings in the event of insider trading.** Before the creation of the EFSA, the CMA only had powers to force directors who broke the rules governing trading in a company's shares to buy back or sell the shares. It could not prosecute them.

2.1.2. Coordination of Supervisory Responsibilities among the Authorities

Coordinating the efforts of the authorities which work to raise governance standards among different types of enterprises in Egypt is essential, particularly given the number of ongoing legal and regulatory initiatives. For instance, the Central Bank is working on a corporate governance code for banks¹³, while the EIOD is working on revising the 2005 *Egyptian Code of Corporate Governance*. The work of the Central Bank and the EIOD needs to be closely coordinated, particularly since the *Code*, in its present form, also applies to financial institutions. Likewise, given that the Companies Law – which applies to some legal forms that can be used by SMEs – is currently under revision, work on any SME code should begin later

and take into consideration the legislative amendments to the Companies Law. The SME code might then attempt to go beyond the requirements in the legislation where necessary and realistic.

Coordination of supervisory responsibilities in the area of corporate governance might indeed be simplified by the introduction of a unified, non-banking financial supervisor and regulator – the Egyptian Financial Supervisory Authority (EFSA), created by Law 10/2009. Prior to the authority's creation, the CMA, the EGX, and a number of other regulatory agencies operated under the umbrella of the Ministry of Investment, which had the authority to approve any regulations they proposed.¹⁴ **Although these institutions –the Egyptian Stock Exchange, the Capital Markets Authority, MISR for Central Clearing, Depository and Registry – are reported to collaborate rather effectively, no formal arrangements such as memoranda of understanding (MOU) provide, strictly speaking, a basis for such cooperation.**

As the institutional arrangements and the operating methods of EFSA emerge, its leadership ought to strengthen the legal grounds of its cooperation with other regulatory entities. It should also consider how its internal structure will allow for a consistent process of reviewing legislation and regulations. The Central Bank, the Ministry of Investment, and other bodies responsible for introducing and monitoring compliance with corporate-governance-related laws and regulations should coordinate their activities more closely in order to ensure greater coherence. A conclusive evaluation of the relations between the different regulatory authorities is not currently possible given the significant amount of reform underway.

It is hoped that the consolidation of the different regulators will ensure that the new Egyptian Financial Supervisory Authority will have the necessary power, integrity and resources to discharge its duties. In this regard, the framework of Law 10 establishing a unified non-banking regulator does provide for an independent budget, though it also states that a part of EFSA's resources will be government allocations. EFSA's chairperson is appointed by the Prime Minister, though the legislation does not state under what terms the chairperson may be removed from office.

Sub-Dimension 2.2.: The Rights and Equitable Treatment of Shareholders

The corporate governance framework should protect and facilitate the exercise of shareholder rights, including such fundamental rights as the right to influence the corporation, the right to sell or transfer shares, and the right to participate in the profits of the corporation. In particular, participation in general shareholder meetings is a fundamental right of all shareholders, both foreign and local, critical to their ability to influence the company. The rights relating to ownership registration, share transfer, voting and electing board members and participating in the profits of the company are also important and should also be addressed in a national corporate governance framework. In addition, equitable treatment of all shareholders, including minority and foreign, is of paramount importance, as is the opportunity for shareholders to obtain effective redress for violation of their rights. Since seeking effective redress for violation of rights (*ex-post* rights) has often proven challenging in a number of emerging markets, policymakers have often put emphasis on *ex-ante* rights such as pre-emptive rights and qualified majorities for certain decisions.

Given these policy objectives, the following section of the report essentially focuses on five areas, namely: 1) the ability of shareholders to exercise basic shareholder rights¹⁵, 2) the disclosure of ownership structures that enable some shareholders to obtain disproportionate control over the enterprise, 3) the rules and procedures related to acquisition of corporate control, 4) equitable treatment of shareholders of the same class, and finally 5) the legal protections available to minority shareholders. These concepts are considered to be crucial to the ability of shareholders, as ultimate owners, to influence the strategy and operations of companies in which they hold a stake. In particular, the presence of adequate legal protection of minority shareholders is important if shareholder activism, often lacking in emerging market countries and in general in markets where the ownership concentration is high, is to develop.

The ownership structure of a particular market has important implications for the corporate governance framework. The fact that ownership in Egypt is extremely concentrated and average free float among Egyptian listed companies is estimated at less than 10% (CMA, 2009) suggests that a special priority should be given to minority shareholder protection and equitable treatment of investors. Greater minority shareholder protection may strengthen investor confidence, which can in turn increase share values and result in increased listings and market liquidity. Of course, it is widely acknowledged that controlling shareholders have strong incentives for closely monitoring the company and its management, which can have a positive impact on the governance of the company. However, their interests may also conflict with the interest of minority shareholders. This conflict is most destructive when the controlling shareholders extract private benefits at the expense of minority shareholders. In this case, all shareholders end up paying the cost of poor corporate governance in the form of lower valuations, reduced access to equity finance, and difficulties with respect to succession planning and accessing outside talent. Moreover, the economy pays through reduced productivity, as investment funds are allocated less efficiently.

2.2.1. Basic Shareholder Rights

Generally speaking, the ability of shareholders to exercise their rights is enshrined in the Companies Law and its Executive Regulations, which explicitly address issues such as participating and voting in general meetings, convening and voting in extraordinary meetings¹⁶, appointing and removing the board, sharing in the profits of the company, etc. From a strictly legal standpoint, shareholders are generally not impeded from exercising any key shareholder rights. The right to secure methods of ownership registration are ensured by the MISR for Central Clearing, Depositary and Registry. The right to transfer shares is also unhindered – with the exception of founder shares to which certain transferability limitations apply. The right to participate and vote in general meetings is also set out by the Companies Law. During general

assembly meetings, all shareholders may discuss the documents presented to them and ask questions of the board.

A number of specific provisions and shareholder behaviour are generally considered to limit the participation of minority shareholders in shareholder assemblies. For instance, the legal provisions for share voting compel shareholders wishing to attend ordinary meetings to prove that their shares have been deposited at the head office or an authorised bank several days prior to the meeting and until the date of the closure of the meeting. **The practice of share blocking, motivated by the current delays in settlement processes in Egypt¹⁷, is not consistent with international good practices and, as such, authorities should consider eliminating it in the medium term. Other practices, such as allowing partially paid-up shares to vote, already highlighted in previous analyses (WB, 2004), are also inconsistent with recognised standards.**

Aside from these relatively minor issues, a more significant obstacle to the effective exercise of shareholder rights relates to the low level of participation of minority shareholders, which leaves the decisions of the majority shareholder or block holder(s) without an effective check. Prior analyses and discussions with experts in Egypt have confirmed that minority investors fail, more often than not, to participate in shareholder meetings and do not exercise their right to convene an assembly when necessary.¹⁸ This passivism is related to investors' low awareness of their rights as shareholders, but also to the acceptance of their limited role in governance in the present ownership context.

Although the authorities have sought to improve minority shareholders' position by giving them the legal rights to challenge majority shareholder(s), they do not, in reality, even when they participate in meetings, necessarily feel up to the task of challenging the controlling shareholder(s). This may, to some extent, be related to the fact that voting in Egypt is generally by show of hands, except for certain very specific matters such as dismissal of a board member, which is done by secret ballot. Allowing minority shareholders to vote on a greater number of potentially sensitive issues by secret ballot may empower them to participate more actively.

Another practice which may prevent shareholders from becoming more active is that proxy voting can only be conducted through another shareholder of the same company. **The regulator should consider abolishing these restrictions and encouraging alternatives like electronic voting, which, while legally permitted, is currently a nascent practice in Egypt.**

Facilitating the exercise of ownership rights by institutional investors (both private and state owned) should also be considered a policy priority. Presently, institutional shareholders enjoy the same rights as other shareholders. However, they are under no obligation to disclose their voting policy or any conflicts of interest that may arise in exercising their voting rights. This is contrary to the position taken by the OECD's *Principles*, which recommend that: "institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments."

Requiring institutional investors to disclose their voting policy, possibly to the CMA or the new financial regulator, might have the benefit of motivating them to take their role as shareholders more seriously. This appears to be particularly important for state-owned investors such as banks and pension funds which, in some instances, have significant stakes in listed companies, but which do not always exercise their voting rights appropriately. The EFSA might in the future wish to conduct further analysis of the voting decisions of institutional investors, which should be facilitated by the fact that its representatives attend shareholder meetings of listed companies.

2.2.2. Proportionality and Control

As mentioned earlier, the Capital Markets Law allows two classes of shares: common and preferred. The latter can have a number of privileges attached to them in terms of voting rights, dividends, etc. In most cases, voting rights are capped at two votes per share, although in principle there is no legal limit. The rights attached to preferred shares must be written into the articles of association of companies on establishment. Otherwise, any changes must be made by a special agreement of all shareholders. The practice of issuing new shares that disproportionately benefit one class of shareholders is rendered impracticable by virtue of the above-mentioned parameters.

That being said, the holding company structure – widespread among both listed and unlisted entities in Egypt – can be used by controlling owners as a means to exercise a control that is not necessarily proportionate to their ownership rights. In this context it ought to be noted however, that pyramid structures (common in some MENA countries) and cross-holdings (often found in other regional economies like Kuwait) are not widespread in Egypt. Therefore, situations where the controlling owner at the apex of a pyramid can exercise control with very little actual ownership over companies at the bottom are uncommon. **However, shareholder agreements are rather common and often undisclosed – a practice which merits further examination by the regulator.**

2.2.3. The Acquisition of Corporate Control

The rules and regulations relating to the acquisition of corporate control are contained primarily in the Capital Markets Authority Law of 1992. According to the law, if any transaction should result in an acquirer obtaining more than 10% of common shares of a company which has previously publicly offered its shares or which has 30% or more of its common shares in public hands, then such an acquirer must notify the company two weeks prior to concluding the transfer. The company must notify the EGX and all shareholders holding at least 1% of its shares within one week of receiving the prospective purchaser's notice. Furthermore, if any transaction should result in the acquirer obtaining more than 15% of the common shares of a company in a public offering or at least 30% of the shares that are traded on the EGX, then the acquirer must make a tender offer.¹⁹

These provisions would appear designed to prevent the formation of block-holders who, in cases of shareholder abuse, may be able to challenge controlling owners and could therefore have a potentially important role in corporate governance. The provisions related to the acquisition of corporate control may indeed provide an explanation as to why the ownership in Egyptian-listed companies is so concentrated. Less problematic in the framework for acquisition of corporate control is the protection given to minority investors. Minority investors have to sell outright in situations where acquisition is of 90% or more of capital in the company. In addition, the tender rules framework stipulates that following acquisition of one-third of the outstanding share capital in the company, an independent opinion must be made available to the shareholders.

While the legal framework covering the acquisition of control in listed companies is relatively developed, the actual merger or acquisition transactions remain rare. There have been some mergers and acquisitions among listed companies over the years, but there have been virtually no hostile takeovers in Egypt, which is indeed unsurprising given the ownership concentration. It is also unsurprising that anti-takeover measures are essentially nonexistent and are not required to be disclosed. While this is not of immediate priority given the relative absence of acquisitions in Egypt, authorities should consider increasing transparency in this area as the markets for corporate control in Egypt become more active.

2.2.4. Equitable Treatment of Shareholders

A crucially important principle of corporate governance is that in a single share class, all shares should carry the same rights and that investors should be able to easily obtain information about the rights attached to all series and classes. Moreover, any changes in voting rights should be subject to approval by those classes of shares which are negatively affected. In Egypt, the Executive Regulations to the CMA Law spell out that: “all the rights and obligations of the shareholders shall be equal. The shareholders shall be responsible only for the amount of each share to which shall be added the share premium and issue costs as the case may be. Their obligations may not be increased under any circumstances”. These regulations remain in place under the new supervisory authority, the EFSA.

The board of directors, acting on serious concerns expressed by shareholders owning at least 5% of a company’s shares, may halt the resolutions of the general assembly which are deemed to be in favour of a certain category of shareholders.

As mentioned, the rights attached to preferred shares must be written into the articles of association of a company at its inception, and in general, rights attached to shares cannot be amended, except subject to a special majority approval procedure. Specifically, the Companies Law provides that:

“A resolution concerning any kind of shares shall only be amended by a resolution adopted by the extraordinary assembly and after the approval of an *ad hoc* assembly including all shareholders of the kind of shares subject to the amendment with the majority of the votes representing two-thirds of the capital represented by those shares.”

As for disclosure of share class information, it is understood that it is available from the shareholders’ prospectus. Nevertheless, continued and timely disclosure of all share classes and their attributes to the prospective investors is an evolving practice. Updates regarding the material attributes of companies’ share capital should be made available to the public, or at least to the shareholders of listed companies, on a regular basis.

2.2.5. Legal Protection of Minority Shareholders

The concentrated ownership landscape which characterises the Egyptian listed companies sector can give rise to shareholder abuse like the extraction of direct benefits via pay and bonuses, abusive related party transactions²⁰, denial of opportunities, changes in capital structure of the company, etc. The Companies and Capital Markets laws provide minority shareholders with a number of *ex ante* measures, some of which were discussed above. As mentioned, key *ex ante* measures include the ability of shareholders holding 5% or more of a company’s capital to call a meeting or, alternatively, to raise objections to a given decision with the EFSA board and even the courts, and ask for its nullification. In addition, even a single shareholder has the right to lodge a complaint with the EFSA which is then obliged to investigate.

In addition to the recommendations related to the exercise of basic shareholder rights outlined above, the authorities could implement other measures to incite minority owners to participate more actively in shareholder meetings. An example of one such measure would be the introduction of cumulative voting, already recommended by the World Bank ROSC in 2004. In fact, cumulative voting is already in place in some 20% of banking organisations in Egypt (EBI, 2006) and the implementation of this mechanism in the banking sector could serve as a precursor to its wider deployment. Other provisions of the Companies Law, such as the stipulation that urgent matters can be discussed and voted on, as long as the majority of the shareholders in the meeting agree, may not be controversial in many jurisdictions. But they do not appear to be ideally suited to the concentrated

ownership landscape of Egyptian listed companies, where “majority of the minority” voting, at least for some decisions, may be more appropriate.

In fact, the legal framework and in particular the Companies Law and its Executive Regulations could be used in order to expand the *ex ante* rights of minority shareholders. One important feature of the current framework is that extraordinary shareholders’ meetings are held at any time at the request of the board or shareholders representing at least 10% of the company’s capital. However, decisions of extraordinary assemblies are passed by a simple majority of the shares represented at the meeting, unless the matter concerns rises or falls in the approved share capital, amendments to objectives, mergers, etc. These provisions are clearly targeted towards highlighting certain decisions as critical and strengthening the approval procedures supporting them.

However, it is notable that Egyptian law does not feature any references to the “majority of the minority” approval procedure – i.e. decisions which would have to be specifically approved by the minority shareholders. Introducing such provisions, at least for related party or other types of sensitive transactions (e.g. substantive divestment of company assets), would create additional incentives for minority shareholders to be more active. However, it is important to note that for such provisions to be effective, the regulator should define who the legitimate minority shareholders are and ensure that all shareholder agreements are adequately disclosed and duly registered.

Another issue which should be addressed within the legal framework, as opposed to voluntary initiatives, is the exact definition of the duties of board members which are not explicitly specified in the existing legislation. As noted in the annotations to the OECD’s *Principles*, abuse of minority shareholders is most pronounced in those countries where the legal and regulatory framework does not establish a clearly stated duty of loyalty of board members and officers in the company to all of its shareholders. While Egyptian legislation does address board members’ and management’s potential conflicts of interest, it does not clearly address such duties of board members as fiduciary duty, duty of care, etc. This is of particular importance given the prevalence of group holding companies and the consequent concern that the duties of board members may be interpreted as being to the group, and not to the specific company on whose board they sit.

Ensuring that board members’ duties are clearly defined and upheld is a key recommendation which relates to the provisions aimed at related party transactions – another important concern for minority investors in Egypt. **The legal framework for related party transactions in Egypt appears to be work in progress.** The Companies Law stipulates that if a given transaction is with a board member, it must be approved by the AGM and the board member has to declare the conflict of interest. Furthermore, a list of related party transactions should be reported at the AGM on an annual basis. While related party transactions are considered legally void if not approved by the AGM, market participants note that this practice is not strictly followed. **Furthermore, the very definition of “related parties” is rather narrow in Egypt and requires revision – much as “insider” was redefined to prevent insider trading provisions. It is worth highlighting that Egyptian Banking Law 88/2003 has a wider definition of related parties²¹ and the authorities are advised to widen the definition of “related parties” to cover a variety of situations which could arise in the context of a holding company structure.**

Such amendments to the legal framework, although important, will not be sufficient given the present ownership structure of the listed sector. The underlying approach of the reform should be focused on empowering minority shareholders and, more importantly, on protecting them. An important step in this direction would be to enable more extensive discussions and consultations among minority shareholders. In principle, there are no legal provisions which prevent minority investors from consolidating their voting power, although it remains a rare practice. It would be helpful in this regard if provisions allowed minorities to coordinate their voting, not only by entering into formal shareholder

agreements but also on a more *ad hoc* basis, as is provided for in the French legal framework. In terms of the institutional framework, it is understood that there is currently no investor association in Egypt. **Establishing an investor association on the basis of examples in other countries (e.g. *Association des Actionnaires Minoritaires* in France) would seem to constitute a step in the right direction.**

In terms of *ex post* remedies, they are essentially two-fold. Shareholders can lodge complaints with the Egyptian Financial Supervisory Authority (EFSA)²² which effectively acts as a court of first instance. The EFSA has wide powers of discovery²³ and significant sanctioning powers, which have been reinforced by Amendments to the Capital Markets Law passed in 2008. These amendments give greater sanctioning powers to the EFSA, which can now levy both administrative and criminal sanctions, unlimited for certain types of crimes. The final sanctioning decisions are taken by the Board of the EFSA, with appeals being taken to its Appeals Committee. If the decision rendered by the EFSA is unsatisfactory to the complainant, he or she still has the right to address the issue in economic courts. Various reports and discussions with stakeholders in Egypt highlight that the way in which the economic courts operate is a significant weakness in the overall governance framework and requires further examination.

As highlighted in the business law chapter of the present report, the court system has been the subject of a considerable reform, with specialised economic courts being introduced in May 2008 and established in eight different governorates²⁴ of Egypt (*Egypt Legal Updates*, October 2009, July 2008). The courts have jurisdiction over both civil and criminal matters relating to the Companies, Capital Markets, Investment, Banking, Investor Protection Law, etc. **Although the economic courts could, in principle, be an important step towards speedier resolution of commercial disputes in Egypt, some participants from the legal profession have expressed reservations about the extent to which they will make an impact, given that commercial circuits existed in Egypt before the new economic courts.** This view appears to be not without credence considering that the judges who staff the commercial and new economic courts are the same. In fact, a number of interviewees concurred that judges' training remains an important priority, and that not all judges have the necessary background to understand the specificity of shareholder concerns in situations of mergers, etc.

Sub-Dimension 2.3.: Transparency and Disclosure

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including its financial situation, performance, ownership and governance. Present and potential shareholders require access to regular, reliable and comparable information in sufficient detail for them to exercise their ownership rights on a fully informed and equal basis. A disclosure regime that promotes transparency is thus a pivotal feature of a market-based corporate governance system. It underpins confidence in the stock market and is a powerful tool for influencing the behaviour of companies and for protecting investor rights. Insufficient or ambiguous information will hamper the ability of the markets to function, increase the cost of capital, and discourage investment. The ultimate objective of such disclosure is the ability of shareholders to exercise their rights on an informed basis, to preserve market integrity, and to increase the accountability of companies to their shareholders.

A key concept which underpins the questions in this section of the report is the concept of materiality. “Material information” can be defined as information whose omission or misstatement could influence the economic decisions taken by the users of that information. Material information can include both financial and non-financial disclosures and the latter is, indeed, necessary to complement the former. In addition to the concept of materiality, the framework considers the channels, timing, and procedures for disseminating corporate information, as it can be just as important as the content of the information itself. Naturally, there is no use in issuing material information if it does not reach the market and the concerned authorities in a cost-effective, easily accessible, predictable and timely fashion.

The discussion in this section of the report revolves around the following three elements: 1) requirements for disclosure, both financial and non-financial, 2) accounting standards followed by companies, and 3) the quality and independence of auditing. All three issues have been subject to considerable and ongoing debate in Egypt, and there is a general recognition of the need to improve the state of corporate disclosure by all types of enterprises. Incidentally, this has been the focus of much recent academic research which seeks to explore the quality of disclosure practices in Egypt and examine the remaining obstacles for companies to provide better disclosure.

2.3.1. Disclosure Requirements

According to the *OECD Principles of Corporate Governance*, disclosure should include, but not be limited to, material information on the financial and operating results of a company, the company’s objectives, and its major share ownership and voting rights. In Egypt, the board of directors is required by the Companies Law to publish the balance sheet, the income statement, the auditors’ report and their own report before a general meeting. Listed companies are required to provide their annual financial and operating results to the EFSA when they have been approved by the board and the auditors, and a copy of the quarterly financial statements and a limited audit report on a quarterly basis. The EFSA is responsible for reviewing them and transmitting comments to the companies, where it deems necessary.²⁵ If the company does not disclose the required information in due time, it is liable to pay significant daily penalties. From discussions with observers and the EFSA itself, it appears that the recourse to the penalties related to the late filing of annual reports is frequent and that the EFSA takes an active monitoring role in this regard.²⁶

The quality, as opposed to the timely submission, of financial and non-financial disclosures provided to the EGX and the CMA (prior to the creation of the EFSA) has proven more difficult to monitor.²⁷ The burden of CMA’s monitoring of corporate disclosures was considerably lightened through the mass de-listing of companies from the EGX in the four years to 2009. As mentioned, the de-listing was prompted by the regulator’s decision to take a tougher stance on monitoring companies’ compliance with the rules of the stock exchange. The future monitoring burden of the EFSA will be further lightened with

the planned de-listing of approximately 80 more listed companies. However, **monitoring corporate disclosure remains a challenge, in particular with respect to non-financial disclosure which market participants estimate as rather weak in Egypt. This is, in part, due to companies' low awareness of what non-financial disclosure is required, but also, in part, to evolving standards in this area.**

In terms of material events, the Listing Rules stipulate that a company facing irregular material events which may affect its activity or financial position, and affect the trading of its shares on the stock exchange, must disclose these events immediately to the EGX. Such events appear on the screens of brokers, but are not made known to the market as a whole – an issue in itself from the perspective of overall market transparency. In addition to material events that affect their financial position, companies are required to immediately notify the EGX of any modification in by-laws, auditors, board composition, or capital structure (in excess of 5%). In terms of the capital structure, the Listing Rules stipulate that, at the time of listing, shareholders owning 5% or more of shares in holding or subsidiary companies should be disclosed. Continuous ownership disclosure is facilitated through MISR for Central Clearing, Depository and Registry. **However, in light of the Egyptian ownership landscape, the authorities should introduce further requirements with respect to beneficial ownership, cross-shareholdings, and company group structures to make ultimate ownership more transparent.**

The Companies Law stipulates that at the AGM, each shareholder has the right to discuss the board of directors' report, the balance sheet, the income statement, and the auditors' report. In principle, the board of directors is obliged to place at the disposal of shareholders, at least 15 days prior to the general meeting, the names of the directors of the board; issues for discussion; the report of the board or management to the general meeting; balance sheet and income statement; auditors' report; etc. In addition, shareholders could access different information through various other sources such as the Companies Department, EFSA, the EGX, the company itself, and the newspapers.²⁸ Company websites could, in principle, be a source of financial and non-financial information about their performance and perspectives, but research has pointed out that not all of the EGX 30 companies have a website.

Limited evidence available from a review of secondary literature points to lagging implementation of disclosure requirements by listed companies. A recent study benchmarked disclosure by the EGX 30 companies against the UN disclosure checklist of 53 parameters and found the average implementation score to be 22%. The results of the study indicated that only four EGX 30 companies had a score of over 50% and some were as low as 6% (Dahawy, 2008). Another recent study noted that the stock market in Egypt needs information sources that complement published reports in order to be more efficient (Ragab, Omran; 2006). Given the available evidence, corroborated in interviews with experts, improving disclosure standards seems to be an issue of high priority in Egypt and **reveals that disclosure practices followed by listed companies are of two kinds. There are those, related to the presence of an adequate disclosure framework, which disclose exactly what is expected of listed companies, and those that show listed companies and auditors are on a learning curve with respect to changing disclosure requirements.**

In terms of the legal framework, as mentioned above, important aspects of the governance process remain opaque given that a number of important non-financial disclosure requirements are lacking in the present legal and regulatory framework. For instance, in Egypt there is no requirement to report on foreseeable risks or on corporate governance structure and policies (but only on some elements concerning the operation of the board). In addition, executive remuneration is not required to be disclosed, even on an aggregate level. In general, market participants interviewed for the purposes of this report noted the absence of a meaningful management discussion and analysis section in annual reports of listed companies. **A window of opportunity for addressing these requirements exists in the ongoing revision of the Companies Law, which could effectively establish a regulatory minimum for disclosure practices. In**

addition, listed companies must be made aware of the EFSA's intention to review not only the financial disclosures, but the non-financial ones as well.²⁹

Additional consideration should be given to the availability of company disclosures to market participants. Presently, information on company affairs and governance practices is available from multiple sources including the EFSA, the EGX, MISR for Central Clearing, Depositary and Registry, and the newspapers (when financial statements are released). For small shareholders, tapping into a variety of these sources may be a difficult task. One means of rectifying the present situation and encouraging shareholders to stay informed on company affairs would be to establish a single electronic platform where company disclosures would be consolidated. Such databases exist in a number of OECD member countries and in some emerging markets and could serve as a useful tool for domestic and foreign investors alike.

2.3.2. Accounting Standards

Recent years have witnessed significant changes in the accounting standards used by Egyptian companies, as the authorities have sought to bring Egyptian Accounting Standards (EAS) closer in line with International Financial Reporting Standards (IFRS). Prior to the issue of the EAS in 1997, the Capital Markets Law required companies subject to it to prepare their financial statements in accordance with the IFRS. In 1997 the first version of the EAS was issued, and in 2006, a complete set of Egyptian Accounting Standards was issued as per the decree of the Minister of Investment.

The main differences between the EAS and IFRS bear on the following four accounting practices:

- accounting for employees' and directors' share of the profit – Standard 1;
- accounting for fixed income and depreciation – Standard 10;
- disclosure of loan loss provisions in banking institutions – Standard 19;
- accounting standards related to lease transactions – Standard 20.³⁰

The authorities are currently attempting to bring the EAS in line with IFRS. However, as experience demonstrates, adapting international accounting standards is often a second-best option to adopting them.

An evaluation of the adequacy of accounting standards used by listed companies is not possible within the scope of this review. Instead, emphasis is given to how well the institutional framework for the oversight of the various standards is functioning and how effective enforcement is. The *OECD Principles for Corporate Governance* take the position that open, independent and public processes involving the private sector and other interested parties, such as professional associations and independent experts, should be engaged in the developments of local standards. The EAS were developed by the Standards Committee of the Egyptian Society of Accountants and Auditors in cooperation with the CMA (now the EFSA). The Standards Committee of the ESAA is comprised of representatives of various bodies including the EFSA, the Central Auditing Organisation,³¹ the Ministry of Investment, the Institute of Accountants and Auditors and other parties, representing a range of opinion. **That being said, the Standards Committee appears to be a cumbersome institution that is not sufficiently proactive in the process of standard setting and engagement with private sector stakeholders.**³²

In part, this is related to the actual process of introducing accounting standards, which sequentially involves the ESAA, the CMA (and now, the EFSA), and the Minister of Investment, who has the authority to make amendments to these standards. This process is seen by some market participants as overly cumbersome and preventing the ESAA from undertaking effective market consultations and introducing the relevant amendments on a timely basis. **A more flexible structure of consultations regarding**

financial and non-financial disclosure standards might be beneficial going forward. Such a structure might wish to seek more extensive private sector feedback in order to better gauge the realities and challenges of implementation. It would appear that, although the ESAA was established as a non-regulatory authority in 1951, it might have the requisite flexibility to play a greater role in standard setting and developing professional standards.

2.3.3. Quality and Independence of Auditing

The *OECD Principles* suggest that an annual audit should be conducted by an independent, competent, qualified auditor in order to provide an external, objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material aspects. Before discussing the quality and independence of auditing in Egypt, it is useful to understand audit requirements in general. In Egypt, the annual and semi-annual statements of listed companies must be audited in accordance with Egyptian Audit Standards. Egyptian Audit Standards (38 in total) were initially introduced in January 2007 and were last revised in June 2008. The committee charged with the review of auditing standards comprises the representatives of the Capital Market Authority, the General Authority for Investment and Free Zones, the Egyptian Accountants and Auditors Association, and the Central Auditing Organisation.

Auditor independence is an important question in Egypt, and one where further efforts from the regulators will be required. In particular, the current procedure for appointing auditors may not achieve the ultimate independence of auditors from company owners. Of note is the fact that there is currently no mandatory requirement for auditor rotations, except in banks. This often leads to auditor capture, particularly in situations where the client may be a significant, or the only client, of a particular auditor. That being the case, the Companies Law does address potential conflicts of interests that can be faced by auditors. In particular, it specifies that an auditor may not participate in incorporation or be a member of the board or engage in any consulting activities for the company until three years have elapsed from the date it performed auditing services for the company. The Egyptian Corporate Governance Code takes this requirement further by suggesting that an external auditor should be “independent and unbiased”. This is a position closer to that held by the OECD, which specifically requires auditors to be independent from the management, board members, and controlling shareholders.

The *OECD Principles* also encourage the process of auditor selection to be overseen by a body such as shareholders or a group of independent board members (an audit committee or an equivalent) which is independent of management. Until relatively recently, Egyptian listed companies were not required to have an audit committee, or other independent body, to oversee the work of external auditors and ensure that the appointed auditors were independent. A decision issued in 2008 by the then CMA’s Board of Directors changed this situation, requiring companies with listed shares or Egyptian certificates of deposit traded on the stock exchange to have an audit committee. According to the Listing Rules of the EGX, the committee may not comprise less than three members from the non-executive members of the board known for their experience. The Listing Rules specify, however, that if the company does not have a sufficient number of non-executive directors, the membership of the audit committee should be made up from experts from outside of the company. In companies where audit committees have been constituted, practitioners note several serious obstacles to their work. They include: the board’s limited understanding of how the audit committee works; a lack of communication between, on one hand, the audit committee and other board committees and, on the other hand, the executives; and a lack of discussion in board meetings about the scope of the audit and audit findings (Hazem Hassan, 2009).

The regulation of the audit profession has been a subject of a longstanding debate in Egypt and an object of recent reforms. Notably, the then CMA in 2009 established an Auditors Oversight Board, introduced continuous certification requirements for auditors, and moved away from the system whereby

auditors were registered on an individual basis. Of particular importance has been the introduction of an Auditors Registry by the CMA in 2006. The then CMA defined specific criteria for auditors in the registry,³³ who alone are permitted to audit companies listed on the stock exchange or offering securities to the public. The registry is continuously reviewed in order to ensure that those registered on it pursue the relevant professional qualifications.³⁴ The rationale behind the registry – and, indeed, behind similar registries by the Central Bank and the Mortgage Authority – in fact highlights a key issues in the exercise of the audit profession in Egypt, *i.e.* the lack of an adequate framework for licensing auditors and the relative underdevelopment of lifelong learning and qualification processes. This approach effectively represents a solution which addresses the consequences, but not the root of the actual problem.

The underlying problem is that in Egypt, until five years ago, there was no professional examination process for auditors. As a result, out of the total population of upwards of 20 000, only 1 500 have passed the professional examinations introduced by the Egyptian Society of Accountants and Auditors. Though the professional examinations have been introduced, the entire auditor population – particularly those who have been practicing the profession for many years – have not had to pass them, given the practical difficulties of doing so. Even today, new auditors can enter the profession by one of two routes: by being a member of the ESAA and sitting the appropriate examinations or by obtaining a university degree, registering at the Ministry of Finance as a trainee for three years, then moving to the Ministry of Finance CPA register. An issue of particular concern here is that an auditor who has followed the second route without sitting professional examinations can eventually obtain the right to be placed on the CMA (now EFSA) register of auditors – at odds with the OECD best practice that auditors of listed companies should be licensed obtaining specific qualifications and meeting competency criteria.³⁵

An initiative to limit the ability of unqualified auditors to audit listed companies has been blocked in Parliament by the Syndicate of Accountants for six years. Market participants note that the present situation is not likely to change in the near future and that the authorities believe the establishment of auditor registries is an appropriate solution. Equally, representatives of the profession interviewed were reluctant to recommend universal examinations for all auditors, given the current market realities. Instead, the authorities should examine the means to raise professional standards among all auditors. Focus should be placed on education and training initiatives including “train the trainers” initiatives, as well as reviewing and standardising the curriculum for auditors in order to increase the currently low pass rate.³⁶ In the longer term, more rigorous means of checking the work of auditors, such as peer reviews, could also be considered,³⁷ alongside streamlining auditor qualification requirements.

Sub-Dimension 2.4.: The Responsibilities of the Board and Rights of Stakeholders

The corporate governance framework should ensure the effective monitoring of management by the board and the board's accountability to the company and its shareholders. The principle behind this arrangement is that companies are professionally managed but subject to effective oversight by the board so as to prevent self-dealing and to ensure that management looks after the interests of shareholders. This principle recognises that the board is chiefly responsible for monitoring managerial performance and achieving an adequate rate of return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. The board is not only accountable to the company and its shareholders but also has a duty to act in their best interests. However, in doing so, boards are expected to take due regard of, and deal fairly with, other stakeholder interests.

An evaluation of the operation of boards presents a particular challenge since board behaviour is often unobservable. This difficulty is accentuated in Egypt, where the legal framework outlines the specific tasks which come under the responsibility of the board, but remains silent on its key duties. It is understood that it is up to the company to establish some of these details itself. Consequently, the actual operation of boards in Egypt is likely to vary among companies, making a comprehensive assessment in this area rather difficult.

Bearing these challenges in mind, this section of the report focuses on several specific questions. One is the functions of the board about which much can be understood merely by considering the legal framework. Overall, the following three issues are explored: 1) the functions of the board of directors, 2) the qualification and objectivity of the board, and 3) the rights of stakeholders. The first two questions focus specifically on the operation of the board, whereas the third examines the responsibilities of companies and their boards to the broader stakeholder community.

2.4.1. Qualification and Objectivity of the Board

Whether the board, as a key corporate organ, is able to exercise an objective, independent and qualified judgement is a question integral to sound corporate governance. The variety of board structures, ownership patterns and practices in different countries requires different approaches to the issue of board objectivity and qualifications. The primary concern in a number of emerging markets, and also in some OECD member countries, is whether boards are independent and objective with regard to the management and controlling shareholders. In Egypt, given the concentrated ownership structure, this is of paramount importance. Before being able to pass any judgement on the qualification and objectivity of boards in Egypt, it is essential to understand board selection and appointment procedures.

Egyptian companies have a single-tier board system and boards are required to be comprised of an odd number of directors (with a legal minimum of three) who are selected by the general assembly for a three-year term.³⁸ The nomination procedures for the board are outlined in the Companies Law and its Executive Regulations which have been subject to revisions in recent years. In particular, a reform passed in 2005 abolished the requirement for board members to acquire the so-called "guarantee shares". Currently, shareholders wishing to act as board members send their nomination requests, along with their credentials and information about the number of shares held, to the company prior to the AGM at which voting for a new board is taking place. Employees can also be appointed if they have worked for the company for at least two years. At the AGM, votes are cast by secret ballot for a list of candidates. The nominees supported by the highest number of shareholders are announced as directors. It is important to note that this procedure is not applicable to "expert directors".³⁹

Given these appointment procedures, and the lack of mechanisms like cumulative voting, there is a significant risk that board members of Egyptian public companies are not independent of the

controlling owner. The ability of the board to maintain independence from management is also uncertain, especially given that it is not mandatory that chairman and CEO should be two separate positions. Consequently they often are not, despite recommendations to the contrary by the Corporate Governance Code. Indeed, there appears to be a general consensus among experts and private sector participants that despite some conflict of interest prohibitions contained in the Companies Law, maintaining board independence is one of the key challenges in corporate governance in Egypt.

The authorities have recently sought to introduce additional requirements in terms of, for instance, the number of non-executive directors sitting on the audit committee. However, these requirements can be circumvented in some cases.⁴⁰ Indeed, while the concept of “non-executive directors” has been much discussed in Egypt, the concept of “independent directors” is very much nascent outside the *Corporate Governance Guidelines for Egyptian Bank Directors*. **The Egyptian Corporate Governance Code does not make reference to independent directors. Instead it recommends a sufficient number of non-executive directors. Indeed, the EIOD might wish to consider revising this provision of the Code in its forthcoming review.** It is worth pointing out that jurisdictions with highly concentrated ownership in their markets frequently adopt requirements and definitions for independent directors that include as a criterion their independence from “significant” or “controlling” shareholders. Furthermore, *Board Independence of Listed Companies* published by the International Organization of Securities Commissions (IOSCO) in March 2007 sets out a number of recommendations regarding the independence of directors. In addition to listing positive criteria, as suggested by the annotation VI.E to the *OECD Principles*, IOSCO lists “negative criteria” which, combined with the positive attributes, increases the likelihood of effective independence.

As for board committees, the only committee that listed companies are required to have and whose composition is specified by the Listing Rules is the audit committee. Though the Companies Law allows the board to apportion work among its members, there is no requirement to form other board committees. Consequently, there is no explicit requirement that the mandate, composition, and working procedures of committees of the board, other than the audit committee, should be disclosed. Instead, there is a requirement that the board should set the rules and conditions for selecting members to committees and that such committees should meet once every two months. In fact, this practice relates to a larger gap referred to earlier concerning the minimal non-financial disclosure provided by listed companies. **With regard to the relevant disclosure on board structure and operations, the present corporate governance framework does not require or encourage companies to disclose the qualifications or attendance record of board members.** Instead, the Companies Law provides that companies are to prepare a list of the capacity and nationality of the members of the board and the chairman on an annual basis.

Increasing the qualification of boards also represents a continuous challenge for policy makers. It is noteworthy that the EIOD has sought to address this issue by offering director education and certification programmes. Currently, the EIOD has certified just over 120 directors, which is an important achievement, but falls significantly short of the demand for professional directors, even in listed companies only. Investing in director education and developing a set of qualified directors should be a policy priority in order to increase the professionalism of boards, particularly as requirements to have non-executive or independent directors become increasingly implemented. **The EIOD can play an essential role in this regard and indeed should be encouraged to focus its efforts in this important area. In parallel, provisions to encourage boards to provide their members with relevant initial and ongoing training should be incorporated in the Egyptian corporate governance framework. Board evaluation processes would be of assistance in this regard.**

2.4.2. Functions of the Board of Directors

The *OECD Principles* suggest that board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and its shareholders. The outcome sought by this is a board which is informed and objective in its oversight of professional management. In addition to the general duties of the board, such as the duty of loyalty or care, the *Principles* also stipulate its specific responsibilities:

- reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets, etc.;
- monitoring the effectiveness of the company's governance practices;
- selecting, compensating, monitoring, replacing key executives, and overseeing succession planning;
- aligning key executive and board remuneration with the longer term interest of the company and its shareholders;
- ensuring a formal and transparent appointment and election process;
- monitoring and managing potential conflicts of interest among management, board, and shareholders, including the misuse of corporate assets and abuse in related party transactions;
- ensuring the integrity of the corporation's accounting and financial reporting systems;
- overseeing the process of disclosure and communication.

In Egypt, the duties of the board are not outlined explicitly as the duties of the General Assembly are in the Companies Law. Provisions of the Companies Law do address some duties of the board, such as ensuring the integrity of its financial reporting and monitoring and managing potential conflicts of interest. There is no mention however, of the board's responsibility to monitor the company's governance practices or risk policy. It is to be expected, therefore, that practices in this regard vary widely among listed companies. In addition, the Corporate Governance Code does outline board responsibilities, but does not comprehensively address all of the above-mentioned duties suggested by the *OECD Principles*. Although the scope of the present analysis rules out examining the implementation of each of the recommended board responsibilities, a number of observations are worth pointing out.

The current financial crisis has highlighted that the lack of an independent committee charged with examining the risk profile of an organisation can lead to major corporate governance failures, particularly in financial sector institutions. The fact that the current legal framework does not mandate the establishment of committees other than the audit committee and that it does not explicitly provide for the performance by the board of some of its key duties can be seen as a weakness, at least in large listed companies. A similar observation applies to the remuneration committee. **In Egypt, the corporate governance framework does stipulate the board's authority to establish remuneration of management, but does not require boards to develop or disclose a remuneration policy statement covering board members and key executives. Furthermore, the corporate governance framework does not require or encourage board remuneration to be handled by a special independent committee of the board, which is recognised as international good practice.**

Finally, the difficulty of assessing whether Egyptian boards do perform their functions as internationally recognised standards would require is related to the challenge of accessing board reports. In principle, boards in Egypt are required to draw up a report on their activity on an annual basis and in compliance with the Listing Rules, then transmit the report to the EFSA and the EGX. To that end, board committees are required to submit to the board annual reports in which they must outline key issues and recommendations concerning them. **In practice, it appears that boards of directors' reports often**

exclude some crucial information, which makes evaluating board performance and accountability difficult. For instance, many board reports do not include information on the attendance of board members during meetings or information concerning their remuneration packages.

2.4.3. Rights of Stakeholders

The *OECD Principles of Corporate Governance* include a chapter on the rights of stakeholders in corporate governance. When the *Principles* refer to the concept of a “stakeholder”, they refer to a provider of resources to the corporation, including employees, creditors, and suppliers. The *Principles* recognise that the relations between these resource providers may be established in the legal framework, but could also be of a contractual nature. The underlying philosophy of the OECD’s approach to stakeholder engagement is that the corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and should encourage active cooperation between corporations and stakeholders. In addition, where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

Due to scope limitations, the present report does not give extensive treatment to the rights of stakeholders in the corporate governance framework. This should not be taken to imply that it is not a subject worthy of exploration in Egypt. The Egyptian Institute of Directors has indeed been active in discussing the rights and protections of stakeholders as part of its efforts to sensitise audiences to principles of corporate social responsibility. These efforts are at their early stages. In general, the Egyptian Companies Law recognises the rights of two types of stakeholders: employees and bondholders. Employees are given rights, in particular the right to “have a share in the management”. Although the legal framework outlines mechanisms for employee representation on boards, the common practice is that companies create “employee committees”, or equivalent bodies, and a director is assigned the task of liaising with this committee. Employee rights are also robust in terms of being represented on the boards of state-owned enterprises, as will be explored in the analysis below on governance of SOEs.

The rights of bondholders are protected under the Capital Markets Law. The holders of bonds or similar instruments are entitled to form a group to protect the interests of its members, and this group should elect a legal representative who may attend the general assembly meetings without participating in voting. Moreover, the representative of this group may submit recommendations to the board of directors of the general assembly, and can request that the contents of such deliberations are recorded in session minutes.

Overall, it appears that the rights of employees and debt holders are reasonably well addressed in the corporate governance framework. Authorities are encouraged to specify the rights of other stakeholders and the role that they could play in the corporate governance framework of Egypt, in addition to other initiatives to promote awareness of the rights of stakeholders that are currently being pursued. The EIOD is currently working on a number of initiatives to promote corporate social responsibility issues, which bear on the companies’ engagement with various stakeholder communities. In particular, a new corporate social responsibility index has been developed in cooperation with Standard and Poors and introduced on the EGX.

Sub-Dimension 2.5.: Corporate Governance of State-Owned Enterprises*

There are differences between the governance of private and state-owned enterprises in most jurisdictions, stemming from a variety of factors, including legal form, degree of government control, etc. The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* note distinct corporate governance challenges faced by SOEs. On the one hand, they may suffer from undue hands-on and politically motivated ownership which may result in an uneven playing field and a loss of transparency. On the other hand, SOEs may also experience situations where state ownership can be characterised as passive or distant. In such circumstances, there may also be a dilution of accountability towards the government, public, and other, shareholders (particularly if an SOE is not wholly owned). Fundamentally, corporate governance difficulties derive from the fact that accountability for the performance of SOEs involves a complex chain of agents without clearly and easily identifiable principals. To structure this complex web of accountabilities and ensure efficient decision making and good corporate governance is a challenge both in OECD and MENA countries alike.

Elements of the Egyptian SOE landscape were mentioned in the introduction to this report. As emphasised in the chapter on privatisation and PPPs, the landscape of the SOE sector in Egypt has changed dramatically since the introduction of the Business Public Sector Law 203 in 1991, which provided a basis for the privatisation process. Beginning in 1995, the government began to privatise SOEs (314 at the outset) through its Asset Management Programme, mostly by means of initial public offerings. As a result of the privatisation transactions undertaken, according to figures from the Ministry of Investment, the SOE sector today comprises approximately 153 companies (termed “affiliate” companies in Egypt).⁴¹ These companies operate in nine holding companies⁴² grouped under the umbrella of the Ministry of Investment. This figure of SOEs excludes listed companies in which state-owned companies, especially SOE banks and insurance companies, own minority stakes. As mentioned, a significant number of the 153 companies considered by the Egyptian authorities as SOEs have listed stock which may be freely traded or, in some cases, detained as a block holding by a one or more individual. An additional complication in this regard is that some partially privatised companies have blocks of shares held by politically powerful individuals whose interests may not be wholly separate from those of the state.

The vast majority of these enterprises are commercially oriented companies, which makes them suitable for analysis using the *OECD Guidelines of Corporate Governance for State Owned Enterprises*. In addition, a number of statutory corporations considered of “strategic interest” operate directly under the responsibility of line ministries (military production, banks, telecom, water, etc.).⁴³ These entities are not addressed in this analysis due to the lack of relevant information and data. Likewise, entities which exist at the sub-national (*i.e.* governorate) level are not addressed, also due to the unavailability of data. This narrow scope of analysis is not meant to imply that the corporate governance arrangements of statutory corporations operating under the responsibility of line ministries or sub-national SOEs do not require further analysis. On the contrary, given that there is no streamlined framework for their governance and general oversight, they may require particular attention.

In Egypt, as in many other jurisdictions, corporate governance of wholly and partially state-owned enterprises is subject to separate legislation and regulation and, as a result, distinct corporate governance practices and challenges. Though SOEs are subject to the regular Companies Law and listed SOEs to the Capital Markets Law, their governance practices and oversight arrangements are quite different. In part, this is due to the fact that the Companies Law applies to the SOEs on a narrow set of issues, which the Public Business Sector Law 203 does not cover. Outside the legal framework, there are also relevant differences between voluntary standards – the *Egyptian Code on Corporate Governance* and the *Code of*

* The chapter on Dimension I-2, “Privatisation Policy and Public Private Partnerships”, discusses SOEs against the background of the uncertain regulatory framework governing privatisation and PPPs.

Corporate Governance for the Public Enterprise Sector. Given these differences and challenges, a number of SOE-specific issues are explored in this last section of the report. They are:

- separation of ownership and regulatory functions,
- a level playing field for SOEs and private sector enterprises,
- the authority and capacity of SOE boards to carry out their functions,
- the accounting and auditing standards applicable to SOEs.

2.5.1. Separation of Ownership and Regulatory Functions of SOEs

The state often plays a dual role as market regulator and owner of SOEs with commercial operations, particularly in partially privatised industries, or in industries where competition was recently introduced. In doing so, the state risks using SOEs as an instrument for industrial policy, which can result in confusion and conflicts of interest between industrial policy and the ownership functions of the state, particularly if the responsibility for industrial policy and the ownership function are vested with the same branch of government. Full administrative separation of responsibilities for ownership and market regulation is a fundamental pre-requisite for creating a level playing field between SOEs and private companies or, at least, for ensuring full transparency to avoid remaining inequalities. In order to prevent conflicts of interest, it is also necessary to clearly separate the ownership function from any entities within the state administration which might be clients or main suppliers to SOEs. The establishment of an overarching ownership policy for SOEs, which may be supplemented by setting performance objectives for SOEs, brings clarity to how the state sees its role as owner of entities. In addition, it is necessary to clearly identify the ministries or entities with which the ownership and regulation of individual SOEs lies.

To understand the relationship between ownership and regulatory functions in Egypt, it is important to understand the governance arrangements of so called “holding” and “affiliate” companies. As mentioned, nine holding companies have been created under the aegis of the Ministry of Investment to coordinate the activities of the state with regard to affiliate companies. The so-called “general assembly” of a holding company, somewhat akin to a supervisory board in other jurisdictions, consists of the Minister of Investment (also acting in the capacity of chairman) and members with relevant experience appointed by prime ministerial decree.⁴⁴ The operations of the holding company are overseen by the board of directors appointed by a resolution of the general assembly upon a proposal from its chairman (*i.e.* the minister). The board is appointed for three years and comprises between seven and eleven members. In keeping with the Public Business Companies Law, it has a full time chairman, at least five persons with the “relevant experience”, and representatives of the Trade Unions of Egypt.

The general assembly of a majority-owned SOE comprises the chairman of the holding company (*i.e.* Minister of Investment), other members of the board of the holding company, other experienced members selected by the general assembly of the holding company (up to four), and two additional members selected by the Trade Union Committee. The board of affiliate companies is comprised of between five and nine members, including a chairman, representative(s) of the employees of the company, the Chairperson of the Trade Union Committee⁴⁵, and other members with the relevant experience. With the exception of employee representation and the Chairman of the Trade Union Committee, the other board members are appointed by the board of the holding company. Slightly different arrangements apply in companies with private sector participation in order to give private investors powers corresponding to their ownership rights. That being said, the chairman of a company which is less than 51% state owned is appointed by the general assembly of the company after being nominated by the holding company’s board of directors. The difference with a wholly owned company is that private sector investors can appoint board members in proportion to their ownership stake in the company.

The governance structure of holding and affiliate companies, as outlined above, does not suggest that there is a clear separation between the state's ownership function and other functions that may influence the conditions for state-owned enterprises. First, it is unclear to what extent sectoral regulators are independent. Likewise, it is also unclear to what extent SOEs are used as an instrument of industrial policy. Although sectoral regulation lies with line ministries or sectoral regulatory agencies, as the case may be, the Ministry of Investment does issue regulations, particularly for listed SOEs (by virtue of the Minister's regulatory authority pursuant to the Capital Markets Law). **Even though the state may not get involved in day-to-day operation of SOEs, further separation of its regulatory and ownership functions would help to increase transparency and reduce potential conflicts of interest surrounding the objectives of state ownership. By establishing a holding company structure, the authorities have essentially prepared the ground for making an independent ownership entity into a professional body responsible for coordinating and executing government ownership policy.**

Establishing an ownership agency would help the government to act as an informed and active owner, to introduce a clear and consistent ownership policy with regard to SOEs, and to ensure that they are governed transparently and accountably. The structure of the ownership agency offers several policy options which should be explored. The ownership function could be centralised in a single entity which is either independent or operated under the authority of a ministry (or ministries). If the ownership function is not centralised, a minimum objective would be to put in place a body that firmly coordinates the activities of the different administrative departments involved. Whatever policy option is deemed most appropriate, the ownership function should be separated from any entities within the state administration which might have commercial relations with the SOEs in order to prevent additional conflicts of interest.

2.5.2. Level Playing Field for SOEs and Private Sector Enterprises

In order to avoid market distortions the legal and regulatory framework for state-owned enterprises should strive to ensure a level playing field in markets where SOEs and private sector companies compete. If SOEs are in a privileged position, competition issues are likely to arise and undermine the accountability of both management and state-as-owner. Clear separation between ownership and regulatory functions, as discussed above, is essential in this regard. Furthermore, SOEs should not be above laws and regulations or be given favourable access to finance. Neither they, nor the state-as-shareholder, should be protected from challenges in the courts or through the regulatory authorities should they infringe the law. On the contrary, stakeholders should be able to challenge the state owner in the courts and be treated fairly and equitably in such cases by the judicial system.

As pointed out, state-owned entities (holdings and subsidiary companies) operating under the purview of the Ministry of Investment are subject to the Public Business Sector Companies Law 203. The law seeks to establish a level playing field for publicly and privately owned entities principally in two ways. First, by stipulating that the provisions of Companies Law 159 shall apply to companies where they do not contradict its own. Second, the Public Business Sector Law states that companies subject to its provisions shall not be deprived of any benefits or be charged with any burdens that may be prejudicial to equating them with joint stock companies governed by the provisions of the Companies Law. In addition, listed SOEs are subject to the provisions of the Capital Markets Law, which implies that, for instance, listed SOEs have to provide exactly the same level of disclosure as other listed companies.⁴⁶

As noted above, though the legal framework does not mention SOEs' right to any special benefits, the Public Business Sector Law does specify that holding companies shall contribute to the development of the national economy in their field of activity through subsidiary companies and within the public policy of the state. The SOE guidelines acknowledge that, in some cases, SOEs may be required to fulfil special responsibilities and obligations for social or public policy purposes. They do, however, recommend that the general public be informed of the nature and extent of these obligations, as

well as of their impact on SOEs' resources and economic performance. They also suggest that related costs be identified, disclosed and adequately compensated by the state budget through specific legal provisions and/or contractual mechanisms. **In this regard, it is worth mentioning that SOE disclosure could be improved. Likewise, transparent budgeting of such costs is necessary.**

These recommendations primarily concern practices related to the subsidisation of SOEs, which the government is understood occasionally to do. Generally speaking, SOEs' operations are generally no longer subsidised by the state. That said, privatisation proceeds are used to finance early retirement and repay the historical debts of SOEs and although they operate outside the purview of the MoI, they are still understood to benefit from some built-in subsidies. In particular, the state may be forced to subsidise entities where decision-making processes suffer from political intervention. For instance, the Egyptian Sugar and Integrated Industries Company reduced the price of sugar earlier this year in the wake of the social unrest caused by the rising price of foodstuffs. This decision is widely believed to have resulted from political pressure exerted on the company. And if the company fails to be profitable this year, the state may be forced to subsidise it. This practice reinforces observations in the preceding section on the need to **further separate ownership from regulatory functions. Furthermore, some non-competitive practices such as related lending by publicly owned banks – once prevalent – are understood to be virtually nonexistent since Law 203 was passed.** For instance, Misr for Weaving and Spinning, an SOE operating in Kafr el-Dawwar, was forced to repay its debts to an SOE bank or risk having its inventories seized.⁴⁷

Establishing a level playing field between SOEs and private sector companies is further helped by the fact that they are subject to anti-trust legislation. That this legislation is indeed applied is supported by some evidence. For instance, the Egyptian Sugar and Integrated Industries Company is currently being investigated by the Anti-Trust Agency. In terms of redress, in principle, the same mechanisms as those available to shareholders in private companies are available to SOEs.⁴⁸ The only exception is that such suits are not heard in the newly established economic courts – as similar actions in private companies would be. This is because the economic courts have no jurisdiction over disputes arising from the application of Law 203, which will continue to be judged by the administrative courts. In terms of criminal matters, however, examples of shareholder activism in SOEs in Egypt can be cited. For instance, in the Mahla Company for Weaving and Spinning, the AGM charged some board members with corruption, the board was investigated, and some of its members tried by the courts received criminal punishments.

2.5.3. Authority and Capacity of SOE boards

The *SOE Guidelines* recommend that the coordinating or ownership agency should ensure that SOEs have efficient and well functioning professional boards with the required mix of competencies to fulfil their responsibilities. This involves an appointment process which should be transparent, clearly structured, and based on an appraisal of the variety of skills, competencies, and experience required of board members. In particular, when the state is a controlling owner, it is in a unique position to nominate and elect the board without the consent of other shareholders. This legitimate right comes with a high degree of responsibility for appointing board members who are skilled and objective enough to monitor managerial performance, prevent conflicts of interest, and balance the competing demands of the organisation. This is particularly important for partly-owned SOEs and those operating in competitive sectors.

The appointment process outlined in the Public Business Companies Law leaves the impression that holding and, perhaps to a lesser extent, affiliate company boards do not have sufficient independence from the state. Presently, board members in holding companies are put forward by the Minister of Investment, while the board nominations for affiliate companies are made by the board of the holding company. Neither process is subject to a transparent, clearly structured process based on an

appraisal of the skills and competencies of incumbent board members. In addition, some board members in affiliate companies are employees of the Ministry of Investment. It appears that the current selection process does not allow for a comprehensive review of nominees to determine whether they are qualified.

In order to increase the professionalism of holding and subsidiary company boards, the Ministry of Investment, and possibly the ownership/coordination agency, could seek to introduce a structured merit-based process of reviewing nominations for board positions. This process might build on the tracking system implemented by some holding companies in an effort to keep a record of the board appointees and qualified candidates. **In particular, it would be important to ensure that board members do not receive voting instructions, do not have to disclose the results of their voting, and respect company confidentiality.**

2.5.4. Accounting and Auditing Standards Applicable to SOEs

In the interest of the general public, SOEs should ideally be as transparent as publicly traded corporations. Regardless of their legal status, and even if they are not listed, all SOEs should conform to best practice accounting and auditing standards. All SOEs should disclose financial and non-financial information, while cost-benefit analyses should be run to determine which large and listed SOEs should do so in accordance with certain high quality, internationally recognised standards. Such analyses might consider that demanding disclosure requirements are both an incentive and a means for the board and management to perform their duties professionally. SOEs under a certain size could, in principle, be excluded, provided that they do not pursue important public policy objectives. Such exceptions have to be evaluated on a pragmatic basis with due consideration to the size, industry, and other parameters that might be relevant.

In Egypt, holding and affiliate companies are, generally speaking, subject to the same accounting and audit requirements as private sector companies (*i.e.* the Egyptian Accounting Standards and the Egyptian Auditing Rules).⁴⁹ The standards and disclosure requirements placed on listed SOEs are identical. In particular, the financial statements of listed companies must be audited by external auditors. For holding or subsidiary companies where the state owns more than a 25% stake, an additional audit by the Central Auditing Organisation (CAO)⁵⁰ is conducted in accordance with Law 52/1942 on the Central Audit Agency. This effectively entails that the CAO audits all holding companies, since they are all wholly owned by the state, as well as some selected subsidiary companies. The CAO audit reviews SOEs' compliance with relevant laws and regulations and ensures compliance with the applicable accounting standards.

Holding companies are required to prepare projected financial statements six months before the beginning of the financial year. The chairman of the board of a holding company is required to send the minister the estimated statements of the company's results for the following year, as well as a quarterly report on its financial performance. Likewise, the board of the directors of an affiliate company must receive a detailed plan of work for the following year along with the audited balance sheet, income statement, and a report on the companies' activities over the year. Before these documents are made available to the subsidiary board, copies are supplied to the chairman of the holding company's board.

Outside the listed SOEs, implementation of these provisions appears to be lagging. The disclosure provided by listed SOEs is monitored by the EFSA and penalties for late or inadequate disclosure are levied accordingly. Non-listed SOE are not subject to the same rigorous supervision and enforcement standards. Yet, in light of the lack of an ownership or coordination entity, disclosure is proving a challenge to them. **Wholly-owned SOEs often provide the legal minimum in terms of disclosure – *i.e.* the publication of financial statements in two Arabic newspapers. However, it has been noted that some SOEs do not even abide by this requirement.**

All SOEs are required to have external auditors as of 2009, but much still remains to be achieved. A particular challenge is that SOE management and boards pay little attention the findings of external auditor. The reason is that, historically, the CAO performed the only audit function in SOEs. SOEs are now required to undergo external audits, but mindsets have not fully grasped this. Boards and management of CEOs are understood to pay greater attention to the CAO reports, given the profile and the reporting lines of the organisation.⁵¹ As a result, if the CAO audit does not reveal any negative findings, the management and boards of SOEs often do not scrutinise the external audit findings or recommendations.

The authorities should focus their efforts on improving the quality of accounting information and non-financial reporting provided by large or strategically important SOEs. In the medium to long term, efforts could be directed at raising the accounting and auditing standards in smaller or less strategically important state-owned entities. In particular, policy measures should be concentrated on ensuring that auditors of SOEs meet the necessary skills and qualification criteria (an issue discussed earlier in this chapter). In parallel to ensuring that SOE's external audit function is adequately performed, the establishment and operation of audit committees in SOEs remains a priority. Though SOEs are required to have an audit committee, a number of them are still in the process of establishing one.

CONCLUSIONS

It is clear that numerous reforms implemented in recent years by the Egyptian government have been effective in raising awareness of the benefits of good corporate governance. In a relatively short time span, the number of corporate governance-related initiatives, including the introduction of two governance codes, amendments to the Companies and the Capital Markets laws and the tightening of the Listing Rules, have indeed been striking. The establishment of a local institution to advance the corporate governance agenda in Egypt – the Egyptian Institute of Directors – has also been an important step. The ongoing review and revision of the legal framework (*i.e.* the Companies Law) and voluntary standards (*i.e.* the Egyptian Code of Corporate Governance) are expected to result in further improvements of the overall corporate governance framework.

Looking ahead, the key challenges for improving corporate governance in listed companies are related to both the existing framework and its implementation. First, as the report points out, a number of important corporate governance issues remain unaddressed. As mentioned, the framework covering related party transactions requires further development, as does the framework stipulating the disclosure requirements. The observations and recommendations made in this report in relation to existing gaps in the corporate governance framework should be taken into account in the ongoing revision of the Companies Law and the *Egyptian Code on Corporate Governance*. The various corporate-governance-related initiatives currently underway need to be closely coordinated in order to ensure that the legal and regulatory requirements are consistent, transparent, and enforceable. The OECD has been a partner to the Egyptian authorities in strengthening the corporate governance framework and practices, and will continue to be involved in the process.

Perhaps more than revision of the legal and regulatory framework, improving the implementation of existing corporate governance provisions remains a priority. This statement holds true of a number of areas –from listing standards to disclosure standards. Actually enforcing existing standards would go a long way towards making the governance of listed companies more transparent. It would also afford greater protection to investors, particularly minority investors – a significant challenge in the context of the highly concentrated ownership structure of listed companies. The introduction of a corporate governance code, while a welcome development from the perspective of raising awareness, has not been as effective in raising the governance standards of listed companies. The reason is its voluntary nature. Giving the code “more bite” – *i.e.* making it applicable on a “comply or explain” basis – is one of the policy alternatives advocated by the report. Also of vital importance is improving the capacity of the newly established regulator to enforce the corporate governance provisions which are in place.

The report highlights a number of specific areas where further improvement is necessary, primarily in relation to minority shareholder protection, increasing the independence and efficiency of boards, and improving disclosure, particularly non-financial. Increasing free floats of companies, currently estimated at less than 10%, remains a priority both from the broader perspective of capital market development and for the purpose of improving minority shareholder protection. Strengthening minority shareholder rights and the development of block holders with the power to challenge the decisions of majority owners, where necessary, are also important in this regard. Recognising the limits posed by the extremely concentrated ownership landscape in Egypt, the report provides a number of recommendations for strengthening minority shareholder protection. The recommendations include, for example, establishing an investor association and introducing “majority of minority” approvals for some transactions. Although the advent of

economic courts has made it difficult to assess the efficiency of *ex post* investor protection, it remains an important area to monitor in the future.

The chapter notes that, in Egypt, boards lack independence from controlling shareholders. Cumulative voting is not practiced and, more generally, board nomination procedures give rise to boards dominated by insiders. While there are certain minority protections such as shareholders owning at least 5% of shares being entitled to call a meeting, they are not sufficient to ensure that the board members act in the best interest of the company and all its shareholders. Of particular concern is the ability of boards to treat shareholders equally in situations where board decisions may affect different shareholder groups differently. Listed companies are not required to constitute board committees. The exception is the audit committee, and even its mandated composition does not necessarily ensure that it can exercise independent judgment on corporate affairs. The fact that the duties and responsibilities of board members set forth in the legal and regulatory framework is also of concern.

Furthermore, continued attention to accounting, audit, and disclosure standards and practices is warranted. Evidence demonstrates that auditing quality could be improved and that the professional qualifications required of Egyptian auditors are not always up to international standards, even since the Capital Market Authority, the Central Bank, and the Mortgage Finance Authority introduced auditor registries. Available evidence of reporting by listed companies highlights significant weaknesses. The ability of the regulator to monitor and challenge the disclosures provided by listed companies has improved over time. However, further efforts are required. In addition, greater precision as to the exact nature of disclosure requirements would be valuable, particularly in light of the complex holding company structures that characterise the listed sector.

The overall issues facing the state-owned sector are broadly similar to those faced by listed companies, but do include challenges that are inherent to governance of SOEs. Reform of the SOE sector, which commenced in the 1990s, appears to have brought positive results, particularly considering the social and political pressures against reforming SOEs in Egypt. Nonetheless, the authorities should introduce further measures to ensure greater transparency of the holding and the remaining affiliate companies operating under the umbrella of the Ministry of Investment.⁵² Further separation of ownership and regulatory functions appears necessary.

As noted above, the current structure of holding companies could facilitate the establishment of an SOE ownership or coordination agency able to carry out the ownership functions once performed by the state. Such an entity could implement an ownership policy – currently lacking – which would define the overall objectives of state ownership and its role in corporate governance. Establishing an ownership or coordination agency would also help improve standards of professionalism in the governance of SOEs and possibly even shield them from political interference. It could also resolve a number of issues, such as the quality and timeliness of financial reporting, highlighted as an area where progress is needed.

Notes

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- ¹ The code targets joint stock companies listed on the stock exchange, financial institutions in the form of joint stock companies and, in general, any company with dispersed ownership and those that use banks as their source of financing.
- ² The code targeted both “holding” and “affiliate companies”. Unlike the common use of the term, “affiliate” does not refer to subsidiaries of SOEs, but to the subsidiaries of holding companies, i.e. the SOEs themselves.
- ³ Eighty-three companies were de-listed in 2008 and 180 in 2007, while 24 and 20 companies, respectively, were listed in the same years.
- ⁴ That said, mid and small cap companies are encouraged to list on a newly established stock exchange (NILEX), designed to attract SMEs. So far, three companies have been listed.
- ⁵ Free float is estimated to be higher in EGX 30 listed companies, as the market capitalisation of shares of companies in the index are adjusted by their free float.
- ⁶ For instance, free float among Moroccan listed companies is currently estimated at 18%.
- ⁷ This is, in fact, to the credit of the regulators who have sought to encourage listings of holding companies, as opposed to subsidiary companies.
- ⁸ A number of other companies, where the SOE banks and other institutional investors have minority ownership stakes, are not included in this figure.
- ⁹ Approximately EUR 7.5 billion.
- ¹⁰ Approximately EUR 650 million, up from EUR 490 million in the previous year.
- ¹¹ It appears that, for the moment, the authorities prefer to continue to incorporate elements of the code in the listing requirements, as opposed to other policy options, such as making the code mandatory for listed companies on a “comply or explain” basis or otherwise. The OECD provided comments to the Egyptian Institute of Directors in August 2009 about the planned revision of the Code.
- ¹² The track record of listed companies’ compliance with the relevant regulatory provisions would also be useful in this regard.
- ¹³ The corporate governance code for banks is due to be released by end 2009 or beginning 2010. It is understood that the code will apply to banks on a voluntary basis.
- ¹⁴ Though the CMA (now the EFSA) and the EGX have limited regulatory powers to issue rules, the regulations pursuant to the laws had to be signed by the Minister of Investment and any amendments to existing laws had to be approved by Parliament.
- ¹⁵ The OECD Principles and accompanying methodology consider basic shareholder rights as those including the right to secure methods of ownership registration, the right to convey or transfer shares, the right to obtain material information on the corporation on a timely and regular basis, the right to participate and vote in general shareholder meetings, the right to elect or remove members of the board, and finally, the right to share in the profits of the corporation.
- ¹⁶ The Egyptian Companies Law provides for 2 types of meetings: ordinary and extraordinary. Ordinary shareholder meetings are convened at the request of the board of Directors or at the request of shareholders holding or representing at least 5% of capital. The extraordinary assembly meets at the invitation of the board of directors. The board should only do this if it is requested by a number of shareholders representing at least 10% of the capital, provided that such shareholders deposit their stocks with the company's head office or a certified bank and that such stocks are withdrawn only after the general assembly is over.
- ¹⁷ Though recent reforms have sought to speed up settlement processes, certain types of securities in Egypt still settle on a T+2 basis.
- ¹⁸ In Egypt, shareholders holding in excess of 5% of the company’s capital can call an assembly to be held.
- ¹⁹ Such a tender offer must be approved by the CMA and remain open for at least one week. It must be published in 2 widely circulated newspapers.
- ²⁰ Abusive related party transactions – where one party enters into a transaction to the detriment of non-controlling shareholders – are one of the biggest corporate governance challenges in emerging markets, and one to which OECD has paid significant attention. A *Guide on Fighting Abusive Related Party Transactions in Asia* was released by the OECD earlier this year to provide policy makers, enforcement authorities, private institutions and other stakeholders with policy approaches to monitoring and curbing such transactions.
- ²¹ According to the Banking Law, banks are prohibited from offering any type of financing or guarantees to the members and chairperson of the board, their spouses, children, or relatives up to second degree, to the board’s auditors, or to any party, where

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- these persons, their spouses, children or relatives up to the second degree are partners or shareholders having an actual control over that party, or are members of their board of directors in their personal capacity.
- ²² Unless the company is incorporated pursuant to the Investment Incentives and Guarantees Law of 1997, in which case complaints should be addressed to the General Authority for Investment and Free Zones (GAFI). It has been noted that this dual complaint mechanism has confused complainants in the past.
- ²³ Its officials have the right to review company documents at its headquarters without seeking a power of attorney.
- ²⁴ Equivalent to municipalities.
- ²⁵ According to its own Annual Report for 2008, the CMA has made comments on 1845 out of the 2108 financial statements it examined.
- ²⁶ In discussions with the CMA, it was revealed that approximately 3% of all listed companies were sanctioned for inadequate or late disclosure.
- ²⁷ It is understood that the CMA is currently working with the World Bank in order to establish a Financial Reporting Unit within its current structure. It will provide an electronic system for storing and analysing company reporting (based on XBRL).
- ²⁸ In Egypt, it is a longstanding practice that financial statements are published in an abbreviated form in two Arabic newspapers.
- ²⁹ Presently, companies are primarily fined for late financial disclosures, and therefore concentrate their efforts on providing audited financial statements without the accompanying analysis that could help investors better understand the affairs of the company.
- ³⁰ The EAS is currently working on bringing this standard into line with IAS.
- ³¹ The Central Auditing Organisation is the supreme audit body in Egypt, as discussed in greater detail in the sub-dimension on corporate governance of SOEs.
- ³² Representatives of the EASS commented that the Standards Committee meets approximately once every two years.
- ³³ This Auditors Registry includes only accountants who are members of the ESAA (those who have passed professional qualifications), those who are on the auditors registry of the Central Bank or those who have adequate qualifications from abroad or a PhD in accounting or proof of having audited five joint-venture companies for five years. The registry currently numbers over 360 accountants.
- ³⁴ The auditors can be removed from the registry by CMA's Board of Directors if they do not pursue professional qualifications. This prerogative has been transferred to the EFSA.
- ³⁵ That being said, it is estimated that approximately 90% of listed companies are audited by auditors who have gone through the ESAA examinations process.
- ³⁶ Currently, the pass rate of auditors is extremely low due to the fact that there is no standardised curriculum and that the roles of the teachers and the exam setters are separate.
- ³⁷ Though peer reviews may prove ultimately useful, policy makers should pay special attention to the design of a system on which audit firms may not engage in a process of reciprocal favours, which would eliminate any value in this process.
- ³⁸ The only exception to this is the first board of directors, appointed by the founders of the company for a maximum term of five years.
- ³⁹ The Egyptian Companies law specifies that the board should act as a representative organ of the shareholders, but allows two experts to sit on the board even though they are not shareholders.
- ⁴⁰ The requirements in their present form allow companies which do not have a sufficient number of non-executive directors (3) to substitute them with other directors, who may or may not be independent.
- ⁴¹ It is important to note that for the purposes of data collection, the OECD uses a 10% state ownership yardstick in classifying SOEs as state entities. It is noteworthy that in Egypt, state SOEs or affiliate companies (as they are called in Egypt) are differentiated on the basis of state ownership of 51%. A lower, 25%, threshold applies in classifying those entities to be audited by the supreme audit body.
- ⁴² The nine holding companies are specialised in the following sectors: textiles and clothing (36 affiliates), mineral industries (16), chemicals (22), pharmaceuticals (11), food (22), construction (21), tourism, hotels and cinema (9), transportation and maritime (16), insurance (1).
- ⁴³ Some, but not all of these entities, are subject to Law 203, in part for purposes of corporatisation.

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- ⁴⁴ The Minister of Investment submits nominations for general assembly members to the Prime Minister, who subsequently issues a decree to formally appoint them.
- ⁴⁵ The vote of the Chairman of the Trade Union Committee is not counted in voting decisions.
- ⁴⁶ It is the responsibility of the Capital Markets Authority to review the compliance of SOEs' disclosures with the requirements of the Capital Markets Law and the Listing Requirements.
- ⁴⁷ In general, the settlement of SOEs' debts to SOE banks was completed in 2007 as part of a joint initiative by the Ministries of Finance and Investment.
- ⁴⁸ In addition to litigation, arbitration may be requested to settle disputes between SOEs or between an SOE and a private company.
- ⁴⁹ With the exception of the fact that the Banking Law requires banks to follow accounting and auditing standards and guidelines set by the Central Bank of Egypt. In addition, the financial statements of state-owned banks must be audited by two auditors (auditing is carried out by individuals as opposed to firms). The Central Bank usually reviews the financial statements and auditors' reports prior to shareholder meetings and discusses any issues with the auditors.
- ⁵⁰ The Central Auditing Organisation was established in 1988 as a supreme audit body responsible for auditing state-owned enterprises and other government entities. The fact that the CAO has the right to participate in SOE board meetings in an observer capacity facilitates its task.
- ⁵¹ The CAO reports directly to the Prime Minister, whereas a report on the performance of the holding companies is made on a quarterly basis by the Minister of Investment and submitted to the Cabinet and the Parliament.
- ⁵² Since the present review did not consider SOEs which operate outside this framework, no recommendations are given in this regard. Naturally, this should not be taken to imply that no further consideration should be given to their governance arrangements. On the contrary, the relative lack of transparency regarding their operation or coordination among the various ministries which oversee the operation of SOEs would seem to indicate that a separate, in-depth review of their governance arrangements is warranted.

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ANNEX

DIMENSION II - 2: CORPORATE GOVERNANCE

A1. ASSESSOR INFORMATION

Name:	
Organisation/Ministry/Agency:	
Title/Position:	
E-mail:	
Phone:	
Fax:	
Mailing Address:	
Date of Assessment:	

A2. GENERAL OBSERVATIONS

To be filled in by assessor:

Please use this space to include any additional observations regarding the assessment of this policy dimension.

A3. OVERVIEW OF SCORES

II – 2: CORPORATE GOVERNANCE		SCORE
2.1	Effective legal and regulatory framework for enterprises	
2.1.1	Effective Corporate Governance Framework	
2.1.2	Coordination of supervisory responsibilities among the authorities	
2.2	The rights and equitable treatment of shareholders	
2.2.1	Basic shareholder rights	
2.2.2	Proportionality and control	
2.2.3	Acquisition of corporate control	
2.2.4	Equitable treatment of shareholders	
2.2.5	Legal protection of minority shareholders	
2.3	Transparency and disclosure	
2.3.1	Disclosure requirements	
2.3.2	Accounting standards	
2.3.3	Quality and independence of audit	
2.4	Responsibilities of the board	
2.4.1	Qualification and objectivity of the board	
2.4.2	Functions of the board of directors	
2.4.3	Rights of Stakeholders	
2.5	Corporate governance of state-owned enterprises	
2.5.1	Separation of ownership and regulatory functions of SOEs	
2.5.2	Level playing field for SOEs and private sector enterprises	
2.5.3	Authority and capacity of SOE boards	
2.5.4	Accounting and auditing standards applicable to SOEs	

A4. ASSESSMENT FRAMEWORK

The objective of the Business Climate Development Strategy chapter on Dimension II-2, “Corporate Governance” chapter of the (BCDS) is to collect information on corporate governance frameworks and practices of countries in the Middle East and North Africa (MENA) region and evaluate them with a view to highlighting good practices and problematic areas. The chapter is rooted in the two key corporate governance instruments of the OECD – the *OECD Principles for Corporate Governance* and the *OECD Guidelines on Corporate Governance of State Owned Enterprises*. They are recognised globally as key instruments in this area. Governments and non-state players working on the promotion of corporate governance standards have used them as the basis for local corporate governance codes and, more generally, as benchmarks in this area. Furthermore, the World Bank uses the *OECD Methodology for Assessing the Implementation of the Principles* as the basis for the assessments under the programme of the Reports of Observance of Standards and Codes (ROSC).

Based on these instruments, key principles and guidelines have been selected in order to prioritise areas which are of fundamental importance to establishing an efficient corporate governance framework in any jurisdiction. Furthermore, in the selection of indicators consideration has been given to the corporate governance concerns which are most prevalent in the MENA region, such as high ownership concentration, minority shareholder abuse, and lack of transparency in financial and non-financial reporting. The indicators in this framework were also selected with due consideration the corporate governance chapter of the *Policy Framework for Investment*, which focuses specifically on elements of the corporate governance framework which are most relevant from the point of view of investment and private sector development.

In line with these considerations, this chapter has been structured into five sections. The first four consider corporate governance standards and practices in listed and non-listed companies. The fifth focuses specifically on SOE governance practices. In many OECD countries, the governance of SOEs, particularly listed SOEs, is subject to the same regulations as other private companies and most of the indicators in sections 1-5 can be applied to SOEs as well. Section 5 includes indicators not covered by the first four areas. They are specific to SOEs.

The evaluation framework comprises the following sections:

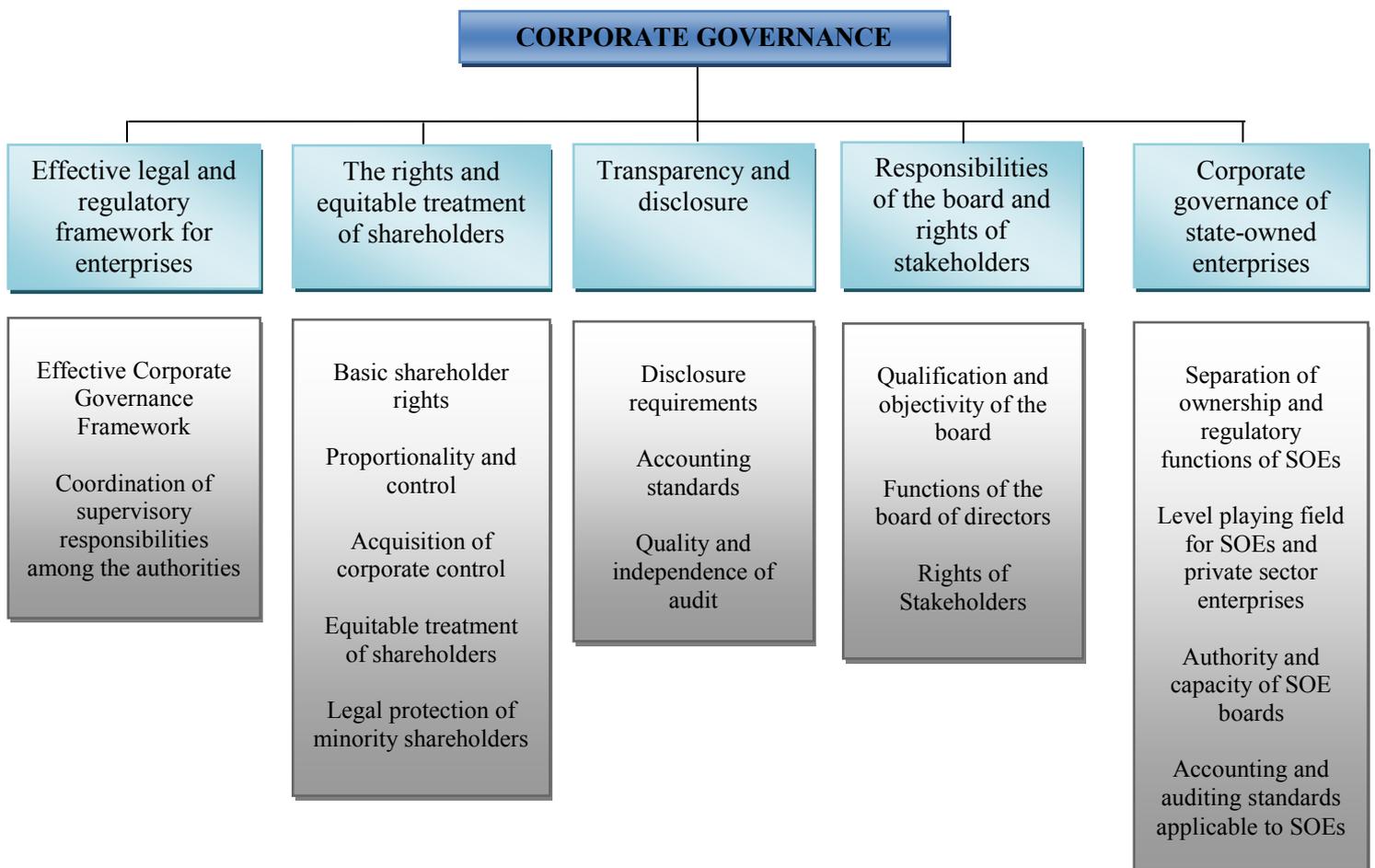
1. Effective Legal and Regulatory Framework for Enterprises
2. The Rights and Equitable Treatment of Shareholders
3. Transparency and Disclosure
4. Responsibilities of the Board and Rights of Stakeholders
5. Corporate Governance of State-Owned Enterprises

Each section includes indicators rated according to a five-level evaluation criteria inspired by the *OECD Methodology for Assessing the Implementation of Principles* and the *OECD Questionnaire on Governance Arrangements of State-Owned Enterprises*.

The outcome of an assessment against these indicators does not aim to provide detailed prescriptions for national initiatives. Rather, the objective is to identify problematic areas and suggest various means for reconciling the existing gaps. The proposed methodology should also enable policymakers to prioritise reforms in the area of corporate governance. The selective approach employed is not designed to allow the assessor to assign a score to one country’s corporate governance practices so that it can be compared with those of other countries. The result of the evaluation under the proposed methodology should not be treated as a definitive assessment of the corporate governance framework, but rather as an indication of the strengths and

weaknesses of a particular framework relative to the MENA region and other best practice jurisdictions. For example, the approach does not allow an assessment of compliance, implementation, and enforcement of regulations or legislation at the company level, as this would require in-depth surveys and review beyond the scope of the present exercise. As such, the recommendations resulting this evaluation should be treated as non-prescriptive.

Figure A1. Assessment Framework for Corporate Governance



A5. MEASUREMENT

An effective corporate governance framework requires a legal, regulatory and institutional foundation that all market participants can rely upon when they enter into contractual relations. Such a foundation typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country’s specific economic circumstances, history, and traditions. The desirable mix between legislation, regulation, self-regulation, and voluntary standards therefore varies from country to country.

In this context, the challenge is to design a regulatory legal framework underpinning the corporate governance system that is sufficiently flexible to meet the needs of corporations operating in widely different circumstances. Another key consideration is the need for effective enforcement and implementation. Among other things, this requires that the responsibilities for supervision, implementation, and enforcement should be clearly assigned to specific authorities so that the competencies of complementary bodies are respected and used to best effect.

SUB-DIMENSION 2.1: EFFECTIVE LEGAL AND REGULATORY FRAMEWORK FOR ENTERPRISES

An effective corporate governance framework requires a legal, regulatory and institutional foundation that all market participants can rely upon when they enter into contractual relations. Such a foundation typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific economic circumstances, history, and traditions. The desirable mix between legislation, regulation, self-regulation, and voluntary standards therefore varies from country to country.

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Indicator 2.1.1: Effective Corporate Governance Framework

Questions

*What steps have been taken to ensure the basis of the corporate governance framework** that promotes overall economic performance and transparent and efficient markets?*

Has this been translated into a coherent, transparent and consistent regulatory framework, backed by effective enforcement?

2.1 – CORPORATE GOVERNANCE: EFFECTIVE LEGAL AND REGULATORY FRAMEWORK FOR ENTERPRISES					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.1.1 Effective Corporate Governance Framework	There is no legal or regulatory framework outlining corporate governance requirements/recommendations for private companies.	Elements of the corporate governance framework are in place but are stipulated in a way which is not clear or inconsistent with other elements of the regulatory framework or the rule of law. The scope of governance provisions is limited and does not address the key components of the corporate governance process (shareholder protection, disclosure, board operation, etc.) Institutional framework to for regulation and compliance is either not established or being established.	Key elements of the corporate governance framework are part of the legislation or regulation for companies, but they are imprecise or inadequate in terms of scope. Elements of the institutional framework to ensure compliance with corporate governance provisions are in place. Enforcement of corporate governance provisions is weak and/or evidence of laws and regulations that have never been tested in court.	Corporate governance provisions pertinent to companies are adequately addressed in relevant legislation (e.g. company or securities law) or though a non-binding governance code. Institutional structure to ensure compliance has been established. Rate of compliance with relevant legislation or recommendations is moderate to high.	The legal and regulatory requirements affecting corporate governance address all key aspects of the <i>OECD Principles for Corporate Governance</i> . There is evidence of enforcement action by the relevant authorities and development of a body of case law on key corporate governance provisions. The institutional framework for ensuring adequate framework for addressing corporate governance related concerns is developed (securities regulator, Institute of Directors, specialised courts, etc.)

*Such a framework could include, but not be limited to listing requirements, provisions in laws, regulations, or codes of corporate governance.

Indicator 2.1.2: Coordination of Supervisory Responsibilities

Questions

Has the division of responsibilities among different authorities been clearly articulated?

Do the supervisory and enforcement authorities have the authority, integrity and resources to fulfil their duties in a professional, objective manner?

2.1 – CORPORATE GOVERNANCE: EFFECTIVE LEGAL AND REGULATORY FRAMEWORK FOR ENTERPRISES					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.1.2 Coordination of supervisory responsibilities	The objectives and scope of action of the supervisory and enforcement authorities and/or non-public bodies are not clearly stated and overlap, precluding effective standard setting and enforcement. Resources to fulfil the regulatory function are largely insufficient. Evidence indicates inconsistencies in the corporate governance requirements.	Some division of responsibilities and authority between the relevant supervisory and standard-setting agencies exists but there is no effective system of cooperation between them (formal or informal). Resources to fulfil the regulatory function are largely insufficient	Informal means of cooperation between the authorities on some (but not all) aspects of the regulatory framework exists. Evidence of ongoing (but not systematic) cooperation between the authorities; the means of coordination are not cost-optimising. Surveillance of companies is not defined and/or occurs on an <i>ad hoc</i> basis.	Evidence of formally documented means of cooperation between the authorities in all the key areas covered by the legal and regulatory framework. Coordination between the regulatory authorities contributes to better enforcement. Surveillance of companies occurs at regular and appropriate periods (for the type of regulation and legislation). Staff professionalism and training are adequate for effective discharge of their responsibilities.	Coordination between the relevant standard setting and enforcement authorities is effective and formally documented in an MOU or otherwise. Information sharing provisions are in place. The operation of private bodies which input into the corporate governance process is transparent and performed in cooperation with the public bodies. There is evidence of consultations between public sector authorities and with non-state actors on corporate governance initiatives.

SUB-DIMENSION 2.2: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS

The corporate governance framework should protect and facilitate the exercise of shareholder rights, including such fundamental rights as the right to influence the corporation, the right to sell or transfer shares, and the right to participate in the profits of the corporation. In particular, participation in general shareholder meetings is a fundamental right of all shareholders, both foreign and local, critical to their ability to influence the company. The rights relating to ownership registration, share transfer, voting and electing board members and participating in the profits of the company are also important and should also be addressed in a national corporate governance framework. In particular, the procedures for notification of shareholder meetings and for casting votes should be designed to facilitate and encourage participation.

The challenge is that shareholder rights may be very specifically defined in some jurisdictions, whereas in others they are loosely stated in law and jurisprudence, and essentially determined by company charters and bylaws.

In this context, the ownership structure has important implications for the corporate governance framework. In many economies, major shareholders control most companies, in some cases through differential voting rights or complex ownership and control structures that allow them to maintain control with relatively little equity. Controlling shareholders have strong incentives for closely monitoring the company and its management, which can have a positive impact on the governance of the company. However, their interests may also conflict with the interest of minority shareholders. This conflict is most destructive when the controlling shareholders extract private benefits at the expense of minority shareholders. In this case, all shareholders end up paying the cost of poor corporate governance in the form of lower valuations, reduced access to equity finance, and difficulties with respect to succession planning and accessing outside talent. Moreover, the economy pays through reduced productivity, as investment funds are allocated less efficiently. To reduce these costs, some controlling shareholders take voluntary measures to improve their corporate governance and reputations with other shareholders.

Indicator 2.2.1.: Basic Shareholder Rights

Question

Are basic shareholder rights⁵³ respected?

*As per the OECD Principles, basic shareholder rights are defined as 1. The right to secure methods of ownership registration (presence of a register of shareholders and possibility by shareholders to inspect it), 2. Convey or transfer shares (the ability of companies to restrict the transfer of shares, efficiency of the clearing and settlement process), 3. Obtain relevant or material information on the corporation in a timely and regular basis (including company charter, articles, by-laws, financial statements, meeting minutes, capital structure), 4. Participate and vote in general shareholder meetings (right to attend by all shareholder), 5. elect and remove board members of the board (cumulative voting, procedural mechanisms to impede shareholders from participating), 6. Share in the profits of the corporation (voting on dividend distribution, power to force payment or increase of dividend, transparency of decisions).

2.2 – CORPORATE GOVERNANCE: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.2.1 Basic shareholder rights	Most of the basic shareholder rights are not addressed in the corporate governance framework	Selected shareholder rights are addressed in the corporate governance framework, but the mechanisms for their protection are not clear or not functioning adequately	All of the basic shareholder rights are protected, but the mechanisms for their protection are not clear or not functioning adequately	All of the basic shareholder rights are addressed in the corporate governance framework and evidence indicates that enforcement actions can be taken in most areas should shareholders feel their rights to be infringed	All of the basic shareholder rights are protected and evidence indicates that enforcement actions can be taken in a cost efficient manner should shareholders feel their rights to be infringed. Relevant authorities support the exercise of shareholder rights

Indicator 2.2.2.: Proportionality and Control

Question

*Are the capital structures and arrangements that enable shareholders to obtain a degree of control disproportionate to their disclosed equity ownership?**

2.2 – CORPORATE GOVERNANCE: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.2.2 Proportionality and control	There is a wide range of legally permitted instruments allowing shareholders to obtain a disproportionate degree of control and they are widely used. Ultimate control of companies is opaque to local and/or foreign investors. There are no disclosure requirements relating to control-enhancing mechanisms to other shareholders and/or the regulator(s).	There is a wide range of legally permitted instruments allowing shareholders to obtain a disproportionate degree of control and they are widely used. Ultimate control of companies is opaque to local and/or foreign investors. Required disclosure is insufficient in terms of frequency/scope and/or applies to certain instruments.	The use of some control enhancing instruments is permitted and disclosure of such capital structures is required, but the scope/frequency of such disclosure are insufficient. There are no capital structures which permit undisclosed control as a product of additional rights attached to specific shares in a class where the other shares do not possess this right.	Control-enhancing instruments are allowed, but they are limited. Shareholders can obtain, on a regular basis, information related to the capital structure of the company (<i>i.e.</i> information on the specific rights in different share classes, etc.). Disclosure obligations are to the regulator, the company, and other shareholders. There are no capital structures which permit undisclosed control as a product of additional rights attached to specific shares in a class where the other shares do not possess this right.	Some control enhancing instruments are available. Stakeholders and the public can obtain access to the ownership and control structure of the corporation as it is disclosed on a periodic basis. Structure of the company groups and material intra-group relations are disclosed. Disclosures are made in easy-to-access format so that interested persons can obtain a clear picture of the capital structures. There are no capital structures which permit undisclosed control as a product of additional rights attached to specific shares in a class where the other shares do not possess this right.

*Such arrangements include, for instance, voting caps, shared with limited or multiple voting rights, golden shares, pyramid structures and cross shareholdings, shareholder agreements.

Indicator 2.2.3.: Acquisition of Corporate Control

Question

*Are the rules and procedures related to acquisition of corporate control in the capital markets articulated and disclosed?**

2.2 – CORPORATE GOVERNANCE: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.2.3 Acquisition of corporate control	The process for acquisition of corporate control is not regulated	There is legislation or regulation of some procedures for acquisition of corporate control, but it does not sufficiently cover all methods of acquisition of control. The regulations may lack clarity or be insufficiently rigorous in relation to ongoing disclosure of beneficial ownership	There is a developed body of law regulating takeovers and other means of acquisition of corporate control. The securities regulator or another regulatory body is charged with the mandate of enforcing these rules. Shareholders of the same class are treated equally during changes in control	There is a developed body of law related to takeovers and other means of acquisition of corporate control. Mandatory tender rules are in place, along with requirement that minority shareholders receive the same price. There is a threshold at which minority shareholders can request to be bought out. Shareholders of the same class are treated equally during changes in control	The rules and procedures for acquisition of corporate control in the capital markets and extraordinary transactions such as mergers are regulated. Securities regulator is actively involved in monitoring that these are observed and case law attest that shareholders can take legal action to dispute the procedures. Shareholders can appeal to a regulator in pursuit of redress during changes in control. Shareholders of the same class are treated equally during changes in control.

* Procedures related to the acquisition of corporate control include hostile takeovers, mergers, and acquisitions of blocks of control or whole companies.

Indicator 2.2.4.: Equitable Treatment of Shareholders (of the same share class)

Question

Are shareholders of the same series of a class treated equally?

2.2 – CORPORATE GOVERNANCE: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.2.4 Equitable treatment of shareholders	There is no law or regulation mandating or encouraging equal treatment of same equity class shareholder. Alternatively, there may be a law or regulation which effectively enables shareholders of the same equity class to be treated unequally ⁵⁴ .	There is a law or regulation mandating or encouraging equal treatment of shareholders of the same equity class in some, but not all, respects. Practices which could result in situations where not all shareholders of the same class are treated unequally are not transparent ⁵⁵ .	There is a law or regulation mandating or encouraging equal treatment of shareholders of the same equity class. It is a responsibility of the securities regulator to investigate cases where such abuses transpire. Nonetheless, enforcement is ineffective (in terms of time spent by affected shareholders or financial resources)	There is a law or regulation mandating or encouraging equal treatment of shareholders of the same equity class and this law applies to foreign investors as well. In addition, the corporate governance framework requires that proposals to change voting rights be submitted for approval at the AGM. It is a responsibility of the securities regulator to investigate cases where such abuses transpire. There is evidence of case law on the subject, showing ability of shareholders to address their grievance to court.	There is a law or regulation mandating or encouraging equal treatment of shareholders of the same equity class and this law applies to foreign investors as well. The corporate governance framework requires companies to disclose sufficient information on the attributes of companies' classes and series of shares on a timely basis. Investors have easy access to up-to-date information on voting rights of shares before they purchase them. Where rights attached to class of shares are changed, adequate procedural rules are followed. There is evidence of case law on the subject, showing ability of shareholders to address their grievance to court.

Indicator 2.2.5.: Legal Protection of Minority Shareholders

Question

Are minority shareholders protected from abusive actions* by, or in the interest of, controlling shareholder(s)?

2.2 – CORPORATE GOVERNANCE: RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.2.5 Legal protection of minority shareholders	The legal protections ⁵⁶ (<i>ex ante</i> or <i>ex post</i>) afforded to minority shareholders are minimal. There are few provisions in the current corporate governance framework that can be used by minority shareholders to take legal action against the majority shareholder. Potential for abuse is high since control enhancing mechanisms are prevalent (refer to 2.3.3).	The legal protections (<i>ex ante</i> or <i>ex post</i>) afforded to minority shareholders are minimal. There are few provisions in the current corporate governance framework that can be used by minority shareholders to take legal action against the majority shareholder. Potential for abuse is moderate since control enhancing mechanisms are not used widely (refer to 2.3.3) The cost of legal action may be prohibitive	Legislation provides an adequate level of protection for minority investors, but it is not widely enforced. They may be barriers for legal action by infringed minority shareholders in the forms of thresholds for shareholder action. Alternatively, the type of minority shareholder protections may be inappropriate for the structure of local market control. The cost of legal action may be prohibitive	Legislation provides an adequate protection of minority investors though a balance of <i>ex ante</i> or <i>ex post</i> measures. There is evidence of successful legal action taken by minority shareholders. The securities regulator or other competent authority is actively involved in monitoring the potential abuse of minority shareholders	There are strong mechanisms for minority shareholder protection though a balance of ex-post and ex-ante measures. There is evidence of successful legal action taken by minority shareholders. The remedies provided to minority shareholders are adequate. The securities regulator or other competent authority is actively involved in monitoring the potential abuse of minority shareholders. In addition, the duties of board members and officers (<i>i.e.</i> loyalty) encourage them to consider the interests of minority shareholders.

* Abusive actions can be carried out in different ways, including the extraction of direct benefits via high pay or bonuses for employed family members, inappropriate related party transactions, and systematic biases in business decisions or change in the capital structure through special issuance of shares favouring the controlling shareholder.

SUB-DIMENSION 2.3: DISCLOSURE AND TRANSPARENCY

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of company. Present and potential shareholders require access to regular, reliable and comparable information in sufficient detail for them to exercise their ownership rights on a fully informed and equal basis. A disclosure regime that promotes transparency is thus a pivotal feature of a market-based corporate governance system. It underpins confidence in the stock market and is a powerful tool for influencing the behaviour of companies and for protecting investor rights. Insufficient or ambiguous information will hamper the ability of the markets to function. It will increase the cost of capital and discourage investment. A discussion about the content of disclosure standards and the dissemination procedures will naturally address numerous trade-offs that relate to the completeness, quality and cost of establishing and disseminating the information.

In order to determine what information should be disclosed at a minimum, many countries apply the concept of materiality. Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of information. In the course of developing a strong disclosure regime, the channels, timing and procedures for disseminating corporate information can be just as important as the content of the information itself. There is no use in issuing material information if it does not reach the market and the concerned authorities in a cost-effective, easily accessible, predictable and timely fashion.

A particular transparency issue in many markets relates to the complex ownership and control structures. Transparent reporting regarding ownership is essential in order to curb, among other things, abusive transactions among related parties. The *OECD Template on Options for Obtaining Beneficial Ownership and Control Information* serves as a reference for improving the availability of such information.

Indicator 2.3.1.: Disclosure Requirements

Question

*Is the disclosure required of companies adequate?**

2.3 – CORPORATE GOVERNANCE: DISCLOSURE AND TRANSPARENCY					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.3.1 Disclosure requirements	There are no or limited provisions in the corporate governance framework on disclosure regime for companies.	Legislation or regulation governing companies requires that they produce an annual report. There is no requirement for such information to be audited externally. The disclosure regime does not enable shareholders to make knowledgeable decisions regarding their investment.	Legislation or regulation governing companies mandates the key elements of financial and non-financial disclosure necessary for shareholders to make decisions regarding their investment. Some important elements of disclosure as they relate to corporate governance are not regulated. There is evidence of incomplete compliance with existing provisions.	Legislation or regulation governing companies mandates the key elements of financial and non-financial disclosure necessary for shareholders to make decisions regarding their investment. The legal and regulatory framework as it relates to disclosure addresses all the key financial and non-financial disclosure elements as described above. It is being observed by the majority of companies in the jurisdiction.	The corporate governance framework requires companies to provide sufficient and timely financial and non-financial disclosures, including forward looking discussion, relevant to investors and potential investors in a company. There are effective mechanisms for enforcing such standards and effective remedial mechanisms for those harmed by inadequate disclosure. Compliance with requisite disclosure standards is widespread.

* Disclosure regime should include, but not be limited to, material information on: the financial and operating results of the company, company objectives, major share ownership and voting rights, remuneration policy for members of board and key executives, information about board members (including information on their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board). Disclosure should also be made in relation to the following points: related party transactions, foreseeable risk factors, issues regarding employees and other stakeholders, governance structures and policies (in particular, the content of any corporate governance code or policy about the process by which it is implemented).

Indicator 2.3.2.: Accounting Standards

Question

Is information prepared and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure?⁵⁷

2.3 – CORPORATE GOVERNANCE: DISCLOSURE AND TRANSPARENCY					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.3.2 Accounting standards	The standard for preparation of financial and non-financial disclosure is a local standard, which is inconsistent with internationally accepted standards.	The standard for preparation of financial and non-financial disclosure is a local standard, which is broadly consistent with internationally accepted standards. The institutional framework for supervision of the development of standards and monitoring compliance is weak.	International accounting standards or high quality local standards are in place and companies are legally obliged to provide disclosure accordingly. Compliance rates are low and regulatory action to enforce compliance weak. There may be an issue with accounting and/or audit regulation and/or lack of effective institutions and high powered incentives on the part of the private sector to enforce standards.	International accounting standards or high quality local standards are in place and companies are legally obliged to provide disclosure accordingly. A government body or an SRO has the mission and resources to enforce the adoption of financial reporting standards. Compliance of companies with the recognised standard, whether international or domestic, is moderate to high.	International accounting standards or high quality local standards are in place and companies are legally obliged to provide disclosure accordingly. The corporate governance framework provides for the development of non-financial statement disclosure standards. Standards are established by an organisation that acts in the public interest of whose work is subject to oversight. The standard setting body has the power and the funding to carry out its duties. The accounting and disclosure standards are regarded as high quality by market participants and are widely observed. Effective sanctions for non-compliance are in place.

Indicator 2.3.3.: Quality and Independence of Auditing

Question

Is the annual audit conducted by independent, competent and qualified auditor to provide external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all financial respects?

2.3 – CORPORATE GOVERNANCE: DISCLOSURE AND TRANSPARENCY					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.3.3 Quality and Independence of Auditing	<p>The question of independence and qualification of auditors are not regulated. There is no or minimum review of the audit profession from the point of view of quality of work performed, competence or independence by the regulators.</p>	<p>Auditors are required to be licensed, but the quality of the procedures is insufficient to ensure the requisite rigor in the exercise of the profession. Key gaps or conflicts of interest in the institutional framework for auditor oversight can be observed which have a bearing on auditor independence and/or qualifications.</p>	<p>Auditors are required to be licensed and independent. A body responsible for the oversight of the accounting profession has been established and functioning. It is limited in exercise of its duties in terms of capacity or mandate. There is a legal or regulatory requirement stipulating the external auditors are appointed by the board, and that they owe duty of care, but this requirement is not widely observed.</p>	<p>Auditors are required to be licensed and independent. There is legislation or regulation stipulating the duties of auditors and setting the framework for the general exercise of the profession. A body has been established to oversee the accounting profession and has the necessary mandate and authority to discharge its duties. Institutional framework for auditor oversight is adequate. IOSCO Principles for Auditor Oversight are observed. There is a legal or regulatory requirement stipulating the external auditors are appointed by the board, and a requirement that they owe a duty of care.</p>	<p>Auditors are required to be licensed and independent. There is legislation or regulation stipulating the duties of auditors and setting the framework for the general exercise of the profession. A body has been established to enforce the audit standards and it is independent of the audit profession. An organisation responsible for developing and interpreting audit standards and ethics for auditors has been established. The legal framework specifies conditions under which shareholders can take legal action against the auditors or the board for financial statements which fail to depict the financial conditions of the company. IOSCO Principles for Auditor Oversight are observed. The corporate governance framework clearly provides that external auditors are accountable to the company’s shareholders in respect of performance of their duties.</p>

SUB-DIMENSION 2.4: RESPONSIBILITIES OF THE BOARD

The key principle for this sub-dimension suggests that the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. The outcome advocated is that companies are professionally managed but subject to effective oversight by the board so as to prevent self-dealing and to ensure that the interests of shareholders are taken into account by the management. In other words, the board's role is to contain the agency problem associated with professionally managed, public companies.

The principle is sufficiently general to apply to whatever board structure is charged with the functions of governing the enterprise and monitoring management. In a two-tier board system this is typically the "supervisory board" composed of non-executive board members, while in unitary systems there are also typically executives on the board. In either case, the principle recognises that the board is chiefly responsible for monitoring managerial performance and achieving an adequate rate of return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. The board is not only accountable to the company and its shareholders but also has a duty to act in their best interests. However, in doing this they are expected to take due regard of, and deal fairly with, other stakeholder interests.

Even where jurisdictions explicitly articulate the responsibilities of the board and those for which management is accountable, the law and associated regulation is by the very nature of the subject incomplete, and in many respects the board is left to establish its own modalities. In other jurisdictions, company law and other regulations are even more general, leaving essential details to be established by the company itself. As a result, the actual structure and operation of boards in any given jurisdiction is likely to vary widely between companies and in some cases, the board might hardly function at all despite a clear legal framework.

Indicator 2.4.1.: *Qualification and Objectivity of the Board*

Question

Is the Board able to exercise objective, independent and qualified judgment on corporate affairs?

2.4 – CORPORATE GOVERNANCE: RESPONSIBILITIES OF THE BOARD					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.4.1 Qualification and objectivity of the board	The corporate governance framework does not pronounce itself on the issue of board independence and ensuring objectivity towards management.	The corporate governance framework recommends that some board members to be independent of management, but this requirement are insufficient to ensure objectivity. ⁵⁸	The corporate governance framework recommends that a sufficient number of board members be independent of management. ⁵⁹ The definition of independence is sufficiently wide. This recommendation is not widely followed.	The corporate governance framework mandates that a sufficient number of board members need to be independent of management. The definition of independence is seen as sufficiently encompassing by market participants. There is wide compliance with this requirement.	The corporate governance framework mandates that a sufficient number of board members need to be independent of management and sets out the criteria for independence that address the primary agency conflicts that arise because of ownership and control structures in the jurisdiction. The framework places onus on companies to declare who they regard as independent directors. The law or regulation also provides that independent board members are to oversee specific operations where potential conflicts of interest could arise such as related party transactions. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board. There is wide compliance with this requirement and enforcement measures in case of non compliance.

Indicator 2.4.2.: Functions of the board of directors

Question

*Does the legal framework require Board mandated and able to fulfil its key functions?**

2.4 – CORPORATE GOVERNANCE: RESPONSIBILITIES OF THE BOARD					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.4.2 Functions of the board of directors	The corporate governance framework does not pronounce itself on the functions of the Board.	The corporate governance framework recommends or mandates some, but not all of the abovementioned duties to be fulfilled by boards. Even with respect to defined duties, compliance can be characterised as lacking.	The corporate governance framework recommends or mandates that boards adhere to most of the abovementioned duties but compliance can be characterised as lacking.	The corporate governance framework mandates that boards adhere to all of the above-mentioned duties, and remedial mechanisms are stipulated for non compliance with these duties. There is some evidence of enforcement by the regulator and/or legal action by shareholders.	The corporate governance framework specifies clearly the key functions of the Board to include the specific requirements outlined above. There are indications, in terms of disclosure to investors about board processes for example, that these principles are followed in practice. The law provides for measures against boards who are in dereliction of their duties such as removal. Boards are recommended or required to assess their performance on a periodic basis.

* According to the OECD Principles of Corporate Governance, key functions of Boards include: 1. reviewing and guiding corporate strategy, major plans for action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures; 2. Monitoring the effectiveness of the company’s governance practices and making changes as needed, 3. selecting, compensating, monitoring and when necessary, replacing key executives and monitoring succession planning, 4. Aligning key executive and board remuneration with the longer terms interests of the company and its shareholders, 5. Ensuring a formal and transparent board nomination and election process, 6. Monitoring and managing potential conflicts of interests of management, board and shareholders, 7. Ensuring the integrity of the corporation’s accounting and financial reporting systems; 8. Overseeing the process of disclosure and communication.

SUB-DIMENSION 2.5: GOVERNANCE OF STATE-OWNED ENTERPRISES

Over the years, the rationale for state ownership of commercial enterprises has varied among countries and industries and has typically comprised a mix of social, economic and strategic interests. The legal form of SOEs has varied according to these and other parameters. SOEs may or may not operate as legal entities separate from the public administration, may or may not have a commercial orientation, and may or may not operate in competitive sectors of the economy. SOEs may be listed or non-listed, and have a varying degree of government ownership and control.

Depending on the specific configuration of these factors, SOEs may face some distinct corporate governance challenges. One is that SOEs may suffer from undue hands-on and politically motivated ownership or, on the other hand, from totally passive or distant ownership by the state. There may also be a dilution of accountability towards the government, public and other shareholders (particularly if an SOE is not wholly owned).

Fundamentally, corporate governance difficulties derive from the fact that the accountability for the performance of SOEs involves a complex chain of agents without clearly and easily identifiable principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge both in OECD and MENA countries alike.

Indicator 2.5.1: Separation of ownership and regulatory functions of SOEs

Questions

Is there a clear separation between the state’s ownership function and other functions linked to the operation of state owned enterprises?

2.5 – CORPORATE GOVERNANCE: CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.5.1 Separation of ownership and regulatory functions of SOEs	SOEs are used as an instrument of industrial, regional or sectoral policies. There is a lack of transparency regarding the state’s objectives as an owner of SOEs. The responsibility for the state’s ownership function is not isolated from its role as a regulator	The responsibility for the state’s ownership function is not isolated from its role as a regulator. The separation of the SOE ownership function from any entities within the state administration (which might be clients or suppliers of SOEs, or in position to affect its objectives and/or performance) is not clear. There is no clear ownership policy document.	Some measures have been taken to ensure separation of responsibilities of the state’s ownership function from its market regulation function and from other government units. SOE objectives are not strictly dictated by non-commercial priorities of the state, but the institutional structure in terms of reporting relationships does not address all potential conflicts of interest	There is institutional and substantive separation of state’s ownership and regulatory functions. Safeguards are in place to avoid actual and potential conflicts of interest of the state as an owner and as a regulator. There is evidence of competitive behaviour between the SOEs and privately owned companies operating in the same sector. General procurement rules apply to SOEs in the same manner as to other companies	Full administrative separation of responsibilities for ownership and market regulation creates a level playing field for SOEs. Both perceived and real conflicts of interest between the state function as an owner and as standard setter are addressed through regulation and the institutional framework. The regulation reflecting separation of state as an owner and as a regulator is applied consistently and measures have been previewed for the private sector to take legal action if in pursuing their objectives, SOEs are given unfair advantages

Indicator 2.5.2: Level Playing Field for SOEs

Questions

Have there been instances where the SOEs are exempt from the application of general laws and regulations or are given preferential treatment (i.e. access to finance)?

Do stakeholders (creditors, consumers, etc.) have access to efficient redress and even-handed ruling when they consider their rights to be violated?

2.5 – CORPORATE GOVERNANCE: CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.5.2 Level playing field for SOEs	The SOEs sector is generally exempt from a number of laws and regulations such as competition or bankruptcy law. ⁶⁰ SOEs may enjoy preferential access to finance through commercial or state controlled banks. Legally and practically, stakeholders do not have access to redress.	Only SOEs considered to be in strategic sectors or otherwise of special value to the government are exempt from application of some laws. Legally and practically, stakeholders do not have access to redress.	Only SOEs considered to be in strategic sectors or otherwise of special value to the government are exempt from application of some laws. There are no legal provisions which exempt SOEs from abiding by relevant legislation, but in practice, there are areas where SOEs are treated unequally. Shareholders and stakeholders have rights to redress, but there have been no cases brought before courts.	SOEs are not exempted from relevant local legislation. Redress mechanisms are estimated to be no less efficient than in similar circumstances the private sector. Special procedures are in place to ensure lack of undue influence by the government. Shareholders and stakeholders have rights to redress, and this right has been exercised.	SOEs are not exempt from relevant laws and regulations. Legal provisions stipulating how the state as the owner of an SOE can be sued are in place. The judicial procedures relating to such suits would not discourage third parties from filing legal grievances. Shareholders and stakeholders have rights to redress, and this right has been exercised.

Indicator 2.5.3: Authority and Capacity of SOE boards

Question

Do SOE Boards have the authority and capacity to carry out their functions of monitoring management and giving strategic guidance?

2.5 – CORPORATE GOVERNANCE: CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.5.3 Authority and capacity of SOE boards	The question of independence and objectivity of SOE Boards is not addressed in the corporate governance framework. Public authorities can influence board decisions of SOEs.	The corporate governance framework regulates the question of composition of SOE boards. The provisions under the applicable laws are seen as insufficient to give SOE boards the authority and capacity to monitor management and give strategic guidance.	The corporate governance framework regulates the question of composition of SOE boards to ensure objectivity and capacity to carry out their functions. The provisions under the applicable laws are seen as broadly sufficient to give SOE boards the authority and capacity to monitor management. Alternatively, these provisions are not widely applied and not enforced by the ownership entity	The corporate governance framework regulates the question of composition of SOE boards to ensure objectivity and capacity to carry out their functions. The provisions under the applicable laws are seen as broadly sufficient to give SOE boards the authority and capacity to monitor management. These provisions are applicable to the whole SOE sector and are enforced.	The corporate governance framework regulates the question of composition of SOE boards to ensure objectivity and capacity to carry out their functions. The provisions under the applicable laws are seen as broadly sufficient to give SOE boards the authority and capacity to monitor management. Specifically, SOE boards have the power to change the top management if necessary. These provisions are applicable to the whole SOE sector and are enforced. There are sanctions for board members who are found to be unduly influenced by outside persons or institutions.

Indicator 2.5.4.: Accounting and Auditing Standards for SOEs

Questions

Are SOEs subject to the same high quality accounting and auditing standards as listed companies?

Do large or listed SOEs disclose financial and non-financial information according to quality internationally recognised standards?

2.5 – CORPORATE GOVERNANCE: CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES					
	Level 1	Level 2	Level 3	Level 4	Level 5
2.5.4 Accounting and auditing standards for SOEs	SOEs are not required to disclose financial or non financial information to the public	Some SOEs are required to make some limited financial and/or non-financial information public, but it is not subject to the same standard as for listed companies. There is no independent audit of SOEs	Some SOEs are required to disclose their financial statements and make other types of non-financial disclosure according to internationally recognised accounting standards or local equivalent standards. There is no independent audit of SOEs.	All large and listed SOEs are required to disclose their financial statements and make other types of non-financial disclosure according to internationally recognised accounting standards or local equivalent standards. There is an independent audit of these financial statements. These requirements are broadly observed.	All SOEs are required to disclose their financial statements and make other types of non-financial disclosure according to internationally recognised accounting standards. There is an independent audit of these financial statements. The audited financial statements of SOEs are available to interested parties.

⁵³ As per the OECD Principles, basic shareholder rights are defined as the right to:

1. secure methods of ownership registration (presence of a register of shareholders and possibility by shareholders to inspect it);
2. convey or transfer shares (the ability of companies to restrict the transfer of shares, efficiency of the clearing and settlement process);
3. obtain relevant or material information on the corporation in a timely and regular basis (including company charter, articles, by-laws, financial statements, meeting minutes, capital structure);
4. participate and vote in general shareholder meetings (right to attend by all shareholder);
5. select and remove board members of the board (cumulative voting, procedural mechanisms to impede shareholders from participating);
6. share in the profits of the corporation (voting on dividend distribution, power to force payment or increase of dividend, transparency of decisions).

⁵⁴ For instance, such a regulation could allow the Board to decide on issuance of a new class of shares or alteration of rights of existing shares without consulting with shareholders of the affected class.

⁵⁵ For instance, if shares can acquire increased voting rights over a period of time, this should be done on a transparent and non-discriminatory basis.

⁵⁶ Such measures could include both ex-ante and ex-post measures such as qualified majorities for certain decisions, minority shareholder's ability to call an extraordinary meeting, derivative or class action suites, pre-emptive rights to acquire shares during share offerings, etc.

⁵⁷ For the assessment of this question, it is neither necessary nor possible for the reviewer to make a detailed assessment of the quality of the national accounting and disclosure standards.

⁵⁸ For instance, the definition of independence could be seen as too narrow or the actual requirement could be insufficient in terms of the proportion of directors required or recommended to be independent.

⁵⁹ Depending on terminology, these could be called independent, outside, or non-affiliated directors.

⁶⁰ For instance, SOEs or their board members enjoy sovereign immunity to lawsuits.

