

# Corporate Governance Regulations for Non-Listed Joint Stock Companies in Saudi Arabia

On 14-08-1439H (30 April 2018), the Saudi Arabian Ministry of Commerce and Investment ('**MoCI**') issued Corporate Governance Regulations ('**CGRs**') for Non-Listed or Closed Joint Stock Companies (referred to below as 'CJSCs' or the 'Company' as appropriate) operating in the Kingdom of Saudi Arabia ('**KSA**').

This article summarises the key provisions of the CGRs.

## Important Qualifications

The new CGRs provide CJSCs operating within KSA with a framework for enhanced accountability, fairness, transparency and efficiency. They are not however binding on CGRs. That is, there is no legal requirement for CGRs to adopt them.

CGRs are meant to be complementary to the Saudi Arabian Companies Law (Royal Decree no. M/3 dated 28-01-1437H corresponding to 11 November 2015) (the '**Companies Law**') and provide a set of guiding principles for CJSCs to implement in conjunction with their existing regulatory obligations. The requirements of the Companies Law take precedence over the provisions of the CGRs where there is any conflict.

What are the Objectives of the CGRs?

The CGRs aim to:

- provide an effective legal framework for corporate governance;
- set out the scope of responsibilities for the board of directors, its committees and executive management;
- promote transparency, integrity and fairness in the Company's business endeavours;
- provide an effective and well-defined mechanism for dealing with potential conflicts of interest; and
- increase the awareness of professional behaviour within the Company.

## Shareholders' Rights

The CGRs provide protections of shareholders' rights. They include the following:

1. fair treatment;
2. receipt of allocated share of the Company's net profits;
3. attend and vote in general assembly meetings;
4. access to the Company's documents and information; and
5. nominate, elect and remove members of the board of directors.

## Shareholders' Assemblies

The CGRs specify the scope of authorities that may be exercised through Shareholders' Assemblies.

## Board of Directors

The CGRs contain a number provisions relevant to boards of directors of CGRs:

1. the CGRs prescribe a list of functions to be carried out by the board of directors. The board of directors is responsible for forming and allocating the functions of the executive management of the Company. The board of directors is also responsible for supervising the executive management and ensuring the implementation of its functions;
2. the board of directors may, within the limits of its authority, delegate some of its authority to committees;
3. the board of directors is required to meet at least four times each year with a meeting being held every three months. At least half of the members of the board of directors would need to be present in order for a meeting to be valid;
4. the number of board of director members should be set out in the Company's articles of association. However, the number of members should not be less than three and not more than eleven;
5. one third of the board members should be independent members and the board should conduct an annual review of its members to ensure that their independence is not compromised;
6. the independence of a board member can be compromised where:
  - the member owns five percent or more of the shares of the Company;
  - the member receives financial remuneration from the Company other than the remuneration received as a member of the board of directors (or any of its committees);
  - the member has a direct or indirect interest in the Company's business; or
  - the member engages in a business that would compete with the Company.
7. members of the board of directors should have the necessary professional and leadership capabilities to enable them to perform their responsibilities effectively;
8. all members of the board of directors are required to adhere to principles of honesty and devotion by avoiding conflicts of interest and performing their responsibilities in accordance with the Companies Law, and the Company's articles of association and policies and procedures; and
9. the board of directors should appoint a chairman and deputy chairman. They have the discretion to appoint a managing director as well. The chairman of the board of directors is prohibited from holding an executive position in the Company unless it is stipulated in the articles of association.

## Training and Evaluation

The Company should develop training programmes for members of the board of directors and executive management to familiarise themselves with the following:

1. the Company's strategy;
2. the financial and operational aspects of the Company's activities;
3. the rights and responsibilities of members of the board of directors and executive management; and
4. the functions and authorities of the Company's committees.

Additional training programmes and courses should be provided to members of the board of directors and executive management on an ongoing basis and as may be necessary.

With the recommendation of the nominations committee, the board of directors should establish procedures for evaluating the performance of the board of directors (including its members), committees and executive management on an annual basis. Key performance indicators may be instituted to achieve

this.

Arrangements should be made for a third party to evaluate the performance of the board of directors every three years.

The chairman's performance should be evaluated by independent members of the board of directors on a periodic basis.



## Conflicts of Interest

The board of directors should establish a written policy for addressing any conflicts of interest that may occur. This would be applicable to all members of the board of directors, committees, executive management and employees of the Company.

- The conflicts of interest policy should include the following:
  - the obligation to disclose any conflicts of interest;
  - illustrative examples of conflicts of interest cases;
  - clear procedures for disclosing conflicts of interest;
  - the obligation to abstain from voting or participating in any decisions when there is a conflict of interest;
  - clear procedures when conducting business with a related party; and
  - measures to be taken by the board of directors in the event the policy is breached.
- Directors must adhere to the following requirements:
  - perform their responsibilities honestly and impartially;
  - prioritise the Company's interests over their personal interests;
  - avoid exploiting their position for personal gain;
  - avoid conflicts of interest and notify the board of directors of any issues that may affect their neutrality when voting in meetings (the relevant member(s) would not be permitted to vote on matters that may affect their neutrality); and
  - maintain the confidentiality of the Company's documents and information.
- If a director intends to participate in a business that would compete with the Company, the following procedures should be taken:
  - the member should inform the board of directors about the competing business, which should be recorded in the minutes of the meeting;
  - the member would need to abstain from voting or participating in any decisions made by the board of directors with regard to the competing business;
  - the chairman of the board of directors should notify the ordinary general assembly about the competing business; and
  - the member should obtain prior authorisation from the ordinary general assembly to engage in the

competing business.

## **Committees**

The committees specifically prescribed by the CGRs are the audit, remuneration, nominations and risk management committees. The following are key requirements:

1. the committees are required to report to the board of directors;
2. the number of members in each committee should not be less than three and not more than five;
3. each committee is required to appoint an adequate number of non-executive and independent members;
4. heads of committees are required to attend the general assembly meetings in order to address any questions the shareholders may have;
5. committees are required to consider the topics referred to them by the board of directors and are required to submit their recommendations to the board of directors for agreement;
6. each committee is authorised to seek the assistance of third party experts and specialists in order to enable it to carry out its obligations effectively;
7. committee meetings cannot be attended by any members of the board of directors or executive management unless they are members of the relevant committee;
8. the Company may merge the remuneration and nominations committees into one committee.

### ***Audit Committee***

The audit committee's functions include the following:

1. evaluating the Company's financial statements and providing the results of such evaluation to the board of directors;
2. identifying any critical or unusual issues contained in the Company's financial statements;
3. recommending to the board of directors the nomination and removal of auditors, determining their fees and evaluating their performance;
4. ensuring compliance with applicable laws, regulations, policies and procedures; and
5. providing the board of directors with a list of issues that need to be resolved while making recommendations for resolving those issues.

The chairman of the Board of Directors cannot be a member of the audit committee.

### ***Remuneration Committee***

The remuneration committee's functions include the following:

1. formulating a policy for the remuneration of the members of the board of directors, its committees and executive management;
2. periodically reviewing and updating the remuneration policy in order to ensure alignment with its objectives; and
3. providing recommendations to the board of directors on the remuneration of its members, its committees and executive management in accordance with the remuneration policy.

## ***Nominations' Committee***

The nominations' committee's functions include the following:

1. formulating policies and criteria for membership on the board of directors and in executive management;
2. providing recommendations to the board of directors on the nomination and re-nomination of its members'
3. annual review of the skills and experience requirements for board membership and executive management functions;
4. reviewing the structure of the board of directors and executive management and providing recommendations for any changes that may be deemed necessary; and
5. annual verification of the independence of independent committee members.

## ***Risk Management Committee***

The risk management committee's functions include the following:

1. developing a comprehensive risk management strategy for the Company;
2. supervising the Company's risk management system and conducting evaluations on the effectiveness of the systems and procedures that are in place for identifying, measuring and monitoring risks that the Company may encounter;
3. preparing and submitting to the board of directors detailed risk exposure reports and outlining steps required to manage identified risks;
4. providing the board of directors with recommendations on risk management issues; and
5. ensuring the availability of adequate resources and systems for risk management.

## **Auditors**

The Company is required to assign its annual audit function to an independent, experienced and qualified auditor. The auditor will be responsible for preparing an objective and independent report to the board of directors and shareholders on the financial position of the Company.

## **Miscellaneous Requirements**

1. The board of directors is required to prepare an annual report on the activities of the Company and all factors affecting the Company's business. The CGRs prescribe a detailed list of items that should be included in the annual report in order to ensure that the Company operates in a transparent manner.
2. The board of directors should develop policies and procedures in order to enable staff of the Company to report any illegal practices that may be taking place. This will include assigning an individual to receive and address complaints and setting up a telephone line and/or email address for receiving complaints.
3. The Company should institute programmes aimed at increasing the participation and performance of its employees. In this regard, specialised workshops should be held in order to solicit feedback from employees about the Company and address any concerns they may have.
4. The board of directors should establish a policy of professional conduct in order to ensure that each member of the board of directors, executive management and employees of the Company take the best interests of the Company (rather than their personal interests) into account when performing their duties.
5. The board of directors should develop programmes to increase awareness on the importance of

engaging in social work for the benefit of the local community.

## **Concluding Observations**

Even though the CGRs are non-binding, CJSC's can reasonably expect that these are standards by which their performance in relation to compliance issues will be judged by regulators and others. This may also have an effect on the overall reputation of a CJSC with the regulators. Non-compliance with the provisions of the CGRs may therefore carry with it legal and other risks.

The auditors of CJSC's may take into consideration the extent of compliance with the CGRs as part of the auditing process.

Since CJSCs may be separately regulated by another authority (i.e. the Capital Markets Authority), it cannot be assumed that the CGRs satisfy all relevant compliance requirements in all cases since the relevant regulator may have more stringent compliance requirements in place.

*Al Tamimi & Company's [Corporate Commercial team](#) regularly advises on issues relating to Non-Listed Joint Stock Companies in Saudi Arabia. For further information, please contact [Mohamad Chehab](#) ([m.chehab@tamimi.com](mailto:m.chehab@tamimi.com)).*