HAWKAMAH
THE INSTITUTE FOR CORPORATE GOVERNANCE

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Insurance Policy Brief Issued

Hawkamah and the Arab Forum of Insurance Regulatory Commissions (AFIRC) announced the release of the Policy Brief on Corporate Governance for the Insurance Industry in the Middle East and North Africa (MENA) region.

The Policy Brief concluded that insurance companies operating in the MENA region have varied strengths and currently face significant challenges in view of the ongoing global financial crisis.

The actionable items outlined by the Policy Brief include committing to good corporate governance; good board practices; adopting and maintaining minimum levels of transparency and disclosure; ensuring an effective control environment; and protection of policyholders and shareholders rights.

The recommendations of the Policy Brief should be viewed as areas for regional improvement, as opposed to an attempt to identify specific problems within a particular company or country. The work is also intended to complement the efforts of other organisations working on these issues, for example the International Association of Insurance Supervisors (IAIS), the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

Mark Dempsey (FSVC), Dr. Bassel Hindawi (AFIRC), and Dr. Nasser Saidi (Hawkamah)

Hawkamah and AFIRC intend to hold a series of workshops and training sessions in the region, and work with local insurance executives and regulators to find the best ways to implement its recommendations.

In this Issue

Families, Governance, and Markets: Building and Sustaining Wealth

Family businesses carry the weight of economic wealth creation in most economies, particularly in the Gulf and the Middle East and North Africa. In many countries, family businesses represent more than 70 percent of the overall businesses and play a key role in the economy growth and workforce employment.

In the Middle East, the total assets of family owned businesses are estimated at USD 1.7 trillion. Within the GCC, over 90 per cent of all commercial activity is estimated to be controlled by family firms. These firms number over 5,000, hold combined assets of more than $500 billion, and employ 70 per cent of the workforce.

Most family businesses, however, have a very short life span beyond their founder's stage and some 95% of family businesses do not survive the third generation of ownership. Family businesses can improve their odds of survival survive by setting an appropriate corporate governance structure in place.

The greatest threats faced by family-run businesses are succession and conflict. Succession should be well planned ahead and family businesses must ensure that a formal succession policy is in place for the Chief Executive Officer as well as other members of the Company's Executive management.

Families need corporate governance
Families need corporate governance
both to operate the business and to manage conflicts of interest and promote family harmony.

Non-alignment of incentives among family members, informality, and lack of discipline can lead to many inefficiencies and internal conflicts that could threaten the continuity of the business.

Many of the successful family businesses that have survived for several generations have created Family councils to deal with family issues. A Family council is a working governing body that is

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Dubai Islamic Bank Supports Hawkamah's Work

Dr. Nasser Saidi, Founder and Director, Hawkamah and Mr. Abdulla Hamli, CEO, DIB

The new partnership shows DIB's commitment towards continuing to strengthen DIB's corporate governance standards, ensuring that they are clear, consistent and fully in line with international best practice. DIB's support of Hawkamah demonstrates its commitment to promoting these practices in the MENA region and in Shari'a compliant financial institutions.

The Hawkamah Institute and DIB partnership will also help Hawkamah with its initiative of introducing international best practices in the corporate governance frameworks of Islamic Banks and Financial Institutions in the region. Working with Hawkamah is a logical step for DIB as it strengthens its corporate governance framework. DIB's decision to be a founding sponsor of Hawkamah demonstrates its confidence in our initiatives aimed at improving corporate governance practices in the region

Thought Leadership Series:
Islamic Finance and Corporate Governance

Part of Hawkamah's thought leadership strategy involves engaging scholars with its work to look at Corporate Governance challenges faced by the region.

Zulkifli Hasan a Ph.d candidate of University of Durham, UK from Malaysia has recently joined for a three-month program and has been working on the Taskforce on Islamic Financial Institutions (IFIs).

His unique research focus is Shari'ah governance and he has analyzed and looked at corporate governance of IFIs in Malaysia, GCC Countries and the UK.

What is Shari'ah governance?

In IFIs, *Shari'ah* governance mostly refers to the management, establishment and affairs of the *Shari'ah* board. The *Shari'ah* board, normally consists of *fiqh* scholars, practitioners and academicians, is an independent body entrusted with the duty of directing, reviewing, supervising the activities of IFIs for purpose of Shari'ah compliance and issuing legal rulings pertaining to Islamic banking and finance.

In carrying out these duties, the Shari'ah board needs sound framework and structure to ensure its independence and effectiveness. On this basis, Shari'ah governance refers to a set of organizational arrangement as to how the Shari'ah board is directed, managed, governed and controlled that ensures the governance structure and framework is in compliance with the principles of *Shari'ah*.

Shari'ah governance aims at ensuring the Islamicity of financial transaction and activities so as to uphold the integrity of the IFIs as inspired by all stakeholders by strengthening the institution of *Shari'ah* board.

What is the main issue involved in relation to Shari'ah governance system?

As Islamic finance becomes an integral part of the international financial system, it will face numerous challenges. The world has experienced numerous distinct banking crises in the past including the recent crisis which are all based on conventional banking system. In order to prove its resilience and provide for a better alternative to its conventional counterpart, the Islamic financial industry needs to ensure that it will not be a source of such financial instability.

A sound Shari'ah governance system is one of the main contributors that guarantee the stability in IFIs because the integrity of IFIs greatly depends on the status of Shari'ah compliance, the impact of products, professional competence and behaviour towards and observance of Shari'ah norms. For instance, one of the major factors of the 1986 failure of Kleinwort Benson, the first investment bank to introduce an Islamic unit trust, was due to investor's reservations about the absence of a Shari'ah governance system. Additionally the closure of Ihlas Finance House in Turkey in 2001 was due to poor governance practice and this includes failures of management, control, strategy and regulators.

Therefore it is very important for us to identify challenges and to promote best practice in relation to Shari'ah governance system such as the independence of Shari'ah board, its operative procedures, transparency and disclosure practices, conflict of interest arrangement and competency board and executives. These efforts will bring into focus the needed measures that need to be carried out to strengthen and improve the Shari'ah Governance system in IFIs.

What do you hope to achieve in relation with Shari'ah governance system in IFIs?

IFIs in Malaysia, GCC Countries, the UK and any other part of the world have different set of frameworks of the

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Financial Crisis & the Corporate Governance Solution

The article below is an excerpt from Dr. Nasser Saidi's speech at the 1st annual compliance and anti-money laundering seminar held in Riyadh, KSA.

The ongoing financial crisis poses a series of challenges to policy makers and regulators as they attempt to stabilize financial markets and prevent a meltdown and avoid the slide of the global economy from its deepest synchronized recession in 60 years into possible depression.

The political and popular backlash is eliciting and promising deep banking and financial sector reform, including in the Bretton Woods international financial architecture and a wave of regulations, encompassing corporate governance.

At the most basic level, the current crisis stemmed from excessive risk taking for short-term profit by senior managements in highly leveraged banking and financial institutions. Boards were not fulfilling their obligations in ensuring the sustainability of their operations. Regulators were failing to provide satisfactory oversight of a system that provided incentive to leverage through securitization and sent the wrong prudential signals through the pro-cyclicality of capital adequacy and value-at-risk measures. In other words, the crisis originated from failures on three principal levels: the senior management level, board level and on the regulatory level.

In these testing times, we need to rethink the overall system, its architecture and incentive schemes; but we must also bear in mind that many of the technical solutions exist and arguably by proper implementation of corporate governance best practices, the crisis could have been avoided or its consequences mitigated.

Role of CG in restoring confidence and building markets

We need to address some key issues going beyond governance in the post credit quake world:

1. Monetary authority. We must rewrite the framework underlying the authority and role of central banks as lenders/rescuers of last resort, as well as the nature of eligible collateral.

2. Regulatory. Basel II and its implementation will require re-engineering; we should introduce time varying anti-cyclical capital adequacy standards to be supplemented by a liquidity risk management framework and a framework for macro-prudential risk and its management.

3. Accounting. The audit and accounting professions must learn from the crisis. There are a number of accounting and disclosure issues relating to fair value accounting and regulations requiring marking to market that may have contributed to market volatility.

4. Credit Rating Agencies. The role and possible regulation of credit rating agencies needs to be addressed. Two measures are important: breaking the symbiotic relationship between regulators and credit rating agencies by removal of references to ratings in regulations, and introducing a separate metric and rating for structured finance products.

In light of the near meltdown of markets, the key objective is restoring market and investor confidence. Markets exist by the grace of investors. Our way out of the crisis is through intelligent regulation, one that does not pre-empt or hinder market driven adjustments, but supports and strengthens financial innovation and the market, and does so through creating and maintaining a culture of transparency and accountability.

Families and Governance continued from Page 1…

elected by the Family Assembly among its members to deliberate on family business issues and coordinate the interests of the family members in their business.
Good governance of a family business is a combination of corporate governance and family governance. Family-run businesses can represent the work and wealth of several generations. It is important to set up a solid family governance system early in the lifecycle of the business to resolve potential conflicts among family members.

To address all these issues, Hawkamah and the International Finance Corporation (IFC) have recently partnered on a family initiative to provide corporate governance assessments and corporate governance advisory services for families in business and families going for IPO. The initiative is being rolled through a regional road show program aiming at assisting families in business in the region to create and manage a family governance system that will work across generations. The road shows also provide family businesses practical solutions for a range of governance, succession and IPO issues.

Did You Know?

As part of Hawkamah's ongoing efforts to collect information and data to assist in building the business case for corporate governance using latest research produced by various institutions, Hawkamah is introducing this part as a regular feature of its newsletter for your reference.

- **Did You Know....that each EU Member State has issued corporate governance guidelines for listed companies?**

In each EU Member State, there is a corporate governance "code", for listed companies[1]. These codes generally require that companies comply with the behaviors they recommend or explain why they did not.

1 See the list of codes and recommendations at: **http://www.ecgi.de/codes/all_codes.php**

Private Equity and Gulf Venture Capital in the M.E

Middle East private equity fund managers raised a record $6.4 billion in 2008, up more than 10% over 2007 and more than double the amount raised in 2005, according to Gulf Venture Capital Association's (GVCA) 2008 report on Private Equity & Venture Capital in the Middle East, which was developed in cooperation with KPMG, and Zawya, and supported by Hawkamah.

There is also tremendous liquidity among regional funds, which are cash rich with $11 billion in capital under management yet to be deployed. The report notes that this "dry powder", as it is called, gives private equity a strategic opportunity vis-à-vis target companies, given the limited scope of other funding sources available in the current environment. This liquidity results from both an increase in fundraising and a decrease in deals, with the number of private equity investments dropping by 22% between 2007 and 2008, as well as the total investment size, which fell by 31%.

The report found that over the past four years, Egypt, Saudi Arabia and the United Arab Emirates were the largest recipients of private equity funds, at 33%, 15% and 14% respectively. The sectors of focus for portfolio acquisitions during 2008 were healthcare, transport, power & utilities and construction. In terms of fund strategies, more and more funds are seeking controlling stakes. While in 2005, only 3% of transactions were control buyouts, by 2008, some 26% of transactions volume and half of transactions values were control buyouts.

The report was optimistic about the future of private equity in the region, noting that as an asset class, it does not have a short-term investment horizon and so is well placed to weather the current crisis.

The 18 private equity fund managers, who were interviewed for the report, expressed an expectation of consolidation in the industry, a decrease in investment, and lower portfolio company growth.

MENA private equity can, and should, play a critical role in diffusing good corporate governance practices across portfolio companies, in terms of board structures, executive compensation better aligned with long term shareholder interest and underlying risk, improved risk management, transparency and disclosure requirements and minority interest protection. This benefits all parties, as empirical evidence shows that investors are willing to pay a premium for companies with good corporate governance. This is why Hawkamah has launched a Private Equity Task Force to develop corporate governance guidelines for private equity firms and portfolio companies in the MENA region.

Interview with Mr. Zulkifli

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The existing Shari'ah governance framework needs further enhancement and improvement and this is important for the consolidation and sustainable of Islamic finance industry globally. I strongly believe that the need to have effective Shari'ah governance is really crucial which would then strengthen the credibility of IFIs. Failure to provide efficient Shari'ah governance would inevitably lead to serious disruptions in the market which would have dire consequences for Islamic finance industry itself. I personally hope that the future Shari'ah governance framework will be nurtured from the best practices and more importantly will be able to promote additional values to the existing corporate governance framework such as trust, fairness, transparency, credibility, responsibility through the underlying Islamic principles of beliefs (aqidah), Shari'ah and ethics (akhlaq). For this purpose, there must be continuous, thorough and intensive research on the subject of corporate governance of IFIs and I believe that in this aspect, Hawkamah is one of the institutions that can contribute something towards this aspiration.

Insurance Policy Brief!

Policy Brief on Corporate Governance in the MENA region's Insurance Industry released by Hawkamah and AFIRC:

It is hoped that the recommendations contained in the Policy Brief will form the basis for creating a minimum standard for the MENA insurance sector as agreed upon by the region's insurance industry regulators.

Please send an email at **info@hawkamah.org** or visit the Hawkamah website **www.hawkamah.org** to reserve your copy today

Forthcoming Events

23 April 2009
Responsible Investment: Profitability meets Sustainability Workshop, Dubai, UAE

27-29 April 2009
Ethics Gulf 2009, Dubai, UAE
Ethics, Governance & Corporate Compliance Gulf Summit
www.corporatecompliancegulf.com

26 May 2009
Insolvency Conference
Insolvency and Creditor-Debtor Rights Systems in MENA, Abu Dhabi, UAE

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