Director independence classification (Middle East & Africa, excluding South Africa)

Background and Overview

Lack of director independence is a major concern in many Middle East and African (MEA) markets. This is notably due to the prevalence in the region of companies with concentrated ownership. A substantial number of local corporate governance codes and regulations set requirements on the minimum number or proportion of independent directors on boards and key committees, reflecting a tightening of governance requirements in several markets in the region during recent years. It is also noted that, historically, company disclosure of directors and information concerning them has been often insufficient and sometimes non-existent, or not made in time to inform shareholders for general meeting voting decisions. However, disclosure is improving in some markets and by some companies, and therefore this trend also provides an opportunity to further develop ISS policy and our approach.

It is proposed to establish criteria for the independence classification of directors at widely-held companies in MEA markets. Such a policy development will reflect an improving governance framework and better assist investors in assessing board independence in their portfolio companies in the MEA region. ISS analysis will focus on the most relevant non-independence criteria in light of the level of stringency of local governance guidelines on director independence, as well as local corporate disclosure standards on directors' background, directorships and affiliations.

It is noted that this excludes South Africa, as ISS has a separate South Africa policy which already includes director independence classification criteria.

Key Changes Under Consideration

Where disclosure is sufficient to do so, directors will be classified by ISS as independent or non-independent based on similar criteria already used in other markets. We expect this to cover widely-held companies in many of the most important MEA markets (at least UAE, Qatar, Nigeria, Egypt, Morocco, Saudi Arabia).

For the assessment of independence, ISS' focus will be based on independence classification criteria already used by ISS in other markets, supplemented by factors taken from market-specific best practices and disclosure standards and other market-specific considerations.

For example, in several MEA markets, directors' past service as external auditor/partner of the external audit firm will be taken into account, with cooling-off periods in accordance with local market best practice (please refer to footnote 7 of the proposed policy below).

Given the sometimes poor disclosure standards, classification determinations will be made based on the available information at the time of the analysis.

Criteria used for the classification of directors shall be as follows:

ISS Classification of Directors – EMEA Regional Policy 2016

Executive Director

› Employee or executive of the company;

› Any director who is classified as a non-executive, but receives salary, fees, bonus, and/or other benefits that are in line with the highest-paid executives of the company[6].

Non-Independent Non-Executive Director (NED)

› Any director who is attested by the board to be a non-independent NED;

› Any director specifically designated as a representative of a significant shareholder of the company;

› Any director who is also an employee or executive of a significant shareholder of the company;

› Any director who is nominated by a dissenting significant shareholder, unless there is a clear lack of material[5] connection with the dissident, either currently or historically;

› Beneficial owner (direct or indirect) of at least 10 percent of the company's stock, either in economic terms or in voting rights (this may be aggregated if voting power is distributed among more than one member of a defined group, e.g., family members who beneficially own less than 10 percent individually, but collectively own more than 10 percent), unless market best practice dictates a lower ownership and/or disclosure threshold (and in other special market-specific circumstances);

› Government representative;

› Currently provides (or a relative[1] provides) professional services[2] to the company, to an affiliate of the company, or to an individual officer of the company or of one of its affiliates in excess of $10,000 per year;

› Represents customer, supplier, creditor, banker, or other entity with which company maintains transactional/commercial relationship (unless company discloses information to apply a materiality test[3]);

› Any director who has conflicting or cross-directorships with executive directors or the chairman of the company [6];

› Relative[1] of a current or former executive of the company or its affiliates;

› A new appointee elected other than by a formal process through the General Meeting (such as a contractual appointment by a substantial shareholder);

› Founder/co-founder/member of founding family but not currently an employee;

› Former executive (five-year cooling off period); [6]

› Years of service is generally not a determining factor unless it is recommended best practice in a market and/or in extreme circumstances, in which case it may be considered.[4]

› Any additional relationship or principle considered to compromise independence under local corporate governance best practice guidance. [7]

Independent NED

› No material[5] connection, either direct or indirect, to the company (other than a board seat) or to a significant shareholder.

Employee Representative

› Represents employees or employee shareholders of the company (classified as "employee representative" but considered a non-independent NED).

Footnotes

[1] "Relative" follows the definition of "immediate family members" which covers spouses, parents, children, stepparents, step-children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.

[2] Professional services can be characterized as advisory in nature and generally include the following: investment banking/financial advisory services; commercial banking (beyond deposit services); investment services; insurance services; accounting/audit services; consulting services; marketing services; and legal services. The case of participation in a banking syndicate by a non-lead bank should be considered a transaction (and hence subject to the associated materiality test) rather than a professional relationship.

[3] A business relationship may be material if the transaction value (of all outstanding transactions) entered into between the company and the company or organization with which the director is associated is equivalent to either 1 percent of the company's turnover or 1 percent of the turnover of the company or organization with which the director is associated. OR, A business relationship may be material if the transaction value (of all outstanding financing operations) entered into between the company and the company or organization with which the director is associated is more than 10 percent of the company's shareholder equity or the transaction value, (of all outstanding financing operations), compared to the company's total assets, is more than 5 percent.

[4] For example, in continental Europe, directors with a tenure exceeding 12 years will be considered non-independent. In the United Kingdom, Ireland, Hong Kong, and Singapore, directors with a tenure exceeding nine years will be considered non-independent, unless the company provides sufficient and clear justification that the director is independent despite his/her long tenure.

[5] For purposes of ISS' director independence classification, "material" will be defined as a standard of relationship financial, personal, or otherwise that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

[6] For purposes of independence classification of directors incorporated in the Middle East and Africa region, this criterion will be taken into account in accordance with market best practice and disclosure standards.

[7] For MEA markets, directors' past services as statutory auditor/partner of the statutory audit firm will be taken into account, with cooling-off periods in accordance with local market best practice.

The independence classification, where available, is not proposed to be used as the basis of ISS voting recommendations at this time, as it is considered that this could discourage improved disclosure in the region by penalizing companies who do disclose sufficient information for assessments to be made. This is proposed to be kept under review as the various markets continue to develop.

Intent and Impact

This policy change is designed to introduce an independence classification of directors and thus enhance the level of information provided in ISS research reports for widely-held MEA companies where such classifications are not currently undertaken.

Focusing on some main criteria applying to companies incorporated in the MEA region would better reflect market specificities in terms of maturity, as most MEA markets have lower levels of disclosure and lower best practice standards than more mature markets elsewhere.

Introduction of an independence classification in some MEA markets will not have any impact on ISS' benchmark vote recommendations for the present, as in low-disclosure markets this may be seen to discourage good disclosure. However, we consider this to be a first step to further policy evolution in future and to adopting future vote recommendations for director elections based on the number or proportion of independent directors with regard to best practice standards in the concerned markets in coming years.

Request for Comment

- In less-developed markets such as many MEA markets, for the purpose of identifying independent directors, do you consider it appropriate and/or useful to perform an independence classification of directors? Please explain your answer.
- Do you consider it appropriate to have less stringent disclosure expectations in the region than those currently applied in other more developed markets (for example, as regards criteria linked to directors' level of remuneration, current directorships, or past service as an executive of the company)?
- Do you consider that future ISS policy development in this region for voting recommendations based on director classifications would be desirable? Or do you consider that, while markets are developing in terms of good practices, it could discourage improved disclosure? Please explain your answer.