



Markets Brief

The DFSA corporate governance regime

Issue No. 13 – August 2015

Introduction

This Markets Brief looks at the DFSA's corporate governance regime for Reporting Entities. It sets out some of the DFSA's general policies on best practices and is designed to encourage better compliance by providing what we hope are some helpful templates for disclosure in a Prospectus and in the annual report.

This Markets Brief is aimed at Applicants¹ for listing of Shares on an Authorised Market Institution ("AMI") in the DIFC, at existing Reporting Entities, and at their advisors.

There is a separate corporate governance regime applicable for Listed Funds. The DFSA published a Markets Brief on Listed Funds which can be found on our website.

Guidance

Please note that the contents of this communication are not intended to be Guidance as contemplated by the Regulatory Law 2004 and the contents should neither be interpreted, nor relied upon, as Guidance. You should refer to the

DFSA Rules for Guidance or contact the DFSA if you require individual guidance.

Technical explanations given in this brief are for illustrative purposes and should not be considered or relied upon as a legal advice. We recommend that independent legal advice is obtained if you are unsure about any aspect of the DFSA markets regime which may apply to you.

Defined terms are identified in this brief by the capitalisation of the initial letter of a word or each word in a phrase and are defined in the Glossary Module of the DFSA Rulebook.

The DFSA corporate governance regime

The DFSA's corporate governance regime for Reporting Entities is a three-tier regime.

First, it imposes an overarching legal obligation under Article 39(1) of the Markets Law 2012 (the "Markets Law") which requires Reporting Entities to have a corporate governance framework in place.

Second, the overarching legal obligation is reinforced by seven Corporate Governance

¹ For the purposes of this Markets Brief, "Applicant" means a Person who applies for admission of its Shares to the DFSA's Official List of Securities, which is typically the Issuer. Once listed, an Applicant in relation to Shares becomes a Reporting Entity.

Principles (the “Principles”) in chapter 3 of the Market Rules (“MKT”)².

Third, each of the Principles are expanded by comply or explain, outcome-based best practice standards (the “best practice standards” or “BPS”)³. The best practice standards also set out certain matters that should be included in the company’s annual report.

What is the overarching legal obligation to have a corporate governance framework?

Article 39(1) of the DFSA Markets Law 2012 requires every Reporting Entity to have a corporate governance framework in place which is adequate to promote prudent and sound management of the company in its long-term interest and that of its shareholders.

What are the Corporate Governance Principles?

In brief, the seven high-level Principles require first that every Reporting Entity must have an effective Board of Directors (“Board”) which is collectively accountable for ensuring that the company’s business is managed prudently and soundly.

The remaining six Principles place a direct obligation on the Board of the reporting Entity. They require the Board to:

1. ensure a clear division between its own responsibilities and those of senior management;
2. have an appropriate balance of skills and have adequate resources;
3. ensure that the company has a proper risk management, internal control and compliance framework;
4. ensure that shareholders’ rights are properly safeguarded;
5. ensure that the company produces proper financial and other reports; and

² The Principles can be found at MKT section 3.2.

³ The best practice standards can be found in Appendix 4 to MKT (APP4).

6. ensure that the company’s remuneration structure is aligned with the long-term interests of the company.

What corporate governance disclosures is a Reporting Entity required to make?

The DFSA requires an Applicant (under Article 15(1) of the Markets Law) to disclose in its Prospectus both the nature of its corporate governance framework and the extent of compliance with the best practice standards. See further below.

Following admission to the List, a Reporting Entity is required, under MKT 3.2.10 to disclose whether the best practice standards have been adopted by the Reporting Entity. If they have not been fully adopted, or have been only partially adopted the Reporting Entity must disclose why the best practice standards were not adopted fully or adopted only partially. It must also explain what alternative actions have been taken by the Reporting Entity to achieve compliance with the Principles if any best practice standards were not adopted, or were only partially adopted.

This Markets Brief includes, in Appendix 1, some templates which the DFSA has designed to help promote compliance by Reporting Entities with the corporate governance disclosure requirements in the Prospectus and annual report. These templates may be amended from time to time to keep them up-to-date with best practices.

Do I have to comply with all 67 of the best practice standards in order to comply with the Principles?

Compliance with the Principles is mandatory. This mandatory compliance can be achieved in two ways. One way is by complying with all of the 67 best practice standards in Appendix 4 of MKT. However, the “comply or explain” approach adopted by the DFSA recognises that there is more than one way to comply with the Principles to achieve sound and prudent governance of the Reporting Entity. Therefore, a company may be able to comply with a Principle using an alternative method to achieve the desired outcome.

The BPSs are designed to provide a degree of flexibility so that a company can achieve the outcomes intended by the Principles whilst taking into account the nature, scale and complexity of its business.

For example, in practice it is possible that a company does not have a formal schedule in place of matters specifically reserved for the decision of the Board, as envisaged by best practice standard 11. However, the company may still consider itself to meet Principle 1, which requires the company to have an effective Board of Directors. This may be because in the particular circumstances of that company its Board can operate equally effectively without such a formal schedule. However, how the Board achieves the desired outcome would need to be explained in the Prospectus and in the annual report.

What disclosures are required at the listing stage?

An Applicant for listing of Shares on an AMI will have to draw up a Prospectus. This Prospectus will need to be approved by the DFSA.

As part of the document submission for approval of its Prospectus an Applicant has to complete and submit to the DFSA a corporate governance checklist, which can be found on our website. The checklist mirrors the best practice standards. In this checklist the Applicant confirms to the DFSA on an item by item basis its compliance with each of the best practice standards.

A signed copy of the checklist will be part of the final set of documents submitted to the DFSA at the approval stage. Where a best practice standard is not or only partially applied or considered non-applicable, we would expect this to be stated, with an explanation in the checklist. The DFSA can ask questions in this regard. For example, where an Applicant indicates it is not in compliance with BPSs 20 and 31 on the independence of the Chairman of the Board and no explanation is provided on mitigating actions taken, we would point this out in our comment sheet.

The outcome could be clarifications to the checklist, additional disclosures in the Prospectus on the company's (non-) compliance with the relevant BPS. In exceptional cases the company may decide to make changes to its corporate governance framework. This would be the case, for example, where the DFSA is of the opinion that the non-compliance materially impacts the company's eligibility for listing. The DFSA published a Markets Brief on eligibility for listing which can be found on our website.

What corporate governance disclosure is required in the Prospectus?

The DFSA expects disclosures on corporate governance to be prominently displayed in the Prospectus.

If the company complies with all of the best practice standards at the time of listing the disclosure in the Prospectus on corporate governance will be a statement to that effect. If the company does not adopt all of the best practice standards, or adopts them only partially, the Prospectus disclosure should make this clear, together with the reasons and any alternative measures adopted to achieve the outcomes intended by and compliance with the relevant Principle.

The **Annex** to this Markets Brief contains templates that a company can use for Prospectus disclosure (and going forward in their annual accounts) on their compliance with the DFSA corporate governance framework.

Template A can be used as the basis for the disclosures to be made by an Issuer that complies with all of the best practice standards in MKT APP4.

Template B can be used as the basis for the disclosures to be made by an Issuer that does not apply all of the best practice standards in MKT APP4.

Where there are square brackets in the template, the Applicant should insert company-specific disclosures, including providing a clear

explanation for deviating from any best practice standards.

Annex 1 also sets out **two examples** of disclosures the DFSA would expect a company to make that is not or not fully in compliance with certain best practice standards.

Does the regime apply to non-DIFC Applicants?

Applicants incorporated outside the DIFC will have to comply with the DFSA corporate governance regime described in this Markets Brief. In addition, foreign applicants have to disclose in the Prospectus, for the last financial year, a statement as to whether or not it is complying with any corporate governance regime applicable to it in its country of incorporation or domicile and if so, whether or not this regime is compatible with the corporate governance regime under the Markets Law and MKT. If the Applicant does not comply with the regime in its home country, a statement to that effect has to be included in the Prospectus, together with an explanation regarding why the Applicant does not comply with such a regime.

What periodic disclosure do I have to make on corporate governance in my annual report?

Similar to the disclosure in the Prospectus, a separate section in the annual report should be devoted to corporate governance, in accordance with MKT 3.2.10. If the Reporting Entity complies with the DFSA corporate governance framework by complying with all of the BPSs, the disclosure in the annual report should contain a statement to that effect.

Where compliance was achieved although not all of the BPSs were (fully) adopted due to particular circumstances of the Reporting Entity, this should be clearly stated and an explanation should be provided. This explanation should make clear in what respect(s) the best practice standards were not (fully) adopted and provide the reasons for doing so.

The annual report must also include a statement by the Directors whether or not, in their opinion,

the corporate governance framework of the Reporting Entity is effective in promoting compliance with the outcome required by article 39(1) of the Markets Law 2012⁴ and the Corporate Governance Principles, with supporting information and assumptions, and qualifications if necessary. See MKT 3.2.10(c). In addition, MKT APP2 sets out certain corporate governance related disclosure requirements for the annual report.

Contraventions – regulation, examples and connection to continuing disclosure obligations

Reporting Entities should note that failure to comply with the DFSA's disclosure obligations in the MKT can lead to the DFSA taking enforcement action against a Reporting Entity. This would apply to failures in respect of the required disclosures for corporate governance.

A breach of any legislation administered by the DFSA may result in a sanction being imposed by the DFSA under Article 90 of the Regulatory Law 2004.

We set out below some of the possible contraventions which may be relevant for non-disclosure in relation to corporate governance.

Prospectus

Inaccurate or false representations in, or omissions from, the Prospectus would breach the prohibition against misleading and deceptive statements in article 20 of the Markets Law 2012.

Annual Report

Any false, misleading or deceptive information in the annual report would breach the prohibition against the provision of false or misleading information to the DFSA in article 66 of the Regulatory Law.

⁴ "A Reporting Entity shall have a corporate governance framework which is adequate to promote prudent and sound management of the Reporting Entity in the long term interest of the Reporting Entity and its shareholders"

For example, pursuant to best practice standard 64 which resorts under Principle 6 on the position and prospects of the company, the Directors must report in the annual and half yearly financial statements that the business is a going concern, with supporting assumptions or qualifications as necessary. If the Board makes this affirmative statement while it knows or could have reasonably known that this is not true, this is likely a breach of article 55 of the Markets Law 2012, the prohibition on the dissemination of false or misleading information.

Corporate governance related contravention of continuing disclosure obligations

False statements in a public disclosure under the MKT Rules could cause a Reporting Entity to breach one or more provisions in Part 6 of the Markets Law 2012 on the prevention of market abuse.

The DFSA has published a Markets Brief on continuing disclosure obligations that can be found on the DFSA website.

Arabic edition

Every Markets Brief is produced in both English and Arabic and is available on the DFSA website.

Contact us

Visit the DFSA website www.dfsa.ae for:

- other editions of the Markets Brief;
- access to DFSA-administered legislation and the DFSA Rulebook; and
- the full text of the Markets Law 2012 and Markets Rules, including MKT APP4 with the DFSA Corporate Governance Principles and best practice standards.

For enquiries:

- Telephone +971 4 362 1500
- Email markets@dfs.ae

Feedback

- We appreciate your feedback and welcome any suggestions that you may have. Please email us at markets@dfs.ae

Annex – Templates and examples for corporate governance disclosure in a Prospectus for Shares

Template A: Issuer complies with all the best practice standards

“CORPORATE GOVERNANCE

I. Introduction

The DFSA corporate governance regime is set out in the DIFC Markets Law 2012 and the DFSA Market Rules. The DFSA corporate governance regime applies to all companies that have Shares listed on an Authorised Market Institution. The regime therefore applies to the Company.

The DFSA corporate governance regime contains a number of high level Corporate Governance Principles and best practice standards. The principles and best practice standards apply in respect of the board of directors, division of responsibilities, board composition and resources, risk management and internal control systems, shareholders rights and effective dialogue, financial position and prospects, and remuneration.

II. Declarations

The Company complies fully with each of the best practice standards in Appendix 4 of the DFSA Markets Rules and hence, with the Corporate Governance Principles.

In the opinion of the Directors the corporate governance framework of the Reporting Entity is effective in promoting compliance with the Corporate Governance Principles.”

Template B: Issuer does not comply with all the best practice standards

“CORPORATE GOVERNANCE

I. Introduction

The DFSA corporate governance regime is set out in the DIFC Markets Law 2012 and the DFSA Market Rules. The DFSA corporate governance regime applies to all companies that have Shares listed on an Authorised Market Institution. The regime therefore applies to the Company.

The DFSA corporate governance regime contains a number of high level Corporate Governance Principles and best practice standards. The Principles and best practice standards apply in respect of the board of Directors, division of responsibilities, board composition and resources, risk management and internal control systems, shareholders rights and effective dialogue, financial position and prospects, and remuneration.

II. Declarations

In the opinion of the Directors the corporate governance framework of the Reporting Entity is effective in promoting compliance with the Corporate Governance Principles.

The Company has [not] [only partially] adopted certain best practice standards specified in Appendix 4 of the DFSA Markets Rules. However, it still achieves the mandatory compliance with the high level Corporate Governance Principles through having alternative arrangements in place in respect of the best practice standards which are [not] [only partially] complied with, as set out below. As a result, the Company is in compliance with the Corporate Governance Principles.

III. Explanation on [partial compliance] [non-compliance] with certain best practice standards and alternative arrangements

[Company to provide clear explanation for why the best practice standard is not (fully) complied with]

[Company to provide clear explanation of actions and alternative arrangements, if any, taken by the Company to achieve the mandatory compliance with the Corporate Governance Principles]"

The template in III above should be followed for each (unrelated) best practice standard not (fully) complied with.

Examples for corporate governance disclosure in a Prospectus for Shares

Example 1

Principle 2, Division of responsibilities

At listing, the Company does not comply with best practice standard 16 in Appendix 4 of the DFSA Markets Rules regarding the roles of the chairman of the Board and CEO.

Best practice standard 16 aims to ensure that the Board's function of providing effective oversight of the management of the Reporting Entity is not compromised, by ensuring that the role of the chairman of the Board and the role of the chief executive of the Reporting Entity are not be held by the same individual.

The Company has, since 2013, joined the roles of chairman of the Board and CEO. This was following the departure of our previous chairman, Mr Jones. Our CEO, Mr Smith, stepped in as interim chairman. Subsequently, the Board took a unanimous view that the functioning of the Board had in fact become more effective since this time, and decided that it would put the joint chairman/CEO to a shareholder vote at the next AGM.

At the next AGM in December 2013, the shareholders voted overwhelmingly (98%) to maintain the joint chairman/CEO role. Additionally, the performance assessment of the CEO/chairman is undertaken by a non-executive Director of the Board Ms El-Amin, with the assistance of XYZ Group, a firm of external management consultants with experience in board performance and remuneration. The joint

chairman/CEO's position is put to a shareholder vote at three-year intervals. The next shareholder vote will be in December 2016.

Example 2

Principle 7, Remuneration committee

At listing, the Company does not fully comply with best practice standard 70 in Appendix 4 of the DFSA Markets Rules regarding the use of a remuneration committee which has delegated responsibility for setting remuneration for all executive Directors and the chairman.

Under best practice standard 70, a company's Board should establish and maintain a remuneration committee to assess the remuneration of Directors (including the chairman). The remuneration committee should comprise at least three members, with a majority of those members being independent non-executive Directors. The chair of the committee should be an independent non-executive Director. In addition, the chairman of the Board may also be a member but not the chair of the committee.

The Company does not consider that it is necessary, at this stage of its lifecycle, to establish and maintain a remuneration committee. Therefore, since the Company's second round of financing in 2008, it has had a policy of outsourcing the role of a remuneration committee to external consultants, XYZ Group. XYZ Group provides the Company with an annual, independent review of the Company's remuneration structure (including performance-based remuneration such as bonuses and share options) and benchmarks the structure against industry and sector peers. Key parts of the annual review (total remuneration and bonuses) are presented to shareholders at the AGM and put to a vote. XYZ Group, which is an international company headquartered in San Francisco, California, has no connection with the Company other than the work it performs for the Board. The Company intends to continue this arrangement post-IPO.