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4 August 2006

By email to: **The Capital Market Authority of Saudi Arabia**

Re: Consultation on the Project to develop Regulations Governing the Management of Companies in the Kingdom of Saudi Arabia, issued in accordance with Royal Decree #r/30 dated 2/6/1424 of Hijra

Dear Sirs,

The CFA Centre for Financial Market Integrity (the "CFA Centre")[1] of CFA Institute, working closely with CFA Arabia which is the CFA Institute society in Saudi Arabia, is pleased to comment on the document *Project for Regulations Governing the Management of Companies in the Kingdom of Saudi Arabia (the "Project")* issued by the Capital Markets Authority Council on 1 July 2006. The Centre, utilising the experience in international markets and different investment disciplines of CFA Institute members, including specialised input in this case from Mohammed AlQatari, CFA and Radi Al-Haddad, CFA, who are respectively the President and Vice President of CFA Arabia, represents the interests of investors and investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis, investment management, corporate governance and the efficiency of global financial markets.

General Comments

The Centre and CFA Arabia support the approach by the Capital Markets Authority (the "CMA") to seek the views of market participants on matters relating to corporate governance and company law. These topics cover systems of shareholder ownership and participation, and of the structure, tasks, remuneration and oversight of the governing bodies of companies, which have a significant impact on decision-making and accountability by company executives and board members. They affect both the specific interests of shareowners and the concerns of other stakeholders in the economy more broadly.

In undertaking a project of this kind it is important to note the considerable body of research and policy formulation that on a global basis has been developed in relation to corporate governance standards for public companies. In addition to the OECD's Principles of Corporate Governance which are intended to have global application, there has been substantial work in both North America and Europe leading to two distinctive philosophies

[1] With headquarters in Charlottesville, Virginia, USA and regional offices in New York, Hong Kong and London, CFA Institute (formerly, the Association for Investment Management and Research®) is a non-profit professional association of over 83,000 financial analysts, portfolio managers, and other investment professionals in 128 countries of which over 70,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 134 Member Societies in 55 countries and territories, among which is the CFA Arabia. The CFA Centre develops, promulgates, and maintains the highest ethical standards for the investment community including the CFA Institute *Code of Ethics* and *Standards of Professional Conduct*.

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and approaches. The prevalent North American method is prescriptive with clear and precise rules setting out what can and cannot be done by or on behalf of company boards and shareowners in the governance process. In Europe by contrast a clear if not universal preference has been displayed for an approach in which companies are required to comply with a chosen set of corporate governance principles and to explain why they do not comply if that is the case. An enforcement process may then be set in train.

The comply or explain method offers greater freedom of choice to a board and requires interaction with shareowners in accounting for why governance choices have been made. This pre-empts the automatic box-ticking mentality induced by prescription in which individuals tend to do as they are told rather than work out what would be best in particular circumstances. But it can lead to greater confusion and without real shareowner power over such matters as board appointments and remuneration or a strong enforcement back-up can be a weak alternative in which explanations become self-justifications for failures in the governance process. Equally, the prescriptive approach in situations where it is presumed that a practice is permitted unless prohibited by law or regulation has often been criticised as a means of setting out the rules in a way that provides a path around them. So enforcement also becomes an issue in this case.

Against this background the ability to have an enforcement capability, either through real shareowner authority in relation to the board, or through some kind of regulatory mechanism, gains in significance. The CFA Centre believes that this issue needs to be re-examined in the context of the current draft Project document or in separate legislation so that the CMA can be satisfied that it has been adequately addressed and dealt with.

As a helpful guide to what investors should look for in the governance of organisations in which they might invest, the CFA Centre has published "The Corporate Governance of Listed Companies: a Manual for Investors". This aims to educate and empower investors but is not a set of best practices nor a guide to the best corporate governance structures. However, in alerting investors to the primary corporate governance issues and risks affecting companies and highlighting some of the factors that investors should consider, the Manual serves to identify some of the key concerns that those developing corporate governance codes should address. It may therefore be of interest in the current context to the CMA. We attach to this letter a copy of the Summary of the Corporate Governance Considerations examined in the Manual, and will be very happy to provide the full text should the CMA be interested.

Responses to Specific Proposals

Chapter 1: Preliminary Provisions:
Article #2 Definitions

a) *Independent Members*

First Class Relatives - We believe that both first class and second class relatives as well as direct family relations by marriage (brother in-law, father in-law) should be considered non-independent due to the heavy family representation on the boards of Saudi companies.

The independence stipulation states that no one who was an executive within the last two years can be considered independent, nor can anyone who entered into "important financial transactions" with the company - but no look back timeframe for this second stipulation is given. We believe that anyone who has engaged in an “important financial transaction” in the past two years should be considered a non-independent director.

“Important financial transaction” needs to be defined. We recommend a monetary definition for initial guidance, although non-monetary links between individuals or groups that could be expected to carry an understanding of reciprocation should be included as well. A monetary transaction above $60,000 should cause someone to be listed as a non-independent director.

Chapter 2: Shareowners Rights and General Assembly
Article #5

b) *The General Assembly is held upon the request of the Board of Directors. The Board of Directors has to invite the General Assembly for the meeting upon the request of the legal Accountant of the company or a number of its shareholders which their shares ownership constitutes at least 5% of the capital.*

The CFA Centre supports the CMA in giving 5% of shareowners the ability to call a special meeting of the General Assembly. It is important that minority shareowners are given the ability to raise issues they believe are important to the prospects of the company and other shareowners.

The CFA Centre also recommends the creation of a mechanism through which shareowners can communicate. It is our understanding that shareowners are not currently afforded the ability to obtain a list of other shareowners. We believe it is important that all shareowners are granted the ability obtain such a listing in order to communicate with other shareowners and elicit support from them in calling a special meeting of the General Assembly or in discussing or voting on other corporate actions.

We understand that all board members are extremely busy and cannot be expected to answer all individual inquiries from investors. A sound mechanism for investor communication and organisation should be established to allow shareowners to communicate with each other, debate their positions and finally approach the board or management with a consensus opinion on the issue they are discussing.

c) *Time and schedule of annual meeting must be announced 20 days prior to meeting.*

The CFA Centre believes that 20 days generally gives investors an adequate amount of time to prepare for the Annual General Assembly, although we consider that 30 days notice may be more appropriate.

The CFA Centre also believes that the agenda for each General Assembly should be electronically posted (on either the company's website or the CMA website) at least 20 – 30 days prior to any general assembly in order to give shareowners ample opportunity to review and understand the issues they will be voting on at the General Assembly.

We also recommend that a preliminary report with preliminary financial statements should be published 30 – 45 days prior to each publicly traded company's Annual General Assembly in order for investors to better understand the company's business prospects and governance when they vote at the Annual General Assembly.

f) *Board has to take into consideration when preparing the General Assembly meeting schedule the subjects which shareowners desire to include in the meeting schedule.*

The CFA Centre believes there should be a formal mechanism by which shareowners may include subjects to be discussed at the annual meeting. This mechanism should include a provision that allows minority shareowners (those who own an amount of shares up to 5%) to propose resolutions to be voted on at the Annual General Assembly. The CMA should set consistent and fair conditions for the inclusion of such resolutions so that legitimate concerns are addressed, while frivolous resolutions are not placed on the Annual General Assembly agenda. An independent mechanism should be set up under CMA oversight to determine which resolutions are frivolous. All resolutions submitted to this mechanism should be publicly disclosed (grouped by company and by year) so that in time shareowners will understand the difference between legitimate resolutions and frivolous ones.

Article #6 Voting Rights

Voting Methods

The CFA Centre believes that each share of a publicly traded company should carry one vote. A company that assigns one vote to each share is more likely to have a board that considers and acts in the best interests of all shareowners.

We also believe that voting should be allowed through electronic means as well as over the telephone in order to allow greater voting in all corporate actions. The technology to trade on-line and over the phone is already well developed throughout the world and would greatly advance the participation of investors and aid them in their role as owners of their investments. Voting should also be allowed through the mail.

The current system of voting that requires shareowners to physically attend the Annual General Meeting or legally designate someone to stand in for them at the annual meeting serves to disenfranchise shareowners who cannot travel to the annual meeting due to monetary constraints, scheduling conflicts, or other matters.

Confidential Voting

The CFA Centre believes that voting should be confidential for individual shareowners and other corporations so that these investors can vote confidently without fear of reprisals. The CMA may wish to require institutional investors to disclose their voting records after the vote so that their shareowners can better understand whether these institutions are voting with the interests of their shareowners in mind.

Removal of Individual Directors

The CFA Centre believes that shareowners should have the power to remove a director from the board with a simple majority vote. Each director up for election at the Annual General Meeting should be required to gain a majority of the outstanding votes in order to continue as a director. In addition, shareowners who individually or collectively own 5% of a company's shares should enjoy the authority to call a special General Assembly and call for an individual director to submit to a vote. If that individual director does not receive 50% of the votes in that special General Assembly, that director should be removed.

Approval of Mergers, Acquisition and other corporate actions

The CFA Centre believes that a vote of either a majority or supermajority of shareowners should be required to approve a merger, acquisition or corporate action. The CMA should set the voting threshold at over 50% for approving ordinary corporate actions, and a supermajority vote of over well 50% may be required to approve significant actions (such as a merger). We do not believe any super-majority threshold of over 66.67% should be used however, as such a high threshold may serve to disenfranchise minority shareholders.

Approval of takeover defences

In an environment in which corporate mergers and acquisitions are a reality, shareowners should be granted the ability to vote on and approve or disapprove any corporate takeover defences such as poison pills. A minimum of a majority vote of all shareowners should be required to approve any takeover defence offered by the board or management, although in such cases a supermajority may be preferable. As noted above, the threshold for approval of any takeover defences should not exceed 66.67% however.

Shareowner votes should be binding

All shareowner vote results should be legally binding, so that the board and management are forced to follow the wishes of their shareowners.

Chapter 3: Disclosure and Transparency:
Article #9 Disclosure in the Board of Directors Report

We would ask that the CMA define the term "Executive Board Members" in Chapter 3: Article 9 to avoid any confusion.

Executive Compensation disclosures

In accordance with global best practices, we believe that each publicly traded corporation should disclose all compensation details of the highest five paid executives of a company that enjoy decision making authority. These disclosures should also include pay details of the CEO and CFO, if for some reason these individuals are not among the top five highest paid individuals.

The details should include the names and position of each individual, their base pay, bonus pay and all other short-term or long-term incentive awards, including options and other derivative awards, and any perquisites. These disclosures should be listed in tabular form and cover the previous three years, or the length of that individual's time at the company if less than three years.

All companies should also be required to disclose all business relationships, related party transactions, change in control agreements and retirement agreements they have entered into with the five highest paid executives with decision making authority at the corporation (also including the CEO and CFO if these individuals are not among the five highest paid individuals).

These disclosures should also include a listing of all shares, restricted shares, options and other derivatives related to the company's shares currently owned by each executive. Such disclosures must contain the amounts each executive bought, sold and was awarded over the previous year.

Director compensation disclosures

Director compensation disclosures should disclose all the information required from executive compensation disclosures (as listed above). This information should be contained in a different table however to avoid confusion.

If an executive is also a director of a company and is among the 5 highest paid executives, this information does not have to be duplicated in the director compensation disclosures. However, if an executive who is also a director is not among the 5 highest paid executives, that director's compensation details should be disclosed in the director compensation section.

Chapter 4: Board of Directors:
Article #11 Board of Directors Responsibilities

h) *The board is not authorised to issue loan contract whose period exceeds three years.*

The system described can still be abused by simply rolling over loans. The regulation should cover all loans with rollover options. Also, the text speaks of (Obtaining permission from the AGM) to take such loans for the sale of assets…etc. What constitutes permission? This should be made clear by the CMA. There should be clear voting on such matters as well or the terms of authority should be given in the company's Articles of Association.

Article #12 Board of Directors Formulation

h) *The member should not attain more than five boards of director's members at one time.*

The CFA Centre believes directors should be restricted to serving on no more than 3 boards at any one time (with a 3 year grace period for current board members serving on more than 3 boards to become compliant). We also believe that no one person should serve as Chairman on more than one board at any one time (the three year grace period should attend here as well). The reason for such limitations stem from the fact that there are only about 80 listed companies in Saudi Arabia while in other markets the numbers often range into the thousands, making it unlikely that a person with 5 board seats would gain excessive power over the universe of listed companies. A person on 5 boards would have a seat on about 6% of listed companies in Saudi Arabia, which would place too much power in that person's hands. Moreover, in order to address the potential conflicts of interest we recommend that there be additional restrictions for persons serving on the boards of companies in the same line of business or sector or in directly competing lines of business or sector.

Article #13 Board of Directors committees and their independency

b) …..b*oard of directors has to follow up the work of the committees.*

Board Independence

The CFA Centre believes that a minimum of 50% of each Corporate board should be composed of independent directors.

Board and Committee Evaluations

Each company should be required to conduct an annual evaluation of board performance. Each committee of the board should also undergo an annual evaluation of its performance.

Article #14 Audit Committee

Independence

The CFA Centre believes that a majority of Audit Committee members should be independent in order to protect the financial integrity of each company's financial statements.

Outside Auditors

The approval of a company's outside auditors should be put to a vote of shareholders. If the outside auditor does not receive majority support from shareowners, the company should be given 90 days to find a new auditor.

Each company should also be required to disclose the services for which they use their outside auditor. These disclosures should include how much a company pays its outside auditor for audit-services and non-audit services.

It is preferable that a company does not use its outside auditor for non-audit services in order to avoid any unnecessary conflicts.

Powers of the Audit Committee

The Audit Committee should enjoy the sole authority to hire and fire a company's outside auditor.

The Audit Committee should enjoy the sole authority to hire any outside legal, auditing or other consultants as it sees fit.

At least once a year, the Audit Committee should meet without members of Management present.

Other Provisions

The Audit Committee should operate under a written charter that enumerates the powers and responsibilities of the committee. This document should be publicly disclosed on a corporate website or other public document for easy access by all shareowners.

Article #15 Nomination and Remuneration Committee

The CFA Centre recommends splitting the Nomination and Remuneration Committee into two separate committees. The nominations process and the remunerations process are two separate and distinct responsibilities that global best practice determines should be carried out by two separate committees.

b) *The rules for choosing the members of the nomination and remuneration committee, the duration of their membership and their assignment techniques.*

Nomination Committee

The Nomination Committee should disclose the experience and skills required of incoming directors.

Independence

The CFA Centre believes that a majority of Nomination Committee members should be independent in order to protect the financial integrity of each company's financial statements.

Nominations Process

The Nomination Committee should disclose what processes 5% and higher owners can undertake to communicate their suggestions to the board concerning new directors.

Powers of the Nomination Committee

The Nomination Committee should enjoy the sole authority to hire and fire any outside legal, nominating or other consultants as it sees fit.

At least once a year, the Nomination Committee should meet without members of Management present.

Other Provisions

The Nomination Committee should operate under a written charter that enumerates the powers and responsibilities of the committee. This document should be publicly disclosed on a corporate website or other public document for easy access by all shareowners.

Remuneration Committee: Independence

The CFA Centre believes that a majority of Remuneration Committee members should be independent in order to protect the financial integrity of each company's financial statements.

Powers of the Remuneration Committee

The Remuneration Committee should enjoy the sole authority to hire and fire any outside legal, compensation or other consultants as it sees fit.

At least once a year, the Remuneration Committee should meet without members of Management present.

Relationships with compensation consultants

If a Remuneration Committee uses outside remuneration consultants, the committee must disclose who such consultants report to. Any outside relationship between any such consultant and any executive or worker with the company must be disclosed.

Other Provisions

The Remuneration Committee should operate under a written charter that enumerates the powers and responsibilities of the committee. This document should be publicly disclosed on a corporate website or other public document for easy access by all shareowners

Article #18 Conflict of Interest in boards of directors

Related Party Transaction disclosures should be thorough and complete so that shareowners can fully understand the transaction. Any transaction above $60,000 should be disclosed in detail, including amounts of each transaction, the duration of the agreement and the names of all related parties involved.

Other Governance Provisions Proposed by the CFA Centre

Codes of Ethics

Each publicly listed company should be required to disclose publicly its internal Code of Ethics. This document should be made public so that shareowners may determine to what lengths each company has gone to ensure executives and company employees behave in an ethical manner and do not engage in corrupt practices.

Corporate Governance Principles

For much the same reasons as we suggest the public disclosure of a Code of Ethics, the CFA Centre proposes that each publicly traded company publicly disclose the corporate governance principles it adheres to in order to ensure that the company, its directors and executives act in the best interests of shareholders.

Such disclosure will give companies with good governance practices the opportunity to reassure shareowners that their investments are protected by strong governance and integrity.

Director Protections

Corporations should be allowed to offer legal protection or indemnification to their directors

so that directors do not fear prosecution for corporate actions taken in the best interests of shareowners.

Legal redress of shareowners

While we believe that corporations should be able to provide directors with legal protections through indemnification, the CFA Centre also believes that shareowners and shareowner groups have the legal rights to challenge and file suit against directors, management and corporations if these shareowners feel that they have legitimate grievances against such parties that have not been adequately addressed by the board, management or the corporation as a whole.

Concluding Remarks

The CFA Centre for Financial Market Integrity and CFA Arabia appreciate the opportunity to provide comment on the CMA's *Project for Regulations Governing the Management of Companies in the Kingdom of Saudi Arabia Consultation.* If you or your staff have questions or seek amplification of our views, please feel free to contact Mohammed AlQatari, CFA by phone at +966 3 882 2220 ext. 7808 or by e-mail at aboabid@yahoo.com, or Radi Al-Haddad, CFA by phone at +966 1 477-8433 ext. 422 or by e-mail at rhaddad@saib.com.sa. You would also be welcome to call CFA Centre staff members John Barrass by phone at +44.20.7712.1553 or by e-mail at john.barrass@cfainstitute.org, or Matt Orsagh CFA, at +1.212.756.7108 or by e-mail at matt.orsagh@cfainstitute.org.

Yours sincerely,

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