



THE WORLD BANK

ROSC

Report on the Observance of  
Standards and Codes (ROSC)

A Corporate Governance  
Country Assessment for

The Arab Republic of Egypt

June 2009

Public Disclosure Authorized

# About the ROSC

## Overview of the Corporate Governance ROSC Program

### What is corporate governance?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The OECD Principles of Corporate Governance provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the board.

### Why is corporate governance important?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research. Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

### The corporate governance ROSC assessments

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment benchmarks a country's legal and regulatory framework, practices and compliance of listed firms, and enforcement capacity vis-à-vis the OECD Principles.

- The assessments are standardized and systematic, and include policy recommendations and a model country action plan. In response, many countries have initiated legal, regulatory, and institutional corporate governance reforms.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the World Bank can also carry-out special policy reviews that focus on specific sectors, in particular for banks and state-owned enterprises.
- Assessments can be updated to measure progress over time.
- Country participation in the assessment process, and the publication of the final report, are voluntary.

By the end of June 2009, 66 assessments had been completed in 55 countries around the world.



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# ROSC

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This Corporate Governance ROSC was carried-out by Sebastian Molineus, Senior Operations Officer, Corporate Governance Group, World Bank. Xavier Devictor, Country Program Coordinator for Egypt; William Mako, Lead Private Sector Development Specialist; Sahar Ahmed Nasr, Lead Economist; Akram Abd El-Aziz Hussein El-Shorbagi, Senior Financial Management Specialist; and Martin Steindl, Operations Officer, IFC, provided substantive comments, input, and overall support to help finalize this Corporate Governance ROSC report.

# Executive Summary

Much has been achieved by the Egyptian government to improve the legal, regulatory, and institutional framework for corporate governance. The Ministry of Investment (MoI) founded the Egyptian Institute of Directors (EIoD), the region's first, and launched codes of corporate governance for private and state-owned companies. A number of changes to the legal and regulatory framework were made, serving to: tighten insider trading related provisions; strengthen disclosure rules; require companies to institute board-level audit committees; and modernize the accounting and auditing framework in-line with international standards. The Capital Markets Authority (CMA) created a special Corporate Governance Department and the Egyptian Stock Exchange (EGX) began to consistently enforce its listing rules, leading to an impressive wave of de-listings from a high of 1,148 in early 2002 to 333 by mid 2009. The Egyptian authorities have implemented many of the key recommendations of the 2001 and 2004 Corporate Governance ROSCs.

On the other hand, actual corporate governance practices of EGX listed companies continue to lag behind the “law on the books”, in particular for companies outside the EGX-30. For example:

- A number of boards do not guide or supervise management by helping them develop and holding them accountable to a set of key performance indicators. Key policies on risk management, internal control and audit processes, and succession planning are often absent. Board nomination processes largely remain opaque and are frequently dominated by majority owners, at times leading to important skills-gaps and insider boards.
- Financial reporting has improved markedly in terms of the timeliness and quality of disclosure; however, non-financial disclosure remains underdeveloped. Few companies publicly disclose their ownership and governance structures, remuneration policies, or foreseeable risk factors online or in their annual reports.
- The laws and regulations that establish shareholder rights have improved markedly, though a few remaining weaknesses exist. Extraordinary transactions do not for example generally require shareholder approval, against good practice, unless the transaction constitutes a merger or an acquisition, or the transaction of a fixed asset, in which case EGM approval is required. In absence of an effective court system, shareholders are in practice unable to hold directors and officers accountable for a breach of their duties.

Egypt can take a major step forward in closing these gaps vis-à-vis the OECD Principles by:

- Requiring companies to implement the Egyptian Corporate Governance Code (ECGC) on a 'comply-or-explain' basis, and amending the ECGC to better meet good practice.
- Reinvigorating the company law reform process to combine the multitude of overlapping laws and regulations into one consistent framework that incorporates recent trends and developments in corporate governance.
- Further strengthening enforcement capacity and supporting the EIoD to roll-out its director training program, focusing on family-owned businesses outside the EGX-30.

This Corporate Governance ROSC proposes a number of reforms to the laws, regulations, and institutions that are requisite in building a modern corporate governance framework. In the end, the key to actually improving corporate governance will be to build a cadre of qualified, experienced, and professional directors and owners that understand the business case for—and have the tools to effectively implement—good corporate governance.

# Landscape

## The Corporate Governance Landscape

This Corporate Governance ROSC Assessment benchmarks Egypt's legal and regulatory framework, practices, and enforcement framework against the OECD Principles of Corporate Governance (OECD Principles), the international reference point for good corporate governance.<sup>1</sup> The OECD Principles and by extension this ROSC Assessment focuses on publicly traded companies, both financial and non-financial, but are equally applicable to other public interest entities, such as large, non-listed joint stock companies and state-owned enterprises (SOEs).<sup>2</sup>

 Company forms and types

Today, mid-2009, there are 1,195 registered issuers in Egypt, of which 333 are listed on the EGX. Of this latter group, 22 are banks, 42 non bank financial institutions, and the remaining 269 companies in the real sector.

 Ownership structure

The ownership of most companies remains concentrated and is typically in family hands, which brings a unique set of corporate governance challenges, including the need to formalize policies, ensure for succession planning, and add independence and professionalism to the board. The free float is less than five percent of total shares for about one-third of EGX listed companies, contrary to the listing rules which require a (relatively low) minimum five percent float.<sup>3</sup> This ownership concentration risks negatively impacting market liquidity, trading, and price discovery. From a corporate governance perspective, concentrated ownership poses a risk in terms of protecting minority shareholders against abusive actions by controlling owners and more generally discourages shareholders from participating in the governance process. The state, too, continues to play an important role as owner in some of the most important companies,<sup>4</sup> and corporate governance is considered to be an important challenge in most SOEs. Experience shows that many family-owned and SOEs have important vested interests that often hinder corporate governance reforms at the company level.

Because minority stakes are often held by retail and not institutional investors,<sup>5</sup> and because neither of these investor types monitors the governance of their investee companies due to a lack of resources and/or incentives, market-based enforcement mechanisms are underdeveloped. Egypt's base of institutional investors remains nascent, with assets under management at less than ten percent of GDP, below the 25 percent expected for a country of Egypt's income level.<sup>6</sup> This lack of a sufficiently-large and dynamic institutional investor base will tend to impede wealth accumulation for retirement, hurt market liquidity, and weaken corporate governance.

<sup>1</sup> It should be noted that this Corporate Governance ROSC differs from previous ROSC assessments in that the information contained in this report is based on a revised assessment methodology. More specifically, in response to the revised OECD Principles of 2004, as well as the current global financial crisis, the World Bank has updated its methodology, revising its old and developing a new set of some 700 data points to more objectively benchmark a country's corporate governance framework against the OECD Principles of Corporate Governance.

<sup>2</sup> Unless otherwise designated, all references to "companies" in this ROSC report shall mean Egyptian companies that are listed on the EGX.

<sup>3</sup> Source: EGX website; World Bank staff analysis. Of note is that the free float is less than 25 percent (which constitutes a blocking minority) for almost three-quarters of EGX listed companies; the free float exceeds 50 percent in only 14 percent of companies.

<sup>4</sup> Between 2004 and 2007, 210 privatization transactions took place, raising L.E. 35.8 billion.

<sup>5</sup> Approximately two-thirds of EGX share trading is done by retail and one-third by institutional investors.

<sup>6</sup> Trading up: Next steps for Egypt's Capital Markets, The World Bank, 2009.

 Key laws and regulations

Egypt's legal framework for companies is based on French civil law; however, Anglo-American common law concepts prevail in the capital markets. The primary laws, regulations, and decrees that shape and influence Egypt's corporate governance framework are the Company Law No. 159 of 1981 (CL), which regulates, *inter alia*, joint stock companies, and its Executive Regulations No. 96 of 1982 (CL-ER); Capital Market Law No. 95 of 1992 (CML), the main law regulating the Egyptian capital market and its Executive Regulations No. 135 of 1993 (CML-ER); and Decree No. 30 of 2002 of the CMA's Board of Directors on Securities and De-Listing Rules of the Cairo and Alexandria Stock Exchanges (Listing Rules or LR). The legal framework contains a significant number of overlapping, ambiguous, and at times inconsistent provisions, leading to some legal uncertainty. For example, it is not clear whether shareholders are able to hold the board and management accountable for a breach of their duties, and whether the definition of a related party contained in the CML is applicable to other laws. On the other hand, the legal framework is not subject to temporary decrees and back-dated amendments, and is not used in an arbitrary manner by the government.<sup>7</sup> Specific to corporate governance, the Egyptian authorities have made an impressive number of reforms to the legal and regulatory framework since the first Corporate Governance ROSC was undertaken in 2001. In summary, Egypt's laws and regulations do not offer companies modern corporate governance or enforcement frameworks that fully protect shareholder rights.

 Key institutions

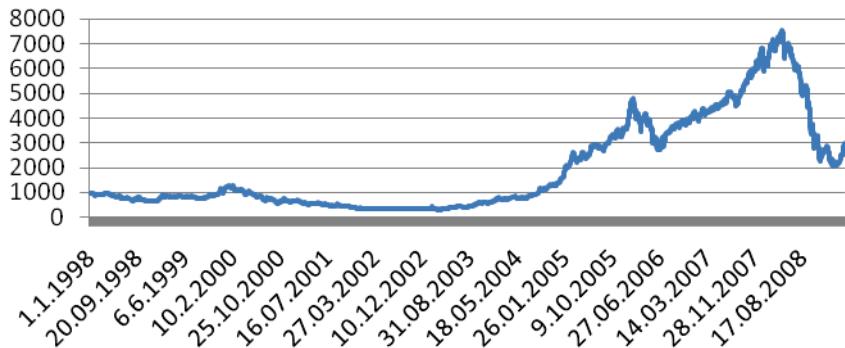
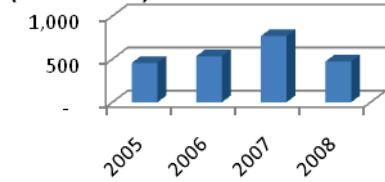
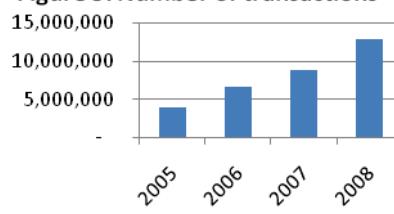
The principle institutions tasked with enforcing the legal and regulatory framework are the CMA, which is responsible for developing, regulating, and enforcing the capital markets; Central Bank of Egypt (CBE), which supervises and regulates banks; EGX, which has the authority to enforce the LRs; Companies Department at the General Authority for Investment (GAFI), which supervises the implementation of the CL. The MoI, established in 2004, oversees all non-bank financial institutions. The CMA and EGX, as well as the Egyptian Insurance Supervisory Authority (EISA) and Mortgage Finance Authority (MFA), report to the MoI, which has led and overseen institutional reforms in these regulatory authorities. Of note is that as of July 1, 2009, the Egyptian Financial Supervisory Authority (EFSA) replaced the CMA, EISA, and MFA. EFSA is responsible for supervising non-bank financial institutions and markets, including the capital and derivatives markets, as well as activities related to insurance services, mortgage finance, financial leasing, factoring, and securitization.<sup>8</sup>

 Capital markets

Egypt's equity market has responded strongly to the above-mentioned reforms. Indeed, Egypt has shown impressive economic growth, averaging 5.3 percent from 2003 to 2008. Despite undergoing a market correction in 2005, the equity markets surged from an average of three percent annual average growth between 2000 and 2002 to almost 50 percent during 2004-2007 (see Figure 1). The volume and number of transaction of listed securities and market capitalization also rose significantly (see Figures 2 and 3).

<sup>7</sup> Egypt, ranks in the 51.9<sup>th</sup> percentile on the WGI project in terms of the rule of law.

<sup>8</sup> Law No. 10 of 2009. Given that the ESFA was only established in July 2009, it was not assessed as part of this ROSC report.

**Figure 1: EGX-30 Index Value 1998 to 2008****Figure 2: Market capitalization (in LE billion)****Figure 3: Number of transactions**

As can be seen from Figure 1, the current financial crisis has had a profound effect on Egypt's equity markets. And while the root of the crisis is found outside of Egypt, its impact on local markets and the economy is a reminder of the role corporate governance can play in building sustainable companies that are better equipped to weather such storms, and minimizing the impact of financial crisis. The crisis should be seen as an opportunity to renew and sustain reform efforts in: (i) building a modern legal and regulatory framework for companies, both requiring and guiding companies to adopt good corporate governance; (ii) strengthening the institutions crucial to enforce the legal and regulatory framework, in particular with respect to good corporate governance; and (iii) raising awareness of and building the business case for companies to implement good corporate governance.

Indeed, a recent World Bank study shows that the largest 31 Egyptian companies show superior performance relative to the other companies listed on the EGX, with higher yearly sales growth of 3.6 percentage points (pps), higher operating profit margins (5.1 pps), return on assets (2.9 pps), and return on equity (5.6 pps).<sup>9</sup> And while there is no empirical evidence linking good corporate governance as practiced by these 31 companies to improved performance, market participants and this ROSC report indicate that the largest companies listed on the EGX do practice corporate governance at a higher level than their peers and hence appear to gain from the benefits of good corporate governance.

<sup>9</sup> Finances of Egyptian Listed Firms and the Performance of the Egyptian Stock Exchange, by Erik Feyen, World Bank, July 2009.

# Key findings

## Board practices

The Egyptian corporate governance framework calls for a one-tiered board structure, i.e. boards comprised of both executive and non-executive directors. In practice, boards typically consist of seven or nine members of which most are insiders, i.e. executive directors, or non-executive directors nominated by and loyal to the majority owner. Market participants cite that most companies are not thought to have truly independent directors. Most (68 percent of the EGX-30 companies)<sup>10</sup> have chosen to combine the position of board chairman and managing directors. Boards typically meet four times per year, in-line with the minimum legal requirement.

### The role of the board

***The lines between board oversight over and guidance to management, and day-to-day decision-making, are often blurred.*** Boards often do not review and guide, but instead actually set corporate strategy and carry-out major plans of action (97 percent of board state that they set, rather than approve, strategy<sup>11</sup>). The line between the board developing policies and implementing concrete action plans is often blurred—in particular in family-owned companies—with boards often becoming involved in day-to-day decision-making. Other focal points for the board's consideration, such as setting the company's risk policy, reviewing key performance objectives and indicators, developing succession policies, and monitoring managerial and corporate performance, are neglected by some company boards.

***Succession planning is virtually non-existent.*** The majority shareholder—rather than the board as a whole—plays the lead role in selecting, compensating, monitoring, and (when necessary) replacing key executives in a number of companies, often informally, without board input. Given the importance of family-controlled companies and the tendency for one decision-maker to dominate company decision-making, the lack of succession planning poses a major risk for many companies.

<sup>10</sup> Board Practices Among EGX-30 Companies in Egypt – A survey by Dr. Ashraf Gamal El-Din A. Rahman, PhD, Executive Director of the EIoD; 27 October, 2008, Cairo, Egypt.

<sup>11</sup> 2007 IFC MENA-wide Corporate Governance Survey.

 The duties of directors

*In a number of companies, directors do not appear to act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and shareholders.* The board is legally accountable to shareholders and the company, and responsible for any falsification of company information. The corporate governance framework on the other hand does not specifically require directors to adhere to a set of duties.<sup>12</sup>

In practice, directors do not generally feel accountable to the company and its shareholders, but to the controlling owner. The norm is for the annual general meeting of shareholders (AGM) to discharge the board from its accountability each year, though a small number of directors have been held liable for criminal offenses. In practice, minority shareholders are unable to hold directors accountable for violations of their duties, largely due to an inefficient court system. As a consequence, boards may fail to treat shareholder fairly, in particular with respect to protecting minority shareholder rights.

*There is no requirement for boards to play an explicit role in managing conflicts of interest.* In practice, boards often do not generally monitor or effectively manage conflicts of interests, in particular related-party transactions. Although 62.9 percent of companies state that they have adopted a code of ethics targeting its board members and senior executives,<sup>13</sup> only one out of the EGX-30 listed companies has published their ethics code.<sup>14</sup> Though required, few directors are thought to properly disclose their interests in other companies to better allow detection of potential conflicts. Public disclosure of related party transactions is generally lacking, and not a single company in the EGX-30 has disclosed its decision-making process for approving related party transactions. Disclosure in this area is likely to improve with the recent amendments to Egyptian Accounting Standards (EAS), updates to the LRs, as well as renewed efforts to enforce Egyptian Standards on Auditing (ESA) which requires the external auditor to review the disclosure of related party transactions.

 Board size and composition

*Most boards appear to be composed of insiders. The corporate governance framework has yet to provide a definition of an independent director and, in practice, few companies are thought to have truly independent directors.* Many boards in Egypt are composed of family members and other insiders, and are frequently selected by the majority owner for their loyalty rather than skills and objectivity, both of which are vital for companies to grow. In fact, 65 percent of companies stated that being a shareholder was a key criterion to being nominated to the board.<sup>15</sup> Consequently, most boards also do not have a sufficient number of non-executive board members capable of exercising independent judgment where there is a potential for conflicts of interests, especially to: (i) ensure the integrity of financial and non-financial reporting; (ii) review related party transactions; (iii) nominate board members and key executives; (iv) set policies on board remuneration; and (v)

<sup>12</sup> For an example of director duties that have been codified in a common law country, see Art. 170 to 177 of the UK Companies Act of 2006. For duties as codified in a civil law jurisdiction, see Section 122 (1) of the Canada Business Corporations Act.

<sup>13</sup> 2007 IFC MENA-wide Corporate Governance Survey.

<sup>14</sup> 2007 Review of the implementation status of corporate governance disclosures: case study Egypt. A note by the UNCTAD secretariat and the American University of Cairo.

<sup>15</sup> 2007 IFC MENA-wide Corporate Governance Survey.

 **Board structure**

develop corporate governance policies.<sup>16</sup> There is no definition of independence in the ECGC and explanation of the role played by an independent director.

 **Board remuneration**

***Key board committees do not exist or, where existent, fail to provide assurance to investors due to a lack of independence.*** The LRs require companies to establish audit committees composed of a majority of non-executive directors; recent decrees have also mandated audit committees for banks and insurance companies. And although 91 percent of EGX-30 companies formally have audit committees,<sup>17</sup> their mandate, composition, and working procedures are not consistently defined and publicly disclosed by the board. Other board-level committees, for example committees on nomination and/or corporate governance (35%), and remuneration (45%), are not widely established in practice.<sup>18</sup> Due to a lack of independent directors, audit (and other) committees are unlikely to provide adequate assurance to investors. In fact, a number of audit committees (29 percent) are known to be composed of executives.

***Executive remuneration is not consistently linked to longer term performance, and is not properly disclosed.*** The corporate governance framework does not effectively differentiate between executive and non-executive remuneration. Most executive and non-executive director remuneration packages are often decided on by the chairman of the board and/or majority owner as opposed to an independent remuneration committee. Both executive and non-executive directors that sit on the boards of the largest Egyptian companies earn board fees that are considered commensurate with their responsibilities; the directors of most other companies tend to collect low board fees.

Of particular concern is that executive remuneration does not appear to be tied to the long-term performance of the company (in only 39.3 percent of companies)<sup>19</sup>. Most executive compensation packages consist of fixed and variable components; the only variable component forms part of the annual share of profits of ten percent of net income that is paid-out to all board members, regardless of their status as executive or non-executive directors, or indeed their or the company's long term performance. Four percent of companies had option plans for their executives, although market participants confirmed that an increasing number of companies were implementing such long-term option plans.

For non-executive directors, 57.6 percent receive meeting-attendance fees, however, only a fraction (14.8 percent) receive additional fees for work in committees or for serving as board chairmen (7.1 percent).<sup>20</sup> As previously stated, few companies have remuneration committees, let alone composed of independent directors.

<sup>16</sup> Of note is that in absence of a definition of an independent director in Egypt, data on the number of independent directors on the boards of Egyptian companies is likely to be flawed.

<sup>17</sup> 2007 IFC MENA-wide Corporate Governance Survey.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

 **Board working procedures**

***Most companies have secretaries to the board and not professional company secretaries.*** Company secretaries are mentioned in the law, though their role is that of a secretarial assistant rather than a professional advisor to the board. Seventeen percent of companies have a full-time company secretary. Boards typically meet four times per year, in-line with the legal requirement, which good practice would however consider wanting in terms of effectively discharging their duties. The quality of board briefing papers vary widely from company, though market participants claim that the majority of companies outside the EGX-30 are thought to have underdeveloped board briefing papers that enable strategic decision-making and proper oversight, even if these are delivered on a timely basis (one week) before the meeting in 82 percent of cases.<sup>21</sup>

 **Board training and self evaluation**

***Except for EGX's ten to 30 largest companies, most boards do not monitor corporate governance.*** Only 8.6 percent of boards carried-out self-evaluations,<sup>22</sup> considered by many as a key component in ensuring that boards carry-out their responsibilities efficiently. The EIoD has accredited over 100 directors, managers, and regulators to date, training these on how to implement good corporate governance. Director training is not, however, widely accepted, and cultural barriers vis-à-vis continuous professional education remain and need to be overcome to further raise awareness of good corporate governance. Ninety-four percent of companies did not offer training programs on corporate governance for their directors. Boards are encouraged to hire outside experts, in-line with good practice, however, a number of boards allow these (unelected) experts to serve on the board and its committees, which runs counter to good practice.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

# Key findings

## Disclosure and transparency

### Financial reporting

*Financial disclosure is thought to have improved significantly over the years, both in terms of quality and timeliness, though quality is still thought to be somewhat of an issue.* All listed companies must produce audited annual financial statements in accordance with EAS. Any listed company with 100 shareholders or more must further produce audited semi-annual financial statements within 90 days following the end of the financial year, as well as quarterly statements that are reviewed by the external auditor after 45 calendar days of the end of the quarter.<sup>23</sup> Stringent enforcement by the EGX and CMA, which are fining companies L.E. 2,000 per day for not submitting their financials in a timely manner, have led companies to comply with this regulatory requirement. In practice, the Accounting and Auditing ROSC finds that the quality of financial disclosure is thought to have improved greatly, though some concerns remain in the application of the new EAS.<sup>24</sup>

### Non-financial reporting

*Non-financial disclosure, on the other hand, remains largely inadequate, in particular for companies outside the EGX-30.* While most of the non-financial disclosure recommendations of the OECD Principles are required or encouraged, few are complied with in practice.<sup>25</sup> For example, the remuneration policy for board members was disclosed by only 13 percent of EGX-30 companies in 2007. Disclosure of related party transactions remains haphazard, though the recent introduction of EAS, in particular the equivalent to IAS 24.1 regulating the disclosure of related party transactions, should help to improve disclosure in this area.<sup>26</sup> Only 16 percent of EGX-30 companies disclosed their governance structures, such as board level committees, and 13 percent did so with respect to the role and functioning of the board. Three percent of EGX-30 companies disclosed policies with respect to their internal audit, internal control, and external audit processes. And finally, ownership structures and arrangements are disclosed by 43 percent of EGX-30 companies; only ten percent disclose changes to their shareholding structure. More recently, a number of EGX-30 companies have launched separate corporate governance sections in their annual reports and efforts are underway by all stakeholders to improve upon non-financial disclosure.

<sup>23</sup> Quarterly statements are submitted with a limited review report which does not include an opinion. Companies with more than 25 percent state ownership must be audited by the Central Audit Agency.

<sup>24</sup> A new draft of the APL, which has been under discussion for some ten years, is in the final stages of completion and should help improve accounting and auditing practices in Egypt, in particular with respect to the: (i) introduction of professional qualification examinations for accountants; (ii) recognition of audit firms and individual auditors as providers of statutory audit services; (iii) emphasis on coordination among professional accountancy organizations through the creation of a council for accounting and auditing; and (iv) enhancement of auditors' independence.

<sup>25</sup> The following data on disclosure is from "the 2007 Review of the implementation of corporate governance disclosures: case study Egypt. A note by the UNCTAD secretariat and the American University of Cairo."

<sup>26</sup> Related party transactions are to be disclosed in financial statements according to IAS 24. Also, LRs require companies to immediately disclose related party transactions by directors or shareholders.

 Accounting and auditing standard setting process

**EAS and ESA are based on international standards.** Financial statements must be prepared in accordance with 35 EAS, which, since 2008, are largely in conformity with IFRS,<sup>27</sup> and audited in accordance with ESA, which in turn are based on International Standards on Auditing (ISAs).<sup>28</sup> The Permanent Committee for Standards of Accounting and Auditing is responsible for setting EAS and ESA.<sup>29</sup> In practice, the Egyptian Society of Accountants and Auditors (ESAA) translates and/or drafts EAS and ESA, and then submits these to the Permanent Committee for discussion and approval. The final version of new or amended EAS and ESA is then sent to the MoI for issuance by ministerial decree. The Permanent Committee for Standards of Accounting and Auditing is not required as such to consult with the public when issuing new accounting standards or interpretations; however, because in practice the ESAA has the main responsibility for drafting EAS and ESA, and represents the accounting and auditing profession, key stakeholders are thus consulted on a *de facto*, if not *de jure* basis. A separate CBE committee is in turn responsible for developing and implementing accounting and financial reporting requirements for the banking sector. The CBE issued a new guidance on financial reporting for the banking sector in December 2008 and banks are now preparing financial reports in-line with IAS/IFRS. The approval process for EAS and ESA for banks and companies as led by the Permanent Committee and CBE remain separate and thus risks leading to separate standards for banks and companies.

 Shareholder access to information

**Financial and non-financial information is not easily accessible by investors.** Information is publicly available through five main channels: (i) the Companies Directorate within GAFI, which keeps company statutes, as well as AGM, extraordinary general meeting of shareholders (EGM), and board minutes; (ii) periodic and material disclosure made to the EGX and CMA, which is immediately available to brokers and investors; (iii) information that is physically available at the company's headquarters; (iv) summary financial statements published in the newspaper; and (v) information on company websites.

Outside of the EGX-30, few companies appear to provide financial information to shareholders online. Few of the listed companies have investor relations officers, and only a handful of the EGX-30 companies have launched investor relations pages on their websites allowing investors to access company information. Only the leading EGX-30 companies publish annual reports on their internet sites of comparable quality to those developed by their peers in other emerging market countries.

Enhanced electronic filing systems have been developed by the EGX and CMA, and the annual financial statements are available online for limited (three day) periods on the EGX website, after which they are only available for a fee via an EGX subsidiary.

<sup>27</sup> There are four key difference between EAS and IFRS, specifically with respect to the: (i) recognition of financial leases and the application of accounting treatments required under the relevant international standard; (ii) the re-evaluation of fixed assets, which is not allowed by Egyptian law; (iii) the accounting treatment for employee and director profit sharing, in that they are treated as dividends and not expenses; and (iv) general provisioning requirements for banks.

<sup>28</sup> There are no Egyptian standards on auditing as such; instead the regulatory framework prescribes the use of International Standards on Auditing, as prepared by the International Federation of Accountants (IFAC's ISAs), which are translated into Arabic. The new audit standards were to be applied on financial reports issued by companies for the fiscal year 2008.

<sup>29</sup> The Permanent Committee was established by the Ministry of Trade in 1997. It reports to the MoI, is chaired by the chairman of the CMA, and comprises nine members, including representatives from the ESAA, the Syndicate, CAO, CBE, MFA, EISA, and GAFI.

# Key findings

## Risk, controls, and audit processes

### Risk management and control structures

**Few companies are thought to have robust risk management and internal control procedures in place.** The ECGC encourages company boards to establish a risk management function and the LRs require the board to examine and review the company's internal control systems through the audit committee. Boards are further required to review accounting policies, review financial statements, and related party transactions through the audit committee, however, are not required or encouraged to ensure for the integrity of the financial reporting process. In practice, 78 percent of boards stated that they were responsible for overseeing risk management in their companies. On the other hand, only 40 percent stated that they have a dedicated risk officer or function in place. Specific to banks, only 13.3 percent had board-level risk committees; and although 86.7 percent of banks stated that they had established management level risk functions, only 12.5 percent cited having any reporting line to the board or board committee.

### The Internal audit function

**Where existent, the internal audit function is thought to lack independence.** The ECGC encourages companies to establish an internal audit function. Against good practice, the ECGC does not call for the internal audit function to be independent, and the ECGC specifies that the chief internal auditor is to be appointed, reappointed, and dismissed by the chief executive officer (CEO) and not the board's independent audit committee as per good practice (though the ECGC does specify that the chief internal auditor's nomination is subject to the approval of the audit committee). Moreover, the chief internal auditor is to report directly to the CEO and not the board's independent audit committee, though s/he may have direct contact and consultation with and is to submit a quarterly report to the board (though to the board's supervisory and not audit committee). In practice, 91.4 percent of companies cited having an internal audit function, however, 91 percent of these audit functions in fact implemented internal control activities and reported to the CEO and not the board's independent audit committee as good practice dictates. In banks, the head of internal audit reported to the CEO in 53 percent of cases and only 29.4 percent cited a reporting line to the board's audit committee.<sup>30</sup>

### The external audit

**Boards nominate and shareholders approve the external auditor, however, nomination processes are frequently controlled by insiders.** The LRs require the audit committee to propose the external auditor's appointment and fees, and the CL requires the board to propose and shareholders to approve the nomination of the external auditor. In practice, the board—albeit without input from an independent audit committee and a formalized nomination process—nominates the external auditor for shareholder approval, and the AGM formally elects the auditor and approves the auditor's compensation in 84.8 percent of companies.<sup>31</sup> The CMA has

<sup>30</sup> 2007 IFC MENA-wide Corporate Governance Survey.

<sup>31</sup> Ibid.

recently developed a registry of auditors that listed companies and non-bank financial institutions must use when selecting their external auditor. The CBE has its own registry for banks. Auditors are liable for misrepresentation and errors, and are required to compensate the company and/or shareholders, if found guilty.

Of note is that the board through its audit committee is not required to ensure for the integrity for the external audit vis-a-vis shareholders. While the audit committee is required and encouraged to monitor the work of the external auditor, there is no requirement for the external auditor to report to the board's audit committee.

*Auditor independence is addressed in the legal and regulatory framework, however, not consistently complied with in practice.* To ensure for auditor independence, the auditor must not be associated with company, board, or employees. The auditor may further not become a director or employee of the company within three years of having conducted the external audit. Auditors are forbidden to provide non-audit services to their clients on "a permanent basis", and a number provide consulting services to their clients, with 62 percent providing tax services and 23 percent legal services.<sup>32</sup> Moreover, auditors often remain with their clients for extensive periods, often exceeding ten years, which is likely to negatively influence auditor independence.

*An audit oversight unit within the CMA was recently established.* The CMA recently established an audit oversight unit to better regulate and monitor the audit profession and better impose penalties on those who do not conform to ESA, in addition to establishing more stringent procedures for auditor licensing, examination, and continuous professional education. It is too early to assess how effectively this audit oversight unit is able to regulate and monitor the audit profession, however, the auditors oversight unit has already issued new listing, delisting, sanction, and quality assurance procedures. Of note is that the unit was recently accepted as a member of the International Forum of Independent Audit Regulators (IFIAR).<sup>33</sup>

#### Compliance

*While boards are encouraged to ensure that the companies they head are fully compliant with laws and regulations, few companies are thought to have an effective compliance function in place.* The ECGC encourages boards to set-out rules, regulations, and procedures ensuring the company's compliance with existing laws and regulations (though the corporate governance framework does not require or encourage boards' compliance policies to extend to subsidiaries). Most companies in the real sector are not thought to have compliance policies or functions in place. The corporate governance framework does not generally highlight the importance of the compliance functions for banks and financial institutions.

<sup>32</sup> 2007 IFC MENA-wide Corporate Governance Survey.

<sup>33</sup> IFIAR was established in September 2006 to help improve external audit quality and thus strengthen investor protection by. See [www.ifiar.org](http://www.ifiar.org).

# Key findings

## Shareholder rights

*A number of basic shareholder rights are contained in the legal and regulatory framework, properly enforced, and complied with in practice.* Specifically: (i) methods of ownership registration are secure and registration with the Misr for Central Clearing, Depository, and Registry (MCSD) provides legal proof of ownership; (ii) shares are freely transferable and previous restrictions, in particular mandatory shares for directors, have been removed from the CL; (iii) relevant information on the corporation (e.g. articles of association, financial information) can be obtained; (iv) shareholders are allowed to vote in the general meeting of shareholders (GMS); (v) shareholders are able to elect directors, though the nomination and election processes are dominated by insiders; and (vi) shareholders share in the profits of the corporation.



### Participating in the GMS

*Direct or indirect shareholder participation, questioning, and voting in the GMS is required and broadly complied with in practice.* Shareholders do have the right to participate and vote in the GMS. Shareholders representing five percent of capital may add items to the GMS agenda. Shareholders have the right to submit written questions on any topic and also pose oral questions during the GMS, which the board is required to answer (unless the company's interest is affected). Voting is to be conducted by secret ballot in specific instances, such as during the election or removal of directors, in-line with good practice. Shareholders are able to vote in person or in absentia;<sup>34</sup> electronic voting is possible, though not practiced.

*Shareholders generally receive timely, if insufficient information prior to the GMS.* Shareholders are generally furnished with sufficient information concerning the date, location, agenda, and other relevant information of the GMS, which is made available at the company's premises. The notice period of 15 days may be insufficient for shareholders, in particular foreign institutional shareholders, to effectively participate in the GMS, although the majority of companies either adhered to (69 percent) or even exceeded (31 percent provided 20 days) this timeline.<sup>35</sup>

*Shares within any series of a class are treated equally and investors are able to obtain information about the rights attached to shares.* "One share, one vote" exists for common shares. Preferred shares may have privileges in terms of voting, receive a fixed percentage of dividends to be paid before other dividends, or have priority in liquidation. In practice, voting rights are capped at two votes per share, but there is no legal limit. All investors are able to obtain information about the rights attached to all series and classes of shares. These rights are included in the company's articles of association, which are publicly available at the company's headquarters or GAFI's Companies Directorate, however, are rarely available via the internet.

<sup>34</sup> Proxy voting is subject to certain limitations: if the proxy is a physical person, then the proxy must be a shareholder, have a power of attorney, cannot be a board member, and cannot represent more than ten percent of total shares and 20 percent of represented shares at the meeting. These requirements do not apply to institutions (legal persons).

<sup>35</sup> 2007 IFC MENA-wide Corporate Governance Survey.

 Nominating and electing directors

**Boards do not generally ensure for a formal and transparent director nomination and election processes.** The corporate governance framework requires companies to provide shareholders with detailed copies of directors' *curricula vitae*, however, does not expressly assign boards the role of overseeing board nomination processes. Shareholders holding five percent or more of shares who submit board nominations are thus not assured that the board, or a board-level nominations committee, properly reviews proposals in a strategic manner, if at all, for example, with a view towards creating an appropriate mix-of-skills. The corporate governance framework does not require or encourage non-executive, ideally independent directors to play a role in the director nomination process. In practice, while shareholders are able to formally elect directors during the AGM, the board nomination and election processes are typically controlled by the majority owner and far from formal and transparent. Cumulative voting is encouraged but ineffective in practice.<sup>36</sup> The result is that many boards in Egypt are constituted with family members, government officials, and related parties and are often chosen for their loyalty to the majority owner and not primarily for their skills and objectivity.

 Sharing in the company's profits

**Shareholders are generally able to share in the profits of the company.** Shareholders have a legal right to share in the profits of the company through declared dividends, based on a proposal from the board and a valid GMS resolution. The board is required to implement the GMS's resolution regarding the distribution of profits within one month. Of note is that shareholders have the right to propose the distribution of a higher dividend payout, if defined in the company's articles of association. In practice, boards do propose and shareholders approve dividends, and dividends are distributed to shareholders by companies through the MCSD, which was specifically lauded by Thomas Murray<sup>37</sup> for its ability to distribute dividends in an effective and timely manner. Contrary to good practice, most companies are not encouraged to develop and disclose dividend policies, and few do so in practice.

 Ex ante minority shareholder protection mechanisms

**Shareholders generally do have the right to participate in and be sufficiently informed on decisions concerning fundamental corporate changes. Extraordinary transactions, on the other hand, do not require shareholder approval; pre-emptive rights<sup>38</sup> are accorded to shareholders when included in the company's articles of associations.** The legal and regulatory framework provides for some *ex ante* protective measures, specifically qualified voting on key issues through the EGM. In-line with good practice, a two-thirds majority vote of attending shareholders is required to modify the articles of association, waive pre-emptive rights (if granted in

<sup>36</sup> Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.

<sup>37</sup> Thomas Murray specializes in rating central securities depositories. It has assigned an overall central securities depository risk rating of "A" or "low risk" to the MCSD, with a stable outlook.

<sup>38</sup> Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.

the articles of association), or add new company objectives, and a *three-fourth* majority is required to, *inter alia*, increase or reduce the authorized capital, change company objectives, and decide on the dissolution, merger, or voluntary delisting.<sup>39</sup> Share repurchases are allowed and treasury shares can be held up to one year before they must be cancelled.

Pre-emptive rights are accorded to shareholders by law when included in the company's articles of association. Boards may increase share capital within the limits of authorized capital, without specific shareholder authorization; for all other instances, shareholder approval is required.

Extraordinary transactions do not require shareholder approval, against good practice, even if all transactions of fixed assets require approval by the EGM.<sup>40</sup>

#### Ex post minority shareholder protection mechanisms

**Court enforcement remains weak and shareholder complaints to the CMA are the best means to hold boards accountable.** Shareholders, in particular minorities, are only partially protected from potential abusive actions by controlling shareholders. More specifically:

- Shareholders who attend the AGM and register their opposition in the minutes can initiate a case in court. In practice, shareholder suits are the exception due to an ineffective and ineffective court system.
- Shareholders have withdrawal rights<sup>41</sup> in limited cases, and are for example able to withdraw from the company in the case of a merger.
- The most powerful form of redress may be a special power of the CMA. Shareholders can submit a complaint to the CMA, which has the power to suspend AGM resolutions that may treat a given group of shareholders unfairly. When acting in this role, the CMA effectively becomes a special court for shareholder disputes.

#### Protecting shareholders from insider trading

**Insider trading and market manipulation are recognized as ongoing, albeit diminishing issues by most market participants.** The Egyptian government, in particular the MoI, CMA, and EGX have taken strong measures against insider dealing and market manipulation. The CMA has, *inter alia*, developed an insiders' database of directors and executives. Insiders now report close supervision, and the LRs require that board members and executives inform the EGX and CMA 24 hours before making any trades, and this information is then published. Blackout periods also exist for insiders. Fines and penalties, as previously mentioned, have also been raised up to L.E. 20 million and imprisonment of up to five years. Previously, individuals who were found guilty of insider trading faced at least two years of imprisonment and/or fines between L.E. 20,000 to 50,000, largely considered insufficient to serve as an effective warning. Moreover, the terms insider, inside

<sup>39</sup> See Art. 68 and 70 CL. EGM resolutions must be issued by a two-thirds or three fourths majority of the shares represented in the meeting, and the meeting is only valid if attended by shareholders representing at least half of the capital (if the first quorum is not met, a second meeting may be called within 30 days and deemed valid if shareholders representing at least one-quarter of the capital are represented).

<sup>40</sup> Only when the sale of major assets are conducted as a (hidden) form of liquidation, or when the transaction is in the form of a merger or acquisition, is shareholder approval required. On the other hand, all transactions of fixed assets require approval by the EGM.

<sup>41</sup> Withdrawal rights (sometimes referred to in other jurisdictions as the "oppressed minority", "appraisal", or "buy-out" remedies) provide shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

information, material information, insider dealing, related groups, and price manipulation, were comprehensively defined and tightened in amendments introduced to the CML-ER in 2006, in-line with good practice, and also expressly stated in the LRs. The government has also introduced stringent regulations for financial intermediaries (e.g. tighter licensing and corporate governance requirements).

 **Protecting shareholders from related party transactions**

*The legal and regulatory framework regarding related party transactions has been strengthened, though abusive related party transactions are thought to be an ongoing investor concern.* The CL provides additional protections against related party transactions. Directors are no longer allowed to conclude contracts with companies where board colleagues are directors, and companies cannot make loans to directors. Conflicted directors must notify the board, have their conflict recorded in the meeting minutes, and abstain from voting, in-line with good practice; the LRs then require the board to notify the AGM and seek shareholder approval before concluding the related party transaction. Most AGMs, however, appear to grant blanket approvals on an *ex ante* basis, against good practice. Directors must also obtain special authorization from the AGM to do business in the same sector as the company, or to be a party to any contract submitted to the board for approval. The LRs furthermore require audit committees to express an opinion on related party transactions; however, until independent directors are appointed to and form a majority on audit committees, potential abuses will continue to pose a risk.<sup>42</sup> Finally, with the recent amendments to EAS, companies are now required to fully disclose related-party transactions in their financial statements. In practice, company disclosure of related party transactions is thought to be wanting, given the recent adoption of new EAS.<sup>43</sup>

<sup>42</sup> According to the 2007 IFC MENA-wide Corporate Governance Survey, only 40.6 percent of companies had audit committees with a majority of independent directors.

<sup>43</sup> The Egypt Accounting and Auditing ROSC found that several of the notes to the financial statements of banks did not contain disclosures for related parties at all; in others there is only information on some outstanding balances, however no definition on the related party relationship.

# Key findings

## Commitment and enforcement

### The legal and regulatory framework

**Important legal reforms have been achieved, while keeping differences in company size and sectors in mind.** The government has introduced a number of legal and regulatory reforms to improve the corporate governance framework since the first ROSC in 2001, for example, amending the: (i) LRs to require audit committees and generally strengthen disclosure; (ii) CML to combat insider dealing, (iii) CL to no longer require directors to hold guarantee shares; and (iv) APL to bring EAS in-line with international standards. In doing so, the government has weighed the costs and benefits of reforms, and their effects on company performance. For example, in 2006 the CMA refrained from launching a regulation that would have imposed overtly stringent corporate governance requirements on companies, such as mandating companies to adopt remuneration and nomination committees.

**The ECGC, one of the region's first, constituted a major step to improve corporate governance, however, an important opportunity was lost when it was issued on a voluntary basis.** The ECGC was launched in 2005 and has played a key role in building awareness and setting a standard of good practice. However, the ECGC does not consistently follow international good practice recommendations, and compliance is voluntary. Adherence to the ECGC is thus low—only 34.3 percent of companies state that they follow the ECGC<sup>44</sup>—and investors consequently do not benefit from high levels of corporate governance disclosure.

### Commitment to build independent and effective enforcement institutions

**Important institutional reforms were made, including the creation of the MoI, reorganization of the CMA and EGX, and development of new economic courts.** More specifically:

- The MoI was established in 2004 and has spearheaded numerous corporate governance reform efforts, including the creation of the EIOPA, the region's first, as well as launch of governance guidelines for SOEs.
- The CMA, which is responsible for developing, regulating, and enforcing the capital markets, has helped strengthen corporate governance by, for example creating a Corporate Governance Department to review company disclosure and improving its market surveillance and follow-up proceedings.<sup>45</sup> Staff retention has improved, but remains an issue. While the CMA is considered independent, its chairman is appointed by Presidential decree and reports to the MoI; parliament neither approves the chairman's nomination nor receives reports from the CMA.

<sup>44</sup> 2007 IFC MENA-wide Corporate Governance Survey.

<sup>45</sup> Egypt, ranks in the 43<sup>rd</sup> percentile on the WGI in terms of regulatory effectiveness. The CMA is moving to a risk-based regulatory approach, focusing less on enforcing laws and regulations *ex post*, but more on identifying potential risks and taking preventative, *ex ante* actions.

- Market participants confirm that Egypt's court system remains inefficient in terms of time and costs, and cite the issue of legal uncertainty with respect to rulings.<sup>46</sup> Egypt recently created specialized economic courts to settle investment-related disputes. Given that these courts were only recently established, it is too early to judge the effects on the efficiency of court proceedings. In the meantime, alternative dispute resolution is widely considered the only viable alternative to the court system.<sup>47</sup>
- The EGX is considered to be an independent, self-regulatory organization and has improved its monitoring of LRs over the past few years, in particular with respect to financial disclosure. It has overseen the delisting of a majority of EGX companies, from a high of 1,148 in 2002 down to 333 in 2008. It is in the process of installing a new market monitoring system to further strengthen market surveillance. The EGX's own corporate governance structures, policies, and practices, remain nascent, in particular at the board level, and it does not publish its annual report online. The EGX is, however, now in the process of implementing improved corporate governance and disclosure practices.

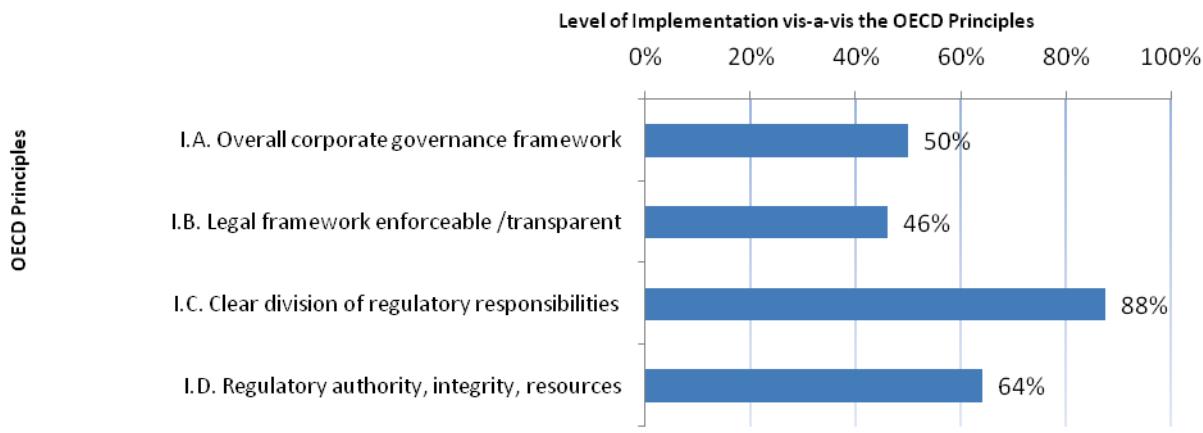
<sup>46</sup> According to the Doing Business Index, Egypt currently ranks 151<sup>st</sup> globally for enforcing contracts.

<sup>47</sup> Both the Cairo Regional Centre for International Commercial Arbitration in Cairo and Alexandria and Sharm El Sheikh International Arbitration Centre enjoy the trust of market participants in Egypt and the wider MENA region.

# Assessment and Recommendations

## Chapter I of the OECD Principles

Figure 4: Egypt's implementation of Chapter I of the OECD Principles



As can be seen from Figure 4, Egypt has on average *partially implemented* Chapter I of the OECD Principles,<sup>48</sup> which calls for the corporate governance framework to promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory, and enforcement authorities.

While capital markets have responded positively to corporate governance and other reforms, and a number of improvements have been made to the legal and regulatory framework, important challenges remain:

- An absence of engaged institutional investors leaves decision-making in the hands of majority owners and insiders, with underdeveloped market discipline.
- The preponderance of family ownership brings a unique set of governance issues.
- Overlapping provisions and inconsistencies causes some legal uncertainty.
- The institutional framework has been strengthened and enforcement capacity has improved markedly, yet important enforcement gaps in, for example, non-financial disclosure, continue.

<sup>48</sup> A Principle is deemed to be '**fully implemented**' when 95 percent or more of a Principle's Essential Criteria are met (see the Annex for the list of Essential Criteria, as well as the World Bank's assessment methodology of the Essential Criteria). A Principle is '**broadly implemented**' where one or more of the applicable Essential Criteria are less than fully implemented (75 – 94.9 percent) in all material respects. A Principle is '**partially implemented**' when 35 to 74.9 percent of a Principle's essential criteria have been met. A '**not implemented**' assessment likely is appropriate where major shortcomings exist, i.e. less than 35 percent of a Principle's Essential Criteria have been implemented. A '**not applicable**' (n/a) assessment is appropriate where an OECD Principle (or one of the Essential Criteria) does not apply due to structural, legal or institutional features.

- The independence of the market oversight framework vis-à-vis the executive government should be strengthened to ensure for maximum regulatory impact.
- Key SROs should themselves follow good corporate governance.

To further close the gap between Egypt's corporate governance framework and Chapter I of the OECD Principles, the government of Egypt should consider the following reforms:

 **Short-term priorities**

- The EIOPA should amend the ECGC through an extensive and transparent consultation process to better reflect good practice; the EGX should subsequently amend and CMA approve an amendment to the LRs, requiring companies to adopt the ECGC on a 'comply or explain' basis.
- The CBE should finalize its corporate governance code or regulations for banks and EISE for insurance companies; ensuring that these are consistent with the new ECGC.
- The EGX should publish its annual report. The EGX and MCSD should, moreover, build on current efforts to enhance their corporate governance practices and fully comply with the ECGC.
- Given the desirability of a wider public float, the CMA and/or EGX should consider raising the minimum public float encourage companies (and their controlling shareholders) with narrower floats to sell additional shares into the market.
- The development of a more vibrant base of institutional investors – now under-developed (see Chapter 5) -- would likely promote additional trading of larger blocks of shares and thereby improve liquidity and price discovery.

 **Medium-term priorities**

- The MoI should re-commit itself to pursue a uniform company law, a new draft of which has already been prepared, with a view towards consolidating the many company law provisions that are scattered across a wide variety of laws, regulations, and decrees, into one principle document.
- The CBE should define a set of 'fit and proper' criteria for shareholders, directors, and managers. The CMA (now EFSA) should continue to step-up enforcement actions of laws and regulations.
- The CMA and EGX should pay particular attention to enforcing company adherence to the comply-or-explain regime of the new ECGC, once passed. The CMA's independence from the executive should be strengthened, ensuring for a reporting line to parliament in addition to the MoI, and the CMA's chairman should be approved by parliament.
- The government should continue with the establishment of economic courts. Court rulings should be made publicly available.
- English language versions of relevant laws and regulations should be newly drafted or reviewed, and designated as official translations.

A more detailed set of recommendations can be found in Annex 1.



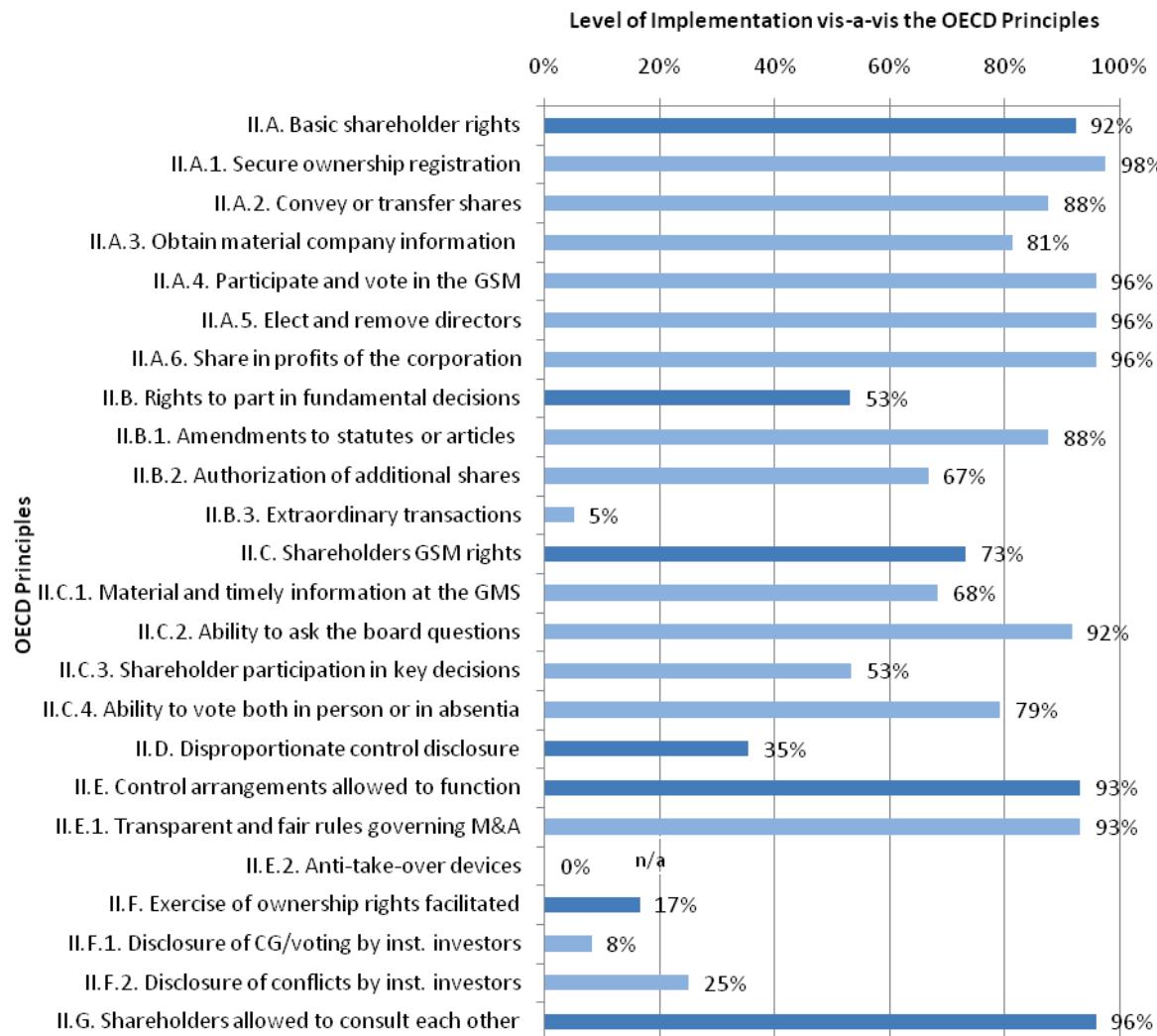
**Learn More**

See the Corporate Governance ROSC Database for a comprehensive gap analysis and set of recommendations vis-à-vis Egypt's implementation of Chapter I of the OECD Principles.

# Assessment and Recommendations

## Chapter II of the OECD Principles

Figure 5: Egypt's implementation of Chapter II of the OECD Principles



As can be seen from Figure 5, Egypt has on the whole *partially implemented* Chapter II of the OECD Principles, which calls for the corporate governance framework to protect and facilitate the exercise of shareholders' rights.

Basic shareholder rights have been incorporated in the legal and regulatory framework. Direct or indirect shareholder participation, questioning, and voting is mandated and enforced as well. On the other hand:

- Extraordinary transactions are not generally subject to GMS approval.
- Institutional investors do not typically vote or engage with their investee companies.

To further close the gap between Egypt's corporate governance framework and Chapter II of the OECD Principles, the government of Egypt should consider the following reforms:

 **Short-term priorities**

- The ECGC should be amended to encourage: (i) all directors, when possible, to attend the GMS; (ii) companies to issue a note to all shareholders explaining their rights; (iii) companies to adopt and disclose policies on dividends; (iv) institutional investors to develop and disclose voting policies, to vote and to disclose their actual voting, and to develop policies on whether and how to affect the corporate governance of their investee companies; (v) institutional investors to further develop and disclose policies for dealing with conflicts of interest.

 **Medium-term priorities**

- The CMA and Companies Department should improve their enforcement efforts with respect to the dissemination of relevant information regarding the issues to be decided on during the GMS.
- The CL and its ERs should be amended to, inter alia: (i) provide shareholders with mandatory pre-emptive rights; (ii) specify that extraordinary transactions above a specific threshold or of a special type are subject to a two-thirds majority shareholder vote; (iii) allow shareholders to review executive compensation policies and approve non-executive compensation; (iv) allow other individuals who are not shareholders to serve as a proxy; (v) provide shareholders holding a defined percentage of shares with access to the shareholder list before the GMS to coordinate voting.
- The CML or LR should: (i) require companies to fully disclose their ownership structure; (ii) provide shareholders the right to obtain information on the company's capital structure; and (iii) require shareholders to disclose shareholdings above five percent on an ongoing basis to the CMA, EGX, and other shareholders. As the market for corporate control develops, the CML or its ERs should require directors and senior executives to follow a duty of loyalty during takeovers, and limit or outright restrict the use of anti-takeover mechanisms.
- The CSDRL should be amended to specify that the MCSD is to be independent from special interests, and have a funding source and nomination process for its chairman that protects its independence.

A more detailed set of recommendations can be found in Annex 1.



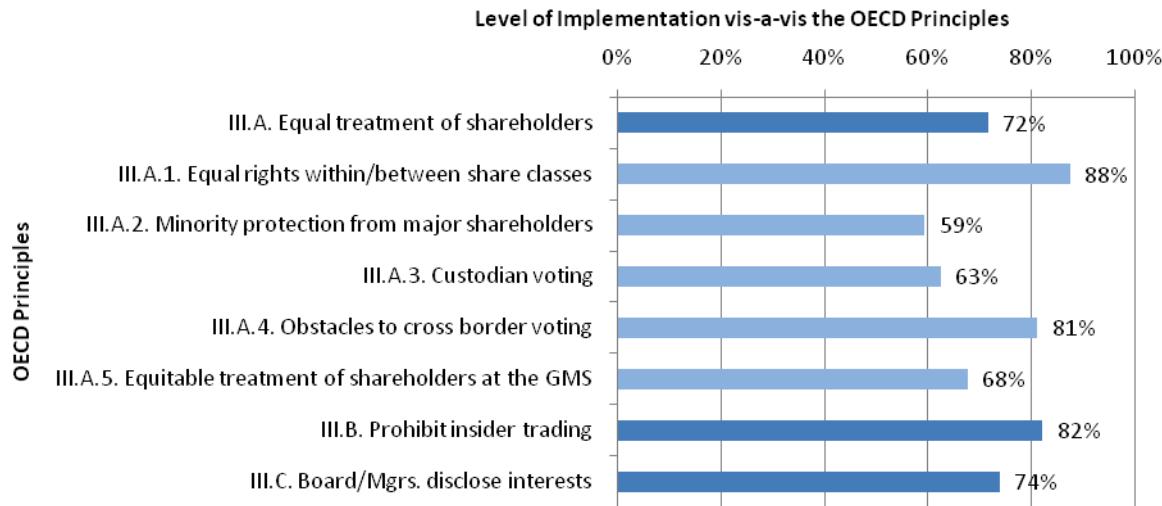
**Learn More**

**See the Corporate Governance ROSC Database for a comprehensive gap analysis and set of recommendations vis-à-vis Egypt's implementation of Chapter II of the OECD Principles.**

# Assessment and Recommendations

## Chapter III of the OECD Principles

Figure 6: Egypt's implementation of Chapter III of the OECD Principles



As can be seen from Figure 6, Egypt has *broadly implemented* Chapter III of the OECD Principles of Corporate Governance, which calls for the corporate governance framework to ensure the equitable treatment of all shareholders, including minority and foreign shareholders, and to provide all shareholders the opportunity to obtain effective redress for violation of their rights.

Shareholders are generally treated equitably; however, minority shareholders are not able to effectively hold the board accountable through a functioning court system.

More specifically:

- Shares within a class are treated equally.
- Court enforcement remains weak; shareholder complaints to the CMA are the best means of holding boards accountable.
- Insider trading and market manipulation are recognized as ongoing, albeit diminishing.
- Related party transactions are relatively common, though shareholder rights are protected by law, if not always in practice.

To further close the gap between Egypt's corporate governance framework and Chapter III of the OECD Principles, the government of Egypt should consider the following reforms:

 Short-term priorities

- The ECGC should encourage companies to: (i) develop policies on how to effectively manage conflict of interest and related party transactions; (ii) ensure that conflicted board members excuse themselves from relevant board discussions; (iii) conduct their GMS at locations that are easily accessible for shareholders.
- The CMA should closely monitor and fully enforce financial disclosure in the coming year through its newly created Financial Reporting Monitoring Unit, given the adoption of new Egyptian Accounting standards (EAS).

 Medium-term priorities

- The CL should be amended to: (i) define the circumstances under which directors and officers are liable for a breach of duties; (ii) introduce the duties of care and loyalty, and possibly the business judgment rule,<sup>49</sup> for directors and officers; (iii) clarify whether equity thresholds exist for shareholders to initiate suits, or whether any shareholder with a single share should be able to sue; and (iv) specify whether shareholders are allowed to initiate direct (personal) or indirect (on behalf of the company) suits. AGMs should further not be allowed to grant blank approvals, but authorize specific transactions or transactions up to a specified amount.
- The CML, and its ERs should be amended to: (i) formalize the "one-share, one-vote" principle for common shares, as well as the maximum cap of two votes for preferred shares; (ii) encourage intra-group transactions to be conducted fairly, at arm's length, and/or at market based pricing and terms.
- The CSDRL should require custodians to disclose their voting policy and actual voting to shareholder, when no voting instructions were given. The CSDRL should also specify who is entitled to control the exercise of voting rights when shares are held by a chain of intermediaries.

A more detailed set of recommendations can be found in Annex 1.

**Learn More**

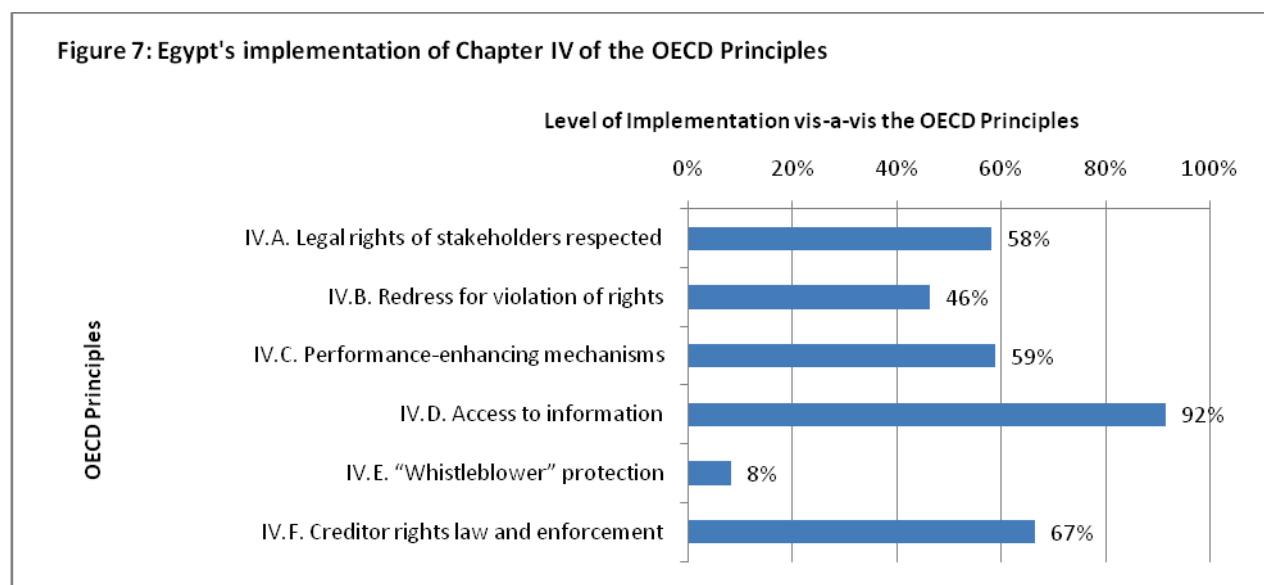
**See the Corporate Governance ROSC Database for a comprehensive gap analysis and set of recommendations vis-à-vis Egypt's implementation of Chapter III of the OECD Principles.**

<sup>49</sup> The business judgment rule is based on a US legal concept that presumes company directors to act in the *bona fide* interests of the company and courts will only rule against directors when they violate their duty of care and loyalty to manage the corporation to the best of their ability. This rule rests on the premise that a shareholder holding a single share may file a derivative lawsuit against directors. In most European systems on the other hand, shareholder are typically only able to file a suit when they, individually or collectively, own an important stake in the company (e.g. five or ten percent of capital), which lessens the importance of protecting directors. The Egyptian authorities will wish to carefully consider the legal threshold to file a suit and, only then, decide on whether to introduce the business judgment rule.

# Assessment and Recommendations

## Chapter IV of the OECD Principles

Figure 7: Egypt's implementation of Chapter IV of the OECD Principles



In aggregate, and as can be seen from Figure 7, Egypt has *partially implemented* Chapter IV of the OECD Principles of Corporate Governance, which calls for the corporate governance framework to recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

The rights of stakeholders, in particular employees, are generally protected by law, if not always in practice. Few boards actively identify the risks and opportunities of engaging with stakeholders. More specifically:

- Employees are allowed to participate in the management of the company through employee committees.
- Share reward and option programs for employees and managers are beginning to take root.
- Whistle-blowing policies are virtually non-existent.
- Creditor rights are underdeveloped and specialized bankruptcy courts inefficient.
- CSR and stakeholder governance is not properly understood as a potential risk or opportunity by boards.

On the other hand, the MoI recently established the Corporate Responsibility Center, which as part of the EIoD has taken important steps to raise awareness of CSR issues and has taken a leadership role in the region in this respect.

To further close the gap between Egypt's corporate governance framework and Chapter IV of the OECD Principles, the government of Egypt should consider the following reforms:

 Short-term priorities

- The ECGC should be amended to encourage boards to: (i) develop a policy that ensures for the company's compliance with existing laws and regulations specific to protecting the rights and interests of stakeholders; (ii) generally consider the interests of stakeholders in their decision-making; (iii) communicate or consult with employees, creditors, and the community regarding major company events; and (iv) develop whistleblower policies.

 Medium-term priorities

- The CL or other appropriate law or regulation should be updated to protect whistle-blowers. Specific recommendations on the insolvency framework are contained in the Insolvency ROSC.

 Long-term priorities

- The legal and regulatory framework should be updated to require company-based pension funds, when established, to have a sufficient number of trustees that are independent from management.

A more detailed set of recommendations can be found in Annex 1.



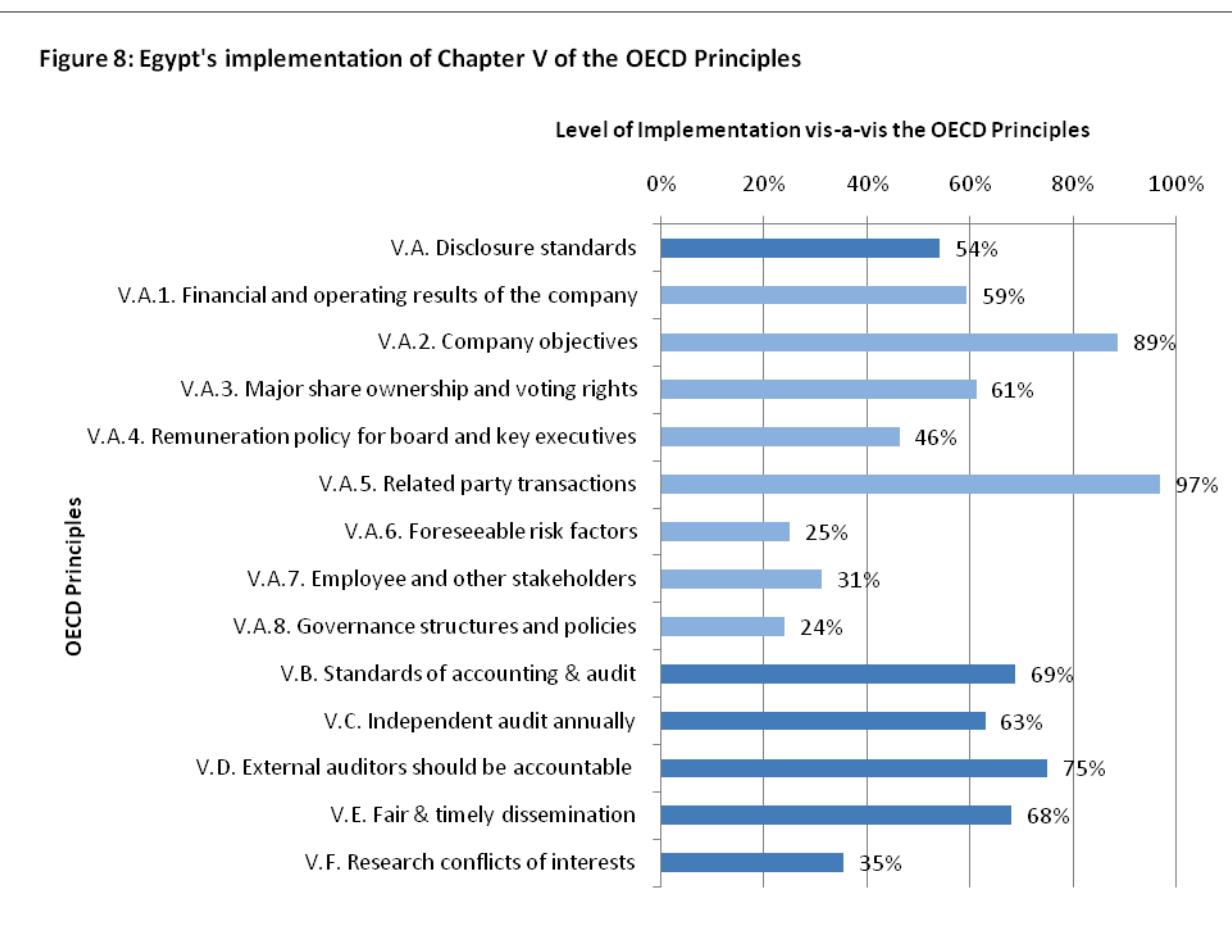
Learn More

See the Corporate Governance ROSC Database for a comprehensive gap analysis and set of recommendations vis-à-vis Egypt's implementation of Chapter IV of the OECD Principles.

# Assessment and Recommendations

## Chapter V of the OECD Principles

Figure 8: Egypt's implementation of Chapter V of the OECD Principles



In aggregate, Egypt has *broadly implemented* Chapter V of the OECD Principles of Corporate Governance, which calls for the corporate governance framework to ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Financial disclosure is thought to have improved significantly over the years. Non-financial disclosure, on the other hand, is inadequate. More specifically:

- Egyptian companies must now follow EAS that are based on IFRS (with the previously mentioned four exceptions to IFRS); auditors must follow ESA, which similarly, are largely (but not exclusively) based on ISAs.
- Non-financial reporting has improved somewhat, however, overall remains underdeveloped; e.g., only 16 percent of EGX-30 companies disclosed their governance structures and three percent their internal control and audit policies.

- The external auditors are required to be independent, though interviews show that this is not always thought to be the case in practice.
- An Audit Oversight Unit within the CMA was established in 2008 and is in its early stages of establishment.
- Material information is not easily accessible via company website, however, available online on the EGX website for a small fee.

To further close the gap between Egypt's corporate governance framework and Chapter V of the OECD Principles, the Egyptian authorities should consider the following reforms:

 **Short-term priorities**

- The LRs should require companies to publish a full annual report.
- The ECGC should encourage companies to *disclose, inter alia*: (i) the criteria it uses to define an independent director; (ii) the attendance record of board members; and (iii) the remuneration of board members and key executives, as well as the link between *remuneration* and company performance. The ECGC should define auditor independence and encourage the board to assure itself of the auditor's independence.
- The government of Egypt should renew their efforts to pass the amended Accounting Practice Law No. 133 of 1951 (APL).
- The EGX and CMA should better enforce material and timely disclosure of non-financial information.
- The EIoD together with the EGX should develop a model annual report and training course on how to develop annual reports, with a particular focus on management's discussion and analysis.

 **Medium-term priorities**

- The CL should be amended to specify whether and under which circumstances the external auditor is liable to shareholders (in addition to the company).
- The CML and its ERs in turn should be amended to: (i) ensure that the prohibition to selectively disclose information is expanded to include board members, executives, and other insiders; (ii) required rating agencies to follow IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies; and (iii) fully implement the IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest.
- The CMA and MoI will both wish to continue their enforcement efforts vis-à-vis financial intermediaries to ensure that market abuses further subsist.

A more detailed set of recommendations can be found in Annex 1.



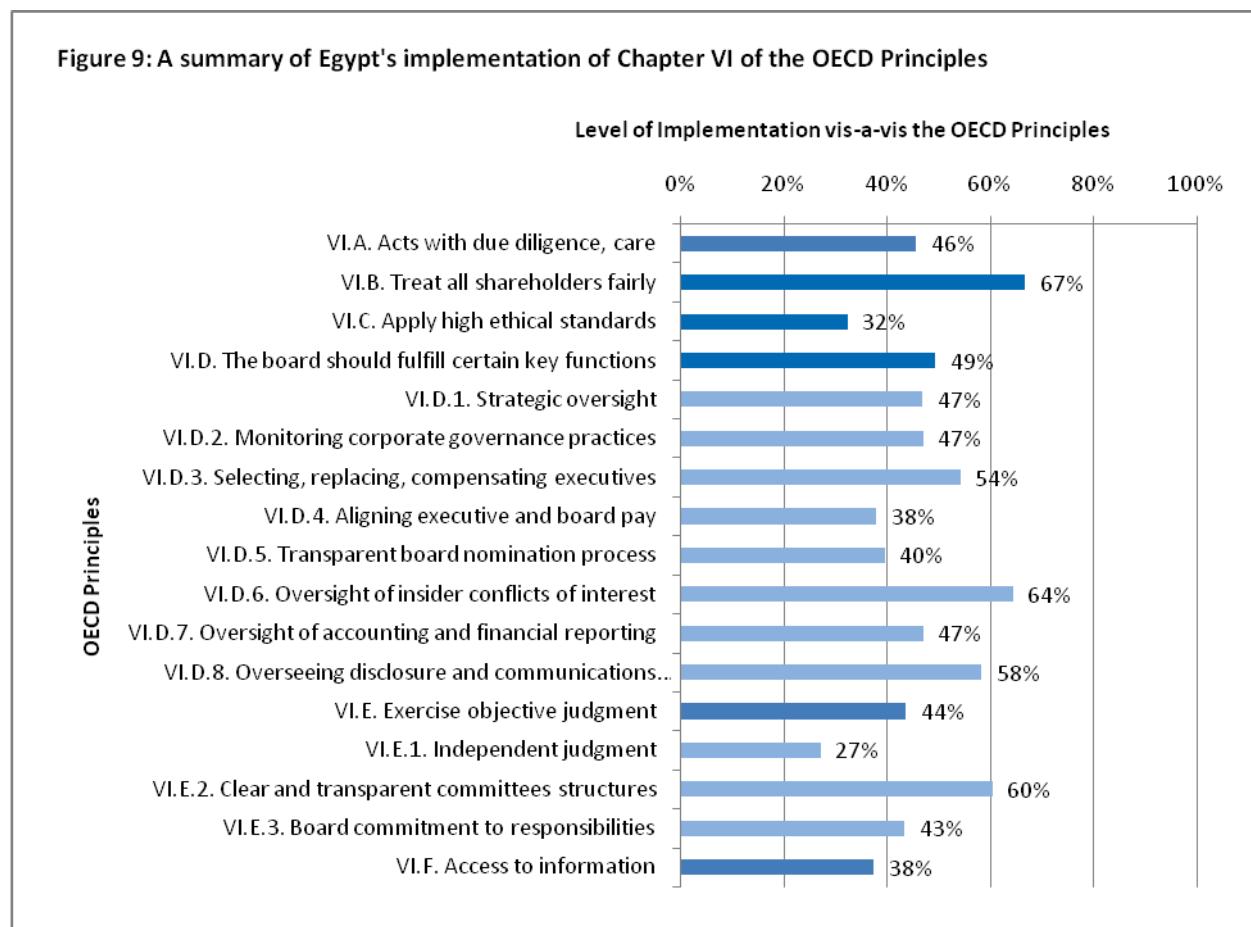
**Learn More**

**See the Corporate Governance ROSC Database for a comprehensive gap analysis and set of recommendations vis-à-vis Egypt's implementation of Chapter V of the OECD Principles.**

# Assessment and Recommendations

## Chapter VI of the OECD Principles

Figure 9: A summary of Egypt's implementation of Chapter VI of the OECD Principles



As can be seen from Figure 9, Egypt has *partially implemented* the implementation of Chapter VI of the OECD Principles of Corporate Governance, which calls for the corporate governance framework to ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The ability of boards to adhere to good corporate governance practices remains the main challenge in terms of implementing the OECD Principles. More specifically:

- The line between board oversight and day-to-day management is often blurred.
- The majority shareholder and not the board plays the lead role in selecting, monitoring, and replacing executives. Few boards have succession policies in place.
- Executive remuneration is not linked to long term company performance.
- Companies do not have robust risk, internal control, and audit policies in place.

- Egypt has yet to define the term "independent director"; few directors are independent.
- Few boards have an effective committee structure in place.

To further close the gap between Egypt's corporate governance framework and Chapter VI of the OECD Principles, the government of Egypt should consider the following reforms:

 **Short-term priorities**

- The ECGC should encourage boards to, *inter alia*: (i) develop key policies on remuneration, succession planning and information disclosure; (ii) form relevant committees and disclose their terms of reference; (iii) conduct annual self-evaluations; (iv) include at least two or three independent directors. The ECGC should also encourage directors to limit their number of directorships and recommend that companies disclose which of their directors is executive, non-executive or independent. More generally, the ECGC should: (i) elaborate on the board's role vis-à-vis management; (ii) include a definition of independence; (iii) recommend that the internal audit function be independent; and (iv) expand on the role of the company secretary.
- The LRs should be amended to require: (i) the audit committees of banks, financial institutions and other relevant companies to be responsible for compliance; (ii) boards to be accountable to shareholders for the integrity of the control environment and financial reporting process; and (iii) require directors to undergo a minimum amount of annual training on corporate governance.

 **Medium-term priorities**

- The CL should be amended to: (i) define a general "duty of loyalty" and "duty of care", requiring company directors (which can then be expanded on in the ECGC); (ii) allow the managing director to select, dismiss, and remunerate the general manager, with board approval; (iii) clearly specify the main authorities of the board; (iv) specify that the managing director and general manager are accountable to the entire board; (v) allow the general manager, when s/he is a board member, to retain his or her voting right during board meetings; and (vi) allow for non-board members to serve as managing director or general manager.
- The EIoD should develop model documents and step-up the roll-out of its director training courses on: (i) succession planning; (ii) remuneration policies and practices; (iii) related party transactions; (iv) the role professional company secretary; and (v) the role of the investor relations officer. The EIoD should further develop and utilize its database of potential independent directors. Finally, the EIoD together with the EGX should offer training courses explaining how to properly implement, and disclose compliance against, the ECGC.

A more detailed set of recommendations can be found in Annex 1.



**Learn More**

**See the Corporate Governance ROSC Database for a comprehensive gap analysis and set of recommendations vis-à-vis Egypt's implementation of Chapter VI of the OECD Principles.**

# Country action plan

## **Recommendation 1: The ECGC should be amended and implemented on a comply-or-explain basis.**

- Activity 1: Form a task force of key stakeholders to serve as steering committee and a drafting team.
- Activity 2: Drafting team to produce amended draft ECGC.
- Activity 3: Comprehensive review process of ECGC with all key stakeholders.
- Activity 4: The EGX should incorporate the ECGC into its LR, requiring companies to “comply or explain” adherence to the ECGC.
- Activity 5: The EIoD should be provided with the necessary resources to roll-out a comprehensive awareness raising and director education program.

## **Recommendation 2: The regulatory institutions should ensure that the existing legal and regulatory framework with respect to corporate governance, as well as ECGC, is strictly enforced in practice.**

- Activity 1: The MoI, CMA, et al should meet with and firmly encourage key owners, chairman and key board members of listed companies to follow the ECGC and undergo a minimum amount of training on corporate governance and related issues, with the implicit understanding that this could be made mandatory should companies not send their directors to attend.
- Activity 2: Once the ECGC is implemented on a comply or explain basis”, the CMA, EGX, et al should be vigilant in monitoring compliance with the ECGC from the very beginning to ensure that it is properly being implemented, together with institutional investors and shareholders. Along with the EGX, the CMA may consider developing a model corporate governance disclosure template, which it can make available on its website to guide all companies in their corporate governance disclosure, in particular those not actively traded. Training should be offered on how to properly report on corporate governance.
- Activity 3: The CMA should require or encourage institutional investors to develop and disclose their voting policies, as well as to actually vote during GMS meetings.

## **Recommendation 3: A number of amendments to the legal and regulatory framework should be made to ensure that the corporate governance fully meets good practice; the government should reinvoke its ongoing efforts to unify company-specific laws and regulations into one comprehensive CL.**

- Activity 1: Form a task force of key stakeholders to serve as steering committee and a drafting team.
- Activity 2: Task force identifies key amendments to legal framework, for example, approval of extraordinary transactions.
- Activity 3: Consider unifying the CL, its executive regulations, and other relevant laws, regulations, and decrees into one comprehensive law.
- Activity 4: Comprehensive review process of with all key stakeholders.

# Annex

## Detailed Recommendations

### **Recommendation 1: The ECGC should be amended and implemented on a comply-or-explain basis.**

- *With respect to the shareholder right, the ECGC should be amended to encourage:*
  - (i) All directors, when possible, to attend the GMS;
  - (ii) Companies to issue a “shareholder briefing note” to all shareholders, listing and explaining their rights;
  - (iii) Companies to adopt and disclose policies on dividends;
  - (iv) Institutional investors to: (i) develop and disclose voting policies, (ii) vote and to disclose their actual voting, and (iii) develop policies on whether and how to affect the corporate governance of their investee companies; and
  - (v) Institutional investors to further develop and disclose policies for dealing with conflicts of interest.
- *With respect to the equitable treatment of shareholders, the ECGC should encourage companies to:*
  - (i) Conduct their GMS at locations that are easily accessible for shareholders;
  - (ii) Develop policies on how to effectively manage conflicts of interest and related party transactions; and
  - (iii) Ensure that conflicted board members excuse themselves from relevant board discussions.
- *With respect to the role of stakeholders, the ECGC should be amended to encourage boards to:*
  - (i) Ensure for the company's compliance with existing laws and regulations specific to protecting established rights and interests of stakeholders;
  - (ii) Generally consider the interests of stakeholders in their decision-making;
  - (iii) Communicate or consult with employees, creditors, and the community regarding major company events; and
  - (iv) Develop whistleblower policies.
- *With respect to transparency and disclosure, the ECGC should be amended to encourage boards to disclose the:*
  - (i) Criteria it uses to define an independent director;
  - (ii) Which of their directors is executive, non-executive and independent;
  - (iii) A director's length of service as a board member and tenure on various board committees;
  - (iv) Attendance record of board members in board and committee meeting;
  - (v) Basic information about the primary employment of its board members, as well as other board seats

	<p>they hold;</p> <ul style="list-style-type: none"><li>(vi) The remuneration of its board members and key executives, ideally on an individual basis;</li><li>(vii) The link between remuneration and company performance;</li><li>(viii) Commercial and non-commercial objectives;</li><li>(ix) Material issues with respect to key employees and stakeholder;</li><li>(x) Compliance against its code of ethics; and</li><li>(xi) Compliance with the ECGC.</li></ul> <ul style="list-style-type: none"><li>▪ <i>The ECGC should be further amended with respect to audit practices, encouraging:</i><ul style="list-style-type: none"><li>(i) The external auditor to be selected based on a competitive selection process;</li><li>(ii) Auditors to apply appropriate audit procedures concerning a client's related parties;</li><li>(iii) Auditors to share information when rotating between audit clients.</li></ul></li></ul> <p><i>The ECGC should further:</i> (i) define auditor independence; (ii) encourage the board's audit committee to conduct a competitive selection process when hiring the external auditor; (iii) assure itself of the auditor's independence, and (iv) report any non-audit work to shareholders.</p> <ul style="list-style-type: none"><li>▪ <i>With respect to board responsibilities, the ECGC should be amended to encourage boards to:</i><ul style="list-style-type: none"><li>(i) Develop remuneration policies for executive and non-executive directors;</li><li>(ii) Supervise the process of developing and implementing a code of ethics;</li><li>(iii) Conduct annual evaluations to gauge board and committee effectiveness, efficiency, and performance; companies should be encouraged to disclose whether they have undertaken such evaluation;</li><li>(iv) Develop and approve a succession policy, and ensure that management develops a succession plan under such policy;</li><li>(v) Establish a compliance function, in particular for financial institutions;</li><li>(vi) Be responsible for the company's communications with the public, and should develop a policy on information disclosure;</li><li>(vii) Meet in "executive session", i.e. for the non-executives to meet without the executive directors;</li><li>(viii) Form remuneration and nomination committees;</li><li>(ix) Receive board briefing papers and information at least five days before the board meeting; and</li><li>(x) Include at least two or three independent directors.</li><li>(i) Limit their number of directorships, i.e. board seats that a director may hold at any one time; and</li></ul></li></ul> <ul style="list-style-type: none"><li>▪ <i>The ECGC should generally be amended to:</i><ul style="list-style-type: none"><li>(i) Elaborate on the board's role vis-à-vis management;</li><li>(ii) Specify that the system of internal controls should also include related party transactions;</li></ul></li></ul>
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- (iii) Clarify the internal auditor's role in auditing related party transactions;
- (iv) Ensure that the internal audit function is independent, providing for dual reporting lines to the CEO (on an administrative basis) and the independent audit committee (on a functional basis);
- (v) Recommend that key board committees, in particular the audit, nomination, and remuneration committees, be chaired by independent directors and/or composed of a majority of independent directors;
- (vi) Expand on the role of the company secretary vis-à-vis secretaries to the board; and
- (vii) Include a definition of independence.

Once the new ECGC has been published, the EGX should propose (and the CMA approve) to amend the LRs to include a provision requiring companies to adopt the ECGC on a 'comply or explain' basis.

The CBE should finalize its corporate governance code or regulations for banks and EISE for insurance companies; these should, together with the corporate governance guidelines for SOEs, be based on the new ECGC to ensure for consistency and implemented on a 'comply or explain' or, if necessary, be made mandatory.

**Recommendation 2: The regulatory institutions should ensure that the existing legal and regulatory framework with respect to corporate governance, as well as ECGC, is strictly enforced in practice.**

- The CMA, EGX, CBE, EISA, and MFA should all continue and step-up their efforts to generally enforce existing laws and regulations.
- The CMA, CBE, EISA, and MFA should each place copies of the MoUs of cooperation signed between themselves and the other enforcement bodies, on their respective websites.
- The government of Egypt should continue with the establishment of economic courts.
- Court rulings should be made publicly available.
- GAFI may wish to assess the feasibility of establishing an online presence for its Companies Department to allow stakeholder to more readily access company information.
- GAFI's Companies Department and the CMA should improve their enforcement efforts with respect to the dissemination of relevant information regarding the issues to be decided on during the GMS.
- The CMA will wish to closely monitor and fully enforce financial disclosure in the coming year, following the adoption of new EAS.
- The CMA's independence from the executive should be strengthened, ensuring for a reporting line to parliament in addition to the MoI, and the CMA's chairman should be approved by parliament.
- In this respect, the CML or CML-ER should be amended to provide for clear criteria for the dismissal of the president and senior executives of the CMA (and other regulatory authorities).
- Parliament or another independent body should continuously review the CMA's resources and salary structure to ensure that both are sufficient to perform its duties.
- The CMA will both wish to continue their enforcement efforts vis-à-vis financial intermediaries to ensure that market abuses further subsist.
- The CMA and EGX should better enforce material and timely disclosure of non-financial information, in particular with respect to: (i) information on share ownership and voting rights; (ii) information on board members and remuneration; and (iii) related party transactions.
- The EGX should itself follow the ECGC.
- The EIoD should develop model policies and roll-out director training courses on: (i) succession planning, focusing in particular on succession planning in family-owned enterprises; (ii) good remuneration policies and practices; (iii) related party transactions; (iv) the role of the professional company secretary; and (v) the role of the investor relations officer.
- The EIoD should further develop and make use of its database of potential independent directors that have successfully passed their certification program and are available to serve as independent directors.
- Finally, the EIoD, jointly with the CMA and EGX, should offer training courses explaining how to properly

implement the ECGC and ensure for appropriate corporate governance disclosure. EGX currently offers, together with the Institute of Investment and Finance as well as JP Morgan, an Investor Relations Course encompassing the appropriate corporate governance disclosure.

- The EIoD together with EGX should develop a model annual report and training course for companies on how to develop annual reports, with a particular focus on the chairman's report and management's discussion and analysis.
- The EIoD should continue to carry-out its annual report and internet disclosure competitions, which serve as invaluable best-practice guidance for corporate governance disclosure.
- The EIoD (and MoI) should periodically reassess its status as a unit within the MoI and reconsider whether it may eventually wish to become a SRO and itself follow the ECGC.
- The MCSD should fully comply with the ECGC.

**Recommendation 3: A number of amendments to the legal and regulatory framework should be made to ensure that the corporate governance fully meets good practice; the government should reinvigorate its ongoing efforts to unify company-specific laws and regulations into one comprehensive CL.**

The MoI should re-commit itself to pursue a uniform CL, with a view towards consolidating the many CL provisions that are scattered across a wide variety of laws, regulations, and decrees, into one principle document. More specifically:

- The CL and/or its ERs should be amended to strengthen shareholder rights by:
  - (i) Providing shareholders with mandatory pre-emptive rights;
  - (ii) Specifying that extraordinary transactions above a specific threshold or of a special type (in particular with related parties) are subject to a majority vote;
  - (iii) Forbidding partially paid-up shares to vote at the GMS;
  - (iv) Allowing shareholders to access relevant documents 21 days prior to a GMS;
  - (v) Requiring companies to maintain a list of shareholders;
  - (vi) Allowing shareholders to review executive compensation policies and approve non-executive compensation (the ECGC more generally encourages that executive and non-executive remuneration are differentiated from one another);
  - (vii) Allowing other individuals who are not shareholders to serve as a proxy;
  - (viii) Providing shareholders holding a defined percentage of shares access to the shareholder list before the GMS to coordinate voting.
- The CL should be amended to ensure for the equitable treatment of shareholders by:
  - (i) Defining the circumstances under which directors and officers may be held liable for a breach of duties;
  - (ii) Introducing the duties of care and loyalty, as potentially the business judgment rule,<sup>50</sup> for directors and officers (the ECGC should then expand on this general requirement by providing a more detailed and practical definition of this duty, as well as concrete examples to guide directors and officers);
  - (iii) Clarifying whether equity thresholds exist for shareholders to initiate suits, or whether any shareholder with a single share should be able to sue;
  - (iv) Specifying whether shareholders are allowed to initiate direct, indirect, and/or class action suits;
  - (v) Providing shareholders with additional withdrawal rights for key company decision; and
  - (vi) Requiring the timely dissemination of voting results at the GMS.
  - (vii) AGMs should further not be allowed to grant blank approvals for related party transactions, but authorize specific transactions.
- The CL should be amended to ensure for the improved transparency and disclosure by:
  - (i) Specifying whether and under which circumstances the external auditor is liable to shareholders (in addition to the company).

<sup>50</sup> See earlier discussion on the business judgment rule.

- The CL should be amended to ensure for the improved board practices by:
  - (i) Encouraging directors to act in the best interest of the subsidiary (as opposed to holding company) in which they are operating in;
  - (ii) Allowing the managing director to select, dismiss, and remunerate the general manager, with board approval;
  - (iii) Clearly specifying the main authorities of the board (the ECGC should then elaborate on specific authorities, e.g., in approving strategy; supervising management and monitoring corporate performance; approving risk management policies; approving budgets and business plans; setting performance objectives and indicators; and overseeing major capital expenditures);
  - (iv) Specifying that the managing director and general manager (when the board has not nominated a managing director to supervise the general manager) are accountable to the entire board;
  - (v) Allowing the general manager, when s/he is a board member, to retain his or her voting right during board meetings;
  - (vi) Allowing for outside candidates, i.e. non-board members, to serve as managing director or general manager;
  - (vii) Specifying that related party transactions are only subject to shareholder approval when crossing certain thresholds, e.g., a monetary threshold;
  - (viii) Including a provision on shadow directors; and
  - (ix) Including an obligation for management to furnish the board with material, accurate, and timely information.

The MoF, MoI, and other authorities should renew their efforts to pass the amended APL. More specifically:

- The government authorities should generally implement the recommendations contained in the 2009 Accounting and Auditing ROSC. Specific to corporate governance, the new APL should:
  - (i) Ensure that the proposed Higher Council is independent from the profession it is to oversee;
  - (ii) Require (or the ECGC to encourage) a client exposure limit to ensure that individual audit firms are not captured by a single audit client when conducting audits for public interest entities; and
  - (iii) Specify that all auditors should be required to pass a minimum number of hours of continuous professional education.

The CML and its ERs (alternatively the LRs) should be amended. More specifically:

- The CML and its ERs (alternatively the LRs) should be amended to strengthen shareholder rights by:
  - (i) Requiring companies to fully disclose their ownership structure on an ongoing basis;
  - (ii) Providing shareholders the right to obtain information on the company's capital structure;
  - (iii) Requiring shareholders to disclose their shareholdings when crossing five, ten, 15, 25, 33, 50, and 75 percent on an ongoing basis to the CMA, EGX, and other shareholders;
  - (iv) According majority owners a squeeze-out right;
  - (v) Requiring companies to disclose shareholder agreements; and

	(vi) Requiring directors and senior executives to follow a duty of loyalty during takeovers, and limit or outright restrict to use of anti-takeover mechanisms.
▪ The CML, and its ERs should be amended to strengthen the equitable treatment of shareholders by:	
	(i) Formalizing the "one-share, one-vote" principle for common shares, as well as the maximum cap of two votes for preferred shares (at a minimum, the ECGC should encourage companies to follow-term this good practice);
	(ii) Encourage intra-group transactions to be conducted fairly, at arm's length, and/or at market based pricing and terms (alternatively, the ECGC may encourage this good practice).
▪ The CML and its ERs should be amended to strengthen disclosure by:	
	(i) Ensuring that the prohibition to selectively disclose information is expanded to include board members, executives, and other insiders;
	(ii) Requiring rating agencies to follow IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies; and
	(iii) Fully implementing the IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest.
The MoI should help the MCSD amend and update the CSDRL. More specifically:	
	(i) Specify that the MCSD is to be independent from special interests, and have a funding source and nomination process for its chairman that protects its independence.
	(ii) Require custodians to disclose their voting policy and actual voting to shareholder, when no voting instructions were given. The CSDRL should also specify who is entitled to control the exercise of voting rights when shares are held by a chain of intermediaries. Companies with foreign participation should be encouraged to utilize the MCSD's electronic voting system for GMS.
The EGX should propose and CMA approve amendments to the LRs. More specifically:	
▪ The LRs should be amended to strengthen transparency and disclosure, in particular requiring companies to disclose:	
	(i) Information on the rights attached to specific classes of shares to facilitate shareholder access, e.g., online or in the annual report.
	(ii) Their quarterly financial statements to shareholders, and not only to the CMA and ESX;
	(iii) A full annual report;
	(iv) Material foreseeable risk factors;
	(v) Special voting arrangements and rights;
	(vi) Relevant information on directors on an ongoing basis.
▪ The LR should also require (or ECGC recommend) for the external auditor to report to the board's independent audit committee.	

- The LRs should strengthen board practices and be amended to:
  - (i) Ensure that the audit committee's remit include the development of a system of compliance with laws and regulations, and internal policies and procedures, including the company's code of ethics;
  - (ii) Include the audit committee's remit to include the review of internal controls with respect to related party transactions;
  - (iii) Specify that the audit committee is further responsible for ensuring for compliance with laws, regulations, and internal policies and processes;
  - (iv) Adopt the ECGC on a 'comply or explain' basis, and hold boards responsible for the company's corporate governance disclosure;
  - (v) Specify that the internal audit function be independent; and
  - (vi) Require to board to be accountable to shareholders for the integrity of the control environment and financial reporting process; require the board to carry the overall responsibility of managing the relationship with the external auditor, and for the external auditor to report to the board, through its independent audit committee, and not to the CEO.
  - (vii) Finally, the LRs should require all directors to undergo a minimum amount of training on corporate governance related issues on an annual basis.

The CUMWA or relevant decree should be amended to specifically mention that an external auditor's license can be suspended or withdrawn for failing to comply with the Auditor Quality Control Unit's standards for the audit profession.

The CBE should define a set of 'fit and proper' criteria for shareholders, directors, and managers.

A wide-ranging and transparent consultation process should be organized, and comments to draft laws and regulations published.

English language versions of relevant laws and regulations should be newly drafted or reviewed, and designated as official translations, by the MoI.

# Acronyms

AGM	Annual General Meeting of Shareholders
APL	Accounting Practice Law
CBE	Central Bank of Egypt
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG ROSC	Corporate Governance Report on the Observance of Standards and Codes
CL	Company Law
CL-ER	Company Law Executive Regulations
CMA	Capital Markets Authority
CML	Capital Markets Law
CML-ER	Capital Markets Law Executive Regulations
CSR	Corporate Social Responsibility
EAS	Egyptian Accounting Standards
ECGC	Egypt Corporate Governance Code
EGM	Extraordinary General Meeting of Shareholders
EGX	Egyptian Stock Exchange
EIoD	Egyptian Institute of Directors
ESA	Egyptian Standards on Auditing
ESOP(s)	Employee Stock Option Plan(s)
GAFI	General Authority for Investment
GMS	General meeting of shareholders
IFAC	International Federation of Accountants
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IR	Investor relations
ISA	International Standards on Auditing
LR	Listing Rules
MCSD	Misr for Central Clearing, Depository, and Registry
CSDRL	Securities Central Depository and Registry Law
CSDRL-ER	Securities Central Depository and Registry Law – Executive Regulations
MD&A	Management Discussion and Analysis
MoI	Ministry of Investment
MoU	Memorandum of Understanding
OECD	Organization for Economic Cooperation and Development
ROSC	Report on the Observance of Standards and Codes
SOE	State-owned enterprise
SRO	Self-regulatory organization
ToRs	Terms of reference
UNCTAD	United Nations Conference on Trade and Development



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This report is one in a series of country-level corporate governance assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments benchmark the legal and regulatory framework, company practices, and enforcement framework against the OCED Principles of Corporate Governance, the international reference point for good corporate governance.

**The ROSC assessments:**

- Use a consistent methodology for assessing national corporate governance practices
- Provide a benchmark by which countries can evaluate themselves and gauge progress in carrying-out corporate governance reforms
- Strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- Provide the basis for policy dialogue resulting in the implementation of policy recommendations

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