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 **HAWKAMAH**
THE INSTITUTE FOR CORPORATE GOVERNANCE

Corporate Governance in Bahrain

– An Investor Perspective



*Task Force Report
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Corporate Governance in Bahrain— An Investor Perspective

CONTENTS

Preface..... i

Executive Summary..... 1

Key Corporate Governance Issues.....4

Growing Economic Impact of Bahrain’s Equity Market.....8

Bahrain’s Banking Sector..... 9

Outlook and Recommendations..... 10

Appendix..... 12

 Bahrain’s Corporate Governance Framework.....12

 Table Comparing Bahrain’s Corporate Governance with the IIF Code of
 Corporate Governance.....17

List of Contacts..... 26

PREFACE

In view of the importance of portfolio equity flows to emerging markets, the Institute of International Finance (IIF) established in January 2001 the IIF Equity Advisory Group (EAG), consisting of senior executives from leading asset management firms throughout the world. The EAG, chaired by Edward Baker, Chief Investment Officer of Global Emerging Markets, AllianceBernstein L.P., is seeking implementation of its Code of Corporate Governance (the “IIF Code”) in key emerging market countries that are of particular interest to the Institute’s membership base. The IIF Code, which was first released in February 2002 and revised in May 2003,¹ endeavors to improve the investment climate in emerging markets by establishing practical guidelines for the treatment of minority shareholders, the structure and responsibilities of the board of directors, and the transparency of ownership and control of companies.

The strategy for promoting the implementation of the IIF Code, as the standard by which the company/ shareholder relationship is measured, is country and regional focused. Country Task Forces have been set up for Brazil, China, India, Lebanon, Mexico, Poland, Russia, South Africa, South Korea, and Turkey. Reports on all these countries have been published, including second reports on several countries.

In June 2006, the IIF entered into a partnership with Hawkamah, the Institute for Corporate Governance,² to jointly conduct a two phase corporate governance survey of countries in the MENA region. Phase 1 of the survey covers countries in the Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE). The motivation for such a survey was prompted by the extraordinary growth in GCC equity markets over the past few years, growing international interest in the region and the importance of helping officials in the GCC identify areas of weakness and potential improvements in current corporate governance frameworks. For Phase 1 of the project Hawkamah provided IIF with financial support to defray most of the cost of the work. In phase 2, the survey will be extended to other countries of the MENA region.

In July 2006, the GCC Task Force held meetings in Abu Dhabi, Manama, Doha, Dubai, Kuwait, Muscat and Riyadh to assess the corporate governance practices in GCC countries. Meetings were held with senior officials from the capital market authorities, central banks and stock exchanges, local fund managers, lawyers, experts, accountants and management consultants involved in corporate governance in GCC countries. Keith Savard, Director Global Economic Analysis, IIF and Dr. Nasser Saidi, Executive Director, Hawkamah, co-chaired the GCC Task Force. Other Task Force members include Nicolai Nadal and Rashid Bin Shabib of the Hawkamah staff and Rakhi Kumar of the IIF staff.

¹Investors’ poor experience in a generally weak corporate governance environment in many emerging markets led to relatively strict and comprehensive original IIF guidelines. Nevertheless, more detailed standards were considered desirable in a few areas in light of far-reaching new legislation such as the Sarbanes-Oxley Act passed by the U.S. Congress in the summer of 2002. The revised standards offer guidance to emerging market officials as they decide what rules and regulations must be put in place to satisfy investors.

²The Hawkamah Institute for Corporate Governance is an autonomous, international association, hosted by the Dubai International Financial Center (DIFC), and serving the MENA and Central Asia countries. Hawkamah was launched in partnership with the Organisation for Economic Cooperation and Development (OECD), the International Finance Corporation (IFC), the Dubai International Financial Centre (DIFC), the World Bank Global Corporate Governance Forum, the Center of International Private Enterprise (CIPE), the Union of Arab Banks (UAB), Young Arab Leaders (YAL) and the countries participating in the OECD-MENA Investment Programme. Its mission is to assist the countries and companies of the region to develop sound and globally well-integrated corporate governance frameworks. It provides technical assistance and cooperates with decision makers to coordinate and sequence the designing, planning and implementation of corporate governance reforms and monitoring the outcome of corporate governance policies at the private sector level. See www.Hawkamah.org

The aim of this report is to offer an assessment as to where countries in the GCC stand relative to the investment environment that members of the IIF Equity Advisory Group would like to see develop in key emerging market countries. Since this is a first-time survey of corporate governance frameworks in the region, the report does not treat all relevant corporate governance matters in depth. Instead, it focuses on the important initial steps that need to be taken to improve the investment environment in GCC countries. We will review at a future date the corporate governance regimes in more detail to assess progress. This report focuses on corporate governance standards and practices only in GCC countries. It is not meant to provide an exhaustive survey of corporate governance in the GCC and, as with other Task Force Reports, neither the Task Force nor the IIF or Hawkamah can in any way attest to or guarantee the accuracy or completeness of the information in the report despite the best effort that has been made. To the extent guidance is given, or advice is inferred, the reader is urged to fully apprise him/herself of the relevance of such content to current or contemplated operations.

TENETS OF THE IIF CODE AND BASIC DIFFERENCE WITH THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

Through its Equity Advisory Group (EAG), the IIF published a code of corporate governance in February 2002 which was revised in May 2003. IIF's analysis of a country's corporate governance framework focuses on five broad areas – (i) minority shareholder rights, (ii) structure and responsibilities of the Board of Directors, (iii) accounting and auditing, (iv) transparency of ownership and control, and (v) the regulatory environment. A detailed explanation of these areas can be found in the "Comparative Analysis of Corporate Governance Frameworks in the GCC" section. These key ideas appear in the OECD Principles of Corporate Governance and the OECD Corporate Governance Guidelines that accompany it. However, the IIF Code has constructed a more detailed set of guiding principles in order to enhance their practical usefulness.

For example, with regards to minority shareholder rights, the IIF Code clearly endorses the one-share one-vote principle and proxy voting. In addition, the IIF Code supports cumulative voting for director elections. However, while the OECD Principles emphasize the importance of giving equal voting rights to all shareholders and allowing votes to be cast by nominees when agreed upon with the share owner, cumulative voting is not addressed. Furthermore, the IIF Code clearly defines independent directors and requires that at least one-third of the board be independent. The OECD Principles require that board members disclose whether they are regarded as independent by the company, but do not specifically identify how many members should be independent, nor what characteristics classify them as independent.

The IIF Code also requires that conflicts of interest for board members and key executives be disclosed publicly and that the head of the audit committee never have a conflict of interest. The OECD Principles agree that this information must be disclosed, however, they limit the scope of disclosure to the board of directors. Because it views accurate accounting and auditing as the core of transparency and good corporate governance, the IIF Code requires that semi-annual reports be filed in addition to the annual audited financial report. The OECD Principles, in contrast, only require an annual audited financial report.

Both the IIF Code and the OECD Principles encourage the implementation of good corporate governance practices, however; the IIF Code was created to promote specific actions and criteria, which, if followed, will help promote the health and stability of emerging market economies.

This report forms part of a country-by-country analysis of corporate governance practices in each of the six member states of the Gulf Cooperation Council (Oman, Bahrain, Kuwait, Qatar, Saudi Arabia and the UAE), based on country missions by staff members of the IIF and Hawkamah. This report should be read in conjunction with a regional overview report—Comparative Survey of Corporate Governance in the GCC—published in September 2006.

EXECUTIVE SUMMARY

Corporate governance-related rules and regulations for listed companies in Bahrain comply with slightly more than one-half of IIF guidelines, but efforts are being made to improve the country’s overall corporate governance framework. The Ministry of Industry and Commerce (MOIC) has drafted a new Commercial Companies Law, which incorporates numerous corporate governance requirements. The Central Bank of Bahrain (CBB), which regulates the capital market, is reviewing new corporate governance-related requirements for listed companies and the new Commercial Companies Law, which if enacted and enforced would imply a strengthening of the corporate governance regime, to make it broadly in line with the IIF guidelines and international best practices. (Our analysis only considers enforceable laws and requirements at the time of publication). Moreover, an alliance of various market participants including, lawyers, accountants, academics and government representatives, has been working over the past few years to improve Bahrain’s corporate governance framework.

The authorities have been promoting corporate governance improvements in Bahraini companies for more than three years. In 2004, KPMG published a white paper, sponsored by the MOIC and the CBB, on shaping corporate governance development in the country. In addition, the authorities also conducted a first-of-its-kind survey of corporate governance practices on Bahraini companies. This includes companies listed on the Bahrain Stock Exchange (BSE), partnerships, limited liability companies, as well as individual respondents. The white paper highlighted the need for significant improvements in the existing corporate governance framework, in particular, the need for a code of corporate governance. The results of the market survey showed that a majority of companies and residents believe that a corporate governance code is required in Bahrain. Importantly, more than 50 percent of the respondents maintained that a corporate governance code should be mandatory.

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Institutionalization of good corporate governance practices remains a challenge, and this includes improvement of the board structure through rules and regulations to address key corporate governance-related issues. The new Commercial Companies Law has yet to be approved by the parliament, which is expected in mid-2007. Once enacted, the law will significantly improve the overall corporate governance framework by introducing more stringent corporate governance requirements for all companies such as allowing cumulative voting for director elections. The authorities are also looking to adopt a code of corporate governance, which is also awaiting Parliamentary approval.

Corporate governance in Bahrain's financial sector is better than in its non-financial sector due to corporate governance guidelines prescribed in the CBB Rulebook applicable only to banks, insurance companies and other financial institutions. Further, about 50 percent of BSE listed companies are in the financial sector which has better corporate governance practices compared to companies in the non-financial sector. This is significant given that the financial sector is the mainstay of Bahrain's non-oil economy and is the second largest by assets in the GCC after Saudi Arabia. Bahrain has long been a leading regional financial center, hosting the largest concentration of banks and other financial institutions in the Middle East. It is also evolving into an important center for Islamic banking. Given its strength in corporate governance in the financial sector, Bahrain should be able to improve corporate governance in its non-financial sector without undue delay.

Specialized agencies within the financial sector have been established to ensure that correct international standards are in place and to further develop the industry. These include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the General Council for Islamic Banks and Financial Institutions, the International Islamic Financial Market, the Liquidity Management Centre, and the International Islamic Rating Agency. Also, Bahrain's financial sector is considered to be generally well managed and supervised.

Nevertheless, Bahrain's regulatory structure does require change if the equity market is to develop. In early September a law passed by parliament converted the BMA into the CBB which will now be the sole regulator of the banking sector, the insurance sector and the stock market. The CBB continues to perform the functions previously undertaken by the BMA but with more authority and greater

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autonomy. The BSE is licensed and regulated by the CBB and its Board of Directors is comprised of a majority of market participants and representatives from the CBB.

The IIF’s corporate governance guidelines call for a separate regulator. This is important in order to maintain credibility within the regulatory environment as it is imperative that regulators not be perceived as under the control or influence of any particular interest group. Accordingly, the GCC Task Force recommends that authorities should consider establishing an independent capital market authority that will regulate capital markets and the BSE. This will allow the regulator to speed up the introduction and implementation of new rules and regulations. Creating an independent capital market regulator will help strengthen surveillance and compliance with legal requirements. Further, an independent and dedicated capital market regulator can also focus on capital market development. The CBB strongly believes that the current regulatory model meets the needs of the country.

Government backing is necessary for real change to occur in Bahrain’s corporate governance environment. Based on its findings, the GCC Task Force recommends that the following actions be taken to help strengthen the framework for corporate governance in the country:

- Adopt and implement mandatory laws/rules/codes designed to strengthen board practices
- Improve surveillance and enforcement, possibly by creating a capital market regulator independent of the government
- Build up a professional and skilled staff at the regulatory level to strengthen enforcement and surveillance
- Continue to promote investor education

“Creating an independent capital market regulator will help strengthen surveillance and compliance with legal requirements.”

KEY CORPORATE GOVERNANCE ISSUES

Changes to current corporate governance framework in the pipeline

Since 2002, the authorities in Bahrain have been interested in developing the country's corporate governance. Recognizing the importance of good corporate governance the Ministry of Industry and Commerce of Bahrain (MOIC) and the BMA (now the CBB), sponsored a project in 2003, the Corporate Governance Initiative, to spread awareness and encourage and inculcate the development of a framework of good corporate governance. Initiatives under the project included:

- An image campaign to raise awareness of the importance of good corporate governance in Bahrain through posters and notices
- Conducting a survey using a questionnaire prepared by the MOIC, which was posted on the MOIC's website and mailed to all businesses in Bahrain, requesting feedback on various aspects of corporate governance to gauge the level of awareness and the attitudes of various participants in Bahrain's markets
- Creating a core project team in early 2004 comprising representatives of the MOIC, the BMA and the Capital Markets Supervision Directorate (CMSD) to execute a Corporate Governance Project with KPMG as the project manager
- Establishing a Corporate Governance Project Steering Committee made up of representatives from a cross section of the private sector as well as the MOIC, CMSD, the BSE and the Bahrain Chamber of Commerce and Industry to guide the development of a good corporate governance culture in the Kingdom

Furthermore, the MOIC prepared and distributed to all companies in Bahrain a number of booklets on corporate governance practices related to board responsibilities and shareholders rights. In 2001, the MOIC also reviewed and amended the Commercial Companies Law, addressing corporate governance-related issues such as the responsibilities of directors, how they are selected, and the voting process and disclosure requirements.

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Authorities should actively institutionalize and incorporate the findings of the Corporate Governance Initiative, which called for the introduction of a code of corporate governance for Bahraini companies. This would reinforce the actions of the authorities who have spent significant time and effort gaining general acceptance of the Code and spreading awareness of its components. Furthermore, authorities claim that actual practices in the market have improved even before the release of the new Commercial Companies Law and Corporate Governance Code.

Regulatory structure

Capital markets in Bahrain are regulated by the Central Bank of Bahrain (CBB), which also regulates the banking and insurance sector. A law passed in June 2006 transformed the BMA into the CBB. The new Central Bank of Bahrain has more power and autonomy than did the BMA in regulating the country's financial markets. However, the GCC Task Force recommends that authorities evaluate the option of creating an independent capital market regulator that will be responsible for overseeing and developing Bahrain's equity and debt market. Benefits of an independent capital market authority include:

- Expanding Bahrain's equity market; currently, Bahrain has one of the smallest equity markets in the GCC
- Allowing for the timely introduction/amendment of capital market rules and regulations, including a code of corporate governance
- Improving the regulation of the stock exchange and market makers
- Improving the surveillance and enforcement environment
- Increasing the credibility of regulators as they will not be perceived to be under the control or influence of any particular interest group

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Large banking sector is well regulated

Better corporate governance practices in Bahrain's financial sector are crucial given the size and importance of the sector to the overall economy. Bahrain has one of the largest financial sectors in the GCC with total assets in the banking system standing at \$163.0 billion in June of 2006. The bulk of these assets, \$134.1 billion (about 82 percent of the total), are held by Offshore Banking Units (OBUs). By contrast, Bahrain's onshore commercial banks account for only \$19.3 billion and investment banks for \$9.5 billion. The total assets held by Islamic banks (including OBUs and commercial and investment banks), although still relatively small at \$9.6 billion, has nearly doubled in the past two years.

As an important center for Islamic banking, the authorities have established a special agency, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which acts with the Islamic Financial Services Board (IFSB) as a standard setting body for Islamic financing. The AAOIFI has issued four governance standards which apply to Shari'a issues and covers the audit and governance committee.

Bahrain's financial sector is generally well regulated. The CBB has issued a number of circulars and regulations pertaining to corporate governance in banks and financial institutions. Moreover, the IMF's Financial System Stability Assessment report, released in January 2006, noted that prudential regulation was modern and comprehensive and that supervision was generally effective, especially in the banking sector. It noted, however, that supervisory capacity needed to be expanded in line with new regulations and to keep up with the growth and increasing sophistication of financial institutions.

Open business culture may increase compliance with higher corporate governance standards

As one of the largest regional financial centers in the GCC, Bahrain has been more receptive to international business standards than other countries in the region. As a result, businesses in Bahrain are more willing to adopt international best practices than their counterparts in other GCC countries. This is evidenced by the response to the independent market survey carried out as part of the government's Corporate Governance Initiative.

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One hundred percent of companies and over 90 percent of residents surveyed were of the view that Bahrain should adopt a corporate governance code. Of these, over 50 percent of both corporations and residents were of the view that such a code should be made mandatory. Bahrain's open business culture creates the type of environment needed for companies to quickly adopt better corporate governance practices once they are made mandatory by authorities.

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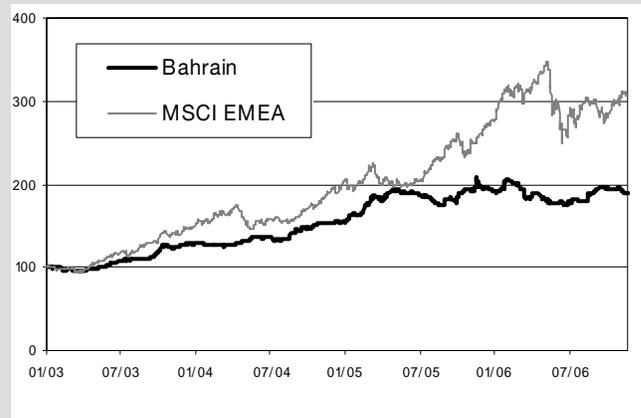
Growing Economic Impact of Bahrain's Equity Market

Bahrain's equity market, established 17 years ago in 1989, is one of the smallest equity markets in the GCC. However, the Bahrain Stock Exchange, the country's stock market, has not suffered from the same volatility experienced in other markets in the region over the past years. It posted solid gains in 2005, with the Bahrain Stock Exchange (BSE) all share index rising 23.8 percent following increases of about 30 percent in each of the previous two years (Chart 1). Strong growth in corporate profitability and relatively modest valuations boosted share prices, while high oil prices and buoyant economic conditions underpinned the market in general. Most sectors performed reasonably well, with the biggest increase being made by investment companies whose index jumped 48.1 percent. Commercial banks (up 14.3 percent) and industrial companies (up 10.9 percent) put in solid performances, which helped offset fairly modest gains in the services and hotel and tourism sectors and a small decline in the insurance index.

Two new companies were listed in 2005, Bander Hotels and Nass Corporation, which brought the total number of listings up to 47. This, together with the increase in equity prices, pushed market capitalization up 28.2 percent to \$17.4 billion, equivalent to some 133 percent of GDP. Trading volume was 36 percent higher than the previous year with activity concentrated in the banking sector.

Equity prices peaked in November 2005 and the market has continued to slide this year. In the first six months the all share index was down 6.8 percent. All the indices fell except banking, which rose 3.7 percent on the back of strong corporate earnings growth. Two companies were listed in the second quarter, Alsalam Bank and Ithmaar Bank. Sound economic fundamentals and oil prices should still support the market, although heightened tensions in the Middle East may weigh on sentiment.

Chart 1
Comparison of the Bahrain stock market index with the MSCI EMEA index from January 1, 2003 to November 15, 2006



Bahrain's Banking Sector

The financial sector is the mainstay of the nonoil economy and the second largest, by assets, in the GCC after Saudi Arabia. Bahrain is a leading regional banking center in the Middle East. It is also evolving into an important center for Islamic banking with over 30 institutions, including commercial, investment and leasing banks, Islamic insurance (takaful) companies, and a growing number of Islamic mutual funds.

Decree No. 64 of 2006, signed in early September, converted the Bahrain Monetary Agency (BMA) into the Central Bank of Bahrain (CBB). The CBB will continue to perform the functions previously undertaken by the BMA as the single regulator of the banking sector, the insurance sector and the stock market, but with more authority and greater autonomy.

Significant changes are taking place in Bahrain's financial markets and regulatory environment. The CBB is preparing the ground for implementation of Basel II regulations governing capital adequacy and risk management. Four working groups, established in 2005, have now completed their missions and the CBB is planning to finalize and publish the guidelines in 2007 to allow a sufficient transition period prior to full implementation of Basel II rules in 2008.

Further, the BMA introduced a comprehensive package of regulatory reforms at the beginning of July 2006 to modernize and strengthen

the licensing framework for banks. Under the new framework, license categories are defined by regulated activity rather than type of institution, making it flexible and better able to respond to market changes. The five basic categories are now conventional bank, Islamic bank, insurance, investment business and specialized licenses. The previous sub-category of full commercial bank group is replaced by retail bank and the two sub-categories of offshore banking unit and investment bank are combined into a single new sub-category called wholesale bank. The changes are designed to enhance the transparency and clarity of the regulations and reduce the regulatory burden on banks. They should also increase competition and provide greater customer choice in banking services by enabling international banks to offer onshore banking to Bahrainis. The CBB hopes that this will spur further growth and investment in the sector.

The fairly rapid growth in personal loans prompted the BMA to tighten regulations covering consumer borrowing in 2005. A consumer credit bureau was set up and banks are now required to scrutinize an applicant's source of income and credit history, and must ensure that monthly payments do not exceed 50 percent of their salary. Following the successful launch of the consumer credit arm, a corporate credit arm of the Bahrain Credit Reference Bureau is now in the process of being set up to give banks and other lenders more information about the credit history of companies. The Bureau hopes to launch the new service by the end of the year.

OUTLOOK AND RECOMMENDATIONS

Bahrain's current corporate governance framework for listed companies complies with a little more than fifty percent of the IIF's corporate governance guidelines. The GCC Task Force expects improvements in Bahrain's corporate governance environment in the coming year. The Ministry of Industry and Commerce has drafted a new Commercial Companies Law that is likely to come into effect by mid-2007. Once implemented, the new law is expected to address many of the deficiencies identified in this report and increase overall compliance with the IIF Code. The authorities are also looking into developing a code of corporate governance for listed companies, although no firm timelines have been set for its development and implementation of the same.

Real change in Bahrain's corporate governance environment will require the firm backing of the government. This stems from the fact that, the corporate structure in the country consists of small- and medium-sized enterprises that are family-owned, while state-owned enterprises are dominant in public utilities and transport. These dominant forms of business have limited institutional capacity, few incentives and willingness to implement and apply corporate governance principles. The government should institutionalize corporate governance best practices by:

- Introducing a code of corporate governance and other related laws that will strengthen Bahrain's corporate governance framework for all listed companies (discussed below)
- Enacting the new Commercial Companies Law
- Focusing on improved practices in state-owned and family-owned listed companies including:

In state-controlled companies (SCCs)

- √ Increase autonomy for management—include a sufficient number of non-executive and independent members, limit the number of state representatives that can serve as directors on the board

- √ Introduce independent board-level nomination committees to appoint directors
- √ Discourage practice of ownership by the state and the possible interference and influence by government
- √ Adopt and implement specific guidelines for the corporate governance of SCCs, ensuring that the governance of SCCs is carried out in a transparent and accountable manner, with a sufficient degree of professionalism and effectiveness

In family-owned companies

- √ Voluntarily adopt mechanisms for governance of the family's ownership stake; for example, creating family councils that deal with family disputes
- √ Reform company boards by increasing overall board independence and reducing the number of family member-directors
- √ Limit the role of family members in senior management
- √ Increase transparency in the ownership structure and related-party transactions
- Strengthening Bahrain's corporate governance infrastructure to create a better investment environment. This includes:
 - √ Establishing a director training institute
 - √ Requiring business schools to provide management training and promote business ethics
 - √ Funding investor education programs that will help foster an equity culture
 - √ Training journalists in financial and investigative reporting

- √ Enhancing websites of CBB and BSE to provide financial data, annual reports and other up-to-date company specific information

Specific changes that would improve the existing corporate governance framework and make it fully compliant with the IIF's Policies for Corporate Governance in Emerging Markets-Revised Guidelines include:

- Introducing cumulative voting in director elections
- Establishing a trigger that will instigate a public offer when ownership exceeds a specified percent (Current law requires a buyer to obtain CBB approval for acquisitions above ten percent of shares. In practice, the CBB requires companies to make a public announcement and a public offer for all shares before granting approval. The GCC Task Force calls to institutionalize into law this current CBB practice.).
- Introducing rules regarding share buybacks

- Defining “independent” and “non-executive” director
- Requiring that at least one-third of directors be non-executive and a majority of non-executive directors be independent
- Requiring independent and non-executive directors to be present to form a quorum for board meetings
- Requiring the establishment of audit, nomination, and compensation committees
- Assigning the audit committee with the duty to monitor risk factors and requiring disclosure of business risks facing the company
- Requiring companies to establish investor relations programs and make a statement on policy concerning environmental issues and social responsibility

BAHRAIN CORPORATE GOVERNANCE FRAMEWORK

Bahrain's legal framework for corporate governance is found in the Commercial Companies Law of 2001, the Bahrain Monetary Agency Disclosure Standards, the Bahrain Monetary Agency Guidelines on Insiders, and Resolution No. 13/1988 on the Issuance of Internal Regulation for the Bahrain Stock Exchange. However, these documents fail to address some corporate governance issues considered important by international investors. Bahrain's corporate governance framework requires strengthening in the following areas assessed by the GCC Task Force. This includes Minority Shareholder Protection, Structure of Board of Directors, Accounting and Auditing and Regulatory environment. The analysis below compares the Commercial Companies Law, BMA Disclosure Standards, and Bahrain Stock Exchange (BSE) Regulations with the IIF Code. Introducing a code of corporate governance for all MOIC companies will help improve Bahrain's overall corporate governance framework.

Minority Shareholder Protection

Bahrain's governance framework addresses slightly more than one-half of the IIF Code that pertains to minority shareholder protections. Scope for improvement lies, among others in introducing cumulative voting in director elections, and in introducing a provision making ownership exceeding 35 percent trigger a public offer.

Voting Rights

The IIF Code encourages companies to allow proxy voting and, as a best practice, make proxy systems universally available to all shareholders. Bahrain's rules and regulations state that all shareholders have the right to participate and vote at general meetings. The Commercial Companies Law allows shareholders to appoint a proxy as long as the delegate does not represent a number of votes exceeding 5 percent of the issued capital in the general assembly meeting.

Bahrain's Commercial Companies Law complies wholly with the one-share, one-vote principle, and clearly states that "each shareholder...shall have a number of votes equal to the number of shares he owns in the company."

There is currently no provision in Bahrain's laws and regulations concerning cumulative voting. However, the draft Commercial Companies Law is said to carry this provision. Provisions for cumulative voting in the election of directors would promote strong minority shareholder protection in Bahrain's legal framework for corporate governance, and is thereby encouraged by the IIF Code.

Company Capital Structure

The IIF Code provides a number of guidelines to protect shareholders with respect to changes in a company's capital structure. These include: (i) shareholder approval for major changes in capital structure such as mergers and major asset transactions, (ii) a public tender offer for all shares when ownership by a single shareholder exceeds 35 percent, and (iii) the right of minority or dissenting shareholders to sell their shares at an appraised value in the event of a merger or takeover.

The Commercial Companies Law reserves issues of mergers and capital increases to the extraordinary general assembly. Further, it also allows shareholders to object to mergers within 60 days of being published. During capital increases, the Commercial Companies Law provides shareholders with a priority right to subscribe to new shares. However, there exists no legal trigger for a public tender offer for all shares when ownership by a single shareholder exceeds 35 percent. The BMA Disclosure requirements require companies to notify the Agency (now the CBB) anytime 10 percent or more of the paid-up capital of a listed issue on the BSE is acquired or disposed of and in practice, the CBB will often require a public tender offer at this time. As a best practice, however, this trigger should be institutionalized into law.

Shareholder Meetings/Other Rights

According to BSE Regulations, a general assembly meeting should be held at least once a year, within three months of the end of the financial year. The guidelines of the IIF Code call for notices and agendas to be sent out within a reasonable amount of time in advance of meetings. For best practice, the IIF Code suggests that meeting notices and agendas be sent to shareholders at least one month prior to the meeting. BSE Regulations abide by this suggestion and state that the date, location, and agenda of each meeting should be decided upon in the company's articles of association and must be published in two local Arabic newspapers at least 15 days prior to the meeting. In addition to the AGM, the Commercial Companies Law allows shareholders representing 10 percent or more of company capital to call special meetings. This provision helps to protect minority shareholders.

Under the Commercial Companies Law, a meeting, and the resolutions passed therein, may only be considered valid if a quorum of shareholders representing 50 percent of the company's capital is formed. If the quorum is not formed, a second meeting must be held, requiring 30 percent of the company's capital to be represented. If the quorum is still not formed, a third meeting will be held and must be considered valid regardless of representation. This partially fulfills the IIF Code's suggestion of forming a quorum with 30 percent of a company's capital represented.

The IIF Code also emphasizes the importance of treating foreign and domestic shareholders equally. Although Bahrain's corporate governance framework allows GCC nationals to own 100 percent of a company, it limits other foreign ownership to 49 percent or less of a company. However, the MOIC has given exemptions to the 49 percent limit on non-GCC ownership and the new Commercial Companies Law is expected to permit 100 percent foreign ownership in Bahrain.

Structure and Responsibilities of the Board of Directors

Bahrain's governance framework addresses less than half of the IIF Code that pertains to boards of directors. Scope for significant improvement lies in requiring non-executive directors and independent directors to serve on the board, and in mandating the formation of nomination, compensation, and audit committees at the board level.

Board Structure

The IIF Code includes a number of key guidelines relating to independent and non-executive directors. Bahrain's regulators have yet to adopt provisions on independent or non-executive directors. The Commercial Companies Law requires directors to own at least ten thousand Bahraini dinars or his representative to own at least one percent of the company's capital, whichever is higher. In addition, the appointment of an expert to the board of directors is only allowed if it abides by the conditions set forth by the Ministry of Industry and Commerce.

Bahrain's legal framework also lacks rules requiring companies to have board committees. However, such requirements are mostly all met with respect to licensed financial institutions, because of the CBB's corporate governance regulations. Moreover, financial institutions account for over half of the listed companies on the BSE, in practice a majority of Bahrain companies have an audit committee. Board committees, in conjunction with independent board members and a mechanism for minority shareholders to propose directors, reduce the risk of dominant owners ignoring minority shareholders and ratifying their own decisions. In Bahrain, where the family ownership structure is prominent, minority shareholder protection is essential.

Board Meetings

The Commercial Companies Law states that the board should meet at least four times each year, which complies with the IIF's provision for the frequency of meetings. Minutes of the meetings are required to be taken and kept at the company's headquarters. According to the IIF Code these minutes should be made a matter of public record. In Bahrain, board minutes are not public record, however, all board of directors' resolutions that might affect the market price must be announced to the public. This is in line with international best practice. The CBB's Disclosure Standards provide for comprehensive rules regarding ongoing obligations of the issuers to make an immediate announcement of any major decisions of the Board.

The IIF Code provides that a quorum for a board of directors meeting should consist of executive, non-executive, and independent non-executive directors. There is no provision in Bahrain's laws or regulations that require the participation of non-executive or independent directors.

Nomination and Election of Directors

The IIF Code states that minority shareholders should have a mechanism for putting forward directors at both Annual General Meetings (AGM) and Extraordinary General Meetings (EGM). Although the Commercial Companies Law mandates that the directors of the board be elected by secret ballot at the AGM, there are no provisions regarding the nomination process of directors.

The IIF Code stipulates that there should be a board-level nomination committee and that it should be chaired by an independent director. Bahrain rules and regulations have no provisions mandating the creation of a board-level nomination committee.

Term Limits for Directors

As for term limits of directors, best practice as indicated by the IIF Code requires that independent directors be re-elected every three years for a maximum of three terms. Bahrain's Commercial Companies Law states that each term should not exceed three years and a director may be re-elected at the expiration of his or her previous term.

Disclosure

The BMA Disclosure Requirements meet the IIF Code's guidelines that any material information, including the acquisition or disposal of substantial assets, board changes, related-party dealings, ownership changes, and director shareholdings that could affect share prices be disclosed through the stock exchange. Information must be disclosed to the CBB, BSE, and business and financial newswire services, internet and/or broadcast media simultaneously.

The IIF Code also recommends that the remuneration of directors be disclosed in the annual report, and include all major compensation schemes, including stock options. These should also be subject to shareholder approval. The BMA Disclosure Requirements only partially meet this recommendation, by requiring that remuneration be disclosed categorically, but not individually for the initial listings.

Other Responsibilities

The Commercial Companies Law requires that directors notify the board of any direct or indirect interest in a matter being considered by the board. Furthermore, it prohibits directors from participating in deliberations or voting on these issues. This fulfills the IIF recommendation regarding conflicts of interest.

Internal control and risk management should, according to the IIF Code, be a function of the audit committee. As mentioned previously, Bahrain's governance framework has no provision regarding board committees. Moreover, it does not provide for these responsibilities to be considered by any other group or person.

The IIF code also encourages companies to have an investor relations program and to provide a policy statement concerning environmental issues and social responsibility. There are no such provisions in Bahrain's corporate governance framework.

Accounting/Auditing

Bahrain's corporate governance framework agrees with a little more than half of the IIF guidelines in the area of accounting/auditing. Adopting provisions on the creation of an audit committee and assigning it the responsibility of monitoring company risks could further strengthen this area.

Standards

Both the IIF Code and the BMA Disclosure Requirements state that all listed companies must comply with IAS and IFRS and that consolidated accounting be employed for subsidiaries. Both sets of provisions also require audited annual and non-audited quarterly reports.

Further, the IIF Code and the Commercial Companies Law requires the appointment of an independent auditor who does not work at or own stock in the company, is not a member of the board and has no second-degree relative overseeing the company's account.

The IIF Code also advocates the disclosure of off-balance-sheet transactions and the implementation of a mechanism to monitor business risks. Bahrain currently lacks specific provisions on these issues. However, off-balance sheet transactions are disclosed to the extent required by the IFRS.

Audit Committee

The IIF Code emphasizes the importance of an effective audit committee headed by an independent director with a financial background. The committee is required to approve and oversee external audit services and to communicate with independent auditors without executive board members present. As noted, the Bahraini legal framework has no provisions for independent directors or for board committees of any kind.

Finally, the IIF Code also states that the independent audit firm should be prohibited from providing non-audit related services to the company. This is partially addressed by the Commercial Companies Law, which requires the auditor to be independent, as described above. However, in practice, most companies in Bahrain have audit committees.

Transparency of Ownership and Control

Bahrain's governance framework addresses slightly more than half of the IIF Code that pertains to transfer of ownership and control. Adopting a provision that a specific percentage of ownership triggers a buyout offer could result in significant improvement in overall shareholder treatment.

Bahrain's laws and regulations define a major shareholder as any shareholder that is the beneficial owner of 5 percent or more of each class of the issuer's voting securities, but they do not have a provision to trigger buyout offers when ownership exceeds a set percentage (as mentioned in the section on major capital changes). However, in practice, shareholdings of 5 percent or more have to be disclosed to the CBB, and shareholdings above 10% have to be approved. The IIF Code also suggests that companies disclose the shareholdings of both directors and senior executives. It also requires disclosure of names of shareholders that own more than 3-10 percent of outstanding shares. Of particular importance is the requirement that all insider dealings by directors and senior executives be disclosed.

The Bahraini legal framework requires that the shareholdings of all directors, shareholders, and employees be disclosed at the end of the financial year. The names of the major shareholders must be listed, along with a schedule representing how many shareholders own how much of the company's capital. In addition, insider dealings must be disclosed to the public immediately, unless permission is granted by the CBB to withhold the information.

Regulatory Environment

Bahrain's corporate governance institutional framework addresses many of the key guidelines found in the IIF Code that pertain to regulatory issues. The most significant issue in this area is the lack of independence each organization has from the government. While the enactment of Law No. 64 of 2006 strengthened the operational independence of the CBB, the creation of a separate securities supervisory authority would be an improvement.

The IIF Code states that the capital markets supervisory authority and the stock exchange should have adequate enforcement powers, and that stock exchanges should have the power to grant, review, suspend or terminate listings. Also, all enforcement authorities should have adequate staffing and professional skills. The disciplinary board of the BSE may suspend trading or strike off companies from the Exchange. Moreover, the CBB also has significant enforcement powers including imposing fines, penalties and imprisonment. According to the IIF Code, both organizations should be politically independent.

**Comparison of IIF Code and
the Commercial Companies Law (CCL), the Bahrain Monetary Agency Disclosure Standards (BMA
Disclosure), and Resolution No. 13/1988 on the Issuance of Internal Regulation for the Bahrain Stock
Exchange (BSE Regulation)**

	IIF	The Commercial Companies Law (CCL), The Bahrain Monetary Agency Disclosure Standards (BMA Disclosure), and Resolution No. 13/1988 on the Issuance of Internal Regulation for the Bahrain Stock Exchange (BSE Regulation)
Minority Shareholder Protection		
Voting rights		
Proxy voting	Firms are encouraged to allow proxy voting.	Any shareholder may delegate a person, from among the shareholders or from among non-shareholders to attend the general assembly on his behalf, provided that this person shall not be the chairman of the board or from among the members of the board of directors or from among the members of the company's staff. However, this shall not prejudice the right to delegate a first-degree relative. The company shall prepare a special written form for this purpose. The delegate shall not represent in this capacity a number of votes exceeding 5% of the issued capital in the general assembly meeting. (CL Article 203)
One-share, one-vote principle	"One-share, one-vote" should be a threshold requirement for new issues.	Each shareholder has a number of votes equal to his number of shares in the company. (CL Article 203)
Cumulative voting	Cumulative voting should be permitted.	No provision.*

* This regulation will be improved with the passing of the Commercial Companies Law

Capital structure		
<p>Takeover/buyout/merger - Procedures on major corporate changes</p>	<p>Shareholder approval of mergers and major asset transactions should be required.</p> <p>If an offer is made above a reasonable minimum threshold of outstanding stock, a significant portion of that purchase must be through a public offer.</p> <p>Ownership exceeding 35% triggers a public offer in which all shareholders are treated equally.</p> <p>Under a merger or takeover, minority shareholders should have a legal right to sell shares at appraised value.</p>	<p>Winding up the company or merging it with another company are matters reserved for the extraordinary general assembly. (CL Article 210)</p> <p>Shareholders may object to merger within 60 days after the publication date. (CL Article 315)</p> <p>Acquisition or disposal of 10% or more of the paid-up capital of any listed issue on the BSE should be approved by the Agency (CBB), prior to the execution of such order on the Exchange. (BSE Disclosure Article 32)</p>
<p>Capital increases (pre-emptive rights)</p>	<p>Shareholder approval is required. Any capital increase over a period of one year and above a minimum threshold must first be offered to all existing shareholders.</p>	<p>Increasing or reducing the company's capital are matters reserved for the extraordinary general assembly. (CL Article 210)</p> <p>Shareholders must be given the priority right to subscribe to new shares. (CL Article 128)</p>
<p>Share buybacks</p>	<p>Details of share buybacks should be fully disclosed to shareholders.</p>	<p>No provision.</p>
Shareholder meeting		
<p>Meeting notice and agenda</p>	<p>Meeting notice and agenda should be sent to shareholders within a reasonable amount of time prior to meetings.</p>	<p>The company is required to hold a meeting at least once a year, within three months of the end of the FY. (BSE Regulation and BSE Disclosure Article 32)</p> <p>The date and location of meetings are decided upon in the company's articles of association, and published in two Arabic newspapers, one of which must be local. These should be published at least 15 days prior to the meeting and must include the agenda. (BSE Regulation)</p>

Special meetings	Minority shareholders should be able to call special meetings with some minimum threshold of the outstanding shares.	Shareholders may call a special meeting if they represent at least 10% of the company's capital. The auditor may also call a special meeting. (CL Article 198, 180)
Treatment of foreign shareholders	Foreign shareholders should be treated equally with domestic shareholders.	GCC nationals may own up to 100% of the shares of listed Bahraini companies. Non-GCC nationals may own up to 49% of a listed company's capital.* (Amiri Decree No. 10/1999)
Conflicts between shareholders	Should have mechanisms whereby a majority of minority shareholders can trigger an arbitration procedure to resolve conflicts between minority and controlling shareholders.	An Arbitration Committee established by the Exchange Board shall adjudicate on all disputes relating to transactions carried out on the Exchange. (Internal Regulation for BSE, Article 56) The court may overrule any resolution passed to the advantage or disadvantage of a certain class of shareholders or members of the BoD or others without taking the company's interests into account. (CL Article 215)
Quorum	Should not be set too high or too low. Suggested level would be about 30% and should include some independent non-majority-owning shareholders.	In order to be valid, 50% of the company's capital must be represented at the meeting. If this is not achieved, a second meeting is called that requires 30% of the company's capital to be represented. If this is also not achieved, a third and final meeting is called which is valid regardless of the percentage of company capital represented. (CL Article 201)
Petition rules/objection to majority shareholder actions	Minority shareholders should have the right to formally present a view to the board if they own some predefined minimum threshold of outstanding shares.	If the competent government body or a shareholding public entity or a number of shareholders representing at least 10% of the company's capital requests the BoD to include a certain subject in the agenda but the board did not do so, the general assembly shall have the right to consider this subject at the request of the interested party. (CL Article 207)

Structure and Responsibilities of the Board of Directors*		
Board structure		
Definition of independence	Cannot have a business or personal relationship with the management or company, and cannot be a controlling shareholder such that independence, or appearance of independence, is jeopardized.	Members of the board of directors must own or represent a person that owns 1% of the capital of the company or shares valued at ten thousand Bahrain dinars or more, whichever is higher. Experts can be appointed if they meet the conditions of the Ministry of Commerce and Industry. (CL Article 177)
Share of independent directors	At least one-third of the board should be non-executive, a majority of whom should be independent.	No provision.
Frequency and record of meetings	For large companies, board meetings every quarter, audit committee meetings every 6 months. Minutes of meetings should become part of public record.	The board of directors must meet at least four times in a financial year. (CL Articles 180, 194) Minutes should be taken at each meeting and kept at the company headquarters and regulated by the same provisions as the commercial books. (BSE Regulation)
Quorum	Should consist of executive, non-executive, and independent non-executive members.	No provision.
Nomination and election of directors	Should be done by nomination committee chaired by an independent director. Minority shareholders should have mechanism for putting forward directors at Annual General Meeting (AGM) and Extraordinary General Meeting (EGM).	Directors must be elected by secret ballot. (CL Article 176)

Term limits for independent directors	For large companies, re-election should be every 3 years with specified term limits.	The term for all directors should be three years, subject to renewal. (CL)
Board committees	The board should set up 3 essential committees: nomination, compensation and audit.	No provision.
Formal evaluation of board members	For large companies, nomination committee must review directors ahead of formal re-election at AGM.	No provision.
Disclosure		
Immediate disclosure of information that affects share prices, including major asset sales or pledges	Any material information that could affect share prices should be disclosed through stock exchange. Material information includes acquisition/disposal of assets, board changes, related-party deals, ownership changes, directors' shareholdings, etc.	Immediate public disclosure is required of any material information that would affect an investor's decision to invest. This includes any change in major shareholders, related-party transactions, etc. (BMA Disclosure)
Procedures for information release	Through local exchanges, and as best practice, through company website.	Material information must be disclosed to the CBB, BSE, and business and financial newswire services, internet and/or broadcast media simultaneously. (BMA Disclosure)
Remuneration of directors	Should be disclosed in annual report. All major compensation schemes, including stock options, should be fully disclosed and subject to shareholder approval.	Remuneration must be disclosed categorically, but not individually for the initial listings. (BMA Disclosure)
Other responsibilities		
Conflict of interest	Any potential or actual conflicts of interest on the part of directors should be disclosed. Board members should abstain from voting if they have a conflict of interest pertaining to that matter.	Directors must notify the board of any direct or indirect interest and must not participate in deliberations or voting on these issues. Notes must be made in the meeting minutes. (CL Article 189)

Integrity of internal control and risk management system	Should be a function of the audit committee.	No provision.
Investor relations	Should have an investor relations program.	No provision.
Social responsibility and ethics	Make a statement on policy concerning environmental issues and social responsibility.	No provision.
Accounting/Auditing		
Standards		
National/international GAAP	Identify accounting standard used. Comply with local practices and use consolidated accounting (annually) for all subsidiaries in which sizable ownership exists.	Companies must comply with IAS and IFRS. (BMA Disclosure)
Frequency	Semi-annually audited report at end-FY.	Companies must publish un-audited semi-annual financial statements and an audited annual financial statement within 3 months of the end of the FY. (BSE Regulation) BMA requires that quarterly reports be submitted to them within 2 months of the end of the quarter and a hard copy of the audited annual financial statement within 6months of the end of the FY. (BMA Disclosure)

<p>Audit quality</p>	<p>Independent public accountant. As a best practice, auditors should adhere to the global standards devised by the International Forum on Accountancy Development (IFAD).</p>	<p>An independent licensed auditor must be appointed by the ordinary general assembly. (CL Article 217)</p> <p>An auditor is considered independent when the following criteria are met:</p> <ul style="list-style-type: none"> • must not be the chairman or a member of the board • must not work for the company • must not be a second-degree relative of a person overseeing the company's account • must not own stock in the company that he is being audited
<p>Off-balance sheet transactions</p>	<p>Listing requirements should specify disclosure of off-balance-sheet transactions in the annual report with materiality level for disclosure.</p>	<p>Disclosure to be made to the extent required by the IFRS.</p>
<p>Risk factors/ monitoring procedures</p>	<p>Should be statement from audit committee in reports and accounts addressing business risks. Need a mechanism for review by auditors.</p>	<p>No provision.</p>
<p>Audit committee</p>		
<p>Audit committee</p>	<p>For large firms, must be chaired by qualified independent director with a financial background</p>	<p>No provision.</p>
<p>Relationship/communication with internal and external auditors</p>	<p>Committee should approve services provided by external auditor. Breakdown of proportion of fees paid for each service should be made available in annual report. As a best practice, communication with auditors should be without executives present. Contemporaneous provision of audit and non-audit services from the same entity should be prohibited.</p>	<p>The company is required to appoint an independent auditor. (CL)</p>

Transparency of Ownership and Control		
Majority ownership	Significant ownership (20-50% including cross-holdings) is deemed to be control.	A major shareholder is defined as a shareholder that is the beneficial owner of 5% or more of each class of the issuer's voting securities. (BMA Disclosure)
Buyout offer to minority shareholders	Ownership exceeding 35% triggers a buyout offer in which all shareholders are treated equally.	Acquisition or disposal of 10% or more of the paid-up capital of any listed issue on the BSE should be approved by the Agency (CBB), prior to the execution of such order on the Exchange. (BSE Disclosure Article 32)
Related-party ownership	Companies should disclose directors' and senior executives' shareholdings, and all insider dealings by directors and senior executives should be disclosed.	The company must disclose shareholdings of all directors, shareholders, and employees. Insider dealings should be immediately disclosed to the public, unless it is insignificant enough not to have affected the market, then, with Agency permission, it may be withheld. (BMA Disclosure)
Minimally significant shareholders	Shareholders with minimally significant ownership (greater than 3-10%) of outstanding shares must disclose their holdings.	The company must disclose shareholdings of all shareholders at the end of the FY by setting out a distribution schedule that provides the number of shares, number of shareholders of each of the following categories: Less than 1% 1% up to less than 5% 5% up to less than 10% 10% up to less than 20% 20% up to less than 50% 50% and above (BMA Disclosure)

Regulatory Environment		
Enforcement powers	The supervisory authority and the exchange must have adequate enforcement powers. Exchanges should have the power to grant, review, suspend, or terminate the listing of securities. Enforcement authorities should have adequate training and an understanding of the judicial process.	<p>The CBB is the regulator for the financial sector, including banking, insurance, and capital markets.</p> <p>The disciplinary board of the BSE may suspend trading in respect of the violating company and may strike off listed and unlisted companies from the Exchange or convert a listed company into an unlisted company whose securities are admitted for trading. (BSE Regulation)</p> <p>The CBB also has a wide range of enforcement powers including imposing fines, penalties and imprisonment for certain violations.</p>
Independence of supervisory body and of exchange	The supervisory body and the exchange should be independent from government and industry.	<p>The CBB is the state-owned central bank of the Kingdom of Bahrain.</p> <p>The BSE is licensed and regulated by the CBB.</p>



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