UAE SECURITIES AND COMMODITIES AUTHORITY: CORPORATE GOVERNANCE UPDATE

The Securities and Commodities Authority ("**SCA**"), as the UAE's securities markets regulator, has played an active role in issuing decisions and relief measures in response to the COVID-19 pandemic. Beyond these response measures, however, the SCA continues to remain active in issuing regulations to align the UAE securities markets with international corporate governance standards. This briefing looks at key developments in relation to the SCA's updated Corporate Governance Regulations and in respect of listed companies in financial distress.

SCA regulatory developments

- Corporate governance regulations: reissued and refocused regulations
- Companies in financial distress: implementation of a stock watch system and other measures for public companies

NEW CORPORATE GOVERNANCE FRAMEWORK

On 27 April 2020, the SCA's newly issued Corporate Governance Regulations (SCA Resolution 3 R/M of 2020) (as amended by the decision of the Chairman of the SCA No. 8 of 21) ("**Updated CG Regulations**") came into effect, repealing the previous 2016 Corporate Governance Regulations.

In terms of scope and application, the Updated CG Regulations apply to all listed PJSCs, other than foreign companies listed on one of the local markets. The objectives of the Updated CG Regulations is to strengthen the key pillars of corporate governance, identified as:

- Accountability
- Fairness
- Disclosure
- Transparency
- Responsibility

While the Updated CG Regulations do not substantially overhaul the previous regulations, there are some key developments which are highlighted below.

Key Themes

Oversight and Management

The Updated CG Regulations introduce the concept of a dual management structure that listed companies may elect to adopt. Similar to the German two tier board system for listed companies, the proposed dual management structure under the Updated CG Regulations, provides for two separate board committees:

- a Control Committee - made up of non-executive members, with oversight function for the Executive Committee and power to appoint or dismiss members of the Executive Committee; and
- an Executive Committee - made up of executive board members and responsible for developing and implementing the company strategy as approved by the Control Committee.

In order to adopt the dual management structure, the board and shareholders of the listed company must approve the change. The adoption of the dual management structure would also require a change to the company's Articles of Association. Disclosures must also be made in respect of the changes and published on the company's website once adopted.

Conflicts of Interest

The Updated CG Regulations place a renewed emphasis on the treatment of conflicts of interest. In alignment with the related obligations under the UAE Commercial Companies Law, the regulations require board members to disclose, in advance, any potential or actual conflict in relation to the listed company and its business. Board members must avoid all potential or actual conflicts and are prohibited from participating in any decision making process where any such conflict may arise.

The Updated CG Regulations also codify a disqualification regime for directors of listed PJSCs. In particular, failure to comply with the conflicts rules can result in the dismissal of board members along with a potential ban on their ability to be elected, or appointed, as a director, or part of the management team, of any listed company for a period of three years from the date of their dismissal.

Where a conflict of interest is not clear from the facts, the relevant individual must disclose the potential conflict to the chairman who must then decide whether or not a conflict exists.

The listed company must maintain detailed records in relation to conflicts of interest and decisions in relation thereto, in addition to recording these in the minutes of the relevant board meetings.

Gender Diversity

The Updated CG Rules require listed companies to have at least one female member on the board of directors and this must be disclosed in the annual governance report.

ESG

In line with global initiatives, the Updated CG Regulations now also focus on environmental, social and governance (ESG) factors with respect to listed companies and require the publication of a sustainability report setting out the company's strategy and the impact of the company's operations from an ESG perspective. Listed companies will also be required to comply with Global Reporting Initiative (GRI) standards and any sustainability standards and reporting requirements issued by the relevant stock exchange on which the company is listed. From the financial year 2021 onwards, the annual sustainability report must be submitted to the SCA on the date that is the earlier of (i) 90 days from the end of each financial year; or (ii) before the date of the annual general assembly.

Companies in Financial Distress and Disclosure Requirements

In recent years, and including in response to the COVID-19 pandemic, the SCA has focused on measures to address financial distress in listed companies and has issued two principal regulations with related disclosure and financial reporting obligations. The key developments are highlighted below.

Disclosures in relation to losses

The SCA, through resolution No. 32/R.M of 2019, introduced a "stock watch" system to deal with listed companies that have accumulated losses that exceed 20% or more of the share capital of the relevant listed company.

Where a listed company has suffered accumulated losses in excess of 20% of its share capital it must include detailed analysis of such losses as part of its financial disclosures, including the reasons for such losses and the steps being taken to address the losses going forward. In addition, where such losses:

1. are between 20 – 50% of the company's share capital, a yellow symbol will be added to the company's name on Market Watch (which will be removed when the losses are reduced to below 20% of the capital); and
2. reach or exceed 50% of the company's share capital, a red symbol will be added to the company's name on Market Watch.

In respect of point 2, the SCA may also suspend trading of the company's shares until a plan has been submitted to address the accumulated losses (which must be submitted within 30 days of the date of disclosure of losses exceeding 50%). The chairman, the board of directors of the company, its general manager, and any of its employees "*who have knowledge of material information of the company*" will also be prohibited from trading in the company's shares during this time.

The company's board of directors must form a committee for the implementation of a recovery plan. The committee must comprise of at least three members, including an independent board member and an expert approved by the SCA. The committee must oversee the implementation of the plan and present a periodical report to the company's board of directors on its progress and results. The company must also inform the SCA and the relevant market, on a monthly basis or upon request, of the progress being made by the company against the recovery plan, including any deviations from it.

Failure to comply with the disclosure requirements in relation to losses may result in fines, suspension of trading or, in extreme cases, cancellation of the listing of the company's shares on the relevant market.

Procedures for dealing with Companies in Financial Distress

Pursuant to the Regulations for the Listing of Securities and Commodities (SCA Decision No. 12 of 2000) (the "**Listing Regulations**"), the SCA issued a set of new rules for listed companies in financial distress through SCA Board Decision No. 13 R.M of 2020, which came into effect on 1 July 2020 (the "**Financial Distress Rules**")

The Financial Distress Rules expand on the conditions for classification as a Category One or Category Two company under Article 6 of the Listing Regulations (see conditions for classification in the textbox on this page).

Stock Watch System for Listed Companies

- Yellow marker - accumulated losses between 20% and 50% of the share capital
- Red marker - accumulated losses exceed 50% of the share capital
- Recovery plan to be submitted to SCA for addressing accumulated losses in case they exceed 50% of the share capital
- Ongoing disclosure requirements in respect of recovery plan

To remain classified as a Category One company, the following conditions must be satisfied:

- the conditions set out in Article 6 of the Listing Regulations;
- the listing of the company's shares must not have been suspended for a period of six (6) months or more; and
- the company has not incurred accumulated losses amounting to 50% or more of its capital, based on its latest audited annual financial statements.

Any company that does not satisfy the above-mentioned conditions will likely be classified as a Category Two company.

If a Category One company becomes a Category Two company as a result of a suspension of its shares for six months or more, its shares will no longer be suspended.

If a company is, or becomes classified as, a Category Two Company:

- its shares will be traded on a designated trading screen developed by the relevant market for Category Two companies and it will be denoted as a Category Two company (in addition to any yellow or red markers imposed under the stock watch system described above); and
- the relevant market must make an announcement of the categorisation, the requirements of the Watch List, (as described below), the company's status and financial position and the risks of investment therein.

The Financial Distress Rules will also establish a monitoring committee comprised of SCA members, members of the relevant markets and regulatory authorities (the "**Monitoring Committee**"). The role of the Monitoring Committee is to monitor companies who are classified as Category Two companies as a result of the failure to comply with the Category 1 conditions under the rules (the "**Watch List**").

Companies on the Watch List must:

- create and provide to the monitoring committee an action plan for adjusting its affairs (approved by its board of directors and a financial expert approved by the SCA); and
- provide a quarterly report (or upon request) to the monitoring committee in relation to the implementation of its action plan and its compliance with disclosure and listing requirements under applicable rules and regulations.

The companies on the Watch List have a period of one year (extendable to three years) from the date of their classification as a Category 2 company to take the necessary actions to regularise their status. If they fail to do so within the prescribed time period, the Monitoring Committee may recommend that such company remains as a Category Two company or that its shares be de-listed. If the SCA decides, after consultation with the relevant market, that the company shares are to be de-listed, the SCA must, within thirty (30) days of such decision, notify the company of the decision. The relevant market must announce the decision on its website within thirty (30) days of the decision, detailing how the de-listed company's shares will be transferred after delisting.

Classification of listed companies under the Listing Regulations – Key Conditions:

- Category One
  - 2 years of audited financial statements
  - SCA approval for listing
  - Paid-up capital is the higher of AED 25 million or 35% of the subscribed capital
  - OGM is held at least once a year
- Category Two
  - does not satisfy one or more Category 1 conditions or any conditions imposed by the SCA from time to time

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