Enhancing Corporate Governance Controls

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Adequate corporate governance controls are particularly important in the banking sector, where the financial risks are relatively high, affecting not only the individual bank in question, but also the banking sector as a whole and the sustainability of the financial market in that country. The financial crisis of 2008 provided a clear, irrefutable example of the substantial costs of failing to have effective controls in place. Recognizing this, the Organization for Economic Co-operation and Development (OECD), the Basel Committee on Banking Supervision, and the Financial Stability Board each issued international standards and/or guiding principles for the enhancement of corporate governance controls, including those applicable to banks.

Most recently, the Central Bank of Jordan ("**Central Bank**") issued the Corporate Governance Instructions for Banks no. 58 for the year 2014 ("**Corporate Governance Instructions**") codifying and developing the principles provided under the Bank Directors' Handbook of Corporate Governance and the Corporate Governance Code for Banks in Jordan issued in 2007, as they apply to conventional banks.

The Corporate Governance Instructions are based on the following principles:

- separation of the authorities of the Chairman of the Board and the General Manager (CEO);
- the independence of the Chairman of the Board of Directors;
- regulatory and administrative frameworks for the allocation of authorities and responsibilities, and for risk control;
- treatment of all stakeholders in a fair and transparent manner, including the importance of proper disclosure for the purposes of accountability;
- accountability of management to stakeholders;
- appropriateness test re the qualifications, competence, integrity, and reputation of the management of the bank.

The Corporate Governance Instructions aim to achieve the foregoing by introducing the following requirements:

I. Board Composition

Pursuant to the Corporate Governance Instructions, the Board of Directors shall be composed of not less than 11 Board members, unless the bank is owned by one shareholder. None of the Board members shall be an "*executive director*", in the sense that none of them shall be entitled to consideration for the day-to-day management of the bank.

Additionally, a minimum of 4 Board members shall be "*independent*". In order to qualify as an independent director, the relevant Board member must satisfy, as a minimum, the following requirements (Article 6(d) of the Corporate Governance Instructions):

- not to have been an executive director of the Board within the last three years;
- not to have been an employee of the bank or any subsidiary thereof, within the last three years;

- not to be related, up to the second degree, to any other Board member or to a member of any board of any subsidiary of the bank, or to any "*qualifying shareholder*" of the bank (i.e. a person holding directly or indirectly 5% or more of the share capital of the bank);
- not to be related, up to the second degree, to any of the senior executive management of the bank, or any senior executive manager of any subsidiary of the bank;
- not to be a partner or employee of the bank's external auditor, currently or within the last three years, and not to be related, to the first degree, to the person responsible for auditing the bank;
- not to be a "*qualifying shareholder*" (as defined above) of the bank, or a representative of or affiliated to a qualifying shareholder, or otherwise holding in concert with its affiliates a qualifying shareholding, or be a qualifying shareholder of a subsidiary of the bank or of the bank's group;
- not to have occupied the position of Board member or member of a management committee of the bank or any of its subsidiaries for more than 8 consecutive years;
- for said member, nor any company in which he is a Board member or qualifying shareholder, to have been granted credit by the bank exceeding 5% of the subscribed share capital of the bank, nor have been a guarantor to a credit exceeding the same threshold; and
- to be of high financial or banking expertise and qualifications.

It should be noted that this marks the first time Jordanian laws and regulations have imposed a legal requirement to have "*independent directors*", as opposed to only best practices or guiding principles, and as such, is seen as a positive step towards ensuring that the banks' Board of Directors are performing their duties to the best interest of the bank *itself*, with regard to all stakeholders.

In addition to the foregoing, all Board members are further required to satisfy an appropriateness test, in accordance with the respective bank's internal policies bearing in mind the minimum standards provided under Article 12 of the Corporate Governance Instructions (e.g. minimum 25 years of age, no less than 5 years of banking, financial or similar experience, not acting as a board member or other senior personnel at another bank, etc.).

II. Responsibilities of the Board

The Board of Directors of the bank is tasked with, *inter alia*, the supervision of the senior executive management of the bank, as well as with the adoption of appropriate policies and procedures for the purpose of supervising the performance of the bank as a whole, including in relation to its strategic objectives. For this purpose, the Board of Directors shall adopt KPIs to measure performance against targeted objectives, adopt strategic policies for the control and operation of risks, ensure the installation of an adequate Management Information System (MIS), etc.

The Board of Directors shall be held responsible for (i) the integrity of all banking operations (ii) the financial position of the bank, (iii) the extent of its compliance with the requirements of the Central Bank and other competent regulatory bodies, (iv) the extent to which it has regard to stakeholders' interests, (v) the extent of its operation within the framework of applicable laws and its internal policies, and (vi) the continuous effective supervision of the activities of the bank, including its outsourced activities.

III. Board Committees

The Corporate Governance Instructions provide for the establishment, composition, and duties of certain committees of the Board, including a Corporate Governance Committee, an Audit Committee, a Nomination and Rewards Committee, and a Risk Management Committee.

IV. Senior Executive Management

Similar to the requirements in relation to Board members, Senior Executive personnel are also required to satisfy an appropriateness test. This includes being persons of high integrity and credibility, holding certain educational qualifications, having not less than 5 (or depending on the position, 10) years of relevant experience, being free to act for the bank full-time, etc.

Additionally, in order to ensure that said personnel continue to perform in the manner which best serves the interests of the bank, their performance and remuneration are subject to review in accordance with the bank's internal policies, having regard to the minimum conditions provided under the Corporate Governance Instructions.

In relation to the General Manager (CEO), it is important to note that the same person may not act as both the General Manager and the Chairman of the Board of Directors. Further, the General Manager shall not be related, up to the fourth degree, to the Chairman of the Board, any Board member, nor any qualifying shareholder.

V. Limiting the Influence of Qualifying Shareholders

To ensure more effective management of banks, the Corporate Governance Instructions provide for certain safeguards as against the influence of qualifying shareholders, by requiring that:

- no qualifying shareholder may occupy a senior executive position at that bank; and
- the senior executive management shall be subordinate to the Board of Directors only, and shall act within the framework of the delegation granted to it by said authority.

VI. Disclosure, Confidentiality of Information and Conflicts of Interest

The Corporate Governance Instructions build upon the conditions provided for under the Jordanian Banking Law, in relation to each of (i) disclosure of information to stakeholders, (ii) the requirement to maintain confidentiality of certain information, and (iii) the manner for dealing with conflicts of interest, including highlighting the minimum standards and courses of action to be undertaken in said context.

VII. Corporate Social Responsibility

The Corporate Governance Instructions further require Boards of Directors of banks to ensure that their respective bank has adopted appropriate social initiatives in the Environment, Health and Safety, and Education fields, and to further the grant of financing to small and medium sized enterprises ("**SMEs**") at appropriate prices and terms.

With regard to the above, it is important to note that banks are granted certain interim periods in which to comply with the Corporate Governance Instructions. Importantly, banks are required to amend their respective Corporate Governance Handbooks to account for the additional requirements provided pursuant to the Corporate Governance Instructions, and forward the same to the Central Bank for approval, within 120 days of the date the Instructions came into force.

The shift towards a more regulated corporate regime is vital in today's modern world. Not only does history show us time and time again that it pays well to abide by corporate governance, but also the requirements and expectations of the global market dictate that in order for Jordanian banks to be able to compete on an international level, certain safeguards are necessary to ensure the continued prosperity and sustainable growth of the relevant banks and the Jordanian financial market as a whole.