The Code of Corporate Governance Practices for Issuers of Securities to the Public

July 2016

Introduction

The Capital Markets Act authorizes the Capital Markets Authority to prescribe guidelines on corporate governance of companies whose securities have been issued to the public.

In exercising this mandate as authorized under the Act, the Capital Markets Authority recently published The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 ("The New Code") which will become effective from 15 December 2016. The New Code will replace the Guidelines on Corporate Governance practices by Public listed Companies in Kenya, 2002. ("2002 Corporate Governance Code"). This alert focuses on the recommendations and requirements of The 2015 Corporate Governance Code which is organized into six pillars namely Board Operations and control, Rights of Shareholders, Stakeholder Relations, Ethics and Social Responsibility, Accountability, Risk Management and Internal Control, and Transparency and Disclosure.

Each of these pillars offers principles and recommendations which are supported by guidelines on implementation.

At the end of every financial year, Boards will be required to disclose in the annual report a statement of policy on good governance and the status of application of The New Code. This level of disclosure will allow stakeholders to comment on and challenge the Board to improve the level of governance within an organization.

At a glance

- Chairman and CEO positions must now be separate
- Board members remuneration to be aligned to pay of directors in the same industry
- Term of Independent Directors now limited to 9 years
- Rigorous disclosures required of the Board
- Code of Ethics to be formalised
- Embracing technology to communicate with shareholders.

The 2015 Corporate Governance Code has also moved away from a "Comply or Explain" approach to an "Apply or explain" approach therefore taking a principle based approach as opposed to the 2002 Corporate Governance Code which was rule based. For this reason, where the Board believes it to be in the best interest of the Company, it can adopt a practice different from that recommended in the New Code but must explain it.

Board Operations and Control

While the old guidelines required formal and transparent procedures for appointment of new Board members, the new guidelines have gone further to recommend that the procedures be documented and approved by the Board before they can be used. Where necessary, the procedures shall be subjected to shareholder approval. This requirement will encourage listed companies to provide greater transparency of their Board process when searching for and selecting new directors and will ensure that appointments to the Board are made on merit and against objective criteria.

No director can serve a cumulative term of more than 9 years but the director after 9 years is permitted to serve on the Board as a non-independent member.

The New Code also recommends that listed companies issue formal appointment letters to the newly appointment Board members setting out the conditions and terms of their appointment. The issuing of a formal letter of appointment emphasizes the importance of the commitment expected of the new director and puts the new director on notice about the Company's expectations of him or her. It also allows the Company as the appointing authority to be clear about the conditions that attach to the director's role.

The New Code has gone further to reduce the number of directorships that a member of the Board can hold at any given time. Under the previous guidelines, a director was allowed to be a director of up to five public listed companies. This has now been reduced to three with the view that this will allow for more effective participation by the Board.

With respect to corporate directors who have appointed alternate directors, the alternate director is now restricted to two public listed companies down from three. Executive directors can only be directors of one other listed company while a Chairperson of the Board is prohibited from holding such a position in more than two public listed companies.

While recognizing that multiple directorships allow for better connections and subsequently expose directors to a wider variety of diverse operating environments, the new limitations underscore the concern that a director of too many companies is unlikely to be an effective monitor of corporate governance due to their inability to allocate sufficient time to any one company.

Role of Chairperson and CEO and Role of Board

The previous Code recommended that the Chairman and CEO positions be separate but allowed for combining them where there was a clear rationale and justification. The New Code, recognizing that it may be difficult to objectively handle the demands of both management and governance, now explicitly prohibits combining these two roles. This new restriction serves to remove the company's entire decision making process from the hands of one person and provides necessary checks and balances. It also allows for objective evaluation of the CEO by a Board on which he or she does not sit on.

The New Code goes further to recommend that the Board puts in place formal policies for sustainability of Environmental, Social and Governance aspects of business which underpin sustainability, related party transactions and conflict of interest. This is in tandem with the Companies Act 2015 that requires directors of listed companies to specify, in their business review within their directors report, the main trends and factors likely to affect the future development and information about environmental matters and social community issues.

With the need to ensure that fiduciaries are not in a state of conflict with their personal interest, and that any conflict of interests are mitigated accordingly, the New Code requires that the Board have in place policies and procedures to ensure independence of its members. In addition to the policies, the independence of the Board members will be assessed on an annual basis.

It shall be the responsibility of the entire Board to conduct this assessment. Like the previous guidelines, the New Code provides clear guidance of who an independent Board member is considered to be but has now relaxed this provision to require a shorter cooling off period for Board members who have previously served in an executive capacity or have served as an advisor or consultant to the company. This period has now been decreased from five to three years.

The New Code now also stipulates a tenure limit to the time an individual can serve as an independent director. No director can serve a cumulative term of more than 9 years but the director after 9 years is permitted to serve on the Board as a non-independent member. Arguably, long tenures allowed directors to accumulate institutional knowledge specific to the business. However, a different school of thought argues

that these long tenures may affect a directors' ability to serve as an independent steward. This restriction on tenure in the New Code is a reflection of global trends where director tenure has been getting increased attention from the investors and regulators.

Company Secretary

The New Code puts the onus of the Board to consult with the Company Secretary on procedural and regulatory matters and empower the Secretary as necessary to allow him or her to carry out her role.

Age Limit

The New Code now recommends an age limit of 70 years but provides for an exception to this if members at an annual general meeting vote to retain a Board member who is over 70 years. The exception provided is an appreciation that shareholders may view Board members as having specialized industry knowledge that extends their usefulness well beyond their 70s and shareholders may therefore want to retain them on the Board.

Code of Ethics

In a departure from the last code which was silent on this issue, the New Code provides that the Board must formalize their ethical standards though the development of a Code of Ethics and Conduct. The Board will be responsible for ensuring that there are sufficient systems in place to support the implementation of the Code of Ethics within the corporation and promote compliance with it. The fact that this responsibility will rest with the Board is an indication that the Capital Markets Authority expects the Board to set the Company's ethical tone.

Board Charter

The New Code now requires the Board to have a charter which shall set out the roles, responsibilities and authorities of the Board and set the direction for the Board. The requirement is that the Board Charter must be published on the company's website.

Work Plan

A common feature of any 'best practice' Board is the existence of a well-thought-out 'Board work plan' and the New Code recognizes this. The New Code provides guidelines that will ensure that the Board identifies key Board considerations and actions required annually. A work plan will ensure that the Board is well aware of and plans its approach. Directors through the work plan will be well aware of what their commitments for the year are and it will ensure that adequate attention is given to various Board functions which might otherwise be deferred or overlooked.

Evaluation Toolkit

To encourage accountability by the Board, the New Code now requires the Board to agree on an annual evaluations toolkit whose parameters must be developed together with independence governance specialists. The provision of this requirement in the New Code is a recognition that Boards need to assess how effectively they are performing

Board Development and evaluation

The New Code is now recommending that each Board member undergoes at least 12 hours of Board Development per annum on areas of governance from credible sources. This is a recognition that there is a need to enhance the knowledge and awareness of Board members on the principles and practices of good governance and that a Board may need new skills in order to respond effectively to a changing business environment. Board development allows for the Boards to develop a framework of knowledge, skills, and competencies that fit their organizational context and can serve as a basis for the Board's appraisal. The New Code also recommends a self evaluation process for the Board to allow the Board to assess its performance and identify potential gaps in the boardroom. The evaluation requirement extends to the Chief Executive Office and the Company Secretary which again indicates the emphasis of the importance of the Board from a governance perspective knowing how well the CEO is executing his or her mandate.

The Code also recommends a self evaluation process for the Board to allow the Board to assess its performance and identify potential gaps in the boardroom.

The previous Code had no such requirement.With respect to remuneration, the New Code now recommends that the remuneration of both executive and non-executive directors be aligned to the pay of other directors in the same industry.

The industry consideration element may indicate the need to compensate directors according to the risk factors associated with the industry and the economic conditions pertaining to the particular industry at any particular time.

Rights of Shareholders

Directors have a discretion to fix the place of the annual general meeting. As with other powers vested in the directors, it is expected that this power should be exercised in good faith but the New Code goes further to provide guidelines that the Board must take into consideration shareholders expenses and convenience as a primary criterion when selecting the venue and location of the Annual General Meeting.

Recognizing that technology offers many advantages, the New Code recommends that Companies employ modern technology facilities such as teleconferencing and videoconferencing to communicate with shareholders. This will encourage larger participation for those unable to physically attend meetings and curb costs borne by the shareholders to attend meetings.

The New Code mandates that companies must give equitable treatment to all shareholders including minority shareholders and allow them an effective means of redress to the extent that they are unsatisfied with any actions taken by the controlling shareholders.

Appreciating that there may be instances where majority shareholders may expect or demand that the company's affairs be conducted in the manner most beneficial to them, even if that is detrimental to the other shareholders, the New Code puts the onus on directors to be mindful of their duty to act fairly between shareholders when shareholder interests conflict and to exercise their powers and manage the company in the interests of all shareholders.

Stakeholder Relations

The New Code now addresses the importance of managing stakeholder relations. Stakeholders are defined as any group that can affect or be affected by the Company, its decisions and reputation and includes shareholders, customers, suppliers, employees, creditors, regulators, lenders, media, auditors and potential investors.

The Directors primary duty to shareholders is to maximize shareholder value. The New Code therefore realizes that directors should to some extent take into account the interests of stakeholders, identify and understand the interests, views and expectations of all the stakeholders which the Board judges have a legitimate interest in the achievement of company objectives and the way in which these objectives are achieved. It is expected that the consideration of the stakeholders' interests will ultimately have a positive impact on the success the organization.

It is also noteworthy that the stakeholder relations provision requires Boards to put in place a whistle blowing policy for concerns which stakeholders believe cannot be raised through any other means.

Accountability, Risk Management and Internal Control

Recognizing that the Board has the ultimate responsibility for risk management and internal controls, the New Code provides recommendations on accountability, risk management and risk control that will among other things guide the Board in determining the risk appetite of the organization as it pursues its strategic objectives.

We highlight below the recommendations brought out by the New Code:

- It is recommended that listed companies rotate independent auditors every six to nine years;
- It is recommended that the Board continuously works towards the introduction of integrated reporting. This will ensure that stakeholders are able to assess organizations against the commercial, social and environmental context within which they operate and
- The Board is encouraged to establish an effective risk management framework and internal controls procedures and processes. The Board shall, at least annually, ensure that a review of the effectiveness of the Company's risk management practices and internal control systems is conducted and a report made to shareholders to indicate that they had done so. The review shall cover all material controls including financial, strategic operational and compliance.

Transparency and Disclosure

The New Code also introduces more rigorous disclosures. This shows an appreciation for the need to avail important information, both financial and non-financial to allow for investors to make informed decision.

Recommended disclosures

1. Members of the Audit Committee, their qualifications, independence and mandate of such committee
2. Whether an evaluation of the Board, the Chairperson, the CEO and Company Secretary was undertaken
3. Whether independent and other non-executive directors constitute at least two thirds of the Board and if satisfied with the representation of the minority shareholders
4. Statement of the Company's vision, mission, values and strategic objectives and how these influence Board and management's behavior towards maximization of shareholder value
5. Compliance with laws, regulations and standards. A legal and compliance audit is required to be carried out. This was also required in the 2002 Corporate Governance Code. However the New Code requires a governance audit in addition to the Compliance audit
6. Details on Board members: Qualification of directors, other Board memberships, the selection process, criteria used to support the director's independence and any other material information
7. The Company's policy on Corporate Social responsibility and investment.
8. The Company's environmental, social and governance policies
9. Narrative on the financial performance of the Company
10. The Governance structure including the composition and size of the Board, the committees of the Board, management and their mandate
11. The Company's policy on Information Technology
12. Any insider dealings
13. The Company's risk management policy
14. Key shareholders and extent of shareholding
15. Company policy on procurement
16. The Company's whistle blowing policy
17. The Company's policy for remuneration including incentives for the Board and Senior management
18. Resignation of Board Members should be disclosed in two newspapers with national reach in addition to disclosure in the annual report
19. The Board shall include in its annual report a statement of compliance with the Corporate Governance Principles. The statement shall indicate aspects of the New Code which have not been applied, the reasons thereof, indicative timelines and proposed strategies towards application

The New Code also recommends that Companies disclose the following on their websites:

1. Company's Board Charter
2. Company's Code of Ethics and Conduct
3. Whistle Blowing Policy
4. Resignation of Board members

Implementation of the above Corporate Governance principles will preserve the longevity of Companies and their value to stakeholders and ultimately provide a positive contribution to our economy.

Our contacts

Richard Njoroge
Partner
+254 20 285 5604
richard.njoroge@ke.pwc.com

Elizabeth Njendu
Associate Director
+254 20 285 5336
elizabeth.njendu@ke.pwc.com

Cynthia Makau-Mutua
Manager
+254 20 285 5584
cynthia.makau@ke.pwc.com