Legal status of an independent board member: A comparative perspective between the legal position in Kuwait and USA

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Abstract:

While there is no clear definition of what corporate governance is, corporate governance principles can be described as an intervention in the management of a company. Every listed company must have a board of directors. One of the most important corporate governance principles is to strengthen the board composition by having an independent director.

This article deals with one of the most important issues related to corporate governance of Kuwait's main securities market: having independent directors on the board. Corporate governance as it relates to listed companies is sensitive to economic, social and political variables. Consequently, the 2015 Kuwaiti Corporate Governance Code (KCGC) raises a number of questions. For example, what requirements should list companies follow when appointing independent directors? To what extent are listed companies obliged to apply it in present circumstances? Finally, can practical solutions be found that will satisfy the parties concerned?

In discussing the role of independent director in KSE, this paper will compare the provisions of corporate governance in the New York Stock Exchange (NYSE) and those in Kuwait Stock Exchange (KSE). This article will be underpinned by a comparative legal analysis of the NYSE relating to corporate governance in an effort to improve the KCGC.

Keywords: independent director, corporate governance, Kuwaiti Stock Exchange, New York Stock Exchange

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1. Introduction

Corporate governance is a recent development in Kuwaiti financial markets. Corporate governance rules have created a number of new ideas, such as the independence of directors, establishing committees, separation of CEO from the chairman, and other related principles(1). This article will focus on the principle of independent directors.

Until now, the principle of independent directors was uncertain(2). Without proper regulation and legislation, there was widespread controversy about this subject. This led the Government of Kuwait to enact a series of acts from 2013 to 2015(3).

1.1 The Aims of the Article

The primary aim of this research article is to seek a detailed understanding of the KCGC as it relates to having an independent director. It will focus on whether it offers an appropriate framework and, if applicable, will suggest amendments to the code.

In addition to the main aim as set out above, the paper aims to improve the knowledge of the Kuwaiti people about corporate governance(4). It is also hoped that the research will be a useful addition

(1) Corporate governance principles are based on ethical behavior, which means that, in listed companies' activities, it is important to know that simply because something is legal does not mean that it should be done. Something that is legal is not necessarily ethical. Saying that a company is law-abiding does not mean the same as saying that a company is ethical.

(2) Business ethics seeks to identify a balance between doing what is right for the community and doing what is best for a company's shareholders. In terms of business ethics, it is important to study the following important points: corporate governance, risk management and how the "comply or explain" approach works. Companies have a social responsibility that comes with different ethical challenges. For example, in business a good reputation can be more important than legal compliance. Being ethical can sometimes be better than following the "letter of the law".

(3) The 2013 Code is the first Kuwaiti Corporate Governance Code. In 2015 the code is replaced and a number of provisions has been changed. For instance, according to 2013 Code, compliance was mandatory, and failure to comply was a breach of Securities Law No 7 of 2010. Moreover, a company must send a quarterly report to the Kuwaiti Capital Market Authority confirming that it has complied with all of the corporate governance provisions, now it is annual report.

(4) Good governance is based on the promotion of three main ideas. The first is to ensure commitment to ethical behavior and good professional conduct; The second is to ensure oversight and accountability, and the third is to provide an administrative organization that properly distributes powers and responsibilities and separates functions.

to the body of literature in this field and will open a new avenue of research for other Kuwaiti scholars to follow to improve and develop the national economy.

1.2 The Benefits of the Article

There are two potential benefits of this research article. The first benefit will be to highlight the weaknesses of the KCGC in terms of having independent directors so that the code may be improved. Secondly, the article will provide original research that will be of interest and benefit to scholars, policy makers, government officials, law enforcement and others with an interest in this area in Kuwait.

1.3 The Methodology of the Article

There are a number of legal research methodologies, and one tries to select a methodology to suit a particular article. A comparison with more developed stock exchanges is beneficial to learn from their experience. Solving legal problems and finding the best way to apply special laws can be highlighted by using a comparative legal analysis. This type of methodology helps scholars to look outside of a countrys laws to understand how other jurisdictions deal with similar problems and how they developed their laws and rules.

This research article will compare similar legislation in the developed market in the United States (US) to evaluate its potential effectiveness in averting future problems and bringing a better understanding of this subject.

The US has legislation to ensure that firms have an independent director. This legislation has evolved over the years in an effort to increase the effectiveness of corporate governance. As a result, the use of a comparative law approach in this article will help to determine which laws and regulations are the most effective.

1.4 The Scope of the Article

The scope of the article is to understand the existing legal frameworks applicable to the KCGC and to analyze the more controversial role of independent directors in the board. This article also intends to make a comparative analysis of corporate governance systems across the US and Kuwait to gain insight into the Kuwaiti system(5) and to propose recommendations accordingly.

1.5 The Organization of the Article

To achieve its aims, this article is divided into three sections. The first section will discuss the approach to independent directors in the NYSE. Section two will consider the current approach in the KSE toward this subject. Section three will be a comparison between these two approaches, with a view to making recommendations for the KSE.

2. What is the Corporate Governance?

Before discussing the independent director in detail, it would be advisable to consider the subject of corporate governance (CG).

The development of corporate governance started as early as the 1970s, when a few corporate scandals started to emerge which highlighted the risk to an investors shareholding from the irresponsible, negligent and even fraudulent (or near fraudulent) actions of those responsible for governing a company leading to a fall in the companys value and even to its complete collapse(6). This trend continued into the 21st century culminating in the 2008 financial crisis. It is thought that the amount of corporate scandals is caused by the hijacking of the management theory from the main economic opinions in the 1980s. Focusing on increasing shareholder returns, such as large dividends at the expense of retaining and reinvesting profits, caused false economic progress beginning in the 1980s(7).

Corporate governance is multi-faceted, and other aspects of corporate governance affect listed companies, such as risk management,

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(5) The Kuwait corporate governance legislation that deals with corporate governance areas includes the Companies Law 2016, the Securities Law 2010 and listing rules, disclosure rules and regulations promulgated under the KCGC. The KCGC shall be applied to companies listed on the KSE and licensed shareholding companies, whether they are listed or unlisted, except the units subject to the supervision of the Central Bank. The Kuwait corporate governance provisions became mandatory in the Kuwaiti corporate governance code 2013. Some of the provisions of the KCGC are mandatory, while others are voluntary, especially those relating to "comply or explain" principles.

(6) Alessio Pacces, Rethinking Corporate Governance: The Law and Economics of Control Powers (Routledge 2012) 3.

(7) Lynn Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Berrett Koehler Publishers 2012) 83-85.

bribery, fraud, and poor board practice. Several possible corporate governance areas have developed over time. These include board composition (leadership), board effectiveness, the role of board committees, risk management, remuneration, relationships with shareholders, bribery and corruption, IT governance, mergers and acquisition, succession planning, sustainability, climate change, and proxy access.

It is difficult to find fixed rules of governance that are suitable for every situation(8). Corporate governance principles do not remain static; they evolve with the surrounding developments and must continue to develop. Controlling corporate governance can be likened to controlling a car, which requires controlling the steering wheel, the brake and the accelerator to ensure that the car reaches its destination(9).

Although the term ‘‘corporate governance’’ is used every day in the financial press, it is a complex term, because it relates to various matters, such as law, economics, management, accounting and other subjects, and each field has its own developments. It is important to remember that there is no clear definition of corporate governance; it is multi-faceted. Corporate governance is about the relationship between the board and the shareholders in governing and controlling the company. Although there is no fixed definition of corporate governance, the idea is based on two points. One is about control of the day-to-day operation, and the other is about the future direction of the business of the company.

Corporate governance is needed to reduce company scandals, to protect the shareholders, to improve performance of listed companies, and to prevent negative manager behavior(10). According to Andrew Chambers' book, Corporate Governance Handbook, there is a relationship between the success of a company and the application of corporate

(8) The traditional ways of enforcing corporate governance principles are not suitable for the real world today. The world needs a new framework for the enforcement of corporate governance principles. Through rules and codes, the securities laws can help to form this framework. There is a diversity of enforcement methods. Different aspects of corporate governance are enforced in different ways. Some are enforced by corporate law, while others are dealt with by securities laws and delegated legislation in the forms of rules as well as voluntary and mandatory codes.

(9) Donald Nordberg, Corporate Governance Principles and Issues (SAGE 2011) 7.

(10) There are different types of failure of corporate governance, such as poor risk management, fraud, fictitious transactions, corruption, financial manipulation (such as Libor manipulation), rogue trading and personal interest. The causes of these problems are usually due to mismanagement.

governance principles. That is to say, the more a company applies governance rules, the greater are the companys chances of success[11].

3. An Independent Director in Companies Listed on the NYSE[12]

In general, a director or a member of a board of directors can be described as an independent director[13] if he or she does not have a material or financial relationship with the company or related persons.

Having independent directors has a number of advantages. They assist the company to achieve a balance of power. In addition, having independent directors will increase the quality of board oversight and reduce the possibility of damaging conflicts of interest[14]. This will likely affect the companys performance, which will reduce the chance of maladministration and maximize shareholder value[15].

In the US[16], there has been a shift to add more independent directors to the board of directors in listed companies. Consequently, from 1950 to 2005, the percentage of independent directors increased from 20% to 75%.[17] In 2012, at least 75% of the members of the board

(11) Andrew Chambers, Corporate Governance Handbook (5th edn, Bloomsbury Professional 2012) 351.

(12) The NYSE is as an example of a trade group. As there was no organised stock exchange, in 1792 stockbrokers signed an agreement setting up the Stock Exchange to regulate prices and the commissions. Twenty-four stockbrokers gathered under a buttonwood tree outside the building located at 68 Wall Street to sign the agreement known as the "Buttonwood Agreement". This agreement remained in force until 1974, when the government broke up the monopoly. Over time, Wall Street has come to represent the US financial markets as a whole. <http://www.nyx.com/en/who-we-are/history/new-york> accessed 11 January 2019.

(13) Known as an outside director.

(14) Section 303A.01 Corporate Governance Standards. NYSE.

(15) Corporate governance principles are at the same time important and dangerous, because they possess the potential to develop a company or to reduce its performance.

(16) There is no corporate governance code in the US. Corporate governance requirements are formed by various federal laws, such as
- the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act),
- the Dodd-Frank Wall Street Reform and the Consumer Protection Act (Dodd-Frank Act)
- the Federal Securities Law
- regulations, rules and other guidance promulgated by the Security and Exchange Commission.
- the listing standards of registered stock exchanges require listed companies to maintain specified corporate governance rules.

(17) Jeffrey N. Gordon, THE RISE OF INDEPENDENT DIRECTORS IN THE UNITED STATES, 1950-2005: OF SHAREHOLDER VALUE AND STOCK MARKET PRICES, 59 Stan. L. Rev. 1465 (2006-2007) 1465.

of directors of 93 of the Top 100 American firms were independent directors(18). This indicates a trend of increasing the number of independent directors in the NYSE, which shows that there is a move to increase the number of independent directors even further.

This article will consider the concept of ‘‘independence’’ in four categories: 1) the number of independent directors; 2) determining the independence of the directors; 3) the criterion of determining the independent director: and 4) obstacles to independence.

3.1 Number of Independent Directors on the Board

The board includes an appropriate combination of executive, non-executive and independent non-executive directors, such that no one individual or small group of individuals dominates the boards decision-making. Protecting the independence of directors is considered to be crucial.

The group of non-executive director can contain two distinct groups. There are those who are truly independent of management and those who are not independent of management because of past or current relationships such as former employees and relationship with the organization.

A non-executive director is a part of a company’s board of directors but who is not part of the executive team. An independent director is a non-executive director who is not involved in the day-to-day activities of the company. That means not all non-executive directors are independent but all independent directors have to be non-executive directors.

The NYSE(19) Listing Manual Rules require that a majority of the board members be independent(20). When a company falls below the independence majority requirements, it has to disclose this fact to the NYSE while it seeks a new independent director.

While no specific number of independent directors is stipulated, it must be a majority. As was noted above, the modern trend is to have 75% of the board be independent.

(18) https://content.next.westlaw.com/Document/Id4af1a411cb511e38578f7ccc38dcbee/View/FullText.html?contextData=(sc.Default)&transitionType=Default&firstPage=true&bhcp=1 accessed at6/1/2019.

(19) The NYSE is an American stock exchange located at 11 Wall Street, New York City, New York.

(20) Section 303A Corporate Governance Standards. NYSE.

3.2 Determining Independence

In reality, the process of determining the independence of a director is extremely important to the concept of independent directors. The most important part of the independence test relates to who is responsible for determining whether a director is independent.

According to NYSE rules, one of the boards responsibilities is to determine who is independent, and who is not. The actual NYSE standards state that ‘‘no director qualifies as independent unless the board of directors affirmatively determines that the director has no material relationship with the listed company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company.’’ Therefore, NYSE boards are left to their own devices to determine who is independent. The test for independence comes down to the three words: "no material relationship".

In Kuwait, there is no such rule, which makes the determining process more complex. This will be discussed in greater detail further in this article.

3.3 Criterion for Determining the Independent Director

The requirements of being an independent board member are different from country to country. Much depends on each countrys rules of corporate governance. For instance, for a company listed on the NYSE, no member of a board qualifies as independent unless the board of directors affirmatively determines that the director has no ‘‘material relationship’’ with the listed firm. That relationship can be direct or indirect. Material relationships can include a commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding(21).

This material relationship can be with the firm directly or indirectly. Examples of an indirect relationship are:

a) a partner;
b) a shareholder; and
c) an officer with other companies having a material relationship with a listed company.

(21) https://www.ghco.com/static-files/60538d32-b4e0-481e-801c-2df74b4163c6 accessed at 2/2/2019.

3.4 Obstacle to Independence[22]

A director cannot be considered an independent member if one of the following situations exists:

3.4.1 Employment

The director, or a family member, has been an employee of the listed firm during the previous three years. Even employment as an interim chairman, CEO or another executive officer position would will disqualify from being an independent director.

If an immediate family member[23] has been an executive officer of the listed company during the previous three years, then the director will similarly not qualify as independent.

3.4.2 Receiving Compensation

If the director or an immediate family member has received more than $120,000 in direct compensation from the company in any twelve-month period during the preceding three years, the director will not qualify as independent.

This amount excludes any payments received by the director, committee fees and pension or other forms of deferred compensation for prior service.

3.4.3 Partner or Audit Relationship

A person is disqualified from serving as an independent director in the following circumstances:

1- If the person is a current partner or employee of a firm that is the listed company's internal or external auditor;

2- If the person has an immediate family member, who is a current partner of such a firm;

3- If the person has an immediate family member, who is a current employee of such a firm and personally works on the listed company's audit; or

(22) http://ccbjournal.com/articles/4072/nyse-corporate-governance-requirements-finalized accessed at 1/2/2019.

(23) "A person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person's home" can be considered an immediate family member. General Commentary to Section 303A.02(b). https://www.ghco.com/static-files/60538d32-b4e0-481e-801c-2df74b4163c6 accessed at 2/2/2019

4- If the person or an immediate family member was during the last three years a partner or employee of such a firm and personally worked on the listed company's audit during that time.

3.4.4 Executive Officers

If, during the preceding three years, the director or an immediate family member was employed as an executive officer of a company and the listed company's present executive officers served on the compensation committee at the same time as the "independent director", the director will be disqualified from serving as an independent director.

3.4.5 Payments

A person is disqualified from serving as an independent director, if the director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, during any of the last three fiscal years, exceeded the greater of $1 million or 2% of such other company's consolidated gross revenues.

4. An Independent Director in Companies Listed on the KSE[24]

Corporate governance is built around the KCGC, which helped to

(24) In 1983, the KSE became an independent body recognised by Emiri Decree No. 20/1983. Kuwait was the first country in the region to establish a legal framework for its stock exchange. Between 1983 and 2010, a number of laws were passed to regulate the stock exchange. In 1988, Decree Law No. 32 granted permission to GCC citizens to hold (own) shares in the Kuwaiti public companies listed on the KSE. Previously, GCC citizens were not permitted to buy shares in Kuwaiti companies. In 1990, the Kuwaiti legislature created a legal system for unit trusts in Act No. 31, which involved organising the trading of securities and the establishment of investment funds. In 2000, Law No. 20 was enacted to allow non-Kuwaiti investors to own shares in Kuwaiti shareholding companies, because the legislature believed in attracting foreign investors to take advantage of their financial investment and expertise.
In 2000, the KSE market capitalisation was US $35 billion, and the value of trading was US $22 billion, making the KSE the second largest in the Arab world. This prompted the government to change the operation of the KSE. In 2005, Emiri Decree No. 158 was issued concerning the amendment of some articles of the decree organising the KSE.
Before 2010, the Ministry of Commerce and Trade (MOCI), the Central Bank of Kuwait (CBK), the Market Committee (MC) and the KSE were responsible for regulating and supervising securities markets in Kuwait. The absence of a comprehensive law involved in creating and organising the KSE and the lack of a single body with responsibility for regulation resulted in some deficiencies that were exploited by unscrupulous dealers at the expense of small and large investors. There was no comprehensive and holistic legal system, the lack of which created misunderstanding and the inability to resolve serious systemic problems. In 2010, the Capital Markets Law (2010) was enacted to address these problems.

apply corporate governance principles[25]. However, the practical application of this code brought to light some shortcomings in the regulation of the stock exchange and specifically the need for legal clarification of independent director matters.

This article will discuss the approach of the NYSE to independent directors based on the four points discussed above and how this can address the shortcomings of the Kuwaiti code.

4.1 Number of Independent Directors on the Board

Kuwait has approached the issue differently than the NYSE by requiring a minimum and maximum number of independent directors.

In Kuwait, the KCGC mentions that any listed companies should have a minimum of one independent director, while the maximum number should not exceed half the number of members of the board of directors[26].

The Kuwaiti legislator took the "minimum and the maximum standard" and did not leave the company the option to determine the number of independent directors on its own. Nevertheless, the majority standard requires that the listed company board consist of a majority of non-executive members.

4.2 Determining the Independence

In Kuwait, according to KSE rules, the board has no responsibility to determine the independence of a director. This makes the determining process more complex.

4.3 Criteria for Determining the Independent Director

The KCGC lists certain criteria for independent directors. These

(25) There are eleven main corporate governance principles in Kuwait. namely: 1) Strengthen board composition; 2) Establish clear roles and responsibilities; 3) Recruit highly qualified candidates for boards of directors and senior management; 4) Safeguard integrity in financial reporting; 5) Require sound systems of risk management and internal controls; 6) Promote ethical standards and responsible conduct; 7) Ensure timely and high quality disclosure; 8) Recognize the legitimate interests of stakeholders; 9) Encourage enhanced performance; 10) Stress the importance of social responsibility; and 11) Protect the rights of shareholders.

(26) Article 2-2 of Rule I "Construct a Balanced Board Composition" of the Executive Bylaws related to Corporate Governance 2015 states: " ..The following must be complied with Board composition: 1,..2, 3- Majority of Members of a Board of Directors must be Non-Executive Members. It shall include one independent member at least. However, independent members shall not exceed half the Members of a Board of Directors".

include certain attributes that directors must have, and certain things that should be avoided.

Firstly, the KCGC sets a general standard for determining the independence of a director. Unlike the NYSE that uses the "material relationship" test the KCGC provides a number of examples and situations that disqualify a person from serving as an independent director. As a result, if any of these situations exist, the director will not be considered an independent member.

Secondly, the following is required for a director to be classified as an independent director:

1) appropriate qualifications;
2) high level experience; and
3) technical skills that are consistent with the companys activity.

The role of an independent director:

Advisory Tasks: The independent director may be entrusted with advisory duties relating to the company's various activities(27).

No External Pressures or Obstacles: The company must ensure that the independent director is free from any restrictions or pressures when carrying out his duties(28).

4.4 Obstacles to Independence

The following cases are examples of obstacles to the director being considered independent. However, this list is not exhaustive.

4.4.1 Holding Company Shares

In Kuwait, the independent member shall not hold 5% or more of the company shares for which he is nominated or represented.(29)

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(27) Article 2-3 of Rule I "Construct a Balanced Board Composition" in The Executive Bylaws related tp Corporate Governance 2015 states that "A company's board must include independent members who shall be assigned advisory tasks in regards to various activities of the company. This shall help the board take valid resolutions which contribute to the fulfilment of company interests."

(28) Article 2-3 of Rule I "Construct a Balanced Board Composition of The Executive Bylaws related to Corporate Governance 2015 states that "Members of a Board of Directors shall include independent members, so that they can exercise their unfettered and independent judgment under no pressures or obstacles."

(29) Article 2-3 of Rule I "Construct a Balanced Board Composition" of the KCGC 2015.

In the NYSE, share ownership does not affect independence as can be seen from the rule which states that "the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding"[(30)].

Comparing the two-stock exchanges shows that having a share in a company can affect the independence of a director in Kuwait, while it does not affect the independence finding in the NYSE. It is advisable that Kuwait consider adopting a rule similar to the NYSE rule.

In order to prevent a conflict of interest caused by the purchase of shares, the Kuwaiti Code has prohibited independent directors from owning more than 5% of a company's shares. However, this is ineffectual and the reference to such a low amount is arbitrary at best. To solve this issue, there are two potential solutions: 1) to allow for independent directors to purchase shares but not limit it to 5% of the total shares, or 2) prevent all purchase of shares by independent directors. In other countries such as the UK, independent directors are allowed to purchase shares and there is no mention of a percentage that limits how much can be bought according to UK corporate governance code 2018[(31)].

4.4.2 Family Relations

An independent director shall not have a first-degree family relationship with any of the members of a board of directors or executive management members in the company or any other company in its group or the relevant main parties[(32)].

In Kuwait, there is a prohibition on appointing first degree family members as independent directors. This is similar to the American prohibition on appointing "immediate family members" as independent directors.

In Kuwaiti law, a first-degree family member includes parents, full siblings and children and anyone related to the independent director by

(30) 303A.02 Independence Tests. New York Stock Exchange Listed Company Manual. https://www.ghco.com/static-files/60538d32-b4e0-481e-801c-2df74b4163c6

(31) Principle 2 "Division of Responsibility" Provisions 10 mentions that "The board should identify in the annual report each non-executive director it considers to be independentWhere any of these or other relevant circumstances apply, and the board nonetheless considers that the non-executive director is independent, a clear explanation should be provided".

(32) Article 2-3 (b) of Rule I "Construct a Balanced Board Composition" of the KCGC 2015.

blood. This means that those related to the independent directors in terms of marriage do not fall within the definition of first-degree family member.

By contrast, the US definition of immediate family member is much wider. It includes family that are directly related to the independent director (so called blood relatives) but also includes those to whom the independent directors feel a particular responsibility. This includes parents, siblings, spouse(s), children as well as individuals whose relation to the independent directors is an equivalent of a family relationship. NYSE rules determine which members of a person's family are affected by those rules. It can be covered as, by blood or marriage, the child, parent, brother, sister, brother-in-law, sister-in-law, son-in-law, grand-parent or grandchild, great-grandparent or great-grandchild, uncle, aunt, nephew, niece, first cousin or 'foster' or 'step' situation within these relationships. marriage clearly means spouse.

It is suggested that the definition in the Kuwaiti code should be expanded to "close family ties" as this will include a wider group of individuals. In cases where there is uncertainty, the capital markets authority or the courts can be called on to pronounce on the matter.

4.4.3 Company Group

An independent director shall not be a member of another board of directors in the same group of companies(33).

4.4.4 Employment

An independent director shall not be an employee of the company or any company in the same group or be employed by any of the stakeholders.

An independent member shall not be an employee of corporate entities who own controlling shares in the company.

5. Comparison between the NYSE and the KSE

After introducing the differing approaches to independent directors in the KSE and the NYSE, this article will now compare the two.

5.1 Independent Directors in Theory or in Practice

(33) Article 2-3 (c) of Rule I "Construct a Balanced Board Composition" of the KCGC 2015.

The topic of the independent director is a recent development in Kuwait society. As a result, there is as yet no case law that can be consulted. There is not even consensus in the way that the concept should be applied. For example, the Capital Markets Authority CMA has requested the Ministry of Commerce and Industry MOCI to set conditions that must be met before a board member can be declared as an independent director. Furthermore, the CMA wants independent directors to apply to the MOCI for such status. As part of this process, independent directors will have to acknowledge that they comply with all conditions related to independence as set out in the code(34).

In terms with international corporate governance principles, the board of directors should always have an independent director to ensure the smooth and proper functioning of the board. Independent directors play an active role in the internal monitoring system of a company. To increase the effectiveness of the internal control mechanisms, companies should enhance the independence of boards of directors. One of the important functions of independent directors is to show the true picture of a company to potential investors and stakeholders, as sometimes CEO's tend to hide the real picture.

Although there is no established definition of an independent director, it can be said that an independent director is a person that holds the position of director on the board of a company, but has no further affiliation or relation with the company that could affect his/her independence(35).

Scholars have not reached a consensus in the corporate governance literature regarding the value of independent directors to the board composition. However, the vital role of independent directors as effective monitors and controllers of firm management is perceived by many researchers.

Independent directors will be able to enhance board efficiency only if they are truly independent without being influenced by the companys management or major shareholders.

(34) https://alqabas.com/496865/ accessed at 15/ 10 /2019.

(35) Bob Tricker, Corporate Governance: Principles, Policies, and Practice (Third Edition, 2015, Oxford Univrsity Press) 93.

However, in reality, there is evidence that companies appoint independent directors, who are overly sympathetic to management while still technically independent according to regulatory definitions(36). This means that independent directors are only independent on paper and they are not truly independent.

In recent times, most countries have laws requiring an independent director on the board of directors of listed companies. The question is whether firms will perform better by having independent directors on the board. However, the importance of having independent directors is beyond the scope of this article.

The introduction of the independent director system is viewed as a revolutionary change to the KCGC. This has led to much debate about the topic.

For example, the Kuwait Chamber of Commerce & Industry (KCCI) criticized the KCGC by saying that, in short, in a country of 1.3 million people, of whom fewer than 700,000 are over the age of 20, an independent director must be either a newly graduated young man, who has not yet acquired any experience, or someone who has been retired for more than two years and who has relatively few family members and relatives.

Further, enacting legislation that requires an independent director be added to the board will create the impression that the other board members are not trusted or seen as ‘‘independent’’, competent or impartial enough to act in the best interests of the shareholders.

In Kuwait, an independent board member must be elected by the general assembly of the company, which in effect is comprised of the owners of the company. This fact alone renders the term ‘‘independent’’ director an empty title rather than having any special meaning.

The concept of ‘‘independence of decision and thought’’ is an ethical and fundamental issue in the first place. Freedom from pressure requires that the director be courageous, and being subject to pressure from the

(36) file:///C:/Users/User/Desktop/indepenant%20Member%20Article/malcofrazIII.pdf accessed at 13/1/2019.

kinship, politics, tribe or sect is a situation that requires the director to have a high moral character[37].

To sum up, Kuwaiti regulators have required companies to increase the number of independent directors on their boards and have created stricter requirements for what qualifies as ‘‘independent’’. Nevertheless, are independent directors nowadays really independent?

5.2 Suggestions to Improve the KCGC

The 2013 Code directed that the board should include independent members. However, Rule I of the KCGC related to ‘‘Construct a Balanced Board Composition’’ states that ‘‘the following must be complied with upon Board composition: 3. It shall include at least one independent member’’. However, independent members shall not exceed half the members of a board of directors. The KCGC reduced the number to one and made it clear that one independent member is enough, while the 2013 code required more than one by saying ‘‘independent members’’.

The following suggestions are made with a view to improving the KCGC:

1- The KCGC should add a clear definition of ‘‘independent member’’. The regulation in the KCGC took a negative approach when defining an independent member. The KCGC states that ‘‘..Independency, is considered void in case of any of the following, for example and without limitation.’’.
   An independent director is ‘‘an independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with -or could reasonably be perceived to materially interfere with – the independent exercise of their judgement’’[38] This definition should be incorporated into the Kuwaiti code as it highlights problematic factors that could reasonably interfere with

(37) www.kuwaitchamber.org.kw/echamber/website/index.jsp?pageID = ws_cmsmenu.jsp&from-Public = yes&language = ar&rootMenu = 549&menuID = 549 accessed at 20/1/2019.

(38) The definition of an independent directors is recommended by the Australian Institute of Company Directors (AICD) in the article entitled AICD wants broader definition of ’independent directors’ for super funds. Money Management; Chatswood [Chatswood]19 Oct 2015.

the independent directors decisions. Currently this is not mentioned in the Kuwaiti code.

2- There should also be specific rules for situations in which the independence of the director can be called into question. There should be clarity on the number of independent directors required on the board. The KSE and the NYSE are totally different with respect to the number of independent directors in the board.
At present, the Kuwait Code refers to "a maximum and minimum" number of the board that should be independent directors. However, this has caused great confusion and has been especially problematic for smaller companies. It is suggested that the Kuwait Code be amended to bring it in line with the Guiding Principles for the unified Corporate Governance for Gulf Cooperation Council (GCC) capital Markets 2013 that refers to "a sufficient number of independent directors" which is to be decided upon by a regulatory body(39). The benefit of this is that it provides a greater measure of flexibility for companies that want to comply but are limited by factors such as the size of the company and availability of independent directors.

3- The KCGC should be more specific when stating who or what authority has the power to declare a director an independent director.
The Kuwaiti Code could be adapted to state that in a companys annual report, the board should identify each non-executive director it considers to be independent. The board should also state who decides on the independence of the directors and include this in its annual reports. This will clear up the ambiguity in this process that currently exists.

4- There should be more flexibility with regards to independent directors. The company should have the option to appoint independent directors to its board voluntarily. Since it is still a fairly new concept in Kuwaiti corporate governance, the government should allow time for companies to apply the concept voluntarily. In time, the rules around independent directors can be

(39) Article 11 part 5 of mentions that "there should be a sufficient number of independent members determined by the regulatory body" According to Guiding Principles for the unified Corporate Governance for Gulf Cooperation Council (GCC) capital Markets 2013.

made compulsory with any necessary penalties that may become applicable.

Lawmakers have different opinions about how to enforce corporate governance principles. Some prefer to enforce these principles by enacting legislation and rules, while others prefer to enforce them via a ‘‘comply or explain’’ regime. Enforcing corporate governance by law has the potential to cause two problems. First, it can harm the growth of the economy. As mentioned above, smaller businesses do not wish to list on the stock exchange for various reasons. As a result, this harms the growth of the business and the economy. The other problem can occur if the company faces financial and administrative burdens as a result of applying all corporate governance principles. This can lead to the company needing to employ more staff, spend more money, and gain more legal knowledge about the way to apply these rules and how to bear the cost of complying. Voluntary compliance has advantages for businesses. The principle of ‘‘comply or explain’’ allows smaller companies to implement corporate governance principles when they are in a suitable position to do so. Until such time, they are afforded the opportunity to explain their non-compliance(40). The nature of business requires an easily developed and a flexible means of enforcement, because one size does not fit all.

Small companies are the engines of economic growth. Complying with compulsory corporate governance rules is a big challenge for small businesses because of the costs involved. If small companies are not encouraged to list their shares, they cannot receive funding from the stock exchange, which is a flexible source of capital. The listing process could result in a situation where the small business is likely to avoid suffering problems such as issues with its cash flow and bad debts. for listed companies, there is no one-size-fits-all approach to corporate governance. Whilst the KCGC requirements do not distinguish between companies of different sizes, what is appropriate for a large company may not be appropriate for a smaller company, which may find compliance to be too costly. Compulsory rules are often onerous for

(40) The consequences of the explanation being unacceptable are beyond the scope of this article.

small and middle-sized listed companies and merely add extra costs to these business entities.

The KCGC states: ‘‘Except for the principle (Comply or Explain), the following principles shall be complied with: Rule I: Article (2-3) of this Module: The Members of a Board of Directors shall include independent members allowing them to make decisions without pressures or obstaclesCompanies shall implement the aforementioned rules. Noncompliance with these rules shall expose the company to the penalties set forth in the Law and these Bylaws.’’ It would be preferable to change this article. As a result, it is recommended that Rule 1 of Article (2-3) should be changed to allow companies to make decisions without any pressure relating to the appointment of independent directors.

6. Conclusion

Corporate governance has a number of principles. This article has addressed principles related to independent directors.

It is important to understand the nature of the independent director system, the existing problems it faces and the possible solutions for those problems. The importance of independent directors as a governance mechanism to protect shareholders interests and to safeguard managerial employment contracts is recognized worldwide.

In fact, the existence of insider control problems can be explained by the conflict of interests between the principal (owner) and the agent (manager). This article has not attempted to discuss the various theories related to corporate governance, such as the agency theory[(41)], because the article focuses on the real-world application of corporate governance principles related to independent directors.

By comparison with the NYSE, the KSE is still at the beginning of its evolutionary process to improve the independence principle.

This article analyses the characteristics of independent directors in the Kuwaiti context and suggests a number of recommendations related

(41) There are various theories about what corporate governance means, but the predominant theory is the ’agency theory’, which considers the shareholders to be the principals and the directors to be their agents. Thus, there is a separation of ownership and control. Christine Mallin, Corporate Governance (4th edn, Oxford University Press 2013) 16-18.

to enhancing independent directors. For example, the article suggests that the KCGC should give the companys board more power to determine who is an independent director. In addition, the ownership of shares should not affect the independence of a director.

This study has found that there is no clear definition as to what constitutes an independent director in Kuwait, which needs to be dealt with.

This study has found that applying independent directors principles by means of the law can cause problems. Although the KCGC could be made voluntary in terms of having independent directors, much work would still be required to explain non-compliance rules.

In conclusion, it is suggested that a change is needed in the financial culture as opposed to merely promulgating new laws. Without a change in the financial culture, Kuwait will not make progress in corporate governance.

List of Abbreviations

CBK	Central Bank of Kuwait
CEO	Chief Executive Officer
CG	Corporate Governance
CMA	Capital Markets Authority
Dodd-Frank Act	Dodd-Frank Wall Street Reform
Protection Act	and the Consumer
KCCI	Kuwait Chamber of Commerce & Industry
KCGC	Kuwaiti Corporate Governance Code
KSE	Kuwait Stock Exchange
MC	Market Committee
MCOI	Ministry of Commerce and Trade
NYSE	New York Stock Exchange
Sarbanes-Oxley Act	Sarbanes-Oxley Act of 2002
US	United States

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