



THE WORLD BANK

# Report on the Observance of Standards and Codes (ROSC)

Corporate Governance

## Corporate Governance Country Assessment

Bhutan

December 2006

# Overview of the Corporate Governance ROSC Program

## WHAT IS CORPORATE GOVERNANCE?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The *OECD Principles of Corporate Governance* provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the Board of Directors.

## WHY IS CORPORATE GOVERNANCE IMPORTANT?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research.

Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

## THE CORPORATE GOVERNANCE ROSC ASSESSMENTS

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment reviews the legal and regulatory framework, as well as practices and compliance of listed firms, and assesses the framework relative to an internationally accepted benchmark.

- Corporate governance frameworks are benchmarked against the OECD Principles of Corporate Governance.
- Country participation in the assessment process, and the publication of the final report, are voluntary.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the ROSCs can also include special policy focuses on specific sectors (for example, banks, other financial institutions, or state-owned enterprises).
- The assessments are standardized and systematic, and include policy recommendations. In response, many countries have initiated legal, regulatory and institutional corporate governance reforms.
- Assessments can be updated to measure progress over time.

By the end of June 2005, 48 assessments had been completed in 40 countries around the world.

# REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

## Corporate governance country assessment

Bhutan

December 2006

### Executive Summary

This report assesses the corporate governance policy framework and enforcement and compliance practices of the Kingdom of Bhutan. It highlights recent improvements in corporate governance regulations, makes policy recommendations, and provides investors with a benchmark against which to measure corporate governance in the kingdom. The report focuses on listed companies but is also relevant to non-listed public companies.

Bhutan has sixteen listed companies and has experienced steady growth in market capitalization, driven in part by ongoing privatization. Equity markets remain small with low turnover. The Royal Government of Bhutan remains the largest owner of equity. Planned reforms include revisions to company law and a dedicated securities law.

While the Company Act provides a solid legal foundation for corporate governance, the current framework has a number of weaknesses. There is no focused securities market regulator and other institutions have limited resources. Shareholders have little legal protection in the case of certain major transactions, including changes in corporate control. Critical information on companies, including ownership information, is not easily accessed. There is limited domestic capacity for auditing or accounting. There is no code of corporate governance and little guidance is provided for boards on board composition or board duties, powers, or functions.

Improving corporate governance to better protect investors, enhance company oversight, and increase confidence in capital markets will require broad-based reform. Planned reforms should move forward and ensure that key legal gaps are addressed. Existing regulators should be strengthened and new bodies for capital market and auditing oversight introduced. Training and other programs to raise awareness should be initiated, including the development of a Code of Corporate Governance. Broader capital market reforms should also be considered, including the possibility of allowing foreign portfolio investment.

## **Acknowledgements**

This assessment of corporate governance in the Kingdom of Bhutan was conducted in May 2006 by David Robinett of the Corporate Governance Department of the World Bank, as part of the Reports on Observance of Standards and Codes Program. The ROSC was based on a corporate governance template-questionnaire completed by Messrs. Sherpa Consultancy. Messrs./Mmes.: Olivier Fremond, Asya Akhlaque, Sue Rutledge, Tatiana Nenova, Alastair McKechnie, Simon Bell, Donna Thompson, and Alex Berg provided advice and comments.

The assessment reflects technical discussions with the Ministry of Finance, Royal Monetary Authority, Registrar of Companies, Royal Audit Authority, Royal Stock Exchange of Bhutan, commercial banks, issuers and numerous market participants.

The ROSC assessment for the Kingdom of Bhutan was cleared for publication by the Ministry of Finance on February, 2007.

## Table of Contents

<b>Market profile</b> .....	1
<b>Key issues</b> .....	1
<i>Investor protection</i> .....	1
<i>Disclosure</i> .....	2
<i>Company oversight and the board</i> .....	3
<i>Enforcement</i> .....	3
<b>Recommendations</b> .....	4
<b>Summary of Key Recommendations</b> .....	8
<b>Summary of Observance of OECD Corporate Governance Principles</b> .....	9
<b>Principle – By – Principle Review of Corporate Governance</b> .....	10
<i>Section I: Ensuring The Basis For An Effective Corporate Governance Framework</i> .....	10
<i>Section II: The Rights of Shareholders and Key Ownership Functions</i> .....	12
<i>Section III: The Equitable treatment of Shareholders</i> .....	16
<i>Section IV: The Role of Stakeholders in Corporate Governance</i> .....	18
<i>Section V: Disclosure and Transparency</i> .....	19
<i>Section VI: The Responsibilities of the Board</i> .....	22
<b>Annex 1: Ownership Structure of Listed Companies</b> .....	25



## Country assessment: Bhutan

This ROSC assessment of corporate governance in the Kingdom of Bhutan benchmarks law and practice against the OECD Principles of Corporate Governance, and focuses on listed companies but is also relevant to non-listed companies. The World Bank is preparing a forthcoming report that will focus on corporate governance challenges unique to state owned enterprises (SOE) in Bhutan.

Bhutan has a small but steadily growing equity market. Driven in large part by privatization, the government remains a major corporate owner. However even with steady growth, a small absolute size and limited number of domestic investors keeps turnover and liquidity extremely low.

The 2000 Company Act provides the legal foundation for the corporate sector. There are gaps in the law and the overall legal framework. There is no law focused specifically on capital markets, no code of corporate governance and no law governing the market for corporate control. Awareness of corporate governance is growing in the public and the private sectors but remains low overall.

### Market profile

*Bhutan's equity market has grown steadily, but remains by far the smallest in the region*

Sixteen companies are listed on the Royal Stock Exchange of Bhutan (RSEB). At the end of 2005 total market capitalization was 4.46 billion Nu, or about 100 million USD. Market capitalization has increased steadily each year over the last decade, and was about 16 percent of GDP. Bhutan has the smallest equity market in the South Asia, with a low turnover of less than two million USD a year.

*The RGB is a major shareholder*

Privatization has been one of the main forces driving the market. The Royal Government of Bhutan (RGB) remains a significant holder of shares, with major stakes in six of the largest listed companies. Other major investors include the three banks, the insurance company, the Provident Fund—a pension fund for employees of the government and government owned companies—and private promoters, some of whom are part of Bhutan's business groups. Bhutan also has thousands of small shareholders, with some companies each having over four thousand shareholders. Foreign investment is restricted, and there are no foreign portfolio investors.

*There is no devoted securities law or securities market regulator*

Key legislation for capital markets includes the 2000 Company Act (CA) and 1992 Financial Institutions Act (FIA). There is no act specifically for securities or capital markets, and no law on takeovers. Insider trading and accounting and auditing are both addressed in the CA. The Royal Monetary Authority (RMA)—the central bank of Bhutan—is the de facto securities market regulator. The Registrar of Companies (Registrar) has a range of powers under the CA, and is primarily responsible for its enforcement.

### Key issues

The following sections highlight the principle-by-principle assessment of Bhutan's compliance with the OECD Principles of Corporate Governance.

#### Investor protection

*Basic shareholders*

Basic shareholders rights are in place in Bhutan. There is a central depository for

*rights have been established*

listed companies that provides for secure registration and relatively timely settlement. Shareholders can request a variety of information from the company and have a clear right to participate in the General Meeting of Shareholders (GMS). Procedures for electing directors are clearly specified in regulation, and directors can be removed by special resolution. Changes to company articles, increases in authorized capital, and certain major transactions require GMS approval. All common stock is one share one vote, the law allows for non-voting preferred shares, but these are not used in practice.

*Directors must declare conflicts of interest, major shareholders and employees are not required to*

The regime for conflicts of interest and related party transactions is provided in the CA. Conflicted directors must declare any interest they have to the board, which must approve the relevant transaction. The conflicted director must recuse herself from the vote. A record of such transaction is to be maintained by the company reported and in filings to the Registrar. The auditor is supposed to review the terms of such transactions. The current regime does not address conflicts involving major shareholders or employees.

*No provisions for changes in control, delisting, or shareholders adding to the GMS agenda*

The legal framework for investor protection and capital markets contains other gaps and weaknesses. The law does not specify which “substantial” transactions shareholders are required to approve and does not explicitly allow shareholders to ask question at the general meeting of shareholders (GMS) or add items to the agenda. In addition, there is no law or regulation on changes in corporate control and hence no tender offers or other requirements for when a shareholder takes a significant stake in a company. There are no procedures for voluntary delisting from the stock exchange.

*Awareness of corporate governance is limited*

The financial institutions and Provident Fund are active, if limited, investors. They participate in the GMS of the few companies they invest in, but even the non-bank institutions have more loans than equity. None have developed voting policies or other guidelines for their participation in the GMS. Small shareholders generally do not participate at all, and overall awareness of corporate governance is low.

### **Disclosure**

*Listed companies are required to prepare annual and semiannual reports*

The law requires companies to prepare financial statements and a directors’ report to be presented at the annual meeting and to the Registrar. Under the Listing Rules of the RSEB they are to prepare semiannual interim reports. The CA also requires companies to maintain a number of registers for inspection by shareholders or the Registrar.

*Key information, including on ownership, can be hard to obtain*

In practice, shareholders normally need to attend the GMS or go directly to the company to obtain corporate information. Certain information, especially the list of shareholders, can be difficult to obtain from companies and is not available from other sources. The RSEB does not have a website and little information is available online. There are no requirements for rapid reporting of material facts to the RSEB or another source.

*The law—not international standards—dictate the form and content of company reports*

The CA provides for the form and content of company reports and the audit report. While Bhutan nominally follows international standards for both accounting and auditing, in practice reports are prepared using the schedules in the CA and basic accounting conventions. The resulting reports tend to have limited non-financial information.

*Accounting and audit capacity in the private*

The Royal Audit Authority (RAA) provides a list of eligible auditors. All are based in India and members of the Institute of Chartered Accountants of India

*sector is limited*

(ICAI). The RAA also conducts proprietary audits of companies where the RGB has ownership. This is in addition to the external audit. There is no other oversight of audit and accounting, no domestic licensing or certification, and a general lack of domestic capabilities in the private sector.

### **Company oversight and the board**

*Boards are normally made up of non-executive directors, including ministry officials*

Bhutan has a single tier board structure. Board members tend to be non-executive, and are generally connected to various shareholders, in some cases including one director to represent small shareholders. Ministers and ministry officials serve on the boards of companies with RGB ownership. The CEO usually also serves as a non-voting board secretary. There are no formal requirements regarding board composition or independence.

*No specific guidance on board powers, liability, or best practice*

The CA defines the duties and broad powers of boards. However there is no code of corporate governance or other source of more specific guidance on what boards should do and how. There is also little precedent or case law indicating when a director may be liable for violating their duties. There is no institute of directors, director training, or other programs to raise awareness of corporate governance in the business community.

*FIs are required to have audit committees and a code of ethics, other companies are not*

Financial institutions have additional requirements for boards and directors. These include an audit committee to oversee both internal and external audit as well as compliance. Boards of financial institutions are also responsible for implementing a company code of ethics provided in regulations. No other companies are known to have specialized committees or a code of ethics.

All public companies are to have secretaries that ensure compliance with the CA. Normally this is the CEO.

*Little use of performance based pay*

Many listed companies were created through privatization, and their remuneration policies are similar to companies still wholly owned by the RGB. Annual bonuses are sometimes allocated to all employees and some positions may receive special allowances. However there is little practice of linking pay to performance.

### **Enforcement**

*The Registrar is the main source of redress*

The Registrar is the primary enforcer of the CA. It conducts regular inspections to ensure that companies have complied with the basic requirements of the law. The Registrar can issue fines and orders directly to companies. The Registrar is part of the Ministry of Trade and Industry (MTI), which can issue implementing regulation under the CA.

*The RMA and RSEB both have limited resources for capital market oversight*

Other sources of enforcement are limited. The RMA is charged with overseeing all financial institutions and acts primarily as a banking regulator, with only a few staff to oversee capital markets. Its main concern has been to ensure that brokerage services, which are not profitable, are provided at all. The RSEB also has a small staff and limited capability to enforce the existing Listing Rules. To date, the court system has played a limited role in adjudicating corporate disputes.

*No “shareholder advocacy”*

Enforcement is also limited by the low awareness of corporate governance. Shareholders have limited awareness of what their rights are. There are no shareholder advocacy organizations. Shareholders do complain to the Registrar about unpaid dividends, but little else.

## Recommendations

Bhutan has initiated draft legislation to upgrade the legal framework for capital markets and corporate governance. Good corporate governance ensures that companies use their resources more efficiently and leads to better relations with workers, creditors, and other stakeholders. It is an important prerequisite for attracting the patient capital needed for sustained long-term economic growth.

### ***Broad based corporate governance reform is needed...***

*Revise the Company Act and introduce a new law for capital markets*

Current plans to revise the CA and develop a Financial Services Act should move forward, and other legal and regulatory changes also considered as part of a broad based program to develop capital markets and improve corporate governance. The revisions and new legislation should seek to provide better protection for shareholders, increase transparency, and improve the performance of the board along the lines of the OECD Principles of Corporate Governance.

*Increase the capability of the RMA to oversee capital markets*

Reform should also seek to strengthen enforcement. This should include increasing the oversight capability of the RMA through the introduction of a dedicated capital market oversight division within the Authority. The new body should have sufficient resources to oversee securities markets and the RSEB. This in turn requires independent and dedicated funding and sufficient powers to inspect and penalize capital market participants. This would be most effective as part of wider reforms to strengthen the RMA as an integrated financial regulator.

*Strengthen the Registrar of Companies*

Stronger enforcement will also require sufficient resources for the Registrar to inspect all public companies on an annual basis, hear and act on a wider range of complaints, and continue the modernization of their data systems to facilitate access by shareholders and the public. Changing the CA to allow for higher fines for violations should also be considered.

*Prepare the RSEB and courts for a larger enforcement role*

Stronger enforcement may require strengthening other institutions. The role of the RSEB should be reviewed in light of the new FSA and the creation of a new capital market oversight body in the RMA. The objective of such a review should be to ensure that listing rules and other requirements currently under the authority of the RSEB are adequately enforced. This may require greater resources for the exchange, and this needs to be approached in a way that is financially sustainable.

To date, the courts have had a limited role in adjudicating corporate governance related disputes. However, that could change as the legal and financial framework evolves. In the long term, training to increase the capacity of the judiciary to adjudicate corporate disputes is important for the continued development of the corporate sector.

*Develop a Code of Corporate Governance in a broad based process that raises awareness of corporate governance*

Another key element of reform is the development of a Code of Corporate Governance. This should seek to supplement the CA and provide constructive guidance to companies, investors, directors and regulators. It should be developed in a broad consultative process that also serves to raise awareness of corporate governance across Bhutan and involves relevant stakeholders. The Global Corporate Governance Forum (GCGF) has developed a Toolkit for introducing a Code, and may be able to provide more assistance in this area.

The code should be relevant for all companies, and can contain special provisions for financial institutions, companies with government ownership, and listed companies. In any case it should be developed in close cooperation with the RMA, Ministry of Finance (which acts as the shareholder for the RGB), and RSEB. Mechanism to monitor the code should also be developed with these

institutions for the relevant company types. This could include a formal requirement to issue a report on compliance with the code, or explain why they don't comply (i.e., "comply or explain").

*Begin the process of opening to foreign investment and integrating into regional capital markets*

While the regime for foreign investment is normally beyond the scope of this ROSC, Bhutan has a small economy, and it may be difficult for its capital market to continue to develop with such limited foreign participation. The RGB should consider putting in place a reform program, in coordination with the RMA, the IMF, the World Bank, the ADB and other donors to gradually allow foreign investors to buy Bhutanese securities. This will require limited capital account convertibility, and should be approached with caution, building on examples of other countries such as Chile and Korea that have had success in gradually liberalizing the regime for foreign investment. The program may include requirements for foreign investors to hold assets for a minimum period of time or limits on investment from any one country to encourage diverse sources of finance.

The RSEB is currently a member of the South Asian Federation of Exchanges (SAFE), which seeks to promote cross border trade and listing in amongst its members. The RSEB should continue to work with SAFE to harmonize its listing requirements with other countries in the region and move towards greater regional integration. The RSEB may also wish to consider closer links with another stock exchange in the region as a means to increase capacity and oversight.

*Technical assistance will be needed*

Bhutan will be challenged to implement an extensive reform program unilaterally. Donors may be encouraged to participate as appropriate and continue to provide high quality technical assistance.

**...to better protect shareholders...**

*Facilitate shareholder participation in the GMS*

The CA should be amended and/or regulation issued by the MTI to facilitate the participation of the shareholders in the GMS. The deadline for announcing the meeting should be increased from 21 to 30 days. Shareholders should be given the explicit option of amending the agenda and asking questions at the meeting. Voting by post should be introduced. The new Code of Corporate Governance should provide guidance on conducting the meeting. The scope for proportional representation or cumulative voting—already practiced by some companies—should be extended through changes to regulation or introduction in the Code.

*Strengthen provisions on conflicts of interest and major transactions*

To protect shareholders from abusive transactions, the current regime for conflicts of interest in the CA should be extended to include major shareholders and employees. Regulation or the Code should define the threshold for "substantial transactions" that shareholders must approve in the GMS. For example as 25 or 30 percent of book value. Quorum requirements for certain major corporate decisions, such as approving a merger or reorganization, should also be considered. The CA, regulation or Code should also allow for shareholders to have final approval of the remuneration of directors and the CEO.

*Protect shareholders during control changes and delisting*

Regulation or a new law should be introduced to clarify the process for changes in control. Shareholders taking a significant stake in a company should have to disclose their holdings, and coordination by shareholders or "acting in concert" to change control of a company should also be disclosed. Rules that require the shareholder taking a controlling stake to make a tender offer to all other shareholders should also be considered. The new law or regulation should also restrict the ability of the board to unilaterally prevent a change of control from taking place.

Similarly, rules should be developed that allow for voluntary delisting from the RSEB that protect shareholders from abuse.

*Require institutional investors to disclose voting and develop policies on conflicts of interest*

Institutional investors play an important role in Bhutan's capital market and should improve their own governance practices. They should be required to disclose their voting in the GMS and their rationale or policy behind such voting. They should also develop and disclose policies on conflict of interest consistent with current legal requirements.

*...enhance transparency...*

*Allow the public access to Registrar documents*

The simplest way to increase corporate transparency is to make all documents filed with the Registrar available for public inspection. Priority should be given to listed and then other public companies. This could probably be implemented by regulation issued by the MTI and without changes to the law. Through time the technical capability of the Registrar should be increased to allow for all documents to be available electronically and ultimately online. The RSEB should also consider developing a website and putting company information online.

*Mandate disclosure of ownership by companies, individuals, and the Registrar*

Ownership disclosure should be improved through better disclosure by the company, owner, and Registrar. Companies must comply with existing legal requirements to provide shareholders with the list of shareholders, and the Registrar should be more active in enforcing compliance. Individual owners should disclose to the RSEB and Registrar when they hold, directly or indirectly, shares at the 5 percent, 10 percent, 30 percent, and higher thresholds. The Registrar and Depository in the RSEB should also work together to ensure that the list of shareholders for each listed company is current, and available for public inspection at the Registrar. In the longer term, this list could be posted on the Registrar or Depository website.

*Provide better guidance on the content of the directors' report*

Other non-financial reporting should also be improved. Regulations or the code should provide stronger guidance for the director's report. This should include requirements to disclose company objectives, foreseeable risk factors, and human resource and other issues related to major stakeholders.

*Establish an Accounting and Auditing Watchdog*

Ensuring high quality disclosure will also require improved oversight of accounting and auditing. This in turn may necessitate establishing an Accounting and Auditing "Watchdog". The body can be part of the RAA, or part of a new capital market oversight body under the RMA. It should seek to work closely with ICIAC, while maintaining independence from it.

The watchdog should review financial statements and audit reports to ensure legal compliance and use of high quality standards of accounting and auditing<sup>1</sup>. Focusing at first on listed companies, the watchdog should collaborate with the RAA on producing the list of eligible auditors and have other powers to penalize company, directors, and auditors that do not meet legal requirements.

*Expand opportunities for accountant and auditor training*

Better accounting and auditing will require significant professional development and new training programs. A priority should be development of domestic accounting capacity. Through time, Bhutan should also seek to develop, or at least have the possibility of, some domestic audit capacity. New training should include both domestic programs and judicious participation in training in India or

<sup>1</sup> Alternately, the new capital market oversight body could review financial statements, and the watchdog would focus on auditing.

other countries in the region. This is an area where donor support would be essential.

*Carryout an Accounting & Auditing ROSC*

Improving transparency will also require launching a longer term program to upgrade accounting and auditing. An Accounting and Auditing ROSC for Bhutan should be conducted which will provide detailed guidance on improving the disclosure regime.

***...and increase the effectiveness of company oversight***

*Provide guidance on board powers and duties and require a company code of ethics*

One central goal of a new Code of Corporate Governance is to provide greater guidance to directors on their duties and powers, consistent with the OECD Principles of Corporate Governance. The Code should also discuss the role of the company secretary. It should require that the secretary is not also the CEO of the company. The Code should also require all listed companies have a code of ethics for their employees. Current requirements for financial institutions can provide guidance in this area. Binding regulation issued by MTI could also be useful in this context.

*The Code should define and require independent directors*

The Code should also seek to facilitate board objectivity by defining independence for directors and requiring companies have a majority of non-executive directors and a minimum number of independent directors. The Code should also encourage companies to have an audit committee, with powers similar to those mandated for financial institutions. Such a committee should have a majority of independent directors.

*Director training should be introduced and foreign directors considered*

For these requirements to be effective, a class of competent independent directors will need to be developed. Director training will be key for this, and can also benefit other board members as well. The GCGF has developed a toolkit for director training and establish institutes of directors and may be able to provide additional guidance in this area. Allowing more foreign directors to serve on the boards of companies should also be given careful consideration. Finally, sitting fees for directors will probably have to be increased to attract a wider range of talent.

*Performance based pay should be considered*

Companies should consider tying compensation to performance for top executives, and the Code or regulation may provide guidance on this issue. Any such pay plans should be carefully designed to provide long term incentives in conjunction with high levels of disclosure. Unless care is taken, such plans can be subject to manipulation that can undermine corporate governance, not enhance it. A new Code of Corporate Governance can provide additional guidance on the use of performance based compensation. The forthcoming report on the corporate governance of SOEs will provide a more in depth analysis of compensation in enterprises owned by the RGB.

## Summary of Key Recommendations

Recommendation	How to be Introduced	Priority/Status
<i>Broad based reform...</i>		
Revise the Company Act and introduce a FSA	Based on current efforts	Immediate
Increase oversight capability of RMA	Changes in relevant legislation and with donor support	Medium-Term
Strengthen the Registrar	Changes in relevant legislation and with donor support	Medium-Term
Prepare RSEB and Courts for enforcement role	With donor support	Long-Term
Develop a Code of Corporate Governance	Broad based consultative process with relevant donor support	Medium-Term
Gradually open to foreign investment	With support of IMF, WB, and other donors	Long-Term
<i>...to better protect shareholders...</i>		
Facilitate GMS participation	Revised CA and new Corporate Governance Code	Medium-Term
Stronger rules on conflicts of interest and major transactions	Revised CA, regulation, and or new Corporate Governance Code	Medium-Term
Rules on delisting and changes in control	New law and regulation	Medium-Term
Institutional investor disclosure and voting	New FSA and regulation	Long-Term
<i>...enhance transparency...</i>		
Public access to Registrar	Revised CA and changes to procedures	Immediate
Improved ownership disclosure	Revised CA, new FSA, and Regulation	Medium-Term
Guidance on Directors' Report	New Corporate Governance Code and regulation	Medium-Term
Establish an accounting and auditing "watchdog"	New legislation	Long-Term
Expanded training for accountants and auditors	Domestic and international training with donor support	Medium-Term
<i>...and increase the effectiveness of company oversight...</i>		
Guidance on board powers and duties	New Code of Corporate Governance and regulation	Medium-Term
Define and require independent directors	New Code of Corporate Governance and regulation	Medium-Term
Introduce director training	New Code of Corporate Governance with donor support	Medium-Term
Consider performance based pay	New Code of Corporate Governance and company-level initiatives	Medium-Term

## Summary of Observance of OECD Corporate Governance Principles

Principle	O	LO	PO	MO	NO	Comment
<b>ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK</b>						
IA Overall corporate governance framework			X			• RGB is the largest shareholder
IB Legal framework enforceable /transparent			X			• Wide ranging company law, no securities law
IC Clear division of regulatory responsibilities			X			• Registrar enforces company law
ID Regulatory authority, integrity, resources			X			• No devoted securities regulator
<b>II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS</b>						
IIA Basic shareholder rights			X			• Basic legal rights are in place
IIB Rights to part. In fundamental decisions			X			• Shareholders have preemptive rights
IIC Shareholders GMS rights				X		• Participation in the GMS is low
IID Disproportionate control disclosure				X		• List of shareholders hard to obtain
IIE Control arrangements allowed to function					X	• No law on takeovers or tender rules
IIF Exercise of ownership rights facilitated				X		• No voting or disclosure requirements for institutions
IIG Shareholders allowed to consult each other			X			• No "acting in concert" concept
<b>III. EQUITABLE TREATMENT OF SHAREHOLDERS</b>						
IIIA All shareholders should be treated equally			X			• Registrar main source of redress
IIIB Prohibit insider trading			X			• Laws in place, no penalties to date
IIIC Board/Mgrs. Disclose interests			X			• Conflicts of interest to be declared and registered
<b>IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE</b>						
IVA Legal rights of stakeholders respected.			X			• Legal framework for stakeholders still evolving
IVB Stakeholder redress			X			• Redress through court and traditional channels
IVC Performance-enhancing mechanisms			X			• Companies use bonuses, provide training
IVD Stakeholder disclosure				X		• Stakeholders have limited access to company info
IVE "Whistleblower" protection			X			• Complaints on SOEs can be made to Audit authority
IVF Creditor rights law and enforcement			X			• Protection poor for SOEs unsecured lenders
<b>V. DISCLOSURE AND TRANSPARENCY</b>						
VA Disclosure standards			X			• Annual and semiannual reports required
VB Standards of accounting & audit			X			• Form and content of reports outlined in company law
VC Independent audit annually			X			• Audit authority maintains list of approved auditors
VD External auditors should be accountable			X			• Auditors chosen by shareholders from approved list
VE Fair & timely dissemination				X		• Information available at company or GMS, not online
VF Research conflicts of interests			X			• Broad restrictions on potential conflicts
<b>VI. RESPONSIBILITIES OF THE BOARD</b>						
VIA Acts with due diligence, care		X				• Basic duties spelled out in company law
VIB Treat all shareholders fairly			X			• No explicit requirement for equal or fair treatment
VIC Apply high ethical standards			X			• Directors liable for legal breaches by company
VID The board should fulfill certain key functions			X			• Board has broad powers, few specifics in law
VIE Exercise objective judgment				X		• No formal independence require
VIF Access to information			X			• Company to maintain a variety of records



## Principle – By – Principle Review of Corporate Governance

This section assesses Bhutan's compliance with each of the OECD Principles of Corporate Governance. **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

### SECTION I: ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

**Principle IA:** The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.

**Assessment:** *Partially observed*

**Capital markets.** Market capitalization at the end of 2005 was 4.46 billion Nu, or 100 million USD. Over the last ten years market capitalization has steadily increased, growing 4% over the last year and 89% since 2000. Market capitalization amounted to 16 percent of GDP at the end of 2004. Bhutan's equity market was the smallest in the region in absolute terms, and somewhat below average as a percent of GDP. Total turnover was only 72 million Nu in 2005, less than 2 million USD, and the turnover ratio was a low 1.6 percent. The shares of about one third of listed companies were not traded at all.

Country Name	Market Cap % GDP 2004*	Market Cap (\$US mill) 2005	Turnover Ratio (%) 2005	Market Cap (% GDP) % of OECD Avg.	Turnover ratio % of OECD Avg.
Bhutan	16	100	1.6	19	1.9
Bangladesh	6	3317	36	7	44
India	56	387851	115	67	140
Nepal	9	576	9.6(2004)	10	12
Pakistan	30	29002	32	35	39
Sri Lanka	18	3657	18	21	22
<b>OECD Average (2004)</b>	84.0	856.1	82.1	100.0	100.0

By April 2006 there were 16 companies listed on the Royal Bhutan Stock Exchange (RBSE). One company was listed in 2005 and one has been listed so far in 2006. There were no new listings in 2003 or 2004. At the end of 2005 the top 4 companies in the market represented 78 percent of total market capitalization and accounted for 47 percent of trading volume. Any company that wishes to sell shares to the public is expected to list. There are no procedures for voluntary delisting. No companies have been delisted.

**Institutional Investors.** Each of the financial institutions—Bank of Bhutan, the Bhutan National Bank, Bhutan Development Finance Corporation Limited, and the Royal Insurance Company of Bhutan—own shares in listed companies. Other institutional investors include the Provident Fund—a pension fund for government employees and employees of companies where the RGB has ownership, the central monastic body, and some funds associated with the military. Each has investments in about three to five listed companies. Along with the banks, the non-bank financial institutions and the Provident fund also make loans, which constitute the majority of their assets.

**Ownership framework.** In addition to the financial institutions and other institutional investors, owners include the RGB, major shareholders ("promoters"), small shareholders and in two cases foreign investors. The annex shows the share of ownership for each type of investor in each listed company. Aggregated figures are presented in the table.

Investor Type	Average share (all companies)	Share of Market Cap.	Number of companies
RGB	13.5%	24%	6
Financial	7%	8%	10
Non-Financial Institutional	8%	20%	11
Foreign	1.3%	4%	2
Major Shareholders	46%	22%	11
Small Shareholders	24%	22%	16

The government remains the largest shareholder with 24% of market cap. This does not include indirect holdings through institutional investors, almost all of which have significant RGB ownership. Ministry officials generally serve on the boards of

companies with government ownership, and they are subject to additional oversight by the RAA.

The government has encouraged small shareholders to purchase shares and Bhutan has over 15,000 shareholder accounts. The average company has about 900 shareholders, however there is large variation between company to company, with some less than 100, and others with more than 4000.

Major private shareholders include the country's three business groups. These can be controlling shareholders, or significant minority shareholders. There seems to be a limited amount of cross-shareholding. One group, centered on the non-listed Tashi Commercial Corporation, has the largest holdings in three of the top ten listed companies, and smaller holdings in two of the other top ten.

The foreign investors are the Marubeni Corporation of Japan, which owns 12 percent of Bhutan Ferro Alloys (BFAL) and the Asian Development Bank, which owns 10 percent of the Bhutan National Bank. The State Bank of India owns part of the non-listed Bank of Bhutan. Foreign investment is only possible with government permission. There are no foreign portfolio investors.

Free float has been estimated by the RSEB at 30 percent.

**Principle IB. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.**

**Assessment: Partially observed**

**Corporate legal framework.** The 2000 Companies Act (CA) provides the legal framework for all companies in Bhutan. It replaced the 1989 Company Act and has been influenced by law and practices in common law countries. The Act is relatively comprehensive and includes provisions similar to those found in laws on securities and accounting and auditing in other countries. Revisions to the Act and implementing regulations are currently being drafted.

**Company types.** The CA allows for three basic kinds of companies: private companies, which have at least two shareholders, can restrict trading in their shares, and cannot list; public companies, which also have at least two shareholders and whose shares must be freely transferable; and government companies, whose shares are one hundred percent owned by the RGB. The act also mentions government controlled companies, which are private or public companies where the government has at least fifty percent ownership, and listed companies, which are public companies whose shares are listed on the exchange.

In 2005 there were 175 registered companies, of which 84 are believed to be active. These included 3 government controlled (public) companies, 15 government companies, 40 private companies, and 26 public companies. A number of the public companies have substantial direct and indirect RGB ownership, but are not classified as government controlled.

The CA does not address partnerships and there is no partnership act.

**Securities law framework.** There is no law focused exclusively on capital market regulation and oversight. The 1992 Financial Institutions Act (FIA) regulates the provision of financial services, including banking and insurance as well as securities related activities. These have been supplemented by the 2002 Prudential Regulations issued by the RMA, which are applicable to bank and non-bank financial institutions. The CA addresses insider trading, the prospectus, and the form and content of companies' financial statements and audit report.

**Listing rules.** Listing Rules for the RSEB require a listing company to have been in operation for at least three years, have at least 25 shareholders and 25 percent of shares held by the public, and a minimum share capital of five million Nu (just over 100,000 USD). The Rules also provide additional requirements in terms of applying to list, ongoing disclosure by issuers and the issuance of additional shares.

**Banking Law.** The FIA and 2002 Prudential Regulations, together with the CA, provide the legal framework for all financial institutions. These include requirements for each financial institution to have an audit committee, and supplement the director qualification and conflict of interest provisions of the CA.

**Codes.** Bhutan does not have a Code of Corporate Governance. MTI has issued Rules and Procedures for Election of Directors that supplement the CA. The 2002 Prudential Regulations include a Code of Ethics for financial institutions.

**Principle IC. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.**

**Assessment: Partially observed**

**Securities regulator.** Under the FIA, the Royal Monetary Authority (RMA) acts as the securities regulator and oversees the RSEB as well financial institutions and brokers. The RMA issues and can revoke licenses, approves corporate control changes in the financial sector, and sets capital and other financial requirements,.

**Stock exchange.** The Royal Stock Exchange of Bhutan (RSEB) is the sole stock exchange. There is no over the counter market and all trades in the shares of listed companies must go through the exchange. The RSEB is responsible for trading, clearing and settlement, the central depository, and overseeing the Listing Rules. It can amend the Listing Rules with the approval of the RMA. Its regulatory functions include oversight of new listing and ensuring orderly trading and that companies make the required disclosure under the Listing Rules. It does not review the quality of the required reports. The

RSEB has the power to issue warnings, and suspend and cancel listings. There have been no suspensions or cancellations. Until 1996 the RSEB was a part of the RMA. It is now owned by Bhutan's four brokers, who constitute the board of the exchange, along with the RMA and MTI. It has six staff, including the head, two support staff, and one responsible for trading, one for listing and one for the depository. Commissions from trading government debt through the exchange have doubled the RSEBs revenue to about 2 million Nu.

The RSEB is currently a member of the South Asian Federation of Exchanges, which seeks to promote cross border trade and listing in amongst its members.

**Central depository.** The central depository is part of the RSEB. It holds shares and maintains a list of beneficial owners for all listed companies. There is one person in the RSEB responsible for its functions.

**Banking regulators.** The RMA is responsible for both banking and securities regulation, as noted above. They oversee certain governance and disclosure requirements of financial institutions found in the FIA and 2002 Prudential Regulations.

**Company Registrar.** The Registrar of Companies (Registrar) is part of the Ministry of Trade and Industry (MTI). Both are given key powers under the CA. The Registrar collects a variety of documents from companies and conducts annual inspections of most companies to ensure they comply with the basic requirements of the Act. Shareholders can only obtain a limited amount of information directly from the Registrar.

The RMA and Registrar sometimes cooperate, but there is no formal or informal mechanism for coordination.

**Principle ID. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.**

**Assessment: Partially observed**

**Authority, integrity and resources of regulators.** The overall resources of regulators are limited. The RMA does not have a formal department or division for capital markets, instead they have a securities unit of two people. The Registrar has a staff of four people who are capable of inspecting most companies during the year, but can only police basic infractions of the CA.

Under the law the powers of both bodies may be adequate, and there is little evidence of political interference. The RMA has formal autonomy, the Registrar does not. The Registrar can conduct on site inspections and issue warnings and fines. The default penalty in the CA is 5000 Nu (a little over 100USD) which can be applied to the company and each director, along with an additional 500 Nu a day for continuing violations of the law. The fine can be appealed to the MTI, which may reduce or waive it. The RMA can revoke licenses, issue cease and desist orders and fines, and has other powers under the FIA.

The RMA and MTI can both issue implementing regulation.

The RSEB lacks formal self regulatory status, has very limited resources, and plays a limited regulatory role.

**Courts.** Both civil and criminal, as well as regulatory, action are possible under the CA and FIA. In practice such cases are rare, and the courts largely untested in terms of complex corporate cases, though more straightforward property rights and contractual cases are common.

By the standards of the region, or developing countries in general, market participants have a generally positive view of the courts. Indicators developed by the World Bank imply that the procedures and time required to enforce a contract through the courts is low for the region, and not that much higher than OECD member countries. Cost of recovery is quite high however, indicating that the courts are more costly to use than many other economies (See Doing Business 2006 at [ru.worldbank.org](http://ru.worldbank.org)).

Contract Enforcement Indicator	Bhutan	South Asia Average	OECD Average
Number of procedures	21	29.5	19.5
Time (days)	275	385	225.7
Cost (% of debt)	113	36.7	10.6

## SECTION II: THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

**Principle IIA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to:**

**Assessment: Partially observed**

(1) Secure methods of ownership registration

Each company (public and private) is required to maintain its own shareholder register (CA, §32). However the RSEB maintains a Central Depository which has a registry of beneficial owners for each listed company. All transactions in the shares of listed

	<p>companies must be registered with the Depository for the change in ownership to be legally binding. The Depository provides information on shareholders directly to issuers.</p> <p>Public companies formed before the CA came into effect have share certificates, the Depository holds the shares of listed companies. The shares for other public companies are dematerialized, and a trade confirmation note of a dealing broker serves as legal proof of change in ownership (CA, §34).</p> <p>The law allows for custodians to hold shares on behalf of beneficial owners who retain their full rights as shareholders (CA, Part V). No such custodians currently exist outside the Central Depository.</p>
(2) Convey or transfer shares	<p>The RSEB handles clearing and settlement for the shares of listed companies. Buyers have to deposit cash within three days of trading for the transaction to clear (T+3). "Delivery versus payment" is used for trading on margin.</p> <p>The CA gives companies up to a month to transfer ownership in their register, and provides for shareholders to go to the Registrar in cases where such transfers are not made (CA, §30). However, in the case of listed companies, any changes in ownership should be immediately registered with the Depository, and be legally binding. Private, but not public companies, may have explicit restrictions on the transfer of shares.</p>
(3) Obtain relevant and material company information on a timely and regular basis	<p>When the AGM is announced, companies generally include contact information for shareholders wishing to obtain more information on the company. Companies also publish summary annual reports, and limited information is available from the Registrar. However some information, including the list of shareholders, can be difficult to obtain.</p>
(4) Participate and vote in general shareholder meetings	<p>Ordinary shareholders have the right to attend shareholder meetings. Holders of preferred shares are not normally allowed in the meeting of ordinary shareholders unless the agenda relates to those shares (CA, §26).</p>
(5) Elect and remove board members	<p><b>Process.</b> MTI has issued "Rules and Procedures for Election of Directors". The Rules require shareholders to be informed of vacancies on the board and require a candidate to be nominated by at least five shareholder up to seven days before the GMS. Voting is conducted by secret ballot in which each ordinary share has one vote. When the number of vacancies exceeds the number of candidates, each candidate must receive a simple majority of votes.</p> <p>The Rules call for 1/3 of the board to retire (based on seniority) each year, unless company Articles can call for all directors to retire each year. A shareholder can also propose an ordinary resolution to remove a director up to fifteen days before the GMS (CA, §81).</p> <p><b>Cumulative voting/proportional representation.</b> The Rules explicitly allow for proportional representation in companies with at least 50% government ownership. The RGB (through the Ministry of Finance and the "administrative ministry" for the company) directly appoint a number of board members proportional to the government's ownership.</p> <p>The Rules otherwise do not explicitly allow for cumulative or proportional representation in other companies, however in practice some other companies do seem to use proportional representation, including those ones where the RGB holds shares, but less than 50 percent.</p>
(6) Share in profits of the corporation	<p>Dividends are declared in the GMS (CA §58) and may only be paid out of the net profits of the company (CA §61). In the directors' report, the board should recommend a certain dividend, and the model Articles in the CA note that "no dividend shall exceed the amount recommended by the board". In practice, the board declares the dividend and the GMS approves it. The Registrar regularly follows up on complaints about late dividends.</p>
<p><b>Principle IIB. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:</b></p>	
<p><b>Assessment: Partially observed</b></p>	
(1) Amendments to statutes, or articles of incorporation or similar governing company documents	<p>The articles may only be changed by special resolution, which requires 75 percent approval in the GMS. The Registrar must also approve the change, and be paid a fee of 1000-2000 Nu (CA §7).</p>
(2) Authorization of additional	<p><b>Issuing share capital.</b> Authorized share capital can be increased through an ordinary</p>

shares	<p>resolution at the GMS (though it technically require a change in the Articles of the company) and by paying a fee of 1000-2000 Nu (CA §9). The change must be filed with the Registrar up to 30 days <i>after</i> the new shares where issued, implying that the issue may be approved after shares are issued.</p> <p>Listing Rules (5.14) imply that the board initiates new issues and notes that directors should obtain the consent of shareholder before “allotting, issuing, or granting” new securities. The GMS can also provide a general mandate for directors to issue shares at their discretion. The number of shares issued in this way cannot “exceed ten percent of the existing share capital of the issuer”.</p> <p><b>Pre-emptive rights.</b> Shareholders have preemptive rights. Shares are to be offered to shareholders in proportion to their current holdings, and have fifteen days to accept the offer. Shareholders can transfer their right to buy the shares to “any other person”. Pre-emptive rights can be waived through a special resolution which requires 75 percent approval in the GMS (CA §19).</p>
(3) Extraordinary transactions, including sales of major corporate assets	<p>Directors must have the approval of the GMS to sell, lease, or dispose of a whole or substantial portion of the company, or to borrow in excess of the company’s book value (CA §84). Major restructuring and mergers require both approval by a majority of shareholders holding at least 75 percent of shares at the GMS, and court approval. The court can make provisions for dissenters who oppose the merger (CA §94). Other significant transactions do not require GMS approval.</p>
<p><b>Principle IIC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:</b></p>	
<p><b>Assessment: Materially not observed</b></p>	
(1) Sufficient and timely information on date, location, agenda, and issues to be decided at the general meeting	<p><b>Meeting deadline.</b> Companies must call the AGM every year on or before April 30 for listed companies and June 30 for private companies. The Registrar can give the company a 30 day extension (CA, §58).</p> <p><b>Meeting notice.</b> Notice of the AGM must be provided at least 21 days before the meeting (CA §60). Notice should be given to all shareholders, in practice companies generally post the notice in the national newspaper and advertise it on the national television network instead of sending directly to shareholders. The law specifies that a failure to give notice does not invalidate the meeting.</p> <p><b>Available information.</b> In practice, the notice for the meeting includes contact information for investors wishing to obtain the agenda. The agenda should specify the personal interest of any director in the business to be discussed (CA §60). Rules and Procedures for Election of Directors require that shareholders be informed which board members are retiring one month before the meeting. Other relevant information can be obtained from the company or Registrar, however the list of shareholders may be difficult to obtain from the company.</p> <p><b>Quorum rules.</b> The model Articles in the CA require at least five shareholders to be present for quorum.</p>
(2) Opportunity to ask the board questions at the general meeting	<p><b>Forcing items onto the agenda.</b> The CA does not specify whether or not shareholders can add to meeting agenda for the annual meeting. In practice, shareholders can raise other issues under the “any other business” portion of the agenda.</p> <p>In the case of an extraordinary meeting, shareholders calling for such a meeting can specify its purpose.</p> <p><b>Questions.</b> In practice shareholders can ask questions under the “any other business” portion of the GMS agenda.</p>
(3) Effective shareholder participation in key governance decisions including board and key executive remuneration policy	<p>The GMS considers the companies accounts, audit report and directors’ report; declares dividends; appoints directors, and appoints and fixes the remuneration of auditors. It also decides on any ordinary or special resolutions (CA §58). The CA implies (but does not explicitly state) that the board determines the remuneration of its members and key executives.</p> <p>The board appoints the CEO, which must be approved by the GMS (CA §85).</p>
(4) Ability to vote both in	<p><b>Proxy regulations.</b> Shareholders can designate proxies to act on their behalf. Proxies may vote in the meeting, but cannot participate in other ways, i.e. they cannot ask</p>

person or in absentia	<p>questions or nominate board members (CA §26). To designate the proxy, the shareholder uses a form provided on the Registrar website and in the CA. They do not need to notarized or provide power of attorney to the proxy.</p> <p><b>Postal and electronic voting.</b> Postal and electronic voting are not possible.</p>
<p><b>Principle IID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.</b></p>	
<p><b>Assessment: Materially not observed</b></p>	
<p><b>Classes of shares.</b> The CA allows for ordinary shares, and non-voting preference shares with fixed dividends based on current or cumulative profit (CA §22). No preference shares have been issued. The CA allows for voting by show of hands in some cases or by secret ballot. In the later case, each ordinary share has one vote, in the former each shareholder effectively has one vote. The RGB does not have any special voting rights or “golden shares” in companies in which it holds equity.</p> <p><b>Ownership disclosure by companies.</b> The CA and Rules and Procedures for Election of Directors provide shareholders the right to inspect the list of shareholders at the office of the company. The annual return filed with the Registrar is also required to include this list. In practice, the list can be hard to obtain. The CA also requires the company to maintain a register of the directors’ shareholdings, and the Listing Rules require this information to be included in the annual report. The Depository only confirms a shareholders own holdings, and does not provide information on other shareholders.</p> <p><b>Ownership disclosure by shareholders.</b> Individual shareholders have no obligation to disclose their holdings. Financial companies generally include their share holdings in their annual report. The direct holdings of the RGB are public knowledge.</p> <p><b>Disclosure of shareholder agreements.</b> Shareholder agreements are not specified in the law, it is unclear if they are used in practice.</p>	
<p><b>Principle IIE: Markets for corporate control should be allowed to function in an efficient and transparent manner.</b></p>	
<p><b>Assessment: Not Observed</b></p>	
(1) Transparent and fair rules and procedures governing acquisition of corporate control	<p><b>Basic description of market for corporate control.</b> With the important exception of privatization by the RGB, there has been no changes in control or major restructuring of listed companies in Bhutan. There is no law on takeovers and limited regulation. Mergers require shareholder and court approval as noted above, and the RMA must approve any merger of financial institutions or the acquisition by a person or persons of more than 20 percent of the ownership of a financial institution</p> <p><b>Tender rules/mandatory bid rules.</b> There are no tender or mandatory bid requirements. Provisions to protect minority shareholders during changes of control are being considered for a revision of the CA.</p> <p><b>Delisting/going private.</b> There are essentially no rules on delisting and there have been no delistings. Conversion from a public to private company is not explicitly mentioned in the CA, but major changes in the company require approval by 75% of shareholders in the GMS (CA §92).</p> <p><b>Squeeze out provisions.</b> There are no squeeze out or buy out rules.</p> <p><b>Abuse of buy-backs/treasury shares.</b> Share buy-back require a special resolution approved by 75 percent of shareholders in the GMS and cannot endanger the solvency of the company. The RGB must approve the buyback, and a fee of 1000-2000 NU be paid to the Registrar. The purchased shares must be canceled, or held for reissue at least 24 months after the buy back. New shares cannot be issued for 12 months after the buyback. If held for reissue, the shares cannot be voted or collect dividends (CA §29).</p>
(2) Anti-take-over devices	<p>Anti-takeover devices are not widely used and not explicitly addressed in the law.</p>
<p><b>Principle IIF: The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.</b></p>	
<p><b>Assessment: Materially not observed</b></p>	
<p>The Provident Fund, banks, and other institutional investors generally participate in the GMS and are often represented on the boards of the companies they invest in.</p>	
(1) Disclosure of corporate governance and voting	<p><b>Special Rules for Institutional Investors / Pension Funds.</b> There are no special rules for institutional investors, who have the same ownership rights and obligations as other</p>

policies by institutional investors	<p>shareholders.</p> <p><b>Voting Policy.</b> There are no special rules requiring disclosure of voting or development of a voting policy. Companies are required to maintain minutes of the GMS, but it is not clear if these would provide substantial information on the position of institutional investors.</p> <p><b>Blocked shares/record date.</b> There is no record date for the GMS in the CA. The law and Listing Rules do seem to allow for the company to close the register of shareholders with notice; however it is ambiguous if this is relevant for listed companies (CA §32&amp;Part V).</p>
(2) Disclosure of management of material conflicts of interest by institutional investors	The FIA requires that assets managers “must not prefer some customers over others or prefer its own interest over that of its customers” (FIA §41 b). Asset managers are not required to disclose potential conflicts of interest.
<p><b>Principle IIG: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.</b></p>	
<p><b>Assessment: Largely/partially observed</b></p>	
<p>There are no limits on institutional investors consulting with each other before or during the GMS.</p> <p><b>Proxy solicitation or other formalities required.</b> Any five shareholders can nominate a candidate for the board. There are no restrictions on shareholders communicating for this purpose.</p> <p><b>Rules on shareholder cooperation and “acting in concert”.</b> There is no “acting in concert” concept.</p>	
<p style="text-align: center;"><b>SECTION III: THE EQUITABLE TREATMENT OF SHAREHOLDERS</b></p> <p>The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.</p>	
<p><b>Principle IIIA: All shareholders of the same series of a class should be treated equally.</b></p>	
<p><b>Assessment: Partially observed</b></p>	
(1) Equality, fairness, and disclosure of rights within and between share classes	<p><b>Availability of share class information.</b> Information on the securities issued by a company and their number and type of shareholders can be obtained from company reports or the RSEB.</p> <p><b>Equal rights within classes.</b> The CA notes that every ordinary shareholder has the right to vote on every resolution, either by show of hands or poll, in the later case he receives one vote per share (CA §26). Ordinary shareholders have equal rights to nominate and elect directors, inspect certain documents, participate in new share issues, etc. A shareholder may be denied their right to vote if his shares have not been paid for in full.</p> <p>Listing Rules mandate that “the issuer shall ensure the equality of treatment for all holders of securities of the same class who are in the same position”.</p> <p><b>Approval by the negatively impacted classes of changes in voting rights.</b> Preferred shareholders may vote “like an equity shareholder” on resolutions which directly affect rights attached to their preference shares. If dividends have not been paid for two years, they may vote on every resolution (CA §26). The model Articles in the CA require that 75% of affected shareholders approve the change.</p>
(2) Minority protection from controlling shareholder abuse; minority redress	<p><b>Ability to call meeting.</b> Ten percent of shareholders can call an extraordinary meeting of the company. The board has 21 days to call the meeting (within 45 days of receipt of the request). If they fail to do so, the requesting shareholders can convene the meeting. All costs incurred are to be reimbursed by the company (CA §59).</p> <p><b>Inspection rights.</b> Shareholders have the right to inspect the company’s registers of: share buy backs, transfers, charges, inter-corporate loans, inter-corporate investments, contracts in which directors are interested, and directors as well as the register of shareholders and the minutes of the GMS (CA §98). Annual accounts and the directors’ report are to be presented in the GMS.</p> <p>The model Articles in the CA note that “no (shareholder) shall have any right of inspecting any accounts or books or documents except as conferred by law or authorized by the Board or by (the GMS)”. In practice, small shareholders may have some difficulty in obtaining certain information from the company.</p> <p><b>Withdrawal rights.</b> There are no dissenter’s or withdrawal rights under the CA that allow</p>

	<p>dissenting shareholders to sell shares back to the company, though in the case of a merger, the court may make provisions for shareholders who dissent from the merger (CA §94).</p> <p><b>Ability to challenge decisions of the general meeting.</b> There is no specific provision in the law allowing shareholders to challenge GMS decisions, however they can complain to the Registrar if there is a specific violation of their rights under the CA.</p> <p><b>Regulatory redress.</b> The Registrar can fine the company and in some cases directors up to 5000 Nu for violating the provisions of the CA. An additional 500 Nu per day can be fined per day for ongoing contravention of the Act (CA §140). Certain violations of the act, including insider trading and false statements in the prospectus, contain additional penalties. In practice shareholders only complain to the Registrar about delayed payment of dividends.</p> <p><b>Ability to sue directors.</b> No suits have been brought against directors to date, and it is unclear how successful such a suit would be.</p>
(3) Custodian voting by instruction from beneficial owners.	Custodians cannot vote shares without some agreement or instruction from beneficial owners. Beneficial owners retain their voting rights, and must exercise them directly or through a proxy using standard procedures (CA §45). Nothing excludes a custodian from arranging proxy voting, but as there are effectively no custodians, this has not been done in practice.
(4) Obstacles to cross border voting should be eliminated.	Foreigners require RGB approval to invest in equity, and have only received this approval in a few special cases. There are no ADR/GDRs for Bhutan companies.
(5) Equitable treatment of all shareholders at GMS	<p>Participation in the GMS by small shareholders is low, though some companies do make an occasional effort to increase participation. This reflects geography, and the trouble of traveling to the meeting location. It also reflects low awareness on the part of small shareholders. Significant minority shareholders do participate in the GMS. In practice minority shareholders can ask questions and discuss off agenda issues under the customary "other items" portion of the agenda.</p> <p>There is no indication of the management or board trying to deter the participation of small shareholders.</p>
<b>Principle IIIB: Insider trading and abusive self-dealing should be prohibited.</b>	
<b>Assessment: Partially observed</b>	
<p><b>Basic insider trading rules.</b> The CA prohibits insiders from dealing in the securities of the company on the basis of "unpublished price sensitive information" or passing on such information or encouraging others to trade based on such information. Insiders are defined as "any person...connected with the company...who (may)...have access to price sensitive information". The Act notes that directors and employees of "any financial institution" are connected persons. It does not specify senior management for non-financial companies.</p> <p><b>Insider trading disclosure.</b> The company is required to maintain a register of director shareholdings that is open for inspection to shareholders and authorities (CA §97). Listing Rules require listed companies to produce an "interim report" every six months that indicates the shareholdings of the directors and chief executive, and their participation in new subscriptions or issuances of securities. There is no requirement to report trading in the companies shares by directors or executives in a rapid or timely manner.</p> <p><b>Criminal/civil/administrative penalties.</b> Insider trading can be punished with imprisonment or a fine of up to 10,000 Nu, or both. To date, there have been no reported cases or penalties.</p>	
<b>Principle IIIC: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.</b>	
<b>Assessment: Partially observed</b>	
<p><b>RPT disclosure rules.</b> Directors are to declare any interest they have in a transaction to the board (CA §89), the agenda for the AGM should include "the nature of the concern or interest" of any director in the issues to be discussed (CA §60), and the company is to maintain registers of inter-company loans, investments, and contracts in which "directors are interested" (CA §97). This information is to be included in the annual return filed with the Registrar. The auditor is also supposed to review the terms of such transactions in their audit report.</p> <p>Listed companies nominally follow IAS, however it is unclear if companies are in compliance with IAS 24 beyond the requirements in the CA. Companies where the RGB is an owner are subject to proprietary audit that generally includes a</p>	

review of major transactions.

**RPT approval rules/rules for approval of board/AGM.** The board must consent to any transaction involving an interested director. The interested party cannot vote or participate in the deliberations on the transaction (CA §89).

**Conflict of interest rules and use of business opportunities.** Directors cannot take loans from the company (CA §87). As noted, directors have disclosure and recusal requirements for transactions in which they may have an interest. There are no explicit rules on misuse of business opportunities.

#### SECTION IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

**The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.**

**Principle IVA: The rights of stakeholders that are established by law or through mutual agreements are to be respected.**

**Assessment: Partially observed**

The legal framework for stakeholders is still emerging and social custom and traditional means of resolving disputes continue to play an important role. The 1999 Bankruptcy Act and the 2000 CA provide protection for creditors. The Environmental Assessment Act was introduced in 2000, and a National Environment Commission introduced. At the end of 2005 the Anticorruption Commission was established and an anti-corruption act is being drafted. There is currently no law on employees, though one is being drafted. A Constitution has also been drafted that may clarify or extend the rights of stakeholders.

The current framework gives no special governance role to stakeholders such as employees or creditors, though in a few cases lenders are represented on the boards of their clients.

**Corporate social responsibility.** Awareness of stakeholder issues and corporate social responsibility has lagged in the private sector. The new Anti-Corruption Commission has sought to cooperate with the private sector, including consultations with the Bhutan Chamber of Commerce and Industry.

**Obligations of companies with government ownership.** Listed companies where the RGB holds equity generally do not have the same social/non-commercial obligations as non listed companies with state ownership. However, the presence of high level government officials on their boards may increase awareness of stakeholder issues.

**Principle IVB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.**

**Assessment: Partially observed**

**Redress mechanisms available to stakeholders.** Disputes are regularly aired either through traditional channels, such as village headmen, or the courts—which hear a number of property related civil cases. All citizens can ultimately appeal to the King, and many do. The basic nature of the legal framework may limit redress in some relevant cases, such as collecting on unsecured loans.

**Principle IVC. Performance-enhancing mechanisms for employee participation should be permitted to develop.**

**Assessment: Partially observed**

The CA allows for employees to receive stock and/or stock options, and some companies use the former. Bonuses for all employees—usually one or two months salary—and special allowances for some positions are used in some companies. Some companies also provide for advance training by their employees. Few companies make use of pay linked to *ex-post* performance.

**Principle IVD: Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.**

**Assessment: Materially not observed**

Stakeholders have limited access to corporate information. They are always able to request information directly from the company, but may not receive what is requested. Creditors wishing to lend to a company do their own assessments which make limited use of published information.

**Annual report discloses economic and financial prospects.** The directors' report is supposed to address "the state of the company's affairs", and some annual reports do discuss the economic and financial prospects of the company.

**Annual report discloses significant facts on employees.** Some companies address human resource issues in the annual report on a voluntary basis.

**Information is timely and regular.** Companies are required to produce annual reports and listed companies semi-annual interim reports (though its not clear that all do the later), however these are not always available to the public.

**Principle IVE: Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.**

**Assessment: Partially observed**

**Whistleblower rules.** Employees of companies where the RGP holds equity can post anonymously on the RAA website about potential wrong doing. There is no similar option for companies without state ownership. Under the 2002 Prudential Regulations financial institutions are to encourage staff members to report violations of the Code of Ethics, and maintain a record for inspection by the RMA. There is no formal protection for known whistleblowers.

**Principle IVF: The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.**

**Assessment: Partially observed**

**Effectiveness of bankruptcy, security/collateral, and debt collection/enforcement codes.** Collateralized lending is relatively well developed in Bhutan: under the CA companies must maintain a register of charges pledge against loans, and seizure of collateral in case of non-payment is fairly straightforward. However standard measures developed by the World Bank indicate that overall creditor rights are weak compared to other countries in the region, and especially weak by international standards. Information for creditors is poor with neither a public credit registry nor private credit bureau and the legal rights provided by the CA and 1999 Bankruptcy act limited. Few public companies have actually completed bankruptcy, and cases involving unsecured loans can drag on in court indefinitely.

Creditor Protection Indicators	Bhutan	South Asia Average	OECD Average
Legal Rights Index (out of a possible 10)	3.0	3.8	6.3
Credit Information Index (out of a possible 6)	0	1.8	5.0
Public credit registry coverage (% of adult population)	0	0.1	7.5
Private bureau coverage (% of adult population)	0	0.6	59.0

#### SECTION V: DISCLOSURE AND TRANSPARENCY

**The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.**

**Principle VA: Disclosure should include, but not be limited to, material information on:**

**Assessment: Partially observed**

(1) Financial and operating results of the company	<p><b>Annual report.</b> The CA requires the company's audited accounts to be presented at the annual GMS. These should include a balance sheet, profit and loss account, and cash flow statement for the year ending December 31<sup>st</sup>. These must be approved by the board and certified by at least one board member and the CEO (§69). They must be accompanied by the auditor's report and a directors' report (§58) and all are to be filed with the Registrar, along with an Annual Return containing non-financial information that is not presented at the GMS (§70). The CA proscribes the basic form and content of each of these statements.</p> <p>Some companies produce annual reports that combine the directors' report with the financial statements. These generally do not include the non-financial information filed with the Registrar in the annual return.</p> <p><b>Semi-annual report.</b> Listing rules require an unaudited interim report to be published every six months in the newspaper. The report should contain basic financial information, the shareholdings of directors and the CEO, and an explanation of significant developments.</p>
(2) Company objectives	The prospectus and the company articles should discuss objectives of the company. In practice, the directors' report may also discuss company objectives.
(3) Major share ownership and	The annual return filed with the Registrar includes the list of shareholders. This list is not necessarily provided to shareholders at the GMS either separately or as part of the

voting rights	combined annual reports issued by some companies.
(4) Remuneration policy for board and key executives, and information about directors	The profit and loss account is supposed to contain the remuneration of the directors and CEO, including salary, commissions, perquisites, pension, etc. Some companies specify the pay of the CEO in their accounts; others report aggregate figures on remuneration for the CEO and directors.  Directors' reports generally contain the name, title and sometimes the address of board members.
(5) Related party transactions	The annual return filed with the Registrar should include "particulars of contracts entered into with the Directors or their relatives or director's interested company(ies)". The company is also to maintain a register of such contracts which can be inspected by shareholders (§97). The CA directs the auditor to confirm that any such transactions are made at prices which are reasonable giving prevailing market prices, and to ensure that the details of such transactions are adequately disclosed in financial statements. Bhutan nominally follows IFRS, however—at best—companies do not seem to comply with IAS 24 beyond what is required in the CA.
(6) Foreseeable risk factors	There is no specific requirement to discuss possible risks or risk management techniques
(7) Issues regarding employees and other stakeholders	There is no specific requirement to discuss human relations or other stakeholder issues in the directors' report, though some companies do so voluntarily. Companies are required to list their number of employees in the annual return filed with the Registrar.
(8) Governance structures and policies	Bhutan does not have a corporate governance code or any sort of "comply or explain" requirements. Some information on governance mechanisms should be available from company articles.

**Principle VB: Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.**

**Assessment: Partially observed**

**Compliance with IFRS.** The CA provides the basic format and content for company disclosure. The 2002 Prudential Regulations contain some additional requirements for financial institutions. In some cases the tax code may be used to determine depreciation rates.

Nominally, in the past Indian GAAP was used to supplement these requirements, according to the RAA IFRS is currently supposed to<sup>2</sup>. In practice, company reports generally conform to Bhutanese legal requirements using basic accounting conventions. The financial statements reviewed made no reference to (other) accounting standards.

The difference is most conspicuous with non-financial reporting, which is limited under the current framework.

**Review/enforcement of compliance.** The RAA, RSEB, Registrar, and RMA all may review compliance with certain reporting requirements; however there is no detailed review of the quality of financial statements or other disclosure.

**Principle VC: An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.**

**Assessment: Partially observed**

**Who must be audited?** All companies must be audited by an external auditor. Companies with government ownership are also subject to an additional "proprietary" audit conducted by the RAA. This audit focuses on transactions such as procurement and employee expenses, but is moving towards broader measures of performance.

**Audit Standards.** The CA provides minimum audit examination and reporting requirements that auditors generally comply with. The RAA is empowered to revise these requirements. The CA also calls for auditors to use "Generally Accepted Auditing Standards" (GAAS), as does the RAA in its terms and conditions for auditors. It is understood that this is a reference to Indian GAAS. Currently all eligible auditors are based in India. The 2004 Accounting and Auditing ROSC for India notes that "Indian Auditing and Assurance Standards (GAAS) are broadly in line with ISA (International Standards of Auditing)". It also notes however that compliance with GAAS for Indian audits is uneven.

For its proprietary audits the RAA uses guidelines based on the relevant standards issued by the International Organization

<sup>2</sup> The 2004 Accounting and Auditing ROSC for India notes that "although Indian Accounting Standards (GAAP) are largely aligned with IFRS, differences do exist".

of Supreme Audit Institutions (INTOSAI) and Asian Organisation of Supreme Audit Institutions (ASOSAI).

**Auditor independence.** The RAA requires the audit firm to be rotated every three years and that a firm providing audit services “shall not render any (other) remunerative services” and that companies “shall ensure that firms who have rendered other professional services in the period or in the previous two years are not appointed as their statutory auditors”. Some market participants dispute that in practice this requires that auditors do not offer other services. The RAA also sets the compensation for the audit firm for companies with government ownership. The CA requires fees paid to audit for audit services and other services be listed separately in the financial reports of the company.

**Auditor qualifications.** The RAA compiles a list of eligible external auditors. To conduct the audit, the auditor must be certified by a relevant professional body in India or elsewhere. In practice this is the Institution of Chartered Accountants of India (ICAI). There is no domestic certification for accountants or auditors in Bhutan.

**Audit oversight and enforcement.** The RAA compiles the list of eligible external auditors and ensures auditor rotation. For companies where the RGB holds equity, it also sets the fee for the audit and can choose the auditor and review their work. They directly engage in the proprietary audit. In practice they rarely review the quality of the audit report.

ICAI is a self regulatory body that has introduced a code of ethics, limited peer review among its members, adjudicates disciplinary cases, and can take certain punitive action against its members. Presumably this oversight extends to work conducted in Bhutan, but this could not be confirmed.

**Audit committee.** The FIA and the 2002 Prudential Regulations issued by the RMA require each financial institution to have an audit committee. The committee should include at least three members, at least one of whom is a director, appointed by shareholders. The committee is to oversee financial reporting, internal controls and internal audit, external audit, and legal compliance. It is to have access to outside experts and should be notified by directors or management of “any error or misstatement of which they become aware”.

In practice, the existing audit committees are considered to be of limited effectiveness by the RMA.

**Principle VD: External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.**

**Assessment: Partially observed**

**Auditor accountability.** Auditors are to be appointed by the GMS from the list maintained by the RAA. When the government has ownership, the RAA can appoint the auditor directly, and can remove the auditor. In other companies the auditor can be removed by special resolution (CA §72). The remuneration of the first auditor chosen by the company is set by the board, for later auditors by the GMS, or by the RAA in companies with government ownership. In financial institutions, the Audit Committee is to appoint the external auditor. It is unclear if this is in contradiction of the CA.

Auditors have various obligations in the CA, but no explicit liability. They may be liable under the general “breach of contract” provisions of the 2004 Penal Act and Bhutanese civil law. In India law auditors are also liable under general contract law. It is unclear if a shareholder or stakeholder in Bhutan could take an Indian auditor to court in India.

**Auditor insurance.** ICAI does not require or recommend that its members have insurance, and suits against auditors are not common in India (and unknown in Bhutan).

**Principle VE: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.**

**Assessment: Materially not observed**

Under the CA, most information should be available at the GMS or from the company. However some information, such as the list of shareholders, can be hard to obtain. The Registrar also provides only limited information to shareholders and little to the general public.

**Material facts.** There is no rapid reporting of material or price sensitive information, and no requirement to do so.

**Published information (papers, web).** Some companies do publish summary annual reports in the newspaper, as required for banks under the FIA, and under Listing Rules all listed companies are required to publish semiannual interim reports in the newspaper, and confirm that they have done so with the RSEB and RMA. It is not clear that all comply. Few companies have websites.

**Principle VF: The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.**

**Assessment: Partially observed**

Bhutan’s small brokerage industry is overseen by the RMA, who should base their licensing decision in part on “the integrity of shareholders with a qualifying shareholding” (FIA §4). No person involved in dealing, marketing or distributing securities

shall “make a misstatement of material fact...or do anything to create a false appearance or engage in any manipulative device” (FIA §27). Persons in the securities business must ensure that a deal recommended for the customer is suitable for the customer, and do not favor one customer over another (FIA §30).

Financial institutions also have general requirement to “introduce suitable arrangements and procedures so that is not placed in a situation where its duty to one customer conflicts with its duty to another”. (FIA §21)

In practice, the securities industry is unprofitable, and the RMA’s main concern is to ensure that such services are provided at all. The low level of activity may limit opportunities for conflicts of interest.

**Disclosure of conflicts of interest by analysts, brokers, rating agencies, etc.** A person giving investment advice “must disclose in writing whether it has any material interest in the investment opportunity recommended” (FIA §43).

#### SECTION VI: THE RESPONSIBILITIES OF THE BOARD

**The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.**

**Principle VIA: Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.**

**Assessment: Largely observed**

**Basic description of board.** Bhutan has a unitary board structure. Public companies must have at least three members, in practice some companies only have three or four directors. Larger companies generally have six to nine; this normally includes non-executive directors with ties to various shareholders—including government ministers and other ministry officials—and the CEO who acts as the secretary and is a non-voting member. Under the act every listed company is to have a secretary “to ensure compliance of the provisions of this act” (FIA §90). The CA does not indicate this should be the CA.

**Nomination and election.** As elaborated in IIA (5), elections are to follow the procedures laid out in the Rules and Procedures for Election of Directors issued by MTI. In practice some companies, including those where the RGB holds equity, use proportional representation. The Ministry of Finance and the designated “administrative ministry” choose some board members, and other directors are chosen by other investors.

**Eligibility requirements.** No person may be appointed a director if they have been declared of unsound mind by the court or ever declared insolvent or convicted of a criminal offense (CA §79). Non-citizens can only serve as directors with the approval of the RGB. Directors of financial institutions are also prohibited from serving if they have been suspended from employment or investigated for a doubtful transaction, directly involved in a company wound up by the court or investigated by the government, or has non-performing loans outstanding.

**Adequacy of duties of loyalty and care.** Every director “shall act honestly and in good faith in the best interest of the company and shall exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances” (CA §91). As noted under IIIA (2), a WB assessment has determined that directors are potentially liable for violating their duties or engaging unfair or abusive practices.

To date there have been no suits against directors for violating their duties, and no director has liability insurance. Directors are punishable with a fine of up to 5000 Nu for general violations of the CA.

**Principle VIB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.**

**Assessment: Partially observed**

Listing Rules require “the issuer shall ensure equality of treatment for all holders of securities of the same class who are in the same position”. The CA includes provisions that regulate potential conflicts of interest involving directors, however there is no explicit requirement for board decisions to treat shareholders equally or fairly or act in the interest of all shareholders. In practice shareholders who feel they have been treated unfairly can appeal to the Registrar.

**Principle VIC: The board should apply high ethical standards. It should take into account the interests of stakeholders.**

**Assessment: Partially observed**

As noted under IV A, stakeholder interest are largely reflected in social conventions and may be given more weight in companies where government officials serve on the board. Under the 2004 Penal Code, directors can be prosecuted, sentenced and fined for legal violations of the company (Chapter 34).

**Code of Ethics.** The 2002 Prudential Regulations contains a Code of Ethics for financial institution that addresses conflicts of interest, misuse of position, misuse of information, and ensuring fair and equitable treatment of all customers and others who rely on or are associated with the financial institution. The board is to take positive steps to establish effective

monitoring devices, including requiring all directors and employees to sign a declaration of their observance of ethical standards. Companies are to maintain a record of observed breaches of the Code for inspection by the RMA.

**Principle VID: The board should fulfill certain key functions, including:**

**Assessment: Partially observed**

(1) Board oversight of general corporate strategy and major decisions	<p><b>Board functionality by law and in practice.</b> The board has broad powers under the CA to “do all such acts and things, as the company is authorized to exercise and do” as long as the act does not reserve the power for the GMS. The act specifies that this includes major financial decisions and investment. However the act also gives the board broad powers of delegation (§83).</p> <p>In practice, the CEO develops the company’s strategy, which then is discussed and approved by the board.</p> <p><b>Director training, IOD.</b> The Bhutan Chamber of Commerce and Industry provides various training programs and seminars. None focus specifically on the duties and responsibilities of directors.</p>
(2) Monitoring effectiveness of company governance practices	<p>The secretary—who generally sits with the board as a non-voting member—is to monitor compliance with the CA, which includes almost all relevant governance provisions (CA §90).</p>
(3) Selecting / compensating / monitoring / replacing key executives	<p>The board appoints the CEO with the approval of the GMS (CA §85). The board generally also determines the CEO remuneration, for other employees appointment and remuneration is normally delegated to the CEO.</p>
(4) Aligning executive and board pay with long term company and shareholder interests	<p>Companies do make limited use of bonus schemes, and the CA allows for compensation through shares or share options. It is not clear that many companies use this later option.</p> <p>Board members normally receive a sitting fee. This is normally about 5000 Nu, and is reported in company accounts.</p>
(5) Transparent board nomination / election process	<p>The process for nominating and electing board members is given in the “Rules and Procedures for Election of Directors” issued by the MTI. Under the rules, an election committee is to be formed. It contains the company secretary but not necessarily any directors. Directors are liable if the rules are not implemented.</p>
(6) Oversight of insider conflicts of interest, including misuse of company assets and abuse in RPTs	<p>As noted under IIIC, a conflicted director must announce his position to the board, the board must approve the transaction involving the conflict, and the conflicted director must recuse themselves from this vote. A register of such transactions must be maintained by the company.</p>
(7) Oversight of accounting and financial reporting systems, including independent audit and control systems	<p>The board is required to issue an annual directors report and approve the accounts of the company. At least one director and the CEO must authenticate the accounts on behalf of the board (CA §69). In financial institutions, the Audit Committee oversees audit and control systems. In companies where the RGB has equity, the RAA plays an oversight role. In other companies, the GMS appoints auditors and determines remuneration.</p>
(8) Overseeing disclosure and communications processes	<p>Communication falls under the general powers of the board, but in practice is delegated to management.</p>

**Principle VIE: The board should be able to exercise objective independent judgment on corporate affairs.**

**Assessment: Materially not observed**

(1) Director independence	<p><b>The role of the chairman.</b> The post of chairman is generally separate from that of CEO, however there is no formal requirement for this separation.</p> <p><b>Director independence in the law.</b> There are no requirements or guidelines to have non-executive or independent directors.</p> <p><b>Director independence in practice.</b> In practice many boards are all non-executive, with the exception of the CEO, who serves as the non-voting secretary. These board members are often shareholders or tied to major shareholders, for example government officials in companies where the RGB has ownership.</p>
---------------------------	--

(2) Clear and transparent rules on board committees	<p><b>Audit committees.</b> Financial Institutions are required to have audit committees (see VC).</p> <p><b>Other committees.</b> The CA allows the board to delegate powers to committees. They are not widely used.</p>
(3) Board commitment to responsibilities	<p><b>Restrictions on the number of board seats.</b> A person can serve on up to five boards (CA §79).</p> <p><b>Board meeting requirements.</b> Boards are to meet five times a year (CA §82). Some companies have had fewer meetings, but the Registrar has been seeking to improve compliance.</p> <p><b>Public availability of board attendance.</b> Minutes are to be kept of board meetings, and these record attendance (CA §65). These minutes are not available to the public.</p>
<p><b>Principle VIF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.</b></p>	
<p><b>Assessment: Partially observed</b></p>	
<p>Boards have broad powers under the CA, and the CA requires the company to maintain a variety of accounts and registrars. Individual directors do not have an explicit right to inspect these books, but there does not seem to be legal way to deny them that right (except perhaps by board decision). Under the 2004 Prudential Regulations members of the Audit Committee in financial institutions have an explicit right to outside advice as well as access to external and internal auditors.</p>	

## Annex 1: Ownership structure of listed companies.

Issuer	Holdings in Percent						Market Cap. (2005) Nu. Mill
	RGB	FI	Other II	Foreign	Founder	Public	
Bhutan Board Particle Limited	44.88	13.26	13.20	-	-	28.66	126.00
Bhutan Carbide & Chemicals Limited	-	39.23	1.35	-	52.11	7.30	600.00
Bhutan Dairy Limited	-	15.00	6.00	-	59.04	19.96	2.50
Bhutan Ferro Alloys Limited	25.73	8.69	9.66	12.00	43.69	0.23	765.00
Bhutan National Bank	13.61	2.10	35.61	10.05	-	38.63	773.56
Bhutan Polymers Company Limited	-	5.10	1.70	-	53.72	39.48	59.84
Bhutan Tourism Corporation Limited	-	-	0.96	-	80.94	18.10	35.62
Druk Petroleum Corporation limited	-	13.42	-	-	83.33	3.26	7.48
Druk Plaster and Chemicals Limited	-	-	-	-	70.00	30.00	35.00
Druk Satair Corporation Limited	-	-	-	-	69.94	30.06	82.70
Druk Stones & Minerals Export Company Limited	-	-	-	-	92.04	7.95	11.31
Penden Cement Authority Limited	42.68	1.82	35.54	-	-	19.96	1,360.00
Royal Insurance Corporation Limited	39.25	0.37	4.59	-	-	55.80	288.00
State Trading Corporation of Bhutan	51.00	11.96	10.90	-	-	26.14	38.00
Bhutan Beverages Company Limited	-	-	9.39	-	60.00	30.60	230.00
EBCC	-	-	-	-	70.00	30.00	52.10

RGB: Royal Government of Bhutan, FI: Financial Institutions, Other II: Other Institutional Investors, Foreign: Foreign investors, Founder: the primary private sector shareholder, Public: other shareholders.

# Bhutan Terms/Acronyms

<b>CA:</b> The 2000 Company Act of Bhutan
<b>CEO:</b> Chief executive officer
<b>Cumulative voting:</b> Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.
<b>FI:</b> Financial institution
<b>FIA:</b> The 1992 Financial Institution Act of Bhutan
<b>GCGF:</b> Global Corporate Governance Forum
<b>GMS:</b> General meeting of shareholders
<b>GDP:</b> Gross Domestic Product
<b>ICAI:</b> Institution of Chartered Accountants of India
<b>IFRS:</b> International Financial Reporting Standards
<b>ISA:</b> International Standards on Auditing
<b>MTI:</b> Ministry of Trade and Industry
<b>Nu:</b> Ngultrum, the currency of Bhutan. The Ngultrum is fixed at parity with the Indian Rupee.
<b>Pre-emptive rights:</b> Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.
<b>Proportional representation:</b> Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.
<b>Pyramid Structures:</b> Pyramid structures are structures of holdings and sub holdings by which ownership and control are built up in layers. They enable certain shareholders to maintain control through multiple layers of ownership, while at the same time they share the investment and the risk with other shareholders at each intermediate ownership tier.
<b>RAA:</b> Royal Audit Authority
<b>Registrar:</b> Registrar of Companies
<b>RGB:</b> Royal Government of Bhutan
<b>RMA:</b> Royal Monetary Authority, the central bank of Bhutan
<b>RSEB:</b> Royal Stock Exchange of Bhutan
<b>RPT:</b> Related party transactions. The OECD Principles of Corporate Governance hold that it is important for the market to know whether a company is being operated with due regard to the interests of all its investors. It is therefore vital for the company to fully disclose material related party transactions to the market, including whether they have occurred at arms-length and on normal market terms. Related parties can include entities that control or are under common control with the company, and significant shareholders, such as relatives and key managers.
<b>SAFE:</b> South Asian Federation of Exchanges
<b>Shareholder agreement:</b> An agreement between shareholders on the administration of the company, shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.
<b>SOE:</b> State owned enterprise. In BiH this includes enterprises with significant entity or cantonal ownership.
<b>Squeeze-out right:</b> The squeeze-out right (sometimes called a "freeze-out") is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.
<b>USD:</b> United States dollar
<b>Withdrawal rights:</b> Withdrawal rights (referred to in some jurisdictions as the "oppressed minority," "appraisal" or "buy-out" remedy) give shareholders the right to have the company buy their shares upon the occurrence of certain fundamental changes in the company.

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities, and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OECD Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate governance practices
- provide a benchmark by which countries can evaluate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
- provide the basis for a policy dialogue which will result in the implementation of policy recommendations

To see the complete list of published ROSCs, please visit  
[http://www.worldbank.org/ifa/rosc\\_cg.html](http://www.worldbank.org/ifa/rosc_cg.html)

To learn more about corporate governance, please visit the IFC/World Bank's corporate governance resource  
Web page at: <http://rru.worldbank.org/Themes/CorporateGovernance/>

---

Contact us at [CG-ROSC@worldbank.org](mailto:CG-ROSC@worldbank.org)