REVIEW OF CORPORATE GOVERNANCE PRACTICES IN THE BALTICS IN 2015

INTRODUCTION /

An effective corporate governance framework is of key importance, as well-run companies are likely to be more competitive and more sustainable in the long term. Corporate governance codes aim to establish principles for good corporate governance in listed companies based on transparency, accountability and a long-term perspective. They provide standards and best practice for companies, enabling them to retain shareholders' confidence in the company, to perform better and therefore contribute to fostering growth, stability and long-term investment.

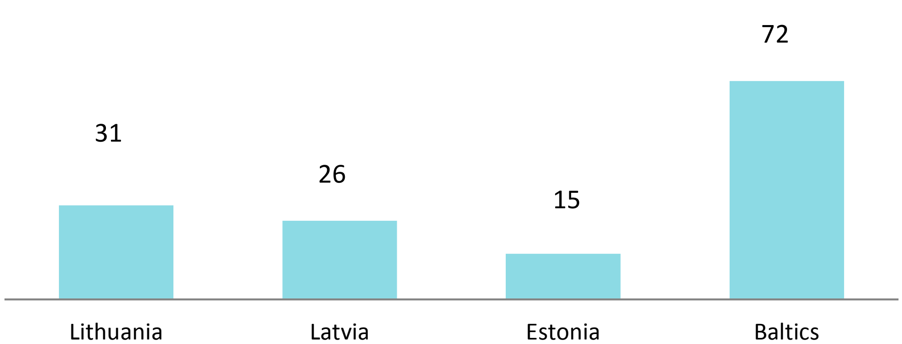
The primary aim of this analysis is to assess Baltic regulated market companies' level of compliance with corporate governance recommendations in Estonia, Latvia and Lithuania. It is the first report on corporate governance to include all three Baltic countries. Attention thus focuses on the recommendations that are comparable for all three. In order to provide more international perspective, other widely discussed aspects of governance, such as gender diversity, are also examined.

Another purpose of the report is to share the findings on corporate governance in the Baltics with the region's listed companies as a basis for discussion where improvements in behavior and/or reporting could be made and what updates to the corporate governance recommendations might be appropriate.

The review is based on corporate governance reports for 2014 and other publicly available information (annual and interim reports, web pages, market announcements, etc.) of companies admitted to trading on Baltic regulated markets. All the data used is available on the Nasdaq Baltic website (www.nasdaqbaltic.com); no interviews or other primary data were used. The 72 Nasdaq Baltic companies that were traded on the Baltic Main and Secondary Lists as of October 1, 2015, were included. Of them, 15 represent Estonian market, 26 Latvian market and 31 Lithuanian market.

The corporate governance structure in Lithuania differs from that in Latvia and Estonia in that a Supervisory Board is not mandatory for public limited liability companies in Lithuania. Thus, for the 17 Lithuanian companies that have chosen not to establish a Supervisory Board, the review instead looks at the Management Board when assessing Supervisory Board practices as long as that does not oppose the essence and purpose of this body.

Figure 1. Number of Baltic regulated market companies



INDEPENDENT MEMBERS ON BOARDS /

Each Baltic regulated market company has to assess the independence of their board members according to the criteria specified in the corporate governance requirements for their country.

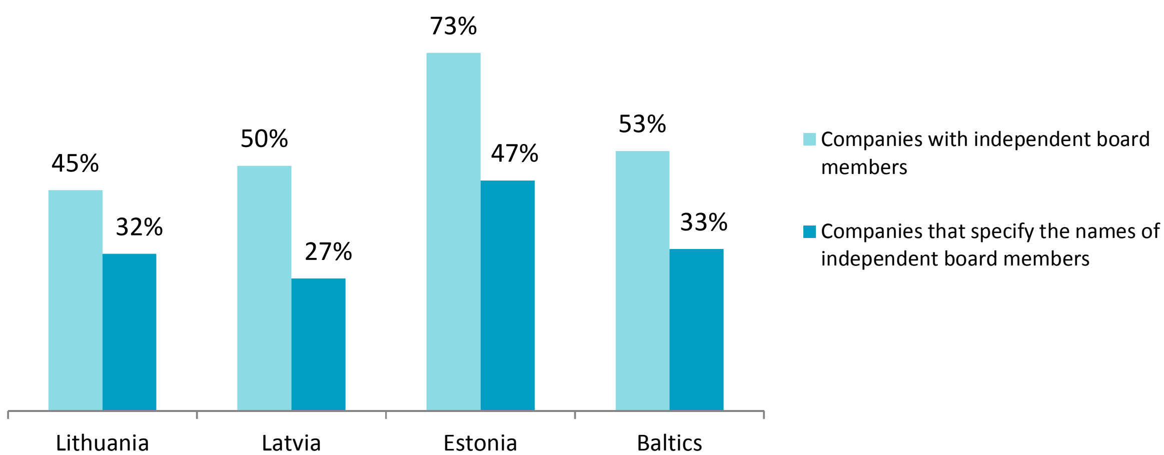
Recommendations regarding independence differ in all three Baltic countries. Lithuanian Corporate Governance Code simply recommends having a sufficient number of independent board members, allowing companies to decide the exact number. Latvian and Estonian recommendations more specifically indicate that at least half of the board members have to be independent. Compliance rates are therefore not directly comparable among the Baltic countries. Nonetheless, the share of companies with independent members on their boards in each country is presented in Figure 2 in percentage.

Slightly more than half of Baltic companies admitted to the Main and Secondary Lists (38 out of 72, or 53%) have at least one independent member on the collegial body elected by shareholders. The leader in this area is Estonia, where the percentage of such companies is 73% (11 of 15) followed by Latvia with 50% (13 of 26) and Lithuania with 45% (14 of 31). It is interesting to note that all Baltic countries have the similar number of such companies. In addition to Estonia with 11 such companies, 13 and 14 of them are in Latvia and Lithuania, accordingly.

There are companies in Latvia and Estonia which, while they have independent members on their Supervisory Boards, those make up less than half of all members. Excluding them, 47% of Estonian companies (7 of 15) and 23% of Latvian companies (6 of 26) fully follow the governance recommendation for at least half of the members of their Supervisory Boards to be independent.

The study also assessed whether companies list the names of independent members in their reports or on their company's website, or simply indicate the existence of independent members. Approximately two-thirds of the Baltic companies that have independent members on their boards also specify which board members are independent. For consistency, Figure 2 also includes the percentage of all Baltic regulated market companies that specify independent members (33%, or 24 of 72).

Figure 2. Number of companies with independent board members, % from regulated market companies



OTHER BOARD COMPOSITION ISSUES /

This section analyses the following four aspects of board composition.

First, in accordance with good corporate governance practices which are also reflected in the criteria for the Baltic Market Awards, it is recommended that companies disclose the names and background information of candidates of the supervisory board (education, qualifications, professional background, engagement in other companies and potential conflicts of interests) prior to the General Meeting where they are to be elected. This ensures that shareholders have sufficient time to make an informed voting decision. Analysis here is based on the information in companies' corporate governance statements and market announcements published before the relevant general meetings, through the Nasdaq Baltic Information Distribution System (GNW), during the period from mid-2014 to mid-2015.

Results show that 59%[1] of all the companies (23 of 39) that held elections of new members to their Supervisory Board in fact publicly disclosed information about the candidates in advance together with the draft decisions of the General Meeting of shareholders. The remaining companies either did not publicly provide this information or provided it together with the approved resolutions regarding the newly elected members.

It can be noted that all three Baltic countries have such a corporate governance recommendation. According to the gathered statistics, 4 out of 5 companies constituting 80% in Estonia provided candidates' names as well as basic information about their education and professional experience prior to the General Meetings of shareholders which elected them. In comparison, 65% (11 of 17) of Lithuanian companies and 47% (8 of 17) of Latvian companies disclosed this information taking into account only those companies that held elections of new members.

Second, the corporate governance requirements for all three Baltic countries stress that each member of a collegial body is expected to dedicate sufficient time to their duties. The regulations recommend notifying shareholders when members have attended less than half of the meetings of the collegial body during the year. Taking a somewhat stricter approach, analysis here looked for more detailed disclosure of statistical information about individual member's participation in meetings.

Among the Baltic traded companies, 35% (25 of 72) specified in their annual reports how many supervisory board meetings took place and what the level of attendance was on an individual basis. In Estonia, disclosure of this information is twice as common (60% or 9 of 15 of companies provide it) as in Lithuania (29% or 9 of 31) or Latvia (27% or 7 of 26). The resulting overall level for the Baltics, as shown in Figure 3, is 35%.

Third, the review examined whether the key functions of supervisory board members are disclosed in Annual Reports or on companies' websites. In majority of cases this information has been made available. Sometimes, however, the companies only indicate that board members' functions are defined in the Commercial Law and therefore are not repeated in the Annual Report or website. This can be confusing for foreign investors, who are not familiar with the local laws of each Baltic country and the current governance structure of a particular company. Therefore, it is recommended that annual reports or companies' websites specify the main functions of Supervisory Board.

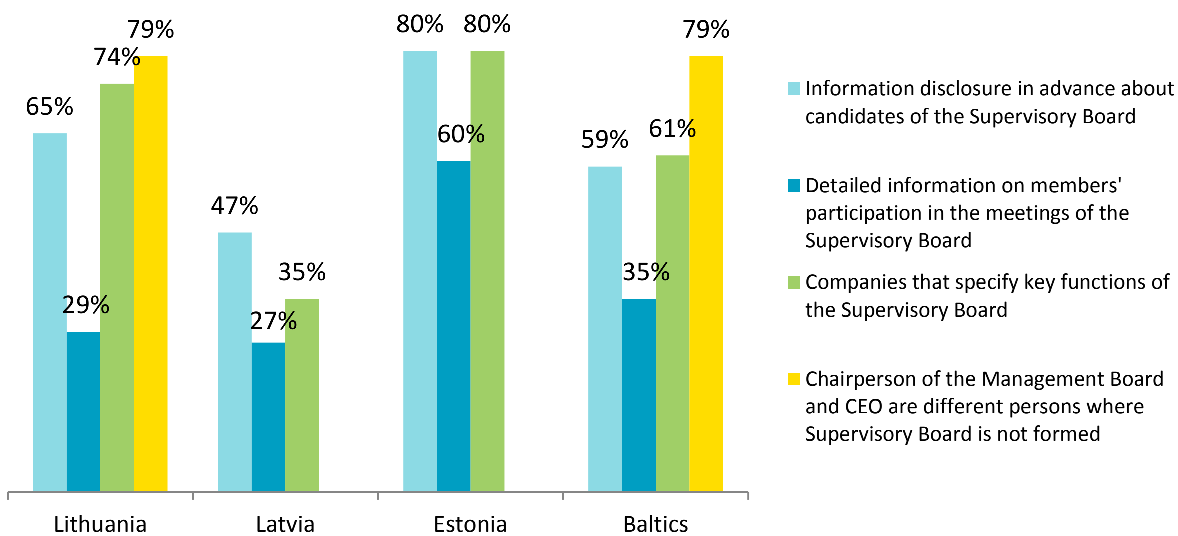
[1] Companies that at least indicated the name and surname of the candidate have been included.

Overall, Annual Reports or websites for 61% of all Baltic public companies (44 of 72) specify the key functions of the collegial body elected by the General Meeting of shareholders. The remaining 39% (28 of 72) explain that they do not duplicate this information because it is already described in the Commercial Law.

Descriptions of board members' functions in annual reports are much more frequent in Lithuania (74%, or 23 of 31 companies include it) and Estonia (80%, or 12 of 15 companies) than in Latvia (35%, or 9 of 26 companies).

Fourth, as a deviation from other countries, for companies in Lithuania that decide to form a Management Board only and not to elect a Supervisory Board, it is recommended that the Chairman of the Bard and Chief Executive Officer be different persons. As of the date of this review, 3 Lithuanian listed companies did not comply with this recommendation. These companies say in their compliance statements that the supervision of the companies' activities is guaranteed by the other board members. They also state that the Management Board carries out supervisory functions as long as that does not oppose the essence and purpose of the management board. Figure 3 gives results on this issue for Lithuania only, as it is not relevant for Latvia or Estonia.

Figure 3. Number of companies with good Board composition practices, %



GENDER DIVERSITY ON BOARDS /

The number of members on Supervisory Boards at traded companies in the Baltics varies from 3 to 11. Supervisory Boards with 5 members are the most frequent, accounting for 28 of the 55 instances, or 51%.

The sizes of Management Boards vary from 1 to 8 members. Three-member boards are the most common. Of the 72 companies reviewed, 21 of them (29%) had Management Boards with 3 members.

The proportion of women on collegial bodies (both Supervisory Boards and Management Boards) averages at 19% among Baltic traded companies. In other words, on average one in five persons elected to these companies' collegial bodies are women. The proportion is slightly higher on Supervisory Boards, where 21% are women; on Management Boards the average is 17%.

The data shows that 24 Supervisory Boards have no female members, which is 44% of the 55 companies in Baltics that form a Supervisory Board. Out of the companies that have such boards, on average every third member is a woman and the absolute number of women on Supervisory Boards varies from 1 to 4.

Nearly half of the Baltic traded companies (49% or 35 of 72) do not have any women on the Management Board. At the rest, the absolute number of women on Management Boards varies from 1 to 3.

Therefore it can be concluded that almost half of Baltic traded companies have no women board members, while at the other half every third person elected to collegial bodies is a woman.

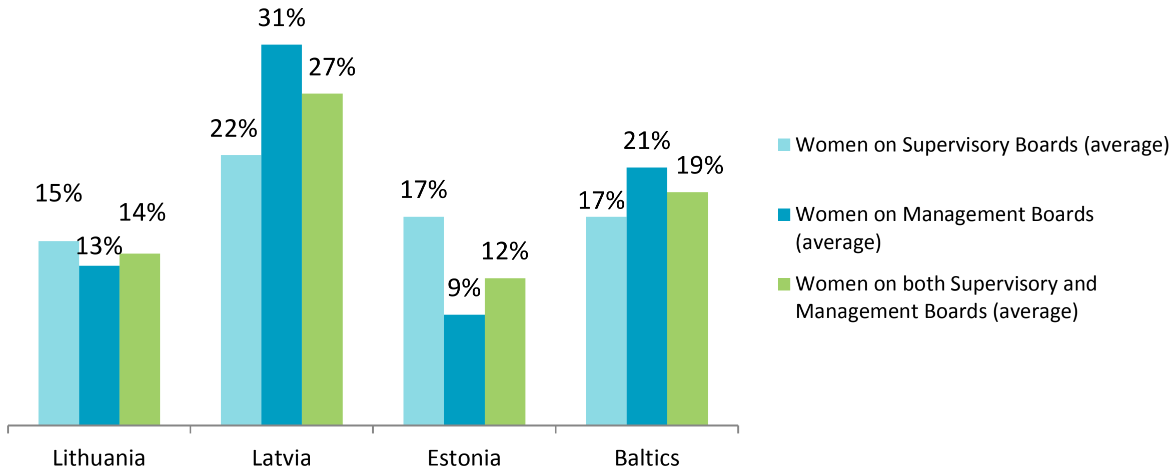
On a country basis, Latvia clearly leads the region for gender diversity in all of the categories indicated in Figure 4. Latvian companies have a larger proportion of women on Supervisory Boards, on Management Boards and on the two collegial bodies combined than do companies in Lithuania and Estonia.

The European Commission reported in 2011 that the average proportion of women on the Management and Supervisory Boards of EU listed companies was 12%.

In comparison, among the publicly traded companies in Finland and Sweden, the proportion of women board members was 24% and 28% in 2015, accordingly. In the Baltics, as can be seen in the Figure 4, the share of women on the boards is equal to 19%.

Gender diversity is only one of the aspects which should be considered in assessing board composition. Professional diversity is also important for achieving an appropriate balance of the needed experience and skills and for large cross-border companies, international diversity can be of value.

Figure 4. Women on the boards, %



AUDIT AND OTHER COMMITTEES /

Among Baltic traded companies, 79%[2] (57 of 72) form an Audit Committee as a specialized advisory body of the Supervisory Board.

In fact, the requirement to have an Audit Committee is set forth in the Law on Audit in Lithuania and in the Law on Financial Instruments in Latvia. Allowing for the fact that in small and medium-sized enterprises the functions of the audit committee may be performed by the supervisory board, the several Lithuanian and the most of Latvian companies explain in their compliance statements that the functions of the audit committees are performed by the supervisory board. However, Estonia does not oblige regulated market companies to set up an audit or any other committee – it is only a recommendation in the corporate governance requirements. So the situation with the audit committees is not comparable among the Baltic countries due to differences in rules and regulations.

For that reason, this review only counted in companies that have established an audit committee as a separate advisory body.

94% of all Lithuanian listed companies (29 out of 31) have established separate audit committees. In Estonia, audit committees have been established by 80% of regulated market companies (12 of 15). In Latvia, 62% of companies have such a committee (16 of 26).

The number of companies that disclose the main functions of their Audit Committee correlates with the number of companies that have formed an Audit Committee. All the companies in Estonia with an Audit Committee describe its functions, and in Lithuania 81% (25 of 31) do so, while in Latvia just 27% (7 of 26) provide information on their audit committee's functions in reports or on their website.

It is encouraging that some companies have begun to report on the activities of their audit committees, generally publishing such information through the Nasdaq Baltic Information Distribution System (GNW). The 4

[2] Including possible exceptions when the Audit Committee is formed in the parent company of the listed company.

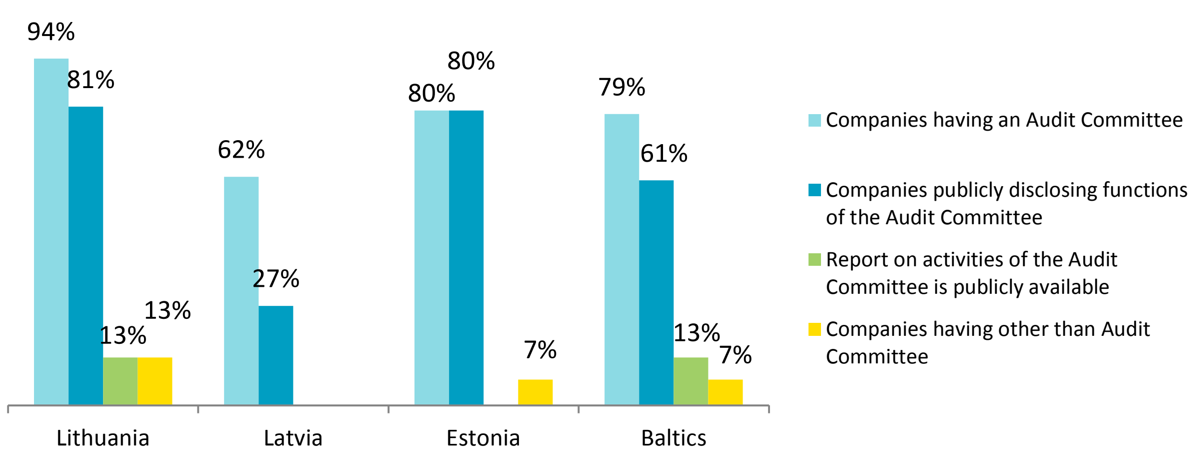
pioneers are Lithuanian companies. This in part reflects a recommendation in the Lithuanian Corporate Governance Code that the collegial body elected by the general meeting of shareholders should at least once a year conduct an assessment of its activities and publicly disclose related information.

To date no audit committee reports have been published in Latvia or Estonia. Latvian Corporate Governance Code recommends that companies provide information about the activities of audit committees on their websites. Estonian Corporate Governance Recommendations states that the supervisory board should regularly assess the activities of the management board.

Lithuanian and Estonian corporate governance recommendations suggest having additional committees, such as nomination or remuneration committee, with the goal of increasing the efficiency of the collegial body. The committees are intended to provide the collegial body with recommendations for decisions on critical issues where there is a higher chance of conflicts of interest, though final decisions are adopted by the collegial body.

The review found one Estonian company which, besides an audit committee, also has two others to advise the supervisory board in specific areas: a nomination and remuneration committee, and a corporate governance committee. In Lithuania, 4[3] companies have formed a remuneration committee or a nomination and remuneration committee in addition to an audit committee.

Figure 5. Number of regulated market companies with Audit and other committees, %

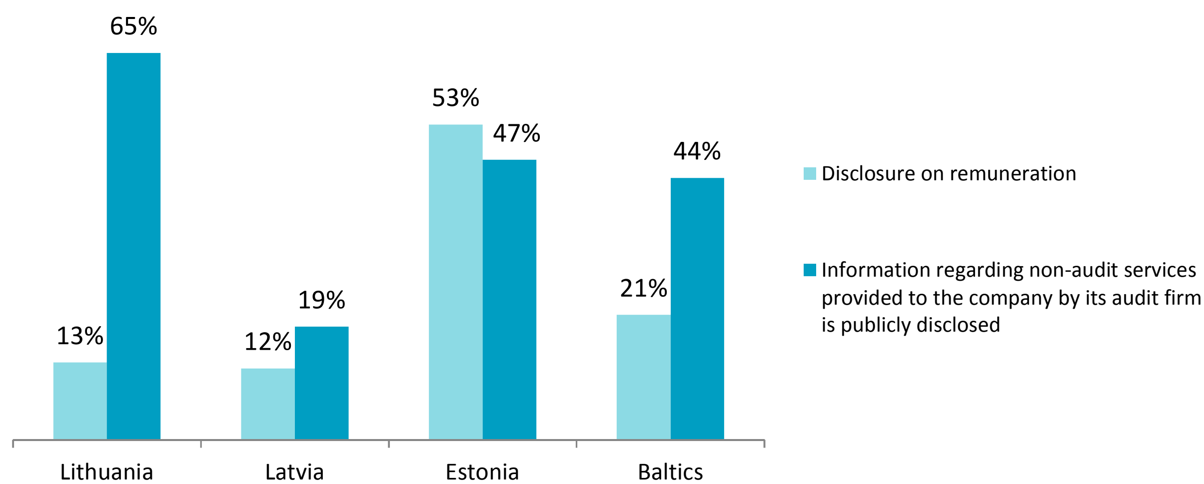


[3] Excluding companies where other than Audit committee is formed in the parent company instead of listed company.

REMUNERATION POLICY AND AUDIT SERVICES /

Remuneration disclosure is the area where most Baltic traded companies have the lowest compliance rate. Companies tend to explain that this information is internal and confidential and can cause a certain competition risk, so therefore is not disclosed. Some state that their company does not even have a remuneration policy. Thus, in this review, companies are counted as disclosing information on remuneration policy if they have provided at least part of the information that should be included in a comprehensive remuneration policy, such as: the fixed and variable components of remuneration; limits on the variable part of remuneration expressed as a percentage of the fixed monthly salary; criteria for variable remuneration; and compensation when leaving the company. On the other hand, total employee-related expenses and total remuneration paid to key members of management during the year are not regarded as remuneration policy.

Figure 6. Number of companies disclosing on remuneration and audit services, %



In Estonia, 53% of companies (8 of 15) disclose their remuneration policy or at least some of its elements. In Lithuania, 13% (4 of 31 companies) provide such information, and in Latvia 12% (3 of 26 companies) do so.

The review examined only one aspect related to audit services. It is recommended that if a company's audit firm has provided other non-audit related services to the company, the company should disclose that to shareholders or inform the supervisory board. This information was sought in annual reports.

Overall, 44% of Baltic companies (32 of 72) disclose what type of non-audit services were provided to them by their audit firm or simply state that no such other services were provided. This information is most often disclosed by companies in Lithuania, where 65% (20 of 31 companies) do so, whereas in Estonia 47% (7 of 15 companies) and in Latvia 19% (5 of 26 companies) provide such information in Annual Reports.

Nasdaq Baltic:

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